Statement of

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IRS Return on Investment and the Need for Modernization

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Chairman Schweikert, Ranking Member Sewell, and Members of the Subcommittee,

Thank you for holding this hearing today and for inviting me to testify on the important topic of IRS return on investment (ROI) and modernization. With funding provided by the Inflation Reduction Act, the Internal Revenue Service (IRS) is at an historic juncture, in that this funding can serve as the opportunity to transform the agency into one that equitably administers and enforces our nation's tax laws. Given the enormity of the task, however, Congressional oversight, such as the hearing today, is vitally important to ensure that this transformation is on track.

My perspective on the matter of IRS transformation and technology is informed by my years representing low and middle income taxpayers and small businesses before the IRS and in the courts, both in private practice and at the Low Income Taxpayer Clinic I founded in 1992, as well as my eighteen years serving as the National Taxpayer Advocate at the IRS, which provided me with a unique vantage point from which to observe IRS planning and operations.

Before discussing specific issues, allow me to raise a threshold matter. However large or small one believes government should be, taxation is the primary way governments are able to address the needs of their populace. Unless a system of taxation is confiscatory, taxpayer trust is key to efficient and effective tax administration. Taxpayers are being asked to give up part of the earnings from their labors or investments in order to advance the public good. What taxpayers want in return, among other things, is to be treated with dignity and respect. Taxpayer rights, including the Taxpayer Bill of Rights, exist to ensure that taxpayers are treated with that dignity and respect. Because taxpayer dignity is closely correlated with taxpayers' trust of the tax agency and willingness to comply with the tax laws, taxpayer rights protections will not only increase taxpayer trust but also increase the efficiency and effectiveness of the tax system.

With that framework in mind, in my statement today I will touch on issues I believe are central to creating a trusted, responsive, and innovative tax agency that is both efficient and effective: (1) IRA funding's impact on IRS information technology and modernization; (2) IRA's impact on other IRS functions; (3) the benefits and risks of investments in digitalization of tax administration; (4) the impact on taxpayer service by stagnant annual appropriations; (5) the IRS mission statement; (6) the IRS Oversight Board; and (7) some specific examples of how efficiency and effectiveness can be gained through technology and staffing advancements with IRA funding, including up-front issue resolution with significant taxpayer protections, and revised correspondence examination procedures.[1] I close with a

[1] The Center for Taxpayer Rights discussed many of these issues in our comments of June 21, 2023 to the Secretary and the Commissioner on the original IRS Strategic Operating Plan (SOP), a copy of which is appended to this testimony. Also in 2023, the Center for Taxpayer Rights held a series of fourteen Tax Chats! and a day-long conference focused on *Transforming Tax Administration: Toward an Effective, Trusted and Inclusive IRS*. This series captured the recommendations of stakeholders who collectively have centuries of experience in tax administration. *See* https://taxpayer-rights.org/transforming-tax-admin-materials/.

discussion of the importance of protecting the confidentiality of tax returns and return information, which is key to maintaining taxpayer trust and willingness to comply with their tax obligations.

I. Inflation Reduction Act funding has enabled the IRS to make progress on transforming its outdated technology and better addressing taxpayer needs.

The IRS is a large organization that touches nearly every person and business entity in the United States. Yet its operations have been mired in mid-twentieth century processes and technology which create inefficiencies and frustrate taxpayers and IRS employees alike. The problem of outdated legacy systems, software, and hardware continually prevents the IRS from being able to provide the service US taxpayers expect and deserve (taxpayers have the right to quality service) and from instituting appropriate and proportional compliance actions (taxpayers have the right to a fair and just tax system). The limitations of outdated systems are compounded by the failure of various IRS databases from communicating with each other. The IRS has over sixty case management systems throughout the agency, with many other smaller databases containing program specific information. Only a fraction of that information shows up on the IRS Master File. Thus, there is no 360-degree picture of the taxpayer's data, interactions, and filings with the IRS.

This situation creates significant inefficiencies. It means that IRS employees must input information that in a more advanced system would be pre-populated from other databases. It means that phone assistors cannot access certain databases and therefore cannot help the taxpayer in real time; instead they must write up a form to send to some other unit that has access to the system. It means IRS case selection – in audits and in collection – does not reflect all the information available in IRS systems and databases, to ensure the IRS is working the right work and cases. And for taxpayers it means that information they send in or provide is often not available for review by the employee with whom they are speaking. The sheer waste of taxpayer and IRS employee time is both infuriating and costly.

In 2001, the IRS's master file system – the official record of taxpayer accounts which the Government Accountability Office (GAO) has labeled as "one of the oldest and highest risk"[2] systems in the federal government – was, in former Commissioner Charles Rossotti's assessment, "ancient." This database is still the backbone of IRS systems today, only it is a quarter of a century older – and now qualifies as being called "prehistoric."

The Individual Masterfile (IMF) is the IRS's core tax processing system for individuals. GAO noted that it is "written in a now outdated language code, is highly complex to maintain, and has limited skilled resources supporting it."[3] This means that even as new applications are being developed or acquired, they have to be made to work with 60 year old, mid-20th

[2] GAO-20-249SP, *Information Technology – Key Attributes of Essential Federal Mission-Critical Acquisitions* at 41 (Sept. 2020).
[3] *Id.*

century technology, which consumes ever-increasing operations and maintenance resources, resources that might otherwise be applied to other customer-facing or compliance technology improvements.[4] It is an endless cycle.[5]

Over the years the IRS has tried to replace the IMF partially or in full, with mixed results. Since 2009, the IRS has attempted to update IMF's Assembly Language Code into modern programming language via the Customer Account Data Engine (CADE2), with completion dates frequently revised. TIGTA describes CADE2 as "one of the most complex modernization programs in the Federal Government."[6] One aspect of CADE2 has been significantly advanced by IRA funding – the Individual Tax Processing Engine Project (ITPE). ITPE is supposed to update two programs that "perform core IMF business functions of posting, settlement, and analysis, and are the most complex IMF processing programs."[7] These two programs are core to almost every IRS program and activity. IRS reported that ITPE was supposed to go live in January 2025, and if it has, it is a major achievement in modernization of IRS technology.

TIGTA has also found the IRS made progress in its information technology modernization efforts. It noted in a 2024 report that one of the transformation objectives jump-started by IRA funding, Objective Four, relates to Advanced Technology and Analytics. TIGTA determined that of the 42 initiatives listed in the IRS IRA Strategic Operating Plan (SOP),[8] 35 (83 percent) are dependent on the eight initiatives under Objective Four.[9]

The first initiative under Objective Four is "transform core account data and processing." According to TIGTA, through Fiscal Year (FY) 2023, $53 million of IRA funds has been spent on the Enterprise Data Platform (EDP), described as a "component-based open architecture platform that delivers universal data access for users and systems at the enterprise level, as well as provides an analytics platform for enterprise users."[10] (Emphasis added.) To

[4] The Treasury Inspector General for Tax Administration (TIGTA) has observed "[t]he reliance on legacy systems, aged hardware and software, and use of outdated programming languages poses significant risks, including increased cybersecurity threats and maintenance costs." TIGTA, *Legacy Systems Management Needs Improvement*, Ref # 2020-20-044 (Aug. 19, 2020) at 4.

[5] To break this cycle, I recommended that Congress require the IRS to produce a five- year strategic plan that sets forth the steps to replace Master File, complete with milestones and cost estimates, and subject to independent review. National Taxpayer Advocate 2018 Annual Report to Congress, Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-year Funding to Replace its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and is Evaluated Annually by an Independent Third Party,* at 351-358 (Dec. 31, 2018).

[6] TIGTA, *The Individual Tax Processing Engine Project is Progressing, But Risks Remain,* Ref # 2024-208-052 (Sept. 15, 2024) at 1.

[7] *Id.*

[8] IRS, Inflation Reduction Act Strategic Operating Plan, FY 2023-2031, Pub. 3744 (Rev. 4, 2023).

[9] TIGTA, *Progress of Information Technology Modernization Efforts,* Ref. # 2024-258-055 (Sept. 11, 2024) at 5.

[10] *Id.* at 12.

date, the IRS has brought major data assets into EDP, enabling them "easy to discover, understand, and use at scale."[11]

I cannot emphasize how important these achievements are. The EDP will enable the IRS to more accurately identify problematic returns and lessen false positives because it will have the full picture of the taxpayer's data. For example, it will allow the IRS to better identify taxpayers at risk of financial hardship and proactively offer tailored payment alternatives, including placing them in currently-not-collectible status, thereby avoiding the wasteful, harmful, and inefficient current approach of levying on taxpayers and then releasing the levy when the taxpayers call and show they are experiencing economic hardship.[12]

But don't just take my word for this. In its conclusion to its September 2024 report, TIGTA wrote:

> The IRS is making progress in its modernization efforts while adhering to its strategic goals. Specifically, in initiatives 4.3 and 4.5, the Information Technology organization is making significant technical advancements in the areas of AI, automation, cloud capabilities, data access, data quality, and data standards. The IRS is undergoing multiple new processes, and once fully operational, they will pave the way for a new technology era across the enterprise. (Emphasis added.)

With the enactment of the Taxpayer First Act, Congress has the tools to ascertain the scope and feasibility of IRS technology plans, their alignment with taxpayer needs and preferences, and the funding required to deliver these plans.[13] The mandate to provide Congress with an ongoing review of IRS's implementation of these plans will ensure that IRS adapts to the changing technological and taxpayer-needs environment. The reporting mechanism should give Congress some confidence that the funds it appropriates are being well spent.

> Recommendation: Protect and retain IRA funding attributable to Business Systems Modernization (BSM) and maintain annual appropriations funding for

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[11] *Id.* at 11. These data assets include Business Master File, Clean Energy, CADE2, Web Apps Online Payment Plan, Direct Debit Installment Agreements, Modernized Individual Custodial Accounting, and Information Returns Master File.

[12] IRC 6343(a)(1)(D) requires the IRS to release a levy where the taxpayer is experiencing economic hardship. I have recommended for years that the IRS use its data to identify taxpayers who are at risk of economic hardship and either proactively protect them from levies or when taxpayers call, collect additional data so IRS can determine they are unable to pay their basic living expenses. The EDP wil make this task much easier to achieve. *See* Nina E. Olson, Procedurally Taxing: *My IRS Wishlist for 2021 Part 2: the Economic Hardship Indicator*, Feb. 1, 2021 at https://www.taxnotes.com/procedurally-taxing/my-irs-wishlist-2021-part-2-economic-hardship-indicator/2021/02/01/7h5p8.

[13] In 2018, Congress responded to IRS's early attempts to articulate a technology modernization plan by adopting section 2101 of the Taxpayer First Act (TFA), in which it created a statutory position for the IRS Chief Information Officer, among whose duties are the development of a multiyear strategic plan for IRS information technology needs, including the resources required to accomplish those needs. Pub. L. No. 116-25; IRC § 7803(f)(4)(A). Moreover, the CIO is to annually review and update the strategic plan to take into consideration new technology and changing environment. IRC § 7803(f)(4)(B).

BSM, so as to maintain the momentum of transforming IRS information technology and increasing the efficiency and effectiveness of tax administration.

II. The interdependencies of IRS operations requires IRA funding to be preserved in order to achieve a more efficient and effective IRS.

In its 2024 Strategic Operating Plan (SOP) annual update, the IRS recorded its first-year achievements using IRA funding.[14] Advances in taxpayer service included enhanced live assistance, expanded online services, Direct File, and notice redesign (reporting 31 notices had been revised and simplified). In the context of compliance activities, the IRS reported a focus on high income/high wealth taxpayers, partnerships, and large corporations. It also addressed racial disparities in audit selection, and is exploring the use of data, including artificial intelligence, to better identify areas of noncompliance. It instituted the "document upload tool" (DUT) for nine of its highest volume notices, so taxpayers can digitally upload documents responsive to the notice, saving taxpayers and IRS significant time and money in mailing, faxing, or scanning. The IRS achieved an 85 percent "level of service" and average speed of answer of three minutes in the 2023 filing season, and it exceeded that level for the 2024 filing season.[15] These are significant achievements that the IRS has wanted to implement for years; before IRA funding, progress on these initiatives has been sporadic as annual appropriations have been granted and then taken away. As a result of IRA funding, the IRS has been able to plan and begin the transformation of the agency.

The IRA funding activity categories do not reflect the reality of IRS operations, nor do they accurately reflect the taxpayer experience with the IRS. This makes it easy to target one category of funding as undesirable. For example, the Enforcement budget category includes so much more than traditional audits and collection:

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[14] The IRS's May 2024 update to its strategic operating plan (SOP) outlines and refines its approach to the transformation of the agency made possible by the historic IRA funding. As the Treasury Inspector General for Tax Administration (TIGTA) has noted in its most recent assessment of the SOP, the IRS has now adopted an implementation roadmap with transformation outcomes and key results for the calendar years 2023-2026. Originally the SOP identified 5 transformation objectives, 42 initiatives and specific milestones that, if met, would be a measure of success. For fiscal year (FY) 2023, the SOP identified 58 milestones for delivery; TIGTA reported that 19 were completed (33%); 36 were in progress (62%); and 3 were delayed (5%). TIGTA, action *Inflation Reduction Act: Assessment of the Internal Revenue Service's 2024 Annual Update to its Strategic Operating Plan,* Ref. No. 2025-1E-R011 (Jan. 28, 2025) at 2.

[15] Dept. of Treasury, Press Release: *IRS Filing Season 2024 Report Card* (Apr. 15, 2024) at https://home.treasury.gov/news/press-releases/jy2250 - :~:text=IRS Achieves 88%25 Level of,around 13%25 compared to 2023. The IRS uses "level of service" or LOS as a "budget projection measure." "But LOS is not the most efficient method or standard to determine the success of customer service and the customer experience." National Taxpayer Advocate Fiscal Year 2025 Objectives Report to Congress at 8. The LOS only reports calls made to the IRS main accounts phone lines, which constitute about 70% of calls received. Thus, calls for tax law questions or compliance issues, including collection matters, are not included in the LOS calculation. Further, in calculating the LOS on account lines, the IRS excludes calls that it automatically routes to automated, rather than live, assistance. Correcting for these omissions, the IRS live assistors answered only about 32% of incoming calls on account lines. *Id.*

- it includes administrative appeals of IRS decisions, a fundamental taxpayer right (taxpayers have the right to appeal a decision of the IRS in an independent forum);
- it includes guidance (formal and informal) to individuals and businesses issued by the Office of Chief Counsel that enables taxpayers to comply with the tax law and avoid costly errors;
- it includes employees who work offers-in-compromise – a statutory taxpayer remedy that enables taxpayers to settle IRS debts based on their ability to pay rather than the absolute amount owed;[16]
- it includes employees who conduct Collection Due Process hearings, a profound taxpayer right that ensures taxpayers have the opportunity to challenge the IRS's first levy or public lien filed with respect to a tax debt in a hearing before an independent Appeals Officer and ultimately petition the US Tax Court with respect to the Appeals Officer's determination in the case;[17] and
- it includes the Return Preparer Office and Office of Professional Responsibility, which help ensure return preparers and Circular 230 tax practitioners are competent and ethical and do not harm taxpayers when they seek professional assistance in meeting their tax obligations.

On the other hand, as noted earlier, information technology and BSM touch every aspect of taxpayer service. Without funding of the former, the agency cannot deliver on the taxpayer's right to quality service.

The reasons for taxpayer noncompliance are myriad, ranging on a continuum from simple mistakes to out-and-out criminal tax evasion. Traditional compliance activities like audits and collection are necessary to address noncompliance, so that taxpayers are confident everyone is paying their tax obligations and others are not gaming the system. But a modern tax agency has many more tools to move the compliance dial, and traditional compliance actions can be counter-productive if disproportionately applied. The category of enforcement spending, then, should include innovative approaches, including educational letters to taxpayers noting potential errors on prior year returns, timed to coincide with the start of the next filing season. Studies have demonstrated how efficient and effective "soft" compliance activities can be in certain circumstances. Proportionality between the compliance action and the underlying noncompliance is key.[18] What is constant for all this activity is the need for stable funding, in

[16] IRC § 7122. The offer in compromise program furthers taxpayers' rights to privacy and to a fair and just tax system. Per IRS Publication 1, Your Rights as a Taxpayer, the right to privacy means taxpayers have "the right to expect that nay IRS inquiry, examination, or enforcement action will … be no more intrusive than necessary;" the right to a fair and just tax system means taxpayers have "the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to process information timely."

[17] IRC §§ 6320 and 6330. Collection Due Process hearings not only address the right to privacy and a fair and just tax system but also the right to challenge the IRS's decision and be heard.

[18] For example, a TAS multi-year research study found that the long-term positive compliance effect of sending an educational letter to taxpayers who claimed the EITC on a prior year return and whose returns were flagged for potential errors out-stripped the long-term positive compliance effect of EITC correspondence audits. *See* National Taxpayer Advocate 2019 Annual Report to Congress: *Study of Subsequent Compliance of Taxpayers Who Received Education Letters from the National Taxpayer Advocate*, at 226.

order to test, pilot, and implement innovative approaches to increasing voluntary compliance and addressing noncompliance.

> Recommendation: Retain the remaining IRA funding for enforcement but provide flexibility to move funding between IRA budget categories, to meet taxpayer service needs, address areas of noncompliance through innovative approaches, and protect taxpayer rights and minimize taxpayer burden.

III. Digitalization of tax administration can be a blessing and a curse.

The IRS also articulated a vision for taxpayer service: "All taxpayers can meet all of their responsibilities, including all interactions with the IRS, in a completely digital manner if they prefer." This focus on digitalization of tax administration is consistent with the approach of tax administrations around the world.[19] Digital self-service tools, automation of manual and clerical steps, and artificial intelligence promise significant cost savings and may reduce taxpayer burden, and IRA funding is essential to realizing these efficiency gains.

The manner in which artificial intelligence applications are used in tax administration will make the difference between them resulting in positive change or significant harm to taxpayers. AI and other automation must be coupled with (1) robust and ongoing oversight; (2) training of employees such that they are knowledgeable in the underlying tax law and are able to properly apply the output of machine learning in human decision-making; and (3) accessible avenues for taxpayers to challenge the decisions made by humans using AI and automation.

Further, AI systems may be tainted because they are trained on results derived from administrative processes that create significant hurdles for taxpayers trying to achieve correct outcomes in their cases. For example, a 2012 TAS study of fully conceded United States Tax Court cases involving Earned Income Tax Credit (EITC) claims showed that taxpayers had attempted to resolve their case in the IRS Correspondence Examination stage by calling the unit on average five times; yet it was not until they actually petitioned the Tax Court that IRS Chief Counsel, without a trial, fully conceded the case and agreed with the taxpayers' original EITC claims.[20] If an AI system were to be trained solely on cases in Correspondence Examination, thousands of taxpayers with legitimate EITC claims would be harmed. On the other hand, an AI application trained on Correspondence Examination, Appeals, Tax Court, and Taxpayer Advocate Services cases would provide a more comprehensive dataset of taxpayer circumstances and legal interpretation. Adding to that dataset cases in which taxpayers were represented, including by low income taxpayer clinics, would train the

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[19] *See, e.g.,* OECD, *Tax Administration 3.0: The Digital Transformation of Tax Administration* (Dec. 8, 2020) at https://www.oecd.org/en/publications/2020/12/tax-administration-3-0-the-digital-transformation-of-tax-administration_886337a7.html

[20] National Taxpayer Advocate, 2012 Annual Report to Congress, vol. 2: *Study of Tax Court Cases in Which the IRS Conceded the Taxpayer Was Entitled to the Earned Income Tax Credit (EITC)*, at 73.

machine on the characteristics of cases in which administrative burdens prevented correct results.

A system that is trained on this broad set of data would more accurately select problematic cases for further attention than the current IRS systems, reduce the risk of auditing the wrong taxpayer, and preserve resources for those cases that require audits to bring taxpayers into compliance.[21] Further, for the system to continue to reflect the changes in external circumstances and the law, the application must be continuously trained on additional data from new cases. This approach increases rather than reduces the need for trained and knowledgeable IRS employees interfacing with taxpayers, person-to-person, to identify those changing circumstances.

Toward that end, digitalization of the tax agency requires both the retention of employees who have institutional knowledge and hands-on experience in tax administration and the hiring of new employees who bring new skills and outside-the-agency experience. This balance between seasoned employees and those with new skillsets will not be achieved if government service is vilified and current IRS employees are painted as inept, or even worse, corrupt.

IRA funding can assist with the efforts of bringing the IRS into the digital age while ensuring taxpayer rights, recourse, and remedies are protected. Funding for this type of work crosses all budget categories of the IRS -- taxpayer service, enforcement, operating support, and business systems modernization. Thus, IRA funding across all budget categories, including enforcement, must be retained so that the march to digitalization is protective, not destructive, of taxpayer rights.

> Recommendation: Retain IRA funding to ensure IRS existing and future employees are better trained in the use of AI as well as tax law in order to effectively use and oversee AI in tax administration.

IV. Notwithstanding the IRA investment, the baseline IRS appropriation must be sustained to keep up with inflation and support the gains made to taxpayer service delivery.

$3.2 billion of IRA funding is allocated to the taxpayer service budget category and through June 30, 2024, the IRS spent $1.4 billion of that funding, or 44.3 percent of the IRA funding dedicated to taxpayer service.[22] IRS expended $2.8 billion in IRA funding on labor costs through June 30, 2024, with approximately $1.3 billion used for taxpayer-facing positions in

[21] One need look no further than The Netherlands to see the harm that can be wrought upon taxpayers by AI systems that are trained on biased human assumptions, human over-reliance on the system's results, and the absence of accessible legal redress. See Council of Europe, Venice Commission for Democracy through Law: *The Netherlands: Opinion on the Legal Protection of Citizens* (Oct. 18, 2021) at https://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2021)031-e

[22] TIGTA, *Quarterly Snapshot: the IRS's Inflation Reduction Act Spending Through June 30, 2024,* Ref. No. 2024-IE-R020 (Sept. 2024) at 4.

Taxpayer Service including customer service representations and Taxpayer Assistance Center staff.[23]

TIGTA also reports the coming challenges for IRS funding. According to TIGTA, $2 billion of the $6.9 billion of IRA funding spent by the IRS through June 2024 ended up supplementing IRS annual appropriated funds to cover normal operating costs, including inflation adjustments. Of the $2 billion IRA funding covering normal operating costs, $858,000 was attributable to taxpayer service.[24] Thus, if the IRS annual appropriation remains flat (or reduced), the IRS will have to use IRA funding merely to cover inflation increases. Maintaining the IRS baseline budget at current levels, then, will undermine the transformational purpose of the IRA funding.

More importantly, if the IRS continues to apply IRA taxpayer service funding to make up for the poor service levels funded by the annual appropriation, it projects it will run out of IRA taxpayer service funding at the end of FY 2025.[25] That means that taxpayers will experience a cliff: in one filing season they are able to get through on the phone and have their returns processed relatively quickly, and in the next filing season, we will be back to pandemic levels of assistance, i.e., almost no assistance at all. This path is unsustainable and violates the trust of US taxpayers, who by and large are trying to comply with the tax laws and pay their taxes.

> Recommendation: Fund the annual IRS appropriation for taxpayer service such that the IRS can routinely answer 85 percent of the calls to all of its lines, process and respond to all correspondence within thirty days, process amended returns within sixty days, and resolve identity theft cases within 180 days.

V. The IRS Mission Statement should be updated to reflect the agency's current dual mission of collecting revenue and delivering benefits.

Unlike most tax systems around the world that tax the individual, the United States taxes the family unit. This approach necessarily introduces legal and factual complexity into the system. By taxing the family unit/household, however, the tax system becomes an efficient mechanism for delivering benefits related to families and children. Thus, over the decades, the IRS has been the go-to agency for delivering the Earned Income Tax Credit, one of the largest federal anti-poverty programs for working families; health insurance subsidies for low income families; and education credits. The IRS's herculean efforts in delivering life-saving benefits to individuals during the pandemic clearly demonstrate the extraordinary reach and importance of the IRS's benefit delivery system for the health and welfare of the U.S. economy and families.

Unfortunately, the IRS's current mission statement does not reflect this aspect of the IRS's work. A mission statement drives an agency's vision which in turn drives its goals, strategies,

[23] *Id.* at 10.
[24] *Id.* at 5.
[25] *Id*. at 7.

initiatives, hiring, training, and skill development. For the IRS to implement the social benefit delivery aspect of its dual mission, the mission statement should explicitly reflect this second "line of business." This explicit recognition will result in the IRS developing performance measures, job descriptions, and training necessary to successfully deliver on the mission and will increase the transparency of its efforts.

Perhaps the most important aspect of a revised mission statement is that it would signal to US taxpayers – and to its employees -- that the IRS is not just about enforcement and auditing. The explicit recognition of the IRS's important role in ensuring the health and welfare of the US population would help restore trust in the agency, and be a clear message to IRS employees that a key component of their jobs is to assist taxpayers and help them comply with the tax laws so they can not only pay the correct amount of tax but also receive the tax benefits for which they are eligible. This is an important first step in culture change at the IRS.

The revised mission statement can help address one of the most significant challenges the IRS faces in years to come – the hiring of qualified employees. How better to attract qualified and professional applicants than by re-stating the agency's mission to make clear its profound role in contributing to the general welfare of the US population, in very real and concrete terms?

> Recommendation: Revise the IRS mission statement to reflect its dual role as revenue collector and benefits administrator, and to explicitly incorporate protection of taxpayer rights.

VI. The IRS Oversight Board should be re-activated and re-invigorated.

One of the most important and innovative aspects of the Internal Revenue Service Restructuring and Reform Act of 1998 was the establishment of the IRS Oversight Board.[26] As National Taxpayer Advocate, I welcomed the oversight of this board, which had more immediate access to IRS initiatives and strategic planning than the traditional oversight agencies. The board's authority to review senior leadership's performance and IRS strategic plans as they were being developed provided an opportunity for the board to not only ensure the IRS was living up to its goals but also that it was continuing to modernize and innovate. Unfortunately, the Oversight Board fell victim to a lack of organizational and political support.

I believe that the time has come to revitalize and reinstate the Oversight Board. The infusion of IRS funding necessitates greater oversight. Both the Government Accountability Office (GAO) and the TIGTA are actively conducting audits. There is no substitute, however, for a board of independent, external, and expert professionals conducting monthly or quarterly meetings with IRS leadership about their plans in real time and making recommendations about those plans as well as an independent recommendation about the IRS annual appropriation. The Oversight Board's reports will also provide Congress with invaluable information it can utilize as it exercises its own oversight responsibilities.

[26] IRC § 7802.

Recommendation: Reinvigorate the IRS Oversight Board by developing a mechanism that ensures continuing appointments and adding members with the necessary skillsets (e.g., backgrounds in education, information technology, small business experience, large business experience, individual taxpayer representation).

VII. Specific recommendations for increasing efficiency while protecting taxpayer rights

In the Center for Taxpayer Rights' comments on the IRS Strategic Operating Plan, we made many actionable recommendations to improve the efficiency and effectiveness of tax administration. Below I discuss two such proposals, to demonstrate that efficiency efforts don't have to come at the cost of taxpayer rights; in fact, taxpayer protections can be enhanced through efficiency gains.

1. Up-front issue resolution, as described in the SOP, can be a positive benefit, but if not carefully implemented it may violate taxpayer rights and improperly reject legitimate returns.

Initiative 2.1 of the IRS Strategic Operating Plan envisions a future whereby the IRS informs the taxpayer at the time of filing if there are questionable claims on their returns. This can be a very positive development. For example, advising a taxpayer at the time of filing that it appears from Social Security Data that the child claimed on the return is too old for a claim of the Child and Dependent Care credit would allow that taxpayer to correct their return before final filing and thus avoid the uncertainty, anxiety and burden of the math error process. On the other hand, if the taxpayer is eligible for the credit because the child is disabled, a poorly designed up-front system would likely deter the taxpayer from claiming a benefit for which they are eligible. Further, if the IRS uses the e-file process to reject this taxpayer's return, it will be violating the law,[27] impairing taxpayer rights, increasing taxpayer burden, and creating downstream work for itself in the form of processing paper returns that previously have been rejected or litigating refund claims. The better system design would be to alert the taxpayer to any issues on the return and provide the taxpayer an option to change the return or to continue with the return as currently configured. In this way the taxpayer retains the ability to electronically file the original return but understands they may need to produce documentation down the line to support their return positions.

- Recommendation: Follow the Beard v. Commissioner test and accept e-filed returns, even where an error has been identified. Process and accept duplicate Taxpayer

[27] According to *Fowler v. Commissioner*, 155 T.C. No. 7 (2020), a return such as the one described above, constitutes a valid return under *Beard v. Commissioner*, 82 T.C. 766 (1984). *Beard* established a multi-prong test for determining whether a document constitutes a tax return: (1) the document purports to be a return and provides sufficient data with which the IRS can calculate the tax liability; (2) the taxpayer makes an honest and reasonable attempt to meet the requirements of the tax laws; and (3) the taxpayer executes the document under penalties of perjury.

Identification Number (TIN) e-filed returns that meet the Beard test as filed. For other e-filed returns, prior to acceptance of a return, alert the taxpayer to any potential errors on the return. Provide the taxpayer with the option to either (a) correct the error per IRS position or (b) file the return as-is with an explanation.

- Recommendation: Where the IRS has identified potential errors on an e-filed return prepared by a for-fee or VITA/TCE preparer, the taxpayer must be directly notified and provide consent for changes other than merely clerical errors such as transposed digits or omission of a required form.

2. IRA funding creates a unique opportunity to dramatically improve the correspondence examination process, which accounts for the vast majority of audits of individual taxpayers.

We commend the IRS and Treasury for committing to not increase the number of audits for taxpayers with income below $400,000, and for the decision to reduce the number of Earned Income Credit audits. But these moves, however commendable, do not address the glaring inequities and deficiencies in the correspondence exam process, which account for between 70 and 80 percent of all audits of individual taxpayers, and over 90 percent of audits for individual taxpayers with total positive income under $50,000.[28] Under the "corr exam" process, no one employee is assigned to the case; each time the taxpayer calls the IRS about the matters under audit, a different employee answers the call. Unlike office and field audits, with corr exam there is no individual continuity or accountability for the conduct of the audit. True to its name, corr exams are conducted via (incomprehensible) correspondence. Ten to 12 percent of IRS corr exam notices are returned as undeliverable. Further, 41.6 percent of the audits are no-response, and 20.4 percent result in default assessments.[29] As a result, over 60 percent of correspondence exam assessments are unconfirmed assessments. That is, the IRS does not actually know if it has achieved the correct result in the audit because it had limited or no engagement with the taxpayer. If this were the result in office or field audits, which generally involve higher income taxpayers, people would be protesting loudly about this violation of taxpayer rights.

Fortunately, IRA funding for both enforcement and business systems modernization provides an opportunity for the IRS to radically restructure the correspondence exam process. Specifically, the IRS could incorporate the benefits of office exams into the correspondence exam process by scheduling appointments with taxpayers to meet with an assigned auditor virtually; during that meeting the auditor would review and explain the issues that are under audit and work with the taxpayer to identify documentation that would support the deduction or credit claim. The taxpayer would leave the audit understanding what steps they need to take to successfully resolve the audit; alternatively the taxpayer would understand why the return was incorrect. Further, because one auditor is assigned to the case, and there is direct engagement with the taxpayer, there will be better communication and response rates, leading to greater trust, accountability, and taxpayer and employee satisfaction.

[28] National Taxpayer Advocate, 2021 Annual Report to Congress, 150.
[29] National Taxpayer Advocate, Fiscal Year 2024 Objectives Report to Congress, at 20.

Recommendation: Conduct correspondence audits as virtual office audits:

- assign one employee to that audit;
- issue an audit notice letter that is tailored and specific to the issue being audited;
- offer a specific date for a virtual audit appointment with the opportunity for the taxpayer to call and reschedule (or do so via smartphone through a QR code provided in the letter);
- conduct the audit via virtual face-to-face technology with camera enabled for document sharing;
- require the auditor to place an outbound call confirming the audit appointment and what elements of the statute the taxpayer needs to prove at the audit; and
- require the auditor to make another outbound or schedule another online meeting prior to issuing the proposed audit report.

VIII. The confidentiality of taxpayer and tax return information is a fundamental taxpayer right and essential to maintaining taxpayer trust.

Internal Revenue Code section 7803(a)(3)(H) provides that taxpayers have the right to confidentiality. This fundamental right is protected and enforced by several Code sections, including sections 6103, 7213, 7213A, 7216, 6713, and 7431.[30] Indeed, the efficiency and effectiveness of our self-assessment tax system is dependent upon taxpayers' trust that the information they voluntarily provide the IRS will be held confidential. IRS employees are trained from day one of their employment about the confidentiality of returns and return information, and that emphasis continues every day of their working lives at the IRS. The recent exposure of tax returns by the contractor Craig Littlejohn demonstrates that one bad actor can significantly erode taxpayer trust in the IRS's ability to protect taxpayer information. Imagine what will happen to that trust – and to voluntary compliance -- if there is widespread inspection and disclosure by actors outside of the IRS.

From the very inception of the income tax, after passage of the Sixteenth Amendment in 1913, tax returns were open to public inspection at the order of the President, under regulations promulgated by the Secretary of the Treasury.[31] The Revenue Act of 1924[32] required the Commissioner to make lists of names and addresses of return filers publicly available, and the United States Supreme Court upheld the right of newspapers to publish those lists.[33] Further, Treasury regulations made individual returns available to other government agencies, upon written request. Over time, with the realization the IRS holds the

[30] IRC §§ 7213 and 7213A set forth the criminal penalties, including imprisonment and fines, for willful unauthorized disclosure of returns and return information or for solicitation of such disclosure, and for inspection of returns or return information, respectively. IRC §§ 7216 and 6713 set forth the criminal and civil penalties, respectively, for the unauthorized use or disclosure of return and return information by tax return preparers (defined broadly). IRC § 7431 provides taxpayers a private right of action against federal officers and employees or other persons in federal district court if their returns or return information are inspected or disclosed in violation of IRC §6103.

[31] Tariff Act of 1913, ch.16, 38 Stat. 114, 177.

[32] Act of June 2, 1924, ch. 234, 43 Stat. 253, 293.

[33] United States v. Dickey, 268 U.S. 378 (1925).

mother lode of data pertaining to family and business relationships, financial dealings, employment, investments, and medical and educational information, federal and state agencies, as well as private sector entities such as lenders, sought access to that data. Things came to a head in the 1970s when President Nixon issued two Executive Orders authorizing the Department of Agriculture Department to inspect returns and return information of all US farmers.[34] Further concerns arose with reports that the White House was attempting to obtain tax return information of the President's enemies and about audits of the President's supporters. All of this led to major reform of what is now IRC section 6103. Whereas before the 1976 amendments, the President controlled public access to returns and return information, the Tax Reform Act of 1976 shifted determinations regarding disclosure to Congress.[35] Section 6103 now starts from the premise that tax returns and tax return information are confidential unless excepted by specific provisions set forth in that section. Criminal penalties are imposed for violations of the statute.

It's worth noting how the Senate Committee Report framed the reasons for this shift in power:

> The committee has reviewed each of the areas in which returns and return information are now subject to disclosure. . . . With respect to each of these areas, the committee has tried to balance the particular office or agency's need for the information involved with the citizen's right to privacy and the related impact of the disclosure upon the continuation of compliance with our country's voluntary assessment system.[36]

This statement is as relevant today as when it was written almost fifty years ago. The current section 6103 contains over 13 sub-sections listing exceptions to the general confidentiality protection, including the broadest exception under 6103(c) pertaining to taxpayer requests for their return or return information to be disclosed to a third party (after all, this is taxpayer information and they should be able to direct the IRS to disclose it per their instructions). Section 6103(l), allowing disclosure for purposes other than tax administration, contains 22 specific exceptions. But for every exception that Congress has created, it also tightened the protections and restrictions on inspection, use, and disclosure. As recently as 2019, in the Taxpayer First Act, Congress imposed limits on the use and disclosure of tax return information by third parties to whom the taxpayer had consented to release it.[37]

Under 6103(i), Congress has authorized disclosure of certain return and return information to federal officers and employees for "administration of federal laws not relating to tax administration." These instances, however, involve very serious endeavors, including use in criminal investigations, investigations of criminal or terrorist activities or in emergency

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[34] Executive Orders 11697 and 11709.

[35] Tax Reform Act of 1976, Pub. L. No. 94-955, 90 Stat. 1667 (1976).

[36] S. Rep. No. 94-938 at 318.

[37] TFA section 2202, amending 6103(c) to provide "[p]ersons designated by the taxpayer under this subsection to receive return information shall not use the information for any purpose other than the express purpose for which consent was granted and shall not disclose return information to any other person without the express permission of, or request by, the taxpayer."

circumstances, in locating fugitives from justice, and relating to terrorist activities. Reading through these exceptions to confidentiality, one finds specific procedural requirements, including in some instances ex parte orders from a federal district court judge or magistrate, before such information may be disclosed by the Secretary.

Congress has recognized that tax returns and tax return information can be very helpful in implementing non-tax administration policies, and that requiring US persons to report the same information to myriad different agencies is inefficient and imposes unreasonable administrative burdens on both those persons and the agencies. Thus, section 6103(l) contains over 22 subparagraphs authorizing the Secretary to disclose tax returns and tax return information for non-tax administration purposes. But every single subparagraph contains language restricting such use and disclosure "for the purpose of, and only to the extent necessary" for carrying out that non-tax administration purpose.[38]

Under section 6103(n), "certain other persons" – i.e., contractors -- are authorized to receive, pursuant to regulations, returns and return information "to the extent necessary in connection with the processing, storage, transmission, and reproduction of such returns and return information, the programming, maintenance, repair, testing, and procurement of equipment, and the providing of other services, for purposes of tax administration." [Italics added.] Thus, if the Secretary contracts with a business to assess or test the efficiency and security of the IRS return submission processing pipeline, that contractor may receive return and return information, but only for the purpose of testing the efficiency and security of the system. It cannot inspect the information to assess, for example, whether the IRS has made "illegal" payments. That type of determination is left to IRS officers and employees pursuant to their tax administration duties under section 6103(h), and oversight by the Treasury Inspector General for Tax Administration under IRC section 6103(k)(6).

I recite this extensive list of exceptions to tax return confidentiality to illustrate that Congress has only granted exceptions where it has carefully balanced the compelling need for disclosure against the fundamental taxpayer guarantee that if they voluntarily provide the IRS with personal and private information, it will remain confidential. Further, where Congress has created such exceptions, it has also imposed significant prohibitions on the re-use and re-disclosure of the information obtained under the exceptions.

Congress has not stopped there. It has imposed criminal and civil sanctions on tax return preparers for the use and disclosure of returns and return information without the taxpayer's express written consent to the specific use or disclosure.[39] And in an extraordinary waiver of sovereign immunity, under IRC section 7431, Congress has created a private right of action

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[38] *See, e.g.*, IRC § 6013(l)(8), authorizing disclosure to federal, state, and local child support enforcement agencies. Only specific tax return information is authorized to be disclosed, including net earnings from self-employment, wages, and retirement income, and "only for purposes of, and to the extent necessary in, establishing and collecting child support obligations from, and locating individuals owing such obligations." In other words, tax return information disclosed under this section cannot be shared with or used by other federal, state or local agencies, or by the child support enforcement agency for another purpose.

[39] IRC §§ 7216 and 6713.

for a taxpayer to bring suit in federal district court against the United States when "any officer or employee of the United States" who knowingly or by reason of negligence inspects or discloses any return or return information with respect to that taxpayer in violation of IRC § 6103. Similarly, a taxpayer may sue "any person" who is not a US employee on the same grounds for violations of sections 6103 and 6104(a), and in this case may also seek punitive damages. If even read-only access to returns and return information is granted to non-IRS employees or contractors of other agencies for vague "efficiency" purposes, we may see a large number of suits in federal district courts in the coming years under this provision.

Congress has also clearly been concerned that, without proper oversight, these exceptions to section 6103 will be misused such that the right to confidentiality will be meaningless. Thus Congress has required the Secretary, under section 6103(p),

- to create and maintain a system of recordkeeping for all requests for inspection or disclosure, and actual inspections and disclosures, of returns and return information;
- report to the Joint Committee on Taxation (JCT), within 90 days of the end of the calendar year, a summary of the records requested and disclosed, excepting any request by the President under 6103(g) regarding any information on any individual who is an employee of the executive branch of government; and
- submit to the Joint Committee on Taxation, within 90 days of the end of the calendar year, a report for disclosure to the public summarizing the disclosures outlined in 6103(p)(A).

The most recent report for Calendar Year 2023 can be accessed at https://www.jct.gov/publications/2024/jcx-14-24/. The number of annual disclosures is eye-popping. In 2023, notwithstanding the statutory exclusion of significant categories of disclosures from the recordkeeping system and reporting, the Secretary reported 42.5 billion disclosures, including 14.5 billion disclosures of bulk Master File data to state tax agencies.

Unfortunately, section 6103(p) excludes important disclosures from this report. For example, requests for disclosure under 6103(c) – i.e., pursuant to taxpayers' requests – are not included; nor are disclosures under 6103(l) (for non-tax administration purposes); 6103(m) (taxpayer identity information disclosures; and 6103(n) ("certain other persons"). It is not clear to me why we would want to exempt these disclosures from reporting to JCT and the public, particularly since in recent years the use of "certain other persons" to further tax administration has expanded exponentially, as have taxpayer consents to disclosure under 6103(c).[40]

I, for one, want to know the number of these disclosures and the category of requestor; they may point out exceptions that need to be narrowed, or instances where the return information is at risk of being mis-used or improperly re-disclosed. In this digital age, capturing this data is not a heavy lift. If it is not being tracked, that points to a profound systemic failure of

[40] *See*, *e.g.*, taxpayer consent to disclose tax return data to Department of Education for FAFSA determination of family contribution or to determine eligibility for or repayment obligations under income-contingent or income-based student loan repayment plans, pursuant to the Fostering Undergraduate Talent by Unlocking Resources for Education Act, Pub. L. No. 116-91, 133 Stat. 1189.

taxpayer rights protections. Erosion of taxpayer confidentiality will also erode trust, reduce voluntary compliance, and increase the enforcement costs of tax administration.

> Recommendation: Amend IRC 6103(p)(A) to include in the recordkeeping required to be maintained by the Secretary all requests for inspection or disclosure of returns and return information (including the reasons for and dates of such requests) and of returns and return information inspected or disclosed under this section and section 6104(c), except under the authority of subsections (h)(1), (3)(A) and (4), and (i)(4).

APPENDIX I: Comments on the IRS Strategic Operating Plan

21 June 2023

Honorable Janet L. Yellen
Secretary
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Washington DC 20220
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Honorable Daniel I. Werfel
Commissioner
Internal Revenue Service
1111 Constitution Ave. NW
Washington DC 20224

By U.S. Mail and email

Re: Internal Revenue Service 2023-2031 Strategic Operating Plan

Dear Secretary Yellen and Commissioner Werfel:

We are writing on behalf of members of the Low Income Taxpayer Clinic (LITC) community to provide our comments and recommendations about the Internal Revenue Service (IRS) 2023 - 2031 Strategic Operating Plan (SOP). The Center for Taxpayer Rights (CTR)[41] hosts a weekly call for Low Income Taxpayer Clinic (LITC) personnel, and during May and June, 2023, we dedicated several of these calls to reviewing the SOP.[42] We applaud the IRS and the Department of the Treasury for the plan's emphasis on providing US taxpayers with the assistance they need to comply with tax laws and obligations. To assist the IRS in achieving its goals and effectively applying the Inflation Reduction Act funding, we offer the recommendations discussed in detail below and summarized in Appendix A. We welcome the opportunity to discuss these matters with you and your staff.

Threshold Considerations

[41] The Center for Taxpayer Rights (CTR) is a §501(c)(3) organization dedicated to the protection of taxpayer rights in the United States and internationally. CTR operates the LITC Support Center, which provides technical support and assistance to LITCs and also provides pro bono representation to low income taxpayers through LITC Connect. CTR was recently awarded supplemental LITC grant funding under IRC § 7526 for 2023.

[42] Over 40 representatives of Low Income Taxpayer Clinics participated in discussing the SOP and reviewing these comments.

As a threshold matter, we believe that the SOP and its implementation should be grounded in the Taxpayer Bill of Rights (TBOR).[43] The TBOR should serve as a framework for the key projects listed under the five main objectives of the plan, including the knowledge, skills, and abilities required of employees to implement the plan's initiatives and the performance measures to gauge the plan's success. Each key project should be analyzed from the perspective of how it furthers the taxpayer protections articulated in the TBOR and provided for in the Internal Revenue Code. Explicitly making the TBOR the organizing principle for implementation of the SOP not only helps the IRS explain its strategy to the taxpaying public but also builds trust with that public and reinforces with IRS employees the critical role taxpayer rights play in increasing and maintaining tax compliance.

We also recommend Treasury and the IRS revise the IRS mission statement to explicitly acknowledge the agency's dual role as a revenue collector and benefits administrator. For it to successfully fulfill the SOP's initiative to "[h]elp taxpayers understand and claim appropriate credits and deductions" (Initiative 1.9) the IRS must develop approaches to the target populations that resemble a benefits administration approach rather than an enforcement agency approach. Acknowledging the dual mission will lead to the development of different and more appropriate performance measures, employee position descriptions and skill requirements, and employee guidance and training.

The IRS's dual mission and service-oriented focus can be furthered by establishing a Family and Worker Benefit Unit (FAWBU) that houses all IRS activities touching this population of taxpayers.[44] We recommend all benefits-related outreach and education, compliance and audit, and collection initiatives not only be planned by this unit but also conducted by the unit's employees. This approach ensures that IRS staff developing the strategies are well-versed in the benefit population's needs and that IRS taxpayer-facing staff are selected for and trained in the skills best-suited for working with this large and diverse population. The FAWBU strategy office should be staffed with specialists with practical experience as well as relevant education in psychology, social work, anthropology and other aspects of human behavior and society.[45] The FAWBU can also promote excellent partnerships with groups

[43] IRC § 7803(a)(3) requires the Commissioner "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, including …" the ten rights enumerated in subparagraphs (A) through (J).

[44] For a discussion of the FAWBU, *see* Nina E. Olson, Procedurally Taxing: *Thinking Out Loud About the Advanced CTC - Part 3: The Family and Worker Benefit Unit* July 1, 2021) at https://proceduralltaxing.com/thinking-out-loud-about-the-advanced-child-tax-credit-part-3-the-family-and-worker-benefit-unit/ and Nina E. Olson, Procedurally Taxing: *FAWBU and Dispute Resolution Redux: A 12-Step Program for Culture Change at the IRS* (Oct. 28, 2021) at https://proceduralltaxing.com/fawbu-and-dispute-resolution-redux-a-12-step-program-for-culture-change-at-the-irs-part-1/.

[45] For example, the office could include (1) a specialist who has focused on plain language, concrete and effective communication, and lowering reading barriers; (2) a specialist who can oversee Limited English Proficiency services, *e.g.*, proper use of interpreters, range of languages and dialects; (3) a specialist in trauma and mental health – and ideally another with extensive knowledge about domestic violence and experience working with survivors; (4) a specialist with experience with challenges of living in poverty or just above poverty, *e.g.*, the practical impact of housing instability, the harsh demands of low wage work, combined with being a single parent and the shortage and inadequacy of child care; and (5) a specialist knowledgeable about

serving this taxpayer sector, as well as undertake innovative research. We also recommend the IRS establish a FAWBU Federal Advisory Committee, composed of LITC and VITA repesentatives, as well as representatives of non-tax legal aid programs and other nonprofits that represent or serve the low income population, to formally advise and be consulted by the IRS on its initiatives and approach to this population.

Taxpayer Service [SOP 1.1]

We applaud the IRS's commitment to multichannel taxpayer assistance and equality of access. As the IRS acknowledges, taxpayer needs and preferences may be different depending on the issue the taxpayer is experiencing. For example, while taxpayers may be comfortable initially using the Where's My Refund app to check the status of their refund, as time passes and delays occur, taxpayer anxiety increases. As the SOP notes, anxiety can be lessened through greater transparency and more personalized information about the refund's status, and we commend the IRS for committing to create these robust self-help tools. But at some point the taxpayer will want to speak to a live human being who has the necessary data and training to advise the taxpayer about the refund's status, the actions (if any) required of the taxpayer, and options for assistance.[46] For example, on Where's my Refund, if the app shows the refund was issued on x date to y account, the app should explicitly state "If not received, click here to initiate a refund trace."

Taxpayer anxiety (and the resulting repeat dialing) can be further reduced by managing taxpayer expectations through providing greater transparency about wait times, processing times, and reasons for unexpected delays. A general dashboard that is updated in real time (not once every three to six months) is helpful and necessary. Toward that end, we recommend the IRS adopt alternate measures of "Level of Service" on the phones that reflect the taxpayer experience. Nothing erodes taxpayer trust more than hearing a LOS figure that the taxpayer knows does not align with their experience.

Similarly, we recommend the IRS conduct detailed analysis of how its phone tree system does or does not meet the needs of the taxpayer public. LITC experience is that the phone tree, through limited or misleading prompts, shunts people to automated lines that do not resolve their issues. For example, taxpayers with math error notices are directed to automated lines when what they need is a live assistor. In some instances, there is no public phone number, for example with the unit processing Individual Taxpayer Identification Numbers (ITINs). Imagine the taxpayer anxiety when one can't get through to find out what has happened to one's child's original passport, submitted to obtain an ITIN. Designing the phone tree from

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the range of assistive technology, and its limitations. With this expertise on staff, the FAWBU would ensure IRS initiatives do not create administrative burdens that result in taxpayers either not receiving benefits for which they are eligible or becoming noncompliant for lack of understanding or assistance.

[46] A "Taxpayer Anxiety Index" analysis is a way to identify when taxpayers stop being comfortable with digital-only tools and need human assistance. This approach can be applied to all IRS workstreams – filing and refunds; examinations; collection – and can assist with workforce staffing and training projections. See National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress, p. 6-8 (June 30, 2019).

the taxpayer's perspective, in conjunction with a Taxpayer Anxiety Index analysis, will enable the IRS to make the case for the appropriate staffing necessary to provide the service taxpayers need and deserve.

Digitalization [SOP 1.2]

Digitalization and a robust online taxpayer account promise to give taxpayers far greater control and access to their own account information. On the other hand, authentication measures designed to protect the privacy of that information raise equity issues and can exacerbate the digital divide, resulting in undue administrative burden for vulnerable taxpayers. At present, LITC clients are unable to access payment options via their smart phones. The IRS should work with NIST and articulate the different types of access to information (retrieval vs. submission) so that identity proofing does not permanently lock out a large segment of the taxpayer population. User testing with this population can identify chokepoints in the process that need to be addressed. Further, this user testing must include international and ITIN taxpayers.

The alternative to online accounts is paper – the IRS mailing letters in envelopes marked "IRS" that end up sitting on radiators in apartment building lobbies, available to anyone. With that exposure to privacy risks as the benchmark, we recommend the IRS work with advocates for low income, disabled, and limited English proficiency (LEP) taxpayers to come up with authentication methods that do not lock them out.[47] We also recommend that the IRS provide greater transparency into the pilots it has underway, e.g., the use of a QR code on correspondence examination notices. Sharing the results of pilots, even midway through, with external experts for the most affected populations, will expand IRS knowledge.

Privacy risks are also implicated in making taxpayer information available to third parties, including preparers who are not otherwise subject to regulation by the IRS (Initiative 1.11). We recommend the IRS limit access to taxpayer data to those tax professionals who are regulated by Circular 230 and those preparers who are participating in the IRS Annual Filing Season Program. Further, because taxpayers must provide consent for the representatives, preparers, and even tax preparation software programs to have access to their account information, the issue surrounding taxpayer and preparer identity authentication and digital consent must be carefully explored. As noted above, too-strict identity authentication means that low income and other vulnerable populations may be blocked from receiving the benefits of this initiative.

Self-service options, including chatbots, while promising can also lead to incorrect results. As Professors Josh Blank and Leigh Osofsky have noted in their study for the Administrative Conference of the United States (ACUS), simplifying complex rules (or "simplexity") can harm taxpayers if the system does not elicit sufficient information with which to provide

[47] We use the term "limited English proficiency" here to include both "English as a Second Language" or "ESL" (the term used in IRC § 7526, which authorizes federal funding of low income taxpayer clinics) as well as individuals who are not able to fully comprehend or fully communicate in English.

correct answers.[48] ACUS has adopted recommendations for how federal agencies should utilize automated legal guidance, and we recommend the IRS follow that guidance and design procedures, including robust testing and even review by external advocates, including LITC personnel, to ensure these systems do not provide inaccurate guidance.[49] Further, where self-service options and chatbots provide such guidance and answers, taxpayers should be able to download a complete transcript of the exchange; where they have acted in reliance of the exchange, we recommend they should not be subject to penalties.

These new or alternate forms of legal guidance also create a risk of a caste system of guidance – that taxpayers with what the IRS deems to be not legally complex issues will receive guidance in an informal format, with no ability to rely on the guidance and no penalty relief, while issues relating to high income/large corporate/partnership taxpayers receive bespoke attention. For example, the final regulation under IRC § 7526, Low Income Taxpayer Clinics, has been through two rounds of Treasury/Chief Counsel/IRS review, and was in final form as of July 2019, yet it has still not been issued because it is deemed low priority. We recommend that the Priority Guidance Plan adopt a more even-handed distribution of issues that are selected for formal guidance. Moreover, we recommend there be greater transparency about the status of projects selected, including to whom the project is assigned.

Up-front Issue Resolution [SOP 2.1]

While we support the concept of early issue resolution, we have a number of concerns we believe must be addressed before this initiative is implemented in order to protect taxpayer rights. Initiative 2.1 of the SOP states "if the return is not corrected, the IRS will follow its normal procedures to reject or accept it. If the return is accepted, the taxpayer will still have opportunities to resolve errors later." We are concerned that the IRS is prioritizing agency expedience over legal rights and sound public policy.

The current IRS approach to issue resolution in the filing process violates taxpayer rights and increases taxpayer burden, which in the context of low income taxpayers can mean they do not receive the benefits for which they are eligible. For example, the IRS currently rejects e-filed returns where another person has already e-filed and claimed the dependent or the taxpayer. This "race-to-filing" often arises in situations involving domestic abuse, whether the domestic violence survivor is the EITC-eligible taxpayer but the abuser wins the race to e-filing. The IRS rejects the legitimate e-filed EITC claim; the taxpayer then has the choice to e-file and lose the benefits for which she is eligible, or file a paper return, with all the attendant delays, including being audited. Only 20 percent of e-filed rejected returns for duplicate Taxpayer Identification Numbers later file on paper.[50]

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[48] For a discussion of the risks and potential mitigation strategies regarding automated legal guidance by federal agencies, see Joshua D. Blank and Leigh Osofsky, *Automated Legal Guidance at Federal Agencies* (May 26, 2022) (report to the Administrative Conference of the United States).

[49] See https://www.acus.gov/recommendation/automated-legal-guidance-federal-agencies (last visited 06/21/23).

[50] IRS, FOIA response to Justin Schwegel, Gulfcoast Legal Services LITC (March 6, 2023).

This approach is flawed on many counts, including the fact that under established case law, Beard v. Commissioner[51] and Fowler v. Commissioner,[52] the rejected e-filed return is actually a return. The IRS, then, is improperly rejecting a return instead of accepting it and putting it through its normal refund review processes. Under Beard, the IRS should simply accept the e-filed return that has a duplicate claim for a child and use its internal data – including historical data of filing behavior – to determine which return (the first or second filed) poses the greatest compliance risk and should be subject to audit or some other compliance "touch."

In other contexts when the IRS detects what it believes is an error upon e-filing, a modern tax administration approach that is based on taxpayer rights would treat the return as follows:

(1) prior to acceptance alert the taxpayer to the potential error;
(2) provide the taxpayer with the option to either (a) correct the error or (b) file the return with the original information and, at the taxpayer's option, provide an explanation for why the IRS is not correct; and
(3) proceed with submission of the return and acceptance by the IRS. The IRS can review the taxpayer's statement and decide whether the return requires further scrutiny.

The above approach has the benefit of both identifying potential errors up front and educating the taxpayer while providing the taxpayer due process – notification of the potential error and provision of an opportunity to explain why the IRS is wrong – in the context of the filing pipeline. This procedure can be used for minor errors – those typically triggering summary assessments ("math errors") under IRC § 6213(b) (e.g., transposed digits in a social security number, or the failure to attach a required form) – that can be easily addressed at time of filing. It can also be used in the context of identity theft – where the IRS informs the taxpayer of a missing Form W-2, but the taxpayer can alert the IRS up-front that that Form W-2 is the result of identity theft and should be disregarded.

The other issue raised by up-front issue resolution is who, exactly, receives the notification of the error. We believe that where taxpayers are using a paid return preparer or off-the-shelf tax preparation software, the taxpayer must be the one notified of the certain potential error (i.e., those errors that are not merely clerical such as transposed digits or omission of a form). We suggest that preparers and software be required to input the taxpayer's email address or cellphone number for texts so taxpayers receive notification and can either respond directly or authorize the preparer to make the adjustment/correction. Without this protection, preparers for low income taxpayers will likely simply remove the dependent claim because they want to be paid their fee. This may also increase return preparer fraud.

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[51] 82 T.C. 766 (1984). Beard established a multi-prong test for determining whether a document constitutes a tax return: (1) the document purports to be a return and provides sufficient data with which the IRS can calculate the tax liability; (2) the taxpayer makes an honest and reasonable attempt to meet the requirements of the tax laws; and (3) the taxpayer executes the document under penalties of perjury.

[52] 155 T.C. No. 7 (2020). For a discussion of the Fowler case, see Keith Fogg, Rejecting Returns That Meet Beard, Procedurally Taxing (Sept. 15, 2020) at https://proceduralltaxing.com/rejecting-returns-that-meet-beard/.

The final issue relates back to one discussed before – identity proofing in order to access a filing system that identifies these errors up front. Because the information about the error is return information covered by IRC § 6103, the IRS needs to know it is the taxpayer (or the taxpayer's representative) it is communicating with. Depending on the nature of the potential error, the preparer may not be authorized or eligible to receive the information. If identity proofing is too burdensome, a low income taxpayer may not be able to access an online account and will thus face delays in processing the return or have it rejected because of lack of response (which we believe is unlawful under the Beard test).

Correspondence Exam and Early/Appropriate Treatments/Tax Certainty (SOP 2.2 and 2.4)

At the outset, the IRS should consider why it is auditing so many EITC returns. In the past, IRS Commissioners have justified this high audit rate by saying the Improper Payments Information Act requires the IRS to conduct these audits. That is not correct. The IPIA requires an agency with improper payments to submit "a report on what actions the agency is taking to reduce the improper payments." The IRS, then, could address EITC and other refundable credit claims by approaches that do not include an audit. For example, TAS research has shown that a mere letter sent two weeks before the start of the filing season to taxpayers whose prior year EITC return triggered scrutiny but were not audited resulted in positive compliance behavior over the next three years.[53]

The taxpayers we represent and advocate on behalf of are disparately impacted by the IRS correspondence exam procedures. TAS research has shown that taxpayers do not even know they are under examination and, if they do understand they are being audited, they don't understand what information and documentation the IRS requires.[54] The correspondence exam process does not tailor its audit approach and notices to the circumstances of the taxpayer. For example, currently an audit may be focusing on only one aspect of eligibility for a credit; the audit notice, however, states the taxpayer must prove every element. LITCs report that auditors generally disallow all benefits attributable to a child if the taxpayer cannot produce a birth certificate, regardless of what other evidence the taxpayer may provide. These approaches create significant administrative burden for low income taxpayers, which are unsurmountable.

Taxpayers would be better served if audits of social benefits delivered through Internal Revenue Code, such as the EITC, are conducted in an inquisitorial manner rather than adversarial one. For example, in determining eligibility for disability, the Social Security Administration can, with the taxpayer's consent, obtain medical information directly from medical providers. The IRS has tested use of an affidavit, Form 8836 and its accompanying Schedule A, Third Party Affidavit, that make it easy for the taxpayer to obtain evidence of joint principal residence, and it should incorporate that form into its audit procedures. On the

[53] National Taxpayer Advocate 2019 Annual Report to Congress, Vol. 2, *Study of Subsequent Compliance of Taxpayers Who Received Educational Letters from the National Taxpayer Advocate,* 239-256 (Dec. 31, 2019).
[54] National Taxpayer Advocate 2007 Annual Report to Congress, Vol. 2, *IRS Earned Income Credit Audits – A Challenge to Taxpayers*, 2-24 (Dec. 31, 2007).

other hand, the IRS's reliance on the Federal Registry for Child Support Orders as (automated) evidence of non-custody is misplaced, since many, if not most, states do not track custody status in the registry.

We recommend that where the IRS believes an audit of a low income taxpayer is necessary, that it conduct the audit as a virtual office audit:

- assign one employee to that audit;
- issue an audit notice letter that is tailored and specific to the issue being audited;
- offer a specific date for a virtual audit appointment with the opportunity for the taxpayer to call and reschedule (or do so via smartphone through a QR code provided in the letter);
- provide a copy of Form 8836 and Schedule A (Third Party Affidavit) where residency is at issue;
- require the auditor to place an outbound call confirming the audit appointment and what elements of the statute the taxpayer needs to prove at the audit; and
- require the auditor to make another outbound or schedule another online meeting prior to issuing the proposed audit report.

This approach will ensure that taxpayers have a discussion with the auditor about what documentation they have and what more they need to provide and also educate taxpayers about eligibility requirements so they do not make mistakes in future years.[55]

Correspondence exams have the lowest agreement rate and highest default rate of any type of examination; surveys have found taxpayer trust of the IRS is lower after a corr exam than other types of exams.[56] Accordingly, we recommend that the IRS partner with LITCs to provide training of Tax Compliance Officers in how to communicate and work with low income and limited English proficiency (LEP) taxpayers, survivors of domestic violence, persons with disabilities, and similar populations. Gaining an understanding of the taxpayer experience and life circumstances will help the IRS get the right answer in these cases, rather than a default answer because the taxpayer could not navigate IRS processes or did not understand what was expected of them.

We applaud the SOP's emphasis on pre-filing assistance. Toward that end, we recommend the IRS establish a year-round toll-free phone line dedicated to providing assistance with respect to family status benefits administered by the IRS, both in the pre-filing and post-filing context.[57] Taxpayers should be able to call and speak with a specially-trained representative

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[55] For a detailed discussion of these recommendations, *see* Nina E. Olson, Procedurally Taxing: *How Did We Get Here – Correspondence Exams and the Erosion of Fundamental Taxpayer Rights* – Part 1 (March 14, 2022) and Part 2 (March 15, 2022) at https://proceduralltaxing.com/how-did-we-get-here-correspondence-exams-and-the-erosion-of-fundamental-taxpayer-rights-part-1/ and https://proceduralltaxing.com/how-did-we-get-here-correspondence-exams-and-the-erosion-of-fundamental-taxpayer-rights-part-2/.

[56] See National Taxpayer Advocate 2017 Annual Report to Congress, Vol. 2, *Audits, Identity Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey,* 148-188 (Dec. 31, 2017) and National Taxpayer Advocate 2019 Annual Report to Congress, Vol. 2, *Audit Impact Study: the Specific Deterrence Implications of Increased Reliance on Correspondence Audits,* 258-268 (Dec. 31, 2019).

[57] See National Taxpayer Advocate, 2015 Annual Report to Congress, 240-247 (Dec. 31, 2015).

about their eligibility for these benefits. Such assistance goes beyond mere chatbots and guards against "simplexity" risks discussed above. The phone line would also provide excellent data on which areas of the law the IRS needs to conduct better education about. The IRS might also consider offering a pre-filing certification pilot, completely voluntary, in which taxpayers during the second half of the calendar year could demonstrate to the IRS that the child met the tax provision's requirements and thus be pre-cleared for expeditious processing during the filing season.[58] This approach would not take the place of an audit, being completely voluntary, but it would be of great value to separated parents and survivors of domestic violence, who often have their e-filed returns rejected because someone else has won the "race to file" and claimed the child, as discussed above.

We also recommend that the IRS analyze audit reconsideration, Taxpayer Advocate Service, Office of Independent Appeals, and Tax Court cases where these entities reversed IRS auditors initial disallowance of the EITC and other credits. The IRS should use these cases to train its audit selection model; further, the cases will provide a roadmap to auditors for how better to communicate with taxpayers and obtain alternative forms of documentation.

Finally, we recommend the IRS partner with external researchers to conduct a study of alternative approaches to correspondence exams, as discussed below and set forth in Appendix B.

Tax Penalties (SOP 2.2.6)

We understand the drive for the IRS to develop efficient processes for determining the application of penalties and penalty abatement. These procedures, however, can seriously impair taxpayer rights if they are not well designed and have a safety valve for cases that do not fit nicely into the automated approach. Below we discuss two instances where the SOP's goals provide an opportunity to re-examine the IRS's approach to penalty administration.

Reasonable Cause/First Time Abatement Penalty. We commend the IRS for developing the first time penalty abatement procedure (FTA) as a means for the IRS and taxpayers to quickly address taxpayer missteps. However, the automatic FTA abatement as the first recourse can actually harm taxpayers because FTA relief is available only once every 3 years.[59] Consider a taxpayer whose situation in year 1 meets the requirements of reasonable cause abatement. Under current policy the IRS never reaches the RCA analysis; instead, it automatically applies FTA. If the taxpayer in year 3 has a different situation which does not meet RCA criteria, FTA is no longer available.

Reasonable cause abatement is a matter of statutory relief, unlike FTA, which is an exercise of administrative discretion. The IRS should restructure its penalty application to reflect the statutory scheme: (1) iteratively train its employees on the case law under reasonable cause abatement so they can override the Reasonable Cause Assistor in appropriate circumstances;

[58] See Internal Revenue Service, *IRS Earned Income Tax Credit Initiatives: Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests* (2008).
[59] IRM 20.1.1.3.3.2.1., First Time Abate.

(2) convert the Reasonable Cause Assistor to a true Artificial Intelligence program that is trained on reasonable cause case law as well as Appeals, Taxpayer Advocate, and court cases where relief was initially denied by the IRS and ultimately obtained; and (3) develop procedures whereby the IRS can retroactively change the basis for penalty relief from FTA to reasonable cause so FTA is available in a later year.

IRC § 32(k) Two-Year/Ten-Year Ban In past years, the National Taxpayer Advocate's Annual Reports to Congress have demonstrated that the IRS's current policies and procedures regarding the implementation of IRC § 32(k) significantly harms eligible taxpayers and violates taxpayer rights.[60] The 32(k) 2-year penalty requires a finding of the taxpayer's "reckless or intentional disregard of rules and regulations." Such intent cannot be imputed under an automated approach or black-and-white rules. The IRS's own data show that 1/3 of the EITC taxpayer population moves in and out of eligibility each year. This creates a steep learning curve for any taxpayer, especially low income and LEP taxpayers. Even where a taxpayer has been audited for the EITC, TAS research has shown that taxpayers do not understand why the credit was disallowed. As discussed above, the IRS approach to correspondence audits is not designed to educate taxpayers about how to avoid problems going forward. To impute such knowledge to a taxpayer who has experienced these flawed audit techniques, with little or no personal interaction, is a fundamental violation of the right to a fair and just tax system. We also believe the current approach to the penalty has a racially disparate impact. We recommend that IRS work with representatives of TAS and the LITC community to revise its procedures with respect to application of the IRC § 32(k) penalty.

Taxpayer-Centric Notices (SOP 2.3)

Coherent, understandable notices are key to effective tax administration. We are very pleased to read that the IRS hopes to substantially increase the number of notices it annually reviews and revises. Making notices and other communications intelligible includes applying plain language standards and ensuring the content provides the necessary information, with key information on the first page, that will encourage the reader to look at additional pages. Past efforts at notice clarification have resulted in the IRS prioritizing enforcement messages over information providing explanations of avenues of relief and taxpayer rights. Important information about access to judicial review, the Taxpayer Advocate Service, and LITCs have been relegated to the second or third pages of notices. Further, as noted earlier, mere simplification (in contrast to plain language standards) may result in incorrect guidance.[61]

The 2018 National Taxpayer Advocate Annual Report to Congress covered IRS Notice Communications extensively, and we recommend the IRS hew closely to those

[60] *See, e.g.*, National Taxpayer Advocate 2019 Annual Report to Congress, Vol. 2*, Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit,* 241-256 (Dec. 31, 2019).
[61] Two sites that have some useful plain language guidance are https://plainlanguagenetwork.org/plain-language/what-is-plain-language/ and https://www.transcend.net/aboutUs/Journey_to_PL.html.

recommendations.[62] Further, we recommend that the IRS adopt a rights-based approach to notices, with emphasis on the availability of due process. If the IRS is to fulfill its service-focused mission, its notices need to emphasize the availability of assistance and alternatives. Moreover, we recommend the IRS prioritize the protection of taxpayer rights in selecting which notices to first revise and translate into other languages. Notices relating to math errors, audit adjustments, Collection Due Process, Notices of Deficiency, refund disallowances, and other communications substantially implicating legal and taxpayer rights should be moved to the front of the line for revision. We also recommend the IRS share all proposed notice revisions with the LITC community for review and comment; this can be efficiently accomplished through the establishment of the FAWBU Federal Advisory Committee, discussed above.

Proactive Debt Resolution (SOP 2.5)

We are pleased to see the IRS's commitment to using "analytics to identify the repayment options best suited to each taxpayer's circumstances." Properly implemented, this initiative protects the right to privacy and the right to a fair and just tax system. The right to privacy provides that "any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary…."[63] This balancing of the government's legitimate interest in collecting the tax due and the taxpayer's interest in such actions being no more intrusive than necessary is an expression of both due process and equal protection principles and should form the basis of any debt collection strategy.

The balancing test can be operationalized in the following manner:

- Develop Allowable Expense guidelines (ALEs) that are based on a sustainable standard of living reflecting geographic diversity, rather than the Bureau of Labor Statistics' data, which only reflects what people actually spend, rather than what people need to spend to have a sustainable life.[64]

- Adopt an Economic Hardship Indicator (EHI), as recommended by the National Taxpayer Advocate.[65] By utilizing an algorithm based on most recent return or

[62] The report contains specific recommendations about how to improve Summary Assessment (math error) notices, Collection Due Process notices, and Notices of Deficiency. National Taxpayer Advocate 2018 Annual Report to Congress, 174-222 (Dec. 31, 2018).
[63] IRS, Publication 1, Your Rights as a Taxpayer.
[64] National Taxpayer Advocate 2016 Annual Report to Congress, 192-202 (Dec. 31, 2016). See also, National Taxpayer Advocate 2018 Annual Report to Congress, Vol. 2, *A Study of the IRS's Use of the Allowable Expense Standards,* 40-52 (Dec. 31, 2018).
[65] *See* National Taxpayer Advocate 2018 Annual Report to Congress, 228-239 (Dec. 31, 2018) and National Taxpayer Advocate 2020 Annual Report to Congress, Vol. 2, *The IRS Can Systemically Identify Taxpayers At Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford,* 249-267 (Dec. 31, 2020). *See also*, Nina E. Olson, Procedurally Taxing: My IRS Wishlist for 2021, Part 2 – The Economic Hardship Indicator (Feb. 1, 2021) at https://proceduralltaxing.com/my-irs-wishlist-for-2021-part-2-the-economic-hardship-indicator/

Information Return data and the IRS's (revised) ALEs, the IRS can place a marker on the taxpayer's account to indicate they are at risk of economic hardship.[66] When a taxpayer with the EHI on their account contacts the IRS by phone, the assistor can receive a prompt to ask specific questions so a determination of economic hardship can be made. If as a result of these questions the taxpayer is placed in Currently Not Collectible – Hardship status, the assistor can evaluate whether an offer in compromise might be the appropriate option and direct the taxpayer to more information about the OIC process, as well as make a direct referral to Low Income Taxpayer Clinics, as authorized by IRC § 7526(c)(6). The EHI also has the side benefit of making the IRS recognize and acknowledge that CNC-Hardship is a legitimate collection alternative.

- Replace the current online Installment Agreement (IA) tool and "chatbot" with a true machine-learning algorithm that is trained on data from existing installment agreement, OIC, and other payment cases, including IAs that were defaulted, and cases from the Taxpayer Advocate Service, the Independent Office of Appeals, and the Tax Court in which IRS collection actions were either upheld or reversed. By training the machine on these cases as well as actual taxpayer data and IRS ALEs, the program may be able to identify candidates for various collection alternatives. Instead of forcing taxpayers into steamlined IAs that they cannot afford, which results in high default rates, the algorithm can be trained to identify those cases requiring additional information and even in-person, human assistance. By having the algorithm operate in conjunction with the Economic Hardship Indicator, the online tool can also automatically request additional information about income and special-needs/extraordinary expenses so that a determination can be made of CNC-hardship status (and a recommendation for an OIC). We also recommend the online IA tool be renamed to reflect a more wholistic approach to debt resolution.

- Exercise the Commissioner's discretion to not offset the EITC portion of a taxpayer's refund, unless it will be otherwise offset by the Treasury Offset Program. This approach not only promotes the underlying policy goals of the EITC but also reduces resources currently directed to the Offset Bypass Refund process.

- Establish an Economic Hardship Unit that will be the first stop for handling all Offset Bypass Refund (OBR) requests and align the criteria for bypassing refunds with the definition of economic hardship in the regulations and the revised ALEs. Given the timing urgency of OBR requests, there is no need for the Taxpayer Advocate Service to be the first stop in the process. By establishing an IRS unit focused on Economic Hardship, the principles of the balancing test, awareness of taxpayer needs, and the IRS impact on those needs is reinforced. TAS can play a role where the processes are not working as intended.

[66] Treas. Reg. § 301.6343-1(b)(4).

- Exercise the Commissioner's discretion in establishing a late payment penalty rate of .25% (as opposed to .50%) while the taxpayer is in CNC-Hardship status. The taxpayer should not be penalized because they do not have the resources to pay for basic living expenses.

Research (SOP 4.8)

We fully applaud the IRS's commitment to the OMB standard to "annually facilitate engagement of non-IRS researchers in high value research." As clinicians, we daily see the downstream effects of IRS actions that harm taxpayers and undermine compliance and trust. These observations lead us to make recommendations on how to revise agency approaches to avoid these negative effects. These recommendations deserved to be tested in a rigorous fashion, but the inability to gain access to IRS data and research staff remains an obstacle.

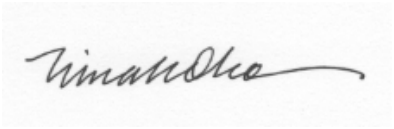
In the 2016 Annual Report to Congress, the National Taxpayer Advocate recommended the IRS establish an outside advisory board to recommend research projects, so that "high value research" was not determined only by IRS insiders, which can result in one-sided, pre-ordained selection of research topics.[67] We support that recommendation.

We also strongly recommend the IRS move forward with the research proposal Improving Revenue Service: Specific Pilot Tests for Improving IRS Correspondence Audits, prepared by Day Manoli of Georgetown University and Nina Olson of the Center for Taxpayer Rights and attached as Appendix B to these comments. This proposal sets forth ways to test the multiple recommendations we have made for improving correspondence audits. Furthermore, this proposal reflects insights from tax researchers who have been studying audits for many years and from tax practitioners who have years of first-hand experiences of the impacts of correspondence exam procedures on low income taxpayers. We recognize that the IRS has internal efforts underway to improve correspondence audits and that IRS staff are busy. However, we recommend that the IRS proceeds with this proposal because it combines internal and external expertise, and this combination will maximize the effectiveness of current internal efforts and best position the IRS to achieve the goals laid out in the Strategic Operating Plan.

The Inflation Reduction Act funding provides an unprecedented opportunity for the Internal Revenue Service to achieve its mission of administering the tax laws in a fair and just manner. The LITC members of the CTR LITC Strategy group support the five goals set forth in the Strategic Operating Plan and offer our recommendations in the spirit of collaboration and partnership. We welcome the opportunity to discuss them with you and appropriate Treasury and IRS staff.

Respectfully submitted,

[67] National Taxpayer Advocate 2016 Annual Report to Congress, 358-363 (Dec. 31, 2016).



Nina E. Olson
Executive Director
Center for Taxpayer Rights
On Behalf of Members of the LITC Strategy Group

Cc: Honorable Wally Adeyemo, Deputy Secretary, Department of the Treasury
Honorable Lily Batchelder, Assistant Secretary for Tax Policy, US Department of the Treasury

APPENDIX A:
Summary of Recommendations for Implementation of the IRS 2023 – 2031 Strategic Operating Plan

Threshold Considerations:

- Revise the IRS mission statement to explicitly acknowledge the agency's dual role as a revenue collector and benefits administrator.
- Establish a Family and Worker Benefit Unit (FAWBU) housing all service, compliance, and enforcement activities touching the benefits population.
- Establish a FAWBU Federal Advisory Committee including LITC and VITA representatives as well as members from nonprofits serving or advocating on behalf of the low income population.

Taxpayer Service:

- Apply a "Taxpayer Anxiety Index" to all IRS service offerings and channels to identify those points at which a live assistor's intervention is appropriate and even necessary.
- Develop a comprehensive dashboard that is updated regularly, providing greater transparency about wait times, processing times and reasons for unexpected delays.
- Provide taxpayers with more detailed information about the status and processing stage of their refund claims on "Where's my refund."
- Adopt alternate measures of "Level of Service" on the phones that better reflects the taxpayer experience.
- Conduct a detailed analysis of the IRS phone tree system from the perspective of taxpayers' needs and preferences and in conjunction with the Taxpayer Anxiety Index.

Digitalization:

- Work with NIST to reduce the identity-proofing burden on low income taxpayers and identify the different levels of access to information that may not require the highest and most restrictive authentication.
- Work with advocates for low income, disabled, and ESL taxpayers to develop authentication methods that are accessible and do not exclude these populations from digital tools.
- Limit access to taxpayer data and digital accounts to those tax professionals who are regulated by Circular 230; for tax return preparers who participate in the Annual Filing Season Program, only provide access to that taxpayer information that is necessary to prepare or correct a return. Unregulated return preparers who do not participate in the Annual Filing Season Program should not have any access to taxpayer digital account information.
- Where self-service options and chatbots provide guidance and answers, provide taxpayers with a complete, downloadable transcript of the exchange; and where they have acted in reliance of that exchange, do not apply penalties.

Up-front Issue Resolution:

- Follow the Beard v. Commissioner test and accept e-filed returns, even where an error has been identified. Process and accept duplicate TIN e-filed returns that meet the Beard test as filed. For other e-filed returns, prior to acceptance of a return, alert the taxpayer to any potential errors on the return. Provide the taxpayer with the option to either (a) correct the error per IRS position or (b) file the return as-is with an explanation.
- Where the IRS has identified potential errors on an e-filed return prepared by a for-fee or VITA/TCE preparer, the taxpayer must be directly notified and provide consent for changes other than merely clerical errors such as transposed digits or omission of a required form.

Correspondence Examination:

- Reform the culture of the IRS correspondence exam function, especially with respect to EITC and CTC audits, from that adversarial to inquisitorial and education-oriented.
- Partner with LITCs and other advocates to provide training of Tax Compliance Officers (TCOs) on how to communicate and work with low income and ESL taxpayers, survivors of domestic violence, persons with disabilities, refugee populations, etc.
- Train the audit selection model on audit reconsiderations, TAS, Appeals, and Tax Court cases where IRS auditors' initial disallowance of the family status provisions have been reversed. TCOs should also be trained on these cases.
- Conduct correspondence audits as "virtual office audits" by assigning one employee to each audit, establishing virtual appointments for review of documents, and making outbound calls to ensure the taxpayer understands the issues.
- Make Form 8836, including Schedule A, available to all taxpayers who are being examined to establish principal residency with the child.
- Establish a year-round toll-free phone line dedicated to provide assistance with respect to IRS family status benefits.
- Consider offering a pre-filing certification pilot during the second half of the tax year so taxpayers could demonstrate they meet the eligibility requirements for a given credit.

Tax Penalties:

- Apply reasonable cause analysis before application of the First Time Abatement authority.
- Iteratively train IRS employees on the case law pertaining to reasonable cause abatement so they are able to override the Reasonable Cause Assistor in appropriate situations.
- Convert the Reasonable Cause Assistor from a rule-based system to a machine-learning/AI model and train the algorithm on reasonable cause case law and TAS, Appeals, and court cases where relief initially denied by the IRs was ultimately obtained.
- Develop procedures to retroactively change the basis for penalty relief from First Time Abatement to reasonable cause.

- Work with TAS and the LITC community to revise the IRS procedures with respect to application of the IRC § 32(k) penalty.

Taxpayer-Centric Notices:

- Adopt a rights-based approach to notices, with emphasis on the availability of due process and avenues for assistance.
- Prioritize the protection of taxpayer rights in selecting which notices to first revise and translate into other languages, i.e., notices substantially implicating legal and taxpayer rights should be prioritized.
- Share draft notice revisions that substantially implicate legal and taxpayer rights with the LITC community, either directly or through the FAWBU Federal Advisory Committee.

Proactive Debt Resolution:

- Adopt Allowable Expense guidelines that are based on a sustainable standard of living reflecting diversity and cost-of-living variations between states and cities.
- Adopt the Economic Hardship Indicator (EHI) as recommended by the National Taxpayer Advocate, and use the EHI to prompt specific questions on by IRS phone assistors or via the online installment agreement tool.
- Replace and rename the current online Installment Agreement tool and chatbot with a machine-learning/AI algorithm that is trained on data from existing IAs, OICs and other payment cases, including defaulted IAs and cases where IRS collection actions were either upheld or reversed by TAS, Appeals, or the courts.
- Exercise the Commissioner's discretion not to offset the EITC portion of a taxpayer's refund, unless it will be offset by the Treasury Offset Program.
- Exercise the Commissioner's discretion in applying a lower .25% late payment penalty rate while the taxpayer is in Currently-Not-Collectible (Hardship) status.

Research:

- Establish an outside advisory board to recommend research projects to the IRS.
- Accept the research proposal, Improving Revenue Service: Specific Pilot Tests for Improving IRS Correspondence Audits.

APPENDIX B: Research Proposal

Improving Revenue Service: Specific Pilot Tests for Improving IRS Correspondence Audits

IRS Proposal – June 2023

Day Manoli, Georgetown University
Nina Olson, Center for Taxpayer Rights

I. Summary

Building on previous work and goals included in the IRS Strategic Operating Plan, this research project will test strategies to improve the IRS' correspondence audit process. The project is motivated by prior research that indicates (1) a significant fraction of correspondence audits result in default outcomes that do not distinguish between taxpayer confusion and confirmed noncompliance, and (2) specific barriers in the correspondence audit process may drive taxpayers to these default outcomes. More specifically, this project will test strategies to reduce and possibly eliminate barriers in the correspondence audit process so that more audited taxpayers complete the process with confirmed, deliberate outcomes instead of default outcomes. These insights will provide valuable evidence to improve IRS operations and taxpayer experiences.

The research project will consider the following specific pilot tests:

- Pilot 1: Plain Language Audit Notifications
- Pilot 2: Understanding Nonresponse and Noncompliance
- Pilot 3: Referrals to LITCs and Virtual Audit Assistance
- Pilot 4: Post-Disallowance Educational Notices
- Pilot 5: Understanding Impacts of Correspondence Audits
- Pilot 6: Investigating Possible At-Filing Filters
- Pilot 7: Developing an Audit Working Group

Each pilot test addresses a distinct barrier in the current correspondence audit process, and more detail on each pilot test is included in Section II. Additionally, each pilot test is independent from the other pilot tests and therefore could be done with or without any of the other pilot tests. For each pilot test, there is an initial developmental phase that will be followed by an experimental phase. The developmental phase will involve background data analytics and creation of novel outreach materials and technologies. The experimental phase will implement a randomized controlled trial to test the effectiveness of the new materials and technologies on reducing default outcomes and increasing deliberate outcomes. The project will aim to complete the developmental phase for each pilot in the first 6 to 12 months (year 1), and then the experimental phase for each pilot would be completed in the next 12 months (year 2).

II. Pilot Tests to Improve Correspondence Audits

Pilot 1: Plain Language Audit Notifications

Key Issue:
Taxpayers do not understand what documentation to provide because they do not understand current audit notices.

Strategy:
To address this barrier, this project will first develop a plain language audit notice and then conduct a randomized controlled trial to test if the simplified, plain language communication reduces nonresponses and default outcomes from audited taxpayers and increases deliberate outcomes.

Many correspondence audits are closed without any responses from taxpayers. These closures results in default disallowances of refundable credits and increases in taxes owed. However, these disallowances may be suboptimal outcomes for taxpayers and the IRS since recent research has highlighted that taxpayers may not understand correspondence audit notices. Specifically, taxpayers may not understand that they are under audit or how to respond to the audit. This project will collaborate with the IRS to design simplified, plain language audit notification letters to improve taxpayer engagement in the correspondence audit process. Furthermore, the project may seek input from focus groups and graphic designers to develop plain language communication.

The effectiveness of the simplified, plain-language audit notification letters will be evaluated using a low-cost randomized controlled trial (RCT). For example, the research would randomly assign some correspondence audits to a treatment group and a control group. The control group could follow the status quo (current) correspondence audit process and receive current notices. The treatment group would receive experimental simplified, plain language audit notification letters. The empirical analysis would test for differences in response rates and audit outcomes (full allowances, partial allowances, or disallowances) across the treatment and control groups and how these differences in response rates vary across various risk scores.

Pilot 2: Understanding Nonresponse and Noncompliance

Key Issue:
Many, if not most, correspondence audits do not yield responses from audited taxpayers. It is essential to know the extent to which nonresponse indicates taxpayer noncompliance versus taxpayers not being aware of being audited or not knowing how to respond.

Strategy:
To gain insights into nonresponse, this project proposes to randomly switch some correspondence audits to field/office audits and some field/office audits to correspondence audits. This will create 4 groups:

1. Taxpayers selected for correspondence audit under current selection criteria

2. Taxpayer who would have been selected for correspondence audit under current selection criteria but were now selected for field/office audits
3. Taxpayers who would have been selected for field/office audits but now receive correspondence audits
4. Taxpayers selected for field/office audits under current selection criteria

The analysis will compare response rates across groups (1) and (2). This comparison will indicate whether in-person field/office audits are more effective at notifying taxpayers that they are under audit and how they should proceed. For example, in-person field/office audits may use strategies to contact taxpayers beyond mailed notices, and this analysis will evaluate the effectiveness of these alternative contact strategies. Relatedly, audited taxpayers may be more responsive to in-person audits than correspondence audits, and the analysis will test this hypothesis. The analysis can examine differences by correspondence audit selection probabilities to understand if in-person field/office audits are similarly effective at increasing responses rates across higher and lower probabilities of correspondence audit selection.

Furthermore, the analysis will compare audit outcomes across groups (1) and (2). This will provide insights into the extent to which nonresponse indicates noncompliance versus inability to respond to correspondence audits. For example, if the field/office audits yield EITC allowances, this would indicate that some marginal nonresponders could have claimed the EITC appropriately. These insights could help guide strategies to reduce nonresponse.

Lastly, comparing response rates and audit outcomes across groups (3) and (4) will provide insights into whether some more costly field/office audits could be handled with less costly correspondence audits. This could provide insights into cost-savings strategies for the IRS.

In addition to (1) through (4) listed above, the project could aim to test "Enhanced communication strategies" such as multiple phone calls from an IRS examiner or LITC staff to taxpayers to clarify notifications and steps toward resolution. The project could also conduct interviews and focus groups with audited individuals to understand taxpayer impressions throughout the audit process.

Overall, this analysis will create a feedback loop between in-person field/office audits and correspondence audits, and this can yield insights to improve both tax enforcement processes.

Pilot 3: Referrals to LITCs and Virtual Audit Assistance

Key Issue:
Taxpayers do not understand where or how to submit documentation because they are not able to access representation to navigate or manage audit communications with the IRS.

Strategy:
To address this barrier, this project will develop plain language to inform audited taxpayers of potential audit assistance from Low Income Taxpayer Clinics (LITCs). Furthermore, the project would work with LITCs to create infrastructure so that audited taxpayers could set up

virtual appointments with LITC staff and securely upload necessary documentation. This infrastructure would allow more taxpayers to use LITCs to represent them with the IRS and help them navigate the correspondence audit process. The initial developmental phase would create this infrastructure, and then in the experimental phase of the research, the project would randomly select audited taxpayers to notify them about the LITCs and test if increased access to LITCs decreases default outcomes and increases response rates and possibly allowance rates. This notification about LITCs could be included in existing notices sent to taxpayers, or it could be included in a new notice sent to taxpayers.

Pilot 4: Post-Disallowance Educational Notices

Key Issue:
Audited taxpayers may not understand what they did incorrectly or what they should do to correctly file and claim benefits in the future.

Strategy:
To address this barrier, this project will develop a plain language, educational notice to send to audited taxpayers once their audits have been closed. The project team will collaborate with the IRS to develop plain-language post-audit educational notices. For example, the notices could explain EITC and CTC rules and requirements, explain IRS Form 8862 (Information to Claim Certain Credits After Disallowance), and explain how taxpayers can work with trusted, certified tax preparers.

After development of the educational notice, the project will experimentally test the effectiveness of the educational notice. Using taxpayers whose audits have been closed, the project will randomly select a treatment group and a control group. The control group will continue with current status quo procedures (no post-audit notices), while the treatment group will receive the experimental post-audit educational notices. The analysis will examine impacts of the post-audit communications on compliant tax filing, EITC claiming, and claiming of other tax credits.

Pilot 5: Understanding Impacts of Correspondence Audits

Key Issue:
The correspondence audit process may cause noncompliance and incomplete take-up.

Strategy:
To assess the impacts of the correspondence audit process on audited taxpayers, this project will randomly swap some current correspondence audits out (ie a "hold out" sample) and replace them with some randomly selected returns that would not have been selected. This will create 4 groups:

A. Taxpayers selected for correspondence audit under current selection criteria
B. Taxpayer who would have been selected for correspondence audit under current selection criteria but were held out

C. Taxpayers who would not have been selected for correspondence audit but were randomly swapped in
D. Taxpayers who would not have been selected for correspondence audit but were randomly not swapped in

To get at causal effects of correspondence audits for the audit population, the project will compare group (A) versus (B) and examine differences in tax outcomes such as responses to audits, disallowances, partial allowances, and full allowances, and tax filing, EITC participation, and earnings in subsequent years. To get at causal effects of correspondence audits for the non-audited population, the project will compare outcomes for group (3) versus (4). Furthermore, the project will analyze impacts of the correspondence audits and nonresponse rates by taxpayer characteristics and audit selection probabilities.

This analysis will provide insight into how correspondence audits are affecting taxpayer experiences and whether correspondence audits are causing noncompliance (for example, not filing and reporting self-employment income in future years) and incomplete take-up of tax benefits.

Pilot 6: Investigating Possible At-Filing Filters

Key Issue:
Use of single-issue correspondence audits could be reduced if additional at-filing filters could be developed.

Strategy:
Many correspondence audits are single-issue audits involving verification of self-employment income or verification of qualifying child eligibility. This project will collaborate with IRS staff to study possible creation of at-filing filters that could reduce the volume of these single-issue correspondence audits. The at-filing filters could prevent potentially noncompliant tax returns from being filed in the first place, so remaining correspondence audits could focus on more complicated multiple-issue audits, and some revenue could be protected by not issuing possibly erroneous refunds and then having to refer post-refund audits to costly collection efforts.

The overall goal of the project is to improve the IRS correspondence audit process. While the proposed strategies have been developed based on recent research, the project will also work closely with IRS collaborators to hear their additional ideas to refine the proposed ideas or design and test new ideas. The project will closely consider taxpayer and examiner experiences with the IRS correspondence audit process, and this could be formalized with taxpayer customer experience surveys and IRS staff surveys.

Pilot 7: Developing an Audit Working Group

Key Issue:

Many tax experts have insights into taxpayer experience and the correspondence audit process, and these insights could inform strategies for improvement.

Strategy:
Tax experts from the IRS, the US Treasury Office of Tax Analysis, academic institutions, and community organizations have an incredible wealth of knowledge on taxpayer experience, tax enforcement, data analysis, and implementation. This project will propose to create an Audit Working Group to have periodic meetings (eg once every 6 months) with a panel of selected experts in tax administration, benefits delivery, and communications, graphics design, and user experience to discuss results from pilot tests, progress on improvements in audit processes, and novel strategies for improving IRS audit processes. This panel will allow many experts to have a coherent collective voice to provide feedback to improve IRS audits rather than having many different one-off contacts with IRS and Treasury staff that can create confusing lines of communications.