

National Taxpayer Advocate Report to Congress

Cross References

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National Taxpayer Advocate Nina E. Olson has released her 2018 Annual Report to Congress, describing challenges the IRS is facing as a result of the recent government shutdown and recommending that Congress provide the IRS with additional multi-year funding to replace its core 1960s-era information technology (IT) systems. The release of the National Taxpayer Advocate's report was delayed by a month because of the government shutdown.

Olson also released the second edition of the National Taxpayer Advocate's "Purple Book," which presents 58 legislative recommendations designed to strengthen taxpayer rights and improve tax administration.

The largest section of the report, which identifies at least 20 of the most serious problems taxpayers face in their dealings with the IRS, is titled, "The Taxpayer's Journey," and is organized sequentially to track a taxpayer's interactions with the tax system from start to finish. Among other issues, it addresses the ability of taxpayers to obtain answers to tax-law questions, return filing, notices, audits, collection actions and Tax Court litigation. The report also contains "road maps"—pictorial representations of the process.

"One of our goals in creating these roadmaps was to help readers understand the complexity of the taxpayer journey," Olson wrote. "It was challenging for us to create these roadmaps and will probably be difficult for readers to follow them, which hints at the extreme frustration many taxpayers experience when they have to interact with the IRS."

Impact of the Government Shutdown on IRS Operations and Taxpayer Rights

In the preface to the report, Olson discusses the impact of the recent government shutdown. A major point of discussion before and during the shutdown was the permissible scope of IRS activities. Under the Anti-Deficiency Act, federal funds may not be spent in the absence of an appropriation except where otherwise provided by law. One exception provided by law is for "emergencies involving the safety of human life or the protection of property." Although not stated in the law or Justice Department guidance, the IRS Office of Chief Counsel has interpreted the "protection of property" exception to apply only to the protection of government property – not a taxpayer's property.

The report says this narrow interpretation can cause severe harm to taxpayers. When the IRS issues a levy to a bank, the bank must freeze the taxpayer's account for 21 days, and then if the levy has not been released, the bank must turn the funds over to the IRS. The Internal Revenue Code requires the IRS to release a levy if it has determined the levy "is

creating an economic hardship due to the financial condition of the taxpayer.” However, the IRS’s legal interpretation of the Anti-Deficiency Act would not permit personnel to be excepted to release levies even in extreme cases, such as where a taxpayer needs the levied funds “to pay for basic living expenses [or even] a life-saving operation,” Olson wrote.

The IRS’s Lapsed Appropriations Contingency Plans excepted employees of the Taxpayer Advocate Service (TAS) to open mail solely to search for checks payable to the government. The plans do not permit TAS employees to assist taxpayers experiencing an economic hardship.

“The IRS’s authority to collect revenue is not unconditional,” Olson wrote. “It is conditioned on statutory protections, and a lapse in appropriations does not eliminate those protections.” If the IRS does not change its interpretation of the Anti-Deficiency Act, the report recommends Congress amend the Act to ensure that taxpayer protections and rights enacted by Congress remain available when the IRS takes enforcement action against a taxpayer during, or has taken enforcement action just prior to, a shutdown.

The report states the shutdown has had a significant impact on IRS operations. The IRS opened the 2019 filing season immediately after the shutdown ended, and a comparison of IRS telephone service during the first week of the 2019 filing season and the first week of the 2018 filing season shows taxpayers are having greater difficulty getting help this year. During the first week of the 2018 filing season, the IRS answered 86% of calls routed to an Accounts Management telephone assistor, and the average wait time was about four minutes. During the first week of this year’s filing season, the IRS answered only 48% of its calls, and the average wait time was 17 minutes.

Among taxpayers calling the Automated Collection System line, 65% got through and waited an average of 19 minutes last year. This year, only 38% of calls were answered, and the average wait time was 48 minutes.

Among callers seeking help on the IRS’s Installment Agreement/Balance Due telephone line, the IRS answered 58% of its calls with an average wait time of 30 minutes during the first week of the filing season last year. This year, the IRS answered only 7% of its calls, and taxpayers who got through had to wait an average of 81 minutes to speak with an assistor.

During the shutdown, correspondence inventories ballooned. By January 24, the IRS had more than five million pieces of mail waiting to be processed; it had 80,000 responses to fiscal year (FY) 2018 Earned Income Tax Credit (EITC) audits that had not been addressed (likely causing eligible taxpayers to have their legitimate EITC claims frozen during the 2019 filing season); and it had 87,000 amended returns waiting to be manually processed.

“Make no mistake about it,” Olson wrote. “These numbers translate into real harm to real taxpayers. And they represent increased re-work for the IRS downstream, at a time when the IRS is already resource-challenged. The IRS will be facing tough decisions in light of the shutdown’s impact.”

On a “dedication” page at the beginning of the report, Olson expressed her appreciation to the IRS workforce, including TAS employees. “Most IRS employees experienced financial challenges as a result of missing two pay checks,” she wrote. “Yet when the shutdown ended, IRS employees returned to work with energy and generally hit the ground running. The IRS faces many challenges as an agency—and this report documents many of them—but the dedication of the IRS workforce is a notable bright spot.”

Funding for IT Modernization

The report’s #1 legislative recommendation is that Congress provide significantly more funding for the IRS to replace its antiquated core IT systems. The IRS systems that hold the official records of taxpayer accounts—the Individual Master File and the Business Master File—date to the 1960s and are the oldest major IT systems still in use in the federal government. In addition, taxpayer information is stored in over 60 separate case management systems that generally do not communicate with each other. There is no database that holds or provides a 360-degree view of the taxpayer’s account and interactions with the IRS. As a result, although the IRS is trying to create taxpayer-friendly online accounts, the report states the inability to pull data from a consolidated case management system poses a significant obstacle.

The report states the IRS does not have an enterprise case selection system, so it cannot be sure it is focusing on the right taxpayers or the right issues in its outreach, audit, and collection activities. A key measure of audit effectiveness is the “no change” rate, which reflects the percentage of audits that do not change a taxpayer’s liability for the year under audit. From FY 2010 through FY 2018, the report states, the average no change rate was 23% for field audits conducted by the Small Business/Self-Employed Division and 32% for field audits conducted by the Large Business and International Division. With better technology, the report states, the IRS audit functions could do a better job of selecting productive cases.

In 2018, the IRS experienced a systems crash on the final day of the filing season, forcing it to extend the filing season by a day. The crash prompted talk of the risk of a catastrophic systems collapse. “That risk does, indeed, exist,” the report states. “But there is a greater risk: IRS performance already is significantly limited by its aging systems, and if those systems aren’t replaced, the gap between what the IRS should be able to do and what the IRS is actually able to do will continue to increase in ways that don’t garner headlines but increasingly harm taxpayers and impair revenue collection.”

According to the report, the IRS is effectively the “accounts receivable department” of the federal government. In FY 2018, it collected nearly \$3.5 trillion on a budget of \$11.43 billion—a return on investment of about 300:1. Yet the report states funding for IRS technology upgrades—provided through the Business Systems Modernization (BSM) account—has been very limited in both absolute and relative terms. As the following chart shows, BSM funding was reduced by 62% from FY 2017 (\$290 million) to FY 2018 (\$110 million) and constituted just one percent of the agency’s overall appropriation in FY 2018.

IRS Appropriations — Fiscal Years 2017–2019			
<i>Fiscal Year</i>	<i>BSM Funding</i>	<i>Total IRS Funding</i>	<i>BSM as % of Total IRS Funding</i>
2017	\$290 M	\$11.24 B	2.6%
2018	\$110 M	\$11.43 B	1.0%
2019 (House Bill)	\$200 M	\$11.62 B	1.7%
2019 (Senate Bill)	\$110 M	\$11.26 B	1.0%

The report states congressional funding for the BSM account has been limited in part because the IRS historically has not done an effective job of planning and executing technology upgrades. To address that concern, the report recommends that additional funding be provided, subject to accountability measures. Specifically, Olson recommends that Congress provide the IRS with additional dedicated, multi-year funding to replace its core IT systems pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party.

Other Major Issues Addressed

Federal law requires the Annual Report to Congress to identify at least 20 of the “most serious problems” encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Overall, this year’s report identifies 20 problems, makes dozens of recommendations for administrative change, makes 10 recommendations for legislative change, analyzes the 10 tax issues most frequently litigated in the federal courts, and presents six research studies and one literature review.

Among the problems addressed are the following:

Obtaining answers to tax law questions. In 2014, the IRS implemented a policy under which it is only answering tax-law questions during the filing season (January through mid-April). It also narrowed the scope of questions it is answering during the filing season by expanding its list of “out-of-scope” topics. The IRS justified these restrictions as a cost-saving step. The National Taxpayer Advocate criticized this decision, maintaining that providing taxpayers with timely and accurate answers to their tax-law questions is a core IRS function, and she has urged the IRS to reverse its policy. The report highlights that the IRS does not collect information when it receives calls asking questions about topics deemed out-of-scope. As a consequence, it does not know when a large number of taxpayers may be confused about a topic and additional guidance should be provided.

Last Spring, the IRS stated it would answer tax-law questions relating to the recently passed Tax Cuts and Jobs Act of 2017 (TCJA) throughout the year. To assess the customer experience with respect to tax-law questions, TAS developed and tested a series of questions relating to:

- i) Issues deemed in-scope that did not change under the TCJA,
- ii) Issues deemed out-of-scope, and
- iii) Issues impacted by the TCJA.

TAS callers encountered inconsistent service, even when asking questions about the TCJA that the IRS had indicated it would answer. In the Fall, several TAS callers were read the same script: “There is no tax law personnel at this time due to budgetary cuts. This tax topic cannot be answered at this time. The employees that will be able to answer this question will be available beginning January 2, 2019, through April 15, 2019.”

On many calls, the answering employee told the caller the call would be transferred; the transfer ended with a pre-recorded message stating the question was out-of-scope and the call was then disconnected. On other calls, answering employees told callers they had not yet received any or much training on the TCJA and apologized for being unable to help. (To assist taxpayers, TAS developed a Tax Reform Changes website addressing common TCJA questions.)

The report recommends the IRS answer tax-law questions year-round; that it deem all questions relating to major new tax legislation as “in scope” for at least two years; and that it track calls and contacts about out-of-scope topics, so it can provide additional guidance on frequently raised issues.

Lack of disclosure of chief counsel legal advice. Over several decades, the IRS has contested lawsuits seeking public access to various forms of legal guidance. In 2007, it settled a case seeking access to legal advice the Office of Chief Counsel provides to national office program managers known as “Program Manager Technical Advice” (PMTA). Yet the Office of Chief Counsel releases relatively few PMTA memos to the public despite the wide range of issues on which it is asked to opine.

TAS sought to determine the standards the Office of Chief Counsel applies in determining which guidance to release. TAS found that the Office of Chief Counsel has not developed written standards describing what constitutes PMTA; it relies on the judgments of hundreds of National Office attorneys who have received little to no training on this subject to decide what to transmit for disclosure; it has no systemic way to identify PMTA or assess general compliance with the terms of the court settlement; and it asserts that only advice provided in memorandum form must be disclosed. The Office of Chief Counsel takes the position that when an attorney provides advice to a national office program manager, the disclosure requirements can be avoided if the attorney transmits the advice as an email rather than as a memorandum (although it says it does not encourage this practice).

The report recommends the Office of Chief Counsel develop clear written guidance that defines when advice constitutes PMTA; that it eliminate the loophole that allows attorneys to keep advice secret if they transmit it by email; and that it establish a process to ensure that advice that should be disclosed as PMTA is identified and disclosed in a timely manner.

Underutilization of IRS free file program. In 2002, the IRS entered into an agreement with a consortium of tax software companies under which the companies would provide free tax return software to a certain percentage of U.S. taxpayers, and in exchange, the IRS would not compete with these companies by providing its own software to taxpayers. The agreement has been renewed at regular intervals, and for at least the past decade,

the agreement has provided that the consortium would make free tax return software available for 70% of taxpayers (as measured by adjusted gross income).

In 2018, taxpayers filed about 152 million tax returns. Thus, about 106 million taxpayers (70%) qualified to use free tax return software. Yet fewer than 2.5 million taxpayers (less than two percent) chose to use a Free File product, with tens of millions of Free File-eligible taxpayers choosing to purchase tax return software instead. The report states the Free File Program is failing to serve its intended purpose of making e-filing cost-free for a large percentage of U.S. taxpayers. The report states there is no marketing budget for the program, the Free File website is confusing, and the IRS has not conducted an effective evaluation of the program to understand why taxpayers eligible to use it are not doing so.

The report recommends, among other things, that the IRS develop actionable goals for the Free File Program, including targeted-use percentages, prior to entering into a new agreement with the consortium; that it work with TAS to create measures evaluating taxpayer satisfaction with the Free File Program; that it test each participating company's software to assess its ability to complete various forms and schedules; and that it prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the services the Free File Program provides. If the Free File Program is not substantially improved, the report recommends the IRS terminate it and instead work with the software industry to improve Free Fillable Forms (the digital equivalent of paper forms) for taxpayers who wish to use them.

The National Taxpayer Advocate Purple Book

As part of the report, the Advocate has released the second edition of "The Purple Book," which presents 58 legislative recommendations intended to strengthen taxpayer rights and improve tax administration. Many of the recommendations have been made in detail in prior National Taxpayer Advocate reports, but others are presented in this publication for the first time.

During the last few years, Congress has showed renewed interest in examining and improving the operations of the IRS. The House Ways and Means Subcommittee on Oversight has held several hearings to consider "IRS reform," and the House passed the Taxpayer First Act of 2018 by a unanimous vote of 414-0 last April. Several bills to improve IRS operations were also introduced in the Senate. Although none of these bills ultimately was enacted and the National Taxpayer Advocate does not endorse every provision in every bill, the report states these bills overall would go a long way toward helping taxpayers and modernizing the IRS, and it urges Congress to again consider comprehensive tax administration legislation in 2019. The Purple Book is designed to assist the tax-writing committees in their efforts by offering a wide range of proposals in a concise, easy-to-read format.

TAS Research Studies and Literature Reviews

Volume two of the report presents research studies on the following topics:

- 1) The potential for a Pay-As-You-Earn (PAYE) withholding system to simplify and improve U.S. tax administration,
- 2) An assessment of how the IRS uses its Allowable Living Expense standards when determining a taxpayer's ability to pay,
- 3) An analysis of how taxpayers respond to the penalty for substantial understatement of tax,
- 4) An analysis of the impact IRS audits have on taxpayer attitudes and perceptions, as reflected in a national survey,
- 5) An assessment of the IRS's offer-in-compromise program for business taxpayers, and
- 6) A further analysis of the effectiveness of notices of federal tax lien and alternative IRS letters on individual tax debt resolution.

The report also contains a literature review on ways to improve IRS notices by taking into account psychological, cognitive, and behavioral science insights.

For more information about the report, go to:
www.TaxpayerAdvocate.irs.gov/2018AnnualReport