Questions for Ms. Collins
National Taxpayer Advocate, Taxpayer
Advocate Service Questions from
Chairman Gerald E. Connolly

October 7, 2020, Hearing: "IRS in the Pandemic"

<u>Question 1</u>: The IRS recently extended the registration deadline for non-filers to claim an Economic Income Payment (EIP) through the Non-Filers tool to November 21, 2020. What agencies or groups is the IRS partnering with to publicize the registration extension to ensure non-filers are aware of their eligibility for EIPs?

Response: This question and several others in this series ask me, as the National Taxpayer Advocate, to describe IRS initiatives or positions. Although I am aware of some of the IRS's activities in this area, I do not speak on behalf of the IRS. Pursuant to IRC § 7803(c), the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the corporate position of the Internal Revenue Service. Because the Commissioner was also a witness at this hearing, I am assuming you have directed the same or a similar question to him, and I defer to him to provide a complete response on behalf of the agency.

<u>Question 2</u>: What testing has the Taxpayer Advocate performed to ensure the Non-Filers tool is designed with the end-user in mind? Of those who start filling out the form, how many complete it? Do you or the IRS know which parts of the form seem the hardest for users to complete?

Response: The Taxpayer Advocate Service (TAS) was not afforded the opportunity to participate in the design or user testing of the Non-Filer tool in advance of its rollout for use by taxpayers. Additionally, TAS does not have access to user data of this tool. Information regarding taxpayer use or concerns would have to come from the IRS.

<u>Question 3</u>: How often does the IRS use customer experience feedback to amend and improve its websites and forms?

Response: Please see response to Question 1.

<u>Question 4</u>: Given that so many workers have received unemployment insurance (UI) who may not understand that they need to pay taxes on that income, what is the IRS doing to assist these taxpayers to ensure that they are in compliance with all tax laws?

Response: Please see response to Question 1 regarding IRS activities.

<u>Question 5</u>: What are the penalties for a taxpayer who does not report receipt of UI on his or her taxes and, thereby, fails to pay taxes on the UI?

Response: Taxpayers who fail to report items of income such as unemployment compensation may be subject to an accuracy-related penalty for the underpayment.[1] If the IRS determines that additional tax is due as a result of an unreported item such as unemployment compensation, the IRS is required by law to charge interest on late payments to compensate it for the time value of money.[2] Generally, interest is calculated from the original due date of the return (without regard to extensions) to the date the amount owed, including accrued interest and any penalty charges, is paid in full. Interest on some penalties accrues from the date the taxpayer is notified of the penalty until it is paid in full. Interest on other penalties, such as failure to file a tax return,[3] starts from the due date or extended due date of the return. Interest rates are variable and may change quarterly.

In addition to interest, the IRS generally will assess the failure-to-pay penalty for failing to pay the tax owed by the due date.[4] The failure-to-pay penalty is assessed at a rate of 0.5 percent monthly and is based on net unpaid tax at the beginning of each penalty month following the payment due date. The penalty is charged for each month or part of a month the payment is late. However, the penalty cannot exceed 25 percent of the late-paid tax. The due date for payment of the tax shown on a return is generally the return due date, without regard to extensions.

Depending on the amount of unemployment compensation received but not reported, taxpayers may also be subject to the accuracy-related penalty for a substantial understatement of tax.[5] For individuals, the understatement of tax is substantial if it exceeds the greater of $5,000 or ten percent of the tax that must be shown on the return for the taxable year.[6] The accuracy-related penalty is 20 percent of the underpayment.

The IRS can waive both the failure-to-pay penalty and the accuracy-related penalty if the taxpayer can prove that the failure to report unemployment compensation and pay the tax owed was due to reasonable cause and not willful neglect.[7]

A taxpayer failing to report unemployment compensation will typically receive IRS Notice CP2000, Request for Verification of Unreported Income, Payments, and/or Credits. This notice will explain any proposed adjustment to income, tax, credits, or deductions caused by the failure to include the income item. The taxpayer will be given a chance to agree with the changes or explain any disagreement.

If the IRS issues a notice demanding payment, the increase in tax must be paid within 21 days of

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[1] IRC § 6662. This penalty applies to the portion of any underpayment that is attributable to a taxpayer's negligence or disregard of the rules or regulations. Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return, as defined in IRC § 6724(d)(1). *See* IRC § 6662(b)(1); Treas. Reg. § 1.6662-3(b)(1)(i).
[2] IRC § 6601.
[3] IRC § 6651(a)(1).
[4] IRC § 6651(a)(2).
[5] IRC § 6662(b)(2).
[6] IRC § 6662(d)(1)(A)(i) **-** (ii). Note, however, that in the case of a taxpayer who claims a deduction allowed under IRC § 199A, the understatement of income tax is substantial if it exceeds the greater of five percent of the tax required to be shown on the return or $5,000. IRC § 6662(d)(1)(C).
[7] IRC §§ 6651(a), 6664(c).

the notice date (ten business days if the amount in the notice is $100,000 or more).[8] If IRS issues a Notice of Intent to Levy and the balance due is not paid within ten days of the date of the notice, the penalty for late payment increases to one percent per month.[9] For individuals who filed on time (including extensions), the penalty decreases to 0.25 percent per month while an approved installment agreement with the IRS is in effect for payment of the tax.[10]

<u>Question 6</u>: Previous disaster-related statutory provisions allowed Earned Income Tax Credit (EITC) recipients to use prior years' earnings to establish eligibility for EITC. Would you recommend that similar or identical provisions be enacted during the COVID pandemic?

Response: To claim the Earned Income Tax Credit (EITC), a taxpayer must satisfy several eligibility criteria, including that he or she has earned income pursuant to IRC § 32(c)(2). Because the EITC is an anti-poverty program, recipients rely on the EITC to meet their basic living expenses. Without receiving the benefits for which they are eligible under this refundable credit, many individuals would experience financial hardship, particularly during a time of an economic disaster.

During a federally-declared disaster, Congress allows the IRS to postpone certain deadlines for qualified taxpayers.[11] Most recently, the IRS allowed such relief as a result of the COVID-19 pandemic.[12] However, this relief does not help taxpayers who struggle to prove their income to qualify for the EITC. During previous federally-declared disasters, Congress took action to allow taxpayers to claim the EITC in the year of the disaster based on income earned in the prior tax year.[13] To make this election, the taxpayer's previous-year income must be greater than the taxpayer's current-year income. I believe allowing this election could provide significant benefits to low-income taxpayers, given the often- greater need for financial support during the time of a disaster.

<u>Question 7</u>: In your testimony, you stated that the IRS does not have enough staff to manually process EIP corrections when there are errors or incorrect payments. What is the cost to the IRS by not being able to process EIP corrections? What is the cost to taxpayers?

Response: TAS cannot calculate the financial cost to the IRS or eligible individuals. However, the failure to address EIP non-payments or underpayments in a timely manner has undoubtedly had an adverse impact on some eligible individuals. Congress authorized EIPs to provide financial assistance to eligible individuals with incomes below specified thresholds, many of whom experienced job loss or other financial setbacks as a result of the COVID-19 pandemic. The CARES Act directed the IRS to make these advance payments "as rapidly as possible."[14] To the extent there have been delays in delivering EIPs to financially struggling individuals, the EIPs have not accomplished their intended purpose of providing prompt financial assistance for

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[8] IRC § 6651(a)(3).
[9] IRC § 6651(d)(1).
[10] IRC § 6651(h).
[11] IRC § 7508A; Treas. Reg. § 301.7508A-1(c)(1)(iv) – (vi); Rev. Proc. 2018-58, 2018-50 I.R.B. 990.
[12] *See, e.g.*, IRS Notice 2020-23, 2020-18 I.R.B. 742.
[13] For example, see IRS Pub. 976, Disaster Relief 14 (March 1, 2018); IRS Pub. 596, Earned Income Credit (EIC*)* 18 (Jan 28, 2020).
[14] *See* IRC § 6428(f)(3)(A).

those individuals.

<u>Question 8:</u> Are taxpayers aware that they might have to wait, on average an extra month, or as long as another full year to have their tax returns processed and receive any refund they are owed? What can the IRS do to address the struggles and concerns of taxpayers who need their refunds?

Response: Unfortunately, some taxpayers may not be fully aware of the potentially significant delays they may experience in receiving refunds or responses from the IRS due to the impact of the COVID-19 pandemic. Taxpayers who filed paper returns have experienced the largest share of delays, but taxpayers whose e-filed returns were flagged by the IRS's refund fraud filters have also had to wait to receive their refunds. Taxpayers often experience significant gaps or delays in receiving information from the IRS on the progress or status of their accounts or receive correspondence that lacks taxpayer-specific information or response timelines. The IRS should publish recurring (weekly) COVID-related delay updates using omnichannel sources to keep taxpayers informed.

<u>Question 9</u>: The coronavirus pandemic has forced the IRS to rethink how it delivers services to the public. What steps should the IRS be taking immediately to improve its taxpayer services?

Response: The COVID-19 pandemic has exposed significant shortcomings in IRS service and communications channels. For many months, taxpayers could not interact with the IRS by phone, mail, or in person.[15] In many cases, the IRS addressed these service shortcomings by developing temporary workaround procedures that enabled taxpayers and representatives to digitally interact with IRS employees.[16] To provide excellent taxpayer service and plan for any future emergencies, I recommend the IRS build upon its temporary initiatives and make permanent improvements in the IRS's digital service offerings by taking the following actions:

1. Accept electronic signatures on all documents that require a signature once the IRS assesses, identifies, and eliminates any data security vulnerabilities.
2. Make permanent the use of a secured messaging system (email) to communicate with taxpayers and their representatives.
3. Make permanent and expand the list of documents the IRS will accept and transmit by email using an established secured messaging system once the IRS assesses, identifies, and eliminates any data security vulnerabilities and file size limitation issues.
4. Assess how the IRS's new e-authentication platform, Secure Access Digital Identity (SADI), will impact different demographic groups and determine the feasibility of potentially increasing access to digital applications as they are integrated with SADI while also maintaining compliance with National Institute of Standards and Technology (NIST) guidelines.[17]

[15] For a more detailed discussion of the IRS's service shortcomings, see *IRS in the Pandemic: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 116th Cong. (Oct. 7, 2020) (written statement of Erin M. Collins, National Taxpayer Advocate).
[16] *See, e.g.*, Memorandum for All Services and Enforcement Employees, NHQ-1-0620-0002, (1) Approval to Accept Images of Signatures and Digital Signatures (2) Approval to Receive Documents and Transmit Encrypted Documents by Email, by IRS Deputy Commissioner, Services and Enforcement (June 12, 2020).
[17] NIST, Special Publication 800-63-3, *Digital Identity Guidelines* (June 2017).

5. Expand the availability of Taxpayer Digital Communications eGain Text Chat as a communication channel option for taxpayers.
6. Continue to develop digital service tools that are mobile-ready.
7. Expand the use of virtual face-to-face technology to as many taxpayer-facing functions as possible.
8. Promote a shift in IRS culture in which IRS employees embrace interacting digitally with taxpayers and representatives.

Question 10: What can the IRS do in the short term to improve its performance and service to taxpayers to ensure it incorporates lessons learned should a second round of stimulus checks get approved by Congress?

Response: The IRS acted quickly to issue stimulus payments to the overwhelming majority of eligible individuals in record time. That effort cannot be understated. But taxpayers in a variety of circumstances did not receive some or all of the payments for which they were eligible. Although the circumstances in which the IRS will address missing EIPs have evolved over time, I detailed these categories in an August 10, 2020, blog post titled, *Need Help With Economic Impact Payment Issues? How TAS Can Assist Those That Qualify*. Unfortunately, the reasons the IRS was unable to pay correct EIPs in the first instance or correct underpayments promptly varied among categories of taxpayers, so there is no "one-size-fits-all" solution. As the year evolved, the IRS generally found ways to resolve problems that could be addressed systemically, but it generally did not resolve problems that required employees to make case-by-case determinations because it did not have the resources to do so. If there is a second round of stimulus payments, I would recommend Congress discuss the timing and any technical changes with the IRS in anticipation of the legislation passing. As this filing season ends and the next filing season ramps up, the IRS has information technology (IT) constraints that may impact the timeliness of the payments. I believe the IRS has learned some lessons that would enable it to improve the payment delivery, but some problems will be difficult to fix immediately.

One example that has been particularly vexing has involved individuals who are victims of domestic abuse. In some cases, these taxpayers filed joint tax returns for 2018 and had not yet filed 2019 returns at the time the IRS paid out EIPs. Pursuant to the CARES Act, the IRS paid EIPs to the bank account that was used to deliver the eligible taxpayers' 2018 refund. If that account was controlled by the abusive spouse, the abused spouse may never have received his or her share of the EIP. For instance, in a situation where a wife/mother left home with two children, the husband/father may have received and kept an EIP worth $3400 (*i.e.*, $1,200 for each spouse and $500 for each qualifying child). The IRS took the position that if it paid the EIPs on the basis of a valid, properly-signed joint return and deposited the overpayment to the bank account and routing number designated by the taxpayers on the return, the IRS was legally precluded from issuing a replacement refund of EIP ("second payment") to the wife/mother of the $2,200 to which she claimed eligibility ($1,200 for herself and $500 for each of two qualifying children). We are continuing to work with the IRS to find a way for payments to be made separately to spouses on a joint return should a second round of stimulus checks be approved by Congress.

Question 11: In your testimony you iterated the need for trust in a voluntary tax system. What impact do you think a reliance on antiquated IT has on taxpayer's trust in the institution?

Response: Timely and accurate tax administration instills confidence and trust. Mistakes and delays in tax administration undermine confidence and trust. The IRS is necessarily heavily dependent on automated processes to administer a tax system as large and complex as ours. Antiquated IT prevents the IRS from developing and offering taxpayers robust online taxpayer accounts and other forms of enhanced taxpayer service. It also increases the risk of a major systems crash. It is well known that the IRS has two of the oldest IT systems in the federal government (dating to the early 1960s),[18] and modernizing its IT remains a priority need.

<u>Question 12</u>: The Taxpayer Advocate Service's 2019 Annual Report to Congress recommended the current rules for setting IRS funding levels be reconsidered. What rules that set IRS funding levels should be reconsidered?

Response: Under the Congressional Budget and Impoundment Control Act of 1974, 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.

That approach makes sense for most federal agencies, because for the most part, a dollar spent is just that – one less dollar available for other purposes. However, that zero-sum game approach makes little sense when setting funding levels for the IRS. As the government's "accounts receivable" department, the IRS in FY 2019 collected nearly $3.6 trillion on a budget of about $11.51 billion, which translates to a return on investment (ROI) of more than 300:1. For that reason, we believe it is financially irresponsible to underfund the IRS. If the accounts receivable department of a private corporation could generate an ROI of 300:1 and the chief executive officer (CEO) failed to provide enough funding for it to do so, the CEO would likely be fired. Yet in general, the federal budget rules exclusively take into account outlays and ignore the revenue those outlays generate.

In some years, Congress has tried to get around the spending caps by authorizing "program integrity cap adjustments" (PICs) that allow 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 ROI. Although the IRS supports PIC adjustments, Congress needs to allow them to cover the downstream costs in Taxpayer Services. Historically, PICs have been used solely to fund enforcement initiatives, leading to imbalances in the IRS's funding and operations.

When Congress requires that all IT projects and technology needs be funded from the Operations Support account and does not adequately fund that account or provide sufficient latitude to reprogram funds from the Enforcement account to Operations Support or Taxpayer Services, the IRS's ability to use technology to improve taxpayer service or to equip its employees with the technology they need to be successful is significantly limited.

[18] *See* Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* 28-30 (May 2016), https://www.gao.gov/assets/680/677436.pdf.

The National Taxpayer Advocate has recommended that Congress revise existing budget rules to fund the IRS in a manner that more closely follows the principles private sector businesses apply in setting funding levels for their accounts receivable departments – while keeping in mind the public sector goal is slightly different and should focus on maximizing tax compliance, especially voluntary compliance, while protecting taxpayer rights and minimizing taxpayer burden. Because we do not have expertise in federal budgeting, we have not made a specific proposal to accomplish this objective. However, it would likely require funding the IRS based in part on revenue projections made by the Congressional Budget Office and the Office of Management and Budget and without regard to otherwise applicable spending caps under Section 302 of the Congressional Budget and Impoundment Control Act of 1974, as amended.