Legislative Recommendation #12

Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship

SUMMARY

- *Problem:* The tax code contains provisions designed to shield taxpayers experiencing economic hardship from IRS collection action, yet the IRS routinely enters into installment agreements (IAs) with taxpayers without undertaking the financial analysis required to determine whether the taxpayers can afford to make payments. Some 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, leaving them unable to pay for basic necessities like food, shelter, and health care for themselves and their families.

- *Solution:* Direct the IRS to implement an algorithm, similar to one developed by TAS, to identify taxpayers at high risk of economic hardship and advise these taxpayers, before they enter into installment agreements, that they may not have to make current payments if they can document their 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 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. While this is convenient and an unintrusive collection alternative for many taxpayers, it is not necessarily good for all taxpayers. 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) 2022 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 basic living expenses for himself and his 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 hardship 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 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 debts 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 pay their basic living expenses, and it would help the IRS avoid the rework that occurs when taxpayers default on IAs they cannot afford.

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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*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_TRRS_EconomicHardship.pdf.

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.

RECOMMENDATION

- Direct the IRS to implement an algorithm that will enable it to (i) identify taxpayers at high risk of economic hardship; (ii) respond appropriately to taxpayers who contact the IRS regarding a balance due; (iii) alert taxpayers at risk of economic hardship who seek to enter into streamlined IAs online of the resources available to them; (iv) 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 (v) possibly rank cases for collection priority.