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National Taxpayer Advocate Delivers Annual Report to Congress; Discusses Tax Reform Implementation and Unveils “Purple Book”

IR-2018-3, Jan. 10, 2018 IRS Selects New Advisory Council Members

WASHINGTON — National Taxpayer Advocate Nina E. Olson today released her [2017 Annual Report to Congress](#), describing challenges the IRS will face as it implements the recently enacted tax reform legislation and unveiling a new publication, “The Purple Book,” that presents 50 legislative recommendations intended to strengthen taxpayer rights and improve tax administration. The report also examines a wide range of other tax administration issues, including the IRS’s administration of the private debt collection program, the agency’s increasing emphasis on online taxpayer accounts, and its implementation of a recent law that would deny or revoke the passports of taxpayers with significant tax debts.

IMPLEMENTATION OF TAX REFORM LEGISLATION

The National Taxpayer Advocate’s report says the reduction in IRS funding since FY 2010, approximately 20 percent in inflation-adjusted terms, has challenged the agency’s ability to perform the basic tasks of administering the tax system. “As the National Taxpayer Advocate, I see daily the consequences of reduced funding of the IRS and the choices made by the agency in the face of these funding constraints,” Olson wrote in the preface to the report. “These impacts are real and affect everything the IRS does. Funding cuts have rendered the IRS unable to provide acceptable levels of taxpayer service, unable to update its technology to improve its efficiency and effectiveness, and unable to maintain compliance programs that both promote compliance and protect taxpayer rights. ‘Shortcuts’ have become the norm, and ‘shortcuts’ are incompatible with high-quality tax administration.”

The report says the IRS is already struggling to meet the service needs of U.S. taxpayers, particularly with regard to telephone service. In most years, the IRS receives more than 100 million telephone calls. Even prior to the enactment of the tax reform legislation, the IRS was projecting it would only be able to answer about six out of 10 calls from taxpayers routed to speak with a telephone assistor during the filing season and about four out of 10 taxpayer calls during the full fiscal year.

Beginning in 2014, the IRS sharply curtailed the scope of tax-law questions it answers. It now answers only “basic” questions during the filing season and it does not answer any tax-law questions after the April 15 filing deadline. The report says the challenges of operating with a substantially reduced workforce have been compounded by a significant reduction in the training budget for the employees who remain. Since FY 2009, the IRS’s employee training budget has been cut by nearly 75 percent.

While Olson said the IRS needs additional funding, she also expressed concern that the agency has sometimes been too quick to cite funding constraints as a basis for inaction. “Limited resources cannot be used as an all-purpose excuse for mediocrity,” she wrote. “There is not a day that goes by inside the agency when someone proposes a good idea only to be told, ‘We don’t have the resources.’” Notwithstanding funding constraints, she said there are steps the IRS can take to improve taxpayer service through creativity and innovation.

Still, the report says the implementation of major tax legislation is always a heavy lift for the agency. Following enactment of the last major tax reform legislation, the Tax Reform Act of 1986, the IRS made changes to 162 existing forms, developed 48 new forms, and created 13 new publications. Call volume increased by 14 percent, and the IRS hired an additional 1,300 staff, increased phone capacity by 30 percent, and expanded hours and phone service to Saturdays.

More recently, enactment of the Economic Stimulus Act of 2008 generated significant processing work and produced a deluge of telephone calls, with incoming calls on the Accounts Management telephone lines rising from about 66 million in FY 2007 to about 151 million in FY 2008 – an increase of more than 125 percent.

The IRS has not yet developed a final cost estimate to implement the new law, but a preliminary estimate from earlier in the year projected the agency would require additional funding of \$495 million in fiscal years 2018 and 2019. Implementation challenges include programming and systems updates, answering taxpayer phone calls, drafting and publishing new forms and publications, revising regulations and issuing other guidance, training employees on the new law and guidance, and developing the systems capacity to verify compliance with new eligibility and documentation requirements.

As one example of the challenges, the new law reduces the maximum home mortgage eligible for the mortgage interest deduction from \$1,000,000 to \$750,000 for indebtedness incurred after Dec. 15, 2017. It provides an exception for most (but not all) refinancings and an exception for some loans closed after Dec. 15, 2017 pursuant to binding purchase contracts. At present, the IRS generally does not know the date of a mortgage closing, the terms of a refinancing, or the date or terms of a purchase contract. It will have to develop clear guidance for taxpayers and develop forms and systems capacity to distinguish between loans subject to the \$1,000,000 cap and loans subject to the \$750,000 cap.

At the time, it developed its preliminary cost estimate, the IRS had identified 131 filing season systems that will be impacted by the new legislative provisions and must be modified to, among other things, reflect new individual and business tax rates, inflation-

indexing changes for deductions and credits, phase-out changes for certain tax benefits, elimination of certain tax benefits, and changes in law that will require updating the IRS's fraud-detection filters.

"The IRS will have its hands full in implementing the new law," Olson said in releasing the report. "We have already seen confusion about withholding changes, confusion about the deductibility of prepaid property taxes, and confusion about whether states can allow taxpayers to make charitable contributions in lieu of taxes as a way of permitting their residents to claim larger tax deductions than would otherwise be allowed because of the new \$10,000 cap on the state and local tax deduction. The IRS will have a lot of issues to work through, and taxpayers will have a lot of questions. But with more funding, strong leadership, and a closer working relationship with Congress, I am convinced the IRS can do the job well."

THE NATIONAL TAXPAYER ADVOCATE PURPLE BOOK

As part of the report, the Advocate has released a new publication, "The Purple Book," that presents 50 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 two 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 Subcommittee Chairman Vern Buchanan has said he plans to develop legislation on a bipartisan basis during 2018 in collaboration with Ranking Member John Lewis.

Modeled on the Treasury Department's "Green Book" of revenue proposals, the Purple Book is designed to assist the Subcommittee in its efforts. Most recommendations are presented on a single page, and many of the recommendations are straightforward, non-controversial proposals that have previously been favorably reported on a bipartisan basis by the House Committee on Ways and Means, the Senate Committee on Finance, or both.

Among the new recommendations, Olson is recommending that Congress codify both the Taxpayer Bill of Rights and the IRS mission statement as Section 1 of the Internal Revenue Code.

Under current law, the Commissioner is required to ensure that IRS employees "act in accord with" the Taxpayer Bill of Rights, but it is not clear whether taxpayers may rely on the rights. Olson urges Congress to clarify that U.S. taxpayers possess these rights because "taxpayer rights should serve as the foundation for the U.S. tax system."

The report says: "While the IRS possesses significant enforcement authority, our system relies on taxpayers to file tax returns on which they self-declare their income (much of which is not reported to the IRS and is therefore difficult for the IRS to discover in the absence of self-reporting) and to pay the required tax. Clarifying that taxpayers possess

these rights is not only the right thing to do, but TAS research suggests that when taxpayers have confidence the tax system is fair, they are more likely to comply voluntarily, which should translate into enhanced revenue collection.”

The Purple Book makes recommendations to strengthen taxpayer rights, improve the tax-return filing process, improve IRS assessment and collection procedures, reform the Internal Revenue Code’s penalty and interest provisions, strengthen taxpayer rights before the Office of Appeals, enhance confidentiality and disclosure protections, and strengthen the independence of the Office of the Taxpayer Advocate.

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 21 problems, makes dozens of recommendations for administrative change, makes 11 recommendations for legislative change, analyzes the 10 tax issues most frequently litigated in the federal courts, and presents seven research studies and two literature reviews.

Among the problems addressed are the following:

Private Debt Collection. The IRS began assigning taxpayer accounts to private collection agencies (PCAs) in April 2017. For FY 2017, the IRS reports the program cost \$20 million to run and collected \$6.7 million in tax payments. In certain circumstances, the IRS paid commissions to PCAs for payments that were attributable to IRS, rather than PCA, actions.

The report acknowledges that the IRS is required by law to use PCAs, but it says the IRS has implemented the program in a manner that causes excessive financial harm to taxpayers and constitutes an end-run around taxpayer rights protections that Congress has enacted in connection with collection activities. Specifically, Congress has required the IRS to “develop and publish schedules of national and local allowances” that ensure taxpayers “have an adequate means to provide for basic living expenses.” These Allowable Living Expenses, or ALEs, are a key component of the IRS’s determination of a taxpayer’s ability to pay a tax debt.

If the IRS determines a taxpayer’s income is below the appropriate ALE amount, the IRS will classify the taxpayer as “Currently Not Collectible – Hardship” and generally not levy or take enforced collection action. Yet the IRS is sending cases of taxpayers with incomes below the ALE amount to PCAs, and the PCAs are collecting from those taxpayers. An analysis of recent returns of taxpayers who entered into installment agreements (IAs) while their debts were assigned to PCAs and made payments on which the PCAs received commissions show that more than 45 percent had incomes below their ALEs.

The law requires the IRS to assign cases to PCAs that it includes in “potentially collectible inventory.” However, the law does not define that term, allowing the IRS the flexibility to define it in a way that makes sense. The report recommends the IRS define the term in a

manner that is consistent with both the statutory requirement that the IRS utilize PCAs and the statutory intent that federal tax collection should not leave taxpayers unable to meet their basic living expenses.

Online Taxpayer Accounts. The IRS's "Future State" plan for taxpayer service places heavy emphasis on "transitioning" taxpayers away from personal communication by phone or in the Taxpayer Assistance Centers and toward digital communication. The Advocate fully supports the IRS's efforts to develop online accounts. However, the report expresses concern that the IRS's migration strategy does not adequately take account of taxpayer needs and preferences for telephone and other methods of receiving service for several reasons. First, some taxpayers do not have the ability to interact effectively with the IRS digitally. About 41 million taxpayers do not have broadband service and almost 14 million have no Internet access at all in their homes.

Second, many taxpayers who have the ability to interact with the IRS digitally do not want to do so. In a recent TAS survey, about 50 percent of respondents indicated they do not feel secure sharing personal financial information over the Internet. Third, even among taxpayers who have the ability and interest in interacting with the IRS digitally, many cannot do so. To protect taxpayer accounts from hacking, the IRS has imposed stringent authentication requirements. As a result, only about 30 percent of taxpayers seeking to create an online account have been able to do so. Fourth, the IRS has run two small pilot programs in which IRS divisions (including TAS) have offered taxpayers the opportunity to interact through secure electronic communication. The number of taxpayers who have elected to participate has been extremely low.

The report recommends that the IRS undertake a comprehensive study of taxpayer needs and preferences by taxpayer segment, using telephone, online, and mail surveys, focus groups, town halls, and research studies, and then develop a multi-faceted omnichannel service strategy based on the results of the study.

Taxpayer Rights in "Real" vs. "Unreal" Audits. The law provides significant protections for taxpayers under audit. Over time, however, the IRS has been increasingly notifying taxpayers that they owe additional tax through means that do not fit within the traditional definition of an audit. From a taxpayer perspective, these tax adjustments feel like audits because they generally require the taxpayer to either accept the adjustment or provide documentation or information to dispute it. Yet the taxpayer protections that apply in the case of "real" audits do not apply in the case of "unreal" audits. These "unreal audits" include proposed adjustments under math error authority, the Automated Underreporter document-matching program, and the Automated Substitute for Return program. In FY 2016, the "real" audit rate was only 0.7 percent, but when these "unreal" audits are added in, the rate rose to 6.2 percent. Among the rights taxpayers generally do not have in unreal audits is the right to seek an administrative review with the Office of Appeals. In the case of math error adjustments, a taxpayer who fails to respond within the required time also loses the right to a prepayment review by the United States Tax Court.

The National Taxpayer Advocate is concerned that as the IRS increasingly relies on "unreal" audits, the taxpayer protections Congress put in place to protect taxpayers from

wrongful adjustments are being diluted. In addition, the report says that measures of IRS compliance activity that focus on the audit rate are misleading, because the overwhelming majority of tax adjustments are now made through “unreal” audits. The report says the IRS is planning to further increase the use of “unreal” audits as part of its “Future State” plan, and it recommends that the IRS reevaluate and revise its definition of an audit and the application of taxpayer protection through the lens of the Taxpayer Bill of Rights.

Streamlined Section 501(c)(3) Approval Process. In 2014, the IRS adopted a streamlined application and approval process to reduce processing times for certain organizations seeking tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Organizations applying under the streamlined procedures do not have to submit their articles of incorporation or bylaws, and the IRS does not evaluate whether applicants are properly organized, have adopted the appropriate charitable purpose clause, and have adopted protections against the misuse of funds. In 2015 and 2016, TAS reviewed a representative sample of organizations that obtained favorable rulings from the IRS and were organized in states that post articles of incorporation on their websites. In those years, the studies found that 37 percent and 26 percent, respectively, of these organizations did not meet the Section 501(c)(3) eligibility requirements. TAS repeated the study in 2017 and found an erroneous approval rate of 42 percent.

The report says that erroneous grants of tax-exempt status can have significant repercussions. They can harm the organizations by failing to give them an opportunity to correct problems before they begin operations. They can reduce federal revenue by allowing organizations that should be paying tax to avoid it and by allowing donors to claim tax deductions for contributions to organizations that should not be treated as tax exempt. Erroneously recognizing organizations as exempt also can undermine public trust in the integrity of the charitable sector. The National Taxpayer Advocate recommends that the IRS review an applicant’s narrative statement of actual or planned activities and the applicant’s organizing documents before deciding whether to approve the application for tax-exempt status.

Passport Denial and Revocation. Under a law passed by Congress in 2015, the Department of State is required to deny an individual’s passport application and is authorized to revoke or limit an existing passport if the IRS has certified the individual as having a seriously delinquent federal tax debt (*i.e.*, a federal tax debt exceeding \$50,000, adjusted annually for inflation, including assessed interest and penalties). The report says the right to travel internationally is a fundamental right of citizenship, and it should not be restricted unless and until a taxpayer has been given adequate advance notice that his or her passport may be denied or revoked and an opportunity to resolve the debt or challenge the IRS’s position. Yet under current procedures, the IRS sends the only stand-alone notice to the taxpayer regarding explaining the passport consequences of the debt at the same time it certifies the debt as seriously delinquent, depriving the taxpayer of the opportunity to be heard before the certification is made.

The IRS has also refused to hold off on certifying cases in which a taxpayer is actively working with the Taxpayer Advocate Service to try to resolve the debt. In addition, the IRS notice does not include information that would be helpful for taxpayers who may have been

victims of identity theft or who may be unable to afford to pay their debts and may qualify for currently not collectible status, both of which may result in decertification. Moreover, neither the IRS's notice nor the Department of State's letter includes information about a statutory exception for taxpayers with an emergency need or humanitarian reason to travel.

While Congress enacted this law to penalize taxpayers who do not resolve their tax debts and to induce them to do so, it did not intend to abridge otherwise applicable taxpayer rights. The National Taxpayer Advocate makes several recommendations to ensure taxpayers receive adequate advance notice and an opportunity to be heard, including that the IRS send a stand-alone notice to all taxpayers at least 30 days prior to certifying their seriously delinquent tax debts (90 days when addressed to a taxpayer outside the United States), which describes the consequences of certification and outlines all options available to the taxpayer to avoid or reverse a certification.

TAS RESEARCH STUDIES AND LITERATURE REVIEWS

Volume 2 of the report contains or outlines research studies on the following topics: (1) the financial circumstances of taxpayers who entered into installment agreements and made payments while their tax debts were assigned to private collection agencies; (2) the subsequent filing behavior of taxpayers who claimed Earned Income Tax Credits, apparently in error, and were not audited but received an educational letter from TAS (follow-on to an earlier study); (3) the effectiveness of the offer-in-compromise program; (4) taxpayers' various abilities and attitudes toward IRS service channels (follow-on to an earlier study); (5) the effect of audits and identity theft investigations on taxpayer attitudes; (6) taxpayer responsiveness to marginal changes in penalty rates (description of future study); and (7) the effectiveness of tax amnesty programs and what the findings suggest about how tax settlement programs such as the IRS's Offshore Voluntary Disclosure Program should be structured.

The report also contains literature reviews on two topics: (1) best practices for telephone call centers utilized in the private sector and by other government agencies and (2) local outreach initiatives undertaken by large businesses, U.S. government agencies, and foreign tax administrations to foster customer or taxpayer engagement.

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Please visit www.TaxpayerAdvocate.irs.gov/2017AnnualReport for more information.

Related Items:

- [Complete Report: 2017 Annual Report to Congress](#)
- [Executive Summary](#)
- [National Taxpayer Advocate Blog](#)

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About the International Conference on Taxpayer Rights

The National Taxpayer Advocate has organized and will convene the third International Conference on Taxpayer Rights in Amsterdam, Netherlands on May 3-4, 2018. The conference will be hosted by the International Bureau of Fiscal Documentation and sponsored by Tax Analysts. Registration is now open on the [Taxpayer Rights Conference](#) website. The conference will bring together government officials, scholars, and practitioners from around the world to explore how global taxpayer rights serve as the foundation for effective tax administration. The second International Conference on Taxpayer Rights, organized by the National Taxpayer Advocate in 2017, attracted more than 160 attendees from over 40 countries. “The International Conferences on Taxpayer Rights broadened the focus on taxpayer rights beyond the United States. Tax administrators, academics, and tax professionals from all over the world were afforded the opportunity to discuss the reasons for and challenges in adopting and implementing a Taxpayer Bill of Rights or taxpayer charter. Equally important, the Conference engendered serious scholarship about the role of tax administration in promoting fairness and effectiveness in tax administration.” said Nina Olson, National Taxpayer Advocate. “One thing we learned very clearly is that effective tax systems place a high priority on taxpayer rights and earning the trust of their taxpayers. I’m delighted there has been strong interest in institutionalizing international conferences on taxpayer rights to share ideas and build on our success.”

About the Taxpayer Advocate Service

The Taxpayer Advocate Service (TAS) is an *independent* organization within the IRS that helps taxpayers and protects taxpayer rights. Your local advocate’s number is in your local directory and at <https://taxpayeradvocate.irs.gov/contact-us>. You can also call TAS toll-free at 1-877-777-4778. TAS can help if you need assistance resolving an IRS problem, if your problem is causing financial difficulty, or if you believe an IRS system or procedure isn’t working as it should. And our service is free. For more information about TAS and your rights under the Taxpayer Bill of Rights, go to <https://taxpayeradvocate.irs.gov>. You can get updates on tax topics at facebook.com/YourVoiceAtIRS, [Twitter.com/YourVoiceatIRS](https://twitter.com/YourVoiceatIRS), and YouTube.com/TASNTA.