

National Taxpayer Advocate **2022 PURPLE BOOK**

Compilation of Legislative Recommendations
to Strengthen Taxpayer Rights and
Improve Tax Administration

December 31, 2021

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TABLE OF CONTENTS

INTRODUCTION	v
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STRENGTHEN TAXPAYER RIGHTS AND TAXPAYER SERVICE

1. Elevate the Importance of the Taxpayer Bill of Rights by Redesignating It as Section 1 of the Internal Revenue Code	1
2. Revamp the IRS Budget Structure and Provide Sufficient Funding to Improve the Taxpayer Experience and Modernize the IRS's Information Technology Systems	3

IMPROVE THE FILING PROCESS

3. Treat Electronically Submitted Tax Payments and Documents as Timely If Submitted Before the Applicable Deadline	7
4. Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers	9
5. Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper	12
6. Extend the Time for Small Businesses to Make Subchapter S Elections	14
7. Adjust Individual Estimated Tax Payment Deadlines to Occur Quarterly.	16
8. Harmonize Reporting Requirements for Taxpayers Subject to Both the Report of Foreign Bank and Financial Accounts and the Foreign Account Tax Compliance Act by Eliminating Duplication and Excluding Accounts Maintained by U.S. Persons in the Countries Where They Are <i>Bona Fide</i> Residents.	17
9. Adjust the Filing Threshold for Taxpayers Filing as Married Filing Separately and Nonresident Alien Individuals	19
10. Amend the Lookback Period for Allowing Tax Credits or Refunds Under IRC § 6511(b)(2)(A) to Include the Period of Any Postponement of Time for Filing a Return Under IRC § 7508A.	21

IMPROVE ASSESSMENT AND COLLECTION PROCEDURES

11. Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail	23
12. Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute	25
13. Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans	28
14. Allow Additional Time for Taxpayers to Request Abatement of a Math Error Assessment Equal to the Additional Time Allowed to Respond to a Notice of Deficiency When the Math Error Notice Is Addressed to a Person Outside the United States	31

15. Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures	33
16. Amend IRC § 6330 to Provide That “an Opportunity to Dispute” an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum	35
17. Amend IRC § 6402(a) to Prohibit Offset of the Earned Income Tax Credit Portion of a Tax Refund	38
18. Require the IRS to Waive User Fees for Taxpayers Who Enter Into Low-Cost Installment Agreements or Who Have an Adjusted Gross Income Equal to or Less Than 250 Percent of the Federal Poverty Level	40
19. Improve Offer in Compromise Program Accessibility by Repealing the Partial Payment Requirement and Restructuring the User Fee	42
20. Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise	44
21. Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise	45
22. Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities	47
23. Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins.	48
24. Protect Retirement Funds From IRS Levies, Including So-Called “Voluntary” Levies, in the Absence of “Flagrant Conduct” by a Taxpayer	50
25. Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence	52
26. Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions	54
27. Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions	56
28. Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship	58
29. Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act.	60

REFORM PENALTY AND INTEREST PROVISIONS

30. Convert the Estimated Tax Penalty Into an Interest Provision to Properly Reflect Its Substance.	62
31. Apply One Interest Rate Per Estimated Tax Underpayment Period	64
32. Pay Interest to Taxpayers on Excess Payments of Estimated Tax to the Same Extent Taxpayers Must Pay a Penalty on Underpayments of Estimated Tax	65
33. Reduce the Federal Tax Deposit Penalty Imposed on Taxpayers Who Make Timely Tax Deposits.	67
34. Extend Reasonable Cause Defense for the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to E-File Their Returns	68

35. Authorize a Penalty for Tax Return Preparers Who Engage in Fraud or Misconduct by Altering a Taxpayer's Tax Return.	71
36. Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties	73
37. Require an Employee to Determine and a Supervisor to Approve All Negligence Penalties Under IRC § 6662(b)(1)	75
38. Modify the Definition of "Willful" for Purposes of Finding Report of Foreign Bank and Financial Accounts Violations and Reduce the Maximum Penalty Amounts	77

STRENGTHEN TAXPAYER RIGHTS BEFORE THE OFFICE OF APPEALS

39. Require Taxpayers' Consent Before Allowing IRS Counsel or Compliance Personnel to Participate in Appeals Conferences.	79
--------------------------------------------------------------------------------------------------------------------------------	----

STRENGTHEN THE OFFICE OF THE TAXPAYER ADVOCATE

40. Clarify That the National Taxpayer Advocate May Hire Legal Counsel to Enable Her to Advocate More Effectively for Taxpayers	81
41. Clarify the Authority of the National Taxpayer Advocate to Make Personnel Decisions to Protect the Independence of the Office of the Taxpayer Advocate.	84
42. Clarify the Taxpayer Advocate Service's Access to Files, Meetings, and Other Information.	86
43. Authorize the National Taxpayer Advocate to File <i>Amicus</i> Briefs	87
44. Require the IRS to Address the National Taxpayer Advocate's Comments in Final Rules	89
45. Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations.	90
46. Repeal Statute Suspension Under IRC § 7811(d) for Taxpayers Seeking Assistance From the Taxpayer Advocate Service.	92

STRENGTHEN TAXPAYER RIGHTS IN JUDICIAL PROCEEDINGS

47. Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties . . .	94
48. Repeal <i>Flora</i> : Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can	96
49. Authorize the Tax Court to Order Refunds or Credits in Collection Due Process Proceedings Where Liability Is at Issue.	99
50. Provide That the Time Limits for Bringing Tax Litigation Are Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling	101
51. Amend IRC § 7456(a) to Expand the Authority of the Tax Court to Issue Subpoenas for the Production of Records Held by a Third Party Prior to a Scheduled Hearing.	104
52. Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is <i>De Novo</i>	106
53. Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases.	109

54. Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits	111
55. Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions	113

MISCELLANEOUS RECOMMENDATIONS

56. Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments	115
57. Allow Taxpayers the Option of Using Prior Year Income to Claim the Earned Income Tax Credit (EITC) During Federally Declared Disasters	119
58. Exclude Taxpayers in Specific Circumstances From the Requirement to Provide a Social Security Number for Their Children to Claim the Child Tax Credit	121
59. Clarify Whether Dependents Are Required to Have Taxpayer Identification Numbers for Purposes of the Credit for Other Dependents	123
60. Allow Members of Certain Religious Sects That Do Not Participate in Social Security and Medicare to Obtain Employment Tax Refunds	125
61. Amend IRC § 36B(d)(2) to Prevent Individuals From Losing Some or All of Their Premium Tax Credits When Receiving Lump-Sum Social Security Benefits Attributable to a Prior Year	127
62. Amend the Combat-Injured Veterans Tax Fairness Act of 2016 to Allow Veterans of the Coast Guard to Exclude Disability Severance Pay From Gross Income and File Claims for Credit or Refund for Taxes Withheld From Excluded Income	129
63. Encourage and Authorize Independent Contractors and Service Recipients to Enter Into Voluntary Withholding Agreements	131
64. Require the IRS to Specify the Information Needed in Third-Party Contact Notices	133
65. Authorize the Treasury Department to Issue Guidance Specific to IRC § 6713 Regarding the Disclosure or Use of Tax Return Information by Preparers	135
66. Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic Program	136
67. Compensate Taxpayers for "No Change" National Research Program Audits	138
68. Establish the Position of IRS Historian Within the Internal Revenue Service to Record and Publish Its History	140

APPENDIX 1: Additional Reference Materials for Legislative Recommendations in This Volume	142
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APPENDIX 2: Prior National Taxpayer Advocate Legislative Recommendations Enacted Into Law	152
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NATIONAL TAXPAYER ADVOCATE 2022 PURPLE BOOK: COMPILATION OF LEGISLATIVE RECOMMENDATIONS TO STRENGTHEN TAXPAYER RIGHTS AND IMPROVE TAX ADMINISTRATION

INTRODUCTION

Section 7803(c)(2)(B)(ii)(IX) of the IRC requires the National Taxpayer Advocate, as part of the annual report to Congress, to propose legislative recommendations to resolve problems encountered by taxpayers. This year, we present 68 legislative recommendations.

We have taken the following steps to make these recommendations as accessible and user-friendly as possible for Members of Congress and their staffs:

- We have consolidated our recommendations from various sections of this year's report, prior reports, and other sources into this single volume.
- We have grouped our recommendations into categories that generally reflect the various stages in the tax administration process so that, for example, return filing issues are presented separately from audit and collection issues.
- We have presented each legislative recommendation in a format like the one used for congressional committee reports, with "Present Law," "Reasons for Change," and "Recommendation(s)" sections.
- Where bills have been introduced in the past that are generally consistent with one of our recommendations, we have included a footnote at the end of the recommendation that identifies those bills. (Because of the large number of bills introduced in each Congress, we almost surely have overlooked some. We apologize for any bills we have inadvertently omitted.)
- We have compiled a table, which appears at the end of this volume as Appendix 1, that identifies additional materials relating to our recommendations, where such materials exist. In addition to identifying a larger number of prior bills than we cite in our footnotes, the table provides references to more detailed issue discussions that have been published in prior National Taxpayer Advocate reports.

By our count, Congress has enacted approximately 50 legislative recommendations that the National Taxpayer Advocate has proposed. See Appendix 2 for a complete listing. That total includes approximately 23 provisions that were included as part of the Taxpayer First Act.¹

The Office of the Taxpayer Advocate is a non-partisan, independent organization within the IRS that advocates for the interests of taxpayers. We have dubbed this the "Purple Book" because the color purple, as a mix of red and blue, has come to symbolize bipartisanship. Historically, tax administration legislation has attracted bipartisan support. Most recently, the Taxpayer First Act was approved by both the House and the Senate on voice votes with no recorded opposition.

We believe most of the recommendations presented in this volume are non-controversial, common sense reforms that will strengthen taxpayer rights and improve tax administration. We hope the tax-writing committees and other Members of Congress find it useful.

¹ Taxpayer First Act, Pub. L. No. 116-25, 133 Stat. 981 (2019). We say Congress enacted "approximately" a certain number of National Taxpayer Advocate recommendations because in some cases, enacted provisions are substantially similar to what we recommended but are not identical. The statement that Congress enacted a National Taxpayer Advocate recommendation is not intended to imply that Congress acted solely because of the recommendation. Congress, of course, receives suggestions from a wide variety of stakeholders on an ongoing basis.

We highlight these ten legislative recommendations for particular attention, in no particular order:

- **Revamp the IRS Budget Structure and Provide Sufficient Funding to Improve the Taxpayer Experience and Modernize the IRS's Information Technology Systems.** Since FY 2010, the IRS budget has been reduced by nearly 20 percent after adjusting for inflation. Largely as a result of these budget reductions, the IRS cannot provide top quality service or enforce the law with fairness to all. For example, the IRS finished the 2021 filing season with a backlog of 35.3 million returns that required manual processing. When taxpayers called the IRS for assistance, only about 11 percent reached a CSR, with hold times for taxpayers who got through averaging about 23 minutes. In addition, the IRS's IT systems desperately need upgrades. In FY 2021, the IRS collected about \$4.1 trillion on a budget of about \$11.9 billion, producing a remarkable average return on investment of about 345:1. Additional funding for the IRS would not only improve taxpayer service but would almost surely increase revenue collection.
- **Amend the Lookback Period for Allowing Tax Credits or Refunds Under IRC § 6511(b)(2)(A) to Include the Period of Any Postponement of Time for Filing a Return Under IRC § 7508A.** Taxes withheld from wages and estimated tax payments are generally deemed paid on the tax return filing deadline of April 15. To be timely, a taxpayer's claim for credit or refund generally must be filed within three years from the date the return was filed or two years from the date the tax was paid, whichever period is longer. If the taxpayer files a refund claim within three years from the date the return was filed, the taxpayer can only get a credit or refund of excess amounts paid within the preceding three years, plus six months (*i.e.*, the lookback period) if the taxpayer obtained a six-month extension for filing the original return. However, a taxpayer who filed pursuant to a "postponement" granted by the IRS because of a federally declared disaster will not recover excess amounts paid within the period of postponement.

Because of the pandemic, the IRS postponed the tax return filing deadline to July 17 in 2020 and to May 17 in 2021. These postponements of the filing deadline limit the amounts that taxpayers can recover in a way that was not intended and that will cause some taxpayers to lose the ability to recover overpayments. For example, a taxpayer who filed her 2019 return by the postponed filing deadline of July 15, 2020, might reasonably believe she would be eligible for a refund if she files a claim before July 15, 2023. However, if her taxes (withholding payments) are deemed paid on April 15, 2020, any claim for credit or refund filed after April 15, 2023, would be disallowed by the IRS. This is a trap for the unwary. We recommend Congress extend the lookback period when the filing deadline is postponed by the IRS due to a disaster declaration to three years *plus the period of the postponement*.

- **Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers.** The IRS receives over 160 million individual income tax returns each year, and paid tax return preparers prepare the majority of these returns. Both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which harms taxpayers and tax administration. To protect the public, federal and state laws generally require lawyers, doctors, securities dealers, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications and, in most cases, to pass competency tests. Taxpayers and the tax system would benefit from requiring tax return preparers to pass minimum competency tests.

The IRS sought to implement minimum standards beginning in 2011, including passing a basic competency test, but a U.S. Court of Appeals affirmed a U.S. district court opinion that held the IRS lacked the authority to impose preparer standards without statutory authorization. The plan the IRS rolled out in 2011 was developed after extensive consultation with stakeholders and was supported by almost all such stakeholders. We recommend Congress authorize the IRS to reinstitute minimum competency standards.

- **Expand the Tax Court’s Jurisdiction to Hear Refund Cases and Assessable Penalties.** Under current law, taxpayers who owe tax and wish to litigate a dispute with the IRS must go to the U.S. Tax Court, while taxpayers who have paid their tax and are seeking a refund must file suit in a U.S. district court or the U.S. Court of Federal Claims. Although this dichotomy between deficiency cases and refund cases has existed for decades, we recommend Congress give all taxpayers the option to litigate their tax disputes in the U.S. Tax Court. Due to the tax expertise of its judges, the Tax Court is often better equipped to consider tax controversies than other courts. It is also more accessible to less knowledgeable and unrepresented taxpayers than other courts because it uses informal procedures, particularly in certain disputes that do not exceed \$50,000 for one tax year or period.
- **Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce the Improper Payments Rate.** TAS has long advocated for dividing the EITC into two credits: (i) a refundable worker credit based on each individual worker’s earned income, despite the presence of a qualifying child, and (ii) a refundable child credit. For wage earners, claims for the worker credit could be verified with nearly 100 percent accuracy by matching claims on tax returns against Forms W-2, reducing the improper payments rate on those claims to nearly zero. The portion of the EITC that varies based on family size would be combined with a child credit into a larger family credit. The National Taxpayer Advocate published a report making this recommendation in 2019, and we continue to advocate for it.
- **Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic (LITC) Program.** The LITC program effectively assists low-income taxpayers and taxpayers who speak English as a second language. When the LITC grant program was established as part of the IRS Restructuring and Reform Act of 1998, IRC § 7526 limited annual grants to no more than \$100,000 per clinic. The law also imposed a 100 percent matching requirement. A clinic cannot receive more in LITC grant funds than it is able to match. The nature and scope of the LITC program has evolved considerably since 1998, and those requirements are preventing the program from providing high quality assistance to the largest possible universe of eligible taxpayers. We recommend that Congress remove the per-clinic cap and allow the IRS to reduce the match requirement to 50 percent if doing so would provide coverage for additional taxpayers.
- **Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties.** IRC § 6751(b)(1) states: “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination...” At first, it seems a requirement that an “initial determination” be approved by a supervisor would mean the approval must occur before the penalty is proposed. However, the timing of this requirement has been the subject of considerable litigation, with some courts holding that the supervisor’s approval might be timely even if provided after a case has gone through the IRS Independent Office of Appeals and is in litigation. Very few taxpayers choose to litigate their tax disputes. Therefore, to effectuate Congress’s intent that the IRS not penalize taxpayers in certain circumstances without supervisory approval, the approval must be required earlier in the process. We recommend that Congress amend IRC § 6751(b)(1) to require that written supervisory approval be provided *before* the IRS sends a written communication to the taxpayer proposing a penalty.
- **Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail.** Under IRC § 6213(b), the IRS may make a summary assessment of tax arising from a mathematical or clerical error, as defined in IRC § 6213(g). When the IRS does so, IRC § 6213(b)(1) requires that it send the taxpayer a notice describing “the error alleged and an explanation thereof.” By law, the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated. Many taxpayers do not understand that failing to respond to an IRS math error notice

within 60 days means they may have unknowingly conceded the adjustment and forfeited their right to challenge the IRS's position in the Tax Court. Amending IRC § 6213(b) to require that the IRS specifically describe the error giving rise to the adjustment and inform taxpayers that they have 60 days to request that the summary assessment be abated would help ensure taxpayers understand the adjustment and their rights. Additionally, requiring the IRS to send the notice either by certified or registered mail would underscore the significance of the notice and provide an additional safeguard to ensure that taxpayers are receiving this critical information.

- **Amend IRC § 6330 to Provide That “an Opportunity to Dispute” an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum.** IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien (NFTL) filed by the IRS or a proposed levy action. The purpose of these collection due process (CDP) rights is to give taxpayers adequate notice of IRS collection activity and provide a meaningful hearing to determine whether the IRS properly filed an NFTL or proposed a levy. The IRS and the courts interpret the current law to mean that an opportunity to dispute the underlying liability includes a prior opportunity for a conference with the IRS Independent Office of Appeals offered either before or after assessment of the liability, even where there is no opportunity for judicial review of the Appeals conference.

The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute the underlying liability in a prepayment judicial forum are precluded from doing so during their CDP hearing. These taxpayers have no alternative but to pay the tax and then seek a refund by filing a suit in a U.S. district court or the U.S. Court of Federal Claims – an option that not all taxpayers can afford. In our view, the circumstances in which taxpayers may challenge the IRS's liability determination in a CDP hearing should be expanded to include taxpayers who did not receive a notice of deficiency or the opportunity to dispute the underlying liability in a prepayment judicial forum.

- **Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures.** IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. IRC § 6671(a) authorizes the IRS to assess some penalties without first issuing a notice of deficiency. These penalties are generally subject to judicial oversight only if taxpayers first pay the penalty and then sue for a refund. The IRS takes the position that various international information reporting penalties are also immediately assessable without issuing a notice of deficiency, including the penalty under IRC § 6038 for failure to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. Taxpayers who are savvy enough to request an abatement based on reasonable cause or to request a conference with the IRS Independent Office of Appeals frequently obtain relief from assessable penalties. Specifying that deficiency procedures apply would prevent the systemic assessments the IRS so often abates. The proposed legislative change would require the IRS to issue a notice of deficiency before assessing penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D, thus allowing taxpayers to seek prepayment judicial review in the U.S. Tax Court and enhancing the taxpayers’ *right to a fair and just tax system*.

STRENGTHEN TAXPAYER RIGHTS AND TAXPAYER SERVICE

Legislative Recommendation #1

Elevate the Importance of the Taxpayer Bill of Rights by Redesignating It as Section 1 of the Internal Revenue Code

PRESENT LAW

IRC § 7803(a)(3) requires the Commissioner to “ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title [the Internal Revenue Code], including –

- (A) *the right to be informed,*
- (B) *the right to quality service,*
- (C) *the right to pay no more than the correct amount of tax,*
- (D) *the right to challenge the position of the Internal Revenue Service and be heard,*
- (E) *the right to appeal a decision of the Internal Revenue Service in an independent forum,*
- (F) *the right to finality,*
- (G) *the right to privacy,*
- (H) *the right to confidentiality,*
- (I) *the right to retain representation, and*
- (J) *the right to a fair and just tax system.”*

REASONS FOR CHANGE

Taxpayer rights serve as the foundation for effective tax administration. The U.S. tax system is frequently characterized as a system of “voluntary compliance.” While taxpayers ultimately may face penalties for noncompliance, we rely in the first instance on the willingness of taxpayers to file returns on which they self-report their income (some of which is not reported to the IRS by third parties and is therefore difficult for the IRS to discover in the absence of self-reporting) and to pay the required tax.

More than 160 million individuals and more than ten million business entities file income tax returns and pay our nation’s bills every year, and they are entitled to be treated with respect. Making clear that taxpayers possess rights is not only the right thing to do, but TAS research suggests that when taxpayers have confidence the tax system is fair, they are more likely to comply voluntarily, which may translate into enhanced revenue collection as well.¹

The National Taxpayer Advocate recommends that the ten rights that make up the Taxpayer Bill of Rights (TBOR) codified in IRC § 7803(a)(3) be relocated and re-codified as Section 1 of the tax code. Doing so would make a strong and important statement about the value Congress places on taxpayer rights.²

1 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 33-55 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, at 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

2 When we first proposed codifying the Taxpayer Bill of Rights in 2007, we recommended enacting ten taxpayer rights and five taxpayer responsibilities. The responsibilities included (i) the responsibility to be honest, (ii) the responsibility to be cooperative, (iii) the responsibility to provide accurate information and documents on time, (iv) the responsibility to keep records, and (v) the responsibility to pay taxes on time. National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*). When Congress added the ten rights to IRC § 7803(a)(3), it did not include the responsibilities.

RECOMMENDATION

- Amend § 1 of the IRC to read as follows (and renumber existing IRC §§ 1, 2, and 3 accordingly):

SECTION 1. TAXPAYER BILL OF RIGHTS.**(a) Taxpayer Rights.**

- (1) In discharging their duties and responsibilities, every officer and employee of the Internal Revenue Service shall act in accordance with taxpayer rights as afforded by other provisions of this title, including –
 - (a) the right to be informed,
 - (b) the right to quality service,
 - (c) the right to pay no more than the correct amount of tax,
 - (d) the right to challenge the position of the Internal Revenue Service and be heard,
 - (e) the right to appeal a decision of the Internal Revenue Service in an independent forum,
 - (f) the right to finality,
 - (g) the right to privacy,
 - (h) the right to confidentiality,
 - (i) the right to retain representation, and
 - (j) the right to a fair and just tax system.³

³ The provisions of the TBOR were codified at IRC § 7803(a)(3). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. Q, § 401(a), 129 Stat. 2242, 3117 (2015). During the drafting of the TBOR language, we understand staff of the Joint Committee on Taxation (JCT) raised concerns that if the TBOR were codified without limitation, some taxpayers might assert purported violations and seek remedies in administrative and litigated disputes, potentially requiring the IRS and the courts to adjudicate vague claims with no clear standard for resolution. After considering the JCT's concerns, the tax-writing committees ultimately settled on the language enacted as IRC § 7803(a)(3). To avoid reopening this issue, we are proposing to relocate the existing language in IRC § 7803(a)(3) virtually without change. We are recommending a minor refinement to the lead-in language that we think makes it read more clearly and does not substantially change the meaning. However, if the JCT believes our refinement does substantially change the meaning, the text of IRC § 7803(a)(3) could be re-designated as IRC § 1 with no change in language at all.

Legislative Recommendation #2**Revamp the IRS Budget Structure and Provide Sufficient Funding to Improve the Taxpayer Experience and Modernize the IRS's Information Technology Systems¹****PRESENT LAW**

Congress controls the IRS's priorities by dividing its annual appropriation into four accounts: Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization. With limited exceptions, the IRS may not reallocate its appropriated funding among its accounts.

Under the Congressional Budget and Impoundment Control Act of 1974,² as amended, the federal appropriations process is generally a zero-sum game: Once Congress establishes spending caps for the upcoming fiscal year, a dollar allocated to one agency or program leaves one less dollar available for allocation to another agency or program.

As an exception to the spending caps, Congress in some years has authorized a "program integrity allocation adjustment" (PIAA), which allows it to appropriate funding for IRS enforcement initiatives in excess of the caps on the basis that the initiatives are projected to generate a positive return on investment (ROI).³ Although Congress has not authorized a PIAA since fiscal year (FY) 2010, when it gave the IRS an additional \$890 million, almost every administration budget proposal has requested one.⁴

REASONS FOR CHANGE

The IRS mission statement says the agency's mission is to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."⁵ Since FY 2010, the IRS budget has been reduced by nearly 20 percent after adjusting for inflation (excluding one-time supplemental funding the IRS received to administer COVID-19-related stimulus programs).⁶ Largely as a result of these budget reductions, the IRS is neither providing top quality service nor enforcing the law with fairness to all.⁷ In addition, its information technology (IT) systems are in desperate need of upgrades.

The IRS Is Not Providing Top Quality Service

The American Customer Satisfaction Index (ACSI) and the Forrester U.S. Federal Customer Experience Index[™] have consistently ranked the Treasury Department and the IRS the worst or among the worst

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- 1 At our publication deadline, Congress was still working to finalize fiscal year (FY) 2022 appropriations levels and was still considering the Build Back Better (BBB) legislation. Appropriations legislation passed by the House and posted as a draft bill by the Senate Appropriations Committee would increase IRS funding by 13.88 percent in FY 2022. The BBB Act would provide the IRS with supplemental funding of nearly \$80 billion to be used over the next 10 years.
 - 2 Pub. L. No. 93-344, 88 Stat. 297 (1974).
 - 3 See, e.g., Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, Div. C, 123 Stat. 3034, 3165 (2009) (IRS Administrative Provision § 105 provided an allocation adjustment of \$890 million for "enhanced tax law enforcement"); H.R. CON. RES. 218, 103rd Cong. § 25 (1994). For a detailed discussion of the mechanics of allocation adjustments, see H.R. REP. NO. 103-490, at 58 (1994).
 - 4 IRS response to TAS information request (Sept. 30, 2020). In prior years, the mechanism was referred to as a "program integrity cap adjustment."
 - 5 See IRS, The Agency, Its Mission and Statutory Authority, <https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority> (last visited Dec. 21, 2021).
 - 6 IRS response to TAS information request (Dec. 17, 2021).
 - 7 See National Taxpayer Advocate 2019 Annual Report to Congress 23-33 (Most Serious Problem: *IRS Funding: The IRS Does Not Have Sufficient Resources to Provide Quality Service*).

performing federal agencies from a customer experience perspective.⁸ (Treasury rankings are largely a measure of IRS performance, as more Americans interact with the IRS each year than with any other federal agency.) In 2020, the most recent year for which data is available, the ACSI report ranked the Treasury Department last among the federal departments it assessed.⁹

Because of the COVID-19 pandemic, taxpayer service in 2021 was historically poor. The IRS finished the 2021 filing season with a backlog of 35.3 million returns that required manual processing, delaying refunds for millions of taxpayers. Among taxpayers who called the IRS for assistance, only about 11 percent reached a customer service representative, with hold times for taxpayers who got through averaging about 23 minutes.

To underscore its longstanding concerns about taxpayer service, Congress enacted the Taxpayer First Act (TFA) in 2019.¹⁰ Among other things, the TFA directed the IRS to develop comprehensive multiyear plans to improve taxpayer services and modernize its IT systems. The plans the IRS developed in response to this directive will require significant additional funding to implement. The IRS will not be able to make much progress in improving either its taxpayer services or its IT systems with its current funding level and with current restrictions on transferring funds among its accounts.

Upgraded Information Technology Systems Are Needed to Improve Service and Enforcement

The two IRS systems containing the official records of individual and business taxpayer accounts are the oldest major technology systems in the federal government. The IRS also has about 60 case management systems that generally are not interconnected. Each function's employees must transcribe or import information from electronic systems and mail or fax it to other functions. Obsolete IT systems limit the functionality of online taxpayer accounts, prevent taxpayers from obtaining full details about the status of their cases, and prevent the IRS from selecting the best cases for compliance actions.

The IRS is taking steps to improve its technology. It has developed a roadmap known as the “Integrated Modernization Business Plan” that would replace legacy systems with modern technology systems and thereby enable the agency to provide superior service to taxpayers and deliver long-term budget efficiencies.¹¹ However, the IRS has estimated it will require between \$2.3 billion and \$2.7 billion in additional funding over the next six years to implement this plan.¹² In FY 2021, the Business Systems Modernization (BSM) account was funded at only about \$223 million.

While the level of BSM funding is critical, so is the predictability of funding. Significant fluctuations from year to year can disrupt IT contracts and increase the long-term cost of upgrades. Over the last five years, the funding level for the BSM account was \$290 million in FY 2017, \$110 million in FY 2018, \$150 million in FY 2019, \$180 million in FY 2020, and about \$223 million in FY 2021.¹³ The IRS cannot effectively plan and execute a long-term IT overhaul if it does not know whether there will be enough funds in future years to support its current commitments.

8 See, e.g., American Customer Satisfaction Index, *ACSI Federal Government Report 2019*, at 4 (2020) (ranking the Treasury Department 11th out of 12 federal agencies assessed); Forrester Research, Inc., *The U.S. Federal Customer Experience Index, 2019*, at 15-16 (June 11, 2019) (ranking the IRS 13th out of 15 federal agencies assessed and characterizing the IRS's score as “very poor.”).

9 American Customer Satisfaction Index, *ACSI Federal Government Report 2020*, at 4 (2021), https://www.theacsi.org/images/stories/images/reports/21feb_GOV-report.pdf.

10 Taxpayer First Act, Pub. L. No. 116-25, §§ 1101 & 2101(a), 133 Stat. 981, 985 & 1008 (2019).

11 IRS Pub. 5336, IRS Integrated Modernization Business Plan (Apr. 2019).

12 IRS response to TAS information request (Sept. 30, 2020).

13 See Department of the Treasury, FY 2022 Budget in Brief 79 (2021) (showing BSM level in FYs 2021 and 2020); Department of the Treasury, FY 2021 Budget in Brief 83 (2020) (showing BSM level in FY 2019); Department of the Treasury, FY 2020 Budget in Brief 69 (2019) (showing BSM level in FY 2018); Department of the Treasury, FY 2019 Budget in Brief 61 (2018) (showing BSM level in FY 2017).

The IRS Is an Extraordinary Investment

In FY 2021, the IRS collected about \$4.1 trillion on a budget of about \$11.9 billion (excluding one-time supplemental funding the agency received to administer COVID-19-related stimulus programs).¹⁴ That translates to an average ROI of about 345:1. It is economically irrational to underfund the IRS. If a company's accounts receivable department could generate an ROI of 345:1 and the chief executive officer (CEO) failed to provide enough funding for it to do so, the CEO would be fired. Yet in general, the federal budget rules exclusively take into account outlays and ignore the revenue those outlays generate. The program integrity allocation adjustment mechanism gives Congress the ability to provide some funding above the spending caps, but because it historically has been used solely to fund enforcement initiatives, it can lead to imbalances in the IRS's operations.

Changes to the IRS Budget Structure and Funding Levels Are Needed

Separate from funding levels, the IRS would benefit from a revamped budget structure. Most IRS initiatives require resources from more than one of the IRS's budget accounts. When the IRS hires more collection personnel through the Enforcement account, for example, it requires funding for additional office space, equipment, and the like from the Operations Support account. When the IRS takes additional enforcement actions against taxpayers and the taxpayers call or visit the IRS, there needs to be sufficient funding in the Taxpayer Services account to answer the calls and handle the visits. If Congress provides a boost to the Enforcement account without corresponding increases to the Operations Support and Taxpayer Services accounts, the IRS cannot use the funding in a way that is reasonable and fair to taxpayers. Similarly, when Congress requires that all IT equipment be funded from the Operations Support account and it does not adequately fund that account, or it does not provide sufficient flexibility for the IRS to reprogram funds from Enforcement or Taxpayer Services to the Operations Support account, it significantly limits the IRS's ability to use technology to improve taxpayer service and to equip its employees with the technology they need to be successful.¹⁵

Therefore, we believe Congress should not rely on program integrity allocation adjustments to fund the IRS unless it takes a holistic view of compliance initiatives and funds the associated downstream costs as well. Ideally, Congress should revisit the current IRS budget structure and develop one that is more in line with the restructured IRS being proposed under TFA and gives the IRS more flexibility to transfer funds among its accounts so it can pay for the full costs associated with its programs and initiatives (*e.g.*, the overhead and downstream taxpayer service costs associated with a compliance initiative).

14 IRS Pub. 5456, IRS FY 2021 Financial Report 8 (Nov. 2021), <https://www.irs.gov/pub/irs-pdf/p5456.pdf>; Department of the Treasury, FY 2022 Budget in Brief 79 (2021), <https://home.treasury.gov/system/files/266/FY-2022-BIB.pdf>. This calculation reflects the average ROI on the IRS's FY 2021 operating plan appropriation and is based on gross federal tax collections before reduction for refunds. The marginal ROI that would be generated by additional IRS funding varies by program and has recently been estimated in the range of roughly 3:1 to 6:1. IRS response to TAS information request (Dec. 17, 2021). Marginal ROI projections include direct revenue from enforcement activities but do not include compliance gains resulting from either improved taxpayer service or the indirect (deterrent) effects of additional enforcement activities.

15 The annual appropriations acts give the IRS some, but limited, ability to transfer funds among its accounts. The acts allow the IRS to transfer up to four percent of funds made available for Enforcement and up to five percent of funds made available for Taxpayer Services, Operations Support, and Business Systems Modernization to other accounts, but only with the advance approval of the House and Senate Appropriations Committees. See Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182, 1387 (2020).

RECOMMENDATIONS¹⁶

- Provide sufficient funding for the IRS to implement its Integrated Modernization Business Plan so it can replace its 1960s technology systems, create an integrated case management system, develop robust online accounts for taxpayers and practitioners, deploy scanning technology that can machine read paper returns to reduce the need for manual data transcription, and implement customer callback technology on all of its telephone lines so taxpayers can elect to receive return calls without waiting on hold.
- Provide sufficient funding for the IRS to implement the Taxpayer First Act, which will change how the IRS engages with taxpayers and increase digital interactions.
- Replace the current IRS budget structure with a new structure that better reflects how the IRS operates and gives the IRS more flexibility to move funds among its accounts so it can pay for the full costs associated with its programs and initiatives (*e.g.*, the overhead and downstream taxpayer service costs associated with a compliance initiative).
- If Congress retains the current budget structure, ensure the IRS receives balanced funding by taking into account the interactive effects of changing the funding level for one IRS account on other IRS accounts, including the downstream increase in telephone calls and TAS cases that are likely to result from increased enforcement funding.

¹⁶ The four recommendations presented herein are relatively high-level. In the “Most Serious Problems” section of the National Taxpayer Advocate’s 2021 Annual Report to Congress, we address more specific funding needs. Among them are funding to increase the IRS’s workforce and funding to increase the “Level of Service” on the IRS’s telephone lines to at least 85 percent. See National Taxpayer Advocate 2021 Annual Report to Congress (Most Serious Problem: *IRS Recruitment, Hiring, and Training: The Lack of Sufficient and Highly Trained Employees Impedes Effective Tax Administration*; Most Serious Problem: *Telephone and In-Person Service: Taxpayers Face Significant Challenges Reaching IRS Representatives Due to Longstanding Deficiencies and Pandemic Complications*).

IMPROVE THE FILING PROCESS

Legislative Recommendation #3

Treat Electronically Submitted Tax Payments and Documents as Timely If Submitted Before the Applicable Deadline

PRESENT LAW

IRC § 7502(a)(1) provides that if certain requirements are satisfied, a mailed document or payment is deemed filed or paid on the date of the postmark stamped on the envelope. Therefore, if the postmark shows a document or payment was mailed by the due date, it will be considered timely, even if it is received after the due date.

IRC § 7502(b) and (c) provide that this timely mailed/timely filed rule (commonly known as the “mailbox rule”) applies to documents and payments sent by U.S. postal mail, designated private delivery services, and electronic filing through an electronic return transmitter. However, the statutory mailbox rule does not apply to all filings and payments. With respect to electronic filing, the Secretary is authorized to promulgate regulations describing the extent to which the mailbox rule shall apply.¹ To date, the only regulations the Secretary has promulgated relating to electronic filing cover documents filed through an electronic return transmitter (*i.e.*, documents that are e-filed).²

REASONS FOR CHANGE

The statutory mailbox rule in IRC § 7502 does not apply to the electronic transmission of payments to the IRS. In addition, the mailbox rule does not apply to the electronic filing of time-sensitive documents (except documents filed electronically through an electronic return transmitter), including those transmitted by fax, email, the digital communication portal, or upload to an online account.³ If the IRS does not receive an electronically submitted document or payment until after the due date, the document or payment is considered late, even if the taxpayer can produce a confirmation that he or she transmitted the payment or document before the due date. This comparatively unfavorable treatment of electronically submitted documents and payments undermines the IRS’s efforts to encourage greater use of digital services and imposes additional cost and burden on taxpayers and the IRS.

Along similar lines, the IRS encourages U.S. taxpayers to make payments electronically using the Treasury Department’s Electronic Federal Tax Payment System (EFTPS). However, the EFTPS website displays the following warning: “Payments using this Web site or our voice response system must be scheduled by **8 p.m. ET the day before the due date** to be received timely by the IRS” (emphasis in original).⁴ This limitation applies to all payments.

Example: If a taxpayer owes a balance due on April 15 and mails the payment to the IRS before midnight on April 15, the payment will be considered timely, even though it may take a week or longer for the IRS to receive, open, and process the check. If the same taxpayer submits the payment using EFTPS, the payment will be considered late if submitted after 8 p.m. on April 14 (28 hours

¹ IRC § 7502(c)(2).

² Treas. Reg. § 301.7502-1(d).

³ See Treas. Reg. § 301.7502-1(d)(3)(i) (containing a definition of an electronic return transmitter). See also Rev. Proc. 2007-40, 2007-1 C.B. 1488 (providing a list of documents that can be filed electronically with an electronic return transmitter).

⁴ See Electronic Federal Tax Payment System, <https://www.eftps.gov/eftps> (last visited Nov. 9, 2021).

earlier), even though the payment generally would be debited from the taxpayer's account on April 16 – often a week sooner than if submitted by mail.

This disparity in the treatment of mailed and electronically submitted payments makes little sense. As compared with a mailed check, an electronic payment is received more quickly, is cheaper to process, and eliminates the risk that a mailed check will be lost or misplaced. Yet rather than encouraging taxpayers to use EFTPS, the earlier deadline serves as a deterrent.

RECOMMENDATION

- Amend IRC § 7502 to direct the Secretary to issue regulations that apply the statutory mailbox rule to all time-sensitive documents and payments electronically submitted to the IRS in a manner comparable to similar documents and payments submitted through the United States Postal Service or a designated delivery service.

Legislative Recommendation #4**Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers****PRESENT LAW**

Federal law imposes no competency or licensing requirements on paid tax return preparers. Credentialed individuals who may prepare tax returns, including attorneys, certified public accountants (CPAs), and enrolled agents (EAs), are generally required to pass competency tests and take continuing education courses (including an ethics component). Volunteers who prepare tax returns as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs also must pass competency tests. However, the vast majority of paid preparers are non-credentialed and are not required to pass competency tests or take any courses in tax return preparation.

REASONS FOR CHANGE

The IRS receives over 160 million individual income tax returns each year, and paid tax return preparers prepare the majority of these returns. Both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which harms taxpayers and the public fisc.

To protect the public, federal and state laws generally require lawyers, doctors, securities dealers, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications, and in most cases pass competency tests. Taxpayers and the tax system would benefit from requiring tax return preparers to pass minimum competency tests.

The following studies illustrate the extent of inaccurate return preparation:

Government Accountability Office (GAO). In 2006, GAO auditors posing as taxpayers made 19 visits to several national tax return preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. On 17 of 19 returns, preparers computed the wrong refund amounts with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly \$2,000. In two cases, the prepared returns would have caused the taxpayer to overpay by more than \$1,500. In five out of ten cases in which the Earned Income Tax Credit (EITC) was claimed, preparers failed to ask where the auditor's child lived or ignored the auditor's answer and prepared returns claiming ineligible children.¹

The GAO conducted a similar study in 2014. It again found that preparers computed the wrong tax liability on 17 of the 19 returns they prepared.²

Treasury Inspector General for Tax Administration (TIGTA). In 2008, TIGTA auditors posing as taxpayers visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. All preparers visited by TIGTA were non-credentialed. Of 28 returns prepared, 61 percent were prepared incorrectly. The average net understatement was \$755 per return. Of seven returns

1 GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 4, 2006) (statement of Michael Brostek, Director – Strategic Issues, Before the Committee on Finance, U.S. Senate).

2 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (Apr. 8, 2014) (statement of James R. McTigue, Jr., Director – Strategic Issues, Before the Committee on Finance, U.S. Senate).

involving EITC claims, none of the non-credentialed preparers exercised due diligence as required under IRC § 6695(g).³

New York State Department of Taxation and Finance. During 2008 and 2009, agents conducted nearly 200 targeted covert visits in which they posed as taxpayers and sought assistance in preparing income or sales tax returns. In testimony at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance testified that investigators found “an epidemic of unethical and criminal behavior.”⁴ At one point, the Department reported that it had found fraud on about 40 percent of its visits, and it had made over 20 arrests and secured 13 convictions.⁵

IRS Study on EITC Noncompliance. The IRS conducted a study to estimate compliance with EITC requirements during the 2006-2008 period. Among the findings of the study, unaffiliated unenrolled preparers (*i.e.*, non-credentialed preparers who are not affiliated with a national tax return preparation firm) were responsible for “the highest frequency and percentage of EITC overclaims.” The study found that half of the EITC returns prepared by unaffiliated unenrolled preparers contained overclaims, and the overclaims averaged between 33 percent and 40 percent.⁶

In 2002, before these studies were published, the National Taxpayer Advocate recommended that Congress authorize the IRS to conduct preparer oversight. Her proposal received widespread support from stakeholders and members of Congress. The Senate Committee on Finance twice approved legislation authorizing preparer oversight on a bipartisan basis under the leadership of Chairman Grassley and Ranking Member Baucus.⁷

On one occasion, the full Senate approved the legislation by unanimous consent.⁸ In 2005, the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations expressed general support for preparer oversight.⁹

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under § 330 of Title 31 of the U.S. Code to regulate tax return preparation as “practice” before the IRS. The IRS initiated extensive hearings and discussions with stakeholder groups to receive comments and develop a system within which all parties believed they could operate.¹⁰ The IRS, together with the Treasury Department, implemented the program in 2011. However, it was terminated two years later after a U.S. district court upheld a challenge to the IRS’s authority to regulate tax return preparation. The court concluded that “mere” tax return preparation did not constitute “practice” before the IRS.¹¹

In response, the IRS created a voluntary “Annual Filing Season Program.” Non-credentialed preparers who participate must meet specific requirements, including taking 18 hours of continuing education each year,

3 TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

4 Statement of Jamie Woodward, Acting Commissioner, *New York Dept. of Taxation and Finance*, Before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009).

5 *Id.* See also Tom Herman, *New York Sting Nabs Tax Preparers*, WALL STREET JOURNAL (Nov. 26, 2008).

6 IRS Pub. 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 24-26 (Aug. 2014).

7 Tax Administration Good Government Act, H.R. 1528, 108th Cong. § 141 (2004) (incorporating Tax Administration Good Government Act, S. 882); Telephone Excise Tax Repeal Act, S. 1321, 109th Cong. § 203 (2006) (incorporating Taxpayer Protection and Assistance Act, S. 832).

8 Tax Administration Good Government Act, H.R. 1528, 108th Cong. § 141 (2004) (incorporating Tax Administration Good Government Act, S. 882).

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

10 See IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

11 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff’d*, 742 F.3d 1013 (D.C. Cir. 2014).

which includes an examined tax refresher course. If they meet the requirements, the IRS will provide them with a “Record of Completion” that they presumably can use in their marketing to attract potential clients.¹² However, the program is less rigorous than the one the IRS implemented in 2011, and most non-credentialed preparers do not participate. This voluntary program does not satisfy the objectives of a comprehensive regime.

Since the 2011 program was invalidated, House and Senate members have introduced legislation to provide the IRS with the statutory authority to establish and enforce minimum standards. In the Senate, Senators Portman and Cardin sponsored bipartisan authorizing legislation in 2018,¹³ and Senators Wyden and Cardin sponsored similar legislation in 2019.¹⁴ In the House, Congressman Panetta and Congressman Rice sponsored bipartisan authorizing legislation in 2021.¹⁵ In the recent past, former Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, sponsored similar legislation.¹⁶

The IRS’s Taxpayer Experience Strategy provides an additional basis for establishing preparer standards.¹⁷ The IRS envisions giving preparers access to taxpayer information through online accounts. While there are considerable benefits to this plan, there are also significant security risks, including identity theft and other fraud. If the IRS proceeds with such access, it must try to mitigate the risks. Requiring minimum standards for preparers is one critical step.

Some have argued that requiring preparers to pass a competency test and take annual continuing education courses would address competence but would not ensure preparers conduct themselves ethically. The National Taxpayer Advocate agrees that tax law competency and ethical conduct are distinct issues. However, we believe preparer standards would raise both competency and ethical conduct levels. A preparer who invests in learning enough about tax return preparation to pass a competency test and takes annual continuing education courses would demonstrate a commitment to return preparation as a profession. The preparer would be a vested partner in the tax system and would have more to lose if he or she is found to have engaged in misconduct, just like attorneys, CPAs, EAs, and other credentialed partners. If tax preparation is characterized as “practice” before the IRS – as the 2011 plan did – the Office of Professional Responsibility would have oversight authority over preparers and could impose sanctions in cases of unethical conduct.

In sum, the GAO, TIGTA, and other compliance studies described above have consistently found that tax returns prepared by non-credentialed preparers are often inaccurate. Minimum standards would directly improve preparer competency levels and are likely to raise ethical norms.

RECOMMENDATION

- Amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.¹⁸

¹² Rev. Proc. 2014-42, 2014-29 I.R.B. 192.

¹³ Protecting Taxpayers Act, S. 3278, 115th Cong. § 202 (2018).

¹⁴ Taxpayer Protection and Preparer Proficiency Act, S. 1192, 116th Cong. (2019).

¹⁵ Taxpayer Protection and Preparer Proficiency Act, H.R. 4184, 117th Cong. (2021).

¹⁶ See Tax Return Preparer Competency Act, H.R. 4141, 114th Cong. § 2 (2015) (Cong. Black) and Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 202 (2015) (Cong. Becerra).

¹⁷ IRS Pub. 5426, Taxpayer First Act Report to Congress 42-45 (rev. Jan. 2021).

¹⁸ For legislative language generally consistent with this recommendation, see Taxpayer Protection and Preparer Proficiency Act, S. 1192 & H.R. 3330, 116th Cong. (2019) and other bills cited herein.

Legislative Recommendation #5**Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper****PRESENT LAW**

Present law does not address the treatment of individual income tax returns prepared electronically but mailed and filed on paper.

REASONS FOR CHANGE

In recent years, about 90 percent of individual income tax returns have been submitted electronically. While this percentage is relatively high, more than 15 million individual income tax returns are still submitted on paper.¹ When the IRS cannot capture the data from a tax return electronically, IRS employees must enter the data from paper-filed returns manually. The manual transcription of millions of lines of return data is expensive, produces transcription errors, and delays return processing and the payment of tax refunds. Because of the impact of the COVID-19 pandemic on IRS operations, backlogs in the processing of paper returns have often exceeded six months, delaying refunds for, and in some cases inflicting financial hardships on, millions of taxpayers.

Technology is available that would allow the IRS to scan paper returns prepared with tax return preparation software and capture the data quickly and efficiently. To enable the IRS to utilize one form of scanning technology, known as “2-D barcoding,” tax return preparation software would generate and imprint a horizontal or vertical barcode containing all return information on the return. The IRS, upon receiving the paper return, would scan the barcode, capture the data, decode it, and process the return as if it had been transmitted electronically. Many states have been using 2-D barcoding for paper-based income tax returns for more than a decade. The IRS itself has partnered with the software industry to enable Schedules K-1 to be filed with a 2-D bar code.

In addition, the IRS has adopted another type of scanning technology, known as “optical character recognition” (OCR), to process certain forms filed on paper. With OCR technology, the IRS scans the paper-filed return (without a barcode), captures the data, stores the tax form images and data in an electronic format, and processes the return as if it had been e-filed.² A major advantage of OCR technology is that it is not limited to digitizing returns prepared with software. It can scan all paper tax returns, including handwritten returns, preventing the need for manual data entry.³

While scanning technology is not considered e-file and still involves the submission of a paper return, it produces significant advantages over traditional paper filing, including (i) faster processing of tax returns and therefore delivery of refunds, (ii) more accurate recording of tax return information, and (iii) cost savings due to the reduction in training, recruiting, and staffing for manual data transcription. Despite these benefits, the IRS does not have updated scanning technology for many paper-filed returns, including individual income tax returns. The IRS has indicated an interest in adding 2-D barcodes on all IRS forms and outgoing

¹ IRS, Filing Season Statistics Report, Week Ending October 23, 2021.

² See Internal Revenue Manual (IRM) 3.41.274, General Instructions for Processing via SCRIPS (Nov. 5, 2019); IRM 3.41.275.1, Program Scope and Objectives (Nov. 14, 2017).

³ In the case of handwritten returns, there will be some scanning errors. For example, a scanner might read a sloppily written “1” as a “7” or vice versa. However, similar errors are made when IRS employees transcribe returns, along with others, so OCR scanning should still be more accurate while reducing processing times.

correspondence due to the industry-proven efficiencies associated with extracting machine-readable data from paper returns and correspondence. It is exploring both 2-D barcode and OCR technology with the software industry as part of a pilot program.⁴ However, widescale expansion of these two technologies will require additional multiyear funding.

RECOMMENDATION

- Provide the IRS with dedicated multiyear funding to purchase and implement scanning technology in order to improve the speed and accuracy of paper returns and correspondence processing.⁵

4 U.S. Department of the Treasury, Pilot IRS Informational Posting (Apr. 2, 2021), <https://sam.gov/opp/5eb4fcfbdf342bd94c0af400dbcca38/view?index=opp&naics=541&page=9>; Department of the Treasury, Pilot IRS: EDCMO Digitalization Technology Pilot OCR Awards (July 26, 2021), <https://sam.gov/opp/3d9a450e51df4bc9b3f75ddc12b9a578/view>.

5 For legislative language that would impose a requirement for 2-D barcode, or scannable code, technology, see Taxpayer First Act of 2018, S. 3246, 115th Cong. § 2104 (2018), <https://www.congress.gov/bill/115th-congress/senate-bill/3246>.

Legislative Recommendation #6**Extend the Time for Small Businesses to Make Subchapter S Elections****PRESENT LAW**

IRC § 1362(b)(1) provides that a small business corporation (“S corporation”) may elect to be treated as a passthrough entity by making an election at any time during the preceding taxable year or at any time on or before the 15th day of the third month of the current taxable year. The prescribed form for making this election is Form 2553, Election by a Small Business Corporation.

IRC § 6072(b) provides that income tax returns of S corporations made on a calendar-year basis must be filed on or before March 15 following the close of the calendar year, and income tax returns of S corporations made on a fiscal year basis must be filed on or before the 15th day of the third month following the close of the taxable year.

REASONS FOR CHANGE

Many small business owners are not familiar with the rules governing S corporations, and they learn about the effects of S corporation status for the first time when they hire a tax professional to prepare their corporation’s income tax return for its first year of operation. By that time, the deadline for electing S corporation status has passed. Failure to make a timely S corporation election can cause significant adverse tax consequences for businesses, such as incurring taxation at the corporate level and rendering shareholders ineligible to deduct operating losses on their individual income tax returns.¹ For context, about five million S corporation returns were filed in fiscal year 2020, which accounted for 73 percent of all corporate returns.

Taxpayers may seek permission from the IRS to make a late S corporation election under Revenue Procedure 2013-30 or through a private letter ruling (PLR) request. Under the revenue procedure, a corporation that failed to timely file Form 2553 may request relief by filing Form 2553 within three years and 75 days of the date the election is intended to be effective. In addition, the corporation must attach a statement explaining its reasonable cause for failing to timely file the election and its diligent actions to correct the mistake upon its discovery.

Finally, all shareholders must sign a statement affirming they have reported their income on all affected returns as if the S corporation election had been timely filed (*i.e.*, during the period between the date the S corporation election would have become effective if timely filed and the date the completed election form is filed). If an entity cannot comply with the revenue procedure, it may request relief through a PLR, for which the IRS charges a user fee ranging from \$6,200 to \$30,000 per request.²

The S corporation election deadline burdens small businesses by requiring them to pay tax professionals and often IRS user fees to request permission to make a late election. It also burdens shareholders, because when the IRS rejects an S corporation return due to the absence of a timely election, the status of the corporation is affected, and that may cause changes on the shareholders’ personal income tax returns. In addition, the

¹ The value of an S corporation election increased for many taxpayers with the passage of the Tax Cuts and Jobs Act, which generally allows individual taxpayers to deduct 20 percent of domestic “qualified business income” (QBI) from a passthrough business, including an S corporation, effectively reducing the individual income tax rate on such income by 20 percent. The deduction is subject to certain income thresholds (first \$315,000 of QBI for joint filers and \$157,500 for single returns), phase-outs for professional services, and limitations based on W-2 wages paid or capital invested by a business owner for larger passthrough entities. See IRC § 199A; Pub. L. No. 115-97, § 11011 (2017); H.R. REP. NO. 115-466, at 205-224 (2017) (Conf. Rep.).

² See Rev. Proc. 2020-1, 2020-1 I.R.B. 1. User fees for PLRs are set forth in the first revenue procedure of each year.

deadline and relief procedures require a commitment of significant resources by the IRS to process late-election requests.

Because small business owners often consider the S corporation election for the first time when they prepare their company's first income tax return, the burdens described above would be substantially eliminated if corporations could make an S corporation election on their first timely filed income tax return.

RECOMMENDATION

- Amend IRC § 1362(b)(1) to allow a small business corporation to elect to be treated as an S corporation by checking a box on its first timely filed (including extensions) Form 1120S, U.S. Income Tax Return for an S Corporation.³

³ For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 304 (2018).

Legislative Recommendation #7**Adjust Individual Estimated Tax Payment Deadlines to Occur Quarterly****PRESENT LAW**

Under IRC § 6654(c), individual taxpayers generally are required to make estimated tax payments in four installments due on or before April 15, June 15, September 15, and January 15. Under IRC § 6654(l), the same deadlines apply for estates and trusts.¹

REASONS FOR CHANGE

Although estimated tax installment payments are sometimes referred to as “quarterly payments,” they do not coincide with calendar year quarters and the payment dates are not evenly spaced. The April 15 and June 15 installments are due two months apart; the June 15 and September 15 installments are due three months apart; the September 15 and January 15 installments are due four months apart; and the January 15 and April 15 installments are due three months apart.

These dates are not intuitive and create compliance burdens. Small business owners and self-employed taxpayers are disproportionately affected by the estimated tax rules because their incomes generally are not subject to wage withholding. Yet small businesses are far more likely to keep their books based on regular three-month quarters than based on the seemingly random intervals prescribed by IRC § 6654.

These uneven intervals make it more difficult for many taxpayers to calculate net income and save appropriately to make estimated tax payments, and thus may reduce compliance.² They also cause confusion, as taxpayers struggle to remember the due dates. This confusion affects both traditionally self-employed workers and workers in the gig economy. Setting due dates to fall 15 days after the end of each calendar quarter would make it substantially easier for taxpayers to remember and comply with the due dates.

RECOMMENDATION

- Amend IRC § 6654(c)(2) to set the estimated tax installment deadlines 15 days after the end of each calendar quarter (*i.e.*, April 15, July 15, October 15, and January 15).³

1 Under IRC § 6655(c), corporate taxpayers generally are required to make estimated tax payments in four installments due on April 15, June 15, September 15, and December 15. Some of the benefits of establishing uniform quarterly estimated payment deadlines apply to corporate taxpayers to the same extent as individuals. However, we have not analyzed the implications of changing the corporate estimated payment deadlines, so this recommendation is limited to the deadline applicable to individual taxpayers.

2 Treasury Inspector General for Tax Administration, Ref. No. 2004-30-040, *While Progress Toward Earlier Intervention With Delinquent Taxpayers Has Been Made, Action Is Needed to Prevent Noncompliance With Estimated Tax Payment Requirements* 12 (Feb. 2004).

3 For legislative language generally consistent with this recommendation, see Tax Deadline Uniformity Act of 2020, H.R. 5979, 116th Cong. § 2 (2020). See also Tax Deadline Simplification Act, H.R. 4214, 117th Cong. § 2 (2021); Protecting Taxpayers Act, S. 3278, 115th Cong. § 305 (2018); Small Business Owners’ Tax Simplification Act, H.R. 3717, 115th Cong. § 2 (2017).

Legislative Recommendation #8**Harmonize Reporting Requirements for Taxpayers Subject to Both the Report of Foreign Bank and Financial Accounts and the Foreign Account Tax Compliance Act by Eliminating Duplication and Excluding Accounts Maintained by U.S. Persons in the Countries Where They Are *Bona Fide* Residents****PRESENT LAW**

The Currency and Foreign Transaction Reporting Act of 1970 (commonly known as the Bank Secrecy Act) requires U.S. citizens and residents to report any foreign account with an aggregate value exceeding \$10,000 at any time during the calendar year to the Financial Crimes Enforcement Network (FinCEN).¹ FinCEN Report 114, Report of Foreign Bank and Financial Accounts (FBAR), has been prescribed for complying with this requirement.

The Foreign Account Tax Compliance Act (FATCA)² added IRC § 6038D, which requires U.S. citizens, resident aliens, and certain non-resident aliens to file a statement with their federal income tax returns to report foreign assets exceeding specified thresholds. IRS Form 8938, Statement of Specified Foreign Financial Assets, has been prescribed for complying with this requirement. As codified by FATCA, IRC §§ 1471-1474 provide that foreign financial institutions (FFIs) that do not register with the IRS and agree to report certain information about their “United States accounts,”³ including accounts held by U.S. persons and accounts of certain foreign entities with substantial U.S. owners, are subject to a 30 percent withholding tax on certain U.S. source payments they receive.

IRC § 1471(d)(1) authorizes the IRS to issue regulations to eliminate duplicative reporting requirements. IRC § 6038D similarly authorizes the IRS to issue regulations or other guidance to provide exceptions from FATCA reporting when such reporting would duplicate other disclosures.

REASONS FOR CHANGE

Many U.S. taxpayers, particularly those living abroad, face increased compliance burdens and costs because the FATCA reporting obligations significantly overlap with the FBAR filing requirements.⁴ The IRS has exercised its regulatory authority to eliminate duplicative reporting of assets on Form 8938 if the assets are reported or reflected on certain other timely filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891).⁵ The IRS has also provided an exception from the reporting rules for *bona fide* residents of U.S. territories for financial accounts held in such territories.⁶

However, the IRS has not adopted the recommendations of the National Taxpayer Advocate that are also supported by other stakeholders, including the Government Accountability Office, to eliminate duplicative FATCA reporting where assets have been reported on an FBAR.⁷ Although FBARs are filed with FinCEN,

1 See 31 U.S.C. § 5314(b)(3) and 31 C.F.R. § 1010.306(c).

2 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

3 See IRC § 1471(d)(1) for a definition of “United States account.”

4 IRS, Comparison of Form 8938 and FBAR Requirements, <https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements> (last visited Nov. 6, 2020).

5 Treas. Reg. § 1.6038D-7(a)(1).

6 Treas. Reg. § 1.6038D-7(c).

7 See, *e.g.*, Government Accountability Office, GAO-12-403, *Reporting Foreign Accounts to the IRS: Extent of Duplication Not Currently Known, But Requirements Can Be Clarified* (Feb. 2012).

the IRS has access to the information on those forms. We understand the IRS is concerned that FinCEN could change the FBAR, leaving the IRS without access to information about foreign accounts that are not required to be reported on a Form 8938. However, this should not be a concern if only accounts actually reported on an FBAR may be omitted from a Form 8938 on which they would otherwise have to be reported.

In addition, the IRS has not adopted the National Taxpayer Advocate's recommendation to provide an exception from FATCA reporting for financial accounts held in the country in which the U.S. taxpayer is a *bona fide* resident. If adopted, these recommendations would reduce compliance burdens for U.S. taxpayers, who currently must file additional complex forms themselves or pay higher tax return preparation fees. If adopted, these recommendations could also reduce the compliance burdens for FFIs, some of which are reluctant to do business with U.S. expatriates because of the significant costs and regulatory risks associated with ongoing FATCA compliance. This reluctance makes it difficult for U.S. citizens to open bank accounts in certain countries.

RECOMMENDATIONS

- Amend IRC § 6038D to (i) eliminate duplicative reporting of assets on Form 8938 where an asset is reported or reflected on an FBAR, and (ii) exclude financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident from the specified foreign financial assets required to be reported on Form 8938.⁸
- Amend IRC § 1471 to exclude financial accounts maintained by a financial institution organized under the laws of the country of which the U.S. person is a *bona fide* resident from the definition of “financial account” subject to reporting by FFIs.⁹

⁸ For legislative language similar to this recommendation, see The Overseas Americans Financial Access Act, H.R. 4362, 116th Cong. §§ 2 & 3 (2019) (providing an exception from certain reporting requirements with respect to the foreign accounts of individuals who are *bona fide* residents of the countries in which their accounts are maintained); H.R. 2136, 115th Cong. §§ 1 & 2 (2017) (same).

⁹ For additional information on the National Taxpayer Advocate's recommendations, see National Taxpayer Advocate 2015 Annual Report to Congress 353-363 (Legislative Recommendation: *Foreign Account Reporting: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in Which a U.S. Taxpayer Is a Bona Fide Resident*).

Legislative Recommendation #9**Adjust the Filing Threshold for Taxpayers Filing as Married Filing Separately and Nonresident Alien Individuals****PRESENT LAW**

IRC § 6012(a)(1)(A) generally requires individuals to file tax returns if their gross income equals or exceeds the sum of (i) the “exemption amount” provided in IRC § 151 and (ii) the applicable standard deduction amount provided in IRC § 63(c). However, some individuals must file returns if their gross income equals or exceeds solely the exemption amount. They are:

- U.S. resident taxpayers who are married but file separate (MFS) returns; and
- Nonresident alien individuals, regardless of their filing status.¹

If the Tax Cuts and Jobs Act of 2017 (TCJA) had not been enacted, the exemption amount for a single taxpayer for tax year (TY) 2018 would have been \$4,150, meaning that these two groups of taxpayers would be required to file returns only if their incomes exceeded that amount.² However, the TCJA suspended the personal exemption for TYs 2018-2025, effectively reducing it to zero.³ As a result, MFS taxpayers and nonresident alien individuals must file tax returns if they have gross income equal to or greater than zero dollars, even if, after taking into account allowable deductions and other adjustments, their taxable income is zero and they owe no tax.

REASONS FOR CHANGE

The House Ways and Means Committee report accompanying the TCJA clarified that its intent in suspending the personal exemption, which was accompanied by an increase in the standard deduction, was to “simplif[y] the tax code while allowing a minimum level of income to be exempt from Federal income taxation.”⁴ For the majority of taxpayers, the TCJA raised the threshold at which the taxpayer must file a return.⁵ However, the result for MFS taxpayers and nonresident alien individuals, who now must file tax returns even if they have zero dollars of gross income, runs contrary to this congressional intent.

Married taxpayers may file MFS for several reasons, ranging from a choice to pay as little tax as possible under the law to a need to protect their privacy in a domestic abuse situation involving a spouse. Without at least a minimum filing threshold, these taxpayers and nonresident aliens must file returns even if they are not working or earning any income during the tax year.

The IRS, recognizing congressional intent and the administrative burden on taxpayers, provided relief to MFS taxpayers by setting the filing threshold at \$5 for TYs 2018, 2019, and 2020.⁶ For nonresident alien individuals, the IRS similarly set the filing threshold at \$5 for TY 2018, but it did not do so for TY 2019 or

1 IRC § 6012(a)(1)(A) (imposing a tax-return filing requirement on married taxpayers filing separate returns without taking into account the standard deduction) and § 63(c)(6) (providing that nonresident alien individuals have a standard deduction amount of zero).

2 TCJA, Pub. L. No. 115-97, 131 Stat. 2054 (2017); Rev. Proc. 2017-58, § 3.24, 2017-45 I.R.B. 489, 494. Having a filing requirement does not necessarily mean there is a tax liability. For example, in TY 2018, tax was imposed on MFS taxpayers whose taxable income exceeded \$9,525. Rev. Proc. 2017-58, § 3.01, 2017-45 I.R.B. 489, 491.

3 TCJA, Pub. L. No. 115-97, § 11041, 131 Stat. 2054, 2082 (2017) (codified at IRC § 151(d)(5)(A)).

4 H.R. REP. NO. 115-409 at 125 (2017).

5 If the TCJA had not been enacted, the standard deduction for a single individual taxpayer for TY 2018 would have been \$6,500 and, as noted, the exemption amount would have been \$4,150, resulting in a filing requirement if gross income equaled or exceeded \$10,650. Rev. Proc. 2017-58, §§ 3.14 and 3.24, 2017-45 I.R.B. 489, 493-494. For TY 2018, the TCJA suspended the personal exemption but raised the standard deduction to \$12,000 for an individual, an increase in the filing threshold of \$1,350. TCJA, Pub. L. No. 115-97, § 11021, 131 Stat. 2054, 2072 (2017) (codified at IRC § 63(c)(7)(A)).

6 IRS Pub. 54, Tax Guide for U.S. Citizens and Resident Aliens Abroad, 3 (2018-2020 versions).

2020.⁷ Although establishing a \$5 filing threshold removes the requirement that these taxpayers file returns when they have no income, it continues to impose a filing burden on those whose income exceeds \$5 but who do not have a tax liability. This filing requirement also imposes an additional burden on the IRS because it must process these returns despite the taxpayers having zero tax liability. Returning the filing threshold for MFS taxpayers and nonresident alien individuals to an amount equal to the personal exemption prior to its suspension would reduce burden for both taxpayers and the IRS. Such a change would also be consistent with Congress's intent to preserve a minimum level of individual income exempt from tax.

RECOMMENDATION

- Amend IRC § 6012(a)(1)(A) to provide that MFS and nonresident alien taxpayers whose gross income does not equal or exceed \$4,150 for TY 2018, adjusted for inflation for TYs 2019-2025, are not required to file a tax return.

⁷ IRS Pub. 519, U.S. Tax Guide for Aliens, 35-36 (Feb. 2019); IRS Pub. 519, U.S. Tax Guide for Aliens, 34 (Mar. 2020); IRS Pub. 519, U.S. Tax Guide for Aliens, 35 (Feb. 2021).

Legislative Recommendation #10**Amend the Lookback Period for Allowing Tax Credits or Refunds Under IRC § 6511(b)(2)(A) to Include the Period of Any Postponement of Time for Filing a Return Under IRC § 7508A****PRESENT LAW**

IRC § 6511(a) provides that taxpayers who believe they have overpaid their taxes may file a claim for credit or refund with the IRS by the later of:

1. Three years from the date the return was filed, or
2. Two years from the date the tax was paid.

IRC § 6511(b) places limits on the amount the IRS may credit or refund by using a two- or three-year lookback period:

1. Taxpayers who file claims for credit or refund within three years from the date the original return was filed will have their credits or refunds limited to the amounts paid within the three-year period before the filing of the claim plus the period of any extension of time for filing the original return (the “three-year lookback period”). *See* IRC § 6511(b)(2)(A).
2. Taxpayers who do not file claims for credit or refund within three years from the date the original return was filed will have their credits or refunds limited to the amounts paid within the two-year period before the filing of the claim. *See* IRC § 6511(b)(2)(B).

For calendar-year taxpayers, IRC § 6513(b) provides that any tax deducted and withheld on wages and any amount paid as estimated tax are deemed to have been paid on April 15 in the year following the close of the taxable year to which the tax is allowable as a credit.

Under IRC § 7508A, when the Secretary determines that a taxpayer has been affected by a federally declared disaster, the Secretary is authorized to “disregard” for up to one year certain acts a taxpayer is required to undertake under the Internal Revenue Code, including the filing of a tax return. The word “disregard” in this context has been interpreted to mean “postpone.” For example, the Secretary exercised this authority to address the COVID-19 pandemic by postponing the filing deadline in 2020 to July 15, and the filing deadline in 2021 to May 17, for calendar-year individual income taxpayers.¹

REASONS FOR CHANGE

For purposes of determining the lookback period for the allowance of tax credits or refunds, there is a legally significant distinction between a return filed after the regular filing deadline due to an *extension* of the filing deadline and a return filed after the regular filing deadline due to a *postponement* of the filing deadline. When a taxpayer files a Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, IRC § 6511(b)(2)(A) extends the three-year lookback for the period of extension (generally by six months). When a filing deadline is postponed under IRC § 7508A, however, the three-year lookback period

¹ See Notice 2020-23, Update to Notice 2020-18, Additional Relief for Taxpayers Affected by Ongoing Coronavirus Disease 2019 Pandemic; Notice 2021-21, Relief for Form 1040 Filers Affected by Ongoing Coronavirus Disease 2019 Pandemic. These notices did not affect the date on which any withheld tax or estimated tax for 2019 is deemed paid. Any withheld tax or estimated tax for 2019 is deemed paid on April 15, 2020, for calendar-year taxpayers.

on amounts paid is not extended to include payments made more than three years earlier than the postponed filing date.²

Example: In 2019, a taxpayer had income tax withheld from his paycheck every two weeks. In 2020, the taxpayer filed his 2019 return on the postponed filing deadline of July 15. The taxpayer's 2019 tax liability was fully paid through withholding, which was deemed paid on April 15, 2020, the due date of the return. Based upon the filing deadline postponement to July 15, the taxpayer timely files a claim for refund on July 14, 2023. Under IRC § 6511(a), the claim for refund is timely. Under the three-year lookback period of IRC § 6511(b), however, the amount of the taxpayer's refund is limited to payments made in the three years prior to filing the claim (*i.e.*, payments made on or after July 15, 2020). The withholding deemed paid on April 15, 2020, falls outside that period (as would any estimated tax payments), so the claim for refund will be denied.

By contrast, if the taxpayer had requested a filing *extension* until October 15, 2020, the taxpayer would have had until October 16, 2023 (October 15, 2023, is a Sunday)³ to be eligible to receive a refund.

We do not believe the outcome in the above example was intended. More likely, it is an unanticipated result of the interaction between the rules governing the filing of a claim for credit or refund and the rules limiting the amount of a credit or refund that may be allowed. The date for filing a claim for credit or refund and the lookback period generally align, but they do not align in these circumstances. Because of the large number of taxpayers who relied on the *postponed* filing deadlines in 2020 and 2021, the National Taxpayer Advocate recommends that Congress act quickly to authorize the IRS to pay refunds with respect to amounts paid within the preceding three-year period plus the period of any postponement of the filing deadline pursuant to IRC § 7508A before these refund claims are filed.

RECOMMENDATION

- Amend IRC § 6511(b)(2)(A) to provide that when the Secretary postpones a filing deadline pursuant to IRC § 7508A, amounts paid in the three-year period preceding the filing of a claim for credit or refund plus the period of any postponement of the filing deadline are eligible for credit or refund.

2 See Chief Counsel Advice 2020-53013 (Dec. 31, 2020) (concluding that the additional time prescribed by Notice 2020-23 is not an "extension" within the meaning of the three-year lookback period). By contrast, an extension of the filing deadline until October 15 will extend the lookback period until October 15. See IRC § 6081; Treas. Reg. § 1.6081-4.

3 See IRC § 7503 (when last day for filing falls on a Saturday, Sunday, or legal holiday, the act will be timely if performed on the next business day).

IMPROVE ASSESSMENT AND COLLECTION PROCEDURES

Legislative Recommendation #11

Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail

PRESENT LAW

Under IRC § 6213(b) the IRS may make a summary assessment of tax arising from a mathematical or clerical error, as defined in IRC § 6213(g). When it does so, IRC § 6213(b)(1) requires that the IRS send the taxpayer a notice describing “the error alleged and an explanation thereof.” By law, the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated.¹ If the taxpayer does not make an abatement request within 60 days, the assessment is final, and the taxpayer has lost his or her right to challenge the IRS’s position in the Tax Court. If the taxpayer requests an abatement, the IRS must abate the summary assessment. If the IRS continues to believe the taxpayer owes the tax, it may audit the taxpayer and propose an adjustment by issuing a notice of deficiency; if it does so, the taxpayer will have the right to challenge the IRS’s position in the Tax Court.

REASONS FOR CHANGE

Many taxpayers do not understand the significance of “deficiency procedures” and do not understand that the failure to respond to an IRS math error notice within 60 days means they have conceded the adjustment and forfeited their right to challenge the IRS’s position in the Tax Court. Notably, the law does not specify how the IRS must describe the math error or require the IRS to inform taxpayers they have 60 days to request the math error assessment be reversed. Further, unlike a notice of deficiency, which carries consequences similar to that of a math error notice (*i.e.*, assessment of tax that may result in future collection actions), IRC § 6213 does not require a math error notice be sent to a taxpayer by certified or registered mail.²

Although the statute requires the IRS to describe “the error alleged and an explanation thereof” in a notice, the descriptions are often very general. Some notices provide taxpayers with a list of possible errors – leaving them uncertain which error, if any, was committed. Other notices may indicate that a taxpayer understated his or her adjusted gross income but not specify which item of gross income was understated. Further, during calendar year (CY) 2021, the IRS neglected to include language informing taxpayers they have 60 days to request an abatement in about 6.5 million math error notices.³ Although the IRS later corrected this omission by sending taxpayers letters explaining the 60-day period, many taxpayers were left confused about what they needed to do, if anything.

¹ IRC § 6213(b)(2)(A).

² IRC § 6212(a). “If the Secretary determines that there is a deficiency in respect of any tax imposed ... he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.”

³ Erin M. Collins, Math Error, Part II: Math Error Notices Aren’t Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

It is unclear whether the IRS's explanation of alleged errors satisfies the statutory requirement when it makes a general statement or states that the error is due to one of multiple possible causes, since the statute does not describe the degree of specificity required. However, it is clear that the omission of the 60-day language from math error notices does not invalidate the notices, because IRC § 6213(b) does not require the IRS to tell taxpayers they have 60 days to request an abatement. While the IRS generally does so, the practice should not be discretionary. Amending IRC § 6213(b) to require that the IRS specifically describe the error giving rise to the adjustment and inform taxpayers they have 60 days to request that the summary assessment be abated would help ensure taxpayers understand the adjustment and their rights. Additionally, requiring the notice be sent either by certified or registered mail would underscore the significance of the notice and be yet another safeguard to ensure that taxpayers are receiving this critical information.

RECOMMENDATION

- Amend IRC § 6213(b)(1) to require that:
 - All math error notices provide a detailed explanation of the specific error, including the line number on the return or the line number on the schedule (whichever is more specific) on which the alleged error was made.
 - All math error notices include a statement that the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated, and prominently display at the top of the notice the date on which the 60-day period expires.
 - All such notices will be sent either by certified or registered mail.

Legislative Recommendation #12**Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute****PRESENT LAW**

Before the IRS may assess a deficiency, IRC § 6213(a) ordinarily requires that it send the taxpayer a "notice of deficiency" that gives the taxpayer 90 days (150 days if addressed to a taxpayer outside the United States) to contest it by filing a petition with the U.S. Tax Court (known as "deficiency procedures"). The taxpayer's ability to appeal a deficiency determination to the Tax Court before paying the tax is central to the taxpayer's *right to appeal an IRS decision in an independent forum*.¹

As an exception to standard deficiency procedures, IRC § 6213(b)(1) authorizes the IRS to summarily assess and collect tax without first providing the taxpayer with a notice of deficiency or access to the Tax Court when addressing "mathematical and clerical" errors (known as "math error authority"). If a taxpayer contests a math error notice within 60 days, IRC § 6213(b)(2)(A) provides that the IRS must abate the assessment. If the IRS abates the assessment, it must follow deficiency procedures before it can reassess the tax. Taxpayers who do not contest a math error notice within 60 days lose the right to do so in court before paying. The IRS may summarily assess 17 types of mathematical or clerical errors, which are codified at IRC § 6213(g)(2) in subparagraphs A-Q.

REASONS FOR CHANGE

Congress generally requires the IRS to follow deficiency procedures, which provide taxpayers with notice and a reasonable opportunity to challenge the IRS's tax adjustment. Math error authority, which provides fewer taxpayer protections, was authorized as a limited exception to regular deficiency procedures. It allows the IRS to make adjustments in cases of clear taxpayer error, such as where a taxpayer incorrectly adds numbers or incorrectly transcribes a number from one form to another. Because taxpayers have fewer protections under math error procedures, the procedures are not intended to be used where a substantive disagreement may exist. When Congress has expanded the IRS's math error authority, it has done so consistent with that principle.

Because math error procedures are cheaper and simpler for the IRS than deficiency procedures, the Department of the Treasury in the past has requested that Congress grant it the authority to add new categories of "correctable errors" by regulation.²

The National Taxpayer Advocate is concerned about the impact on taxpayer rights of giving the IRS broad authority to add new categories of math error. In our reports to Congress, we have documented

1 See IRC § 7803(a)(3)(E) (identifying the "right to appeal a decision of the Internal Revenue Service in an independent forum" as a taxpayer right).

2 See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 245-246 (Feb. 2015); Joint Committee on Taxation, JCS-1-19, *Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal* 62, 64 (July 8, 2019).

circumstances in which the IRS has used math error authority to address discrepancies that have undermined taxpayer rights.³

If the IRS uses math error authority to address more complex issues that require additional fact finding, its assessments are more likely to be wrong, and the IRS's computer-generated notices, which confuse many taxpayers in the simplest of circumstances, are likely to become even more difficult to understand.⁴ A recent example illustrates a significant omission on math error notices, where taxpayers' Recovery Rebate Credits were adjusted. In 2021 the IRS issued about 6.5 million math error notices that omitted the 60-day time period language for requesting an abatement of the tax.⁵ The IRS later reissued letters to these taxpayers informing them of their right to request an abatement, and restarted the 60-day time period from the date of these new letters. Confusing notices such as these may prevent some taxpayers from responding timely. As a result, these taxpayers will lose their right to challenge the adjustments in court before paying, undermining the taxpayers' *right to appeal an IRS decision in an independent forum*.

Math error authority may be appropriate to use where required schedules are omitted, or annual or lifetime dollar caps have been exceeded. It also may be appropriate to use where there is a discrepancy between a return entry and data available to the IRS from a reliable government database, such as records maintained by the Social Security Administration. But the IRS should not be the arbiter of that reliability. Rather, Congress should retain full authority to determine whether the administrative "efficiency" of using math error authority in these instances outweighs the loss of the significant taxpayer protections that deficiency procedures provide.

RECOMMENDATIONS

- Do not give the IRS authority to add new categories of "correctable errors" by regulation. Because the deficiency procedures created by Congress provide important taxpayer protections, Congress should retain the sole authority to determine whether and when to create new exceptions to deficiency procedures by adding categories of mathematical or clerical errors.
- Amend IRC § 6213(g) to authorize the IRS to exercise its existing (and any new) authority to summarily assess a deficiency due to "clerical errors" only where: (i) there is a discrepancy between a return entry

3 See, e.g., National Taxpayer Advocate 2018 Annual Report to Congress 164 (Most Serious Problem: *Post-Processing Math Error Authority: The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers*); National Taxpayer Advocate 2018 Annual Report to Congress 174 (*Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden*); National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*); National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 5 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 92-93 (*Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*); National Taxpayer Advocate 2006 Annual Report to Congress 311 (Most Serious Problem: *IRS Implementation of Math Error Authority Impairs Taxpayer Rights*); National Taxpayer Advocate 2003 Annual Report to Congress 113 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 25 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 186 (Legislative Recommendation: *Math Error Authority*); National Taxpayer Advocate 2001 Annual Report to Congress 33 (Most Serious Problem: *Explanations on Math Error Authority*).

4 Erin M. Collins, Math Error, Part I, NATIONAL TAXPAYER ADVOCATE BLOG (July 28, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-i/>; Erin M. Collins, Math Error, Part II: Math Error Notices Aren't Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

5 Erin M. Collins, Math Error, Part II: Math Error Notices Aren't Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

and reliable government data; (ii) the IRS's notice clearly describes the discrepancy and how to contest it; (iii) the IRS has researched all information in its possession that could help reconcile the discrepancy; (iv) the IRS does not have to evaluate documentation to make a determination; and (v) there is a low abatement rate for taxpayers who respond.

- Amend IRC § 6213(g) to provide that the IRS is not authorized to use any new criteria or data to make summary assessments unless the Department of the Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported on the reliability of the criteria or data for that intended use.⁶

6 For a more limited recommendation, see National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*).

Legislative Recommendation #13**Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans****PRESENT LAW**

IRC §§ 24(g), 25A(b), and 32(k) require the IRS to ban a taxpayer from claiming the Child Tax Credit (CTC), the Credit for Other Dependents (ODC), the American Opportunity Tax Credit (AOTC), and the Earned Income Tax Credit (EITC) for two years if the IRS makes a final determination that the taxpayer improperly claimed the credit with reckless or intentional disregard of rules and regulations. The duration of the ban increases to ten years if the IRS makes a final determination that the credit was claimed fraudulently.

IRC § 6214 grants the Tax Court jurisdiction to redetermine a deficiency for the tax year(s) before the court, but it does not grant the Tax Court jurisdiction to redetermine deficiencies for other tax years.

IRC § 6213 authorizes the IRS to disallow credits claimed while a ban is in effect pursuant to its summary assessment procedures (sometimes known as math error authority).

IRC § 6751(b) prohibits the IRS from assessing certain penalties unless an employee's initial determination to impose a penalty is personally approved (in writing) by his or her immediate supervisor or a higher-level official.

REASONS FOR CHANGE

Congress directed the IRS to impose multiyear bans on CTC, ODC, AOTC, and EITC eligibility to deter and penalize certain taxpayers who improperly claim these credits. Multiyear bans are highly unusual because they mean taxpayers will be denied credits in future years even if the taxpayers otherwise satisfy all of the eligibility requirements in those years.

These refundable credits can be a lifeline to low-income taxpayers. A 2019 TAS study found that on average, EITC accounted for more than 20 percent of taxpayers' adjusted gross incomes. Given the potentially devastating financial impact of multiyear bans, adequate safeguards are critical to ensure both that the IRS imposes a ban only when a taxpayer acts with the requisite state of mind and that a taxpayer has access to meaningful review of an IRS final determination to assert the ban.

Presently, the IRS may disallow an examined year's credit and assert a multiyear ban against claiming the credit in future years when it issues a notice of deficiency at the conclusion of an audit. A taxpayer may contest a notice of deficiency in the Tax Court, but it is uncertain whether the court has jurisdiction to review the IRS's assertion of a ban applicable to future tax years that has no impact on the taxpayer's liability for the tax year before the court.¹ Once a ban on claiming a credit in future years takes effect, the IRS will disallow the credit if the taxpayer claims it, and it may do so using its summary assessment procedures. The IRS would issue a notice of deficiency in that instance only if the taxpayer disputes the summary assessment.

¹ Compare *Garcia v. Comm'r*, T.C. Summ. Op. 2013-28 (holding, in a nonprecedential case, that a ban did not apply) with *Ballard v. Comm'r*, No. 03843-15S (T.C. Feb. 12, 2016) (declining to rule on the application of IRC § 32(k), noting that the application of the ban had no effect on the taxpayer's federal income tax liability for the year before it).

Written Managerial Approval

The IRS's internal rules allow it to impose two-year bans automatically in some EITC cases.² The IRS is expanding the practice of automatically imposing bans to include the refundable portion of the CTC (referred to as the additional child tax credit, or ACTC).³ In all other ban cases, IRS procedures require a manager to review the case independently and approve the assertion of a ban in writing.⁴ IRC § 6751(b), which generally requires managerial approval before the IRS imposes penalties, does not apply to multiyear bans. Significantly, two TAS research studies of two-year ban cases found that this required managerial approval is usually lacking.⁵

The National Taxpayer Advocate does not believe that automatic or systemic imposition of multiyear bans is ever appropriate. The law requires imposition of the two-year ban only in cases where the IRS determines a taxpayer acted recklessly or with intentional disregard of rules and regulations, and imposition of the ten-year ban only in cases where the IRS determines a taxpayer's claim was fraudulent. The law does not permit the IRS to impose multiyear bans when an improper claim is due to inadvertent error or even due to negligence.

A computer is not capable of assessing a taxpayer's state of mind and therefore cannot determine whether an improper claim was due to inadvertent error or due to reckless or intentional disregard of rules and regulations. This determination requires an independent facts-and-circumstances investigation by an employee. And in light of the harsh impact of multiyear bans, managerial approval should be required in all cases before they are imposed.

Tax Court Jurisdiction

IRC § 6214 restricts the Tax Court to determining the amount of tax owed in the tax year(s) before the court. Thus, the court may determine whether the taxpayer properly claimed credits for the year that is the subject of a notice of deficiency. By contrast, the court may not have jurisdiction to determine whether the IRS's asserted ban should apply to the future years that are not before it, even if the ban is proposed in the notice of deficiency, because a ban has no effect on a taxpayer's liability in the tax year in which it is imposed (it affects only the following two or ten years).⁶ If the Tax Court does not consider whether a ban was properly imposed and the ban is left intact, and the taxpayer claims the banned credit on a subsequent return, the IRS will disallow the claim and may do so pursuant to its summary assessment procedures. The taxpayer would then be required to dispute the summary assessment and, once the IRS issues a notice of deficiency for the subsequent year, seek Tax Court review to determine whether the taxpayer properly claimed the credits. However, it is not clear whether the Tax Court has jurisdiction to determine whether the IRS properly imposed the ban in an earlier year that is not before the court (and if it lacks that jurisdiction, it may conclude that because the ban is intact, the court does not have the authority to allow the credit in the ban years).

Transparency is a critical element of taxpayer rights and fairness, and taxpayers should understand clearly when they may seek Tax Court review of an adverse IRS determination. In most cases, the law is clear. Here,

2 Internal Revenue Manual (IRM) 4.19.14.7.1.5, Project Codes 0027 and 0028 – EITC Recertification with a Proposed 2 Year EITC Ban (Dec. 16, 2020).

3 The American Rescue Plan Act, Pub. L. No. 117-2, § 9611, 135 Stat. 4, 359-376 (2021), makes the CTC fully refundable for tax year 2021. See Treasury Inspector General for Tax Administration, Ref. No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* 8 (May 10, 2021) (reporting that "IRS management stated that, starting in Processing Year 2021, systemic processes will assess the two-year ban for the ACTC.").

4 IRM 4.19.14.7.1(3), 2/10 Year Ban – Correspondence Guidelines for Exam Technicians (CET) (Dec. 11, 2019).

5 See National Taxpayer Advocate 2019 Annual Report to Congress vol. 2, at 239-256 (Research Study: *Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit*); National Taxpayer Advocate 2013 Annual Report to Congress 103-115 (Most Serious Problem: Earned Income Tax Credit: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*).

6 See note 1, *supra*.

the law is not clear, and there appear to be four possible outcomes: (i) the Tax Court may have jurisdiction to review a ban both for the year in which it is imposed and for the year in which it is effective; (ii) the Tax Court may have jurisdiction to review a ban for the year in which it is imposed but not for the year in which it is effective; (iii) the Tax Court may not have jurisdiction to review a ban for the year in which it is imposed but may have jurisdiction to review it for the year in which it is effective; or (iv) the Tax Court may not have jurisdiction to review a ban at any time. These procedural uncertainties undermine the taxpayer's *rights to appeal an IRS decision in an independent forum and to a fair and just tax system* and require clarification.

RECOMMENDATIONS

- Amend IRC §§ 24(g), 25A(b), and 32(k) to require independent managerial review and written approval based on consideration of all relevant facts and circumstances before the IRS asserts a multiyear ban. Alternatively, amend IRC § 6751 to implement this change.
- Amend IRC § 6214 to grant the Tax Court jurisdiction to (i) review the IRS's final determination to impose a multiyear ban under IRC §§ 24(g), 25A(b), or 32(k) in any deficiency proceeding in which the notice of deficiency asserts a multiyear ban or any subsequent deficiency proceeding in which the IRS disallows a claimed credit because a multiyear ban is in effect and (ii) allow the affected credit if it finds a multiyear ban was improperly imposed and the taxpayer otherwise qualifies for the credit.

Legislative Recommendation #14**Allow Additional Time for Taxpayers to Request Abatement of a Math Error Assessment Equal to the Additional Time Allowed to Respond to a Notice of Deficiency When the Math Error Notice Is Addressed to a Person Outside the United States****PRESENT LAW**

IRC § 6213(b) authorizes the IRS to make a “summary assessment” of tax arising from mathematical or clerical errors as defined in IRC § 6213(g), thus bypassing otherwise applicable deficiency procedures. A taxpayer has no right to file a petition in the U.S. Tax Court based on a math error notice. However, under IRC § 6213(b)(2)(A) a taxpayer has 60 days after a math error notice is sent to request abatement. If the taxpayer makes an abatement request within 60 days, the IRS must abate the summary assessment and then follow deficiency procedures under IRC § 6212 if it wishes to reassess an increase in tax. If the taxpayer does not submit an abatement request within 60 days, the taxpayer forfeits his or her right to file a petition in the Tax Court. No additional time beyond the 60 days is allowed to request an abatement when the math error notice is addressed to a taxpayer outside the United States.

By contrast, a taxpayer outside the United States who receives a notice of deficiency is given additional time to respond. In general, a taxpayer may file a petition in the Tax Court for a redetermination of a deficiency within 90 days from the date the notice is mailed. However, when the notice of deficiency “is addressed to a person outside the United States,” IRC § 6213(a) provides that the taxpayer has 150 days from the date the notice is mailed to file a Tax Court petition. The Tax Court has construed this language broadly, concluding among other things that the 150-day period for filing a petition applies not only when a notice of deficiency is mailed to an address outside the United States, but also when a notice of deficiency is mailed to an address within the United States, provided the taxpayer is located outside the United States.¹

REASONS FOR CHANGE

An estimated nine million U.S. citizens live abroad, as well as about 228,000 U.S. military service personnel.² In addition, more than 340,000 U.S. students study overseas.³ Taxpayers living abroad (temporarily or permanently) often require more time to respond to IRS notices than taxpayers living in the United States. Mail delivery takes longer in both directions – in some cases, depending on where the taxpayer is located, substantially longer. In addition, persons temporarily abroad often do not have access to their tax or financial records, making it difficult for them to respond immediately.

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- 1 See, e.g., *Levy v. Comm’r*, 76 T.C. 228 (1981) (holding that the 150-day rule is applicable to a U.S. resident who is temporarily outside the country when the notice is mailed and delivered); *Looper v. Comm’r*, 73 T.C. 690 (1980) (holding that the 150-day rule is applicable where a notice is mailed to an address outside the United States); *Lewy v. Comm’r*, 68 T.C. 779 (1977) (holding that the 150-day rule is applicable to a foreign resident who is in the United States when the notice is mailed but is outside the United States when the notice is delivered); *Hamilton v. Comm’r*, 13 T.C. 747 (1949) (holding that the 150-day rule is applicable to a foreign resident who is outside the United States when the notice is mailed and delivered).
 - 2 For Fiscal Year (FY) 2019, the Department of State estimates that about nine million U.S. citizens lived abroad. U.S. Department of State, Bureau of Consular Affairs, *Consular Affairs by the Numbers*, FY 2019 data (Jan. 2020), <https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf>. As of June 30, 2021, about 228,000 U.S. military service personnel were stationed abroad, including military reserve personnel and Department of Defense civilian employees. U.S. Department of Defense, Defense Manpower Data Center (DMDC), *Military and Civilian Personnel by Service/Agency by State/Country*, <https://dwp.dmdc.osd.mil/dwp/app/dod-data-reports/workforce-reports>.
 - 3 Open Doors, U.S. Study Abroad: All Destinations, <https://opendoorsdata.org/data/us-study-abroad/all-destinations> (last visited Sept. 2, 2020) (showing 341,751 U.S. students studied abroad during the 2017-2018 academic year).

By giving taxpayers living abroad 60 additional days to file a petition in the Tax Court in response to a notice of deficiency, Congress recognized that holding overseas taxpayers to the same deadlines as taxpayers located in the United States would be unreasonable. The same logic applies with respect to math error notices. In fact, the need for additional time is arguably greater in the case of math error notices because the standard response deadline is 60 days (as opposed to 90 days for filing a Tax Court petition in response to a notice of deficiency).

RECOMMENDATION

- Amend IRC § 6213(b)(2)(A) to allow taxpayers 120 days to request an abatement of tax when a math error notice is addressed to a person outside the United States.

Legislative Recommendation #15**Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures****PRESENT LAW**

IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days for notices addressed to a person outside the U.S.) to review the IRS determination.

IRC § 6671(a) authorizes the IRS to assess some penalties without first issuing a notice of deficiency.¹ These penalties are generally subject to judicial oversight only if taxpayers first pay the penalty and then incur the cost of taking the case to a U.S. district court or the U.S. Court of Federal Claims.² Although IRC § 6671(a) specifically references only the “penalties and liabilities provided by this subchapter” (*i.e.*, Chapter 68, Subchapter B of the IRC), the IRS takes the position that various international information reporting penalties in Chapter 61 are also immediately assessable without the issuance of a notice of deficiency, including the penalty under IRC § 6038 for failure to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.³

REASONS FOR CHANGE

Taxpayers who are savvy enough to request an abatement based on reasonable cause or to request a conference with the IRS Independent Office of Appeals frequently obtain relief from assessable penalties, particularly where the IRS systemically imposes a penalty (rather than imposing it manually during an audit).⁴ TAS has previously reported that the IRS abated between 71 percent and 88 percent of dollars systemically assessed under IRC §§ 6038 and 6038A. Specifying that deficiency procedures apply would prevent the systemic assessments the IRS so often abates, a process that unnecessarily consumes resources for the IRS and imposes undue burdens on taxpayers. Moreover, allowing taxpayers to seek judicial review without the necessity of prepayment would remove a restriction that Congress did not impose and that disproportionately affects taxpayers with limited resources.

The National Taxpayer Advocate does not agree with the IRS’s legal position that foreign information reporting penalties in Chapter 61 may be assessed without the issuance of a notice of deficiency under current

1 These “assessable” penalties are generally those that are due and payable upon notice and demand. Unlike penalties subject to deficiency procedures, assessable penalties carry no rights to a 30-day letter, agreement form, or notice requirements prior to assessment. Internal Revenue Manual (IRM) 20.1.9.1.5, Common Terms and Acronyms (Jan. 29, 2021).

2 See IRC § 7422 for requirements relating to refund suits. For legislative recommendations to address the issue of “pay to play” judicial review, see Legislative Recommendation: *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*, and Legislative Recommendation: *Expand the Tax Court’s Jurisdiction to Hear Refund Cases and Assessable Penalties*, *infra*. See also National Taxpayer Advocate 2021 Purple Book, Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 94-97 (*Repeal Flora and Expand the Tax Court’s Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

3 The IRS also treats the penalties imposed under IRC §§ 6038A, 6038B, 6038C, and 6038D for failing to file various international information returns as assessable penalties. IRM 20.1.9.2 (Jan. 29, 2021); IRM 20.1.9.7.3 (Jan. 29, 2021).

4 See National Taxpayer Advocate 2020 Annual Report to Congress 119, 124-125 (Most Serious Problem: *International: The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*) (reporting that when penalties under IRC §§ 6038 and 6038A are applied systemically, the abatement percentage, measured by number of penalties, ranges from 55 to 72 percent, and by dollar value of penalties ranges from 71 to 88 percent). The IRS abates manual assessments at rates ranging from 17 percent to about 39 percent by number, and from eight percent to about 66 percent by dollar.

law. In light of its position, however, the proposed legislative change would eliminate future litigation and enhance the taxpayers' *right to a fair and just tax system*.⁵

RECOMMENDATION

- Amend IRC § 6212 to require the IRS to issue a notice of deficiency before assessing penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D.

5 See National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*).

Legislative Recommendation #16**Amend IRC § 6330 to Provide That “an Opportunity to Dispute” an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum****PRESENT LAW**

IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien filed by the IRS or of a proposed levy action. The purpose of these collection due process (CDP) rights is to give taxpayers adequate notice of IRS collection activity and provide a meaningful hearing to determine whether the IRS properly filed a notice of federal tax lien or whether it may proceed to deprive the taxpayer of property through a levy. In a CDP hearing, conducted by a settlement officer with the IRS Independent Office of Appeals (Appeals), a taxpayer may raise a variety of issues, including collection alternatives and spousal defenses. Under IRC § 6330(c)(2)(B), however, a taxpayer may only dispute the existence or amount of the underlying tax liability if the taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.”¹

The IRS and the courts interpret IRC § 6330(c)(2)(B) and Treasury regulations under IRC §§ 6320 and 6330 to mean that an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals, even where the taxpayer had no prior opportunity for prepayment judicial review of the liability and no subsequent prepayment judicial review of the Appeals determination is available.² Additionally, at least one Court of Appeals has held that IRC § 6330(c)(4)(A) is an independent basis for denying a merits hearing in the CDP process if a prior merits hearing occurred.³

In a recent deficiency case applying these rules, *Lander v. Commissioner*,⁴ the Tax Court held the taxpayer was not permitted to dispute the underlying liability in a CDP hearing where the taxpayer did not receive the notice of deficiency sent by the IRS but obtained an Appeals hearing as a part of the audit reconsideration process.⁵ Because the underlying liability was not at issue in the CDP hearing, the taxpayer was precluded from disputing the underlying liability in the Tax Court proceeding.⁶ Thus, by seeking to resolve his tax liability through audit reconsideration, the taxpayer forfeited his right to seek judicial review of the liability in a prepayment forum.

1 IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties and additions to tax, and statutory interest. *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).

2 Treas. Reg. §§ 301.6320-1(e)(3), Q&A (E)(2), 301.6330-1(e)(3), Q&A (E)(2), provides that “an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability. An opportunity for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.” The Tax Court and at least three Courts of Appeal have upheld the validity of these regulations. *Lewis v. Comm’r*, 128 T.C. 48, 61 (2007); *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Services II, Inc. v. Comm’r*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Enterprises, Inc. v. Comm’r*, 855 F.3d 773 (7th Cir. 2017).

3 *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017). IRC § 6330(c)(4)(A) provides that an issue may not be raised at a CDP hearing “(i) if the issue was raised and considered at a previous hearing under section 6320 or in any other previous administrative or judicial proceeding; and (ii) the person seeking to raise the issue participated meaningfully in such hearing or proceeding.”

4 *Lander v. Comm’r*, 154 T.C. 104 (2020), holding that the conference with Appeals as part of the audit reconsideration process constituted “an opportunity to dispute the tax liability” under IRC § 6330(c)(2)(B).

5 A notice of deficiency allows taxpayers to petition the Tax Court for *de novo* review of the IRS’s determination under IRC § 6213(a), but audit reconsiderations are not subject to Tax Court review.

6 At the conclusion of a CDP hearing, the taxpayer, within 30 days of the Appeals settlement officer’s determination, may petition the Tax Court for review of the determination. IRC §§ 6230(c), 6330(d). If the taxpayer’s underlying liability was not at issue in the CDP hearing, the taxpayer will be precluded from disputing the underlying liability in the Tax Court proceedings. Treas. Reg. § 301.6330-1(f)(2), Q&A (F)(3).

In some non-deficiency cases, mere notification of the right to request an Appeals conference is treated as a “prior opportunity” to dispute the liability. For example, the IRS assesses certain penalties without issuing a notice of deficiency.⁷ Some “summary” penalty assessments are made systemically (*i.e.*, they are automatically imposed by a computer rather than manually imposed during an audit).⁸ When the IRS makes these summary assessments, it notifies the taxpayer of the proposed penalty by sending a letter or notice that makes mention of the taxpayer’s right to seek a conference with Appeals.⁹ For purposes of the Trust Fund Recovery Penalty, for example, this correspondence constitutes “an opportunity to dispute such liability,” even when the taxpayer does not request a conference in response to the letter and no conference takes place.¹⁰ Whether or not the taxpayer requests or receives a conference with Appeals in response to the letter, the taxpayer will not be permitted to dispute the merits of the liability at a CDP hearing or in Tax Court, even if the liability resulted from an automated system rather than any human intervention. To obtain judicial review of the underlying liability, the taxpayer must pay the tax – generally the full amount due – and seek a refund.¹¹

One exception to the full payment rule applies to “divisible” taxes. When an assessment may be divisible into a tax on each transaction or event, the taxpayer need only pay enough to cover a single transaction or event before filing suit.¹²

Additional provisions in IRC § 6330 preserve the integrity of CDP hearings. Appeals Officers may disregard requests for CDP hearings that are made to delay collection.¹³ Among the matters that cannot be raised at a CDP hearing are “specified frivolous submissions” as defined in IRC § 6702(b)(2)(A).¹⁴

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- 7 Assessable penalties are primarily found in IRC §§ 6671 through 6720C. The IRS also treats the penalties found in IRC §§ 6038 and 6038A as assessable penalties, a practice the National Taxpayer Advocate believes is not supported by statute. See National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*). See also Legislative Recommendation: Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures, *supra*.
 - 8 IRM 21.8.2.20.2(1), Form 5471 Penalties Systemically Assessed From Late-Filed Form 1120 Series or Form 1065 (Mar. 26, 2018); IRM 21.8.2.21, Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Oct. 1, 2016); IRM 21.8.2.21.2(1), Form 5472 Penalties Systemically Assessed From Late-Filed Form 1120 Series (Mar. 18, 2020).
 - 9 In some notices, a description of the right to seek a conference with Appeals is brief and does not appear until the end of the notice. For example, the IRS issues Notice CP 15, Notice of Penalty Charge, to advise taxpayers of a proposed assessable penalty under IRC § 6038. On the second page of the notice, near the end, the notice advises: “If you wish to appeal this penalty, send the IRS at the address shown on page 1 of this notice a written request to appeal within 30 days from the date of this notice. Your request should include any explanation and documents that will support your position. Your explanation should reflect all facts that you contend are reasonable cause for not asserting this penalty.”
 - 10 Treas. Reg. §§ 301.6320-1(e)(4), Example 3, 301.6330-1(e)(4), Example 3, relating to the trust fund recovery penalty (TFRP) under IRC § 6672. The IRS sends Letter 1153, Proposed Trust Fund Recovery Penalty Notification, to inform taxpayers it is asserting the TFRP and courts have held Letter 1153 is an “opportunity to dispute such liability.” *Bletsas v. Comm’r*, T.C. Memo. 2018-128, *aff’d* 784 F. App’x 835 (2d Cir. 2019); *Smith v. Comm’r*, T.C. Memo. 2015-60; *Thompson v. Comm’r*, T.C. Memo. 2012-87.
 - 11 See 28 U.S.C. § 1346(a)(1) (providing that once a taxpayer pays the tax, the taxpayer may file suit in a U.S. district court or the U.S. Court of Federal Claims to recover any tax the taxpayer believes has been erroneously assessed or collected). In *Flora v. United States*, 362 U.S. 145 (1960), the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before filing suit in these courts.
 - 12 The TFRP, for example, is a divisible tax. After the IRS assesses the penalty, the responsible person need only pay the amount due with respect to a single employee for a single quarter before filing suit. Other exceptions to the full payment rule include IRC § 6694(c) (applicable to those who have paid 15 percent of certain assessable preparer penalties) and IRC § 6703(c) (applicable to those who have paid 15 percent of the assessable penalties under IRC §§ 6700 and 6701 relating to promoting abusive tax shelters and aiding and abetting understatements).
 - 13 IRC § 6330(g) provides: “Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”
 - 14 IRC § 6330(c)(4)(B). IRC § 6702 allows for the imposition of a penalty of up to \$5,000 where a request for a CDP hearing is “either based on a position the IRS has identified as frivolous or reflects a desire to delay or impede the administration of federal tax laws.” IRC § 6702(b)(2)(A)(i) & (ii), (B)(i), (c).

REASONS FOR CHANGE

The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute the underlying liability in a prepayment judicial forum are precluded from doing so during their CDP hearing. Taxpayers who wish to dispute their underlying liability in a judicial forum but cannot raise the issue in a CDP hearing due to the application of IRC § 6330(c)(2)(B) have no alternative but to pay the tax and then seek a refund, an option that not all taxpayers can afford, particularly when the liability consists of high-dollar assessable, non-divisible penalties.¹⁵ In addition, in deficiency cases where the taxpayer did not receive a notice of deficiency, the decision whether to request a conference with Appeals has ramifications that most taxpayers will not anticipate and that reward taxpayers who have skilled representation. Specifically, savvy taxpayers may refrain from seeking to resolve their liabilities through, for example, the audit reconsideration process in order to preserve their ability to adjudicate their underlying liabilities in a later CDP hearing, while taxpayers without sophisticated knowledge of these rules may request audit reconsideration without recognizing that doing so will cause them to lose their ability to later adjudicate their underlying liabilities in a CDP hearing.

The National Taxpayer Advocate believes that judicial and administrative interpretations limiting a taxpayer's ability to challenge the IRS's liability determination in a CDP hearing are inconsistent with Congress's intent when it enacted CDP procedures. Compared to the burden the current rules place on taxpayers, and in view of the statutory safeguards already in place to prevent frivolous or meritless CDP proceedings, allowing more taxpayers to dispute their tax liabilities in CDP hearings will better protect taxpayer rights without imposing an undue administrative burden on the IRS or the Tax Court.

RECOMMENDATIONS

- Amend IRC § 6330(c)(2)(B) to allow taxpayers to raise challenges to the existence or amount of the underlying tax liability at a CDP hearing for any tax period if the taxpayer did not receive a valid notice of deficiency for such liability or, in non-deficiency cases, the taxpayer did not have an opportunity to dispute the liability in a prepayment judicial forum.
- Clarify that IRC § 6330(c)(4)(A) applies only to collection issues and not to liability issues, which are addressed exclusively in IRC § 6330(c)(2)(B).

¹⁵ For legislative recommendations to address the issue of “pay to play” judicial review, see Legislative Recommendation: *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*, and Legislative Recommendation: *Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties*, *infra*. See also National Taxpayer Advocate 2021 Purple Book, Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 94-97 (*Repeal Flora and Expand the Tax Court's Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

Legislative Recommendation #17**Amend IRC § 6402(a) to Prohibit Offset of the Earned Income Tax Credit Portion of a Tax Refund****PRESENT LAW**

IRC § 6343(a)(1)(D) requires the Secretary to release a levy if she determines the levy “is creating an economic hardship due to the financial condition of the taxpayer.”

IRC § 7122 authorizes the IRS to accept offers in compromise and requires the Secretary to publish guidelines for evaluating offers to ensure “that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”

IRC § 6402(a) generally authorizes the IRS to offset a taxpayer’s refund and apply it to satisfy a prior-year federal tax liability, but it does not require the IRS to do so. For taxpayers who are experiencing an economic hardship, the IRS may “bypass” the offset and issue the refund to the taxpayer.¹ This is referred to as an “offset bypass refund” (OBR).² The timeframe for requesting an OBR is narrow. The IRS must approve an OBR between the date the return is filed and the date the IRS assesses the tax shown on the return. This period is approximately ten to 20 days when a return is filed electronically.³ Once an offset has taken place, the IRS does not have the legal authority to pay the refund even if a taxpayer can demonstrate economic hardship.

The Earned Income Tax Credit (EITC) is a refundable credit for low-income working individuals and families.⁴ For tax year 2020, the maximum amount of the credit was \$6,660 for a family consisting of one adult with three children and earning between \$14,800 and \$19,349.⁵ The EITC is claimed on a tax return and is included in the computations that determine whether a taxpayer is entitled to receive a refund and, if so, the amount of the refund. Therefore, when a refund is offset to satisfy a prior-year federal tax liability, the taxpayer will not receive some or all of the EITC for which he or she is otherwise eligible.

REASONS FOR CHANGE

Congress created the EITC to provide financial support for low-income individuals and families, enhance workforce participation, and reduce poverty. It enacted such statutes as IRC §§ 6343(a)(1)(D) and 7122, to protect taxpayers from IRS collection actions where these actions would leave a taxpayer unable to pay his or her basic living expenses. To determine whether a collection action would leave a taxpayer in that position, the IRS publishes schedules of national and local allowances annually known as “Allowable Living Expenses” (ALEs). The IRS generally will refrain from taking collection actions if it determines that a taxpayer’s ALEs are less than the taxpayer’s income. However, the IRS may continue to offset refunds the taxpayer claims on a return, unless the taxpayer knows to request an OBR.

The OBR process is obscure and difficult to navigate. OBRs may only be approved during the short timeframe between the date a tax return is filed and the date the tax is assessed – typically, ten to 20 days.

1 Treas. Reg. § 301.6343-1(b)(4)(i) provides that an economic hardship exists when an IRS action would cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.

2 However, if the taxpayer has non-tax federal debts, past due child support, or state income tax or unemployment compensation debts, the IRS must make an offset with respect to those liabilities. See IRC § 6402(c) & (d).

3 With the IRS transitioning to CADE 2, this period will become shorter. Internal Revenue Manual 21.2.1.4, Customer Account Data Engine 2 (CADE 2) (Jan. 4, 2012), explains in paragraph (2) that some of the benefits of CADE 2 are daily transaction posting and quicker refunds.

4 IRC § 32.

5 IRS, Pub. 596, Earned Income Credit (EIC) 34 (Jan. 26, 2021).

In fiscal year 2021, only 511 taxpayers received OBRs.⁶ Particularly during the last two years when many Americans have been struggling financially due to the COVID-19 pandemic, significantly more taxpayers could have benefited from an OBR but did not know to request one.

Consistent with congressional intent that the IRS refrain from taking collection actions that will impose economic hardships on taxpayers, the National Taxpayer Advocate recommends that Congress prohibit the IRS from offsetting the portion of a taxpayer's refund attributable to the EITC. While EITC eligibility is not the sole indicator of economic hardship, it provides a good approximation because the credit is only available to taxpayers whose incomes are below a specified threshold. The credit in tax year 2020 plateaued at \$538 for a single taxpayer with no qualifying children who earned between \$7,000 and \$8,749. The same credit plateau applied to married taxpayers filing jointly with no qualifying children who earned between \$7,000 and \$9,200. For a single taxpayer with three qualifying children earning between \$14,800 and \$19,349, the credit plateaued at \$6,660.⁷

Using the EITC as a proxy for economic hardship for purposes of OBR eligibility will also eliminate the administrative burden the current process imposes on both taxpayers, who have to produce substantiation of hardship, and the IRS, which must review each request on a case-by-case basis. To be clear, we are not recommending that the full refund be released – just the amount attributable to the EITC. Programming would be straightforward, rendering it easily administrable.⁸

RECOMMENDATION

- Amend IRC § 6402(a) to prohibit offset of the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities.

⁶ IRS, Compliance Data Warehouse, Individual Master File Transaction History table (data as of Oct. 28, 2021).

⁷ IRS, Pub. 596, Earned Income Credit (EIC) 32-34 (Jan. 26, 2021).

⁸ The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients. It recently wrote: "OBRs are narrow in the relief they provide, typically only resulting in a payment of the amount of the specifically demonstrated past due bill or other emergency. This might provide only temporary relief when the taxpayer's hardship is a recurring expense, or when the hardship is one that is not easily quantified (for example, food insecurity)." ABA, Comments Regarding Review of Regulatory and Other Relief to Support Taxpayers During COVID-19 Pandemic (Jan. 15, 2021), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2021/011521comments.pdf> (footnote omitted).

Legislative Recommendation #18**Require the IRS to Waive User Fees for Taxpayers Who Enter Into Low-Cost Installment Agreements or Who Have an Adjusted Gross Income Equal to or Less Than 250 Percent of the Federal Poverty Level****PRESENT LAW**

In cases where a taxpayer is unable to pay the full amount of his or her tax liability in a single lump sum, IRC § 6159(a) authorizes the IRS to enter into an installment agreement (IA) under which the taxpayer will pay the liability in monthly installments. A taxpayer can apply for an IA on paper or by using an online payment agreement (OPA).

The Independent Offices Appropriations Act of 1952 (31 U.S.C. § 9701) and Office of Management and Budget Circular A-25 authorize the IRS to set user fees by regulation. In 2016, the IRS increased the IA fee.¹ Pursuant to Treas. Reg. § 300.1, it now charges \$225 for entering into paper IAs and \$149 for entering into OPAs. If a taxpayer authorizes the IRS to “direct debit” a bank account each month, the fee is reduced to \$107 for paper IAs and \$31 for OPAs. These fees are designed to enable the agency to recover the full costs of administering IAs.

For low-income taxpayers (*i.e.*, taxpayers whose incomes do not exceed 250 percent of the Federal Poverty Level), Treas. Reg. § 300.1 caps the IA fee at \$43. In addition, IRC § 6159(f)(2)(A) waives the fee for low-income taxpayers who enter into direct-debit IAs (DDIAs). Low-income taxpayers who cannot enter into DDIAs (*e.g.*, because they do not have a bank account) must pay the IA fee, but if they make all payments required under the IA, IRC § 6159(f)(2)(B) requires the IRS to reimburse the amount of the IA fee to them. In 2018, Congress amended IRC § 6159(f)(1) to prohibit the IRS from increasing the IA user fees.

REASONS FOR CHANGE

Even the reduced IA user fee for low-income taxpayers may deter these taxpayers from applying for IAs and paying their taxes voluntarily. Taxpayers ineligible for the reduced fee may also be experiencing some level of financial hardship, as evidenced by their inability to pay their balance at once. The cost to the IRS of OPAs and DDIAs is so low that requiring a user fee may cost the government more in lost tax revenue and increased enforcement costs than the user fee generates.

The IRS is required to identify low-income individuals who request an installment agreement, and it does so systemically by placing an indicator on a taxpayer’s account based on the taxpayer’s last filed return. Taxpayers whose accounts are marked with a low-income indicator do not pay the \$43 fee when they request an IA. Low-income taxpayers without the indicator on their accounts may complete and submit Form 13844, Application for Reduced User Fee for Installment Agreement, for fee waiver approval. Removing the requirement to pay for an IA could encourage more low-income taxpayers to become compliant with their tax obligations. Taxpayers whose incomes exceed the 250 percent threshold and who enter into DDIAs should also be relieved of paying an IA user fee. This would incentivize more taxpayers to shift to an online resolution and acknowledge that this virtual transaction involves minimal employee cost for the IRS.

¹ See User Fees for Installment Agreements (IAs), T.D. 9798, 81 Fed. Reg. 86,955 (Dec. 2, 2016).

RECOMMENDATION

- Amend IRC § 6159 to require the IRS to waive the user fee for all direct-debit IAs and for IAs with taxpayers whose adjusted gross income is equal to or less than 250 percent of the Federal Poverty Level.²

² For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 301 (2017); Taxpayer Protection and Assistance Act, S. 1321, 109th Cong. § 301 (2006).

Legislative Recommendation #19**Improve Offer in Compromise Program Accessibility by Repealing the Partial Payment Requirement and Restructuring the User Fee****PRESENT LAW**

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an offer in compromise (OIC). According to Policy Statement 5-100, the IRS will “accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.” Taxpayers whose offers are accepted must file and pay their taxes for the next five years, as stated on IRS Form 656, Offer in Compromise (2021) (Section 7, items l and m). If they fail to remain in compliance for the five-year period, the IRS may seek to collect the amounts it compromised.

IRC § 7122(c)(1)(A) requires a taxpayer who would like the IRS to consider a “lump-sum” offer – payable in five or fewer installments – to include a nonrefundable partial payment of 20 percent of the amount of the offer with the application. IRC § 7122(c)(1)(B) requires a taxpayer who would like the IRS to consider a “periodic payment” offer – an offer payable in six or more installments – to include the first proposed installment with the application and to continue to make installment payments while the IRS is considering it. In addition to these partial payments, Treas. Reg. § 300.3 requires that most offer applications include a \$205 user fee. IRC § 7122(c)(3) provides that taxpayers with low incomes (*i.e.*, not more than 250 percent of the Federal Poverty Level) are not subject to the user fee or the partial payment requirement. They may apply for a waiver on Form 656.

REASONS FOR CHANGE

By accepting an offer, the IRS generally collects money it would not otherwise collect and may convert a noncompliant taxpayer into a compliant one by requiring the taxpayer, as a condition of the agreement, to timely file returns and pay taxes for the following five years. The Treasury Department’s General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals acknowledged the benefit of offers by proposing to repeal the partial payment requirement, explaining that the requirement “may substantially reduce access to the offer in compromise program. ... Reducing access to the offer-in-compromise program makes it more difficult and costly to obtain the collectable portion of existing tax liabilities.” The Treasury Department estimated that repealing the requirement would raise revenue.¹

A 2007 TAS study found that taxpayers above the low-income threshold were no better able to afford to make partial payments than those below it and that those below it frequently did not obtain a waiver. Similarly, a 2005 Treasury Inspector General for Tax Administration report found that when the IRS first imposed a \$150 OIC fee in 2003, offer submissions declined by more than 20 percent among taxpayers at every income level, including those who were eligible for a fee waiver. Furthermore, after the partial payment requirement was imposed, the offer acceptance rate did not increase, suggesting that higher up-front costs did not deter bad offers at a higher rate than good ones. Thus, upfront payments such as the user fee and the partial payment requirement likely reduce collections and increase enforcement costs.

¹ In the past, the IRS expressed concern that repealing the partial payment requirement or limiting the user fee might have the effect of increasing the number of frivolous offers. To address concerns about frivolous submissions, Congress enacted a frivolous submissions penalty under IRC § 6702(b). In general, it imposes a penalty of \$5,000 on any person who submits a frivolous OIC application (among other frivolous submissions).

RECOMMENDATION

- Amend IRC § 7122(c) to remove the requirement that taxpayers include a partial payment with offer applications and restructure the user fee so that it is collected out of amounts otherwise due on accepted offers.²

² For legislative language generally consistent with this recommendation, see John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 206 (2021); Taxpayer Protection Act, H.R. 2171, 115th Cong. § 206 (2017); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 206 (2015); Taxpayer Assistance Act, H.R. 4994, 111th Cong. § 202 (2010). For additional background, see, e.g., National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*).

Legislative Recommendation #20**Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise****PRESENT LAW**

IRC § 7122 authorizes the Secretary to enter into an agreement with a taxpayer that settles the taxpayer's tax liabilities for less than the full amount owed, as long as the taxpayer's case has not been referred to the Department of Justice. Such an agreement is known as an offer in compromise (OIC). Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. The regulations further define these terms and describe instances when compromise is appropriate.

IRC § 7122(b) requires the Treasury Department's General Counsel to review and provide an opinion in support of accepted OICs in all criminal cases and in all civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, and assessable penalty) is \$50,000 or more. This authority is exercised by the IRS Office of Chief Counsel.¹

REASONS FOR CHANGE

The IRS receives tens of thousands of OIC applications every year and must verify that the legal and IRS policy requirements for compromise are met prior to proposing acceptance. The time Office of Chief Counsel employees spend learning the facts of every criminal OIC and civil OIC where the unpaid amount of tax assessed is \$50,000 or more and writing supporting opinions creates significant delays in OIC processing and is often duplicative of work the IRS has already performed. It also requires a significant commitment of legal resources on the part of the IRS. The Office of Chief Counsel reports that it spends thousands of hours each year reviewing OICs.² Taxpayers would be better served if those resources could be allocated elsewhere.

In addition, delays in OIC processing may impede a taxpayer's ability to make other financial decisions while awaiting a response and may even jeopardize the taxpayer's ability to pay the amount offered if his or her financial circumstances change.

The National Taxpayer Advocate believes the OIC process would be improved if Congress repeals the blanket requirement that Counsel review all OICs in civil cases where the unpaid tax assessed is \$50,000 or more and replace it with language authorizing the Secretary to require Counsel review in cases that present significant legal issues.

RECOMMENDATION

- Amend IRC § 7122(b) to repeal the requirement that Counsel review all OICs in civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, or assessable penalty) is \$50,000 or more and replace it with language authorizing the Secretary to require Counsel review of OICs in cases that she determines present significant legal issues.³

1 See Internal Revenue Manual 8.23.4.3.2, Counsel Review of Acceptance Recommendations (Apr. 24, 2020).

2 Emails from IRS Office of Chief Counsel (Nov. 29, 2021, Sept. 1, 2020, and Aug. 9, 2019).

3 For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 303 (2017); Taxpayer Bill of Rights Enhancement Act of 2015, S. 1578, 114th Cong. § 403 (2015); Tax Administration Good Government Act, S. 882, 108th Cong. § 104 (2003); Tax Administration Good Government Act, H.R. 1528, 108th Cong. § 304 (2004).

Legislative Recommendation #21**Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise****PRESENT LAW**

IRC § 7122 authorizes the Secretary to sign an agreement (an “offer in compromise” or OIC) with a taxpayer to settle the taxpayer’s tax liabilities for less than the amount owed. OICs take one of two forms: (i) the taxpayer may pay the agreed amount in a single lump-sum¹ or (ii) the taxpayer may pay the agreed amount through periodic payments,² generally monthly. Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. With respect to offers based on doubt as to collectibility, the IRS has a legal basis to compromise when the taxpayer’s equity in assets and future income potential are less than the taxpayer’s liabilities. The IRS follows guidelines set forth in Internal Revenue Manual (IRM) 5.8.5 to evaluate a taxpayer’s equity in assets and future income potential. According to IRS Policy Statement 5-100, an OIC is considered a “legitimate alternative to declaring a case as currently not collectible or to a protracted installment agreement” and the goal is to “achieve the collection of what is potentially collectible at the earliest possible time and at the least cost to the government.”

Taxpayers seeking an OIC must complete Form 656, Offer in Compromise. Taxpayers seeking an OIC based on Doubt as to Collectibility must also complete a Collection Information Statement on Form 433. Section 7 of Form 656 includes certain terms and conditions a taxpayer must accept when submitting an OIC. In Paragraph (o) of Section 7, taxpayers agree that failure to meet the terms of an OIC, such as by missing payments, may cause default of the offer, possibly resulting in reinstatement of the full tax liability, plus penalties and interest. In Paragraph (q) of Section 7, taxpayers agree that:

The IRS may file a Notice of Federal Tax Lien during consideration of the offer or for offers that will be paid over time. If the offer is accepted, the tax lien(s) for the periods and taxes listed in Section 1 will be released within 35 days after the payment has been received and verified. The time it takes to transfer funds to the IRS from commercial institutions varies based on the form of payment. If I have not finished paying my offer amount, then the IRS may be entitled to any proceeds from the sale of my property. The IRS will not file a Notice of Federal Tax Lien on any individual shared responsibility debt.

IRC § 6331(a) authorizes the IRS to “levy upon all property and rights to property,” but the IRS generally cannot enforce a levy while an offer is pending, for 30 days following the rejection of an offer, or during any period when an appeal is being considered.³ The IRS may maintain a lien on any property owned by the taxpayer until all payments are made.⁴

REASONS FOR CHANGE

When the IRS accepts an OIC, the IRS contracts to settle a tax liability for less than the full amount of the liability. Prior to accepting an OIC, the IRS carefully reviews and verifies the taxpayer’s financial condition.⁵

¹ See IRC § 7122(c)(1)(A).

² See IRC § 7122(c)(1)(B).

³ See IRC § 6331(k).

⁴ IRS Form 656-B, Offer in Compromise (Apr. 2020).

⁵ IRM 5.8.5, Financial Analysis (Mar. 23, 2018).

It calculates a taxpayer's "reasonable collection potential" (RCP), accounting for assets, future income, other lienholders, and allowable living expenses.⁶ Generally, an OIC is not accepted unless the offer proposed by the taxpayer is equal to or greater than the RCP, as calculated by the IRS.

In certain situations where the IRS has filed a lien on taxpayer property, the IRS may end up collecting more than the amount originally calculated as the taxpayer's reasonable collection potential. IRC § 6325 and IRS internal guidance call for a lien on property to remain in place until the taxpayer has made all payments.⁷ If a taxpayer sells property subject to lien prior to completing payment on the OIC, liens superior to the federal tax lien must be satisfied and the costs of sale must be paid. Thereafter, the IRS may take the remaining sale proceeds up to the full amount of its original lien, as provided by IRC § 6321 and stated in Section 7, Paragraph (q), of Form 656. As a result, the IRS may collect more than the taxpayer's RCP that it had computed when it accepted the OIC.⁸

RECOMMENDATION

- Amend IRC § 7122 to require the IRS to return to the taxpayer any amount collected pursuant to a federal tax lien in excess of the payment amount of an accepted OIC, unless otherwise agreed upon, provided the taxpayer disclosed all material income and assets⁹ to the IRS on his or her application and made all payments in accordance with the terms of the agreement.

⁶ IRM 5.8.4.3.1, Components of Collectibility (Apr. 30, 2015).

⁷ IRM 5.8.10.6, Discharge and Subordination Requests (July 20, 2020).

⁸ In some cases, the IRS enters into collateral agreements in which the IRS and the taxpayer agree that if real property is sold, the IRS will automatically receive a certain percentage of the sale price, even if the OIC offer amount is paid in full.

⁹ IRS Form 656-B, Offer in Compromise (Apr. 2020).

Legislative Recommendation #22**Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities****PRESENT LAW**

IRC § 7524 requires the IRS, “[n]ot less often than annually,” to send taxpayers with delinquent accounts a written notice that sets forth the amount of the tax delinquency as of the date of the notice.

REASONS FOR CHANGE

The IRS satisfies the IRC § 7524 requirement by sending taxpayers with delinquent accounts Notice CP-71, Reminder Notice, once a year. However, the infrequency of IRS billing notices leaves collectible revenue uncollected and subjects taxpayers who would make payments if they received more frequent reminders to additional penalties and interest charges.

We recognize that sending more frequent notices after the IRS’s initial notice stream would entail additional postage and processing costs. However, private sector businesses, including credit card issuers and retailers, face this same trade-off, and they almost uniformly send billing notices more frequently than once a year. Most send delinquency notices on at least a monthly basis. Thus, private businesses that depend on maximizing net revenue have consistently found that the collection costs of mailing more frequent notices more than pay for themselves.

We believe the IRS would similarly collect more revenue, net of costs, if it sends more frequent notices. In addition, taxpayers receiving more frequent notices would be more aware that penalties (up to the maximum allowed by law) and interest charges continue to accrue, causing their balances to increase. This would provide an additional incentive for them to resolve their liabilities.

RECOMMENDATION

- Amend IRC § 7524 to require the IRS to notify taxpayers of delinquent tax liabilities at least quarterly.¹

¹ For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, § 201, 115th Cong. (2018). The IRS may reach a point in the next few years where it can transmit information to taxpayers with online accounts electronically rather than by snail mail. For that reason, we are phrasing our recommendation broadly to allow that means of communication as an option.

Legislative Recommendation #23**Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins****PRESENT LAW**

IRC § 6331(a) allows the IRS to levy on a taxpayer's property and rights to property that exist at the time the levy is served. Rights to property include fixed and determinable obligations to which the levy attaches, even if receipt of a payment arising from the obligation is deferred until a later date.

IRC § 6331(e) allows the IRS to serve a levy on the taxpayer's salary or wages that continues from the date the levy is first made until the levy is released under IRC § 6343.

IRC § 6331(h) allows the IRS to serve a levy on federal payments specified under that provision, such as Social Security benefits, which continues from the date the levy is first made until the levy is released. This levy is made by electronic means under the Federal Payment Levy Program (FPLP).

IRC § 6343(b) authorizes the IRS to return money levied upon or money received from the sale of levied property to *third parties* when it determines the levy was wrongful within the meaning of IRC § 7426(a)(1) if the third party requests the return within two years from the "date of levy."

IRC § 6343(d) authorizes the IRS to return money levied upon or money received from the sale of levied property *to the taxpayer* when it determines one of the circumstances specified in IRC § 6343(d)(2) exists if the taxpayer requests the return within two years from the "date of levy."¹ Neither IRC § 6343 nor the Treasury regulations promulgated thereunder define the term "date of levy."

For levies delivered by hand, the IRS takes the position that the "date of levy" is the date of delivery.² For mailed levies, Treas. Reg. § 301.6331-1(c) similarly defines the term "date of levy" as the date the levy is delivered to the person in possession of the property. By contrast, for levies imposed by electronic means through the FPLP, the IRS has adopted a policy to return all or a portion of the FPLP proceeds it received during the two-year period preceding the date of request for their return without regard to the date the initial levy was delivered.³

REASONS FOR CHANGE

The IRS may issue levies to attach a taxpayer's assets, such as wages, pension benefits, annuities, or Social Security benefits, that result in multiple payments over many years. The IRS has the authority to return levy proceeds to a third party or the taxpayer if the person requests the proceeds within two years of the date of levy. The IRS generally interprets the "date of levy" to mean the date the IRS delivers by mail or by hand a notice of levy to the person in possession of the property levied. In the case of a continuous levy under IRC § 6331(e), the date of levy is the date the notice of levy is first served by hand or by mail on the person in

1 IRC § 6343(b) & (d) permits the IRS to return specific property levied upon at any time.

2 Cf. *American Honda Motor Co., Inc. v. United States*, 363 F. Supp. 988, 991-992 (S.D.N.Y. 1973) (holding that date of levy for purposes of timely filing suit under IRC § 6532(c)(1) is the date when the notice of levy is served upon the person in possession of the taxpayer's property).

3 The Treasury regulations under IRC § 6331 do not define the term "date of levy" when the levy occurs through electronic means as used in the FPLP. The IRS's policy is set forth in the Internal Revenue Manual (IRM). See IRM 5.11.7.2.7, Returning FPLP Levy Proceeds (Sept. 23, 2016); IRM 5.19.9.3.8, Return of FPLP Levy Proceeds (Oct. 20, 2016).

possession of the taxpayer's salary or wages.⁴ If the taxpayer requests return of levy payments more than two years after the date the notice of levy was served, the IRS is not authorized to return any payments. In the case of FPLP levies under IRC § 6331(h), however, the IRS will return a levied payment if the payment was made within the two-year period before the date of the request for return. This results in similarly situated persons being treated differently and infringes upon a third party or taxpayer's *right to a fair and just tax system*.

To illustrate, assume the IRS issues a continuous levy under IRC § 6331(e) to the taxpayer's employer in Year One, and the employer withholds and pays over to the IRS a portion of the taxpayer's paychecks for each month of the next four years. Then in Year Four, the taxpayer's dependent becomes ill, and as a result, his living expenses increase significantly due to large medical bills. The levy is now causing an economic hardship to the taxpayer. The taxpayer asks the IRS to release the levy and return a portion of the levy proceeds, and the IRS agrees that it is in the best interests of the taxpayer and the government to do so. However, the IRS is prohibited from returning the levy proceeds to the taxpayer because more than two years have elapsed since the date the levy was served on the employer. Contrast this result with a taxpayer whose Social Security benefits are levied under the FPLP. The IRS may return up to the last two years of levy payments even if the request occurs more than two years after the FPLP levies began.

RECOMMENDATION

- Amend IRC § 6343(b) to strike the term “date of such levy” and substitute “each date the IRS receives money from the levy or the date the IRS receives the money from the sale of levied property.”

4 Such a levy is issued via Form 668-W and is generally a “paper” levy. A paper levy is defined as “either a manual or systemic levy on Form 668-A, or Form 668-W, that is prepared and issued by an RO.” IRM 5.11.5.1.6, Terms/Definitions/Acronyms (June 13, 2018). This differs from an FPLP levy, which is an automated levy. Automated levies are “levies issued through the Automated Levy Programs. These levies are transmitted electronically. The proceeds are also received electronically.” IRM 5.11.5.1.6, Terms/Definitions/Acronyms (June 13, 2018). See also IRM 5.11.7.2.5.1, FPLP or Paper Levy (Form 668-A/668-W) (Sept. 23, 2016).

Legislative Recommendation #24**Protect Retirement Funds From IRS Levies, Including So-Called “Voluntary” Levies, in the Absence of “Flagrant Conduct” by a Taxpayer****PRESENT LAW**

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) provides that the IRS generally may “levy upon all property and rights to property,” which includes retirement savings. Some property is exempt from levy pursuant to IRC § 6334.

As a policy matter, the IRS has decided not to levy on a taxpayer’s retirement savings unless it determines that the taxpayer has engaged in “flagrant conduct.”¹ Neither the IRC, the regulations, nor internal IRS guidance defines the term “flagrant conduct” for purposes of this analysis.²

REASONS FOR CHANGE

Congress has provided significant tax incentives to encourage taxpayers to save for retirement. There are strong public policy reasons to encourage retirement savings – and to shield retirement savings from IRS levies. Almost all workers eventually retire, and they require retirement savings for support. In addition, retired taxpayers who do not have sufficient savings are more likely to experience economic hardship and qualify for public assistance, which other taxpayers pay to provide.

The IRS has taken certain steps to protect retirement savings by requiring a specialized analysis prior to levy, including a determination of whether the taxpayer engaged in “flagrant conduct.” However, recent changes in IRS procedures have eroded these protections. Specifically, the IRS has adopted procedures that allow taxpayers to request or agree to “voluntary” levies on retirement accounts.³ If a taxpayer agrees to a “voluntary” levy, the IRS bypasses the determination of “flagrant conduct.”⁴

As a result, taxpayers who have not engaged in “flagrant conduct” in their tax matters and who therefore would have been shielded from levies on their retirement accounts in the past may agree to “voluntary” levies out of fear or anxiety, and thus may find themselves in economic hardship during retirement.

Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined that the IRS should not levy on child support payments because doing so would likely harm the children who rely on those benefits for support. To better protect retirement savings, the National Taxpayer Advocate believes that retirement savings should be added to the list of exempt property, absent “flagrant conduct,” and that the term “flagrant conduct” should be defined in the statute.

1 Internal Revenue Manual (IRM) 5.11.6.3(5), Funds in Pension or Retirement Plans (May 26, 2021).

2 The IRM provides examples of flagrant conduct. See IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (May 26, 2021). However, the IRM does not provide a definition of the term and it can be changed at any time.

3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (May 26, 2021).

4 The IRS will still verify that the taxpayer has received collection due process rights, consider collection alternatives, and analyze whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (May 26, 2021).

RECOMMENDATIONS

- Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy unless it is determined that the taxpayer has engaged in “flagrant conduct.”
- Amend IRC § 6334 to define “flagrant conduct” as willful action (or failure to act) that is voluntarily, consciously, and knowingly committed in violation of any provision of chapters 1, 61, 62, 65, 68, 70, or 75 and that appears to a reasonable person to be a gross violation of any such provision.⁵

5 For legislative language generally consistent with this recommendation, see John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 203 (2021); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 203 (2016); and Taxpayer Rights Act, S. 2333 and H.R. 4128, 114th Cong. §§ 306 & 307 (2015).

Legislative Recommendation #25**Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence****PRESENT LAW**

The IRS may follow either of two sets of procedures to seize the principal residence of a taxpayer to satisfy a delinquent tax liability: (i) an administrative seizure or (ii) a lien foreclosure suit. The two cannot be used concurrently.

Administrative Seizure. IRC § 6334(a)(13) provides that the principal residence of a taxpayer is generally exempt from levy, except as provided in subsection (e). IRC § 6334(e) provides that a principal residence shall not be exempt from levy if a judge or magistrate of a U.S. district court “approves (in writing) the levy of such residence.” An administrative seizure is generally subject to significant taxpayer protections. Among them, IRC § 6343(a) requires the IRS to release a levy under certain circumstances, including where it determines that the levy “is creating an economic hardship due to the financial condition of the taxpayer.”

Lien Foreclosure Suit. IRC § 7403 authorizes the Department of Justice (DOJ) to file a civil action against a taxpayer in U.S. district court to enforce a tax lien and foreclose on a taxpayer’s property. There is no exclusion for property consisting of a taxpayer’s principal residence. As compared with administrative seizures, statutory taxpayer protections are considerably more limited in lien foreclosure suits. For example, the Supreme Court has held: “We can think of virtually no circumstances ... in which it would be permissible to refuse to authorize a sale simply to protect the interests of the delinquent taxpayer himself or herself.”¹ A court has some discretion to refuse to authorize a sale that would impact a spouse, children, or other third parties, but even in that circumstance, the discretion is limited.²

REASONS FOR CHANGE

In enacting the IRS Restructuring and Reform Act of 1998, the Senate Finance Committee report stated that the “seizure of the taxpayer’s principal residence is particularly disruptive to the occupants” and a principal residence therefore “should only be seized to satisfy tax liability as a last resort.”³

Meaningful taxpayer protections are needed to protect not only the delinquent taxpayer but also family members, including a spouse and minor children, who may live in the house.

As described above, taxpayers have far fewer statutory protections in lien foreclosure suits under IRC § 7403 than in administrative seizures under IRC § 6334(e).

At the recommendation of the Office of the Taxpayer Advocate, the IRS has written procedures into its Internal Revenue Manual (IRM) that provide additional taxpayer protections before a case may be referred to the DOJ for the filing of a lien foreclosure suit.⁴ The IRM prescribes certain initial steps IRS employees must take, such as attempting to identify the occupants of a residence and advising the taxpayer about Taxpayer Advocate Service assistance options. It also sets forth an internal approval process prior to referring a lien enforcement case to the DOJ. However, the IRM is simply a set of instructions to IRS staff. Taxpayers

¹ *United States v. Rodgers*, 461 U.S. 677, 709 (1983).

² *Id.* at 680, 709-710.

³ S. REP. NO. 105-174, at 86-87 (1998).

⁴ See, e.g., IRM 5.17.4.8.2.5, Lien Foreclosure on a Principal Residence (May 23, 2019); IRM 5.17.12.20.2.2.4, Additional Items for Lien Foreclosure of Taxpayer’s Principal Residence (May 24, 2019); IRM 25.3.2.4.5.2(3), Actions Involving the Principal Residence of the Taxpayer (Nov. 24, 2021).

generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time.

Because of the devastating impact the seizure of a taxpayer's principal residence may have on the taxpayer and his or her family, the National Taxpayer Advocate believes taxpayer protections from lien foreclosure suit referrals should be codified and not left for the IRS to determine through IRM procedures.

RECOMMENDATIONS

- Amend IRC § 7403 to codify current IRM administrative protections, including that an IRS employee must receive executive-level written approval to proceed with a lien foreclosure suit referral.
- Amend IRC § 7403 to preclude IRS employees from requesting that the DOJ file a civil action in U.S. district court seeking to enforce a tax lien and foreclose on a taxpayer's principal residence, except where the employee has determined that (1) the taxpayer's other property or rights to property, if sold, would be insufficient to pay the amount due, including the expenses of the proceedings, and (2) the foreclosure and sale of the residence would not create an economic hardship due to the financial condition of the taxpayer.⁵

5 For legislative language generally consistent with this recommendation, see Small Business Taxpayer Bill of Rights Act, H.R. 1828, 114th Cong. § 16 (2015); Small Business Taxpayer Bill of Rights Act, S. 949, 114th Cong. § 16 (2015); and Eliminating Improper and Abusive IRS Audits Act, S. 2215, 113th Cong. § 8 (2014).

Legislative Recommendation #26**Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions****PRESENT LAW**

Current law authorizes the IRS to file Notices of Federal Tax Lien (NFTLs) and levy upon (seize) all property or rights to property of “any person liable to pay any tax” who neglects or refuses to do so, including property owned by certain third parties (individuals or entities). These third parties include nominees, alter egos and persons to whom lien-encumbered property is transferred (collectively, “affected third parties”).¹ In connection with taking these collection actions, the Secretary must provide collection due process (CDP) rights to “the person described in section 6321” (in the case of liens) and to “any person with respect to any unpaid tax” before levying against property (in the case of levies).²

REASONS FOR CHANGE

Congress created the CDP notice and hearing procedures to give taxpayers the right to a meaningful hearing before the IRS levies their property or immediately after the IRS files an NFTL against their property. During a CDP hearing with the IRS Independent Office of Appeals (Appeals), a taxpayer has the right to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives. If the parties cannot otherwise resolve the issue, Appeals may issue an adverse Notice of Determination that is subject to review in the U.S. Tax Court and that may thereafter be appealed to the U.S. Courts of Appeals.

For purposes of CDP eligibility, the Treasury regulations interpret the statutory term “person” as including only the taxpayer (*i.e.*, the person upon whom the tax was imposed and who refused or neglected to pay following notice and demand). Thus, affected third parties are not afforded CDP rights.³ This interpretation is inconsistent in some respects with the stated congressional intent, and the Treasury Department could have interpreted the statute otherwise. The CDP regime was enacted by the IRS Restructuring and Reform Act of 1998, and in explaining CDP rights, the accompanying conference report referred to “[t]he taxpayer (or affected third party).”⁴ In addition, CDP levy rights are statutorily afforded to “persons,” and are neither limited to taxpayers nor to persons who originally neglected or refused to pay the tax. The term “taxpayer” is defined in IRC § 7701(a)(14) as “any person subject to any internal revenue tax,” which in this context arguably may include affected third parties, given that the IRS is seeking to collect from them.

In some affected third-party circumstances, the IRS seeks to collect from specific property (*e.g.*, encumbered property that has been transferred to a third party, whether or not as a nominee). In other cases, the IRS seeks to collect from all property of the affected third party (*e.g.*, an alter ego).⁵ In both situations, the IRS may file NFTLs that identify the affected third party and levy upon property that, under state law, belongs to the affected third party.

¹ See IRC §§ 6323(f) and 6331(a).

² IRC §§ 6320(a)(1) and 6331(d)(1). See also IRC §§ 6321, 6322, 6323(a), 6323(f), 6323(h)(6), and 6331(a). Section 6321 also refers to “any person liable to pay any tax.” A CDP lien notice will only be given to the person described in IRC § 6321 who is named on the NFTL. Treas. Reg. § 301.6320-1(a)(2) Question and Answer (Q&A)-A1. A CDP levy notice will only be given to the person described in IRC § 6331(a). Treas. Reg. § 301.6330-1(a)(3) Q&A-A1.

³ See Treas. Reg. §§ 301.6320-1(a)(2) Q&A-A7, 301.6330-1(a)(3) Q&A-A2, 301.6320-1(b)(2) Q&A-B5, and 301.6330-1(b)(2) Q&A-B5.

⁴ H.R. REP. NO. 105-599, at 264 (1998) (Conf. Rep.).

⁵ See *Oxford Capital Corp. v. U.S.*, 211 F.3d 280, 284 (5th Cir. 2000); Internal Revenue Manual 5.17.2.5.7(2), Property Held by Third Parties (Jan. 8, 2016).

Importantly, the current collection regime, including the available remedies for alleged nominees, alter egos, and persons to whom encumbered property is transferred is costly, unduly burdensome, and inefficient, and it lacks adequate procedural safeguards. First, there is no opportunity for administrative review of the IRS's underlying, and sometimes opaque, determination that a person is a nominee or alter ego of a taxpayer. Second, without CDP rights affected third parties may seek administrative relief, where available, only after the respective collection action has occurred – meaning only after the harm, which may be irreparable, has occurred.⁶ Third, the available judicial remedies are not likely to provide expeditious relief from the effect of the third-party NFTL or levy and are costly for the third parties and the government.⁷ Some third parties who cannot afford the significant expense and burden of litigation may never be able to challenge an inappropriate or unlawful collection action.

In pre-pandemic years, the IRS generally issued over 1.5 million CDP notices to taxpayers, tens of thousands of taxpayers requested CDP hearings, and over a thousand taxpayers filed CDP petitions in the U.S. Tax Court.⁸ By comparison, the IRS filed only about 1,500 nominee and 500 alter ego NFTLs annually when we last obtained data.⁹ Thus, expressly providing CDP rights to affected third parties would not impose an undue administrative burden on the IRS. Rather, it would save resources for both the government and the affected third parties by reducing litigation costs.

For these reasons, the National Taxpayer Advocate believes it is inequitable for taxpayers responsible for tax debts to receive the full protection of IRC §§ 6320 and 6330, while innocent third parties holding legal title to property subject to IRS collection actions do not receive these due process protections.

RECOMMENDATION

- Amend IRC §§ 6320 and 6330 to extend CDP rights to affected third parties who hold legal title to property subject to IRS collection actions.¹⁰

6 The third party may seek reconsideration by the IRS office collecting the tax, by requesting a Collection Appeals Program (CAP) hearing before Appeals, or by requesting assistance from the National Taxpayer Advocate. Because a CAP hearing is not a CDP hearing under IRC § 6330, any determination made as part of the CAP hearing is not subject to judicial review by the U.S. Tax Court under IRC § 6330(d)(1).

7 For example, if the IRS has filed an NFTL, the third party who holds the title is left with the option to bring an action to quiet title under 28 U.S.C. § 2410 in district court. To contest a nominee, alter ego, or transferee levy, the affected third party has to file a wrongful levy action under IRC § 7426 in district court.

8 In addition, we identified 107,359 business taxpayers that requested CDP hearings in FY 2021. IRS Compliance Data Warehouse (CDW), Business Master File Transaction History table (FY 2021); IRS CDW, Individual Master File Transaction History table (FY 2021). The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel (Nov. 18, 2021). IRS, Counsel Automated Tracking System, Subtype DU. Inventory pending as of September 30, 2021. This data does not include cases on appeal. The IRS has taken fewer collection actions since the start of the COVID-19 pandemic, and CDP requests have therefore been lower over the last two years.

9 See National Taxpayer Advocate 2012 Annual Report to Congress 545, 550 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

10 For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

Legislative Recommendation #27**Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions****PRESENT LAW**

IRC § 7433(a) provides that if an IRS employee recklessly or intentionally, or by reason of negligence, disregards any provision of the IRC or any regulation in connection with the collection of federal tax, the taxpayer harmed by the improper collection action may sue the United States for damages. Under IRC § 7433(d)(3) and Treas. Reg. § 301.7433-1(g)(2), the suit must be brought in a U.S. district court within two years from the date on which the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action.

Under IRC § 7433(d)(1), before bringing suit, the taxpayer must file an administrative claim with the IRS. Treas. Reg. § 301.7433-1(d) provides that a taxpayer generally may not file suit in court until the earlier of (i) the date six months after filing an administrative claim or (ii) the date on which the IRS renders a decision on the claim. However, if the claim is filed within the last six months of the two-year period for filing suit, the taxpayer may file suit in court at any time before expiration of the two-year period.

REASONS FOR CHANGE

IRC § 7433(d)(1) reflects a policy decision that it is generally in the best interests of both the taxpayer and the government to allow the IRS to consider and render a decision on a taxpayer's claim before a case is brought to court. If a case is resolved at the administrative level, both parties are spared the time and expense of litigation. Treas. Reg. § 301.7433-1(d) reflects a complementary policy decision that where the IRS does not render a decision on an administrative claim within six months, taxpayers should be able to bring their cases to court without having to wait indefinitely for an IRS decision.

However, the existing rules do not always achieve the goal of allowing the IRS to consider and render a decision before suit is filed. For example, while a claim is pending at the administrative level, the two-year period for filing suit in a U.S. district court continues to run. If a taxpayer files an administrative claim during the final six months of the two-year period, the taxpayer may be forced to file suit in a U.S. district court before the IRS has an opportunity to render a decision on the administrative claim (or forfeit the right to do so).

To give the IRS an opportunity to render an administrative decision while preserving the taxpayer's right to challenge an adverse decision in court, the two-year period that commences when the right of action accrues should be tied to the deadline for filing an administrative claim (rather than the deadline for filing suit). Specifically, if the IRS renders an adverse or partially adverse decision on a timely-filed administrative claim, the taxpayer should be allowed to file suit within two years from the date of the IRS's decision (*i.e.*, similar to the time period allowed for filing suit after a refund claim is denied).

At the same time, to ensure taxpayers do not have to wait indefinitely for an IRS decision, a taxpayer should be permitted to file suit in a U.S. district court if a timely-filed administrative claim goes unanswered for six months. These rules would ensure the IRS has a full six-month period to consider and render a decision on a taxpayer's damages claim based on an alleged improper collection action, while preserving the taxpayer's right to file suit if the IRS does not render a timely decision.

RECOMMENDATION

- Amend IRC § 7433(d)(3) to allow taxpayers who file an administrative claim with the IRS within two years after the date a right of action accrues to file a civil action in a U.S. district court (i) no earlier than six months from the date on which the administrative claim was filed and (ii) no later than two years from the date on which the IRS mails its decision on the administrative claim to the taxpayer by certified or registered mail.¹

¹ The Taxpayer Bill of Rights Enhancement Act, S. 1793, 115th Cong. § 201(c) (2017), and S. 1578, 114th Cong. § 301 (2015), would have amended IRC § 7433(d)(3) to replace the requirement that taxpayers bring suit within two years of the date the cause of action accrues with a requirement that a suit be commenced by *“the later of the date on which administrative remedies available within the Internal Revenue Service have been exhausted or the date on which the taxpayer reasonably could have discovered that the actions of the officer or employee were done in disregard of a provision of this title or any regulation promulgated under this title.”* (Emphasis added.) This proposed change would prevent taxpayers from being forced to file suit before the IRS has had the opportunity to render a decision on the administrative claim and is thus generally consistent with this recommendation. However, the recommendation we are making would also preserve the IRC § 7433(d)(1) requirement that taxpayers must file an administrative claim before they can bring suit in a U.S. district court and is thus more comprehensive.

Legislative Recommendation #28**Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship****PRESENT LAW**

The IRC contains several provisions that protect taxpayers experiencing economic hardship from IRS collection actions. IRC § 6330 authorizes a taxpayer in a collection due process hearing to propose collection alternatives, which may be based on an inability to pay the tax due to economic hardship.

IRC § 6343 requires the IRS to release a levy if the IRS determines that the levy “is creating an economic hardship due to the financial condition of the taxpayer.” Under Treas. Reg § 301.6343-1 and the Internal Revenue Manual, economic hardship exists when an individual is “unable to pay his or her reasonable basic living expenses.”

IRC § 7122(d) requires the IRS to develop and publish schedules of national and local allowances (known as allowable living expenses or ALEs) to ensure that taxpayers entering into offers in compromise are left with “an adequate means to provide for basic living expenses.”

REASONS FOR CHANGE

In general, the IRS is required to halt collection actions if a taxpayer demonstrates that he or she is in economic hardship. However, the IRS routinely enters into installment agreements (IAs) with taxpayers without undertaking the financial analysis required to make a hardship determination. For example, taxpayers are not required to submit any financial information to qualify for streamlined IAs and may enter into them online without interacting with an IRS employee. Many anxious or intimidated taxpayers seek to resolve their liabilities quickly and do not know the IRS is required to halt collection action if they are in economic hardship. As a result, taxpayers often agree to make tax payments they cannot afford.

TAS estimates that about 27 percent of taxpayers who entered into streamlined IAs through the IRS’s Automated Collection System (ACS) in fiscal year (FY) 2019 had incomes at or below their ALEs.¹ To emphasize the point: more than a quarter of taxpayers who agreed to streamlined IAs in ACS would have received the benefit of collection alternatives, such as offers in compromise or currently not collectible hardship (CNC-Hardship) status, if they had known to call the IRS to explain their financial circumstances.

That is not a fair result. Whether a taxpayer is left with sufficient funds to pay for the basic living expenses for himself or herself and family should not depend on the taxpayer’s knowledge of the IRS’s procedural rules.

Furthermore, taxpayers with incomes below their ALEs who paid their liabilities are disproportionately likely to have incurred economic hardships to do so. Some of these taxpayers will default on their IAs, which subjects them to additional collection actions and further increases their burden.

To address this problem, the TAS Research function has developed an automated algorithm that we believe can, with a high degree of accuracy, identify taxpayers whose incomes are below their ALEs. If the IRS

1 In FY 2018, TAS estimated that 39 percent of ACS taxpayers who entered into streamlined IAs had incomes at or below their ALEs. This estimate allowed two-vehicle ownership expenses for married taxpayers filing joint returns. TAS published a study on the feasibility of using an algorithm to identify taxpayers at risk of economic hardship in the National Taxpayer Advocate 2020 Annual Report to Congress. This study used a more conservative estimate of ALEs, allowing only one vehicle-ownership expense. See National Taxpayer Advocate 2020 Annual Report to Congress 249-267 (TAS Research Study: *The IRS Can Systemically Identify Taxpayers at Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford*).

validates this formula or develops an alternative formula that is reasonably accurate, it could place a “low-income” indicator on the accounts of all taxpayers whom the formula identifies as having incomes below their ALEs.²

While the ALE standards represent only average expenses for taxpayers and should not be used to automatically close a case as CNC-Hardship, an ALE-based indicator would be a useful starting point for financial analysis in the collection context. It could be used to alert collection employees speaking with a taxpayer over the phone of the need to request additional financial information so the IRS can analyze the specific facts and circumstances of the taxpayer’s case. The indicator could be used to trigger a notification to taxpayers entering into online IAs that informs them of their right to contact the IRS collection function for assistance if they believe they cannot pay their tax debt without incurring economic hardship. The IRS could also use this algorithm to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, selection for referral to private collection agencies, or passport certification, unless and until the IRS has made direct personal contact with the taxpayer to verify his or her financial information.

In short, an automated economic hardship screen would benefit taxpayers and the IRS alike. It would help protect low-income taxpayers from agreeing to make payments that would leave them without adequate means to provide for their basic living expenses, and it would help the IRS avoid the rework that occurs when taxpayers default on IAs they cannot afford.

RECOMMENDATION

- Direct the IRS to implement an algorithm to identify taxpayers at high risk of economic hardship and to use it to respond appropriately to taxpayers who contact the IRS regarding a balance due; alert taxpayers at risk of economic hardship who seek to enter into streamlined IAs online of the resources available to them; determine whether to exclude taxpayers’ debts from automated collection treatments such as the Federal Payment Levy Program, the private debt collection program, and passport certification; and possibly rank cases for collection priority.

2 In 2018, in response to legislation that directed the IRS to waive or reimburse IA user fees for taxpayers with adjusted gross incomes at or below 250 percent of the Federal Poverty Level, the IRS developed a “Low Income Indicator” (LII). To date, however, the IRS uses the LII solely to determine user fees – not to determine a taxpayer’s eligibility for collection alternatives. In addition, although the legislation directed the IRS to determine adjusted gross income for “the most recent year for which such information is available,” the IRS is making the determination solely on the basis of the taxpayer’s most recent filed return, even if the taxpayer has not filed a return, or even had a filing requirement, in recent years. Where no return has been filed within the past two years, we recommend the IRS utilize information reporting data (e.g., Forms W-2 and 1099) to make the determination.

Legislative Recommendation #29**Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act****PRESENT LAW**

IRC § 6306 directs the Secretary to enter into qualified tax collection contracts with private debt collection agencies (PCAs) to collect certain “inactive tax receivables.”¹ Subsection (d) lists categories of collection cases that are not eligible for assignment to PCAs.

The Taxpayer First Act (TFA) added the following category to the list:²

[A] taxpayer who is an individual with adjusted gross income, as determined for the most recent taxable year for which such information is available, which does not exceed 200 percent of the applicable poverty level (as determined by the Secretary).

REASONS FOR CHANGE

The IRS has implemented the exclusion for taxpayers with adjusted gross incomes (AGI) that do not exceed 200 percent of the Federal Poverty Level in a manner that fails to identify those taxpayers accurately. While the TFA directed the IRS to not send the accounts of taxpayers with AGIs at or below 200 percent of the Federal Poverty Level to PCAs, it did not specify how the IRS should determine AGI. There are two possible methods. One method is to rely exclusively on a filed tax return, even if it is not recent. The other method is to rely on third-party information reporting documents (*e.g.*, Forms W-2 and 1099) when no recent return has been filed.

The IRS exclusively uses a taxpayer’s last-filed tax return to determine AGI – and if there is no recent return, it will reach back up to *ten years* to locate one. Under this approach, the results may be dramatically underinclusive and overinclusive of the population the provision is designed to protect. Liability determinations and collectibility determinations are made at different points in time. For example, if a taxpayer files a tax return for tax year 2012, the liability determination reflects the taxpayer’s income, deductions, and credits for that year. By contrast, if a taxpayer still has an unpaid 2012 tax liability today, the determination of whether the taxpayer has sufficient income to pay the liability is made on the basis of the taxpayer’s current financial condition, and not the taxpayer’s financial condition in the year the liability was incurred.³

The TFA underscored this point by directing the IRS to determine an individual’s AGI “for the most recent taxable year for which such information is available.” Using tax returns going back ten years to make current collection decisions stands the logic of collectibility determinations on its head. A taxpayer who could afford to pay tax in 2012 may not be able to do so today – and these are the cases Congress intended to exclude from assignment to PCAs. Conversely, a taxpayer who could not afford to pay tax in 2012 might have earned additional income or acquired additional assets and be able to make payments currently.

Example: A taxpayer last filed a tax return in 2012 when he earned \$60,000. In 2013, he retired due to age or disability. He did not pay his tax liability and still has a balance due. Since 2012,

¹ IRC § 6306(a) & (c).

² TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).

³ See, *e.g.*, IRC § 7122(d) (directing the Secretary, for purposes of evaluating offer-in-compromise submissions, to “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses”).

his income has consisted solely of Social Security benefits, and he has not had a filing obligation. Under the IRS's approach, it will look at his 2012 tax return, determine his income is above 200 percent of the Federal Poverty Level, and assign his case to a PCA. Yet this is a case the TFA sought to exclude from assignment to a PCA.

By contrast, if the same taxpayer earned only \$30,000 in 2012, and third-party information reports show he earned \$100,000 in 2019, the case might not be assigned to a PCA under the IRS's approach, even though the taxpayer can make payments currently.

To ensure that collectibility determinations are made based on current data, TAS has recommended that the IRS utilize information on a tax return if one has been filed in the last two years and, if not, that the IRS compute AGI from the information reporting documents the IRS receives. No method will be perfect. If the IRS uses third-party information reporting documents to make collectibility determinations, income not reported on those documents, such as self-employment income, will not be taken into account. But that is likely to be true even when the IRS relies on filed tax returns, as tax gap studies show most income not reported to the IRS on third-party documents is not reported on tax returns, either.⁴

In addition, the IRS will have to use gross income rather than AGI when relying on information reporting documents because it will not know for which adjustments a taxpayer qualifies. That may have the effect of overestimating a taxpayer's AGI and therefore assigning some cases to PCAs that should have been excluded. Even so, we believe that basing collectibility determinations on recent information will be far more accurate than reaching back for information up to ten years old.⁵ In a recent audit report, the Treasury Inspector General for Tax Administration (TIGTA) reached a similar conclusion and similarly recommended that the IRS consider using "both last return filed information and third-party income information in its methodology to exclude low-income taxpayers from PCA inventory."⁶

RECOMMENDATION

- Amend IRC § 6306(d)(3)(F) to direct the IRS to determine an individual's adjusted gross income "for the most recent taxable year for which such information is available" by reference to the individual's most recently filed tax return if one has been filed in the preceding two years or, if not, by reference to information reporting documents described in part III of subchapter A of chapter 61 of the Internal Revenue Code.

4 IRS Pub. 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013, at 14 (Sept. 2019), <https://www.irs.gov/pub/irs-pdf/p1415.pdf>. The study estimated the net misreporting percentage (NMP) of income subject to little or no information reporting is 55 percent. The NMP is roughly equivalent to the percentage of income that goes unreported. Prior tax gap studies have shown, as one would expect, that the nonreporting percentage is higher for income subject to no information reporting than income subject to little information reporting.

5 A data run the IRS performed to compare the method the IRS is using with the method TAS has proposed found it would exclude roughly the same number of taxpayers. Cases assigned to PCAs as of September 12, 2019, were matched to the Individual Returns Transaction File to determine the last individual income tax return filed and to the Information Returns Master File to determine current income reported by third-party payors. For the reasons described above, we believe the TAS approach would do a better job of identifying the taxpayers whom Congress intended to exclude.

6 Treasury Inspector General for Tax Administration, Ref. No. 2021-30-010, *Fiscal Year 2021 Biannual Independent Assessment of Private Collection Agency Performance* 20 (Dec. 2020).

REFORM PENALTY AND INTEREST PROVISIONS

Legislative Recommendation #30

Convert the Estimated Tax Penalty Into an Interest Provision to Properly Reflect Its Substance

PRESENT LAW

Through the combination of wage withholding and estimated tax payments, the IRC aims to ensure that federal income and payroll taxes are paid ratably throughout the year. IRC § 3402 generally requires employers to withhold tax on wages paid to employees. IRC § 6654 generally requires individual taxpayers to pay at least the lesser of (i) 90 percent of the tax shown on a tax return for the current tax year or (ii) 100 percent of the tax shown on a tax return for the preceding tax year (reduced by the amount of wage withholding) in four installment payments due on April 15, June 15, September 15, and January 15 of the following tax year.¹ IRC § 6655 generally requires corporate taxpayers to pay at least 100 percent of the tax shown on a tax return for the current tax year or, in some cases, 100 percent of the tax shown on a tax return for the preceding tax year in four installment payments due on April 15, June 15, September 15, and December 15.

IRC §§ 6654(a) and 6655(a) provide that a taxpayer who fails to pay sufficient estimated tax will be liable for a penalty that is computed by applying (i) the underpayment rate established under IRC § 6621(ii) to the amount of the underpayment (iii) for the period of the underpayment. IRC § 6621 is an interest provision. Therefore, the additional amount a taxpayer owes for failing to pay sufficient estimated tax is computed as an interest charge, even though it is denominated as a “penalty.”

REASONS FOR CHANGE

For a variety of reasons, taxpayers often have difficulty predicting how much tax they will owe. Self-employed taxpayers or taxpayers who own small businesses may experience significant fluctuations in their incomes and expenses from year to year. Similarly, taxpayers with sizable investment income may experience significant fluctuations. In addition, substantial changes in tax laws, such as those that took effect in 2018, affect tax liabilities in ways that taxpayers may not fully anticipate. As a result, millions of taxpayers do not satisfy the requirements of IRC § 6654 and are liable for penalties, even though many have attempted to comply. Corporate taxpayers face similar challenges.

The term “penalty” carries negative connotations, and the National Taxpayer Advocate believes it should be reserved for circumstances in which a taxpayer has failed to make reasonable efforts to comply with the law. Thus, she agrees with the assessment of the House Committee on Ways and Means when it wrote during a previous Congress: “Because the penalties for failure to pay estimated tax are calculated as interest charges, the Committee believes that conforming their title to the substance of the provision will improve taxpayers’ perceptions of the fairness of the estimated tax payment system.”² Along these lines, the Office of the Taxpayer Advocate has conducted research studies that have found “tax morale” has an impact on tax compliance.³

1 If the adjusted gross income of a taxpayer for the preceding tax year exceeds \$150,000, “110 percent” is substituted for “100 percent” in applying clause (ii). IRC § 6654(d)(1)(C).

2 H.R. REP NO. 108-61, at 23-24 (2003).

3 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 1-13 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

When the IRS imposes a “penalty” on a taxpayer, there is a strong implication that the taxpayer has engaged in improper conduct. For that reason, penalties generally should be subject to waiver for reasonable cause. Under current law, the estimated tax penalty cannot be waived. Thus, an individual who experiences a fire, flood, heart attack, or other exigent circumstance that precludes payment by the estimated tax deadline will still be “penalized.” This is not good for “tax morale.” If the addition to tax is recharacterized as an interest charge designed solely to compensate the government for the time value of money, it would be easier to justify imposing it without waiver.

RECOMMENDATIONS

- Recharacterize the penalty for failure to pay sufficient estimated tax as an interest charge – which is the basis for the calculation. Toward that end, relocate IRC §§ 6654 and 6655 from part I of subchapter A of chapter 68 to the end of subchapter C of chapter 67 and make conforming modifications to the headings and text.⁴
- If a failure to pay sufficient estimated tax continues to be treated as a penalty, enact a reasonable cause exception so that the penalty will not apply when a payment is late due to circumstances beyond the taxpayer’s control, such as a fire, flood, or medical condition that makes compliance impractical.⁵

4 For legislative language generally consistent with this recommendation, see Taxpayer Protection and IRS Accountability Act, H.R. 1528, 108th Cong. § 101 (2003).

5 For more detail on our recommendation to enact a reasonable cause exception if the additional charge for failure to pay estimated tax remains a penalty, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 34-36 (Research Study: A Framework for Reforming the Penalty Regime).

Legislative Recommendation #31**Apply One Interest Rate Per Estimated Tax Underpayment Period****PRESENT LAW**

IRC § 6654(c) provides that taxpayers who make estimated tax payments must submit those payments on or before April 15, June 15, September 15, and January 15 of the following tax year. Similarly, IRC § 6655(c) provides that corporations required to make installment payments submit those payments on or before April 15, June 15, September 15, and December 15.¹ Failure to make required estimated tax payments results in a penalty that is determined by the underpayment rate, the amount of the underpayment, and the period of the underpayment.

Under IRC § 6621(a)(2), the underpayment rate is equal to the federal short-term interest rate, plus three percentage points. Under IRC § 6621(b)(1), the federal short-term interest rate is determined quarterly by the Secretary of the Treasury. If the Secretary determines a change in the federal short-term interest rate, the change is effective January 1, April 1, July 1, and October 1.

REASONS FOR CHANGE

Under current law, more than one interest rate may apply for a single estimated tax underpayment period. For example, if a taxpayer fails to make an estimated tax payment due June 15 and the Secretary determines a change in the federal short-term interest rate effective July 1, one interest rate would apply for the period from June 16 through June 30, while another interest rate would apply for any continued delinquency from July 1 through September 15. The application of more than one interest rate for a single underpayment period causes unnecessary complexity and burden for taxpayers. This complexity and burden would be reduced if a single interest rate were applied for each period.

RECOMMENDATION

- Amend IRC § 6654 and IRC § 6655 to provide that the underpayment rate for any day during an estimated tax underpayment period shall be the underpayment rate established by IRC § 6621 for the first day of the calendar quarter in which the underpayment period begins.²

¹ To make compliance easier, the National Taxpayer Advocate has recommended that Congress set the estimated tax payment deadlines 15 days after the end of each calendar quarter (April 15, July 15, October 15, and January 15). See National Taxpayer Advocate 2022 Purple Book, *Adjust Individual Estimated Tax Payment Deadlines to Occur Quarterly*, *supra*.

² For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 305 (2017). If this proposal is adopted, repeal of IRC § 6621(b)(2)(B) may be required. See also H.R. REP. NO. 108-61, at 25 (2003); Taxpayer Protection and IRS Accountability Act, H.R. 1528, 108th Cong. § 101 (2003).

Legislative Recommendation #32**Pay Interest to Taxpayers on Excess Payments of Estimated Tax to the Same Extent Taxpayers Must Pay a Penalty on Underpayments of Estimated Tax****PRESENT LAW**

Through wage withholding and estimated tax payments, Congress aims to ensure that taxes are prepaid ratably throughout the year. IRC § 3402 generally requires employers to withhold tax on wages paid to employees. IRC § 6654(g) provides that income taxes withheld from wages are deemed paid in equal amounts on the estimated tax installment due dates throughout the year unless the taxpayer establishes the dates on which the amounts were withheld. IRC §§ 6654 and 6655 generally require individual and corporate taxpayers, respectively, to prepay their tax in four installment payments. A taxpayer who fails to pay enough estimated tax will be liable for a “penalty” determined at a rate that is roughly equal to the interest rate on an underpayment under IRC § 6621 beginning on the date the estimated tax payment was due. However, the government does not pay interest on excessive estimated tax payments made by taxpayers.

IRC § 6621(a) provides that the overpayment and underpayment rates are generally the federal short-term rate, plus three percentage points (or two percentage points for corporations).¹ IRC § 6611(b)(2) provides that the government is, in practice, generally entitled to a grace period of up to 30 days before it has to pay interest. IRC § 6611(b)(3) provides that if a return is late, the government does not pay interest for any day before it is filed.

REASONS FOR CHANGE

There are at least three good reasons for the government to pay interest on excess estimated tax payments. First, it would be reciprocal and fair. The government effectively charges interest on estimated tax underpayments.² It seems one-sided that it does not pay interest on excess payments of estimated tax.

Second, paying interest could improve voluntary tax compliance. Experts advise taxpayers that it is foolish to make excess estimated tax payments because they are, in effect, giving the government an interest-free loan.³ But it is difficult for taxpayers to estimate exactly how much they should pay. A telephone survey found approximately two-thirds of individual taxpayers with balances due did not plan to owe a balance upon filing.⁴ Taxpayers who owe a balance upon filing are more likely than others to understate their tax liabilities.⁵

1 Corporations receive a lower overpayment rate to the extent their overpayments exceed \$10,000 and are charged a higher underpayment rate to the extent their underpayments exceed \$100,000. IRC §§ 6621(a)(1)(B) & (c)(1). To the extent that interest is payable on equivalent underpayments and overpayments made by the same taxpayer, however, the net rate of interest is zero. IRC § 6621(d).

2 Technically, amounts the government charges for tax underpayments are denominated as penalties pursuant to IRC §§ 6654(a) (individuals) and 6655 (corporations), but the amounts are computed by reference to IRC § 6621, which is an interest provision. For a recommendation to convert the estimated tax penalty into an interest provision, see *Convert the Estimated Tax Penalty Into an Interest Provision to Properly Reflect Its Substance*, *supra*.

3 See, e.g., Aimee Picchi, *Tax season 2020: Most Americans Don't Understand How Tax Refunds Work, and It Might Cost Them*, USA TODAY, Dec. 30, 2019.

4 See Wage and Investment Division (W&I), Research Group 5, Project No. 5-03-06-2-028N, Experimental Tests of Remedial Actions to Reduce Insufficient Prepayments: Effectiveness of 2002 Letters 7 (Jan. 16, 2004), *citing* W&I Customer Research Group 5, Causes and Potential Treatments for Underwithholding and Insufficient Estimated Payments (2000).

5 Charles Christian, Phoenix District Office of Research and Analysis, *The Association Between Underwithholding and Noncompliance* 1-2 (July 14, 1995) (finding that “[o]n average, understated tax on balance due returns is ten times as large as understated tax on other returns”).

More than 20 percent of such taxpayers with a balance due fail to pay it in full.⁶ Thus, if encouraging excess estimated tax payments reduces underpayments, it should improve both reporting and payment compliance. Furthermore, estimated tax overpayment interest would provide an additional incentive for taxpayers to file timely – to avoid losing the interest under IRC § 6611(b)(3). Therefore, it might also improve filing compliance.

Third, paying interest would encourage savings and encourage taxpayers to pay their tax obligations during the year that the income is earned. Paying interest on excess estimated tax payments would make it easier for taxpayers to save without buying bonds. If encouraging overpayments increases tax refunds, it could increase savings, which is an independent tax policy goal.⁷

RECOMMENDATION

- Amend IRC § 6621 to pay interest on excess estimated tax payments at the overpayment rate beginning on the due date of the payments. If Congress wishes to minimize the budget impact of this recommendation, it could cap the excess estimated tax payment amount that will bear interest for each taxpayer on an annual basis.

6 See W&I, Research Group 5, Project No. 5-03-06-2-028N, Experimental Tests of Remedial Actions to Reduce Insufficient Prepayments: Effectiveness of 2002 Letters 7 (Jan. 16, 2004).

7 See, e.g., Michael S. Barr and Jane K. Dokko, Tax Filing Experiences and Withholding Preferences of Low- and Moderate-Income Households: Preliminary Evidence From a New Survey, 2006 IRS Research Conference 206 (2006), <https://www.irs.gov/pub/irs-soi/06barr.pdf> (“Our findings suggest that low- and moderate-income households may find savings plans that are tied to tax refunds... attractive”).

Legislative Recommendation #33**Reduce the Federal Tax Deposit Penalty Imposed on Taxpayers Who Make Timely Tax Deposits****PRESENT LAW**

IRC § 6656(a) imposes a penalty, computed as a percentage of a tax underpayment, for the failure to deposit (FTD) taxes in a manner prescribed by regulation, unless the failure is due to reasonable cause and not due to willful neglect. The penalty rate for FTD varies, depending on the length of the taxpayer's delay in making the deposit. IRC § 6656(b)(1)(A) provides that the penalty is two percent for an FTD of not more than five days, five percent for an FTD of more than five days but not more than 15 days, and ten percent for an FTD of more than 15 days.¹ Thus, taxpayers must make deposits on time, in full, and in the correct manner to avoid a penalty for FTD.²

IRC § 6302(h) directs the Secretary to prescribe “such regulations as may be necessary for the development and implementation of an electronic fund transfer system which is required to be used for the collection of depository taxes.” Treas. Reg. § 31.6302-1(h) implements this directive by requiring that federal tax deposits be made electronically via electronic funds transfer. To comply with this requirement, many taxpayers use the Electronic Federal Tax Payment System (EFTPS), a free service offered by the Department of the Treasury.

REASONS FOR CHANGE

The IRS has taken the position that the maximum ten percent penalty rate automatically applies if a deposit is not made in the manner prescribed by the regulation.³ As a result, taxpayers who timely remit full payment to the IRS but who do not do so in the manner prescribed may be subject to a higher penalty rate than taxpayers who do not make a timely payment at all. The National Taxpayer Advocate believes it is inappropriate to penalize taxpayers who make timely payments more harshly than taxpayers who do not. Moreover, the House Ways and Means Committee has observed that this approach “does not reflect the intent of the Congress.”⁴

RECOMMENDATION

- Amend IRC § 6656 to establish a penalty rate of two percent for FTDs that are fully and timely paid in a manner other than that prescribed by the Secretary of the Treasury.⁵

1 IRC § 6656(b)(1)(B) imposes a penalty of 15 percent in certain circumstances.

2 See *F.E. Schumacher Co. v. United States*, 308 F. Supp. 2d 819, 830 (N.D. Ohio 2004) (“penalties assessed pursuant to Section 6656 are appropriate even where taxes are timely paid, albeit by means other than [Electronic Funds Transfer]”).

3 Rev. Rul. 95-68, 1995-2 C.B. 272; Internal Revenue Manual 20.1.4.2.2.1, Electronic Funds Transfer (EFT) (Feb. 9, 2018).

4 H.R. REP. NO. 108-61, at 36 (2003).

5 For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 309 (2017); Taxpayer Protection and IRS Accountability Act, H.R. 1528, 108th Cong. § 108 (2003).

Legislative Recommendation #34**Extend Reasonable Cause Defense for the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to E-File Their Returns****PRESENT LAW**

IRC § 6651 imposes an addition to tax when a taxpayer fails to file a return by the return due date, unless the taxpayer can show the failure was due to reasonable cause and not due to willful neglect (hereinafter, the “failure-to-file penalty”).¹ Reasonable cause exists when a taxpayer has exercised ordinary business care and prudence but was unable to file the return within the prescribed time.²

In *United States v. Boyle*, the Supreme Court held that a taxpayer’s reliance on an agent to file a return did not constitute “reasonable cause” for late filing.³ In *Boyle*, the tax return at issue was filed on paper. At least two U.S. district courts have ruled that the *Boyle* holding applies in the e-filing context as well.⁴

In the IRS Restructuring and Reform Act of 1998, Congress adopted a policy that “paperless filing should be the preferred method and most convenient means of filing Federal tax and information returns” and gave the Secretary broad authority to incentivize taxpayers to file returns electronically.⁵

IRC § 6011(e)(3) authorizes the Secretary to require tax return preparers to file returns electronically unless they reasonably expect to file ten or fewer individual income tax returns during a calendar year. Treas. Reg. § 301.6011-7 implements this requirement.

REASONS FOR CHANGE

At the time *Boyle* was decided, all tax returns were filed on paper. Taxpayers generally could fulfill the basic responsibility of mailing returns to the IRS themselves, even when they engaged tax professionals to prepare them. In ruling that the taxpayer in *Boyle* was not entitled to “reasonable cause” abatement as a matter of law, the Supreme Court stated that “[i]t requires no special training or effort to ascertain a deadline and make sure that it is met.”⁶

In effect, the *Boyle* decision concluded that the duty to file a return is non-delegable. While that rule may make sense in a paper-filing context, it is not reasonable to apply it in the e-filing context. Today, most taxpayers effectively delegate the electronic filing of their returns to preparers or use software providers. Particularly when a taxpayer uses a preparer, the taxpayer is generally several steps removed from the filing process. When a preparer e-files a tax return, he or she must transmit it through an electronic return originator (typically, a software company) to the IRS. Thus, there are four parties sequentially involved in this chain: (i) the taxpayer; (ii) the preparer; (iii) the software company; and (iv) the IRS. If the IRS rejects an e-filed tax return, it generally sends a notification back through the software company to the preparer, but it

1 IRC § 6651(a)(1). The penalty amount is five percent of the tax due for each month or partial month the return is late, up to a maximum of 25 percent. The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

2 Treas. Reg. § 301.6651-1(c)(1). See also Internal Revenue Manual (IRM) 20.1.1.3.2, Reasonable Cause (Nov. 21, 2017).

3 *Boyle*, 469 U.S. 241 (1985).

4 See, e.g., *Haynes v. United States*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), vacated and remanded, *Haynes v. United States*, 760 F. App’x 324 (5th Cir. 2019); *Intress v. United States*, 404 F. Supp. 3d 1174 (M.D. Tenn. 2019).

5 Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723 (1998); IRC § 6011(f).

6 *Boyle*, 469 U.S. at 252.

will not notify the taxpayer directly.⁷ In these circumstances, there is no practical way for a taxpayer to ensure his or her return has been properly submitted by the preparer and accepted by the IRS. In addition, the IRS rejects e-filed returns before processing for a wide variety of reasons, and unlike with paper filing, a return that is e-filed with the IRS but rejected is not treated as timely filed.

We note that Treasury regulations exempt paid preparers from the e-filing requirements if a taxpayer provides a preparer with “a hand-signed and dated statement” that says the taxpayer chooses to file a paper return.⁸ This “opt-out” reduces a taxpayer’s risk of incurring a failure-to-file penalty. In light of the congressional directive to incentivize e-filing, however, it makes little sense for the government to tell taxpayers, in effect, that they can reduce their risk of incurring a failure-to-file penalty by filing their returns on paper.⁹

In *Haynes v. United States*, a married couple employed a certified public accountant to prepare and file their joint tax return.¹⁰ The preparer timely e-filed the return, but the IRS did not accept it for processing because a taxpayer identifying number was listed on the wrong line. The preparer did not receive a rejection notice from the IRS. The preparer notified the taxpayers that their return had been timely filed. Ten months later, the IRS notified the taxpayers that their return had not been received and asserted the failure-to-file penalty.

The taxpayers requested penalty abatement for reasonable cause, asserting that they had sought to file their return timely, that their preparer had transmitted the return timely, and that both the preparer and the taxpayers believed the return had been received. The taxpayers argued that *Boyle* should not apply in the context of electronic filing because the complexities of e-filing vastly exceed the comparatively simple and verifiable task of mailing a return. The IRS rejected the taxpayers’ position, and the taxpayers then paid the penalty and filed a refund suit in a U.S. district court. The district court concluded that the holding in *Boyle* applies to e-filed returns to the same extent as paper-filed returns and ruled in the government’s favor as a matter of law. On appeal, the U.S. Court of Appeals for the Fifth Circuit vacated and remanded the district court’s decision on the ground that there was a genuine issue of material fact about whether it was reasonable for the preparer to assume, based on the IRS’s silence, that it had accepted the taxpayers’ return. However, the appeals court did not take a position on the *Boyle* issue of whether the taxpayers’ reliance on a preparer to e-file their tax return constituted reasonable cause for a failure-to-file.¹¹

In 2019, a different U.S. district court reached a conclusion similar to the decision in *Haynes*.¹²

The issue in these cases is not whether the failure-to-file penalty is applicable in the first instance. Based on the wording of the statute, there is no doubt the penalty is applicable if the return is filed late. Rather, the issue is whether taxpayers are entitled to request abatement of the penalty on “reasonable cause” grounds. Because the *Boyle* decision used relatively sweeping language, lower courts have seemingly felt bound to apply its holding in the context of e-filed returns, notwithstanding the significant differences between paper filing and electronic filing.

7 IRM 3.42.5.7.2(1), Online Filing (Oct. 10, 2018).

8 Treas. Reg. § 301.6011-7(a)(4)(ii).

9 For context, nearly half of all individual income tax returns filed during 2020 were prepared by professionals and e-filed (81 million returns). See IRS 2020 Filing Season Statistics (week ending Dec. 11, 2020), <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-11-2020>.

10 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017).

11 *Haynes v. United States*, 760 F. App’x 324 (5th Cir. 2019). The government subsequently conceded the case, but it has not conceded the *Boyle* issue. See Keith Fogg, *Reliance on Preparer Does Not Excuse Late E-Filing of Return*, PROCEDURALLY TAXING BLOG (Sept. 4, 2019), <https://procedurallytaxing.com/reliance-on-preparer-does-not-excuse-late-e-filing-of-return>.

12 *Intress v. United States*, 404 F. Supp. 3d 1174 (M.D. Tenn. 2019).

While the bright-line rule embodied in *Boyle* is convenient for the IRS to administer, the nearly automatic assessment of the failure-to-file penalty for e-filed returns deemed late (often where the return was submitted timely by the taxpayer or preparer but rejected by the IRS) is grossly unfair and undermines the congressional policy that e-filing be encouraged. The American College of Tax Counsel shares this view and submitted a compelling *amicus curiae* brief in the appeal of the *Haynes* decision.¹³

RECOMMENDATION

- Amend IRC § 6651 to specify that reasonable cause relief may be available to taxpayers that use return preparers to submit their returns electronically and direct the Secretary to issue regulations specifying what constitutes ordinary business care and prudence for e-filed returns.

¹³ See Brief of American College of Tax Counsel (Nov. 27, 2017), https://www.actconline.org/wp-content/uploads/2018/02/ACTC_Amicus_Brief_Haynes.pdf.

Legislative Recommendation #35**Authorize a Penalty for Tax Return Preparers Who Engage in Fraud or Misconduct by Altering a Taxpayer's Tax Return****PRESENT LAW**

IRC § 6694(b) authorizes the IRS to impose a penalty when a tax return preparer has understated a tax liability on a “return or claim for refund” and the understatement is due to willful or reckless conduct.¹ IRC § 6695(f) imposes a \$500 penalty (adjusted for inflation) on a preparer who negotiates a taxpayer's refund check.²

REASONS FOR CHANGE

TAS has handled hundreds of cases involving return preparer fraud or misconduct. In the most common scenario, a taxpayer visits a preparer to get his tax return prepared, the preparer completes the return while the taxpayer is present, and the preparer alters the return after the taxpayer leaves before submitting it to the IRS. In some cases, the items of income, deduction, and credit are accurate, but the preparer alters the direct deposit routing information so the entire refund is directed to his account instead of the taxpayer's account. In other cases, the preparer increases the refund amount and elects a “split refund,”³ so the taxpayer receives the refund amount he expects and the additional amount goes to the preparer.

The Department of Justice (DOJ) may bring criminal charges against preparers who alter tax returns, but resource constraints generally preclude criminal charges except in cases of widespread schemes. In addition, the dollar amount of a refund obtained by a preparer in these cases often will determine whether DOJ pursues an erroneous refund suit under IRC § 7405, as resources again constrain the number of suits that can be brought each year.⁴ It is therefore important that the IRS have the authority to impose sizeable civil tax penalties against preparers who alter tax returns without the knowledge or consent of taxpayers.

Under current law, the IRS has very limited authority to impose civil penalties in instances of preparer fraud or misconduct. The IRC § 6694 penalty generally will not apply to either of the scenarios described above for the following reasons:

- When a preparer has altered items of income, deduction, or credit in an attempt to increase a taxpayer's refund after the taxpayer has reviewed and approved the return for filing, the IRS Office of Chief Counsel has concluded that the resulting document is not a valid “return.”⁵ As a consequence, the IRC § 6694 penalty does not apply.
- When a preparer has altered only the direct deposit information on the return and has not changed the tax liability, there is no understatement of tax.

¹ The amount of the penalty is per return or claim for refund and is equal to the greater of \$5,000 or 75 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

² Similarly, Section 10.31 of Circular 230 (31 C.F.R. Part 10) prohibits a tax practitioner who prepares tax returns from endorsing or negotiating a client's federal tax refund check.

³ Taxpayers can split their refunds among up to three accounts at a bank or other financial institution. See IRS Form 8888, Allocation of Refund (Including Savings Bond Purchases) (2019). The instructions to Form 8888 specifically advise taxpayers not to deposit their refunds into their tax return preparer's account.

⁴ See Internal Revenue Manual (IRM) 21.4.5.15(6), Collection Methods for Category D Erroneous Refunds (Oct. 1, 2007) (“The erroneous refund suit is limited to amounts that exceed the litigating threshold established by the Department of Justice.”).

⁵ Program Manager Technical Advice (PMTA) 2011-20, Tax Return Preparer's Alteration of a Return (June 27, 2011); PMTA 2011-13, Horse's Tax Service (May 12, 2003).

In addition, it is unclear whether the IRC § 6695(f) penalty applies. Treasury regulations have interpreted the IRC § 6695(f) penalty as applicable to a preparer who negotiates “a check (including an electronic version of a check).”⁶ Although the IRS’s internal procedures currently treat direct deposits as subject to the IRC § 6695(f) penalty, the tax code and regulations do not make clear whether a “direct deposit” is legally identical to an “electronic version of a check.”⁷ Moreover, even if the penalty is applicable, the penalty amount of \$530 is typically small in relation to the size of refunds that some preparers have misappropriated and does not serve as a deterrent.

The National Taxpayer Advocate recommends the IRS be given the authority to impose civil penalties on tax return preparers who engage in fraud or misconduct by altering the return of a taxpayer for personal financial gain.

RECOMMENDATIONS

- Amend IRC § 6694(b) so the penalty the IRS may assess against a tax return preparer for understating a taxpayer’s liability is broadened beyond tax returns and claims for refund by adding the words “and other submissions purporting to be returns.”
- Amend IRC § 6695 to explicitly cover a preparer who misappropriates a taxpayer’s refund by changing the direct deposit information and to increase the dollar amount of the penalty to deter preparers from engaging in this type of fraud or misconduct. To make the public fisc whole, the penalty should be equal to 100 percent of the amount a preparer has improperly converted to his own use by altering a taxpayer’s tax return.

⁶ Treas. Reg. § 1.6695-1(f)(1).

⁷ See IRM 20.1.6.5.6, Negotiation of Check – IRC 6695(f) (Aug. 25, 2020).

Legislative Recommendation #36

Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties

PRESENT LAW

IRC § 6751(b)(1) states: “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.” IRC § 6751(b)(2) carves out two categories of exceptions from this supervisory approval requirement: (i) the penalties for failure to file a tax return (IRC § 6651(a)(1)), failure to pay the tax due (IRC § 6651(a)(2)), and failure to pay sufficient estimated tax (IRC §§ 6654 and 6655) and (ii) any other penalty that is “automatically calculated through electronic means.”

REASONS FOR CHANGE

IRC § 6751(b) protects taxpayers’ *right to a fair and just tax system* by ensuring penalties are only imposed in appropriate circumstances and not used as a bargaining chip to encourage settlement.¹ However, the phrase “initial determination of [an] assessment” is unclear. A “determination” is made on the basis of calculation or research. An “assessment” is merely the entry of a decision on IRS records. Therefore, while a penalty can be determined and a penalty can be assessed, “one cannot ‘determine’ an ‘assessment.’”² Due to this ambiguity in the statute, an increasing number of court cases have had to grapple with when written supervisory approval must be provided.³ In recent years, courts have found that the supervisory approval must occur at even earlier times than previously determined:

- In 2016, the Tax Court held in *Graev v. Commissioner* (which was later vacated) that supervisory approval could occur at any point before the assessment was made.⁴
- In 2017, the U.S. Court of Appeals for the Second Circuit held in *Chai v. Commissioner* that supervisory approval was required no later than the date on which the IRS issued the notice of deficiency, or if the penalty was asserted through an answer or amended answer, the time of that filing.⁵
- In 2019, the Tax Court held in *Clay v. Commissioner* that supervisory approval was required prior to sending the taxpayer a formal communication that included the right to go to the IRS Independent Office of Appeals.⁶

In late 2019, however, the Tax Court declined to require supervisory approval prior to that point. In *Belair Woods LLC v. Commissioner*, the Tax Court found the IRS did not have to obtain supervisory approval before sending the taxpayer a Letter 1807, TEFRA Partnership Cover Letter for Summary Report, which invited the taxpayer to a closing conference to discuss proposed adjustments.⁷ Instead, the court found the Letter 1807 only advised the taxpayer of the possibility that the penalties could be proposed and the pivotal moment requiring supervisory approval was when the IRS sent the 60-day letter, formally communicating its definite decision to assert the penalties.

1 See S. REP. NO. 105-174, at 65 (1998).

2 *Chai v. Comm’r*, 851 F.3d 190, 218-219 (2d Cir. 2017) (quoting *Graev v. Comm’r*, 147 T.C. 460 (2016) (Gustafson, J., dissenting)).

3 See National Taxpayer Advocate 2019 Annual Report to Congress, 149-157 (Most Litigated Issue: *Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)*); National Taxpayer Advocate 2018 Annual Report to Congress 447-457 (Most Litigated Issue: *Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)*).

4 147 T.C. at 460, superseded by, in part, modified by, in part 149 T.C. 485 (2017).

5 851 F.3d 190 (2d Cir. 2017).

6 152 T.C. 223 (2019).

7 154 T.C. No. 1, Tax Ct. Rep. Dec. (RIA) 154.1 (Jan. 6, 2020).

The IRS issued interim guidance that instructs employees to obtain written supervisory approval before sending a written communication that offers the taxpayer an opportunity to sign an agreement or consent to assessment or proposal of a penalty.⁸ The interim guidance specifies that prior to obtaining written supervisory approval, employees can share written communications with the taxpayer that reflect proposed adjustments as long as they do not offer the opportunity to sign an agreement or consent, or request an Appeals conference.

However, both *Belair Woods* and the IRS's interim guidance leave open the possibility that IRS employees could use penalties as a bargaining chip – precisely what Congress sought to prevent by enacting IRC § 6751(b). Under *Belair Woods*, IRS employees can propose penalties in order to induce a resolution without first obtaining written supervisory approval, as long as the communication is deemed a proposal and not a definite decision. This approach undermines the statutory intent because, as explained in the dissent in *Belair Woods*, “[e]very communication from the Commissioner proposing a deficiency and a related penalty – whether it is a preliminary report, a 30- or 60-day letter, or a notice of deficiency – sets forth proposed adjustments, which do not become final until a decision is entered or an assessment is properly recorded.”⁹ The IRS's interim guidance seeks to resolve the question of what is merely a proposal versus a definite decision by drawing the line at written communications that offer a chance to agree to assessment or consent to proposal of a penalty. However, employees could still use penalties as a bargaining chip because some taxpayers may feel pressured to resolve their cases when penalties are first put on the table as proposed adjustments.

In addition to the timing issue, the statutory language of IRC § 6751(b)(1) is also problematic because of its focus on “assessment(s).” In *Wells Fargo & Company v. Commissioner*, the U.S. Court of Appeals for the Eighth Circuit found that supervisory approval under IRC § 6751(b) was not required because there was no assessment.¹⁰ There, the IRS asserted the accuracy-related penalty in a refund suit to offset any refund granted to the taxpayer. Because the penalty, if upheld by the court, would only lead to a reduced refund and not a balance to be assessed, the court found there would be no assessment and thus no requirement for supervisory approval. Under this holding, the IRS can assert penalties in refund litigation to persuade taxpayers to settle without supervisory approval to ensure the penalties are appropriate. Thus, IRC § 6751(b)(1) should be revised to specify that supervisory approval is required in situations where the penalty is included as part of a final judicial decision.

In practice, the overwhelming majority of penalties imposed by the IRS are excluded from the supervisory approval requirement through one of the exceptions in IRC § 6751(b)(1).¹¹ But where written supervisory approval is required, it should be required early enough in the process to ensure it is meaningful and not merely an after-the-fact rubber-stamp applied in the limited number of cases in which a taxpayer challenges a proposed penalty.

RECOMMENDATION

- Amend IRC § 6751(b)(1) to clarify that no penalty under Title 26 shall be assessed or entered in a final judicial decision unless the penalty is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate *prior to the first time the IRS sends a written communication to the taxpayer proposing the penalty as an adjustment.*

8 Memorandum from Director, Examination Field and Campus Policy, to Directors, Field Examination, SBSE-04-0920-0054 (Sept. 24, 2020).

9 154 T.C. No. 1, Tax Ct. Rep. Dec. (RIA) 154.1, 11 (Jan. 6, 2020) (Marvel, J., dissenting).

10 957 F.3d 840 (8th Cir. 2020), *aff'd* 260 F. Supp. 3d 1140 (D. Minn. 2017).

11 In FY 2020, the IRS imposed 40.5 million penalties on individuals, estates, and trusts in connection with income tax liabilities. The following penalties, generally imposed by electronic means, accounted for over 80 percent of the total: failure to pay (19.3 million), failure to pay estimated tax (10.7 million), failure to file (2.4 million) and bad checks (1.1 million). IRS, 2020 Data Book, Table 26, Civil Penalties Assessed and Abated, by Type of Tax and Type of Penalty, Fiscal Year 2020, at 60 (2021).

Legislative Recommendation #37**Require an Employee to Determine and a Supervisor to Approve All Negligence Penalties Under IRC § 6662(b)(1)****PRESENT LAW**

IRC § 6662(b)(1) imposes a penalty equal to 20 percent of any underpayment of tax required to be shown on a tax return that is attributable to negligence or disregard of rules or regulations. IRC § 6662(c) defines “negligence” to include “any failure to make a reasonable attempt to comply with the provisions of this title” and “disregard” to include “any careless, reckless, or intentional disregard.”

IRC § 6751(b)(1) provides: “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.”¹ IRC § 6751(b)(2) carves out two categories of exception from this supervisory approval requirement: (i) the penalties for failure to file a tax return (IRC § 6651(a)(1)), failure to pay the tax due (IRC § 6651(a)(2)), and failure to pay sufficient estimated tax (IRC §§ 6654 and 6655) and (ii) any other penalty that is “automatically calculated through electronic means.”

REASONS FOR CHANGE

IRC § 6751 states that the initial determination of penalties must be personally approved (in writing) by the immediate supervisor of the individual making the initial determination, subject to the exceptions described above. In the significant majority of cases, the IRS imposes penalties by electronic means, because it is easier and cheaper to do so.² Where the imposition of a penalty is mechanical, such as the penalties for failure to file, failure to pay, or failure to pay estimated tax, that approach is justifiable.

However, imposition of a penalty for “negligence or disregard of rules or regulations” is different. To assess whether a taxpayer made a “reasonable attempt to comply” with the law, an employee must assess both the actions the taxpayer took to comply and the taxpayer’s motivations for taking those actions. A computer cannot do this.

Nevertheless, Treas. Reg. § 1.6662-3(b)(1)(i) states that negligence is strongly indicated when a taxpayer omits income from an information return on his or her income tax return. In reliance on this regulation, the IRS has programmed its computers to calculate certain negligence penalties automatically as part of its Automated Underreporter (AUR) program. For example, the AUR system proposes the negligence penalty where IRS data suggests the taxpayer failed to report income reflected on a third-party information return for a second tax year in a row.³

Legal advice from the Office of Chief Counsel goes further, concluding that “in the absence of any other evidence suggesting the failure was not negligent, it is appropriate to propose and subsequently assess an

1 The meaning of “initial determination of such assessment” and the timing required for approval have been the subject of litigation. See, e.g., *Belair Woods v. Comm’r*, 154 T.C. No. 1, Tax Ct. Rep. Dec. (RIA) 154.1 (Jan. 6, 2020). For a recommendation to clarify the timing, see Legislative Recommendation: *Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties*, *supra*.

2 In FY 2020, the IRS imposed 40.5 million penalties on individuals, estates, and trusts in connection with income tax liabilities. The following penalties, generally imposed by electronic means, accounted for over 80 percent of the total: failure to pay (19.3 million), failure to pay estimated tax (10.7 million), failure to file (2.4 million) and bad checks (1.1 million). IRS, 2020 Data Book, Table 26, Civil Penalties Assessed and Abated, by Type of Tax and Type of Penalty, Fiscal Year 2020, at 60 (2021).

3 Internal Revenue Manual (IRM) 4.19.3.22.1.4, Accuracy-Related Penalties (Sept. 21, 2020).

accuracy-related penalty for negligence when a taxpayer does not include on an income tax return an amount of income shown on an information return.”⁴ However, the AUR system in this scenario solely checks for the presence of information returns and unreported income. It cannot determine there is no other evidence that would rebut the negligence finding, such as whether the information return was mailed to a different address than the one used by the taxpayer when filing the return or whether the information return contained an error. An employee must review the case to consider facts and circumstances that may suggest the taxpayer was not negligent.

Although the AUR program does require supervisory approval for the negligence penalty if the taxpayer submits a response,⁵ there are many reasons a taxpayer may not respond. A taxpayer may have moved and not received the notice. A taxpayer may put the notice aside and not reply before the response deadline. Or a taxpayer may accept the proposed tax adjustment without realizing that he or she must respond to avoid the penalty assessment. In these and other circumstances, taxpayers may face a penalty for negligence without any analysis into their reasonable attempts to comply with tax laws. Thus, allowing a computer to determine negligence without employee involvement harms taxpayers and undermines the protections afforded by IRC § 6751(b).

RECOMMENDATION

- Amend IRC § 6751(b)(2)(B) to clarify that the exception for “other penalties automatically calculated through electronic means” does not apply to the penalty for “negligence or disregard of rules or regulations” under IRC § 6662(b)(1).

⁴ IRS, Program Manager Technical Advice 2008-01249 (Oct. 22, 2007).

⁵ IRM 4.19.3.22.1.4, Accuracy-Related Penalties (Sept. 21, 2020).

Legislative Recommendation #38**Modify the Definition of "Willful" for Purposes of Finding Report of Foreign Bank and Financial Accounts Violations and Reduce the Maximum Penalty Amounts****PRESENT LAW**

U.S. citizens or residents with foreign account balances exceeding \$10,000 in the aggregate during the year generally are required by 31 U.S.C. § 5314 and 31 C.F.R. § 1010.350 to report the accounts to the Financial Criminal Enforcement Network (FinCEN) in the Treasury Department. They must do so on FinCEN Form 114, Report of Foreign Bank and Financial Accounts (or FBAR). 31 U.S.C. § 5321(a)(5) imposes civil penalties for failing to report accounts. The amount depends on whether the failure was “willful” or “non-willful.” The maximum penalty for a non-willful violation is \$10,000 (adjusted for inflation).¹ The maximum civil penalty for a willful violation is 50 percent of the maximum account balance during the year (or, if greater, \$100,000 [adjusted for inflation] per violation).² Under 31 U.S.C. § 5321(a)(5)(B), no penalty may be imposed for a non-willful violation if the account holder reported all income from the account and had reasonable cause for failing to file the FBAR.

The IRS has created procedures that allow some account holders to correct non-willful noncompliance if they learn about the problem early. Under its Delinquent FBAR Submission Procedures and Streamlined Filing Compliance Procedures, the IRS will not impose a penalty (or will impose a penalty of five percent) for non-willful violations if an account holder reports the accounts on an FBAR and reports and pays tax on the income from the foreign financial accounts before being contacted by the IRS about an examination or FBAR violation.³ However, account holders who first learn of their FBAR violations when the IRS initiates an exam or contacts them about a violation are ineligible for these procedures.

REASONS FOR CHANGE

The maximum FBAR penalty is among the harshest civil penalties the government may impose. For example, if an account holder maintains a balance of \$25,000 in a foreign account that he willfully fails to report, the IRS may impose a penalty of over \$100,000 per year and may go back six years, producing an aggregate statutory maximum penalty of over \$600,000.⁴ Some commentators have suggested the penalty is so severe that it might violate the U.S. Constitution’s prohibition against excessive fines.⁵ Individuals who have lived in foreign countries or have immigrated to the United States often maintain foreign bank accounts and may overlook this requirement for benign reasons.

Although the Internal Revenue Manual (IRM) limits the total amount of the penalties for non-willful violations to 50 percent of the highest aggregate balance (HAB) of all unreported foreign financial accounts for all years under examination, examiners are still free to recommend a penalty of up to 100 percent of the

¹ 31 U.S.C. § 5321(a)(5)(B)(i); 31 C.F.R. § 1010.821.

² 31 U.S.C. § 5321(a)(5)(C), (D)(ii).

³ See IRS, Delinquent FBAR Submission Procedures, <https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures> (last visited Nov. 3, 2021) (no penalty if no underreporting and fixed before contact); IRS, Streamlined Filing Compliance Procedures, <https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures> (last visited Nov. 3, 2021) (five percent penalty for U.S. residents if noncompliance fixed before contact and violation was non-willful).

⁴ Under current guidance, the IRS is unlikely to impose such a severe penalty. See IRM 4.26.16.5.5, Penalty for Willful FBAR Violations (June 24, 2021) (discussed in the text below).

⁵ See Alison Bennett, *New FBAR Penalty Limits Seen Reflecting IRS Concern on Eighth Amendment Litigation*, BNA TAX MGMT WEEKLY REPT (June 15, 2015).

HAB for willful violations if a manager approves.⁶ Even half the HAB can be more than the current balance if the account value has declined. Account holders have argued in many cases that the harshness of the maximum penalty, particularly the “willful” penalty, is disproportionate to the reporting failure.

While the distinction between willful and non-willful violations makes sense, it generates controversy because it can be difficult for taxpayers to establish that a violation was not willful. Schedule B of Form 1040, U.S. Individual Income Tax Return, asks if the taxpayer has a foreign account and references the FBAR filing requirement. Taxpayers are presumed to know the contents of their returns when they sign the return under penalty of perjury, swearing “Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.” It may be considered reckless or “willful blindness” for them not to learn about the FBAR filing requirement after having been directed to the FBAR form by Schedule B.⁷ For this reason, the government might reasonably argue (and a court might reasonably find) that *any* failure to file an FBAR form is willful where a taxpayer filed a federal tax return that included Schedule B, which directs taxpayers to the FBAR filing requirement.⁸

Account holders who do not file required FBAR forms due to negligence, inadvertence, or similar non-nefarious causes may be subject to penalties for non-willful violations (which have a reasonable cause exception). But they should not face uncertainty regarding the possible application of the potentially harsh penalties for “willful” violations. The National Taxpayer Advocate recommends that Congress clarify that the IRS must prove a violation was “willful” without relying so heavily on the instructions to Schedule B or the failure to check the box on Schedule B before imposing a willful FBAR penalty.

RECOMMENDATIONS⁹

- Clarify that the government has the burden to establish willfulness before asserting a civil willful FBAR penalty and that the government cannot meet this burden by relying primarily on the Schedule B attached to a return.
- Reduce the statutory maximum civil penalty for a willful FBAR violation to the maximum penalty the IRM currently allows its examiners to assert without managerial approval (*i.e.*, no greater than 50 percent of the highest annual asset balance in the unreported account during the years of noncompliance).

6 See IRM 4.26.16.5.4.1, Penalty for Non-willful Violations – Calculation (June 24, 2021); IRM 4.26.16.5.5.3, Penalty for Willful FBAR Violations – Calculation (June 24, 2021). The IRS also has “mitigation” guidelines that could result in lower penalties. See IRM Exhibit 4.26.16-2, FBAR Penalty Mitigation Guidelines for Violations Occurring After October 22, 2004 (June 24, 2021). Commentators have suggested the IRS limited the maximum FBAR its examiners would propose to address concerns that the statutory maximums could violate the Excessive Fines clause of the Eighth Amendment to the Constitution. See, e.g., Alison Bennett, *New FBAR Penalty Limits Seen Reflecting IRS Concern on Eighth Amendment Litigation*, BNA TAX MGMT WEEKLY REPT (June 15, 2015).

7 See, e.g., *Norman v. United States*, 942 F.3d 1111, 1115 (Fed. Cir. 2019).

8 See, e.g., *United States v. Bohanec*, 263 F. Supp. 3d 881, 890 (C.D. Cal. 2016) (finding willful blindness, in part, because “Schedule B of Defendants’ 1998 tax return put them on notice that they needed to file an FBAR,” even though it was checked “yes” to indicate foreign accounts).

9 For more detail, see National Taxpayer Advocate 2014 Annual Report to Congress 331-345 (Legislative Recommendation: *Foreign Account Reporting: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*).

STRENGTHEN TAXPAYER RIGHTS BEFORE THE OFFICE OF APPEALS

Legislative Recommendation #39

Require Taxpayers' Consent Before Allowing IRS Counsel or Compliance Personnel to Participate in Appeals Conferences

PRESENT LAW

Although the IRS had long operated an Office of Appeals under its administrative authority, Congress codified the office and retitled it the “Internal Revenue Service Independent Office of Appeals” (Appeals) as part of the Taxpayer First Act of 2019.¹ The intent of the provision was to “reassure taxpayers of the independence” of Appeals.²

Present law does not directly address the inclusion of personnel from the IRS Office of Chief Counsel or IRS compliance functions in conferences held by Appeals.

REASONS FOR CHANGE

Historically, Counsel and Compliance provided input into Appeals conferences via the case file and, if the case was particularly large or complex, at a pre-conference. The Appeals conference itself generally was devoted to presentation of the taxpayer's case and settlement negotiations between the taxpayer (or the taxpayer's representative) and the Appeals Officer. Counsel and Compliance personnel rarely attended such conferences, leaving taxpayers and Appeals Officers free to develop rapport, seek common ground, and pursue case resolution.³

In October 2016, Appeals revised provisions of the Internal Revenue Manual to allow Appeals Officers to include personnel from Counsel and Compliance in Appeals conferences as a matter of routine. Counsel and Compliance are not a party to the actual settlement discussions, which occur near the conclusion of the conference, but they are typically given the opportunity to present an oral argument and question taxpayers and their representatives.

Under the revised procedures, an Appeals Officer may invite the additional participants regardless of whether taxpayers agree or object to their presence. Appeals has agreed to solicit and consider the views of taxpayers before inviting Counsel and Compliance to attend a conference, but has stopped short of making taxpayer consent a prerequisite for such attendance.⁴ Including Counsel and Compliance personnel over taxpayer objections contravenes the purpose of an independent Appeals conference, which is neither to give Compliance personnel another bite at the apple nor to transform Appeals into a mediation forum. Instead, the mission and credibility of Appeals rests on its ability to undertake direct and unbiased settlement negotiations with taxpayers and their representatives, independent of the Counsel and Compliance functions.

¹ Taxpayer First Act, Pub. L. No. 116-25, § 1001, 133 Stat. 981, 983 (2019) (codified at IRC § 7803(e)).

² H.R. REP. NO. 116-39, pt. 1, at 29 (2019) (accompanying H.R. 1957, which was enacted into law without change to this provision as H.R. 3151). In 2012, the IRS published Revenue Procedure 2012-18, which, among other things, places parameters around *ex parte* communications between Appeals and other representatives of the IRS, such as Counsel and Compliance. This guidance is premised on the recognition that Appeals must be unbiased and impartial, both in fact and in appearance.

³ For a more detailed discussion of this topic, see National Taxpayer Advocate 2019 Annual Report to Congress 62-68 (Most Serious Problem: *Appeals: The Inclusion of Chief Counsel and Compliance Personnel in Taxpayer Conferences Undermines the Independence of the Office of Appeals*).

⁴ IRS Independent Office of Appeals, *Appeals Team Case Leader Conferencing Initiative: Summary of Findings and Next Steps* (Sept. 2021).

The expansion of Appeals conferences to routinely involve Counsel and Compliance personnel alters the relationship between taxpayers and Appeals Officers. It makes interactions less negotiation-based and transforms the conference into a more contentious and one-sided proceeding. This approach is also seemingly inconsistent with Congress's intent to "reassure taxpayers of the independence" of Appeals.

RECOMMENDATION

- Amend IRC § 7803(e) to provide: "A taxpayer shall have the right to a conference with the Independent Office of Appeals that does not include personnel from the Office of Chief Counsel or the compliance functions of the Internal Revenue Service unless the taxpayer specifically consents to the participation of those parties in the conference."⁵

5 For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 601 (2018). This recommendation is not intended to limit the ability of Appeals to obtain legal assistance and advice from the Office of Chief Counsel, as permitted by IRC § 7803(e)(6)(B).

STRENGTHEN THE OFFICE OF THE TAXPAYER ADVOCATE

Legislative Recommendation #40

Clarify That the National Taxpayer Advocate May Hire Legal Counsel to Enable Her to Advocate More Effectively for Taxpayers

PRESENT LAW

Pursuant to 31 U.S.C. § 301(f), the General Counsel of the Department of the Treasury is the chief law officer for the Department. The IRS Chief Counsel is an Assistant General Counsel and the chief law officer for the IRS. With few exceptions, Treasury Department Order 107-04 provides that all attorneys in the Treasury Department must work in the Legal Division and report to the General Counsel.¹ Treasury's Inspectors General and the Office of the Comptroller of the Currency (OCC) are excluded from this requirement based on specific statutory language in 5 U.S.C. App. III § 3(g) and 12 U.S.C. § 482, respectively, and therefore are authorized to hire and supervise their own attorneys.² No law specifically authorizes the National Taxpayer Advocate to hire and supervise attorneys.

IRC § 7803(c) makes clear, however, that TAS is expected to operate independently of the IRS in key respects. IRC § 7803(c)(2)(A) directs TAS to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have problems in their dealings with the IRS, and to make administrative and legislative recommendations to mitigate such problems. IRC § 7803(c)(4)(A) requires each local taxpayer advocate to notify taxpayers that its offices "operate independently of any other Internal Revenue Service office and report directly to Congress through the National Taxpayer Advocate." IRC § 7803(c)(2)(B)(iii) requires the National Taxpayer Advocate to submit reports to Congress directly "without any prior review or comment from ... the Commissioner, the Secretary of the Treasury, the Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget." This provision is similar to the one that applies to the OCC (12 U.S.C. § 250).

When Congress reorganized the IRS in 1998, it recognized that the National Taxpayer Advocate requires independent counsel to advocate for her positions. The version of the IRS Restructuring and Reform Act of 1998 passed by the Senate contained the following authorization: "The National Taxpayer Advocate shall have the responsibility and authority to ... appoint a counsel in the Office of the Taxpayer Advocate to report directly to the National Taxpayer Advocate."³ In explaining the provision, Senator Grassley said: "In order to make the Taxpayer Advocate more independent, which is what this bill does, it logically follows that the Taxpayer Advocate should have its own legal counsel."⁴

1 Treasury Order 107-04 states:

With the exception of persons employed by the Treasury Inspector General, TIGTA, SIGTARP, and the Chief Counsel of the Office of the Comptroller of the Currency, all attorneys whose duties include providing legal advice to officials in any office or bureau of the Department are part of the Legal Division under the supervision of the General Counsel.

2 The Inspector General Act of 1978, as amended (codified at 5 U.S.C. App. III § 3(g)), provides:

Each Inspector General shall, in accordance with applicable laws and regulations governing the civil service, obtain legal advice from a counsel either reporting directly to the Inspector General or another Inspector General.

Similarly, 12 U.S.C. § 482 provides:

Notwithstanding any of the provisions of section 481 of this title or section 301(f)(1) of title 31 to the contrary, the Comptroller of the Currency shall, subject to chapter 71 of title 5, fix the compensation and number of, and appoint and direct, all employees of the Office of the Comptroller of the Currency.

3 H.R. 2676, 105th Cong. § 1102(a) (as passed by Senate, May 7, 1998).

4 144 CONG. REC. S4460 (May 7, 1998). The provision was added to the bill as an amendment on the Senate floor sponsored by Senator Grassley.

This provision was not included in the final bill. However, the conference report stated that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.”⁵

REASONS FOR CHANGE

Since 2004, with the approval of the Commissioner of Internal Revenue, TAS has employed attorney-advisors. The National Taxpayer Advocate requires independent attorney-advisors because she often takes positions, both in working taxpayer cases and in systemic advocacy, that are directly contrary to the position of the IRS and the Office of Chief Counsel.

Once attorneys in the Office of Chief Counsel have adopted a legal position interpreting a law or regulation for purposes of IRS operations, procedures, or litigation, it would be unrealistic to expect that those same attorneys could effectively help the National Taxpayer Advocate develop a legal position that challenges their own interpretation or an interpretation adopted by the Chief Counsel organization for which they work. Notably, the Chief Counsel organization requires its attorneys to reconcile disputes internally so that they ultimately all “speak with one voice.”⁶ Thus, although the National Taxpayer Advocate sometimes receives legal advice from Chief Counsel attorneys, the advice is not independent from the advice they provide to the rest of the IRS. By contrast, TAS’s own attorney-advisors have enabled the National Taxpayer Advocate to develop an independent perspective and advocate for taxpayers as the law intends.

In 2015, the IRS for the first time denied a routine TAS request to backfill existing attorney positions due to attrition. It cited Treasury Department General Counsel Directive No. 2, which states: “Except for positions in the Inspectors General offices or within the Office of the Comptroller of the Currency, attorney positions shall not be established outside of the Legal Division” unless the General Counsel or Deputy General Counsel(s) provides a waiver. On November 29, 2016, the National Taxpayer Advocate submitted a nine-page memo to the Acting General Counsel requesting permission to continue to hire attorney-advisors. It asked the Acting General Counsel to modify General Counsel Directive No. 2 to add a carve-out for the Office of the Taxpayer Advocate as it does for the Inspectors General offices. Alternatively, the National Taxpayer Advocate orally requested that a “waiver” be granted, as provided in the directive. In the fall of 2018, TAS submitted another hiring request, and it was again denied by the IRS.

The inability of the National Taxpayer Advocate to hire attorney-advisors extends to announcing higher graded positions for attorneys currently working in TAS. Therefore, TAS is not only barred from hiring new attorneys, but well-performing attorneys cannot be promoted to higher-graded positions. This has accelerated attrition. If the National Taxpayer Advocate is not able to hire attorney-advisors, TAS’s ability to advocate for taxpayers both individually and systemically and the National Taxpayer Advocate’s ability to produce high-quality reports to Congress will be significantly compromised. In 2019, the National Taxpayer Advocate and her staff met with the General Counsel and his staff to discuss this issue. The National Taxpayer Advocate believes the conference report language stating that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate” provides a sufficient legal basis for her to hire attorneys that report to her. The General Counsel has disagreed, maintaining that a statutory change is required.

⁵ H.R. REP. NO. 105-599, at 216 (1998) (Conf. Rep.).

⁶ See Chief Counsel Directives Manual (CCDM) 35.4.1.4, Coordination with Other Counsel Offices (Feb. 7, 2013); CCDM 31.1.4.6, Reconciliation of Disputes (Aug. 11, 2004).

RECOMMENDATION

- Amend IRC § 7803(c)(2)(D) to expressly authorize the National Taxpayer Advocate to hire legal counsel that report directly to him or her.⁷

⁷ For more detail, see National Taxpayer Advocate 2016 Annual Report to Congress 37-39 (Special Focus: *Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues*) (recommending that Congress “[a]uthorize the National Taxpayer Advocate to appoint independent counsel who report directly to the National Taxpayer Advocate, provide independent legal advice, help prepare *amicus curiae* briefs and comments on proposed or temporary regulations, and assist the National Taxpayer Advocate in preparing the Annual Report to Congress and in advocating for taxpayers individually and systemically”); National Taxpayer Advocate 2011 Annual Report to Congress 573-581 (same); National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (same). The Taxpayer and Fairness Protection Act, H.R. 1661, 108th Cong. § 335 (2003), would have authorized the National Taxpayer Advocate to “appoint a counsel in the Office of the Taxpayer Advocate to report solely to the National Taxpayer Advocate.”

Legislative Recommendation #41**Clarify the Authority of the National Taxpayer Advocate to Make Personnel Decisions to Protect the Independence of the Office of the Taxpayer Advocate****PRESENT LAW**

The IRS Restructuring and Reform Act of 1998 (RRA 98) included provisions to protect TAS's independence from other IRS functions. For example, IRC § 7803(c)(4)(A)(iii) requires local TAS offices to notify taxpayers they “operate independently of any other Internal Revenue Service office and report directly to Congress through the National Taxpayer Advocate.” To bolster this independence, IRC § 7803(c)(2)(D) provides the National Taxpayer Advocate with the authority to “appoint” local taxpayer advocates in each state and to “evaluate and take personnel actions (including dismissal) with respect to any employee of any local office.”

The National Taxpayer Advocate's authority to make independent personnel decisions is discussed in the legislative history of RRA 98. The conference report states that the National Taxpayer Advocate “has the responsibility to evaluate and take personnel actions (including dismissal) with respect to *any local Taxpayer Advocate or any employee in the Office of the Taxpayer Advocate.*”¹ Thus, there is an inconsistency between the conference report and the statute. The conference report states the statute gives the National Taxpayer Advocate the authority to make independent personnel decisions regarding all TAS employees, while the statute confers that authority only regarding employees of TAS's local offices.

REASONS FOR CHANGE

IRC § 7803(c)(2)(A) assigns the National Taxpayer Advocate two principal responsibilities: (i) to advocate for taxpayers in specific cases (case advocacy) and (ii) to advocate for administrative and legislative changes to resolve problems that affect groups of taxpayers or all taxpayers (systemic advocacy). Although the conference report language indicates Congress intended to give the National Taxpayer Advocate independent personnel authority over employees engaged in both case advocacy and systemic advocacy functions, the statute as written only covers employees of local offices, who primarily are engaged in case advocacy. The National Taxpayer Advocate currently does not have independent personnel authority over TAS's senior leadership, TAS attorney-advisors, employees of TAS's systemic advocacy and research functions, and other national office employees, even though those employees are also charged with engaging in independent advocacy on behalf of taxpayers, have the same potential conflicts, and face the same potential retaliatory personnel actions by the IRS leadership that Congress sought to address in 1998.

The rationale for giving the National Taxpayer Advocate the authority to make independent personnel decisions for TAS's national office employees is, in key respects, even stronger than the rationale for giving her that authority for local office employees. National office employees primarily advocate for systemic change, which often places them in direct conflict with senior officials in other parts of the IRS. This concern is not merely theoretical. In recent years, peer executives at the IRS have reviewed and approved performance ratings for senior TAS leaders. This creates the potential for TAS leaders perceived as “team players” to receive better performance reviews and bonuses than TAS leaders who are perceived to be more aggressive in seeking changes in IRS policies or actions. For the same reasons that it would be inappropriate for IRS leaders to

1 H.R. REP. NO. 105-599, at 214 (1998) (Conf. Rep.) (emphasis added). The report states that the conference committee adopted the Senate amendment with respect to the National Taxpayer Advocate provisions, except as modified. H.R. REP. NO. 105-599, at 216 (1998) (Conf. Rep.). The Senate bill and report contained the same inconsistency as the conference bill and report. See H.R. 2676, 105th Cong. § 1102 (as passed by the U.S. Senate, May 7, 1998); S. REP. NO. 105-174, at 23 (1998).

evaluate and make salary and bonus determinations for employees of the Treasury Inspector General for Tax Administration, the IRS's ability to affect the salary or bonuses of TAS's national office employees has the potential to undermine TAS's independent advocacy.

Because of the inconsistency between the statutory language and the explanatory language in the conference report and in light of the strong rationale for providing the National Taxpayer Advocate with independent personnel authority over all TAS employees, TAS believes that the more limited statutory language probably reflected a drafting error and should be corrected.

RECOMMENDATION

- Amend IRC § 7803(c)(2)(D) to clarify that the National Taxpayer Advocate shall have the responsibility to evaluate and take personnel actions with respect to all employees of the Office of the Taxpayer Advocate.

Legislative Recommendation #42**Clarify the Taxpayer Advocate Service's Access to Files, Meetings, and Other Information****PRESENT LAW**

IRC § 7803(c)(2) requires TAS to assist taxpayers in resolving problems with the IRS, identify areas in which taxpayers are experiencing problems in their dealings with the IRS, make administrative and legislative recommendations to mitigate those problems, and annually report to Congress. IRC § 6103 generally prohibits the disclosure of tax returns or return information, but IRC § 6103(h) provides that “returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.”

Because TAS employees must review tax return information to fulfill their statutory duties, they are authorized by IRC § 6103(h) to do so. In furtherance of their duties, they may also need to attend meetings between taxpayers or their representatives and other IRS employees, and obtain other information from the IRS. Similarly, the National Taxpayer Advocate requires information to analyze systemic problems and provide Congress with a “full and substantive analysis” of such problems in her annual reports to Congress, as required by IRC § 7803(c)(2)(B). However, the law does not expressly state that the National Taxpayer Advocate is authorized to access return information, attend meetings with other IRS employees, or obtain other information from the IRS.

REASONS FOR CHANGE

In general, the National Taxpayer Advocate has significant access to IRS systems and data. However, the IRS has sometimes declined to provide TAS with access to (1) audit files of taxpayers with cases open in TAS; (2) meetings between the IRS and taxpayers with cases open in TAS, even when the taxpayer has requested TAS's attendance; (3) advice that Counsel has provided to other business units; and (4) information required by the National Taxpayer Advocate to enable her to analyze systemic problems for the Annual Report to Congress.

RECOMMENDATIONS

- Amend IRC § 7803(c) to clarify that the National Taxpayer Advocate (and authorized TAS employees) shall have access to tax returns, return information, and legal advice provided by Counsel to any IRS employee regarding cases open and pending in TAS, and may participate in meetings between taxpayers and the IRS when asked to do so by a taxpayer.
- Clarify that, in furtherance of her tax administrative duties, the National Taxpayer Advocate (and authorized TAS employees) shall have access to all data, statistical information, legal advice provided by Counsel to any IRS employee, and documents necessary to perform a “full and substantive analysis” of the issues, as required by IRC § 7803(c)(2)(B).¹

¹ For more detail, see National Taxpayer Advocate 2016 Annual Report to Congress 34-36 (Special Focus: *Reinforce the National Taxpayer Advocate's Right of Access to Taxpayer and IRS Information and to Meetings Between the IRS and Taxpayers*). Under the Taxpayer First Act of 2019, Pub. L. No. 116-25, § 1301(b), 133 Stat. 981 (2019), the Secretary is now required to provide the National Taxpayer Advocate with “statistical support” for the Annual Report to Congress. However, this requirement only encompasses statistical studies, compilations, and the review of information already obtained by TAS. It does not address TAS's broader need for access to information, including the right to review case files and attend taxpayer meetings. The Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 403 (2015), and S. 2333, 114th Cong. § 403 (2015), would have granted TAS access to case-related files and meetings, but it did not address TAS's need for access to information required to report on systemic issues.

Legislative Recommendation #43**Authorize the National Taxpayer Advocate to File *Amicus* Briefs****PRESENT LAW**

IRC § 7803(c)(2)(A) requires the Office of the Taxpayer Advocate to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers experience problems in their dealings with the IRS, and to make administrative and legislative recommendations to mitigate such problems. IRC § 7803(c)(2)(B)(ii)(XI) directs the National Taxpayer Advocate in her annual reports to Congress to “identify the 10 most litigated issues for each category of taxpayers, including recommendations for mitigating such disputes.”

Under 28 U.S.C. § 516, only officers of the Department of Justice may represent the United States in litigation, except as otherwise authorized by law. Similarly, 5 U.S.C. § 3106 provides that the head of an executive department may not employ an attorney or counsel for the conduct of litigation in which the United States is a party, except as otherwise authorized by law. IRC § 7452 specifies that the Secretary of the Treasury “shall be represented by the Chief Counsel” or his delegate in litigation before the U.S. Tax Court.

Under 5 U.S.C. § 612(b), the Small Business Administration (SBA) Chief Counsel for Advocacy is statutorily authorized to represent the interests of small businesses by appearing in litigated cases as an *amicus curiae*. By contrast, the National Taxpayer Advocate, who is often referred to as “the voice of the taxpayer” both within the IRS and before Congress, is not authorized to represent the interests of taxpayers by appearing in litigated cases as an *amicus curiae*.

REASONS FOR CHANGE

While the conduct of trials is best left to trial lawyers equipped to advocate zealously on behalf of clients to win individual cases, precedential issues that could affect all or many taxpayers sometimes come before the courts with no one representing the interests of taxpayers as a group.

For example, in *Facebook, Inc. v. IRS*, the U.S. District Court for the Northern District of California considered Facebook’s claim that it was legally entitled to a hearing before the IRS Office of Appeals.¹ For support, *Facebook* cited the provision of the Taxpayer Bill of Rights (TBOR) that describes “the right to appeal a decision of the Internal Revenue Service in an independent forum.” See IRC § 7803(a)(3)(E). The court rejected Facebook’s position, broadly holding that the TBOR “did not grant [taxpayers] new enforceable rights.” The court’s decision may well be correct, but in the rare cases where a court’s decision has the potential to affect the fundamental taxpayer rights of all or a large group of taxpayers, the court would benefit from hearing and considering the position of the National Taxpayer Advocate as the statutory voice of the taxpayer.

Just as the SBA Chief Counsel for Advocacy may file briefs to help ensure the federal courts are informed about the impact of regulations on small businesses, the National Taxpayer Advocate could be more effective in protecting taxpayer rights if she were granted comparable authority to file *amicus curiae* briefs in cases that affect taxpayer rights. It is anticipated this authority would be used sparingly, as is also the practice of the SBA Chief Counsel for Advocacy.

¹ *Facebook, Inc. & Subsidiaries v. IRS*, 2018-1 U.S.T.C. (CCH) ¶50,248 (N.D. Cal. May 14, 2018).

RECOMMENDATION

- Amend IRC §§ 7803 and 7452 to authorize the National Taxpayer Advocate to submit briefs in federal litigation as an *amicus curiae* on matters relating to the protection of taxpayer rights.²

2 For more detail, see National Taxpayer Advocate 2016 Annual Report to Congress 37-39 (Special Focus: *Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues*); National Taxpayer Advocate 2011 Annual Report to Congress 573-581 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*); and National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*). See also Program Manager Technical Advice 2007-00566 (Oct. 2, 2002), <https://www.irs.gov/privacy-disclosure/legal-advice-issued-to-program-managers-during-2007>.

Legislative Recommendation #44**Require the IRS to Address the National Taxpayer Advocate's Comments in Final Rules****PRESENT LAW**

IRC § 7805(f) requires the Secretary of the Treasury to submit certain proposed or temporary regulations to the Chief Counsel for Advocacy of the Small Business Administration (SBA) for comment regarding the impact such regulations may have on small businesses and to discuss any response to such comments in the preamble to the final regulations. Yet despite the fact that the National Taxpayer Advocate is required by IRC § 7803(c)(2)(A) to assist taxpayers in resolving problems with the IRS and to identify administrative and legislative solutions, there is no comparable provision that requires the Secretary to seek comments from the National Taxpayer Advocate on proposed or temporary regulations or to discuss any response to such comments in the preamble to the final regulations.

REASONS FOR CHANGE

The requirement that the Secretary solicit and respond to comments from the SBA Chief Counsel for Advocacy benefits tax administration because it forces the agency to consider and respond to concerns about the impact of regulations on small businesses. Similarly, tax administration would benefit if the Secretary were required to consider and respond to the National Taxpayer Advocate's concerns about the impact of regulations on taxpayer rights and taxpayer burden.

The National Taxpayer Advocate currently provides comments to the IRS on an informal basis before proposed, temporary, and final regulations are made public and should continue to do so. But when the National Taxpayer Advocate believes a proposed or temporary regulation that has been publicly issued will have a significant adverse impact on taxpayers, the National Taxpayer Advocate should have the authority to submit formal comments to which the Treasury Department and the IRS must respond in the preamble to the final regulation. When the Treasury Department and the IRS decline to adopt the National Taxpayer Advocate's recommendations, the taxpaying public would benefit from knowing why. Such a procedure would strike an appropriate balance between allowing the National Taxpayer Advocate to provide informal comments within the agency and allowing her to raise concerns and compel an agency explanation where significant disagreements cannot be reconciled internally.

RECOMMENDATION

- Amend IRC § 7805 to require the Secretary to submit proposed or temporary regulations to the National Taxpayer Advocate for comment within a reasonable time and to address any comments formally submitted by the National Taxpayer Advocate in the preamble to final agency rules.¹

¹ For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act 2015, S. 1578, 114th Cong. § 404 (2015) (except, as a timing matter, this bill would require the IRS to solicit comments from the National Taxpayer Advocate before publication of proposed or temporary regulations rather than after publication of such regulations, as the statute currently requires for SBA comments). For more detail, see National Taxpayer Advocate 2016 Annual Report to Congress 37-39 (Special Focus: *Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues*); National Taxpayer Advocate 2011 Annual Report to Congress 573-581 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*); and National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

Legislative Recommendation #45**Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations****PRESENT LAW**

Article I of the Constitution provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.”¹ The Antideficiency Act is one of several statutes that implement this provision.² Specifically, 31 U.S.C. § 1341(a), among other things, prohibits any officer or employee of the United States government or the District of Columbia government from (i) making or authorizing an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation or (ii) involving his or her respective government employer in a contract or obligation for the payment of money before an appropriation is made, unless authorized by law. The Antideficiency Act contains an additional prohibition on the acceptance of voluntary services in 31 U.S.C. § 1342, except “for emergencies involving the safety of human life or the protection of property.”

IRC § 6343(a)(1)(D) requires the Secretary to release a levy and promptly notify the affected person when the Secretary has determined the levy “is creating an economic hardship due to the financial condition of the taxpayer.”

IRC § 7803(c)(2)(A) directs the Office of the Taxpayer Advocate to “assist taxpayers in resolving problems with the Internal Revenue Service,” among other things. IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) where a “taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.” A significant hardship includes “an immediate threat of adverse action” and “irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted.” A TAO may require the Secretary “within a specified time period ... to release property of the taxpayer levied upon.”

REASONS FOR CHANGE

Lien and levy activities carried out by automation, which do not require the expenditure of additional appropriations, are permitted to continue during a lapse in appropriations. During both the 2018-2019 and 2013 shutdowns, the IRS issued thousands of notices of levy on financial accounts of individuals and businesses, on wages, and on Social Security and other government benefits because these notices were pre-programmed into the IRS’s computer systems before the shutdowns began.

Applicable IRC provisions include:

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

¹ U.S. CONST. art. I, § 9, cl. 7.

² Pub. L. No. 97-258, 96 Stat. 877, 923 (1982).

Despite these provisions, the IRS has not allowed IRS or TAS employees, including the National Taxpayer Advocate, to work these cases during a shutdown.³ When these activities are not recognized as exceptions to the Anti-Deficiency Act, taxpayers facing economic hardships are unable to obtain assistance from TAS to request or obtain releases of these levies.⁴ Additionally, when cases that were in TAS's inventory at the time of the shutdown cannot be worked, some taxpayers who requested the assistance of the National Taxpayer Advocate and TAS immediately prior to the shutdown will experience significant hardships and irreparable injuries.

RECOMMENDATION

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

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

4 For additional discussion of how TAS's statutory authority to assist taxpayers suffering or about to suffer significant hardships was undermined during a shutdown, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 79-91 (Area of Focus: *The IRS's Decision Not to Except Any TAS Employees During the Government Shutdown Resulted in Violations of Taxpayer Rights and Undermined TAS's Statutory Authority to Assist Taxpayers Suffering or About to Suffer Significant Hardship*) and National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress 40-44 (*Impact of the 35-Day Partial Government Shutdown on the Taxpayer Advocate Service*).

Legislative Recommendation #46**Repeal Statute Suspension Under IRC § 7811(d) for Taxpayers Seeking Assistance From the Taxpayer Advocate Service****PRESENT LAW**

IRC § 7811(d) suspends the statutory period of limitations for any action with respect to which a taxpayer is seeking assistance from TAS. The period is only suspended, however, if the taxpayer submits a written application for relief.¹

REASONS FOR CHANGE

Despite the fact that Congress enacted this provision in 1988,² the IRS has never implemented it. The intent of the provision was to protect the interests of the government, but the IRS has not seen a need to make use of it. Relatedly, implementation of the rule would require significant technology upgrades and procedural changes that the IRS has chosen not to undertake.

In concept, IRC § 7811(d) aims to ensure that the IRS will not lose the ability to assess or collect tax if the applicable statutory deadlines pass while a taxpayer's case is pending with TAS. Suspension of the assessment or collection period would give the IRS more time to take enforcement actions.

However, statute suspensions are unnecessary to protect the government's interests. If the end of a limitations period is near, the IRS routinely asks the taxpayer to agree to an extension, even if TAS is involved. The IRS also may take enforcement actions against taxpayers with open TAS cases, if necessary, to protect the government's interests.³

Moreover, if IRC § 7811(d) were ever to be implemented, it would cause similarly situated taxpayers to be treated differently. By its terms, the provision only applies when a taxpayer submits a written request for TAS assistance. It does not apply when a taxpayer requests TAS assistance by phone, which is the method by which most taxpayers seek TAS's help. Thus, this provision – apart from being unnecessary and unutilized – would produce disparate outcomes for taxpayers who, despite lacking any knowledge of this issue, contact TAS by different means.

Lastly, despite the IRS's decision not to implement the provision, it has been raised in litigation.⁴ Because this provision has not been utilized since it was enacted more than 30 years ago, because it serves no useful purpose, and to avoid future litigation in which this provision is cited, the National Taxpayer Advocate recommends that it be repealed.

1 Treas. Reg. § 301.7811-1(e)(4).

2 Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6230, 102 Stat. 3342, 3734 (1988).

3 Even if TAS issues a Taxpayer Assistance Order (TAO) directing the IRS to suspend collection, TAS will generally agree to modify the TAO if collection is in jeopardy. And if TAS ever did not agree to do so, the Commissioner or Deputy Commissioner could modify or rescind the TAO.

4 In *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015), *rev'd* 2014 WL 4986884 (M.D. La. Sept. 15, 2014), the United States Court of Appeals for the Fifth Circuit held, in relevant part, that IRC § 7811(d) tolled the period for filing a wrongful levy claim, which by operation of IRC § 6532(c)(2) extended the period for filing suit. IRS Action on Decision (AOD) 2020-03 (Apr. 24, 2020) explains that except for cases appealable to the Fifth Circuit, the IRS will not follow the holding in *Rothkamm* that IRC § 7811(d) suspends the running of the limitations periods for third parties to file wrongful levy claims or suits, and outside the Fifth Circuit, the government will continue to defend its interpretation.

RECOMMENDATION

- Repeal IRC § 7811(d).⁵

⁵ For legislative language generally consistent with this recommendation, see John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 202 (2021); Taxpayer Protection Act, H.R. 2171, 115th Cong. § 202 (2017); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 202 (2016). For more detail, see National Taxpayer Advocate 2015 Annual Report to Congress 316-328 (Legislative Recommendation: *Repeal or Fix Statute Suspension Under IRC § 7811(d)*).

STRENGTHEN TAXPAYER RIGHTS IN JUDICIAL PROCEEDINGS

Legislative Recommendation #47

Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties

PRESENT LAW

IRC § 7442 defines the jurisdiction of the U.S. Tax Court. IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days if the notice is addressed to a person outside the U.S.) to review the IRS determination.

If a taxpayer does not receive a notice of deficiency and seeks judicial review of an adverse IRS determination, the taxpayer must file suit in a U.S. district court or the U.S. Court of Federal Claims. This situation generally arises when the taxpayer is claiming a refund of tax that has been paid. Taxpayers solely seeking refunds cannot litigate their cases in the Tax Court.

REASONS FOR CHANGE

Due to the tax expertise of its judges, the Tax Court is often better equipped to consider tax controversies than other courts. It is also more accessible to less knowledgeable and unrepresented taxpayers than other courts because it uses informal procedures, particularly in disputes that do not exceed \$50,000. Another benefit is that taxpayers are generally offered the option of receiving free legal assistance from a Low Income Taxpayer Clinic or *pro bono* representative. In most instances, the Tax Court is the least expensive and best forum for low-income taxpayers to get their day in court.

Under current law, taxpayers who owe tax, receive a notice of deficiency, and wish to litigate a dispute with the IRS can file a petition in the Tax Court, while taxpayers who have paid their tax and are seeking a refund must sue for a refund in a U.S. district court or the U.S. Court of Federal Claims for a judicial determination. The National Taxpayer Advocate recommends that all taxpayers be given the option to litigate their tax disputes in the Tax Court without regard to the payment or nonpayment of the underlying tax.

Two examples will illustrate the benefits of this approach:

- Assume a taxpayer files a return that reflects additional tax due of \$3,000, but the taxpayer cannot afford to make payment. Shortly after filing his original return, his preparer discovers an error, and the preparer files an amended return for the taxpayer showing a tax liability of \$4,000 less (*i.e.*, eliminating the \$3,000 liability and generating a refund of \$1,000 of withholding taxes paid). The IRS denies the claim. Under current law, the taxpayer could not go to Tax Court because there is no deficiency. To litigate his refund claim, the taxpayer would have to pay the \$3,000 liability to get into a U.S. district court or the U.S. Court of Federal Claims to pursue his \$4,000 refund claim. This taxpayer would be unlikely to file suit because of the greater cost and need to retain an attorney to litigate in the refund courts.
- Assume the IRS imposes assessable penalties of \$20,000. Because no notice of deficiency has been issued, this case, too, could not be brought in the Tax Court under existing law. Again, the taxpayer would have to pay the higher court fees and would probably have to retain an attorney to dispute the assessment. If the taxpayer could bring her case in the Tax Court, a judge with tax expertise would hear the case and the Tax Court's simplified procedures might allow the taxpayer to represent herself. This

may make the difference between the taxpayer having her day in court or agreeing to an assessment simply because the costs of contesting it are too great.

By expanding the Tax Court's jurisdiction, Congress can give all taxpayers a realistic opportunity to obtain judicial review of adverse IRS liability determinations, without regard to their ability to pay.

RECOMMENDATION

- Amend IRC §§ 7442 and 7422 to give the Tax Court jurisdiction to determine liabilities in refund suits to the same extent as the U.S. district courts and the U.S. Court of Federal Claims, without regard to how much of the liability has been paid.¹

¹ For more detail, see Legislative Recommendation: *Repeal Flora and Expand the Tax Court's Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can, infra*.

Legislative Recommendation #48**Repeal *Flora*: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can****PRESENT LAW**

IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days if the notice is addressed to a person outside the United States) to review the IRS determination.

If a taxpayer does not receive a notice of deficiency or lets the period for filing a petition with the U.S. Tax Court lapse, the taxpayer must file suit in a U.S. district court or the U.S. Court of Federal Claims to obtain judicial review of an adverse IRS determination. This generally occurs when the taxpayer is claiming a refund of tax that has been paid. It may also occur when the IRS has imposed certain “assessable penalties” (*e.g.*, penalties codified in IRC §§ 6671-6725), without first issuing a notice of deficiency. In these circumstances, the taxpayer generally must pay the full amount of the tax due, or any penalty assessed, prior to seeking judicial review via a refund suit.

Before filing a refund suit, a taxpayer must make a timely administrative claim for refund.¹ The IRC generally requires that an administrative claim be filed by the later of (i) three years from the date the original return was filed or (ii) two years from the date the tax was paid.² If the claim is filed within the three-year period, then the taxpayer can only recover amounts paid during the three-year period (plus any extension of time to file) preceding the date of the claim.³ Otherwise, the taxpayer can only recover amounts paid within the two-year period preceding the date of the claim.⁴ If the IRS issues a notice of claim disallowance, a taxpayer generally has two years from the date of the notice within which to file suit; the two-year period can be extended upon written agreement between the taxpayer and the IRS.⁵ If the IRS does not issue a notice of claim disallowance, the taxpayer may file suit beginning six months after filing a refund claim.⁶

A taxpayer may sue in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) to recover “any internal-revenue tax” that the taxpayer believes has been “erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.” In *Flora v. United States*, 362 U.S. 145 (1960), however, the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before suing in these courts.

IRC § 7421 (the Anti-Injunction Act) prohibits any suit by any person for the purpose of restraining the assessment or collection of any tax except as provided in IRC §§ 6015(e), 6212(a) and (c), 6213(a), 6232(c), 6330(e)(1), 6331(i), 6672(c), 6694(c), 7426(a) and (b)(1), 7429(b), and 7436. In addition, 28 U.S.C. § 2201 (also known as the “tax exception” to the Declaratory Judgment Act) states in relevant part that federal courts may not issue declaratory judgments “with respect to Federal taxes” other than in actions brought under IRC § 7428 relating to status and classification of certain organizations (such as under section 501(c)(3)).

¹ IRC § 7422(a).

² IRC § 6511(a).

³ IRC § 6511(b)(2)(A).

⁴ IRC § 6511(b)(2)(B).

⁵ IRC § 6532(a)(1) & (2).

⁶ IRC § 6532(a)(1).

REASONS FOR CHANGE

Consistent with the taxpayer's *right to appeal an IRS decision in an independent forum*, all taxpayers should generally have an opportunity to take their cases to court.⁷ Taxpayers who cannot afford to pay what the IRS says they owe should have the same opportunities to choose a judicial forum as wealthier taxpayers who can afford to pay.

Under current law, wealthy individuals and corporations typically may choose between paying the tax and litigating their cases in a U.S. district court or the Court of Federal Claims or not paying the tax and litigating in the Tax Court. They may select the court with the precedents and procedures most favorable to their position from among these three options. Taxpayers who cannot afford to pay the tax only have one option – the Tax Court. While the Tax Court is often the easiest court for taxpayers to navigate, there is no reason some taxpayers should have more options than others.

U.S. Tax Court Judge Howard Dawson once observed:

It is unfortunate and unfair that a taxpayer's financial condition is an important aspect of forum selection. It is obviously inequitable to have a procedure where the doors of certain courts are open to those with the financial resources to pay their putative tax liability in advance and closed to those who cannot raise the money required. This is an aberration in the system that is indefensible. It clearly favors rich individuals and wealthy corporations over low- and middle-income persons and small corporations. I am too much of a populist to believe that this is good for the tax litigation system. Why should a select group of taxpayers be able to utilize differences in court procedures to gain a significant advantage? Why should some taxpayers be able to select a forum where the trend of prior decisions seems more conducive to success while others for financial reason do not have that choice?⁸

As eloquently stated by Judge Dawson, we should not have a system that provides more benefits for the wealthy – access to more federal courts – than those less fortunate. Allowing all taxpayers to file suit in the judicial forum of their choice would be fairer to all taxpayers.

Under existing rules, the inability to litigate in the Tax Court can create extreme burdens. If the IRS imposes an “assessable penalty,” no notice of deficiency is issued, so the Tax Court is not authorized to hear a dispute. Therefore, a taxpayer may obtain judicial review only if he or she is wealthy enough to full pay the penalty and then sue for a refund.⁹ In addition, even taxpayers who fully pay may lose the opportunity to recover a portion of their payments if they pay in installments. For example, if a taxpayer does not file a refund claim within three years from the date the original return was filed, the taxpayer can only recover amounts paid within two years before the date of the claim. In this situation, a taxpayer who is not affluent enough to pay his or her alleged debt within two years will lose the right to request a refund of the early payments, even if he or she eventually pays in full and the court agrees with him or her on the merits of the refund claim.

Although the Supreme Court once feared that giving the relatively few wealthy persons subject to tax the option to litigate rather than pay could threaten the solvency of the government, the U.S. tax base is much broader today, and as a result, whether judicial review occurs before or after payment in individual cases is not significant from a budgetary standpoint. The National Taxpayer Advocate recommends that Congress provide all taxpayers with an equal opportunity to choose the judicial forum in which to challenge an adverse IRS

⁷ IRS, Taxpayer Bill of Rights, <https://www.irs.gov/taxpayer-bill-of-rights>.

⁸ Howard Dawson, *Should the Federal Tax Litigation System Be Restructured?*, 40 TAX NOTES 1427 (2000).

⁹ For a legislative recommendation to require the IRS to follow deficiency procedures before assessing certain penalties, see Legislative Recommendation: Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures, *supra*.

determination without regard to their ability to pay. This recommendation aims to provide all taxpayers with an opportunity to choose between paying the tax and litigating their cases in a U.S. district court or the Court of Federal Claims and not paying the tax and litigating in the Tax Court. Removing the full payment rule would allow all taxpayers to file refund suits and have an opportunity to have their issues heard, regardless of whether they have the money to pay the liability.

RECOMMENDATION¹⁰

- Amend 28 U.S.C. § 1346(a)(1) to clarify that a person is not required to fully pay before filing suit in a U.S. district court or the U.S. Court of Federal Claims (*i.e.*, repeal the *Flora* Court's full payment rule), notwithstanding any provisions of IRC § 7421(a) and 28 U.S.C. § 2201(a) to the contrary.¹¹

¹⁰ For more detail, see National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 94-97 (*Repeal Flora and Expand the Tax Court's Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*); National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 82-84 (*Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*); National Taxpayer Advocate 2018 Annual Report to Congress 364-386 (Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

¹¹ The doctrines of *res judicata* and collateral estoppel should help ensure the IRS does not re-litigate the same issues with respect to unpaid liabilities. See, e.g., Chief Counsel Directives Manual 34.5.1.1.2.2.4 (Aug. 11, 2004).

Legislative Recommendation #49**Authorize the Tax Court to Order Refunds or Credits in Collection Due Process Proceedings Where Liability Is at Issue****PRESENT LAW**

IRC § 6512(b) grants the Tax Court jurisdiction in deficiency suits to determine that a taxpayer made an overpayment of income tax for the period at issue and that such amount must be refunded or credited to the taxpayer.¹ IRC § 6511(a) generally requires a taxpayer to file a claim for credit or refund by the later of three years from the time a return was filed or, if no return was filed, two years from the time the tax was paid.

IRC § 6330 allows a taxpayer in certain instances to challenge the underlying liability in a Collection Due Process (CDP) proceeding. Unlike in deficiency cases, however, IRC § 6330 does not grant the Tax Court jurisdiction to determine the extent to which a taxpayer has made an overpayment and is entitled to a refund or credit.² For a taxpayer in a CDP proceeding to receive a refund, the taxpayer must fully pay the assessed tax for the taxable year(s) at issue, file a timely administrative refund claim with the IRS under IRC § 6511 and, if the claim is denied, timely file a refund suit in a U.S. district court or the U.S. Court of Federal Claims.

REASONS FOR CHANGE

The limitation on the Tax Court's jurisdiction to determine an overpayment and order a refund in CDP cases prevents taxpayers from obtaining resolution of their tax disputes in a single forum and imposes unnecessary financial and administrative burdens on taxpayers and the court system.

The Tax Court, unlike other federal courts, is a pre-payment forum that ordinarily allows taxpayers to dispute their liabilities without having to first pay them in full. In a CDP proceeding, only taxpayers who did not otherwise have an opportunity to dispute their underlying liabilities are permitted to contest them.

CDP taxpayers who may challenge the existence or amount of an underlying tax liability pursuant to IRC § 6330(c)(2)(B) should, similar to taxpayers in deficiency proceedings, have the opportunity to obtain a refund in a pre-payment forum, rather than be required to full-pay the asserted liability and then incur additional time and expense to dispute the liability in another forum. Amending IRC § 6330 to explicitly grant the Tax Court the authority to determine overpayments and order refunds in CDP cases will protect taxpayers' right to finality, reduce taxpayer burden, and better ensure the IRS collects the correct amount of tax. Furthermore, the Tax Court could apply to CDP proceedings its long-established procedures for determining an overpayment in deficiency cases.

RECOMMENDATION

- Amend IRC § 6330(d)(1) to grant the Tax Court jurisdiction to determine overpayments for the tax periods at issue and to order refunds or credits, subject to the limitations of IRC §§ 6511(a) and

¹ IRC § 6401 provides that the term "overpayment" includes "that part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto." The Supreme Court has stated that an overpayment occurs "when a taxpayer pays more than is owed, for whatever reason or no reason at all." *United States v. Dalm*, 494 U.S. 596, 609 n.6 (1990). See also *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947).

² See *Greene-Thapedi v. Comm'r*, 126 T.C. 1 (2006); *Willson v. Comm'r*, 805 F.3d 316 (D.C. Cir. 2015); *McLane v. Comm'r*, T.C. Memo. 2018-149.

6512(b)(3), if the court determines the taxpayer's underlying tax liability for a taxable year is less than the amounts paid or credited for that year.³

3 Under this proposal, refund claims in CDP cases would continue to be subject to the limitations of IRC §§ 6511(a) and 6512(b)(3). If the claim was filed by the taxpayer within three years from the time a return was filed, the refund would be limited to the amount paid in the three-year period (plus extensions) before the notice of deficiency was mailed and the amount paid after the notice of deficiency was mailed.

Legislative Recommendation #50**Provide That the Time Limits for Bringing Tax Litigation Are Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling****PRESENT LAW**

Various provisions in the IRC authorize proceedings or suits against the government, provided such actions are brought timely. These actions are generally brought in the U.S. Tax Court, a U.S. district court, or the U.S. Court of Federal Claims.¹

Equitable doctrines that, if available, might excuse an untimely filing include equitable tolling (applicable when it is unfair to hold a plaintiff to a statutory deadline because of an extraordinary event that impeded the plaintiff's compliance); equitable estoppel (applicable when it is unfair to allow the defendant to benefit from the statutory deadline because of something the defendant did to prevent a timely suit); forfeiture (applicable when the parties have acted as if the case need not operate under the statutory deadlines); and waiver (applicable when the parties have agreed explicitly that a case need not operate under legal deadlines).

U.S. Tax Court

For some controversies, the U.S. Tax Court is the only judicial forum in which taxpayers, by filing a petition within a specified period, may litigate their tax liabilities without first paying the tax. Examples include deficiency proceedings, collection due process (CDP) proceedings, and “stand-alone” innocent spouse cases (*i.e.*, where innocent spouse relief is sought other than in response to a notice of deficiency or as part of a CDP proceeding).

Other types of cases brought in the Tax Court include interest abatement cases, worker classification cases, and whistleblower claims.

IRC § 7442, which describes the jurisdiction of the Tax Court, does not specify that prescribed periods for petitioning the Tax Court are not subject to equitable doctrines. Absent a timely filed petition, however, the Tax Court has held it does not have jurisdiction to redetermine deficiencies, hear appeals from IRS CDP proceedings, consider stand-alone innocent spouse claims, or decide whistleblower claims.

Regarding deficiency cases and stand-alone innocent spouse cases, several U.S. Courts of Appeals have agreed with the Tax Court that the time limits for filing a Tax Court petition are jurisdictional requirements that cannot be modified by applying equitable doctrines. In addition, two appellate courts agreed with the Tax Court that the deadline for filing a petition in a CDP case is not subject to equitable tolling.² The U.S. Supreme Court has agreed to review one of these cases.³ Additionally, a different appellate court, interpreting language in IRC § 7432 (the whistleblower statute) that is “nearly identical in structure” to the language

1 Some tax claims may also be heard by U.S. bankruptcy courts. For a fuller discussion of this recommendation, see National Taxpayer Advocate 2017 Annual Report to Congress 283-292 (Legislative Recommendation: *Equitable Doctrines: Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency Is Not a Decision on the Merits of a Case*).

2 *Boechler v. Comm'r*, 967 F.3d 760, 765 (8th Cir. 2020), cert. granted, 2021 WL 4464219 (Sept. 30, 2021) (No. 20-1472); *Duggan v. Comm'r*, 879 F.3d 1029, 1034 (9th Cir. 2018).

3 *Boechler v. Comm'r*, 967 F.3d 760, 765 (8th Cir. 2020), cert. granted, 2021 WL 4464219 (Sept. 30, 2021) (No. 20-1472).

in IRC § 6330 (the CDP statute), reversed a Tax Court dismissal and held that the filing deadline for whistleblower cases is not jurisdictional and is subject to equitable tolling.⁴

Other Federal Courts

Sometimes taxpayers may obtain judicial review in federal courts other than the Tax Court if they sue within a specified period. For example, a refund suit can generally be brought in the U.S. district courts or in the U.S. Court of Federal Claims within two years from the date the IRS denies a claim. There is a split among the circuits regarding whether the statutory period for seeking refunds is subject to equitable doctrines.⁵

Similarly, taxpayers may sue in a U.S. district court to enjoin enforcement of a wrongful levy or sale or to recover property (or proceeds from the sale of property) if they do so within a specified period (generally, within two years of levy). Several federal courts have held that the period is not subject to equitable tolling,⁶ but at least one appellate court has held that it is.⁷

Taxpayers may also bring suit, if they do so within the specified periods, to seek civil damages in a U.S. district court or bankruptcy court regarding unauthorized actions by the IRS. Courts have differed on whether equitable doctrines can toll the period for bringing suit.⁸

REASONS FOR CHANGE

The sanction for failing to commence suit in the Tax Court or another federal court within the time limits prescribed by the IRC is severe: Taxpayers lose their day in court.

Treating the IRC time limits for bringing suit as jurisdictional – which means that taxpayers who file suit even seconds late are barred from court regardless of the cause – can lead to harsh and unfair results. For example, the IRS itself occasionally provides inaccurate information to taxpayers regarding the filing deadline, and even in that circumstance, the court has declined to hear the taxpayer's case.⁹ Other extenuating circumstances may include a medical emergency (*e.g.*, a heart attack or other medical condition that requires a taxpayer to be hospitalized or causes him or her to be in a coma).¹⁰ Moreover, most Tax Court petitioners do not have representation, and unrepresented taxpayers are less likely to recognize the severe consequences of filing a late Tax Court petition.

4 *Myers v. Comm'r*, 928 F.3d 1025, 1036 (D.C. Cir. 2019), *reh'g en banc denied*, No. 18-1003 (D.C. Cir. Oct. 4, 2019).

5 *Compare RHI Holdings, Inc. v. United States*, 142 F.3d 1459, 1460-1463 (Fed. Cir. 1998) (declining to apply equitable principles to IRC § 6352), with *Wagner v. United States*, 2018-2 U.S.T.C. (CCH) 50,496 (E.D. Wash. 2018) (concluding the time limits set forth in IRC § 6532 are not jurisdictional and, moreover, that plaintiff's petition was timely filed), and *Howard Bank v. United States*, 759 F. Supp. 1073, 1080 (D. Vt. 1991), *aff'd*, 948 F.2d 1275 (2d Cir. 1991) (applying equitable principles to IRC § 6352 and estopping the IRS from raising the limitations period as a bar to suit).

6 *See Becton Dickinson and Co. v. Wolckenhauer*, 215 F.3d 340, 351-354 (3d Cir. 2000) and cases cited therein (holding that the IRC § 6532(c) period is not subject to equitable tolling).

7 *See, e.g., Volpicelli v. United States*, 777 F.3d 1042, 1047 (9th Cir. 2015) (holding that the IRC § 6532(c) period is subject to equitable tolling); *Supermail Cargo, Inc. v. United States*, 68 F.3d 1204 (9th Cir. 1995) (same).

8 *Compare Aloe Vera of America, Inc. v. United States*, 580 F.3d 867, 871-872 (9th Cir. 2009) (time for bringing suit under IRC § 7431 is not subject to equitable tolling) with *United States v. Marsh*, 89 F. Supp. 2d 1171, 1177 (D. Haw. 2000) (doctrine of equitable tolling is an extraordinary remedy that did not apply in an IRC § 7433 action), *Ramos v. United States*, 2002-2 U.S.T.C. (CCH) ¶50,767 (N.D. Cal. 2002) (denying motion to dismiss because doctrine of equitable tolling might apply to an IRC § 7433 action), and *Bennett v. United States*, 366 F. Supp. 2d 877, 879 (D. Neb. 2005) (application of equitable tolling to IRC §§ 7432 and 7433 actions has not been definitively determined, but it is an extraordinary remedy and did not apply in this case).

9 *See, e.g., Naufflett v. Comm'r*, 892 F.3d 649, 652-654 (4th Cir. 2018) (doctrine of equitable tolling did not apply to innocent spouse case despite reliance on erroneous IRS advice regarding the filing deadline); *Rubel v. Comm'r*, 856 F.3d 301, 306 (3d Cir. 2017) (same).

10 In the context of refunds, the tax code essentially incorporates the doctrine of equitable estoppel. Under IRC § 6511(h), a taxpayer in a coma would likely be able to show that he or she was "financially disabled" and, in that case, would be allowed to request a refund even if the deadline for doing so otherwise would have expired. We see no reason why court filing deadlines should provide less flexibility.

The *right to a fair and just tax system*¹¹ requires that equitable doctrines be available to excuse a late filing in extenuating circumstances. Taxpayers would still be required to demonstrate that an equitable doctrine applies, and courts could apply the doctrines narrowly. But the National Taxpayer Advocate believes courts should have the flexibility to make those judgments.

RECOMMENDATION

- Enact a new section of the IRC, or amend IRC § 7442, to provide that the periods in the IRC within which taxpayers may petition the Tax Court or file suit in other federal courts are not jurisdictional and are subject to the judicial doctrines of forfeiture, waiver, estoppel, and equitable tolling.¹²

¹¹ See IRC § 7803(a)(3)(J) (identifying the “right to a fair and just tax system” as a taxpayer right).

¹² If this change to the IRC were enacted, late-filed claims would no longer be dismissed for lack of jurisdiction, which would mean the taxpayer would have no right to pursue a refund suit. As a result, we are also recommending that IRC § 7459(d) be amended to make clear that a dismissal based on timeliness is not a decision on the merits.

Legislative Recommendation #51**Amend IRC § 7456(a) to Expand the Authority of the Tax Court to Issue Subpoenas for the Production of Records Held by a Third Party Prior to a Scheduled Hearing****PRESENT LAW**

IRC § 7456(a) authorizes the Tax Court to issue subpoenas for the “production of all necessary returns, books, papers, documents, correspondence, and other evidence, from any place in the United States at any designated place of hearing...” The Tax Court interprets IRC § 7456(a) as permitting it to issue subpoenas for the production of documents by a third party at trial sessions, at depositions, and at pre-trial conferences.¹ Outside of these designated hearings, the Tax Court does not believe it has the authority to issue a subpoena directing a third party to produce records in advance of a trial session to facilitate pre-trial discovery.

REASONS FOR CHANGE

Efficient pre-trial discovery is an important means of limiting litigation and promoting settlement between the parties. Rule 45 of the Federal Rules of Civil Procedure (FRCP) allows for the use of subpoenas to secure pre-trial discovery of documents, including third-party documents to be produced prior to the scheduling of any hearing or deposition. The Tax Court, however, is governed by Tax Court Rules rather than the FRCP. Unlike FRCP Rule 45, the analogous Tax Court rule (Tax Court Rule 147) does not provide for the use of subpoenas to enforce delivery of documents prior to a hearing, such as a deposition or a trial.

The Tax Court’s authority was addressed in *Johnson v. Commissioner*.² In that case, the IRS issued a third-party subpoena to Bank of America for the production of documents. The taxpayer assented to the subpoena. Likewise, Bank of America expressed a willingness to comply, but not before the date specified in a properly authorized subpoena.

The IRS filed a motion asking the Tax Court to permit it to issue a subpoena directing Bank of America to produce the requested documents “prior to” the date of the scheduled trial session. The motion stated that obtaining the documents in advance of the scheduled trial might obviate the need for Bank of America to appear at the trial and facilitate settlement discussions with the taxpayer that might eliminate the need for a trial. The Tax Court stated that the IRS’s position was “not unreasonable” and that production of the documents might benefit all parties. Nevertheless, it concluded that it lacked the authority to issue such a subpoena. Under IRC § 7456(a), the Tax Court concluded it could only authorize a third-party subpoena for the production of documents on the hearing date.

Recognizing the potential benefits arising from earlier document delivery, the Tax Court’s order discussed several workarounds the litigants could employ to secure the documents before trial. The National Taxpayer Advocate believes this should not be necessary. There is no good reason the authority of the Tax Court should be more limited than the authority of other federal courts to issue subpoenas that would allow the parties to engage in pre-trial discovery to resolve or narrow issues without the need for judicial involvement.

¹ *Johnson v. Comm’r*, Docket No. 17324-18 (Dec. 26, 2019).

² *Id.*

RECOMMENDATION

- Amend IRC § 7456(a) to expand the authority of the Tax Court to issue subpoenas directing the production of records held by a third party prior to a scheduled hearing.³

3 A similar recommendation was proposed in the Procedurally Taxing blog in January 2020. See William Schmidt, *Serving Subpoenas: Designated Orders 12/23/19 to 12/27/19*, PROCEDURALLY TAXING, <https://procedurallytaxing.com/serving-subpoenas-designated-orders-12-23-19-to-12-27-19/> (Jan. 29, 2020).

Legislative Recommendation #52**Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is *De Novo*****PRESENT LAW**

Taxpayers who file joint federal income tax returns are jointly and severally liable for any deficiency or tax due in connection with their joint returns. IRC § 6015, sometimes referred to as the “innocent spouse” rules, provides relief from joint and several liability under certain circumstances. If “traditional” relief from a deficiency is unavailable under subsection (b) and “separation of liability” from a deficiency is unavailable under subsection (c), a taxpayer may qualify for “equitable” relief from deficiencies and underpayments under subsection (f). Relief under IRC § 6015(f) is appropriate when, considering all the facts and circumstances of a case, it would be inequitable to hold a joint filer liable for the unpaid tax or deficiency. If the IRS denies relief under any subsection of IRC § 6015 or a request for relief has gone unanswered for six months, the taxpayer may petition the Tax Court.

In 2008, the Tax Court held that the scope of its review in IRC § 6015(f) cases, like its review in IRC § 6015(b) and (c) cases, is *de novo*, meaning it may consider evidence introduced at trial that was not included in the administrative record.¹ In 2009, the Tax Court held that the standard of review in IRC § 6015(f) cases is also *de novo*, meaning that the Tax Court will consider the case anew, without deference to the IRS’s determination.²

In 2009, the IRS Office of Chief Counsel (Chief Counsel) issued guidance to its attorneys instructing them to argue, contrary to the Tax Court’s holdings, that review in all IRC § 6015(f) cases is limited to issues and evidence presented before the IRS Appeals or Examination functions and that the proper standard of review is abuse of discretion.³ In 2011, the National Taxpayer Advocate recommended that Congress amend IRC § 6015 to reflect the Tax Court’s holdings and reject the IRS’s position.

In June 2013, following an appellate court decision affirming the Tax Court’s holdings, Chief Counsel issued guidance instructing its attorneys to cease arguing that the scope and standard of review in IRC § 6015(f) cases are not *de novo*.⁴ In June 2013, Chief Counsel also issued an Action on Decision stating that although the IRS disagrees that section 6015(e)(1) provides for both a *de novo* standard of review and a *de novo* scope of review, the IRS would no longer argue that the Tax Court should limit its review to the administrative record or review section 6015(f) claims solely for an abuse of discretion.⁵

In 2019, Congress added paragraph (7) to IRC § 6015(e). It provides that “any review of a determination made under this section is *de novo* by the Tax Court.”⁶ However, this *de novo* review is limited to consideration of “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.” The provision does not define the terms “newly discovered” or “previously unavailable.”

¹ *Porter v. Comm’r*, 130 T.C. 115 (2008).

² *Porter v. Comm’r*, 132 T.C. 203 (2009) (a continuation of the same case that produced the 2008 holding, discussed above, that Tax Court’s review of denials of relief under IRC § 6015(f) is not limited to the administrative record).

³ Notice CC-2009-021, Litigating Cases Involving Claims for Relief From Joint and Several Liability Under Section 6015(f): Scope and Standard of Review (June 30, 2009).

⁴ Notice CC-2013-011, Litigating Cases That Involve Claims for Relief From Joint and Several Liability Under Section 6015 (June 7, 2013).

⁵ Action on Decision (AOD) 2012-07, I.R.B. 2013-25 (June 17, 2013), issued in response to *Wilson v. Comm’r*, 705 F.3d 980 (9th Cir. 2013), *aff’g* T.C. Memo. 2010-134. An AOD is a formal memorandum prepared by Chief Counsel that announces the litigation position the IRS will take in the future regarding the issue addressed in the AOD.

⁶ Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981 (2019).

REASONS FOR CHANGE

IRC § 6015(e)(7), which limits the Tax Court's scope of review, applies to determinations made "under this section" (*i.e.*, IRC § 6015). Thus, the provision supersedes Tax Court jurisprudence regarding the review not only in IRC § 6015(f) cases, but also in cases involving the application of IRC § 6015(b) and (c).

The provision may be intended to encourage the IRS and taxpayers to compile a complete administrative record or resolve cases without litigation. In some cases, however, taxpayers – and particularly taxpayers not represented by counsel – may not appreciate the significance of certain evidence or the consequences of failing to present it to the IRS. In other cases, taxpayers may present relevant evidence during trial to a neutral third party – the judge – that they are reluctant to share with the IRS, such as evidence of the other joint filer's domestic violence or abuse.⁷ It is difficult to imagine a state law that bars victims of domestic violence from introducing evidence at trial that goes beyond what they initially told police and was included in police records. The requirement that the Tax Court generally limit itself to considering evidence included in the administrative record is conceptually analogous.

Some taxpayers could be deprived of meaningful Tax Court review – particularly taxpayers who filed Tax Court petitions when their requests for relief went unanswered for six months – because the administrative record may consist of little more than the taxpayer's skeletal responses to the information solicited by Form 8857, Request for Innocent Spouse Relief, and the IRS may argue that the taxpayer's evidence is not "newly discovered" or "previously unavailable."⁸ If the IRS argues under IRC § 6015(e)(7) that the taxpayer's evidence should not be considered because it was available but not presented when the IRS made its determination and the Tax Court accepts this argument, the court may decide the case *de novo* based on the scant evidence contained in the administrative record.⁹ To enable the Tax Court to make the correct decision based on the merits, the National Taxpayer Advocate believes the court should be permitted to consider all evidence, whether or not it could have been provided to the IRS in a prior administrative proceeding.

Finally, some taxpayers who wish to obtain review by a federal court that is *de novo* in scope may pay the asserted tax and bring a refund suit before a U.S. district court or the U.S. Court of Federal Claims. But this approach carries the risk that these courts may conclude they lack jurisdiction to hear innocent spouse claims.¹⁰ To address these cases, the National Taxpayer Advocate recommends the statute be amended to allow all courts with jurisdiction to consider all evidence in IRC § 6015 cases.

7 Abuse that prevented a taxpayer from challenging the treatment of an item on a joint return out of fear the other spouse might retaliate would weigh in favor of granting relief. *Stephenson v. Comm'r*, T.C. Memo. 2011-16, is an example of a case in which the Tax Court's finding that the petitioner was physically and verbally abused by her husband was largely based on evidence produced at trial because the issue of abuse was not fully developed administratively.

8 Chief Counsel has not issued formal guidance to its attorneys about what arguments to make in cases in which IRC § 6015(e)(7) may apply.

9 Where the IRS does not answer a taxpayer's request for relief for more than six months, the court may remand the case and direct the IRS to do so, which may prolong resolution of the case.

10 The National Taxpayer Advocate recommends that Congress address this risk. See *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.

RECOMMENDATION

- Remove IRC § 6015(e)(7)(A) and (B) and revise IRC § 6015(e)(7) to provide: “The standard and scope of any review of a determination made under this section by the Tax Court or other court of competent jurisdiction shall be *de novo*.”¹¹

11 This recommendation averts the possibility that the language in IRC § 6015(e)(7) that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court” could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would preclude innocent spouse relief in collection, bankruptcy, and refund cases litigated in other federal courts and would be inconsistent with IRC § 6015(e)(1)(A) (conferring Tax Court jurisdiction “in addition to any other remedy provided by law”). Such an interpretation would also be inconsistent with the legislative recommendations *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *infra*, and *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.

Legislative Recommendation #53**Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases¹****PRESENT LAW**

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due. Spouses who live in community property states and file separate returns are generally required to report half the community income on their separate returns. IRC §§ 6015 and 66, sometimes referred to as the “innocent spouse” rules, provide relief from joint and several liability and from the operation of community property rules. Taxpayers seeking innocent spouse relief generally file Form 8857, Request for Innocent Spouse Relief. After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part.

If a taxpayer files a petition within 90 days from the date the IRS issues its final notice of determination, the U.S. Tax Court has jurisdiction to determine the appropriate relief. The Tax Court’s jurisdiction to decide innocent spouse claims does not appear to be exclusive; IRC § 6015(e)(1)(A) provides that an individual may petition the Tax Court for review of an innocent spouse determination “in addition to any other remedy provided by law.”²

However, the Tax Court’s review is not *de novo*, but is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”³

The Tax Court does not have jurisdiction over collection suits arising under IRC §§ 7402 or 7403 or over bankruptcy proceedings arising under Title 11 of the United States Code. Some federal courts with jurisdiction have considered taxpayers’ innocent spouse claims and determined that they are entitled to innocent spouse relief, which is consistent with IRC § 6015(e)(1)(A).⁴ These courts have not limited the scope of their consideration of the innocent spouse claim.

However, other federal courts have held that the Tax Court’s jurisdiction to decide innocent spouse claims is exclusive and have declined to consider such claims in collection or bankruptcy cases.⁵

- 1 Our recommendation that Congress clarify that taxpayers may seek innocent spouse relief in collection proceedings and bankruptcy cases addresses issues similar to those discussed in our recommendation that Congress clarify that taxpayers may seek innocent spouse relief in refund cases. See *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits*, *infra*.
- 2 Moreover, IRC § 6015(e)(3) provides that the Tax Court loses jurisdiction to the extent jurisdiction is acquired by the district court or the U.S. Court of Federal Claims in a refund suit, indicating that the Tax Court does not have exclusive jurisdiction over innocent spouse claims.
- 3 IRC § 6015(e)(7). This provision was enacted by the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981, 988 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.
- 4 See, e.g., *United States v. Diehl*, 460 F. Supp. 1282 (S.D. Tex. 1976), *aff’d per curiam*, 586 F.2d 1080 (5th Cir. 1978) (IRC § 7402 suit to reduce an assessment to judgment); *In re Pendergraft*, 119 A.F.T.R.2d (RIA) 1229 (Bankr. S.D. Tex. 2017) (bankruptcy proceeding). See also *In re Bowman*, No. 20-11512 (Bankr. E.D. La. 2021), a bankruptcy proceeding in which the court decided it had jurisdiction to hear an innocent spouse issue, although it denied the debtor’s motion for summary judgment that she was entitled to such relief.
- 5 *United States v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (IRC § 7402 suit to reduce an assessment to judgment); *United States v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006) (IRC § 7403 suit to foreclose on federal tax liens); and *In re Mikels*, 524 B.R. 805 (Bankr. S.D. Ind. 2015) (bankruptcy proceeding). Moreover, if the innocent spouse claim is raised for the first time in a refund suit, then it is arguable that the IRS, although it may make a recommendation to the Justice Department about whether relief should be granted, does not make a “determination” that the Tax Court would have jurisdiction to review. If the IRS has not made a determination and IRC § 6015(e)(7) does not apply, the statute should not be construed as conferring exclusive jurisdiction on the Tax Court.

REASONS FOR CHANGE

Inconsistent decisions about whether taxpayers may raise innocent spouse relief as a defense in collection suits and bankruptcy proceedings have created confusion and resulted in different treatment of similarly situated taxpayers. The effect of treating the Tax Court as having exclusive jurisdiction over innocent spouse claims may create economic hardships. If the federal courts that decide collection suits and bankruptcy proceedings cannot consider innocent spouse claims, taxpayers in those cases may be left without any forum in which to seek innocent spouse relief before a court enters a financially damaging judgment or, in rare cases, a taxpayer loses his or her home to foreclosure. In some cases, taxpayers forced to raise their innocent spouse claims in Tax Court will be deprived of a *de novo* scope of review that would be available in other federal courts.

Legislation is needed to clarify that the statutory language of IRC § 6015 conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims and that U.S. district courts and bankruptcy courts may also consider whether innocent spouse relief should be granted.⁶

RECOMMENDATION

- Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to raise innocent spouse relief as a defense in proceedings brought under any provision of Title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) and in cases arising under Title 11 of the United States Code.

⁶ As noted above, IRC § 6015(e)(7) provides that “[a]ny review of a determination under this section shall be reviewed de novo by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the new provision could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). Such an interpretation would also be inconsistent with this recommendation relating to raising innocent spouse as a defense in collection suits and bankruptcy proceedings and with the recommendation to *Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits, infra*. For this reason, the National Taxpayer Advocate recommends clarifying that the scope and standard of review are *de novo* in innocent spouse cases adjudicated by the Tax Court “or other court of competent jurisdiction,” thereby avoiding the inference that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo, supra*.

Legislative Recommendation #54**Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits¹****PRESENT LAW**

IRC §§ 6015 and 66, sometimes referred to as the “innocent spouse” rules, provide relief from the joint and several liability that arises from filing a joint federal income tax return and from the operation of community property rules. Taxpayers may request that the IRS grant innocent spouse relief, and if a request is denied, they may seek judicial review.

U.S. Tax Court

Under IRC § 6015(e), the Tax Court has jurisdiction to review the IRS’s denial of a claim for innocent spouse relief and to determine the appropriate relief. There is no right to a jury trial in Tax Court, and while the standard of review of a denial of a claim for innocent spouse relief under IRC § 6015 is *de novo*, the scope of the Tax Court’s review is limited to “(A) the administrative record established at the time of the determination, and (B) any additional newly discovered or previously unavailable evidence.”²

Other Federal Courts

Taxpayers who pay a proposed deficiency before filing a Tax Court petition and whose administrative claims for tax refunds have been denied by the IRS cannot bring refund suits in the Tax Court, but they may seek refunds by filing suit in a U.S. district court or in the U.S. Court of Federal Claims. They may raise their innocent spouse claims for the first time in proceedings before those courts.³

IRC § 6015(e) provides that a taxpayer’s right to petition the Tax Court for innocent spouse relief is provided “[i]n addition to any other remedy provided by law.” Despite this quoted language, a U.S. district court concluded in the case of *Chandler v. United States* that it lacked jurisdiction to consider a taxpayer’s innocent spouse claim in a refund suit arising under IRC § 7422.⁴

A jury trial is available if a refund suit is brought in a U.S. district court, and the scope of the court’s review in a refund suit is *de novo* (i.e., not limited, for example, to the administrative record).⁵

1 This recommendation that Congress clarify that taxpayers may seek innocent spouse relief in refund cases addresses issues similar to those discussed in our recommendation *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *supra*.

2 IRC § 6015(e)(7). This provision was enacted as part of the Taxpayer First Act, Pub. L. No. 116-25, § 1203, 133 Stat. 981, 988 (2019). The National Taxpayer Advocate recommends revising IRC § 6015(e)(7) to remove this limitation on the Tax Court’s scope of review. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

3 If the innocent spouse claim is raised for the first time in a refund suit, then it is arguable that the IRS, although it may make a recommendation to the Justice Department about whether relief should be granted, does not make a “determination” that the Tax Court would have jurisdiction to review. If the IRS has not made a determination and IRC § 6015(e)(7) does not apply, the statute should not be construed as conferring exclusive jurisdiction on the Tax Court.

4 *Chandler v. United States*, 2018 U.S. Dist. LEXIS 173880 (N.D. Tex. 2018), adopting 2018 U.S. Dist. LEXIS 174482 (N.D. Tex. 2018). The decision quoted *United States v. Elman*, 2012 U.S. Dist. LEXIS 173026, at *8 (N.D. Ill. 2012), which stated that “although the statute itself does not address whether the Tax Court’s jurisdiction is exclusive, courts interpreting the statute have concluded that it is.”

5 See *Vons Companies v. United States*, 51 Fed. Cl. 1, 5-6 (2001), noting “the axiomatic principle that tax refund cases are *de novo* proceedings” in which the court’s determination of the taxpayer’s tax liability is “based upon the facts and merits presented to the court and does not require (or even ordinarily permit) this court to review findings or a record previously developed at the administrative level.” (Citations omitted.)

REASONS FOR CHANGE

The *Chandler* decision is inconsistent with decisions by other federal courts that for decades have allowed taxpayers to seek innocent spouse relief in refund suits.⁶ The decision in *Chandler*, by foreclosing district court review of innocent spouse claims, leaves taxpayers with only one forum – the Tax Court – in which to seek review of adverse IRS determinations. Taxpayers are thus deprived of judicial review of their cases that is *de novo* in scope. Because there is no right to a jury trial in the Tax Court, the *Chandler* decision also undermines taxpayers' right to have their cases decided by a jury.

Moreover, a refund suit may involve issues other than innocent spouse relief over which the court would clearly have jurisdiction. Requiring taxpayers to litigate the innocent spouse claim in the Tax Court and other issues in a different federal court imposes unreasonable burdens on taxpayers and undermines judicial economy.

Legislation is needed to clarify that the statutory language of IRC § 6015, conferring Tax Court jurisdiction “in addition to any other remedy provided by law” does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims, and that U.S. district courts and the U.S. Court of Federal Claims are also authorized to consider whether innocent spouse relief should be granted in refund suits.⁷ Clarification will prevent further confusion as to whether seeking innocent spouse relief is allowable in those courts and will provide uniformity among all federal courts.⁸

RECOMMENDATION

- Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to assert claims for innocent spouse relief in refund suits arising under IRC § 7422.

6 See, e.g., *Sanders v. United States*, 509 F.2d 162 (5th Cir. 1975) *aff'g* 369 F. Supp. 160 (N.D. Ala. 1973); *Mlay v. IRS*, 168 F. Supp. 2d 781 (S.D. Ohio 2001); *Flores v. United States*, 51 Fed. Cl. 49 (2001); *Hockin v. United States*, 2019 U.S. Dist. LEXIS 137972, at *15 n. 2 (D. Or. 2019) (distinguishing the *Chandler* case, observing that “notably the plaintiff [in the *Chandler* case] did not respond to the motion to dismiss, so that district court was deprived of the benefit of reasoned argument on the issue from both parties”).

7 IRC § 6015(e)(3) provides that the Tax Court loses jurisdiction to the extent jurisdiction is acquired by a U.S. district court or the U.S. Court of Federal Claims in a refund suit, indicating that the Tax Court does not have exclusive jurisdiction over innocent spouse claims. See *Coggin v. Comm’r*, 157 T.C. No. 12 (2021) for a discussion of IRC § 6015(e)(3).

8 As noted above, IRC § 6015(e)(7) provides that “[a]ny review of a determination under this section shall be reviewed *de novo* by the Tax Court.” The National Taxpayer Advocate agrees that the standard and scope of Tax Court review of innocent spouse cases should be *de novo*. However, the new provision could be construed as conferring exclusive jurisdiction on the Tax Court to hear innocent spouse claims, which would be inconsistent with IRC § 6015(e)(1)(A). Such an interpretation would also be inconsistent with this recommendation relating to seeking innocent spouse relief in refund suits and with the recommendation to *Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and Bankruptcy Cases*, *supra*. For this reason, the National Taxpayer Advocate recommends clarifying that the scope and standard of review are *de novo* in innocent spouse cases before the Tax Court “or other court of competent jurisdiction,” thereby precluding any implication that the Tax Court has exclusive jurisdiction over innocent spouse claims. See *Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is De Novo*, *supra*.

Legislative Recommendation #55**Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions****PRESENT LAW**

IRC § 6511(a) provides that the limitations period for filing a claim for refund generally expires two years after paying the tax or three years after filing the return, whichever is later. The amount a taxpayer can recover is limited to amounts paid within the applicable lookback period provided by IRC § 6511(b)(2). If the claim was filed within three years of the return, then the lookback period is three years, plus any filing extension. If the claim wasn't filed within three years of the return or the taxpayer never filed a return, the lookback period is two years.

When a taxpayer does not file a return, the IRS sometimes sends a notice of deficiency to assess additional tax. A notice of deficiency gives the taxpayer the right to petition the United States Tax Court, and if the taxpayer timely does so, then the Tax Court generally has jurisdiction under IRC § 6512(b) to determine whether the taxpayer is due a refund for the taxable year at issue, provided the tax was paid within the applicable lookback period under IRC § 6511(b). Under IRC § 6512(b), if the taxpayer did not file a return before receiving the notice of deficiency, the date on the notice of deficiency becomes the hypothetical date of the taxpayer's refund claim, and the two- or three-year lookback period in IRC § 6511(b)(2) runs from the date the IRS mailed the notice of deficiency. Absent a special rule, the Tax Court would have no jurisdiction to award refunds to non-filers who are issued a notice of deficiency more than two years after paying the tax.

However, the flush language of IRC § 6512(b)(3) provides such a rule. It says that certain taxpayers who do not file a tax return are entitled to a three-year lookback period. Before Congress amended IRC § 6512 to add this special rule, a taxpayer who had not filed a return before the IRS mailed a notice of deficiency was entitled only to a two-year lookback period. But Congress, seeking to extend the lookback period available to such non-filing taxpayers, provided that if a notice of deficiency is mailed "during the third year after the due date (with extensions) for filing the return," and if no return was filed before the notice of deficiency was mailed, the lookback period is three years.

This special rule contains an unintended glitch. In the case of a non-filer who had requested an extension of time to file and then received a notice of deficiency, the words "with extensions" could delay by six months the beginning of the "third year after the due date." As a result, if the IRS mailed a notice of deficiency before the beginning of the third year, the Tax Court would not have jurisdiction to look back more than two years from the notice of deficiency, and thus would not be able to consider any overpayment that had been paid on the original due date of the return, usually April 15. Thus, there is a six-month "donut hole" during which the IRS can send a notice of deficiency without triggering the Tax Court's jurisdiction to consider the taxpayer's claim for refund.

An example may help to illustrate these rules. Assume John Doe had made estimated tax payments in excess of his tax liability by April 15, 2016, the original filing deadline for a 2015 tax return. He had requested a six-month extension of time to file but did not file a return. On July 2, 2018, the IRS mailed him a notice of deficiency for the 2015 tax year. He responded to the notice by petitioning the Tax Court and explaining the notice was incorrect because he had paid the asserted deficiency. He then filed a tax return showing he had overpaid his tax and was due a refund. Under the flush language of IRC § 6512, the Tax Court can only refund payments made within two years of the date on the notice of deficiency, without regard to extensions (*i.e.*, for taxes paid on or after July 2, 2016). The special rule (flush language of IRC § 6512(b)(3)) would not help Mr. Doe because the notice of deficiency was mailed on July 2, 2018.

The special rule would only apply if the IRS had mailed the notice of deficiency during the third year after the due date of his return (with extensions) (*i.e.*, the year beginning after October 15, 2018). Because the IRS mailed his notice of deficiency before the third year had begun, the special rule did not apply, and John Doe could not get his refund.

REASONS FOR CHANGE

According to the legislative history, Congress enacted the special rule of IRC § 6512(b)(3) to put non-filers who receive notices of deficiency after the two-year lookback period on the same footing as taxpayers who file returns on the same day the IRS mailed the notice of deficiency. The special rule was supposed to allow non-filers “who receive a notice of deficiency and file suit to contest it in Tax Court during the third year after the return due date, to obtain a refund of excessive amounts paid within the three-year period prior to the date of the deficiency notice.”¹

However, the statute as written may not fix the problem it was enacted to solve. In *Borenstein*, the Tax Court concluded that it had no jurisdiction to determine a non-filer’s overpayment because the non-filer had requested a six-month extension to file and the IRS mailed the notice of deficiency during the first six months of the third year following the original due date – after the second year following the due date (without extensions) and before the third year following the due date (with extensions).² Thus, the court found that the special rule of IRC § 6512(b)(3) leaves a donut hole in its jurisdiction. Although the U.S. Court of Appeals for the Second Circuit reversed the Tax Court’s decision, the Tax Court is not required to follow the Second Circuit’s decision in cases arising in other circuits.³ Thus, unless the Tax Court revisits its decision, a legislative fix is still needed.

Although this problem only affects the relatively limited number of taxpayers who request a six-month filing extension and then, for whatever reason, do not file a return, Congress felt it was important to provide non-filers with this special rule. We believe it is important to highlight this unintended result and recommend a solution.

RECOMMENDATION⁴

- Amend IRC § 6512(b)(3) to clarify that when the IRS mails a notice of deficiency to a non-filer after the second year following the due date of the return (without regard to extensions), the limitations and lookback periods for filing a claim for refund or credit are at least three years from the due date of the return (without regard to extensions).

1 H.R. REP. NO. 105-220, at 701 (1997) (Conf. Rep.).

2 *Borenstein v. Comm’r*, 149 T.C. 263 (2017), *rev’d*, 919 F.3d 746 (2d Cir. 2019).

3 *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971).

4 For more detail, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Tax Court Jurisdiction: Fix the Donut Hole in the Tax Court’s Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions*); Nina E. Olson, The Second Circuit in *Borenstein* Helped to Close the Gap in the Tax Court’s Refund Jurisdiction, But Only for Taxpayers in That Circuit, NATIONAL TAXPAYER ADVOCATE BLOG (Apr. 24, 2019), <https://www.taxpayeradvocate.irs.gov/news/ntablog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-courts-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit/>. This recommendation could be implemented by revising the flush language in IRC § 6512(b)(3) to insert the word “original” before “due date” and striking the parenthetical phrase “(with extensions).”

MISCELLANEOUS RECOMMENDATIONS

Legislative Recommendation #56

Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments

PRESENT LAW

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working individuals and families. Eligibility for the EITC and the amount of EITC a taxpayer may claim are based on a variety of factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status.¹ For tax year (TY) 2020, the EITC plateaued at \$6,660 for a family of one adult with three children earning between \$14,800 and \$19,349.²

An individual must meet three primary requirements to be a taxpayer's "qualifying child" for the EITC.³ First, the individual must have a specific blood or legal relationship to the taxpayer.⁴ Second, the individual must share a residence in the United States with the taxpayer for more than half the year.⁵ Third, the individual must be under the age of 19 (or under age 24 if a full-time student) or be permanently and totally disabled.⁶

Taxpayers without children may also claim the EITC.⁷ Prior to 2021, the "childless" EITC was limited to taxpayers aged 25 to 64. In TY 2020, the credit plateaued at \$538 for married taxpayers with no qualifying children filing jointly earning between \$7,000 and \$9,199, and at the same \$538 amount for single taxpayers without qualifying children earning between \$7,000 and \$8,749. The American Rescue Plan Act of 2021 (ARPA) raised the maximum EITC from \$538 to \$1,502 and raised the income eligibility cap to \$27,379 for married taxpayers filing jointly and to \$21,429 for single taxpayers.⁸ ARPA temporarily expanded the age range of childless workers eligible for the EITC to include younger adults aged 19 to 24 (excluding students under 24 attending school at least part time) and temporarily removed the upper age limit (previously age 64) for TY 2021.⁹ Qualified former foster youth and qualified homeless youth also temporarily became eligible to claim the EITC at age 18.¹⁰

Unemployment compensation (UC),¹¹ while based on a taxpayer's earned income and included in adjusted gross income (AGI), is not generally included in earned income and thus does not count in computing the amount of EITC for which a taxpayer is eligible.¹²

1 IRC § 32.

2 IRS, Pub. 596, Earned Income Credit (EIC) 33-34 (Jan. 26, 2021).

3 Where there are competing claims for the same child, "tie breaker" rules prioritize the claims. IRC § 152(c)(4)(B).

4 IRC §§ 32(c)(3)(a) & 152(c)(2).

5 IRC § 32(c)(3)(c).

6 IRC §§ 32(c)(3)(A) & 152(c)(3). The individual must also have a Social Security number that is valid for employment. IRC § 32(c)(3)(D) & (m).

7 IRC § 32(c)(1)(A)(iii).

8 ARPA, Pub. L. No. 117-2, § 9621, 135 Stat. 4, 152-153 (2021) (codified in IRC § 32(n)).

9 IRC § 32(n).

10 IRC § 32(n)(1)(B)(iii).

11 IRC § 85; Treas. Reg. § 1.85-1(b)(1). Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or a state.

12 IRC § 32(c)(2); Treas. Reg. § 1.32-2(c)(2).

REASONS FOR CHANGE

Enacted in 1975, the EITC is one of the federal government's largest anti-poverty programs for low-income workers.¹³ For TY 2020, taxpayers filed about 25 million returns claiming EITC benefits worth about \$62 billion.¹⁴ The EITC is considered to be an effective anti-poverty program. However, the eligibility requirements are complex, and as a result, the program suffers from a relatively high rate of improper payments that could be reduced if the eligibility requirements were simplified.¹⁵ In addition, the EITC was enacted at a time when families with biological or legal relationships with the claimed children predominated. Modernizing the eligibility requirements to recognize non-traditional families could increase the participation rate among eligible taxpayers, allow guardians other than parents to receive benefits when they are the principal caretakers, and reduce improper payments. Finally, the credit should be made available to taxpayers who enter the workforce at age 19 and taxpayers who remain in the workforce after age 65.

Restructure the EITC as Two Credits: A Worker Credit and a Child Credit

The National Taxpayer Advocate recommends restructuring the EITC into two credits where the taxpayer is claiming qualifying children: (i) a refundable *worker credit* based on each individual worker's earned income, irrespective of the presence of a qualifying child, and (ii) a refundable *child credit* that would reflect the costs of caring for one or more children.

Worker Credit

Much like the current EITC, the credit would phase in as a percentage of earned income, reach a plateau, and then phase out.¹⁶ Unlike the current EITC, the credit amount would depend solely on income and would not vary based on whether the taxpayer is claiming one or more qualifying children. Increasing the worker component of the EITC would provide a greater incentive to work, which is a main objective of the credit. This structure also would target the credit to the lowest-earning taxpayers, based on AGI (a broader measure of income that includes unearned income like capital gains, dividends, rents, and royalties).¹⁷ This would be similar to the current EITC provision that denies the credit to taxpayers with excessive investment income.¹⁸

This change could also substantially reduce improper payments. The IRS receives Forms W-2 and other information reporting documents directly from employers and other payors of income. For that reason, it can accurately verify income amounts for EITC recipients who are employees, by far the largest group of EITC claimants.¹⁹

13 IRS, About EITC, <https://www.etc.irs.gov/etc-central/about-etc/about-etc> (last visited Nov. 2, 2021).

14 IRS, Statistics for Tax Returns With the Earned Income Tax Credit (EITC), <https://www.etc.irs.gov/etc-central/statistics-for-tax-returns-with-etc/statistics-for-tax-returns-with-the-earned-income> (updated Dec. 6, 2021) (showing data as of December 2020).

15 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, § 2(e), 124 Stat. 2224 (2010), amending Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) (striking § 2(f) and adding § (f)(2)). For fiscal year 2019, the IRS estimates that approximately 25 percent of the total EITC program payments were improper. Treasury Inspector General for Tax Administration, Ref. No. 2020-40-025, *Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments 2* (Apr. 30, 2020).

16 For examples regarding how to structure a per-worker credit, see Elaine Maag, *Investing in Work by Reforming the Earned Income Tax Credit* (2015).

17 Some experts caution that without a minimum wage, employers would reduce and capture the benefit of an increased EITC. See Austin Nichols & Jesse Rothstein, *The Earned Income Tax Credit*, *ECONOMICS OF MEANS-TESTED TRANSFER PROGRAMS IN THE UNITED STATES*, vol. 1, at 137 (Robert A. Moffitt ed., 2016). Therefore, many proposals couple an increased childless EITC or worker credit with an increased minimum wage. See Isabel V. Sawhill & Quentin Karpiw, *Raising the Minimum Wage and Redesigning the EITC*, *BROOKINGS INST.* (Jan. 30, 2014), <https://www.brookings.edu/research/raising-the-minimum-wage-and-redesigning-the-etc>.

18 IRC § 32(i).

19 A relatively small percentage of EITC claimants are self-employed individuals. The IRS receives somewhat less information from third-party payors with respect to self-employed individuals.

Unemployment Compensation

Taxpayers who receive UC based on their employment earnings cannot use their UC income to qualify for the EITC. The apparent rationale for not counting UC is that the EITC was designed largely to provide a work incentive. However, UC is paid exclusively to individuals who were working and became separated from their jobs due to no fault of their own. Most recently, millions of individuals who had been employed lost their jobs during the COVID-19 pandemic when certain segments of the economy, such as restaurants, hotels, and airlines, substantially reduced their workforces. In other instances, local disasters such as hurricanes adversely affect segments of the economy and lead to mass layoffs. Because UC is effectively a replacement for a portion of the wages working individuals would have earned if they had not been separated from their jobs and because UC benefits are only paid for a limited number of months, treating UC as EITC-qualifying income would maintain the nexus between working and receiving EITC.²⁰

Child Credit

The child credit would be designed as a fixed amount per qualifying child, subject to an AGI phase-out, and would replace the portion of the existing EITC that is based on the number of qualifying children the taxpayer claims. This could be accomplished by retaining ARPA's changes to the Child Tax Credit (CTC) and by modernizing the definition of qualifying child. Some of ARPA's CTC changes include increasing the maximum credit amount from \$2,000 to \$3,000 (\$3,600 for children under six), making the credit fully refundable for certain taxpayers, increasing a qualifying child's age from 17 to 18, and changing the income phase-outs.

Modernize the Definition of a Qualifying Child

The qualifying child rules of the current EITC structure may not reflect real-life living arrangements. A 2016 study by the Tax Policy Center found that the number of households made up of "traditional families" (married parents with only biological children) has declined, while alternative family types, such as families led by single parents or cohabitating adults, have increased.²¹ Only 51.6 percent of children living in families with incomes at or below 200 percent of the Federal Poverty Level were in families headed by married couples. Low-income children were more likely to live with a single parent or in a multigenerational household, a cohabiting household, or a family with at least one non-biological child, as compared with higher income families.²² Since the EITC is a credit for lower income families, its eligibility should more accurately reflect its target population.²³

RECOMMENDATIONS

- Separate the refundable EITC into two components: a worker credit and a child credit.
- Permanently expand the expiring age eligibility for the EITC to individuals who have attained age 19 (age 18 in the case of qualified former foster youth or qualified homeless youth and age 24 for specified students), with no upper age limit.

20 Note: we recognize an unintended consequence of UC being included in AGI is that it may diminish a taxpayer's EITC claim, and in some instances, may make taxpayers ineligible to claim the EITC.

21 Elaine Maag, H. Elizabeth Peters & Sarah Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits* 10 (2016). See also National Taxpayer Advocate 2016 Annual Report to Congress 334 (Legislative Recommendation: Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden).

22 Elaine Maag, H. Elizabeth Peters & Sarah Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits* 10 (2016).

23 For more discussion on modernizing the definition of "qualifying child," see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17-19 (*Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*).

- Amend IRC § 32(c)(2)(A)(i) to include unemployment compensation as EITC-qualifying earned income.
- Amend IRC §§ 32(c) and 24(c) to modernize the definition of a qualifying child in IRC § 152(c), to reflect evolving family units.²⁴

²⁴ Relevant considerations should include which adult performs caregiving and makes caregiving decisions for the child, including factors like who prepares meals, who transports the child to school, and who makes medical appointments for the child. For a more detailed discussion on modernizing the definition of a "qualifying child," see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17-19 (*Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*).

Legislative Recommendation #57**Allow Taxpayers the Option of Using Prior Year Income to Claim the Earned Income Tax Credit (EITC) During Federally Declared Disasters****PRESENT LAW**

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on several factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status.¹ Taxpayers without qualifying children may be eligible for the "childless EITC."²

IRC § 165(i)(5) defines a "Federally declared disaster" as any disaster determined by the President to warrant federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, and a "disaster area" as any area so determined to warrant federal assistance.

On numerous occasions when the President has declared a disaster, Congress has passed legislation to give taxpayers who earn less income in the disaster year than the prior year the option of using their prior-year income to calculate their EITC benefits.³ This provision is referred to as the "EITC lookback rule." Most recently, Congress authorized the EITC lookback rule for tax years 2020 and 2021 to provide relief from the COVID-19 pandemic.⁴

REASONS FOR CHANGE

In general, the EITC is designed to incentivize work, and its benefits are only available to individuals who have earned income. During major disasters like the COVID-19 pandemic or hurricanes, many employed individuals experience a disruption in work, a furlough, or a job termination. If these taxpayers have income levels that qualified them for EITC benefits, they may suffer a double financial hit. They not only lose the income from their jobs, but because they are no longer earning income, they also may lose their EITC benefits.

The EITC lookback rule is designed to provide relief to taxpayers in this circumstance. To illustrate, assume an individual who was consistently employed for several years was laid off when the COVID-19 pandemic struck in early 2020. As a result, she did not have sufficient 2020 earned income to qualify for significant EITC benefits. The EITC lookback rule provided relief by allowing her to qualify for EITC benefits on the basis of her income in 2019.

To date, Congress has authorized use of the EITC lookback rule on a disaster-by-disaster basis. This one-off approach leaves taxpayers (and the IRS) with uncertainty and means that relief is only provided in circumstances where Congress takes an affirmative act. To ensure that all individuals affected by a federally declared disaster receive relief, the National Taxpayer Advocate recommends that Congress revise IRC § 32 to

1 IRC § 32.

2 *Id.*

3 See, e.g., American Rescue Plan Act, Pub. L. No. 117-2, § 9626, 135 Stat. 4, 157 (2021); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, § 211, Div. EE, Title II (2020); Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, § 504, 131 Stat. 1168, 1183 (2017); Heartland Disaster Tax Relief of 2008, Pub. L. No. 110-343, Div. C, Title VII, Subtitle A, § 701, 122 Stat. 3765, 3912 (2008); Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, Title IV, § 406, 119 Stat. 2016, 2028 (2005).

4 *Id.*

permanently provide this election to all taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5).

RECOMMENDATION

- Amend IRC § 32 to allow taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5) to elect the use of their prior year's earned income to calculate and claim the EITC.⁵

⁵ For legislative language generally consistent with this recommendation, see COVID-19 Earned Income Act, S. 3542 & H.R. 6762, 116th Cong. (2020), except that our recommendation is to make relief permanent rather than specific to a single tax year.

Legislative Recommendation #58**Exclude Taxpayers in Specific Circumstances From the Requirement to Provide a Social Security Number for Their Children to Claim the Child Tax Credit****PRESENT LAW**

The Tax Cuts and Jobs Act (TCJA) amended IRC § 24 to require a taxpayer claiming the Child Tax Credit (CTC) to provide a Social Security number (SSN) valid for employment for a qualifying child.¹

IRC § 1402(g) exempts members of certain religious faiths from the requirement to pay self-employment tax if certain conditions are met. An individual may apply for an exemption from the self-employment tax requirements:

... if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act).

To claim the exemption, the individual must apply on IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits.²

REASONS FOR CHANGE

The requirement under IRC § 24 that a qualifying child claimed for the CTC have an SSN valid for employment was intended to prevent a taxpayer whose child is not a U.S. citizen or is not otherwise eligible for an SSN from receiving the CTC. However, the provision is having the unintended effect of disqualifying several taxpayer populations whose dependents do not have SSNs due to unique circumstances but who otherwise meet the requirements for the credit. These populations are being denied a valuable tax benefit that Congress did not intend to deny them. Affected taxpayers include:

- Taxpayers who do not apply for SSNs due to their deeply held religious beliefs, most notably the Amish;
- Taxpayers whose adopted children have not yet received SSNs; and
- Taxpayers unable to obtain an SSN for a qualifying child because the child was born and died in the same or consecutive tax years.

Prior to the TCJA amendment, IRC § 24 only required a taxpayer claiming a child as a qualifying child for the CTC to provide a taxpayer identification number (TIN) for the child. The IRS provided administrative relief to allow the credit to a taxpayer without a TIN for a qualifying child due to the taxpayer's deeply held religious beliefs. Specifically, taxpayers whose qualifying children did not have an SSN or other TIN due to the taxpayers' deeply held religious beliefs were allowed the credit if the taxpayers indicated on their tax returns that they have an approved Form 4029 establishing that they had met the requirements under IRC § 1402(g).

In certain circumstances, the IRS would request additional information from the taxpayer to prove the age, relationship, and residence of the child. Further, the language in the CTC prior to the TCJA permitted the

¹ TCJA, Pub. L. No. 115-97, § 11022(a), 131 Stat. 2054, 2073-2074 (2017) (codified at IRC § 24(h)(7)).

² IRC § 1402(g).

IRS to allow the credit for taxpayers whose children only had Adoption Taxpayer Identification Numbers (ATINs), which are tax identification numbers issued for use while waiting to receive SSNs for the adopted children. Now, the IRS is no longer providing administrative relief to allow the CTC if a qualifying child lacks an SSN, unless the taxpayer's child was born and died in the same or consecutive tax years.³

The National Taxpayer Advocate believes that the affected taxpayer populations are being treated unjustly because the TCJA language did not provide an exception to the SSN requirement for qualifying children for these specific groups, thereby denying them the CTC to which they are otherwise entitled.

RECOMMENDATION

- Amend IRC § 24(h)(7) to allow a taxpayer to claim the CTC with respect to a qualifying child without an SSN if the taxpayer meets all other eligibility requirements for the credit and if the taxpayer:
 - Is a member of a recognized religious group and meets the requirements under IRC § 1402(g);
 - Adopted a child (or has a child lawfully placed with the taxpayer for adoption) and provides an ATIN for the qualifying child; or
 - Had a child that was born and died in the same or consecutive tax years.

3 The IRS Office of Chief Counsel has opined that the IRS is legally prohibited from allowing the CTC with respect to a child who lacks an SSN because of religious or conscience-based objections. See Program Manager Technical Advice (PMTA), Administration of the Child Tax Credit for Objectors to Social Security Numbers, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019). For an in-depth discussion regarding TAS's disagreement with this advice, see *The Tax Filing Season: Hearing Before the H. Subcomm. on Government Oversight of the H. Comm. on Ways and Means*, 116th Cong. 22-27 (2019) (testimony of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress 48 (Area of Focus: *TAS Will Urge the IRS to Reconsider Its Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under IRC § 24(h)(7), Which Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups*); Nina E. Olson, *The IRS's Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under Internal Revenue Code § 24(h)(7) Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups*, NATIONAL TAXPAYER ADVOCATE BLOG (June 26, 2019), <https://www.taxpayeradvocate.irs.gov/news/ntablog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-courts-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit/>. See also Internal Revenue Manual 3.12.3.26.17.6, TIN Requirements (EC 287) (Apr. 15, 2020).

Legislative Recommendation #59**Clarify Whether Dependents Are Required to Have Taxpayer Identification Numbers for Purposes of the Credit for Other Dependents****PRESENT LAW**

IRC § 24 authorizes a Child Tax Credit (CTC) of up to \$2,000 per “qualifying child,” of which up to \$1,400 is refundable.¹ The Tax Cuts and Jobs Act (TCJA) added a new provision to IRC § 24 that allows a nonrefundable credit of \$500 for each “dependent” who is not a “qualifying child.”² This nonrefundable credit is referred to as the credit for other dependents (ODC).³

IRC § 24(e) provides that a “qualifying child” must have a Taxpayer Identification Number (TIN) to be claimed under this section. IRC § 24(h)(7) further provides that the qualifying child’s TIN must be a Social Security number (SSN) valid for employment in the United States.

Under IRC § 24(h)(4), the ODC is available for a “dependent of the taxpayer (as defined in section 152).” There is no requirement in IRC § 152 that to be a “dependent,” an individual must have a TIN (either an SSN or an Individual Taxpayer Identification Number (ITIN)). IRC § 24 specifically provides that where a qualifying child’s lack of an SSN prevents a taxpayer from claiming the CTC for that child, the taxpayer may receive the ODC for that child.⁴

REASONS FOR CHANGE

Despite the absence of a TIN requirement in the statute, the IRS has instructed taxpayers that to claim a dependent for the ODC, the dependent must have a TIN.⁵ The IRS has used its summary assessment authority to disallow the ODC claimed by over 118,000 taxpayers on their 2019 returns because their dependents did not have TINs.⁶

In response to TAS’s inquiry, the IRS Office of Chief Counsel explained its legal rationale as follows: “[I]n order to avoid treating dependents for whom a taxpayer may claim a credit under section 24(h)(4)(A) [*i.e.*, the ODC] inconsistently, section 24(e)(1) [which imposes a TIN requirement for claiming a “qualifying child” for a credit under section 24] should be interpreted as applying to all dependents for whom a taxpayer claims

1 The American Rescue Plan Act, Pub. L. No. 117-2, § 9611, 135 Stat. 4, 359-376 (2021) makes this credit fully refundable and, for tax year 2021, increases it to \$3,000 for children under 18 and to \$3,600 for children under six.

2 Tax Cuts and Jobs Act (TCJA), Pub. L. 115-97, § 11022, 131 Stat. 2054, 2073 (2017), adding IRC § 24(h)(4), applicable to taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2026.

3 IRC § 24(h)(4).

4 IRC § 24(h)(4)(C).

5 See, e.g., IRS Pub. 972, Child Tax Credit and Credit for Other Dependents 2 (Jan. 11, 2021). See also IRS Form 1040 and 1040-SR Instructions 20 (Apr. 13, 2021).

6 We presume that the IRS exercised its summary assessment authority in reliance on IRC § 6213(g)(2)(I), which includes in the definition of “mathematical or clerical error” “an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return.” Over 118,000 taxpayers were issued summary assessment notices, removing 102,146 dependents with respect to whom the ODC had been claimed because the dependents had invalid or missing TINs. (The 118,000 taxpayers include both primary and secondary taxpayers on married filing joint returns, and correspond to 70,248 tax returns.) IRS, Compliance Data Warehouse, Individual Master File Individual Returns Transaction File (IRTF) Form 1040 and Entity tables, TY 2019, returns posted by cycle 202134. If \$500 of ODC was claimed with respect to each dependent, then the total amount of disallowed ODC would be over \$51 million (*i.e.*, 102,146 times \$500).

a credit under section 24(h)(4)(A), not only a qualifying child described in section 24(h)(4)(C) [*i.e.*, who is a “qualifying child” but lacks the SSN required by section 24(h)(7)].”⁷

It is a basic canon of statutory construction that the plain language of a statute controls absent a clearly expressed legislative intent to the contrary.⁸ Here, there is no statutory requirement that a dependent have a TIN to be claimed for the ODC. The IRS Office of Chief Counsel (OCC) appears to have imposed the requirement on its own, likely to deter fraudulent claims. The TCJA legislative history suggests Congress considered a TIN requirement and did not adopt it. The House version of the TCJA included a requirement that a dependent have a TIN for purposes of the ODC but the subsequent Senate version of the TCJA did not, and the enacted bill followed the Senate approach.⁹ It is possible that a drafting error was made, but if so, Congress – not the IRS – should fix it.¹⁰

To resolve the inconsistency between the absence of a TIN requirement in the ODC statute and the IRS’s decision to impose the requirement on its own, the National Taxpayer Advocate recommends that Congress clarify its intent.

RECOMMENDATIONS

- Clarify whether a dependent with respect to whom a taxpayer claims the ODC under IRC § 24(h)(4) is required to have a taxpayer identification number.
- If a dependent with respect to whom a taxpayer claims the ODC is required to have a taxpayer identification number, clarify the type of taxpayer identification number required.

7 Email communication from the Office of Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program) to TAS Management & Program Analyst (Dec. 19, 2019) (on file with TAS). The email does not contain any references or citations to any legal authority for this position.

8 See, e.g., *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980) (“We begin with the familiar canon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.”); *Connecticut Nat’l Bank v. Germain*, 503 U.S. 245, 254 (1992) (“[W]hen the words of a statute are unambiguous, then, this first canon is also the last: ‘judicial inquiry is complete.’”).

9 See H.R. CONF. REP. NO. 115-466, at 225-227 (Dec. 15, 2017), <https://www.congress.gov/115/crpt/hrpt466/CRPT-115hrpt466.pdf>.

10 A technical correction was proposed, but the correction was not enacted into law. See Joint Committee on Taxation, JCX-1-19, *Technical Explanation of the House Ways and Means Committee Chairman’s Discussion Draft of the “Tax Technical and Clerical Corrections Act”* 5 (Jan. 2, 2019), <https://www.jct.gov/publications.html?func=startdown&id=5154>. The fact that Congress sought to make this a “technical correction” provides further evidence that the law does not require dependents to have TINs for purposes of the ODC.

Legislative Recommendation #60**Allow Members of Certain Religious Sects That Do Not Participate in Social Security and Medicare to Obtain Employment Tax Refunds****PRESENT LAW**

IRC § 3101 imposes a tax on wages paid to employees to fund old-age, survivors, and disability insurance (Social Security) and hospital insurance (Medicare) pursuant to the Federal Insurance Contributions Act (FICA).¹ FICA tax is paid half by the employer and half by the employee.

IRC § 1401 imposes a comparable tax on self-employed individuals pursuant to the Self-Employment Contributions Act (SECA). SECA tax is paid by the self-employed individual.

Members of the Amish community sought exclusions from these taxes because the tenets of their religion prohibit them from accepting social insurance benefits. In response, Congress enacted IRC § 1402(g), which exempts self-employed individuals who are members of certain religious faiths from the requirement to pay SECA tax. An individual may apply for an exemption from SECA tax by filing IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits,

... if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act).

Congress subsequently enacted IRC § 3127 to exempt employers from paying their portion of FICA tax under IRC § 3111, provided that both the employer and the employee are members of a recognized religious sect, both the employer and the employee are adherents of established tenets or teachings of the sect, and both the employer and employee file and receive approval for exemption from their respective portions of FICA tax.² The employer and employee each may receive approval by filing IRS Form 4029.³

IRC § 6413(b) requires the IRS to refund any overpayment of a taxpayer's FICA tax.

REASONS FOR CHANGE

The exemptions under IRC §§ 1402(g) and 3127 do not extend to members of recognized religious sects who work for employers that are *not* members of the same or any religious sect. Members of these sects pay for Social Security and Medicare benefits that their religious beliefs prohibit them from accepting. The National Taxpayer Advocate believes this result is inequitable. For example, the rationale for exempting self-employed

1 Under IRC § 3101, a tax of 6.2 percent is imposed on employee wages to fund old-age, survivors and disability insurance, and an additional tax of 1.45 percent is imposed to fund hospital insurance. In certain circumstances, employee wages are subject to an additional 0.9 percent tax to further fund hospital insurance (Additional Medicare Tax). Employers are generally required to withhold FICA taxes from their employees' wages under IRC § 3102(a).

2 IRC § 3127 establishes the requirements for employers and employees who are members and adherents of a recognized religious sect to be exempt from their respective FICA tax obligations as required under IRC §§ 3101 and 3111. If the employer is a partnership, all partners of that partnership must be members of and adhere to the tenets of a recognized religious sect. All partners of the partnership must apply and be approved individually for the exemption. Treas. Reg. § 31.3127-1(a).

3 For more information regarding the Form 4029 exemption application for members of recognized religious sects, see IRS Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers (Jan. 2020).

Amish workers and Amish employees of Amish employers, as the law provides, applies equally to Amish employees who work for non-Amish employers.⁴

This inequity can be resolved by amending IRC § 6413 to allow employees who are members of a recognized religious group and work for an employer who is *not* a member of a recognized religious group to file a refund claim for their portion of remitted FICA tax. Amish leaders have expressed a preference for allowing Amish employees of non-Amish employers to recover the employee's portion of the FICA tax through a refund claim, rather than by exempting the employee from paying the FICA tax, to avoid imposing an additional recordkeeping burden on employers.⁵

RECOMMENDATION

- Amend IRC § 6413 to allow employees who meet the definition of “a member of a recognized religious sect or division thereof” in IRC § 1402(g) to claim a credit or refund of the employee's portion of FICA taxes withheld from their wages.⁶

4 IRC § 1402(g). The discussion in this legislative recommendation applies to any member of a recognized religious sect or division thereof as described in IRC § 1402(g). Historically, the Amish and the Mennonites have been the religious groups that have utilized this provision.

5 Meeting between TAS and Amish leaders (Aug. 16, 2019). If this recommendation is enacted, an employer who is not a qualifying member of a recognized religious sect would remain liable for his or her portion of the FICA tax pursuant to IRC § 3111.

6 For legislative language generally consistent with this recommendation, see Religious Exemptions for Social Security and Healthcare Taxes Act, H.R. 6183, 117th Cong. (2021).

Legislative Recommendation #61**Amend IRC § 36B(d)(2) to Prevent Individuals From Losing Some or All of Their Premium Tax Credits When Receiving Lump-Sum Social Security Benefits Attributable to a Prior Year****PRESENT LAW**

IRC § 36B, enacted as part of the Patient Protection and Affordable Care Act, provides a tax credit to certain taxpayers to help them purchase health insurance through a Health Insurance Marketplace (*i.e.*, the Exchange).¹ For years other than 2021 and 2022,² this credit, known as the “premium tax credit” (PTC), is only available to taxpayers with household incomes between 100 percent and 400 percent of the Federal Poverty Level.³ It does not make any accommodation for taxpayers who receive a one-time lump-sum payment of Social Security benefits.

Eligible taxpayers can choose to have advance payments of the PTC (referred to as APTC) in monthly amounts paid directly to the taxpayer’s insurance provider. The amount of APTC for which a taxpayer is eligible is based in part on the taxpayer’s anticipated household income for the year.⁴ The taxpayer must “reconcile” on his or her tax return the amount of APTC paid on his or her behalf with the amount of PTC that the taxpayer is allowed for the year of coverage.⁵ If the APTC paid exceeds the PTC allowed, the taxpayer will incur a tax liability equal to the excess APTC amount, subject to a limitation for taxpayers with household incomes under 400 percent of the Federal Poverty Level.⁶ If a taxpayer’s household income exceeds 400 percent of the Federal Poverty Level, the taxpayer generally must increase his or her tax liability by the full APTC amount paid on the taxpayer’s behalf.

When individuals apply for Social Security disability benefits, they may not receive a determination from the Social Security Administration (SSA) for one or more years. Consequently, the SSA may issue a substantial lump-sum award retroactive to the date the application was filed. A portion of these benefits may be taxable. To compute the taxable portion of the lump-sum award in the year the SSA makes the payment, the taxpayer has the option of (i) calculating the taxable amount of the lump-sum payment using the general rules of IRC § 86, which base the taxability of Social Security payments on the taxpayer’s income for the year of receipt of the payment or (ii) making an election under IRC § 86(e) to allocate the lump-sum payment over the period of years the payment covers and calculating the taxable portion of the payment based on the taxpayer’s income for those years.

However, IRC § 36B(d)(2)(B) does not allocate a multiyear lump-sum payment when computing modified adjusted gross income (MAGI) for PTC purposes. It requires the inclusion of the entire multiyear retroactive

1 Congress enacted the Patient Protection and Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), to “improve access to and the delivery of health care services for all individuals, particularly low income, underserved, uninsured, minority, health disparity, and rural populations.” § 5001, 124 Stat. 588.

2 Section 9661 of the American Rescue Plan Act of 2021 (ARPA), Pub. L. No. 117-2, 135 Stat. 4, 182-83 (2021), allows taxpayers with household incomes over 400 percent of the Federal Poverty Level to be eligible for a PTC, but only for tax years beginning in 2021 and 2022.

3 IRC § 36B(c)(1); Treas. Reg. § 1.36B-2(b)(1). The Federal Poverty Level is defined by the Office of Management and Budget and is updated annually by the Secretary of Health and Human Services. See, e.g., 86 Fed. Reg. 7732 (Feb. 1, 2021).

4 Household income is the sum of the taxpayer’s modified adjusted gross income (MAGI), the MAGI of the taxpayer’s spouse if a joint return is filed, and the MAGI of the taxpayer’s dependents required to file a federal income tax return under IRC § 1. See IRC § 36B(d)(2).

5 IRC § 36B(f).

6 *But cf.*, section 9662 of the ARPA, which suspends the requirement to increase tax liability for excess APTC for tax years beginning in 2020. Pub. L. No. 117-2, 135 Stat. 4, 183 (2021).

award in the year of receipt,⁷ even if a portion of that award would be excludable from gross income under IRC § 86. This one-time lump-sum payment increases the taxpayer's MAGI for that year only and may push household income over 400 percent of the Federal Poverty Level, regardless of whether any portion of the Social Security benefits relates to prior years or whether the benefits are includible in income in the year of receipt.

REASONS FOR CHANGE

A taxpayer cannot control the SSA's application review process to plan for the month – or year – in which the SSA will issue the benefit award and potentially impact the APTC helping the taxpayer maintain health insurance. Consequently, the taxpayer's household income in the year of the award will be artificially inflated when compared to prior and subsequent years due to the delay in the benefit award. For example, assume a low-income taxpayer without other income applied for Social Security benefits that would pay her \$17,500 a year. If the SSA approved the application immediately, the taxpayer would receive annual benefits of \$17,500 and could continue to qualify for the PTC in all years. However, if the SSA approved the application two years later, the taxpayer could receive a lump-sum payment of \$52,500 in the third year (\$17,500 benefits multiplied by two years of SSA evaluation plus \$17,500 in the award year), which would result in household income over 400 percent of the Federal Poverty Level, thus rendering her ineligible for the PTC in that year and potentially requiring her to increase her tax liability by the amount of APTC already paid on her behalf in that year.⁸

The PTC and APTC are benefits designed for low- and moderate-income individuals to assist with health insurance premium payments. The impact of receiving Social Security benefits in a lump sum can be so harsh as to not only eliminate the value of this assistance in a given year but also to create a substantial tax liability.⁹ Just as IRC § 86(e) gives taxpayers who receive lump-sum Social Security payments covering multiple years the option of computing their income for the year of the lump-sum payment by, in effect, treating the payment as having been received in the years to which the payment relates, the National Taxpayer Advocate recommends adjusting the calculation of MAGI to exclude any portion of a lump-sum Social Security benefits payment attributable to a prior year for purposes of determining the amount of PTC for which they are eligible.

RECOMMENDATION

- Amend IRC § 36B(d)(2) to exclude from MAGI any portion of a lump-sum Social Security benefits payment attributable to a prior year pursuant to IRC § 86 for purposes of determining whether a taxpayer is eligible for a PTC and, if eligible, the amount of PTC allowed.¹⁰

7 TAS Research estimates that nearly 288,000 taxpayers were impacted by this lump-sum consequence in tax year 2019, which would have resulted in their disqualification for PTC. IRS, Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File.

8 This example is based on the 2020 Federal Poverty Level for a single-person household in the 48 contiguous states and Washington, D.C.

9 While this legislative recommendation focuses on the interaction between the PTC/APTC and Social Security benefits, we suggest considering the framework we present here for taxpayers who may experience the same financial impact when receiving other one-time lump-sum payments, such as Railroad Retirement Board (RRB) benefits.

10 For legislative language generally consistent with this recommendation, see Build Back Better Act, H.R. 5376, 117th Cong. § 137303 (as passed by the U.S. House of Representatives, Nov. 19, 2021).

Legislative Recommendation #62**Amend the Combat-Injured Veterans Tax Fairness Act of 2016 to Allow Veterans of the Coast Guard to Exclude Disability Severance Pay From Gross Income and File Claims for Credit or Refund for Taxes Withheld From Excluded Income****PRESENT LAW**

IRC § 61(a)(1) provides that compensation for services is includable in gross income. Severance payments generally are treated as compensation and therefore subject to taxation.

IRC § 104(a)(4) provides an exclusion from gross income for payments received for personal injuries or sickness resulting from active service in the armed forces.

IRC § 104(b)(2) clarifies that the exclusion from gross income in IRC § 104(a)(4) applies to an amount received because of a combat-related injury or if an individual, upon application, could receive disability compensation from the Department of Veterans Affairs. IRC § 104(b)(3) defines “combat-related injury” as a personal injury or sickness that occurred “as a direct result of armed conflict, while engaged in extrahazardous service, or under conditions simulating war; or which is caused by an instrumentality of war.”

To obtain a credit or refund, a taxpayer must file a timely claim. IRC § 6511(a) provides that a taxpayer generally must file a claim for credit or refund within three years from the time the tax return was filed or two years from the time the tax was paid, whichever period expires later.

In 2016, Congress passed the Combat-Injured Veterans Tax Fairness Act (the “Act”).¹ In a findings section, the Act states: “Since 1991, the Secretary of Defense has improperly withheld taxes from severance pay for wounded veterans, thus denying them their due compensation and a significant benefit intended by Congress.” Recognizing that the period of limitation for filing a claim for credit or refund to recover overwithheld tax had long since expired for most tax years since 1991, the Act created an exception from the general period of limitation.

Specifically, the Act directed the Secretary of Defense (i) to identify disability severance pay (DSP) that was not considered gross income pursuant to IRC § 104(a)(4) and from which the Secretary improperly withheld tax and (ii) to send notices to all affected veterans notifying them of their eligibility to receive credits or refunds and providing instructions for filing amended tax returns. It further provided that veterans who received DSP from the Department of Defense may file timely claims for credit or refund within one year from the date of the notice sent by the Secretary of Defense or by the date the period of limitations described in IRC § 6511(a) expires, whichever is later.

IRC § 7701(a)(15) defines the terms “military or naval forces of the United States” and “Armed Forces of the United States” to include “all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force [as well as] the Coast Guard.”

¹ Pub. L. No. 114-292, 130 Stat. 1500 (2016).

REASONS FOR CHANGE

Notwithstanding that the IRC's definition of "military or naval forces of the United States" includes the Coast Guard, the Act as drafted excludes veterans of the Coast Guard from its scope. Section 3(a) of the Act directed the Secretary of Defense to identify DSP paid after January 17, 1991, that should have been excluded from gross income, but the Coast Guard does not report to the Secretary of Defense. The Coast Guard reports to the Secretary of Homeland Security.

It seems likely that omitting the Coast Guard from the DSP tax relief provision resulted from a drafting error. Like members of the services within the Department of Defense, members of the Coast Guard often face perilous circumstances and potential injuries as they perform their mandated duties. For example, the Coast Guard maintains a "state of readiness to assist in the defense of the United States, including when functioning as a specialized service in the Navy pursuant to [14 USC] section 103."² There is no reason Coast Guard veterans should not be provided the same additional time to file a claim for credit or refund as other veterans of the "military or naval forces of the United States." While the number of veterans affected by this issue is relatively limited,³ the National Taxpayer Advocate believes fairness and parity in treatment among the armed forces of the United States require that this apparent drafting error be corrected.

RECOMMENDATION

- Amend Section 3(a) of the Combat-Injured Veterans Tax Fairness Act of 2016 to provide that the severance payments specified under Section 3(a) include those paid by the Secretary of Homeland Security (or predecessor) and to require the Secretary of Homeland Security to notify veterans of the Coast Guard about disability severance pay from which taxes were withheld.⁴

² 14 U.S.C. § 102.

³ The Treasury Inspector General for Tax Administration (TIGTA) recently estimated that 1,116 Coast Guard veterans are affected. See TIGTA, Ref. No. 2020-40-029, *Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled* 13 (May 26, 2020).

⁴ For legislative language generally consistent with this recommendation, see Coast Guard Combat-Injured Tax Fairness Act, H.R. 3739, 117th Cong. § 2 (2021).

Legislative Recommendation #63**Encourage and Authorize Independent Contractors and Service Recipients to Enter Into Voluntary Withholding Agreements****PRESENT LAW**

IRC Chapter 24, Collection of Income Tax at Source on Wages, provides for required withholding of taxes on wages paid to employees, certain gambling winnings, certain pensions and annuities, amounts subject to backup withholding, and certain other payments. In addition, IRC § 3402(p) provides for voluntary withholding at the option of the income recipient on certain payments such as Social Security benefits, unemployment benefits, and certain other benefits.¹ IRC § 3402(p)(3) authorizes the Secretary to promulgate regulations to provide for withholding from any payment that does not constitute wages if the Secretary finds withholding would be appropriate and the payor and recipient of the payment agree to such withholding.²

Although the Secretary may issue guidance by publication in the Internal Revenue Bulletin describing payments for which withholding under a voluntary withholding agreement would be appropriate,³ the only such guidance issued to date is Notice 2013-77, dealing with dividends and other distributions by Alaska Native Corporations.⁴

IRC § 6654(a) generally imposes a penalty for failure to pay sufficient estimated tax during the year, computed by applying (i) the underpayment rate established under IRC § 6621, (ii) to the underpayment, (iii) for the period of the underpayment.

REASONS FOR CHANGE

Unlike employees, whose wage payments are subject to federal income tax withholding, independent contractors are generally responsible for paying their own income taxes. Independent contractors generally must make four estimated tax payments during the year. However, many contractors fail to make estimated tax payments for a variety of reasons and therefore face penalties under IRC § 6654. In addition, some do not save enough funds to pay their taxes at the end of the year. As a result, they face additional penalties and interest charges, and they may face IRS collection action, including liens and levies.

The absence of withholding on payments to independent contractors also has a negative impact on revenue collection. IRS National Research Program studies show that tax compliance is substantially lower among workers whose income taxes are not withheld.⁵

This problem may be increasing as more workers are working in the so-called “gig economy.” In fact, as of 2021 there were about 50 million U.S. workers participating in the gig economy.⁶ To reduce the risk they will not save enough money to pay their taxes, some independent contractors would prefer that taxes be withheld throughout the year, as they are for employees. There is a legitimate debate about the circumstances under

¹ IRC § 3402(p)(1)(C) & (p)(2).

² IRC § 3402(p)(3) authorizes the promulgation of regulations for withholding from (i) an employee's remuneration for services that do not constitute wages and (ii) any other agreed-upon source that the Secretary finds appropriate. The Secretary must find the withholding would be appropriate “under the provisions of [IRC chapter 24, Collection of Income Tax at Source on Wages].” Payments made when a voluntary withholding agreement is in effect are treated as if they are wages paid by an employer to an employee for purposes of the income tax withholding provisions and related procedural provisions of subtitle F of the IRC.

³ See Treas. Reg. § 31.3402(p)-1(c).

⁴ Notice 2013-77, 2013-50 I.R.B. 632.

⁵ Government Accountability Office, GAO-17-371, *Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates* (Apr. 18, 2017), <https://www.gao.gov/products/GAO-17-371>.

⁶ Statista, *Gig Economy in the U.S. – Statistics & Facts* (Jan. 21, 2021), <https://www.statista.com/topics/4891/gig-economy-in-the-us/>.

which withholding should be required. However, the National Taxpayer Advocate believes the law should not discourage workers and businesses from entering into voluntary withholding agreements when both parties wish to do so.

For many businesses, withholding on payments to independent contractors will not impose additional burden. In addition to paying independent contractors, most large companies have full-time employees, such as administrative staff, so they already have procedures in place to withhold. We understand businesses are reluctant to withhold due to concerns that the IRS may cite the existence of withholding agreements to challenge underlying worker classification arrangements. These concerns would be addressed if the IRS is restricted from citing the existence of a voluntary withholding agreement as a factor in worker classification disputes. Indeed, the IRS could, on a case-by-case basis, provide a safe-harbor worker classification in which it affirmatively agrees not to challenge the classification of workers who are party to such agreements, since these agreements will help ensure the IRS collects taxes.

RECOMMENDATIONS

- Amend IRC § 3402(p) to clarify that when voluntary withholding agreements are entered into by parties who do not treat themselves as engaged in an employer-employee relationship, the IRS may not consider the existence of such agreements as a factor when challenging worker classification arrangements.
- Direct the Secretary to evaluate the benefits of agreeing not to challenge worker classification arrangements when voluntary withholding agreements are in place.⁷

⁷ For legislative language generally consistent with this recommendation, see Small Business Owners' Tax Simplification Act, H.R. 3717, 115th Cong. § 9 (2017).

Legislative Recommendation #64**Require the IRS to Specify the Information Needed in Third-Party Contact Notices****PRESENT LAW**

IRC § 7602(c)(1) generally requires the IRS to give taxpayers notice before contacting third parties (*e.g.*, banks, employers, employees, vendors, customers, friends, and neighbors) to request information about them. The IRS may provide this third-party contact (TPC) notice only if it intends to make a TPC during the period specified in the notice, which may not exceed one year. Generally, the IRS must send the notice at least 45 days before making the TPC.

IRC § 7602(c)(3) waives the TPC notice requirement if (i) the taxpayer has authorized the contact; (ii) the IRS determines for good cause that notice would jeopardize the IRS's tax collection efforts or may involve reprisal against any person; or (iii) the contact is made in connection with a criminal investigation. No law expressly requires the IRS to let the taxpayer know what specific information it needs (or needs to verify) before contacting third parties.

REASONS FOR CHANGE

The TPC notice requirement was enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). The Senate report accompanying the bill explained that “taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.”¹ The House-Senate conference report accompanying RRA 98 stated that “in general” the TPC notice “will be provided as part of an existing IRS notice.”² Based on the conference report, the IRS implemented the TPC notice requirement by including generic language in Publication 1, *Your Rights as a Taxpayer*, which the IRS sends to taxpayers in a variety of circumstances whether or not it plans to make a TPC.³

When Congress enacted the Taxpayer First Act (TFA), it rejected the generic approach of including the TPC language in Publication 1. The TFA amended IRC § 7602(c) to require the IRS to send the TPC notice only when it intends to make a TPC and to send the TPC notice at least 45 days before making the contact.⁴ In explaining the change, the House report accompanying the TFA quoted testimony from a former IRS official who said the then-existing TPC notice requirement was “useless and does not effectively apprise taxpayers that such contact will be made, to whom it will be made, or that the taxpayer can request a third party contact report from the IRS.”⁵ The House report said TPCs “may have a chilling effect on the taxpayer’s business and could damage the taxpayer’s reputation in the community.” It also said the change would “provide taxpayers more of an opportunity to resolve issues and volunteer information before the IRS contacts third parties.”

If the TPC notices were included “as part of an existing IRS notice” such as Form 4564, *Information Document Request*, which requests information from the taxpayer, then the new 45-day period would give the taxpayer a realistic opportunity to avoid a TPC that seeks new information by providing the information

1 S. REP. NO. 105-174, at 77 (1998).

2 H.R. REP. NO. 105-599, at 277 (1998) (Conf. Rep.).

3 IRS Pub. 1, *Your Rights as a Taxpayer* (Sept. 2017). Under the heading “Potential Third Party Contacts,” Pub. 1 states, in part: “[W]e sometimes talk with other persons if we need information that you have been unable to provide or to verify information we have received.”

4 Pub. L. No. 116-25, § 1206, 133 Stat. 981, 990 (2019).

5 H.R. REP. NO. 116-39, pt. 1, at 44-45 (2019). This report accompanied H.R. 1957, 116th Cong. (2019). Congress ultimately made one change to H.R. 1957 unrelated to the TPC provision and enacted the TFA as H.R. 3151, 116th Cong. (2019). However, H.R. REP. NO. 116-39 remains the sole committee report explaining the TFA.

requested on the form. However, the IRS generally does not include a request for that information with the TPC notice.⁶

A tailored notice that identifies the specific information for which the IRS is about to contact third parties would be more effective in motivating taxpayers to provide the information than a generic notice. The IRS has previously tailored TPC notices in this way.⁷ Generating tailored notices would not unduly burden the IRS because most IRS third-party contacts occur in the collection context, where the IRS is seeking assets rather than information.⁸ In addition, in the subset of cases where the IRS is seeking specific information, identifying what information the IRS is seeking would empower the taxpayer to protect his or her reputation by providing the information so that the TPC is unnecessary. Thus, using tailored TPC notices is consistent with a taxpayer's *right to be informed* and *right to privacy*, which includes the right to expect enforcement to be no more intrusive than necessary,⁹ and it might reduce the need for the IRS to spend resources needed to make the TPCs as well.

RECOMMENDATION

- Amend IRC § 7602(c) to clarify that the IRS must tell the taxpayer in a TPC notice what information it needs and allow the taxpayer a reasonable opportunity to provide the information before contacting a third party, unless doing so would be pointless (*e.g.*, because the taxpayer does not have the information the IRS needs) or an exception applies.

6 See, *e.g.*, IRS, New Third Party Contact Requirements, SBSE-05-0520-0639 (May 26, 2020); Letters 3164, Notification of Third Party Contact.

7 For further discussion, see National Taxpayer Advocate 2015 Annual Report to Congress 123, 127 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*); National Taxpayer Advocate 2018 Objectives Report to Congress 98-101 (Area of Focus: *IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective*).

8 Third-party contacts often arise from IRS requests for payment from third parties, such as banks served with a levy for the taxpayer's funds on deposit or in connection with the advertising or conduct of public auction sales of the taxpayer's property. A prior TAS study found that the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases. National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*). This proposal generally does not cover collection contacts, because in those cases, the IRS is not asking a third party for information that the taxpayer could provide.

9 IRS, Pub. 1, Your Rights as a Taxpayer (Sept. 2017).

Legislative Recommendation #65**Authorize the Treasury Department to Issue Guidance Specific to IRC § 6713 Regarding the Disclosure or Use of Tax Return Information by Preparers****PRESENT LAW**

IRC §§ 7216 and 6713 impose criminal and civil sanctions, respectively, on preparers who disclose or use tax return information for any purpose other than preparing or assisting in the preparation of a tax return, except as expressly permitted by statute or regulation. IRC § 7216 requires that a disclosure or use be knowing or reckless to constitute a criminal violation. IRC § 6713 does not require knowledge or recklessness for a civil violation.

Exceptions to the broad prohibition in IRC § 6713 are provided in IRC § 6713(c), which states that the rules of IRC § 7216(b) apply. IRC § 7216(b) authorizes the Secretary to create regulatory exceptions to the criminal penalty statute. Thus, the current statutory framework seemingly requires that exceptions be made either to both the criminal and civil statutes or to neither.

REASONS FOR CHANGE

IRC § 6713 has historically been identified as the civil counterpart to the criminal penalty imposed on tax return preparers under IRC § 7216. As one would expect, the criminal penalty under IRC § 7216 is substantially harsher than the civil penalty under IRC § 6713.¹ For that reason, the Treasury Department is understandably reluctant to subject preparers to criminal sanctions except for egregious conduct, so it has used its regulatory authority to carve out broad exceptions from the general prohibition on the disclosure or use of tax return information set forth in IRC § 7216.²

Because the exceptions under IRC § 7216 (criminal statute) are deemed to apply to IRC § 6713 (civil statute), there is no room for the Treasury Department and the IRS to designate the disclosure or use of tax return information due to negligence or for certain questionable business practices or the sale of certain products with high abuse potential as civil violations without also making them criminal violations. Therefore, if a prohibited disclosure or use is not egregious in nature (*e.g.*, negligent noncompliance with form-and-content requirements for taxpayer consents), it is generally tolerated. The Treasury Department and the IRS will be more likely to strengthen taxpayer protections against the improper disclosure or use of taxpayer return information by return preparers if they are given the flexibility to promulgate separate regulations applicable to the civil penalty, without concern that the criminal penalty will also apply.³

RECOMMENDATION

- Amend IRC § 6713 to authorize the Secretary to prescribe regulations under IRC § 6713.

1 IRC § 6713 imposes a \$250 penalty for each improper disclosure or use, with total penalties not to exceed \$10,000 per calendar year. The penalty amount increases to \$1,000 for each disclosure and use related to identity theft, with total penalties not to exceed \$50,000 per calendar year. By contrast, IRC § 7216 makes the preparer guilty of a misdemeanor, and upon conviction, the preparer will be fined not more than \$1,000 (\$100,000 if the disclosure or use is related to identity theft) or imprisoned for not more than one year, or both, and liable for the costs of prosecution.

2 See Treas. Reg. § 301.7216-2.

3 As a general matter, IRC § 7805(a) grants the Secretary the broad authority to promulgate regulations under the Internal Revenue Code. However, because IRC § 6713(c) provides that exceptions to IRC § 6713 are governed by the rules of IRC § 7216(b), it is not clear that the IRS may establish separate sets of exceptions for the two Code provisions.

Legislative Recommendation #66**Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic Program****PRESENT LAW**

IRC § 7526 authorizes the Secretary, subject to the availability of appropriated funds, to provide grants as matching funds for the development, expansion, or continuation of Low Income Taxpayer Clinics (LITCs). The LTC program was authorized as part of the IRS Restructuring and Reform Act of 1998 to provide free or nominal-cost representation of low-income taxpayers who are involved in controversies with the IRS and to provide education about taxpayer rights and responsibilities in multiple languages for taxpayers who speak English as a second language (ESL taxpayers).

IRC § 7526(c)(1) imposes an annual aggregate limitation of \$6 million for LTC grants “[u]nless otherwise provided by specific appropriation.”

IRC § 7526(c)(2) imposes an annual limitation on grants to a single clinic of \$100,000.

IRC § 7526(c)(5) limits the amount of federal LTC funding a clinic may receive to the amount it raises from other sources (*i.e.*, a 100 percent matching funds requirement). The match may be in cash or third party in-kind contributions (*e.g.*, volunteer time, donated supplies).

REASONS FOR CHANGE

The LTC program is an effective and low-cost means to assist low-income and ESL taxpayers. In 2021, the LTC Program Office awarded grants to 130 organizations in 47 states and the District of Columbia.¹ In 2020, the most recent year for which complete data is available, clinics receiving grant funds represented nearly 20,000 taxpayers dealing with an IRS tax controversy, including in cases before the U.S. Tax Court. They provided consultations or advice to an additional 18,000 taxpayers. The clinics work closely with the Tax Court and the IRS Office of Chief Counsel to resolve docketed cases on a pre-trial basis where possible. They helped taxpayers secure more than \$5.8 million in tax refunds and reduced or corrected taxpayers’ liabilities by more than \$116 million. They also brought thousands of taxpayers back into filing and payment compliance, and helped ensure that individuals understood their rights and responsibilities as U.S. taxpayers by conducting more than 1,000 educational activities that were attended by nearly 134,000 individuals.²

The success of the LTC program is tied largely to the extensive use of volunteers. Some 1,500 volunteers contributed to the success of LITCs by volunteering over 42,000 hours of their time. More than 65 percent of the volunteers were attorneys, certified public accountants, or enrolled agents.³

There are many underserved low-income taxpayers across the nation that could benefit from LTC assistance, but IRC § 7526 contains restrictions that limit expansion of the LTC program to assist additional taxpayers. First, the annual limitation on grants to a single clinic of \$100,000, which has remained unchanged since 1998, prevents the LTC Program Office from awarding additional funds to qualified clinics that have demonstrated excellence in assisting low-income and ESL taxpayers and the ability to efficiently handle more cases. Even if the restriction were to be retained, the \$100,000 cap enacted in 1998 would have to be

¹ See IRS Pub. 4134, Low Income Taxpayer Clinic List (July 2021).

² See IRS Pub. 5066, Low Income Taxpayer Clinics 2021 Program Report 4 (revised Nov. 2021), <https://www.irs.gov/pub/irs-pdf/p5066.pdf>.

³ *Id.* at 14.

raised to about \$170,000 simply to reflect the effects of inflation.⁴ However, the LITC Program Office could ensure more taxpayers receive LITC services if it is given discretion to provide larger grants to clinics that demonstrate they can use funds productively, consistent with the objective of providing maximum geographic coverage to taxpayers across the United States. In 2019, Congress authorized an analogous program, the Volunteer Income Tax Assistance (VITA) matching grant program, which provides free tax return preparation for individuals with low to moderate incomes (*i.e.*, below the maximum EITC threshold), individuals with disabilities, and individuals with limited English proficiency.⁵ In doing so, it did not impose a per-program grant limitation. We recommend that the per-clinic limitation in the LITC statute be similarly removed.

Second, the 100 percent matching funds requirement may serve as a barrier to coverage. The purpose of the match requirement is to ensure that each clinic's management has a broad commitment to serving taxpayers and solicits resources to further that objective. In general, strong clinics do not have difficulty meeting the requirement, and we believe the match requirement generally should be retained. In limited circumstances, however, resources to meet the match requirement may be limited, and taxpayers would be better served if the LITC Program Office is given the discretion to reduce it (but not below 50 percent). The LITC Program Office has encountered difficulty identifying and funding clinics in certain geographic areas, and a lower match requirement may make it economically feasible for other potential clinics to operate. If our recommendation to eliminate the \$100,000 per-clinic funding cap is adopted, clinics that can meet the 100 percent matching funds requirement when receiving grants of \$100,000 may have difficulty raising funds in excess of \$100,000 on a 1:1 basis. Thus, clinics awarded grants in excess of \$100,000 should not be held to the same 100 percent matching funds requirement, and the LITC Program Office should be authorized to exercise limited discretion in setting an appropriate matching rate.

Third, the LITC statute, written in 1998, authorizes the program at a funding level of up to \$6 million “[u]nless otherwise provided by specific appropriation.” In practice, the \$6 million authorization has not had an impact because the program is routinely funded by specific appropriation. The current appropriation is for \$13 million.⁶ However, raising the authorized appropriation level would make a statement of congressional support regarding the success of the program and the importance of providing representation for low-income taxpayers and education and outreach for ESL taxpayers.

RECOMMENDATIONS

- Eliminate the \$100,000 per-clinic funding cap imposed under current law by removing subsection (2) from IRC § 7526(c) and renumbering subsequent subsections accordingly.
- Amend IRC § 7526(c)(5) to provide that the 100 percent “matching funds” requirement is the general rule but that the Secretary has the discretion to set a lesser matching rate (but not below 50 percent) where doing so would expand coverage to additional taxpayers.
- Raise the overall authorized LITC program funding limitation from \$6 million to \$25 million in IRC § 7526(c)(1) and provide that the amount is to be increased annually by the percentage increase during the preceding calendar year in the Chained Consumer Price Index for All Urban Consumers (as published by the Bureau of Labor Statistics of the Department of Labor).

4 See Bureau of Labor Statistics, CPI Inflation Calculator, https://www.bls.gov/data/inflation_calculator.htm (last visited Nov. 24, 2021).

5 See IRC § 7526A (generally modeled after the IRC § 7526 LITC statute).

6 Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182, 1385 (2020).

Legislative Recommendation #67**Compensate Taxpayers for “No Change” National Research Program Audits****PRESENT LAW**

There is no provision under present law that authorizes compensation of taxpayers who are audited under the IRS’s National Research Program (NRP) or provides relief from the assessment of tax, interest, and penalties that may result from an NRP audit.

REASONS FOR CHANGE

Through the NRP, the IRS conducts audits of randomly selected taxpayers. The NRP benefits tax administration by gathering strategic information about taxpayer compliance behavior as well as information about the causes of reporting errors. This information helps the IRS update its workload selection formulas and thereby enables it to focus its audits on returns with relatively high likelihoods of error. It also helps the IRS to estimate the “tax gap.” In addition, NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policies.

For the tens of thousands of individual taxpayers (or businesses) that are subject to NRP audits, however, they impose significant burdens. In essence, these taxpayers, even if fully compliant, serve as “guinea pigs” to help the IRS improve the way it does its job. They must contend with random and intensive audits that consume their time, drain resources (including representation fees), and may impose an emotional and reputational toll.

In 1995, the House Ways and Means Subcommittee on Oversight held a hearing on the NRP’s predecessor, the Taxpayer Compliance Measurement Program (TCMP).¹ Testimony provided during the hearing, and subsequent witness responses to questions-for-the-record, indicated that TCMP audits imposed a heavy burden on taxpayers and reflected a strong view that audited taxpayers were bearing the brunt of a research project intended to benefit the tax system as a whole. Proposals raised at the hearing included compensating taxpayers selected for TCMP audits as well as possibly waiving tax, interest, and penalties assessed during the audits.

Following the hearing, the House Budget Committee included a proposal in its 1995 budget reconciliation bill to compensate individual taxpayers by providing a tax credit of up to \$3,000 for TCMP-related expenses.² Ultimately, this proposal was not adopted. Instead, the IRS was pressured to stop conducting TCMP audits. The inability to perform regular TCMP audits, however, undermined effective tax administration because it prevented the IRS from updating its audit formulas. Using older formulas likely meant that more compliant taxpayers faced (unproductive) audits and that audit revenue declined.

About a decade later, the IRS reinstated the TCMP under the new NRP name. Some procedures were changed, but the random selection of taxpayers and the burden on many of these taxpayers remained substantially unchanged. For the same reasons identified during the 1995 House hearing, the National Taxpayer Advocate believes it is appropriate to recognize that taxpayers audited under the NRP are bearing a heavy burden to help the IRS improve the effectiveness of its compliance activities. A tax credit or authorized payment would alleviate the monetary component of the burden. Further relief could be provided by waiving any assessment of tax, interest, and penalties resulting from an NRP audit. Such a waiver might also improve

¹ *Taxpayer Compliance Measurement Program, Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means, 104th Cong. (1995).*

² *See H.R. REP. NO. 104-280, vol. 2, at 28 (1995).*

the accuracy of the NRP audits, as taxpayers might be more likely to be forthcoming with an auditor if they were assured they would not face additional assessments. However, this waiver should not apply where tax fraud or an intent to evade tax is uncovered in an NRP audit.

RECOMMENDATIONS

- Amend the IRC to compensate taxpayers for no change NRP audits through a tax credit or other means.
- Consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.

Legislative Recommendation #68**Establish the Position of IRS Historian Within the Internal Revenue Service to Record and Publish Its History****PRESENT LAW**

The IRS, as a federal agency, is required to properly maintain and manage its records under the Federal Records Act¹ and to provide public access to these records under the Freedom of Information Act.² However, the IRS is not required to publish a historical analysis of its tax administration programs and policies.

REASONS FOR CHANGE

A documented history of the IRS's programs and policies would assist Congress, the agency itself, and the public. It would assist Congress by helping Members and staff gain a fuller understanding of the IRS's successes and failures, so future legislation can be developed that plays to the agency's strengths and helps to address the agency's weaknesses. It would help the IRS assess its programs, reduce redundant efforts, and share knowledge within the agency. In addition, an IRS historian could assist the public by promoting a more accountable and transparent IRS.³

During the early 1990s, the IRS decided to hire an IRS historian. However, the relationship was tense, and the individual who held the position told Congress that the IRS undermined her work and fought transparency, concluding that "the IRS shreds its paper trail, which means there is no history, no evidence, and ultimately no accountability."⁴ The IRS eliminated the position and never hired a historian again.

Numerous offices of history operate in the executive, judicial, and legislative branches.⁵ Government historians serve various roles, such as researching and writing for publication and internal use, editing historical documents, preserving historical sites and artifacts, and providing historical information to the public through websites and other media.⁶ Historians should be objective and accurate.⁷ For example, the Historian of the Department of State is required to publish a documentary history of the foreign policy decisions and actions of the United States, including facts providing support for, and alternative views to, policy positions ultimately adopted, without omitting or concealing defects in policy.⁸ Historians in federal agencies serve an important role, and because more U.S. citizens interact with the IRS than any other federal agency, the public interest and potential benefit in learning from the agency's successes and failures are high.

RECOMMENDATION

- Add a new subsection to IRC § 7803 to establish the position of IRS historian within the IRS. The IRS historian should have expertise in federal taxation and archival methods, be appointed by the Secretary

1 44 U.S.C. §§ 3101-3107.

2 5 U.S.C. § 552.

3 See, e.g., 22 U.S.C. § 4351(a), which states in pertinent part: "Volumes of this publication [Foreign Relations of the United States historical series] shall include *all records* needed to provide a comprehensive documentation of the major foreign policy decisions and actions of the United States Government, including the facts which contributed to the formulation of policies and records providing supporting and alternative views to the policy position ultimately adopted" (emphasis added).

4 See *Practices & Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 35 (Sept. 23-25, 1997) (statement of Shelley Davis, former IRS Historian).

5 Society for History in the Federal Government, *History at the Federal Government*, <http://www.shfg.org/history-at-fedgov> (last visited Sept. 28, 2021).

6 Society for History in the Federal Government, *Historical Programs in the Federal Government: A Guide* (1992), <http://www.shfg.org/resources/Documents/Historical%20Programs.pdf>.

7 *Id.*

8 22 U.S.C. § 4351(a).

of the Treasury in consultation with the Archivist of the United States, and report to the Commissioner of Internal Revenue. The duties of the IRS historian require access to IRS records, including tax returns and return information (subject to the confidentiality and disclosure provisions of IRC § 6103). The IRS historian should be required to report IRS history objectively and accurately, without omitting or concealing defects in policy.⁹

⁹ For additional background, see National Taxpayer Advocate 2011 Annual Report to Congress 582-586 (Legislative Recommendation: *Appoint an IRS Historian*).

APPENDIX 1: Additional Reference Materials for Legislative Recommendations in This Volume

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
Strengthen Taxpayer Rights			
1	Elevate the Importance of the Taxpayer Bill of Rights by Redesignating It as Section 1 of the Internal Revenue Code.	NTA 2017 Annual Report 93; NTA 2016 Annual Report 15; NTA 2016 Annual Report 98; NTA 2013 Annual Report 51; NTA 2013 Annual Report 5; NTA 2011 Annual Report 493; NTA 2007 Annual Report 478.	S. 3278, 115th Cong. § 102(2) (2018) (taxpayer rights training requirement); S. 2333, 114th Cong. § 308 (2015) (same); H.R. 4128, 114th Cong. § 308 (2015) (same).
2	Revamp the IRS Budget Structure and Provide Sufficient Funding to Improve the Taxpayer Experience and Modernize the IRS's Information Technology Systems.	NTA 2020 Annual Report 12; NTA 2019 Annual Report 14; NTA 2019 Annual Report 22; NTA 2019 Annual Report 33.	IRS Enhancement and Tax Gap Reduction Act of 2021, H.R. 1116, 117th Congress (2021) (partial); IRS Enhancement and Tax Gap Reduction Act of 2020, H.R. 6076, 116th Cong. (2020) (partial).
Improve the Filing Process			
3	Treat Electronically Submitted Tax Payments and Documents as Timely If Submitted Before the Applicable Deadline.	N/A	H.R. 7641, 116th Cong. § 1 (2020).
4	Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers.	NTA 2009 Annual Report 41; NTA 2008 Annual Report 423.	Taxpayer Protection and Preparer Proficiency Act, H.R. 4184, 117th Cong. (2021); S. 1192, 116th Cong. § 2(c) (2019); S. 1138, 116th Cong. § 5(c) (2019); H.R. 3157, 116th Cong. § 5 (2019); H.R. 3330, 116th Cong. § 2 (2019); H.R. 3466, 116th Cong. § 1 (2019) (allows the Department of the Treasury to rescind ID numbers of tax return preparers); H.R. 4751, 116th Cong. § 2 (2019) (adds penalties for tax return preparers who are not representatives practicing before the Department of the Treasury); S. 3278, 115th Cong. § 202 (2018); H.R. 4912, 114th Cong. § 401 (2016); S. 676, 114th Cong. § 406 (2015); S. 2333, 114th Cong. § 202 (2015); H.R. 4128, 114th Cong. § 202 (2015); S. 137, 114th Cong. § 2 (2015); H.R. 4141, 114th Cong. § 2 (2015);

LR #4 continued on next page

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
			H.R. 1528, 108th Cong. § 141 (2004) (passed by Senate); S. 882, 108th Cong. § 141 (2003) (reported by Sen. Fin. Comm.), <i>see also</i> S. REP. No. 108-257, at 30-31 (2003).
5	Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper.	NTA 2020 Annual Report 75; NTA 2013 Annual Report vol. 2, at 70, 91, & 96.	S. 3246, 115th Cong. § 2104 (2018); S. 606, 115th Cong. § 205 (2017); S. 3157, 114th Cong. § 205 (2016) (reported by Sen. Fin. Comm.), <i>see also</i> S. REP. No. 114-299, at 20-21 (2016); S. 2736, 113th Cong. § 4 (2014).
6	Extend the Time for Small Businesses to Make Subchapter S Elections.	NTA 2010 Annual Report 410; NTA 2004 Annual Report 390; NTA 2002 Annual Report 246.	S. 3278, 115th Cong. § 304 (2018); S. 711, 115th Cong. § 7 (2017); H.R. 1696, 115th Cong. § 7 (2017); H.R. 1, 113th Cong. § 3606 (2014); S. 2271, 112th Cong. § 2 (2012); H.R. 3629, 109th Cong. § 2 (2005); H.R. 3841, 109th Cong. § 302 (2005).
7	Adjust Estimated Tax Payment Deadlines to Occur Quarterly.	N/A	H.R. 593, 116th Cong. § 2 (2019); S. 3278, 115th Cong. § 305 (2018); H.R. 3717, 115th Cong. § 2 (2017).
8	Harmonize Reporting Requirements for Taxpayers Subject to Both the Report of Foreign Bank and Financial Accounts and the Foreign Account Tax Compliance Act by Eliminating Duplication and Excluding Accounts Maintained by U.S. Persons in the Country Where They Are <i>Bona Fide</i> Residents.	NTA 2015 Annual Report 353.	S. 869, 115th Cong. § 1 (2017) (pertaining to FATCA reporting requirements repeal); H.R. 2054, 115th Cong. § 1 (2017) (same); H.R. 2136, 115th Cong. § 1 (2017) (same); H.R. 5935, 114th Cong. § 1 (2016) (same); S. 663, 114th Cong. § 1 (2015) (same); S. 887, 113th Cong. § 1 (2013) (same).
9	Adjust the Filing Threshold for Taxpayers Filing as Married Filing Separately and Nonresident Alien Individuals.	N/A	N/A
10	Amend the Lookback Period for Allowing Tax Credits or Refunds Under IRC § 6511(b)(2)(A) to Include the Period of Any Postponement of Time for Filing a Return Under IRC § 7508A.	NTA 2018 Annual Report 392.	N/A

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
Improve Assessment and Collection Procedures			
11	Require That Math Error Notices Describe the Reason(s) for the Adjustment with Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified Mail.	NTA 2018 Annual Report 174; NTA 2014 Annual Report 163; NTA 2011 Annual Report 74; NTA 2004 Annual report 163; NTA 2003 Annual report 113; NTA 2001 Annual Report 33.	N/A
12	Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute.	NTA 2015 Annual Report 329; NTA 2014 Annual Report 163; NTA 2011 Annual Report 74.	N/A
13	Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans.	N/A	N/A
14	Allow Additional Time for Taxpayers to Request Abatement of a Math Error Assessment Equal to the Additional Time Allowed to Respond to a Notice of Deficiency When the Math Error Notice Is Addressed to a Person Outside the United States.	NTA 2016 Annual Report 393.	N/A
15	Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures.	NTA 2020 Annual Report 119.	N/A
16	Amend IRC § 6330 to Provide That "An Opportunity to Dispute" an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum.	NTA 2018 Annual Report 367.	N/A
17	Amend IRC § 6402(a) to Prohibit Offset of the Earned Income Tax Credit (EITC) Portion of a Tax Refund.	NTA 2016 Annual Report 325; NTA 2009 Annual Report 365.	N/A

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
18	Require the IRS to Waive User Fees for Taxpayers Who Enter Into Low-Cost Installment Agreements or Who Have an Adjusted Gross Income Equal to or Less Than 250 Percent of the Federal Poverty Level.	NTA 2017 Annual Report 307; NTA 2015 Annual Report 14; NTA 2007 Annual Report 66.	S. 1793, 115th Cong. § 301 (2017); S. 3471, 114th Cong. § 504 (2016) (reported by Sen. Fin. Comm.) (low-income fee waiver provisions and limitation on future increase), <i>see also</i> S. REP. No. 114-375, at 84 (2016); S. 3156, 114th Cong. § 114 (2016) (low-income fee waiver provisions and limitation on future increase), <i>see also</i> S. REP. No. 114-298, at 17-19 (2016); S. 1321, 109th Cong. § 301 (2006); H.R. 1528, 108th Cong. § 101 (2004) (passed by Senate); S. 882, 108th Cong. § 101 (2003), <i>see also</i> S. REP. No. 108-257, at 5-6 (2003).
19	Improve Offer in Compromise Program Accessibility by Repealing the Partial Payment Requirement and Restructuring the User Fee.	NTA 2006 Annual Report 507.	H.R. 3738, 117th Cong. § 206 (2021); S. 2689, 115th Cong. § 17 (2018); H.R. 5444, 115th Cong. § 11203 (2018) (low income waiver); S. 3278, 115th Cong. § 504 (2018) (low income waiver); H.R. 2171, 115th Cong. § 206 (2017); H.R. 4912, 114th Cong. § 206 (2015).
20	Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise.	N/A	S. 1793, 115th Cong. § 303 (2017); S. 1578, 114th Cong. § 403 (2015); H.R. 1528, 108th Cong. § 304 (2004) (passed by Senate); S. 882, 108th Cong. § 104 (2003), <i>see also</i> S. REP. No. 108-257, at 8-9 (2003); H.R. 1528, 108th Cong. § 304 (2003) (passed by House), <i>see also</i> H.R. REP. No. 108-61, at 43-44 (2003).
21	Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise.	NTA 2006 Annual Report 507-519.	Taxpayer Protection Act, H.R. 2171, 115th Cong. § 206 (2017); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 206 (2015).
22	Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities.	N/A	S. 3278, 115th Cong. § 201 (2018).
23	Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins.	N/A	N/A

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
24	Protect Retirement Funds From IRS Levies, Including So-Called "Voluntary" Levies, in the Absence of "Flagrant Conduct" by a Taxpayer.	NTA 2015 Annual Report 340; NTA 2006 Annual Report 527.	H.R. 3738, 117th Cong. § 203 (2021); H.R. 2171, 115th Cong. § 203 (2017); H.R. 3340, 115th Cong. § 204 (2017); H.R. 4912, 114th Cong. § 203 (2016); S. 2333, 114th Cong. §§ 306 & 307 (2015); H.R. 4128, 114th Cong. §§ 306 & 307 (2015).
25	Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence.	NTA 2019 Annual Report 176; NTA 2012 Annual Report 537.	S. 949, 114th Cong. § 16 (2015); H.R. 1828, 114th Cong. § 16 (2015); S. 2215, 113th Cong. § 8 (2014).
26	Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions.	NTA 2019 Annual Report 176; NTA 2012 Annual Report 544.	S. REP. No. 105-174, at 68 (1998) (Senate report accompanying its version of the RRA 98 legislation referred to "[t]he taxpayer (or affected third party).").
27	Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions.	N/A	S. 1793, 115th Cong. § 201(c) (2017) (extends the time limit, though not by the recommended amount); S. 1578, 114th Cong. § 301(c) (2015) (same).
28	Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship.	N/A	N/A
29	Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act.	N/A	N/A
Reform Penalty and Interest Provisions			
30	Convert the Estimated Tax Penalty Into an Interest Provision to Properly Reflect Its Substance.	N/A	H.R. 1528, 108th Cong. § 101 (2003) (passed by House), <i>see also</i> H.R. REP. No. 108-61, at 23-24 (2003).
31	Apply One Interest Rate Per Estimated Tax Underpayment Period.	N/A	S. 1793, 115th Cong. § 305 (2017); S. 1578, 114th Cong. § 405 (2015); H.R. 1528, 108th Cong. § 101 (2003) (passed by House), <i>see also</i> H.R. REP. No. 108-61, at 25 (2003).
32	Pay Interest to Taxpayers on Excess Payments of Estimated Tax to the Same Extent Taxpayers Must Pay a Penalty on Underpayments of Estimated Tax.	N/A	N/A

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
33	Reduce the Federal Tax Deposit Penalty Imposed on Taxpayers Who Make Timely Tax Deposits.	NTA 2001 Annual Report 222.	S. 1793, 115th Cong. § 309 (2017); S. 1578, 114th Cong. § 409 (2015); S. 1321, 109th Cong. § 405 (2005), <i>see also</i> S. REP. No. 109-336, at 48-49 (2005); H.R. 1528, 108th Cong. § 207 (2004) (passed by Senate); S. 882, 108th Cong. § 208 (2003), <i>see also</i> S. Rep. No. 108-257, at 45 (2004); H.R. 1528, 108th Cong. § 108 (2003) (passed by House), <i>see also</i> H.R. REP. No. 108-61, at 35-36 (2003).
34	Extend Reasonable Cause Defense for the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to E-File Their Returns.	N/A	N/A
35	Authorize a Penalty for Tax Return Preparers Who Engage in Fraud or Misconduct by Altering a Taxpayer's Tax Return.	NTA 2011 Annual Report 558.	S. 2333, 114th Cong. § 203 (2015); H.R. 4128, 114th Cong. § 203 (2015).
36	Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties.	NTA 2019 Annual Report 157.	N/A
37	Require an Employee to Determine and a Supervisor to Approve All Negligence Penalties Under IRC § 6662(b)(1).	NTA 2021 Purple Book 71.	N/A
38	Modify the Definition of "Willful" for Purposes of Finding Report of Foreign Bank and Financial Accounts Violations and Reduce the Maximum Penalty Amounts.	NTA 2014 Annual Report 331-345.	N/A
Strengthen Taxpayer Rights Before the Office of Appeals			
39	Require Taxpayers' Consent Before Allowing IRS Counsel or Compliance Personnel to Participate in Appeals Conferences.	NTA 2017 Annual Report 203.	S. 3278, 115th Cong. § 601 (2018); S. 2689, 115th Cong. § 7 (2018); S. 949, 114th Cong. § 7 (2015) (bans <i>ex parte</i> communications between Appeals and other IRS employees on matters before Appeals); H.R. 1828, 114th Cong. § 7 (2015) (same); S. 725, 113th Cong. § 7 (2013) (same); H.R. 3479, 113th Cong. § 7 (2013) (same); S. 2291, 112th Cong. § 7 (2012) (same); H.R. 4375, 112th Cong. § 7 (2012) (same).

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
Strengthen the Office of the Taxpayer Advocate			
40	Clarify That the National Taxpayer Advocate May Hire Legal Counsel to Enable Her to Advocate Effectively for Taxpayers.	NTA 2016 Annual Report 37; NTA 2011 Annual Report 573; NTA 2002 Annual Report 198.	H.R. 1528, 108th Cong. § 306 (2003) (passed by House), <i>see also</i> H.R. REP. No. 108-61, at 44-45 (2003); H.R. 1661, 108th Cong. § 335 (2003).
41	Clarify the Authority of the National Taxpayer Advocate to Make Personnel Decisions to Protect the Independence of the Office of the Taxpayer Advocate.	N/A	N/A
42	Clarify the Taxpayer Advocate Service's Access to Files, Meetings, and Other Information.	NTA 2016 Annual Report 34.	H.R. 5444, 115th Cong. § 11402(b)(3)(A) (2018) (providing "statistical support" for the Annual Report to Congress); S. 2333, 114th Cong. § 403 (2015) (addressing case-related file and meeting access); H.R. 4128, 114th Cong. § 403 (2015) (addressing case-related file and meeting access).
43	Authorize the National Taxpayer Advocate to File <i>Amicus</i> Briefs.	NTA 2016 Annual Report 37; NTA 2011 Annual Report 573; NTA 2002 Annual Report 198.	N/A
44	Require the IRS to Address the National Taxpayer Advocate's Comments in Final Rules.	NTA 2016 Annual Report 37; NTA 2011 Annual Report 573.	S. 1578, 114th Cong. § 404 (2015) (require the IRS to solicit NTA comments before publication rather than after).
45	Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations.	NTA 2011 Annual Report 552.	S. 2333, 114th Cong. § 404 (2015) (TAS may provide assistance to taxpayers facing enforcement actions during a lapse in appropriations); H.R. 4128, 114th Cong. § 404 (2015) (same).
46	Repeal Statute Suspension Under IRC § 7811(d) for Taxpayers Seeking Assistance From the Taxpayer Advocate Service.	NTA 2015 Annual Report 316.	H.R. 2171, 115th Cong. § 202 (2017); H.R. 4912, 114th Cong. § 202 (2016).
Strengthen Taxpayer Rights in Judicial Proceedings			
47	Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties.	NTA 2021 Purple Book 94-97; NTA 2018 Annual Report 364.	N/A
48	Repeal <i>Flora</i> : Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can.	NTA 2018 Annual Report 364.	N/A

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
49	Authorize the Tax Court to Order Refunds or Credits in Collection Due Process Proceedings Where Liability Is at Issue.	N/A	N/A
50	Provide That the Time Limits for Bringing Tax Litigation Are Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling.	NTA 2017 Annual Report 283.	N/A
51	Amend IRC § 7456(a) to Expand the Authority of the Tax Court to Issue Subpoenas for the Production of Records Held by a Third Party Prior to a Scheduled Hearing.	N/A	N/A
52	Provide That the Scope of Judicial Review of Determinations Under IRC § 6015 Is <i>De Novo</i> .	NTA 2011 Annual Report 531.	H.R. 5444, 115th Cong. § 11303 (2018); S. 3246, 115th Cong. § 1003 (2018); H.R. 3340, 115th Cong. § 202 (2017); S. 3156, 114th Cong. § 113 (2016); H.R. 4128, 114th Cong. § 303 (2015); S. 2333, 114th Cong. § 303 (2015).
53	Clarify That Taxpayers May Raise Innocent Spouse Relief as a Defense in Collection Proceedings and in Bankruptcy Cases.	NTA 2010 Annual Report 377; NTA 2009 Annual Report 378; NTA 2007 Annual Report 549.	N/A
54	Clarify That Taxpayers May Seek Innocent Spouse Relief in Refund Suits.	NTA 2018 Annual Report 387.	N/A
55	Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers With Filing Extensions.	NTA 2018 Annual Report 392.	N/A
Miscellaneous Recommendations			
56	Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments.	NTA Fiscal Year 2020 Objectives Report vol. 3, at 8, 14, 17-19.	H.R. 4665, 117th Cong. § 2 (2021); H.R. 174, 117th Cong. § 3 (2021); H.R. 2461, 116th Cong. § 2 (2019).
57	Allow Taxpayers the Option of Using Prior Year Income to Claim the Earned Income Tax Credit (EITC) During Federally Declared Disasters.	N/A	COVID-19 Earned Income Act, S. 3542; H.R. 6762, 116th Cong. (2020).

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
58	Exclude Taxpayers in Specified Circumstances From the Requirement to Provide a Social Security Number for Their Children to Claim the Child Tax Credit.	N/A	S. 1150, 116th Cong. § 2 (2019) (credit allowed with respect to children who were born and died in the same tax year).
59	Clarify Whether Dependents Are Required to Have Taxpayer Identification Numbers for Purposes of the Credit for Other Dependents.	N/A	H.R. CONF. REP. NO. 115-466, 115th Cong., 1st. Sess. at 225-227 (Dec. 15, 2017).
60	Allow Members of Certain Religious Sects That Do Not Participate in Social Security and Medicare to Obtain Employment Tax Refunds.	N/A	Religious Exemptions for Social Security and Healthcare Taxes Act, H.R. 6183, 117th Cong. (2021).
61	Amend IRC § 36B(d)(2) to Prevent Individuals From Losing Some or All of Their Premium Tax Credits When Receiving Lump-Sum Social Security Benefits Attributable to a Prior Year.	N/A	Build Back Better Act, H.R. 5376, 117th Cong. § 137303 (as passed by House, Nov. 19, 2021).
62	Amend the Combat-Injured Veterans Tax Fairness Act of 2016 to Allow Veterans of the Coast Guard to Exclude Disability Severance Pay From Gross Income and File Claims for Credit or Refund for Taxes Withheld From Excluded Income.	N/A	Coast Guard Combat-Injured Tax Fairness Act, H.R. 7605, 116th Cong. § 2 (2020); Coast Guard Combat-Injured Tax Fairness Act, H.R. 3739, 117th Cong. § 2 (2021).
63	Encourage and Authorize Independent Contractors and Service Recipients to Enter Into Voluntary Withholding Agreements.	NTA 2016 Annual Report 322; NTA 2012 Annual Report 19; NTA 2010 Annual Report 371; NTA 2008 Annual Report 375.	H.R. 593, 116th Cong. § 9 (2019); H.R. 1625, 116th Cong. § 2(b) (2019); H.R. 3717, 115th Cong. § 9 (2017).
64	Require the IRS to Specify the Information Needed in Third-Party Contact Notices.	N/A	N/A
65	Authorize the Treasury Department to Issue Guidance Specific to IRC § 6713 Regarding the Disclosure or Use of Tax Return Information by Preparers.	NTA 2007 Annual Report 547.	S. 2856, 117th Congress § 2 (2021) (partial).
66	Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic Program.	N/A	H.R. 3738, 117th Cong. § 501 (2021).

LR #	Tax Administration Legislative Recommendations	National Taxpayer Advocate (NTA) Annual Report References	Congressional Bill and Committee Report References
67	Compensate Taxpayers for “No Change” National Research Program Audits.	N/A	S. 2689, 115th Cong. § 14 (2018); H.R. REP. No. 104-280, vol. 2, at 28 (1995).
68	Establish the Position of IRS Historian Within the Internal Revenue Service to Record and Publish Its History.	NTA 2011 Annual Report 582.	N/A

APPENDIX 2: Prior National Taxpayer Advocate Legislative Recommendations Enacted Into Law

LR #	Legislative Recommendations	Selected National Taxpayer Advocate (NTA) Report References	Public Laws Adopting the Recommendations (in Whole or in Part)
Strengthen Taxpayer Rights and Taxpayer Service			
1	Enact a Taxpayer Bill of Rights.	NTA 2014 Annual Report, Legislative Recommendation #1, 275-310; and NTA 2013 Annual Report, Most Serious Problem #1, 1-5.	Pub. L. No. 114-113, Division Q, Title IV, § 401 (2015) (codified at IRC § 7803(a)(3)).
2	Require the IRS to Provide Annual Taxpayer Rights Training to Employees.	2017 Purple Book #2, 5-7.	Pub. L. No. 116-25, § 2402 (2019).
3	Improve Customer Service by Meeting the Preferences of Taxpayers and Stakeholders.	NTA 2008 Annual Report, Most Serious Problem #6, 95-113.	Pub. L. No. 116-25, § 1101(a) (2019).
4	Provide the IRS with Sufficient Funding to Meet Taxpayer Needs and Improve the Federal Tax Compliance.	2020 Purple Book #2, 3-6; NTA 2019 Annual Report, Most Serious Problem #1, 3-14; NTA 2019 Annual Report, Most Serious Problem #2, 15-22; and NTA 2019 Annual Report, Most Serious Problem #3, 23-33.	Pub. L. No. 117-2, § 9601 (2021) (in part).
Improve the Filing Process			
5	Authorize the Volunteer Income Tax Assistance Grant Program.	2019 Purple Book #3, 8-10; and 2017 Purple Book #5, 12-13.	Pub. L. No. 116-25, § 1401 (2019) (codified at IRC § 7526A).
6	Authorize the IRS to Work With Financial Institutions to Reverse Misdirected Deposits.	2019 Purple Book #9, 20-21; and 2017 Purple Book #11, 24-25.	Pub. L. No. 116-25, § 1407 (2019) (codified at IRC § 6402(n)).
7	Provide Victims With Notice of Suspected Identity Theft.	NTA 2011 Annual Report, Most Serious Problem #3, 48-73.	Pub. L. No. 116-25, § 2007 (2019) (codified at IRC § 7529).
8	Provide All Taxpayers With the Option to Receive and Use an Identity Protection Personal Identification Number.	NTA 2017 Annual Report, Most Serious Problem #19, 211-218; and NTA 2015 Annual Report, Most Serious Problem #16, 180-187.	Pub. L. No. 116-25, § 2005 (2019).
9	Provide Identity Theft Victims With a Single Point of Contact at the IRS.	NTA 2017 Annual Report, Most Serious Problem #19, 211-218; NTA 2015 Annual Report, Most Serious Problem #16, 180-187; NTA 2013 Annual Report, Most Serious Problem #6, 75-83; and NTA 2011 Annual Report, Most Serious Problem #3, 48-73.	Pub. L. No. 116-25, § 2006 (2019).

LR #	Legislative Recommendations	Selected National Taxpayer Advocate (NTA) Report References	Public Laws Adopting the Recommendations (in Whole or in Part)
10	Develop and Implement Guidelines for Managing Stolen Identity Refund Fraud Cases.	NTA 2017 Annual Report, Most Serious Problem #19, 211-218; NTA 2015 Annual Report, Most Serious Problem #16, 180-187; NTA 2013 Annual Report, Most Serious Problem #6, 75-83; and NTA 2011 Annual Report, Most Serious Problem #3, 48-73.	Pub. L. No. 116-25, § 2008 (2019).
11	Collaborate With the Public and Private Sectors to Protect Taxpayers From Identity Theft and Refund Fraud.	NTA 2017 Annual Report, Most Serious Problem #20, 219-226.	Pub. L. No. 116-25, § 2001 (2019).
12	Require Employers Filing More Than Five Forms W-2, 1099-MISC, and 941 to File Them Electronically.	2019 Purple Book #8, 17-19; and 2017 Purple Book #10, 21-23.	Pub. L. No. 116-25, § 2301 (2019) (codified at IRC § 6011(e)(2)(A)).
13	Increase Preparer Penalties.	NTA 2003 Annual Report, Key Legislative Recommendation, 270-301.	Pub. L. No. 114-113, § 501 (2011) (codified at IRC § 6695(g)).
14	Allow Married Co-owners of a Business to Elect to File as Sole Proprietors Rather Than as Partners.	NTA 2002 Annual Report, Key Legislative Recommendation, 172-184.	Pub. L. No. 110-28, Title VIII, § 8215 (2007) (codified at IRC § 761(a)).
15	Tax a Child's Income at Rates That Do Not Depend on the Parent's (<i>i.e.</i> , Fix the "Kiddie Tax").	NTA 2002 Annual Report, Key Legislative Recommendation, 231-242.	Pub. L. No. 115-97, § 11001 (2017) (codified at IRC § 1).
16	Authorize the IRS to Require Brokers to Report Basis Information Upon the Sale of Securities.	NTA 2005 Annual Report, Key Legislative Recommendation #5, 433-441.	Pub. L. No. 110-343, § 403 (2008) (codified at IRC § 6045(g)).
17	Accelerate the Filing Deadline for Certain Information Returns.	NTA 2013 Annual Report, vol. 2, 68-96.	Pub. L. No. 114-113, Division Q, Title II § 201 (2015) (codified at IRC § 6071).
18	Do Not Require Correction of <i>De Minimis</i> Errors on Certain Information Returns.	NTA 2013 Annual Report, vol. 2, 68-96.	Pub. L. No. 114-113, Division Q, Title II § 202 (2015) (codified at IRC § 6721(c)).
19	Accelerate the Filing Deadline for Certain Partnerships and Trusts.	NTA 2003 Annual Report, Key Legislative Recommendation, 302-307.	Pub. L. No. 114-41, § 2006(a) (2015) (codified at IRC § 6072).
20	Change the Deadline for Filing FinCEN Report 114 (Relating to Report of Foreign Bank and Financial Accounts) to Match the Deadline for Filing Federal Income Tax Returns and Form 8938 (Including Extensions).	NTA 2014 Annual Report, Legislative Recommendation #6, 331-333.	Pub. L. No. 114-41, § 2006(b)(11) (2015).

LR #	Legislative Recommendations	Selected National Taxpayer Advocate (NTA) Report References	Public Laws Adopting the Recommendations (in Whole or in Part)
21	Eliminate Tax Strategy Patents.	NTA 2007 Annual Report, Legislative Recommendation #4, 512-524.	Pub. L. No. 112-29, § 14(a) (2011).
Improve Assessment and Collection Procedures			
22	Extend the Period for a Third Party to Request a Return of Levied Proceeds From Nine Months to Two Years.	NTA 2001 Annual Report, Key Legislative Recommendation, 202-208.	Pub. L. No. 115-97, § 11071 (2017) (codified at IRC § 6343).
23	Allow Taxpayers to Request Equitable Innocent Spouse Relief Under IRC § 6015(f) Any Time Before Expiration of the Period of Limitations on Collection.	2019 Purple Book #26, 48-49; and 2017 Purple Book #16, 33.	Pub. L. No. 116-25, § 1203 (2019) (codified at IRC § 6015(f)(2)).
24	Prevent the Debts of Low-Income Taxpayers From Being Assigned to Private Collection Agencies.	2019 Purple Book #28, 52-53.	Pub. L. No. 116-25, § 1205 (2019) (codified at IRC § 6306(d)(3)).
25	Hold Taxpayers Harmless When the IRS Returns Funds Levied From a Retirement Plan or Account.	2017 Purple Book #22, 41-42.	Pub. L. No. 115-123, § 41104 (2018) (codified at IRC § 6343(f)).
26	Authorize the IRS to Enter Into Partial Payment Installment Agreements That Do Not Fully Pay the Liability Before Expiration of the Limitations Period.	NTA 2001 Annual Report, Key Legislative Recommendation, 210-214.	Pub. L. No. 108-357, § 843 (2004) (codified at IRC § 6159(a)).
27	Send Change of Address Notices to an Employer's Old and New Addresses and Promote the Use of Offers in Compromise for Victims of Payroll Tax Fraud.	NTA 2012 Annual Report, Most Serious Problem #23, 426-444.	Pub. L. No. 113-76, Division E, Title I, § 106 (2014) and subsequent appropriations acts.
Reform Penalty and Interest Provisions			
28	Clarify That a Reasonable Cause Exception Applies to the Penalty for Erroneous Refund or Credit Claims Under IRC § 6676.	NTA 2014 Annual Report, Legislative Recommendation #8, 351-356; and NTA 2011 Annual Report, Legislative Recommendation #6, 544-547.	Pub. L. No. 114-113, Division Q, Title II, § 209(c) (2015) (codified at IRC § 6676(a)).
29	Notify Exempt Organizations When They Have Failed to File Two Consecutive Returns or Notices Before Their Exemption Is Automatically Revoked.	NTA 2011 Annual Report, Status Update #2, 437-450.	Pub. L. No. 116-25, § 3102 (2019) (codified at IRC § 6033(j)(1)).
30	Reduce the Disproportionate Penalty for Failure to Make Special Disclosures of "Listed Transactions" Under IRC § 6707A.	NTA 2008 Annual Report, Legislative Recommendation #10, 419-422.	Pub. L. No. 111-240, § 2041 (2010) (codified at IRC § 6707A(b)).

LR #	Legislative Recommendations	Selected National Taxpayer Advocate (NTA) Report References	Public Laws Adopting the Recommendations (in Whole or in Part)
Strengthen Taxpayer Rights Before the Office of Appeals			
31	Codify the Independent Office of Appeals and Allow Those Denied Access to Appeals to Protest to the IRS Commissioner.	2019 Purple Book #35, 64.	Pub. L. No. 116-25, § 1001(a) (2019) (codified at IRC § 7803(e)).
Enhance Confidentiality and Disclosure Protections			
32	Limit Redisclosures and Unauthorized Uses of Tax Returns and Tax Return Information Obtained Through IRC § 6103-Based "Consent" Disclosures.	2019 Purple Book #38, 67; and 2017 Purple Book #39, 66.	Pub. L. No. 116-25, § 2202 (2019) (codified at IRC § 6103(c)).
33	Penalize Unauthorized Disclosures of Return Information by Tax Whistleblowers.	NTA 2015 Annual Report, Legislative Recommendation #14, 413-418.	Pub. L. No. 116-25, § 1405(a)(2) (2019) (codified at IRC § 7213(a)(2)).
34	Provide Status Updates Sufficient to Allow a Whistleblower to Monitor the Progress of the Claim.	NTA 2015 Annual Report, Most Serious Problem #13, 143-158.	Pub. L. No. 116-25, § 1405(a)(1) (2019) (codified at IRC § 6103(k)(13)).
Strengthen the Office of the Taxpayer Advocate			
35	Codify the Taxpayer Advocate Directive (TAD) Appeal Process and Require the NTA to Report to Congress on Any TAD Not Honored By the IRS.	2019 Purple Book #43, 75-76; 2017 Purple Book #41, 68-69; and NTA 2016 Annual Report, Special Focus 39-40.	Pub. L. No. 116-25, § 1301(a) (2019) (codified at IRC § 7803(c)(5) and IRC § 7803(c)(2)(B)(ii)).
36	Establish the Compensation of the NTA by Statute.	2019 Purple Book #49, 83-84; and 2017 Purple Book #49, 79-80.	Pub. L. No. 116-25, § 1301(c) (2019) (codified at IRC § 7803(c)(1)(B)(i)).
Strengthen Taxpayer Rights in Judicial Proceedings			
37	Clarify That IRS Employees May Refer Taxpayers to a Specific Low Income Taxpayer Clinic.	2019 Purple Book #14, 29-30; 2017 Purple Book #8, 18; and NTA 2007 Annual Report, Additional Legislative Recommendation #4, 551-553.	Pub. L. No. 116-25, § 1402 (2019) (codified at IRC § 7526(c)(6)).
38	Consolidate Judicial Review of Collection Due Process Hearings in the Tax Court.	NTA 2005 Annual Report, Key Legislative Recommendation #7, 447-470.	Pub. L. No. 109-280, § 855 (2006) (codified at IRC § 6330(d)(1)).
39	Clarify That the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is De Novo.	2019 Purple Book #52, 91-93; and NTA 2011 Annual Report, Legislative Recommendation #4, 531-536.	Pub. L. No. 116-25, § 1203(a)(1) (2019) (codified at IRC § 6015(e)(7)).
40	Clarify That the Tax Court Has Jurisdiction to Review Stand Alone Equitable Innocent Spouse Relief Determinations Under IRC § 6015(f).	NTA 2001 Annual Report, Key Legislative Recommendation, 159-165.	Pub. L. No. 109-432, Division C, Title IV, § 408 (2006) (codified at IRC § 6015(e)(1)).

LR #	Legislative Recommendations	Selected National Taxpayer Advocate (NTA) Report References	Public Laws Adopting the Recommendations (in Whole or in Part)
41	Allow Taxpayers Seeking Exemption Under IRC § 501(c)(4) and Certain Others to Seek a Declaratory Judgment Just Like Those Seeking Exemption Under IRC § 501(c)(3).	NTA 2014 Annual Report, Legislative Recommendation #12, 371-379.	Pub. L. No. 114-113, Division Q, Title IV, § 406 (2015) (codified at IRC § 7428(a)(1)).
42	Protect Tax Whistleblowers From Retaliation.	NTA 2015 Annual Report, Legislative Recommendation #13, 409-412.	Pub. L. No. 116-25, § 1405(b) (2019) (codified at IRC § 7623(d)).
Miscellaneous Provisions			
43	Generally, Avoid Forfeiture or Seizure of Deposits Structured to Avoid Currency Reporting When They Are From a Legal Source.	IRS Reform: Perspectives From The National Taxpayer Advocate, Hearing Before the H. Comm. on Oversight, 115th Cong., at 23 (May 19, 2017) (statement of Nina E. Olson, National Taxpayer Advocate).	Pub. L. No. 116-25, § 1201 (2019) (codified at 31 USC § 5317(c)(2)).
44	Provide Commercial Fishermen the Benefit of Income Averaging Currently Available to Commercial Farmers.	NTA 2001 Annual Report, Additional Legislative Recommendation, 226.	Pub. L. No. 108-357, § 314 (2004) (codified at IRC § 1301(a)).
45	Allow Self-Employed Individuals a Deduction for Health Insurance Premiums.	NTA 2001 Annual Report, Additional Legislative Recommendation, 223.	Pub. L. No. 111-240, § 2042 (2010) (codified at IRC § 162(l)).
46	Clarify That Attorney Fees for Discrimination Suits Are Deductible by Victims.	NTA 2002 Annual Report, Key Legislative Recommendation, 161-171.	Pub. L. No. 108-357, § 703 (2004) (codified at IRC § 62(a)(19) and then subsequently renumbered).
47	Create a Uniform Definition of "Qualifying Child" for Tax Provisions Relating to Children and Family Status.	NTA 2001 Annual Report, Key Legislative Recommendation, 78-100.	Pub. L. No. 108-311, § 201 (2004) (codified at IRC § 152).
48	Amend IRC §§ 108(a) and 6050P to Provide That Gross Income Does Not Include, and the Department of Education Is Not Required to Report, Income From the Cancellation of Student Loans Under the Coronavirus Aid, Relief and Economic Security Act.	2020 Purple Book, #59, 131-132.	Pub. L. No. 117-2, § 9675 (2021) (codified at IRC § 108(a)(1)).
49	Restructure the Earned Income Tax Credit to Make It Simpler for Taxpayers and Reduce Improper Payments.	NTA Fiscal Year 2020 Objectives Report, vol. 3, at 8, 14, 17-19; and 2020 Purple Book, #53, 115-119.	Pub. L. No. 117-2, §§ 9621, 9622, and 9623 (2021) (in part).
50	Provide Earned Income Tax Credit Relief During National Disasters.	2020 Purple Book, #53, 120-121.	Pub. L. No. 117-2, §§ 9611 and 9626 (2021) (in part).



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