

WRITTEN STATEMENT OF

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Chairman Platts, Ranking Member Towns, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today about the subjects of the tax gap and tax-related identity theft.¹ Both of these issues present challenges to tax administration, and in this testimony, I will describe some approaches to mitigate them. However, as with most problems, minimizing both the tax gap and identity theft will require a balancing act. For example, even as we allocate resources toward “closing the tax gap” by going after those trying to evade their responsibilities, we must not inadvertently increase the tax gap by alienating taxpayers who are trying to comply. We may alienate them if we treat them like tax cheats, sidestep taxpayer rights, or fail to provide reasonable taxpayer services. Similarly, even as we implement procedures to protect federal revenue against identity theft and other schemes, we must take care not to harm taxpayers whose legitimate refunds are delayed by those procedures.

In addressing the tax gap, the following points should be kept in mind:

1. Enhanced information reporting can help minimize the tax gap, but must not impose undue reporting burdens.
2. Making it easier for taxpayers to make estimated tax payments could help minimize the tax gap.
3. Funding balanced enforcement initiatives that include a service component could help minimize the tax gap.
4. Funding the IRS at a level that allows it to promptly communicate with taxpayers could help minimize the tax gap. The IRS has increased automated enforcement, which can sidestep taxpayer rights and unduly burden taxpayers. This may reduce voluntary compliance, particularly if the IRS cannot answer calls or letters timely. Thus, the IRS may need to contact taxpayers by phone or at least answer their calls and letters promptly to prevent the tax gap from increasing.

In addressing identity theft, the following points should be kept in mind:

1. The IRS should continue working with the Social Security Administration to restrict access to the Death Master File.

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

2. Congress should take into account that new exceptions to taxpayer privacy protections pose risks and should be approached carefully, if at all.
3. The IRS's taxpayer protection unit needs significantly more staffing to increase its level of service.
4. At the same time that it is trying to curtail identity theft, the IRS is doing its best to process tax returns and provide prompt refunds to the nearly 145 million taxpayers who file legitimate returns, and measures likely to make a major dent in the identity theft problem are likely to burden these legitimate taxpayers.

I. The Tax Gap

According to the IRS's most recent estimate, the net tax gap – the difference between the taxes people owe and the amount they pay – stood at \$385 billion in 2006,² when there were about 114 million U.S. households.³ This means the average household paid a “noncompliance surtax” of nearly \$3,400 to enable the federal government to raise the same revenue it would have collected if all taxpayers had reported their income and paid their taxes in full. For this reason, minimizing the tax gap is a matter of fairness to all taxpayers.

The largest portion of the gross tax gap is due to underreporting (\$376 billion), with smaller amounts attributable to underpayment (\$46 billion) and nonfiling (\$28 billion).⁴ Tax credits, which are often discussed as a major problem, are included in the underreporting gap, but they constitute a relatively small portion of the gross tax gap (\$28 billion, or about six percent).⁵ The largest portion of the underreporting gap is due to underreporting of business income by individuals (\$122 billion).⁶ The percentage of income that goes unreported (or the net misreporting percentage) is lowest (at one percent) for income subject to information reporting and withholding,

² See IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012), <http://www.irs.gov/newsroom/article/0,,id=252038,00.html>. The IRS computes the net tax gap by subtracting the \$65 billion that the IRS estimates it will eventually collect through enforcement and late payments from the \$450 billion gross tax gap – the difference between the taxes people owed and the amount they voluntarily and timely paid. *Id.*

³ U.S. Census Bureau, *America's Families and Living Arrangements: 2006, Table AVG1* (2007), <http://www.census.gov/population/www/socdemo/hh-fam/cps2006.html>.

⁴ See IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (accompanying charts).

⁵ See *id.*

⁶ See *id.*

such as wages, and highest (at 56 percent) for income subject to little or no information reporting, such as cash receipts earned by sole proprietors.⁷

A. Enhanced Information Reporting Could Help Minimize the Tax Gap if It Does Not Create Excessive Burden.

The tax gap data (above) suggest that we could reduce the tax gap through increased information reporting (or even withholding) on taxable payments, particularly payments to small businesses. I have offered recommendations in this area, many of which have been adopted.⁸ For example, pursuant to legislation enacted in 2008, brokers are required to report tax basis to customers and the IRS.⁹ Similarly, credit card companies are required to report receipts to businesses and the IRS.¹⁰

However, the benefit of increased compliance and revenue must be balanced against the burden of information reporting and withholding. Overly burdensome requirements are not practical. One example: The Patient Protection and Affordable Care Act (PPACA), signed into law on March 23, 2010, included an overly burdensome expansion of information reporting that Congress chose to repeal before it even took effect.¹¹

I had previously recommended that Congress require service recipients to issue Forms 1099-MISC to incorporated service providers, which are exempt from the requirement, applicable to unincorporated businesses. The PPACA reflected this recommendation, eliminating a reporting exemption for payments to corporate providers of property and services.¹² However, the PPACA also contained a

⁷ See IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (accompanying charts).

⁸ For a list of proposals to expand information reporting and withholding, see National Taxpayer Advocate 2011 Annual Report to Congress 469-471, 485-486 (legislative proposals to reduce the tax gap). The Taxpayer Advocacy and Government Accountability Promotion Act of 2011 (also known as the "TAX GAP Act") includes several of the National Taxpayer Advocate's recommendations. S. 1289, 112th Cong. (2011).

⁹ See Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, Div. B, § 403, 122 Stat. 3765, 3854 (2008). The National Taxpayer Advocate made a similar recommendation in 2005. National Taxpayer Advocate 2005 Annual Report to Congress 433-441 (Legislative Recommendation: *Requiring Brokers to Track and Report Cost Basis for Stocks and Mutual Funds*).

¹⁰ See Housing Assistance Tax Act of 2008, Pub. L. No. 110-289, Div. C, § 3091, 122 Stat. 2654, 2908 (2008) (codified at IRC § 6050W). The National Taxpayer Advocate made a similar recommendation in 2007. National Taxpayer Advocate 2007 Annual Report to Congress 500-501 (Legislative Recommendation: *Require Information Reporting by Financial Institutions on Credit and Other "Payment Card" Receipts*).

¹¹ Pub. L. No. 111-148, Title IX, Subtitle A, § 9006 (2010) (codified at IRC § 6041), *repealed by* The Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Pub. L. No. 112-9, 125 Stat. 36 (2011).

¹² *Id.*

reporting requirement for goods sold, which I opposed because of the enormous burden it would place on businesses.¹³ After I highlighted the burden such reporting would impose in the National Taxpayer Advocate's Fiscal Year (FY) 2011 Objectives report, Congress repealed it.¹⁴

Nonetheless, there are still some ways that Congress could expand information reporting without imposing excessive taxpayer burden. For example, Congress could close the loophole that allows incorporated businesses to avoid information reporting on income from services.

Congress could also expand information reporting applicable to bank accounts, which are currently only subject to information reporting if they pay more than \$10 in interest per year.¹⁵ Tracking cash flows through a taxpayer's financial institutions is a common method of identifying underreporting. While it is possible to avoid using a bank account when operating on a purely cash basis, this option is not practical for many businesses. Taxpayers may be less likely to underreport income if they know that the financial institution in which the income is deposited must provide information about their accounts to the IRS. Moreover, IRS auditors would be more likely to uncover underreporting if they could request account statements using specific names of financial institutions and account numbers.

Recommendations: Eliminate the \$10 threshold on interest reporting by financial institutions so that non-interest bearing accounts receive more transparency without significantly increasing the burden to taxpayers; and close the loophole that allows small businesses to avoid information reporting on payments for services by incorporating.¹⁶

¹³ See National Taxpayer Advocate 2010 Annual Report to Congress 373-376.

¹⁴ See National Taxpayer Advocate FY 2011 Objectives Report 9-13 (describing the magnitude of the burden the requirement would impose and pointing out that it would affect 26 million non-farm sole proprietorships, four million S corporations, two million C corporations, three million partnerships, two million farming businesses, one million charities and other tax-exempt organizations, and probably more than 100,000 federal, state, and local government entities). The requirement was repealed by The Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, at an estimated 10-year cost of about \$22 billion. Pub. L. No. 112-9, 125 Stat. 36 (2011); Joint Committee on Taxation (JCT), JCX-12-11, *Estimated Revenue Effects of the Chairman's Amendment in the Nature of a Substitute to H.R. 4* (Feb. 15, 2011), <http://www.jct.gov/publications.html?func=startdown&id=3736>. The Act also repealed Section 2101 of the 2010 Small Business Jobs Act (P.L. 111-240), which would have required information reporting by landlords on Form 1099 of certain rental property expense payments of \$600 or more in conjunction with their rental properties, at an estimated 10-year cost of nearly \$3 billion. *Id.*

¹⁵ IRC § 6049.

¹⁶ For additional proposals, see National Taxpayer Advocate 2011 Annual Report to Congress 469-471, 485-486 (legislative proposals to reduce the tax gap). In addition, in response to repeated recommendations by the National Taxpayer Advocate, the IRS recently added two checkboxes to Form 1040, Schedule C – the form used by sole proprietors. They ask: "Did you make any payments in 2011 that would require you to file Form(s) 1099?" and "[I]f 'Yes,' did you or will you file all required Forms 1099?" This should help improve information reporting compliance. However, the IRS has not

B. Making It Easier for Taxpayers to Make Estimated Tax Payments Could Help Minimize the Tax Gap.

Taxpayers sometimes inadvertently fall behind on their estimated tax payments, which are due on four oddly-spaced dates: April 15, June 15, September 15, and January 15.¹⁷ Taxpayers who owe a balance upon filing a return are more likely to understate their tax liability than other taxpayers.¹⁸ Moreover, more than 20 percent of such taxpayers with a balance due fail to pay it in full.¹⁹ Thus, if the IRS could reduce estimated tax payment shortfalls, it could increase both reporting and payment compliance. The Electronic Federal Tax Payment System (EFTPS) allows a taxpayer to have tax payments electronically debited from a bank account.

Current law requires the IRS to use an electronic system such as EFTPS to collect at least 94 percent of depository taxes (*i.e.*, withheld income taxes and employment taxes), but no similar goal exists for estimated tax payments.²⁰ A similar goal could motivate the IRS and the Financial Management Service to do more to actively promote EFTPS for estimated tax payments, provide incentives for using it (*e.g.*, penalty waivers), make the system easier to use, and allocate adequate funding for any necessary enhancements and advertising.

Similarly, expressly authorizing voluntary withholding agreements could make it easier for some contractors to pay estimated taxes. Even though withholding is not required on payments to independent contractors (payees), some contractors may wish to have customers (payors) withhold taxes for them, just as they do for employees. Such withholding would help contractors avoid the burdens of making timely quarterly estimated tax payments. Some payors, such as hair salon operators or travel agencies, may be willing to do this as a convenience to the contractors they pay, particularly if they already withhold and remit employment taxes for employees. It is unclear, however, whether statutory authority to enter into such agreements currently exists.²¹

adopted the National Taxpayer Advocate's related recommendation to add a line to Schedule C so that taxpayers separately report (1) the amount of income reported on Forms 1099, *U.S. Information Return*, and (2) other income not reported on Forms 1099. Accordingly, Congress could require the IRS to do so.

¹⁷ IRC § 6654(c)(2); IRS, Pub. 505, *Tax Withholding and Estimated Tax Payments*, 22 (Feb. 2007).

¹⁸ Wage and Investment Division, Research Group 5, Project No. 5-03-06-2-028N, *Experimental Tests of Remedial Actions to Reduce Insufficient Prepayments: Effectiveness of 2002 Letters*, 7 (Jan. 16, 2004).

¹⁹ *Id.* at 1.

²⁰ See IRC § 6302(h)(2)(C). By "employment taxes" we mean Federal Insurance Contribution Act (FICA) taxes, and Federal Unemployment Tax Act (FUTA) taxes.

²¹ IRC § 3402(p)(1) provides for voluntary withholding on certain federal payments (such as Social Security benefits). IRC § 3402(p)(2) provides for voluntary withholding on unemployment compensation payments. IRC § 3402(p)(3) provides for "other voluntary withholding" agreements and

Recommendations: Require the IRS to promote the use of EFTPS to make estimated tax payments and establish a goal of collecting more estimated taxes electronically; and expressly authorize voluntary withholding agreements, which would make it easier for some contractors to make sufficient estimated tax payments.²²

C. Funding Balanced Enforcement Initiatives that Include a Service Component Could Help Minimize the Tax Gap.

As I have discussed in detail in testimony and reports, I believe we can increase voluntary compliance by simplifying the tax code, making tax compliance easier, and offering services to help the vast majority of taxpayers who want to pay what they owe, while reserving enforcement for the small minority who do not.²³

The most recent tax gap data, which reflect tax year 2006 returns, confirm that the IRS collects most taxes by promoting voluntary compliance, not through direct enforcement efforts. The data show that taxpayers paid about 83.1 percent of their taxes voluntarily and timely (\$2.210 trillion of the \$2.660 trillion due), and the IRS eventually collected another two percent through late payments or enforcement (\$65 billion out of \$2.660 trillion).²⁴ In other words, taxpayers voluntarily and timely paid about 34 times as much as the IRS collects through enforcement and voluntary late payments.²⁵ Similarly, of the \$2.4 trillion in tax revenue received by the IRS in FY 2011, direct enforcement revenue accounted for only \$55.2 billion, or about

authorizes the Secretary, by regulation, to provide for withholding from (1) payments from employer to employee that do not constitute wages, and (2) "any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of [IRC chapter 24, Collection of Income Tax at Source]." No such regulations have been issued and the Secretary's authority to issue regulations that would permit such voluntary withholding agreements has been questioned. See National Taxpayer Advocate 2005 Annual Report to Congress 381, 393 (discussing IRS concerns about issuing regulations without additional statutory authorization).

²² The legislation should also make clear that the agreement would not be taken into account in determining whether the service provider is an employee (rather than an independent contractor) for tax purposes.

²³ For a discussion of suggestions for reforming the current tax code to reduce burden and promote compliance, see, e.g., *Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due: Hearing Before the S. Comm. on Finance* (June 28, 2011) (statement of Nina E. Olson, National Taxpayer Advocate).

²⁴ IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012) (accompanying charts).

²⁵ For example, if the IRS could collect one percent more through a collection strategy that would reduce voluntary compliance by one percent, overall revenues would decline by 34 times as much as collections increased. However, because the IRS does not measure the impact of its activities on voluntary compliance, IRS metrics would not alert anyone to a problem.

two percent.²⁶ The remaining 98 percent resulted from voluntary compliance. Accordingly, trying to reduce the tax gap by increasing the two percent of revenue that results from enforcement, while ignoring the 98 percent that results from voluntary compliance, would be a bit like letting the tail wag the dog.

Overall, the IRS is an extraordinary investment. On a FY 2011 budget of \$12.1 billion, it collected \$2.4 trillion in tax revenue, bringing in about \$200 for every dollar invested.²⁷ As shown by the tax gap data above, it collects most of this revenue by promoting voluntary compliance through a balanced combination of service and enforcement, rather than through direct enforcement actions. Yet in recent years, the IRS budget has utilized a mechanism that makes it easier for Congress to fund the IRS Enforcement account than its Taxpayer Services account.

Under this mechanism, known as a “program integrity allocation adjustment,” new funding appropriated for IRS enforcement programs generally does not count against otherwise applicable spending ceilings provided that

- (1) the IRS’s existing enforcement base is fully funded, and
- (2) a determination is made that the proposed additional expenditures will generate a return-on-investment (ROI) of greater than 1:1 (*i.e.*, the additional expenditures will reduce the deficit on a net basis).

These conditions reflect the fact that the IRS is able to project the direct ROI of its enforcement activities – it can measure to the dollar the amounts collected by its Examination, Collection, and document-matching functions – but it faces a much harder task in measuring the ROI of taxpayer services.

It seems intuitively clear that the ROI of taxpayer service activities is greater than 1:1, and services – such as timely answering the phone and opening the mail – are an essential component of the IRS’s increasingly automated enforcement procedures, which prompt taxpayers to contact the IRS, as described below. Basic services like publishing tax forms, providing guidance, and answering taxpayer questions are also essential for enabling taxpayers to file returns and enabling the IRS to collect revenue. Yet because the IRS cannot quantify either the overall ROI of taxpayer service spending or the ROI of specific taxpayer service initiatives, Taxpayer Services spending is not currently considered eligible for program integrity allocation adjustments.

As a consequence, allocations for the Enforcement account have *decreased by one percent* while spending for the Taxpayer Services account has *decreased by*

²⁶ Government Accountability Office (GAO), GAO-12-165, *IRS’s Fiscal Years 2011 and 2010 Financial Statements* 23 (Nov. 2011), http://cfo.fin.irs.gov/4all_docs/docs/gao_reports/financial_audits/gao12165.pdf.

²⁷ *Id.*

eight percent between FY 2006 and FY 2012 on an inflation-adjusted basis.²⁸ Further, if the Administration's proposed FY 2013 budget is adopted without change, spending for the Enforcement account will have *increased by six percent* while spending for the Taxpayer Services account will have *decreased by eight percent* since FY 2006 on an inflation adjusted basis.²⁹

I am deeply concerned about the widening resource gap between the IRS's taxpayer service and enforcement programs. First, I think the distinction between service and enforcement can be highly artificial and arbitrary. To substantially increase funding to any program that gets classified as "enforcement" while reducing or holding flat spending for any program that gets classified as "taxpayer service" will not result in a balanced agency and may even encourage the IRS to engage in game-playing to classify priority programs as enforcement. The classification of a program as "enforcement" rather than "service" also has significant implications for the way the IRS treats taxpayers.

Second, it is widely acknowledged that taxpayer service contributes significantly to compliance. In some cases, service may contribute even more than enforcement to improved compliance. As noted, however, because the IRS is unable to compute an ROI for service activities, service activities by themselves do not qualify for allocation adjustments.

Third, Congress has given the IRS an increasing number of social and economic benefits programs to administer, and as I will discuss below, both of these types of benefits programs typically require more service.

Thus, if we are not careful and do not adopt a more balanced approach to IRS funding, we may end up increasing the tax gap by not providing necessary services and assistance to taxpayers. As a result of the failure to provide services, we may convert formerly compliant taxpayers into noncompliant ones. And because these taxpayers have lost faith in the tax agency, it will be very difficult to convert them back to compliant taxpayers.

The use of program integrity allocation adjustments has enabled the IRS to receive more funding than it would otherwise, and I think that is positive. But I strongly encourage the IRS and Congress to consider ways to modify the way allocation adjustments are used so that the IRS meets taxpayer needs and remains a balanced

²⁸ Compare U.S. Department of the Treasury, 2008 *Budget in Brief, Internal Revenue Service*, available at http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/FY_2008_BIB_IRS.pdf with U.S. Department of the Treasury, 2013 *Budget in Brief, Internal Revenue Service*, available at <http://www.irs.gov/pub/newsroom/budget-in-brief-fy2013.pdf>. Inflation adjustments were made using the Bureau of Labor Statistics inflation calculator, available at <http://data.bls.gov/cgi-bin/cpicalc.pl>.

²⁹ *Id.* Because we do not know the inflation rate for 2013, we converted the 2006 dollars to 2012 dollars using the inflation calculator, and then compared the result with the administration's unadjusted proposal for 2013.

agency. One possibility is to define new compliance initiatives more broadly, so that they include both enforcement and service components. Because the projected ROI of some types of enforcement initiatives is high, a more broadly constructed initiative could still produce a provable ROI of greater than 1:1 (*i.e.*, the service components would piggyback on the high-ROI enforcement activity). That could satisfy the requirements for an allocation adjustment while giving the agency more flexibility to meet taxpayer needs and improve compliance in obvious yet currently immeasurable ways.

Example of a Broader Compliance Initiative

Assume the IRS is planning a new enforcement initiative to improve compliance among small business taxpayers. The initiative will cost \$50 million and is projected to produce an ROI of 6:1 (or \$300 million in additional revenue). The IRS intends to request \$50 million for this initiative as a program integrity allocation adjustment (*i.e.*, not counting against otherwise applicable spending ceilings). Assume further that the IRS has identified taxpayer service activities that would also improve small business compliance, such as new or additional types of outreach and education. The cost of the service initiative would be \$25 million, but the IRS cannot quantify the ROI.

If the IRS defines new compliance initiatives more broadly to include service activities, it could package the enforcement measures with the outreach and education measures and request \$75 million for the combined initiative as an allocation adjustment. The ROI would still be positive (the \$75 million cost and projected revenue of \$300 million would produce an ROI of 4:1). Most important, the IRS would be operating a more integrated, effective, and balanced compliance program.

If the IRS cannot obtain \$25 million for services in this compliance initiative without exceeding the prescribed spending levels, it will be forced to take the funding from other service programs, thus undermining compliance for one group of taxpayers while trying to increase compliance among others. If it chooses to not fund the \$25 million for new taxpayer service initiatives at all, the IRS will be following an unbalanced, less effective enforcement strategy that may harm taxpayers and violate their rights.

Recommendation: I recommend that the IRS and Congress consider ways to broaden the use of program integrity allocation adjustments so that compliance initiatives include taxpayer service components, which work in tandem with enforcement to increase voluntary compliance and reduce the tax gap more effectively, as described below.

D. Funding the IRS at a Level that Allows It to Promptly Communicate with Taxpayers Could Help Minimize the Tax Gap.

IRS funding is declining. The agency's budget was reduced slightly from FY 2010 to FY 2011,³⁰ and has been cut by an additional 2.5 percent for FY 2012.³¹ While these cuts may not seem very deep, they come as the IRS faces increasing responsibilities.

In recent years, Congress has expanded the IRS's traditional role as tax collector to include that of benefits administrator, which requires the IRS to serve an increasingly diverse population.³² Historically, the Earned Income Tax Credit (EITC) was the main significant refundable credit.³³ But Congress recently has enacted the First-Time Homebuyer Credit,³⁴ the Making Work Pay credit,³⁵ the American Opportunity tax credit,³⁶ and the health care premium tax credit.³⁷ It has also made the adoption tax credit fully refundable,³⁸ and the child tax credit partially refundable.³⁹

For the 2011 filing season, 75 percent of all individual income tax returns claimed refunds, and the average refund was \$2,913.⁴⁰ Because so many people file just to

³⁰ Department of Defense and Full-Year Continuing Appropriations Act, 2011, Pub. L. No. 112-10, § 1119, 1125 Stat. 38, 107 (2011).

³¹ Consolidated Appropriations Act, 2012, Pub. L. No. 112-74, Div. C, Title I, 125 Stat. 786, 884 (2011).

³² See National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 1-62 (*From Tax Collector To Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*); National Taxpayer Advocate 2011 Annual Report to Congress 273-323 (*Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics, and related Most Serious Problems*).

³³ IRC § 32. The EITC is effectively a wage supplement for low income workers.

³⁴ IRC § 36. The First-Time Homebuyer credit, as modified, most recently provided up to \$8,000 to certain first-time homeowners (\$6,500 for long-time residents) for qualifying 2010 purchases.

³⁵ IRC § 36A. The Making Work Pay credit expired on Dec. 31, 2010.

³⁶ IRC § 25A(i). The American Opportunity tax credit is partially refundable and may be used to offset the costs of college tuition, course materials, and certain fees. See IRC § 25A(i)(6).

³⁷ IRC § 36B. The health care premium tax credit is designed to help low income individuals purchase coverage under a qualified health plan beginning in 2014. Congress also recently added the Small Business Health Care Tax Credit, a credit for small business employee health insurance expenses, which may be partially refunded to certain tax-exempt entities. Pub. L. No. 111-148, § 1421, 124 Stat. 119, 237 (2010) (codified at IRC § 45R).

³⁸ IRC § 36C (applicable to tax years (TY) 2010 and 2011). The adoption credit, which offsets the costs of adoptions, is non-refundable for TY 2012 unless Congress extends its refundable status. See IRC § 23.

³⁹ IRC § 24(d). The refundable portion is known as the Additional Child Tax Credit, and eligibility is dependent on earnings.

⁴⁰ IRS, *2011 and Prior Year, Filing Season Statistics, Cumulative through the weeks ending 12/31/10 and 12/31/11* (Jan. 9, 2012), <http://www.irs.gov/newsroom/article/0,,id=252176,00.html> (indicating 109,337,000 out of 145,320,000 received refunds).

receive government benefits, the IRS has had to devote resources to performing its role of payment disburser and benefits administrator while serving new and more diverse segments of the population, preventing fraudulent refund claims, addressing tax-related identity theft, and juggling constant (and sometimes retroactive) tax law changes and increasing responsibilities in other areas.

For example, as noted above, Congress has enacted several new third-party information reporting requirements in recent years, which the IRS must implement. Most notably, credit card issuers generally must report the aggregate amount of reportable payments they process for businesses,⁴¹ and brokerage firms generally must report the cost basis (as well as gross proceeds) of stock, bond, and mutual fund sales.⁴²

1. The IRS Has Increased Automated Enforcement, Which Can Sidestep Taxpayer Rights and Unduly Burden Taxpayers, Particularly if the IRS Does Not Timely Answer Calls or Letters.

Faced with a deluge of new third-party data, new responsibility for distributing tax credits, the responsibility of paying only valid refund claims, and shrinking resources, the IRS has increasingly been turning to automation to achieve greater efficiencies. But these efficiencies often come at the expense of taxpayer rights or adequate service.

i. The IRS Increasingly Uses “Unreal” Audits.

With 140,837,499 individual income tax returns filed in the 2010 calendar year, the IRS conducted and closed a total of 1,564,690 audits in FY 2011, for a “coverage” rate of 1.11 percent, which is in line with historic rates.⁴³ However, the IRS is increasingly relying on unexplained data mismatches to adjust a person’s liability and to deny or delay refunds using a variety of procedures. I have characterized these procedures as “unreal” audits because they do not provide the same taxpayer rights as “real” examinations. For example, while the IRS generally will not audit a return twice, it may examine a return that was already subject to an “unreal” audit.

To get a sense of how many taxpayers are affected by IRS adjustments, our research staff compiled a breakdown of FY 2010 “real” and “unreal” audits by income level. To do that, they used the IRS Compliance Data Warehouse, an internal IRS research database that houses taxpayer account information by tax year. The numbers in our breakdown do not exactly mesh with what the IRS reports in its Statistics of Income Data Book. In part, this is because we counted each taxpayer

⁴¹ IRC § 6050W.

⁴² IRC § 6045(g).

⁴³ IRS, *Fiscal Year 2011 Enforcement and Service Results* (2011), http://www.irs.gov/pub/newsroom/fy_2011_enforcement_results_table.pdf

only once. So, for example, the IRS conducted 1.6 million individual audits in FY 2010, but the audits affected only 1.4 million taxpayers; some taxpayers may have been audited for more than one year. Similarly, if a taxpayer was touched by more than one program, we count him or her in just one of the programs, with the order of preference for counting purposes as Examination, Automated Substitute for Return, Automated Underreporter, and Math Error (I'll explain these terms below).⁴⁴

The data show that in addition to conducting “real” audits of 1.4 million individual taxpayers in FY 2010, the IRS conducted “unreal” audits of 9.2 million individual taxpayers as follows:

- 3,911,005 Automated Underreporter (AUR) cases, in which the IRS matches income reported by the taxpayer on his or her return with income reported to the IRS by third-party payers;
- 4,740,909 math error notices, in which the IRS corrects mathematical or other inconsistent entries on a return and assesses tax before the taxpayer has a chance to contest the change; and
- 563,927 Automated Substitute for Returns (ASFRs), in which the IRS creates a substitute return for a nonfiler based on third-party payer information.

As the table below indicates, the combined impact of “real” and “unreal” audits in terms of coverage by income segment is very different from that of “real” audits alone.

⁴⁴ Two more notes on the data: First, for the discussion and table in the text below, we excluded 4.6 million math error notices that the IRS says related to the Making Work Pay credit. The IRS says these notices advised taxpayers who had failed to claim the credit that they were entitled to it. Although we have not verified this statement, we agree that if it is true, giving taxpayers a refund would not feel like an audit to the taxpayer and therefore should not be included in our totals. Second, our income breakdown in the chart below is based on each taxpayer’s self-reported Adjusted Gross Income (AGI). Because the ASFR program generates returns for taxpayers who have not filed returns on their own, we do not have an AGI breakdown for ASFRs. Therefore, ASFR amounts are listed only in the “Total” row at the bottom and are not included in the column labeled “Combined” or in the percentages in the final column (except for the grand total).

Table 1: “Real” and “Unreal” Audit Coverage by Adjusted Gross Income

Adjusted Gross Income Category	Exams	Exam Coverage %	ASFR	AUR	Math Error	Combined	Returns Filed in Calendar Year 2009	Combined Coverage %
No adjusted gross income	158,194	5.2%		29,216	110,540	297,950	3,040,573	9.8%
\$1 under \$25,000	633,380	1.1%		1,124,251	1,904,185	3,661,816	57,093,609	6.4%
\$25,000 under \$50,000	232,781	0.7%		1,150,382	1,178,156	2,561,319	34,527,079	7.4%
\$50,000 under \$75,000	138,287	0.7%		572,762	665,300	1,376,349	19,324,212	7.1%
\$75,000 under \$100,000	69,385	0.6%		345,479	365,531	780,395	11,830,856	6.6%
Subtotal - under \$100,000	1,232,027	1.0%		3,222,090	4,223,712	8,677,829	125,816,329	6.9%
\$100,000 under \$200,000	85,796	0.6%		498,665	435,114	1,019,575	13,891,529	7.3%
\$200,000 under \$500,000	59,480	1.7%		145,713	65,435	270,628	3,472,882	7.8%
\$500,000 under \$1,000,000	17,253	2.9%		28,273	9,964	55,490	590,822	9.4%
\$1,000,000 under \$5,000,000	16,046	5.6%		14,411	5,649	36,106	288,206	12.5%
\$5,000,000 under \$10,000,000	2,175	15.1%		1,137	556	3,868	14,410	26.8%
\$10,000,000 or more	1,887	13.1%		716	479	3,082	14,410	21.4%
Total	1,414,664	1.0%	563,927	3,911,005	4,740,909	10,630,505	144,088,590	7.4%

Although the “real” audit coverage rate for individual taxpayers with incomes below \$100,000 is about one percent, the combined coverage rate balloons to 6.9 percent, an increase of over 600 percent, when we include “unreal” audits in the mix. For individual taxpayers reporting incomes between \$100,000 and \$200,000, the FY 2010 “real” audit coverage rate is 0.6 percent, but when we include the “unreal” audit contacts, the coverage rate rises to 7.3 percent – an increase of about 1,100 percent. Including “unreal” audits also increases the coverage rate of the wealthiest taxpayers – those reporting incomes over \$10 million – from 13.1 percent to 21.4 percent. (And these totals understate the total number of “unreal” audits because the percentages within income categories do not include ASFRs and because we have not addressed a few additional programs that adjust taxpayer liabilities, including some flagged by the Electronic Fraud Detection System.)

The bottom line: The overwhelming majority of IRS notices proposing to increase a taxpayer’s liability are not deemed to be “audits” and therefore do not give taxpayers some of the protections provided in the context of audits.

ii. The IRS Increasingly Uses Automated Collection Tools.

After a delinquency is assessed – sometimes as a result of an unreal audit that did not include any communication with the taxpayer – IRS computers send collection notices and begin offsetting refunds. In FY 2011, 3.7 million cases remained unresolved after this initial stage and moved to the Automated Collection System (ACS),⁴⁵ where the IRS traditionally spends only about three percent of its direct time

⁴⁵ In FY 2011, the IRS collected nearly \$9.5 billion on nearly 2.7 million taxpayer accounts through the notice stream, but the Automated Collection System (ACS) received 3,706,183 taxpayer cases. IRS, Collection Activity Report NO-5000-242, *Taxpayer Delinquent Account Cumulative Report, Part 2 – Accounts Receivable Notices* (Oct. 2011); IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Reports* (Oct. 2011).

making outgoing calls.⁴⁶ According to recent data, 60 percent of the cases in ACS have been there six months or longer.⁴⁷ The collection industry estimates that the probability of collecting unpaid accounts falls to 70 percent after three months, 52 percent after six months, and 23 percent after a year.⁴⁸ Thus, the IRS is probably losing money every day that it fails to call these taxpayers, especially given that tax delinquencies continue to accrue penalties and interest, making them more difficult to resolve.

Rather than calling or visiting taxpayers, the IRS either moves these accounts to the “queue” where they age until a revenue officer can work them or it files a Notice of Federal Tax Lien (NFTL) or levies assets.⁴⁹ The dollar value of cases assigned to the queue has doubled in the last six years – to over \$56.2 billion at the end of FY 2011.⁵⁰ In FY 2010, ACS received approximately 3.7 million taxpayer cases, and issued over 2.9 million levies – an average of nearly four levies for every five cases it received.⁵¹ In FY 2011, the IRS filed over one million NFTLs⁵² and issued 3.7 million levies.⁵³ The obvious result of placing an account in the queue is that it becomes less collectable. But liens, levies and even refund offsets may also be problematic, particularly before any meaningful communication with the taxpayer takes place.

Using automated enforcement tools to prompt taxpayers to communicate with the IRS may result in rework when taxpayers do not owe the liability. For example, ACS might issue a levy, seizing all available funds in a taxpayer’s bank account before anyone talks to the taxpayer. When the taxpayer learns he no longer has access to the money, he may call ACS and explain why he does not owe the tax balance. ACS might research the issue, determine the taxpayer is correct, release the levy, and

⁴⁶ Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-30-046, *More Management Information is Needed to Improve Oversight of Automated Collection System Outbound Calls* 6 (Apr. 28, 2010).

⁴⁷ At the conclusion of FY 2011, 2,454,770 ACS modules were in ACS less than six months, out of a total inventory of 6,080,835. IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Reports* (Oct. 2011).

⁴⁸ BANXQUOTE Rx, Business Debt Restructuring Solutions, www.banx.com/rx/ (last visited Apr. 16, 2012) (citing collectability statistics based on a survey conducted by the Commercial Collection Agency Association among its members, who collectively handle about eighty percent of all commercial debt claims placed for collection in the United States).

⁴⁹ The IRS generally moves taxpayer cases to the queue after ACS makes some attempt to resolve the accounts (usually by lien or levy).

⁵⁰ IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Reports* (Oct. 2011). A Taxpayer Delinquent Account (TDA) represents a balance due account for a specific taxpayer, tax return, and period.

⁵¹ National Taxpayer Advocate 2010 Annual Report to Congress vol. 2 53 n.48 (citing IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Reports* (Oct. 2010); IRS, Collection Activity Report NO-5000-23, *Collection Workload Indicators* (Oct. 2010)).

⁵² IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators* (Oct. 2011).

⁵³ *Id.*

prepare paperwork to adjust the balance. If ACS had phoned the taxpayer first in this example, the levy and subsequent release might have been avoided, saving both the taxpayer and the IRS time and money.⁵⁴

IRS rework also occurs in the Automated Substitute for Return program, where IRS computers prepare a return for the taxpayer based on third-party information reporting documents.⁵⁵ Because the IRS does not have access to information about all of the taxpayer's deductions or expenses, the taxpayer usually ends up owing more on the IRS-prepared return. Once the taxpayer files a return, the IRS must adjust the tax balance, penalty, and interest to correct the assessment.⁵⁶ Based on this approach, the IRS spends excess time processing accounts, when a simple phone call early in the delinquency could resolve the problem faster and more efficiently, at least in many cases.

Since 2004, the National Taxpayer Advocate has urged the IRS to adopt collection policies that emphasize early personal contact, both by telephone and face-to-face.⁵⁷ In fact, an IRS pilot program that incorporates personal taxpayer contacts has resolved 40 percent more cases within six months than cases handled under the IRS's standard procedures.⁵⁸ The IRS declined to adopt our recommendations

⁵⁴ Even when the IRS releases a levy, the taxpayer may still incur bank fees (e.g., for overdraft protection or insufficient funds in an account).

⁵⁵ IRC § 6020(b); IRM 5.1.11.6.3.1 (Jan. 15, 2010). See also National Taxpayer Advocate 2011 Annual Report to Congress 93-108 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*).

⁵⁶ See National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 40-70 (TAS Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); see also National Taxpayer Advocate 2011 Annual Report to Congress 93-108 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*).

⁵⁷ See National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The IRS Does Not Emphasize The Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 40-70 (TAS Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem: *Early Intervention in IRS Collection Cases*), 83-109 (Most Serious Problem: *IRS Collection Payment Alternatives*), 110-129 (Most Serious Problem: *Levies*), 141-156 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 114-125 (Most Serious Problem: *Navigating the IRS*); National Taxpayer Advocate 2004 Annual Report to Congress 226-245 (Most Serious Problem: *IRS Collection Strategy*).

⁵⁸ Response to TAS information request (Sept. 28, 2011). The IRS is currently testing a streamlined offer in compromise (OIC) program that requires "outbound" calls to taxpayers. Under the standard

between 2006 and 2011 as its enforcement budget expanded; these recommendations – although they could increase collections while reducing both IRS and taxpayer burden – may be even less likely to be adopted in an environment of declining resources.

Recommendation: The IRS should call or visit certain delinquent taxpayers (e.g., those with higher-dollar notice accounts, repeated delinquencies, and potentially defaulted installment agreements or offers in compromise) before sending their accounts to the collection queue.⁵⁹

iii. Automated Enforcement Tools Prompt Taxpayers to Try to Communicate with the IRS.

When a taxpayer is trying to resolve a tax problem proactively, he or she may try to contact the IRS. Similarly, when the IRS sends the taxpayer an assessment or collection notice, or issues notices of lien and levy, it often prompts the taxpayer or representative to call or write to resolve the problem. Increasingly, however, nobody at the IRS answers the phone or reads correspondence – at least not promptly.

iv. The IRS Does Not Always Answer the Phone.

Taxpayers, particularly low income taxpayers who are frequently subject to automated IRS procedures, often call the IRS for clarification before responding to a letter.⁶⁰ However, they often have difficulty reaching the IRS by phone. Although IRS telephone customer service representatives (CSR) achieved an 88 percent level of service (LOS) in FY 2004, the LOS declined to 70 percent in FY 2011, and due to funding constraints, *the IRS has reduced its LOS goal to 61 percent for FY 2012.*⁶¹

program, 48.07 percent of cases are resolved within six months. Under the streamlined program, 68.46 percent are resolved within six months, even though that figure includes cases that were already aged before being brought into the program.

⁵⁹ National Taxpayer Advocate 2011 Annual Report to Congress 336.

⁶⁰ One survey of those who were subject to an Earned Income Tax Credit (EITC) audit found that:

Even though slightly over half of the respondents indicated that they understood what was being questioned and knew what they needed to do, overall, more than 90 percent contacted the IRS. Seventy-two percent of the respondents said that they either called or visited the IRS in response to the letter. More than 75 percent of those taxpayers contacting the IRS about their audit letter did so by telephone. National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 103-104 (*IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

⁶¹ IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services – CAS* (week ending Sept. 30, 2011); Wage and Investment, Business Performance Review 4 (Feb. 2012), http://win.web.irs.gov/strategy/stratdocs/bpr_document.pdf (“CAS received a reduction in funding for Toll-free telephone and correspondence services resulting in a CSR LOS goal for FY 2012 of 61%, compared to 70% achieved in FY 2011. This decrease translates to longer customer wait times, increased customer abandons, and an increased number of customers redialing the IRS Toll-free lines for service.”). As of April 14, 2012, the LOS for FY 2012 stood at 67.5 percent, as compared with 75.2

In other words, in FY 2011, nearly one in three calls did not get through, and *the IRS's goal for FY 2012 is that only about six in ten* calls get through. Even last week – the last week of the filing season when the IRS typically staffs its phones at the highest levels of the year – the LOS stood at 71.6 percent.⁶² Further, when taxpayers do reach the IRS by phone, the person they reach often cannot resolve the issue.⁶³

v. The IRS Does Not Always Timely Respond to Mail.

When a taxpayer writes to the IRS, the IRS does not always timely process the letter.⁶⁴ For example, one report suggested the IRS was late in responding to math error correspondence about 40 percent of the time.⁶⁵ Comparing the final week of FY 2004 with the final week of FY 2011, the backlog of taxpayer correspondence in the tax adjustments inventory jumped by 158 percent (from 357,151 to 920,768), and the percentage classified as “over-age” increased by 309 percent (from 11.5 percent to 47.0 percent of correspondence).⁶⁶

The IRS's inability to timely respond to taxpayers could worsen very quickly. When the IRS does not respond to calls or it cannot resolve the matter by phone, some taxpayers send in correspondence. If the IRS does not respond to their first letters, some will call or write again, increasing IRS backlogs even further. Others may give

percent at the same point in FY 2011. IRS, Joint Operations Center Executive Level Summary Report (Apr. 14, 2012).

⁶² IRS, Joint Operations Center Executive Level Summary Report (Apr. 14, 2012) (IRS-wide figures). The LOS was 65.3 percent on the National Taxpayer Advocate toll free line and 71.7 percent on the 1040 line during the same period. *Id.*

⁶³ National Taxpayer Advocate 2007 Annual Report to Congress 259, 271 (Most Serious Problem: *Automated Underreporter*) (noting that when callers did get through to the AUR toll-free operation the IRS resolved just seven percent of the cases).

⁶⁴ See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 235 (Most Serious Problem: *The IRS Does Not Process Vital Taxpayer Responses Timely*) (noting that over 75 percent of IRS correspondence received in two Compliance Service Collection Operations took more than 14 days to be processed and that for all Correspondence Imaging System cases closed in FY 2009, it took between 15 and 30 days to assign the correspondence).

⁶⁵ TIGTA, Ref. No. 2011-40-059, *Some Taxpayer Responses to Math Error Adjustments Were Not Worked Timely and Accurately* 4 (July 7, 2011) (Figure 3), <http://www.treasury.gov/tigta/auditreports/2011reports/201140059fr.pdf>.

⁶⁶ Compare IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 1, 2011) with IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004). Correspondence generally is considered over-age when it is 45 days old or older and the issue it addresses has not been resolved. W&I FY 2012 Account Management Program Letter and Operating Guidelines (Dec. 12, 2011). In some instances, the definition of over-age varies based on factors such as the type of work, the program, the site, and inventory levels. TAS conversation with Joint Operations Center Paper Inventory Analyst (Dec. 13, 2011).

up trying to comply, potentially reducing voluntary compliance and increasing the tax gap today or in the future.

2. Taxpayer Service Levels May Decline Further if Additional Budget Reductions Are Enacted, Potentially Increasing the Tax Gap.

In a recent letter to the chairmen and ranking members of key committees of Congress, the Commissioner of Internal Revenue warned:

[C]uts of the magnitude contemplated in the current appropriations bills (approximately \$525 million from core IRS accounts in the Senate bill and \$650 million in the House bill) would lead to noticeable degradation of both service and enforcement and would have a serious detrimental impact on voluntary compliance for years to come. . . .

Responses to taxpayers' letters (including taxpayers who have received a notice and are trying to resolve account issues) would be delayed up to 5 months. Approximately half of the nation's taxpayers attempting to call the IRS would either be unable to get through or hang up in frustration.⁶⁷

The Chairman of the IRS Oversight Board expressed similar concerns in a letter to the chairmen and ranking members of House and Senate Appropriations Committees. He also stated:

The private sector experience of the Board members reinforces our belief that taxpayers who contact the IRS seeking assistance deserve service, and when taxpayers experience delays in obtaining service, the results are dysfunctional. For example, taxpayers may make costly mistakes, put themselves in jeopardy of enforcement action by the IRS, and in the long term, lose confidence in the tax system.⁶⁸

The Internal Revenue Service Advisory Council (IRSAC), a federal advisory committee composed of members of the public, has also sounded alarm bells. In a section of its recently released 2011 annual report titled "The IRS Must Receive Consistent, Adequate and Appropriate Funding to Achieve the Proper Administrative Balance Between Service, Compliance and Tax Enforcement," the IRSAC wrote:

⁶⁷ Letter from Douglas H. Shulman, Commissioner of Internal Revenue, to the Chairs and Ranking Members of the House and Senate Appropriations Subcommittees on Financial Services and General Government, the House Committee on Ways and Means and its Subcommittee on Oversight, and the Senate Committee on Finance (Oct. 17, 2011).

⁶⁸ Letter from Paul Cherecwich, Jr., Chairman of the IRS Oversight Board, to the Chairs and Ranking Members of the House and Senate Committees on Appropriations (Oct. 20, 2011). The board recently expressed similar concerns. See IRS Oversight Board, *FY2013 IRS Budget Recommendation Special Report* (Apr. 2012),

<http://www.treasury.gov/irsob/reports/2012/IRSOB%20FY13%20BUDGET%20REPORT.pdf>.

Limited resources are forcing the IRS to continually streamline its services. An example of this approach is the limited ability of taxpayers to interface with a local IRS representative when responding to a notice, when seeking resolution of an issue, or during the process of tax collection or the processing of offers in compromise. Instead, taxpayers and representatives often encounter numerous erroneous notices and lengthy holding periods on the telephone followed by a non-discretionary approach that sometimes fails to comprehend the unique issues involved. Every taxpayer is not alike and the need for face-to-face interaction should not be overlooked or ignored in favor of budgetary concerns. . . .

Congress should appropriately fund the IRS to assure continued success in service, compliance, and enforcement. Without adequate funding, both taxpayers and the tax system will continue to suffer.⁶⁹

The National Taxpayer Advocate shares the concerns expressed by the Commissioner, the Oversight Board, and the IRSAC. If these concerns are not addressed, the IRS's enforcement revenue may suffer. As I've noted earlier, the real danger is not a decline in the two percent of tax revenue the IRS collects directly through enforcement, but that any significant portion of the 98 percent stops being paid voluntarily and timely, as taxpayers become frustrated by automated procedures, conclude that the IRS does not really detect tax cheating unless there is a document mismatch, or simply lose faith in the system and give up trying to comply.

Obtaining a little extra money to bring in a lot of extra money remains an intractable challenge for the IRS, and that is unfortunate. Without additional resources, the IRS will be unable to provide timely and effective taxpayer service and will be unable to make much, if any, progress in reducing the tax gap.

Recommendation: I recommend that due to the IRS's unique role as revenue collector, Congress develop new budget procedures designed to fund the IRS at a level that will enable it to meet taxpayer needs and maximize tax compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.

II. Tax-Related Identity Theft

Tax-related identity theft is a serious problem – for its victims, for the IRS and, when Treasury funds are improperly paid to the perpetrators, for all taxpayers. Since 2004, I have written extensively about the impact of identity theft on taxpayers and tax administration and have worked closely with the IRS to improve its efforts to assist

⁶⁹ Internal Revenue Service Advisory Council, 2011 General Report (Nov. 16, 2011), <http://www.irs.gov/taxpros/article/0,,id=250783,00.html>.

taxpayers who are identity theft victims.⁷⁰ The IRS has made significant progress in this area in recent years, including adopting many of my office's recommendations. Notwithstanding these efforts, it is clear that combating identity theft continues to pose significant challenges for the IRS.

In general, tax-related identity theft occurs when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return with the intention of obtaining an unauthorized refund.⁷¹ Today, identity theft can be an organized, large-scale operation. Indeed, the most recent IRS data show more than 450,000 identity theft cases servicewide.⁷²

My written testimony at a Senate Finance subcommittee hearing last month addresses this subject in considerable detail.⁷³ I will highlight four points that I think deserve particular emphasis.

⁷⁰ See National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133-136 (Most Serious Problem: *Inconsistence Campus Procedures*); *Tax Fraud by Identity Theft Part 2: Status, Progress, and Potential Solutions: Hearing before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth*, 112th Cong. (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *The Spread of Tax Fraud by Identity Theft: A Threat to Taxpayers, a Drain on the Public Treasury: Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth*, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Filing Season Update: Current IRS Issues: Hearing Before the S. Comm. on Finance*, 111th Cong. (Apr. 15, 2010) (statement of Nina E. Olson, National Taxpayer Advocate); *Identity Theft: Who's Got Your Number: Hearing Before the S. Comm. on Finance*, 110th Cong. (Apr. 10, 2008) (statement of Nina E. Olson, National Taxpayer Advocate).

⁷¹ This type of tax-related identity theft is referred to as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own taxpayer identification number, but uses another individual's SSN in order to obtain employment, and consequently, the wages are reported to the IRS under the SSN. The IRS has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, I will focus on refund-related identity theft for this testimony.

⁷² Data provided by the IRS Office of Privacy, Government Liaison, and Disclosure (e-mail dated Apr. 17, 2012).

⁷³ *Tax Fraud by Identity Theft, Part 2: Status, Progress, and Potential Solutions: Hearing Before the S. Comm. on Finance, Subcomm. on Fiscal Responsibility and Economic Growth*, 112th Cong. (Mar. 20, 2012) (statement of Nina E. Olson, National Taxpayer Advocate).

A. The IRS Should Continue Working with the Social Security Administration (SSA) to Restrict Access to the Death Master File.

I am concerned that the federal government continues to facilitate tax-related identity theft by making public the Death Master File (DMF) – a list of recently deceased individuals that includes their full name, SSN, date of birth, date of death, and the county, state, and ZIP code of the last address on record.⁷⁴ There is some uncertainty about whether the SSA has the legal authority to restrict public access to DMF records in light of the Freedom of Information Act. For that reason, I strongly support legislation that would eliminate the uncertainty by making clear that public access to the DMF can and should be limited. However, I want to be clear that my legal staff believes the SSA has at least a reasonable basis for seeking to limit public access to the DMF, and if legislation is not enacted, I encourage the SSA to act on its own.

B. Creating New Exceptions to Taxpayer Privacy Protections Poses Risks and Should Be Approached Carefully, If At All.

I am aware that some state and local law enforcement agencies would like more information to enable them to help combat identity theft and are seeking access to taxpayer return information to do it. I have significant concerns about loosening taxpayer privacy protections and believe this is an area where we need to tread carefully. But I think we may have a solution. I am very pleased that the IRS Office of Chief Counsel recently advised that because a return filed by an identity thief may be considered return information of the victim, the victim may obtain a copy of the bad return as well as other information pertaining to the processing of the bad return. The victim then may authorize the IRS to share all of this information with state and local law enforcement agencies. I believe this approach strikes an appropriate balance – protecting taxpayer return information while simultaneously giving state and local law enforcement authorities more information to help them investigate and combat identity theft. However, this approach makes it all the more urgent for Congress to adopt my legislative recommendation that misuse and re-disclosure safeguards and penalties apply to recipients of tax return information shared via taxpayer consent.⁷⁵

C. The Taxpayer Protection Unit Needs Significantly More Staffing to Increase Its Level of Service.

I am pleased that, this filing season, the IRS has established a dedicated Taxpayer Protection Unit (TPU) to answer phone calls from legitimate taxpayers who have been caught up in identity theft filters and to try to assist them. Initially, the TPU was woefully

⁷⁴ See Office of the Inspector General, SSA, *Personally Identifiable Information Made Available to the General Public Via the Death Master File*, A-06-08-18042 (June 2008).

⁷⁵ See National Taxpayer Advocate 2011 Annual Report to Congress 505; National Taxpayer Advocate 2003 Annual Report to Congress 232.

understaffed to handle the volume of calls that came in. For the week ending March 10, the level of service on this unit's phone line was 11.7 percent, meaning that only about one out of every nine calls was answered.⁷⁶ And those callers that did get through had to wait on hold an average of an hour and six minutes!⁷⁷

In the following weeks, the IRS provided additional staffing for the TPU, and the level of service for this line has improved. For the week ending April 14, the TPU achieved a 35.3 percent level of service, with the average wait time remaining at one hour and six minutes.⁷⁸ This performance is unacceptable; the TPU clearly requires more support. I note, however, that in a zero-sum budget environment, providing more resources for this unit means another unit in the IRS will have less.

D. When Analyzing the Impact of Identity Theft, a Broad Perspective Is Necessary.

I want to squarely present a “big picture” issue that Congress and others will need to consider carefully if tax-related identity theft and other refund fraud continue at the current pace. At the same time that the IRS is being urged to do much more to combat identity theft, taxpayers are clamoring for the IRS to process returns and issue refunds faster. While there is still room for the IRS to make marginal improvements in both areas, the two goals are fundamentally at odds. Given the constantly evolving nature of identity theft schemes, IRS identity theft filters will never be perfect. Therefore, we have to set our priority.

If our overriding goal is to process tax returns and deliver refunds as quickly as possible for the vast majority of taxpayers who file legitimate returns, it is inevitable that some identity thieves will get away with refund fraud and some honest taxpayers will be harmed. On the other hand, if we decide to place a greater value on protecting taxpayers against identity theft and the Treasury against fraudulent refund claims, the IRS will need more time to review returns and the roughly 110 million taxpayers who receive refunds will have to wait longer to get them, perhaps considerably longer.⁷⁹ Alternatively, the IRS will require a considerably larger staff to enable it to review questionable returns more quickly. There is no way around these trade-offs.

⁷⁶ IRS, Joint Operations Center Executive Level Summary Report (Mar. 13, 2012). Level of service (LOS) measures the relative success rate of taxpayers that call for toll-free services seeking assistance from customer service representatives (CSRs). LOS is calculated by dividing the number of calls answered by the total number of callers attempting to reach the CSR queue. See IRS Performance Measures 2009 Data Dictionary (Aug. 4, 2009).

⁷⁷ The average speed of answer was 3,962 seconds. IRS, Joint Operations Center Executive Level Summary Report (Mar. 10, 2012).

⁷⁸ The average speed of answer was 3,967 seconds for this period. IRS, Joint Operations Center Executive Level Summary Report (Apr. 14, 2012).

⁷⁹ In calendar year 2011, the IRS processed 145,320,000 individual tax returns, with 109,337,000 requests for refunds. IRS, *Filing Season Statistics – Dec. 31, 2011*, at <http://www.irs.gov/newsroom/article/0,,id=252176,00.html> (last visited Apr. 17, 2012).

Nina E. Olson serves as an advocate for taxpayers to the IRS and Congress. She leads the Taxpayer Advocate Service, a nationwide organization of approximately 2,000 taxpayer advocates who help U.S. taxpayers resolve problems and work with the IRS to correct systemic and procedural problems.

Nina's work as the "voice of the taxpayers" at the IRS has won national acclaim: She is a member of the American College of Tax Counsel, and delivered the group's prestigious Griswold Lecture in January, 2010. The non-profit Tax Foundation selected her to receive its Public Sector Distinguished Service Award in 2007. Accounting Today magazine named her one of its Top 100 Most Influential People in the accounting profession each year since 2004. In January 2005, Money magazine named her one of the 12 "Class Acts of 2004."

Nina is an attorney licensed in Virginia and North Carolina. She was the founder and Executive Director of The Community Tax Law Project, the first independent § 501(c)(3) low income taxpayer clinic in the United States. The Community Tax Law Project provides free legal services to Virginia low income taxpayers in federal, state, and local tax disputes.

Prior to her appointment as the NTA in January 2001, Nina maintained a private law practice, concentrating in tax controversy representation. From 1975 until 1991, she owned and operated Accounting, Tax & Information Services, a tax planning and preparation firm in Chapel Hill, North Carolina. Nina served as the chair of the American Bar Association (ABA) Section of Taxation's Low Income Taxpayers Committee as well as the Pro Se/Pro Bono Task Force of the ABA Tax Section's Court Procedure Committee. Nina is the 1999 recipient of both the Virginia Bar Association's Pro Bono Publico Award and the City of Richmond Bar Association's Pro Bono Award.

Nina graduated from Bryn Mawr College cum laude with an A.B. in Fine Arts. She received her J.D. cum laude from North Carolina Central School of Law and her Masters of Law in Taxation, with distinction, from Georgetown University Law Center. Nina has served as an adjunct professor at several law schools.