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IRS ASSISTANCE TO TAXPAYERS FACING ECONOMIC DIFFICULTIES

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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IRS ASSISTANCE TO TAXPAYERS FACING ECONOMIC DIFFICULTIES

THURSDAY, FEBRUARY 26, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:07 a.m. in room 1100, Longworth House Office Building, the Honorable John Lewis, [Chairman of the subcommittee], presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
February 19, 2009
OV–1

CONTACT: (202) 225–5522

Lewis Announces a Hearing on IRS Assistance for Taxpayers Experiencing Economic Difficulties

House Ways and Means Oversight Subcommittee Chairman John Lewis (D–GA) today announced that the Subcommittee on Oversight will hold a hearing on assistance available from the Internal Revenue Service (IRS) to taxpayers experiencing economic difficulties. **The hearing will take place on Thursday, February 26, 2009, at 10:00 a.m. in the main Committee hearing room, 1100 Longworth House Office Building.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. The National Taxpayer Advocate, Nina E. Olson, and the IRS Deputy Commissioner for Services and Enforcement, Linda E. Stiff, have been invited to testify. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

During this recession, taxpayers are experiencing financial difficulties. In 2008, there were 3.4 million foreclosure filings and 2.6 million job losses. Many taxpayers are struggling to meet their daily living expenses as they face a wide range of financial and personal issues, which may make it difficult to meet their tax obligations.

On January 6, 2009, the IRS kicked off the 2009 filing season with an announcement of steps taken to help financially distressed taxpayers. The IRS announced that its employees have greater flexibility to assist struggling taxpayers and may be able to adjust payments for back taxes, expedite levy releases, or postpone collections. Further, the IRS encouraged taxpayers to take advantage of new and existing credits (such as the first-time homebuyer credit and the earned income tax credit), deductions (such as the standard deduction for real estate taxes), and electronic filing options (such as Free File Fillable Tax Forms) to maximize and expedite refunds.

The National Taxpayer Advocate, an independent official appointed to address taxpayer problems (established in Public Law 104–168), indicates that more action may be warranted to address the problems of struggling taxpayers. The Taxpayer Advocate's most recent report to Congress focused on the challenges to taxpayers and tax administration during the economic downturn. The report recommended that the IRS change some of its collection practices in order to avoid exacerbating the financial distress of taxpayers. The Taxpayer Advocate noted that the IRS is underutilizing collection alternatives, particularly offers in compromise and partial pay installment agreements, and IRS employees need more guidance on how to identify and help distressed taxpayers.

The Subcommittee will discuss the specific problems encountered by taxpayers during this recession. The Subcommittee will review the steps taken by the IRS to assist struggling taxpayers and consider recommendations of the National Taxpayer Advocate.

In announcing the hearing, Chairman Lewis said, "**Americans are suffering during these difficult economic times. They are trying to do the right thing and pay their taxes, but they may be unable. We need to understand their problems. They need to reach out to the IRS for assistance. Together, we must find ways to collect the proper amount of taxes owed in a manner that is fair and recognizes the problems that taxpayers are facing during this recession."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select "*Committee Hearings*". Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, complete all informational forms and click "submit" on the final page. ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, March 12, 2009**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

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The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

Chairman LEWIS. Good morning. The hearing is now called to order, the hearing of the oversight Committee.

People all over the country are ready. A record number of people, our friends, our family and our neighbors are losing their jobs, losing their homes, and getting in line at food banks. People are suf-

fering. These are hard-working people with families who for the first time in their lives are struggling to stay afloat while their debts increase. We must reach out to help them.

Today, the Ways and Means Subcommittee on Oversight will discuss what the Internal Revenue Service can do for taxpayers in need. We want people to know that there is help and help must be on the way. We need to tell people that they can get free help to prepare their tax returns during the following season. We want to tell them how to get their refund faster, especially if there is an emergency. We want them to know what steps to take if they owe taxes, and want to pay but cannot. In summary, we want to see the gentler and sweet side of the IRS.

And I am grateful to our witness for appearing today. We look forward to you being here and your testimony. As always, we ask you tell us how the Congress can help you during this following season and beyond. And I call on the Ranking Member, Mr. Boustany for his opening statement.

Mr. BOUSTANY. Thank you, Mr. Chairman, and I thank you for holding this hearing, and I welcome both of our witnesses.

I think this will be a very productive hearing. With so many new Members of this Subcommittee, it is prudent to start the congress with a hearing that will focus on the operations of the internal revenue service. As Members of the Ways and Means Committee, we are asked to consider legislation that changes the Tax Code and affects millions of Americans. As such, we also need to be cognizant of the IRS' role, and if they have the resources to administer and enforce those laws.

We all met, I think, 2 weeks ago, with the Commissioner, and he discussed building a world class organization dedicated to taxpayer service while prudently enforcing the law. Their mission now includes meeting the substantial challenge of a recession with millions of taxpayers losing their jobs, resulting in financial hardship that is making it difficult for them to fulfill their tax obligations.

The IRS is trying to help the taxpayers navigate the options available and in doing so, of course, with some additional resources we recently provided. But at the same time this is coming up along with the new tax filing season. So I believe this hearing will deepen our understanding of the IRS's taxpayer services, their use of enforcement tools, which is essential knowledge for all Members of this Subcommittee, and more, it will allow us to explore what more can be done for financially distressed taxpayers.

One final note, Mr. Chairman, as a follow-up to yesterday's Full Committee hearing: I wanted to offer my full support for protecting the jurisdiction of the Ways and Means Committee. I know as we look at all these issues, and there will be multiple Committees working on some of these, our side is offering full support to you and to the Chairman of the Full Committee, and I would be glad to work with you if the opportunity arises to use this subcommittee to assert our jurisdiction and to work with you and the chairman.

Chairman LEWIS. Well, thank you very much. I know the chair of the Full Committee and all the Members would appreciate your support and we all look forward to working together.

Mr. BOUSTANY. Thank you, Mr. Chairman.

And, finally, before I yield back my time, I want to acknowledge Chris Giosa, who is leading our side, as a very dedicated and hard-working staffer. He's the Staff Director of this Subcommittee. Chris, we want to thank you for all your great work, and we wish you all the best in your new role in working with our partner, the IRS, and so while we're losing a very valuable staffer here and someone who's very knowledgeable in this issues, we feel that we'll have a partner working in the executive branch. So, Chris, we offer our deep and sincere thanks to you.

Mr. Chairman, I yield back.

Chairman LEWIS. Mr. Ranking Member, I want to join you in wishing Chris the best and thank him for his wonderful years of service. And we wish you well in the days to come. Thank you so much.

Now we're going to hear from our witnesses. I ask that you limit your testimony to 5 minutes. Without objection your entire statement will be included in the record. And now here's my great pleasure to introduce the IRS Deputy Commissioner Linda Stiff and welcome.

STATEMENT OF LINDA E. STIFF, DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT, INTERNAL REVENUE SERVICE

Ms. STIFF. Thank you. Chairman Lewis, Ranking Member Boustany and Members of the Subcommittee, I appreciate the opportunity to discuss how the IRS is assisting economically distressed taxpayers during this period of great need. This country is currently experiencing an economic crisis unlike any we have seen in our lifetime.

Every day we see the fall out with families, friends and neighbors struggling to hold on to jobs and homes and provide their families with basic necessities. The IRS' effort to assist taxpayers during these difficult times are confirmation of part of our core mission which is to assist taxpayers in every way possible to meet their obligations. Therefore, the IRS has taken deliberate and focused actions to provide tangible relief to taxpayers in distress, while also helping others from straying across the line into non-compliance.

Let me briefly describe some of those actions. America's low income taxpayers have been particularly hard-hit by financial hardship. Many of these working families may be eligible for the earned income tax credit, which can put money in their pockets. The IRS has an aggressive outreach program to promote greater community awareness of this refundable credit for low-wage taxpayers. This outreach program includes a specific day each year devoted to press events, promoting and explaining the earned income tax credit.

I want to thank all of the Committee Members for your support in this effort, especially Chairman Lewis for your recent help and participation in an event publicizing the EITC as well as for the time you took to share the law with the IRS family. This year on January 30th more than 80 partners from across the country conducted news conferences and over a hundred more issued press releases on EITC awareness day. Our efforts to make taxpayers aware of the EITC continue throughout the year. We send marketing materials to our community partners to distribute. We in-

clude information in English and Spanish on our website, on IRS dot gov, and by a number of media opportunities.

There are also more than 12,000 free tax preparation sites for low income individuals, seniors, and other eligible taxpayers around the country. When taxpayers visit one of these sites, our volunteers can also check to see if they are potentially eligible, not just for the EITC, but for other credits, deductions and exclusions, such as the child tax credit.

We also understand that taxpayer service can only go so far in assisting millions of distressed taxpayers. This year, many taxpayers will owe money to the IRS and face difficulties paying those amounts. Accordingly, we have given our frontline, collection personnel more flexibility to work through these issues with taxpayers with a particular focus on previously compliant taxpayers, who may find themselves for the first time unable to meet the obligation to pay their Federal taxes.

Depending on their circumstances, these taxpayers may be able to adjust payments for back taxes, avoid defaulting on payment agreements, or possibly defer collection action. We have reminded our frontline employees about offering installment agreements at the end of an audit for taxpayers, enabling them to minimize interest and penalty charges. Another good example involves the offer-in-compromise program, which oftentimes is impacted by today's battered real estates market.

For individual taxpayers, we have responded quickly by expediting the process and creating flexibilities for people trying to sell or refinance a home. The bottom line is that the IRS should not be the reason someone can't get out of a real estate jam. We have centralized our process to review home equity values in the volatile market, especially in the offer in compromise situations.

We urge all taxpayers to visit our website, IRS dot gov, the fastest way to give information from the IRS or get questions answered. This year we even added what we call "what if" scenarios to our website. The "what if" scenarios allow taxpayers to go through what if A, what if B, to deal with payment and other financial problems.

I would also like to put one issue on the Subcommittee's radar screen: the recently enacted stimulus bill includes a number of refundable credits. We hope taxpayers will take advantage of these. We also recognize that such credits create the potential for abuse. We will watch them closely and report back to you if we see a problem.

Thank you again, Mr. Chairman, for the opportunity to testify. The IRS is committed to assist America's taxpayers in any way it can. You have my commitment and that of Commissioner Shulman to work closely with you as we move forward.

Thank you.

[The statement of Ms. Stiff follows:]

WRITTEN TESTIMONY OF
LINDA STIFF
DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT
ON
ASSISTANCE FOR DISTRESSED TAXPAYERS
FEBRUARY 26, 2009

Good morning, Chairman Lewis, Ranking Member Boustany, and Members of the Subcommittee on Oversight. I appreciate the opportunity to appear this morning and discuss efforts the IRS has made to assist economically distressed taxpayers during this period of greatest need. This is our first visit before the Subcommittee this year, and I look forward to continuing the productive relationship with the Subcommittee and its Members as we have had in previous years.

Our effort to assist taxpayers during these difficult times is a confirmation of part of IRS' core mission, which is to assist taxpayers in any way possible to meet their obligations. Commissioner Shulman said as much earlier this year when he remarked:

> *"We need to ensure that we balance our responsibility to enforce the law with the economic realities facing many American citizens today. We want to go the extra mile to help taxpayers, especially those who've done the right thing in the past and are facing unusual hardships."*

What this means in real terms is that on a wide range of situations, IRS employees now have the flexibility to work with struggling taxpayers to assist them with their situation. Depending on the circumstances, taxpayers in hardship situations may be able to adjust payments for back taxes, avoid defaulting on payment agreements or possibly defer collection action.

The IRS reminds taxpayers who are behind on tax payments and need assistance to contact the phone numbers listed on their IRS correspondence. There could be additional help available for these taxpayers facing unusual hardship situations.

For example, four days after President Barack Obama signed the American Recovery and Reinvestment Act of 2009 into law, the U.S. Department of the Treasury began directing employers to reduce the amount of taxes withheld from the paychecks of millions of American workers – a step unprecedented in its speed and scope.

Under the law signed last Tuesday by President Obama, 95 percent of all working families will realize a tax cut. By April 1st, the Making Work Pay credit, a key provision of the new law, will send the typical family home with at least $65 more every month.

Treasury and the Internal Revenue Service (IRS) worked to develop withholding tables released today by the IRS to incorporate this credit and provide expedited guidance to employers on the new provision. As Treasury Secretary Geithner observed, "Just days after the President signed this landmark legislation into law, we have the wheels turning to deliver much needed boosts to the paychecks of working Americans."

The IRS posted the new withholding tables on IRS.gov and will shortly publish additional instructions related to the new tax law online. The paper version of this publication (15-T) will also be mailed to more than 9 million employers in mid-March. Employers are asked to start using the new tables as soon as possible but no later than April 1. To view the tables and additional guidance on the Making Work Pay credit, please see IRS.gov.

We look forward to working with the Subcommittee to ensure these programs are carried out in an efficient, effective way. Before discussing these programs, however, I would first like to discuss what the IRS is doing for taxpayers having difficulty meeting their tax obligations.

Assisting Taxpayers

IRS is nearing the completion of its strategic plan for the years 2009-2014. One of the plan's two key objectives is to offer high levels of customer service to those taxpayers who need it. Meeting this objective will require us to continue our taxpayer service efforts reflected in the Taxpayer Assistance Blueprint (TAB) and in other areas.

A key component of that plan is performing outreach that both helps us determine taxpayer needs and also allows us to provide information to taxpayers on critical benefit programs. Nowhere in recent history has the need for taxpayers to avail themselves of every available tax benefit been greater.

However, we also understand taxpayer service can only go so far in assisting millions of distressed taxpayers suffering from the current economic crisis. The taxpayer may owe money to the IRS and be unable to pay.

Accordingly, we are attempting to assist these taxpayers in a number of ways by reminding our enforcement personnel of certain tools available when working with distressed taxpayers who owe money to the IRS. These include:

- **Offering Installment Agreements:** We have reminded examination employees of their responsibilities to consider collectability during the pre-audit phase. They were also reminded of their ability to offer installment agreements at the end of an audit where taxpayers are having difficulty satisfying their obligations immediately, thereby enabling them to minimize interest and penalty charges.

- **Postponement of Collection Actions:** IRS employees may suspend collection actions in certain hardship cases where taxpayers are unable to pay. This includes instances when the taxpayer has recently lost a job, is relying solely on Social Security or welfare income or is facing devastating illness or significant medical bills. If an individual has recently encountered this type of financial problem, IRS assistors may be able to suspend collection without further documentation to minimize the tax burden on the taxpayer.

- **Added Flexibility for Missed Payments:** The IRS has flexibility in working with previously compliant individuals in existing Installment Agreements who have difficulty making payments because of a job loss or other financial hardship. The IRS may allow a skipped payment or a reduced monthly payment amount without automatically suspending the Installment Agreement. We will issue taxpayers in such a difficult financial situation a notice asking them to contact the IRS.

- **Additional Review for Offers in Compromise on Home Values**: An Offer in Compromise (OIC), an agreement between a taxpayer and the IRS that settles the taxpayer's tax debt for less than the full amount owed, may be a viable option for taxpayers experiencing economic difficulties. However, the equity taxpayers have in real property can be a barrier to an OIC being accepted. With the uncertainty in the housing market, the IRS recognizes that the real-estate valuations used to assess ability to pay may not be accurate.

  In cases where the accuracy of the real estate valuation is in question, the offer will be referred to a specialized group who will conduct a second review to confirm the value of the real property and ensure the reasonable collection potential has been properly determined and revised, if appropriate.

- **Prevention of Offer in Compromise Defaults:** Taxpayers who are unable to meet the payment terms of an accepted OIC will receive a letter from the IRS outlining options available to help them avoid default.

- **Expedited Levy Releases:** The IRS will speed the delivery of levy releases by easing requirements on taxpayers who request expedited levy releases for hardship reasons. Taxpayers seeking expedited releases for levies to an employer or bank should contact the IRS number shown on the notice of levy to discuss available options. When calling, taxpayers requesting a levy release due to hardship should be prepared to provide the IRS with the fax number of the bank or employer processing the levy.

- **Voluntary Tip Reporting Agreements:** Recognizing the impact of the current economic downturn, IRS reached out to the commercial casino industry via their primary representatives: the American Gaming Association (AGA) and the Culinary Union. We hosted a Tip Summit in late October and obtained key financial data indicating the rough magnitude of the downturn on casinos and

their workers. A month later, we reduced our voluntary tip rates for all Las Vegas Casinos by 20 percent and delayed imposition of a scheduled 33 percent increase on January 1st. We also proactively reached out to Atlantic City and delayed a scheduled 33 percent increase scheduled for the first of January; we also addressed Northern Illinois floating casinos and reduced their rates 20 percent. We are also ensuring that the process is fair and equitable for all commercial casinos located throughout the United States.

- **Fast Track Settlement**: IRS is also vigorously pursuing Fast Track Settlement (FTS) for field cases. FTS is designed to settle cases more quickly than is possible with traditional Appeals procedures. This process is especially beneficial to taxpayers who have a tax liability in dispute that is greater than $25,000. In FTS, the examiner brings in an Appeals official to facilitate settlement while the case remains at the group level. It is being piloted in eight cities throughout the country.

- **Technical Guidance:** We are actively working with the National Council of State Housing Agencies (NCSHA) and individual agencies to provide technical assistance and administrative oversight for the Low Income Housing Credit (LIHC) program.

  We also continue to respond to tax questions from the public with respect to a wide variety of technical issues including: historic tax incentives, Passive Activity Losses, Partnerships, Sub S Corps, and specific industry related issues (such as Retail, Construction, LIHC, Fishing and Services).

- **What If Scenarios:** Finally, taxpayers with financial problems who discover they can't pay when they file their 2008 tax returns also have options available. IRS.gov has a list of "What If?" scenarios that deal with payment and other financial problems. These scenarios, in question-and-answer format, provide information on specific actions taxpayers can take. Taxpayers unable to pay in full can likewise contact the IRS to discuss additional options to pay.

Earned Income Tax Credit

One important benefit available to many taxpayers of low- to moderate-income is the earned income tax credit (EITC). The American Recovery and Reinvestment Act that was recently signed into law temporarily reduced marriage penalties for EITC recipients and increased the credit for individuals and families with 3 or more qualifying children. The IRS has in place an aggressive outreach program designed to reach every taxpayer that qualifies for the EITC. Efforts to advise taxpayers about the availability of the EITC include:

- **EITC Awareness Day** – Each year the IRS schedules a specific day to focus on the availability of the EITC credit. We work with hundreds of partners in the states and local communities to provide information and answer questions about

the credit. We also schedule press briefings with the national media and other events to highlight the importance of the EITC. I know that Chairman Rangel and Subcommittee Chairman Lewis have often accompanied the IRS Commissioner to such important EITC outreach events. We appreciate those efforts and are ready to work with other Members of Congress who might wish to schedule an EITC related event in their state or district.

This year, EITC Awareness Day was held on Friday, January 30th when more than 80 partners from across the country conducted news conferences and over a hundred more issued press releases all focused on getting the word out about the availability of the EITC. In all, 480 press conferences were held or press releases issued by IRS partners. IRS officials participated in events across the country including one in Peoria, IL with the new Governor of that state.

- In collaboration with EITC Awareness Day activities, we also offered EITC assistance in more than 170 Taxpayer Assistance Centers across the country on three Saturdays: January 31, February 7 and February 21, 2009. IRS employees prepared income tax returns for EITC-eligible taxpayers.

- **Greater Utilization of IRS.gov** – We live in an electronic age, and the IRS is making as many resources as possible available on its website, IRS.gov. Relative to the EITC, a visitor to IRS.gov could, in English or Spanish, determine his or her eligibility for the EITC. In addition, there are a number of tools available to both our local community partners or to paid tax preparers that will assist them in helping EITC-eligible clients. For example, information available to paid preparers include: (a) The latest EITC updates; (b) EITC eligibility criteria; (c) Tips and tools for preparation of EITC returns; (d) EITC due diligence educational materials; (e) Specialized products and links to other helpful resources; and (f) an electronic toolkit for tax professionals at EITC Central.

  For our community partners, the offerings are focused on marketing materials designed to get the word out to potential recipients. IRS provides an electronic "Partner Toolkit" that includes an array of useful general and specialized marketing tools, such as templates, statistics, fact sheets, how-to tips, specialized products and links to other helpful resources. It allows the partner to create and customize EITC communication products with location, logo and personal messages.

  There is also a wealth of other information on IRS.gov that will assist employers in notifying their employees about the potential availability of the EITC and the possibility of receiving advance EITC – a program that allows employees to receive the EITC benefits through the course of the year, and not as part of a lump sum payment when that same employee files his or her Federal tax return.

- **Direct and Indirect Outreach** – Efforts to make taxpayers aware of potential EITC eligibility are not limited to just a single day. IRS continues promotional

efforts throughout the entire tax season. This includes working with both the local and national media keeping them aware of the availability of EITC, as well as the publication and distribution of materials that can be handed out in local communities.

Other Tax Credits

The EITC is not the only credit for which taxpayers may be eligible. Information is available for all these credits on IRS.gov. They include:

- **Making Work Pay Credit:** As part of the American Recovery and Reinvestment Act of 2009, this provision allows a tax credit for each eligible individual for the taxable year in an amount equal to 6.2 percent of earned income of the taxpayer, or $400 ($800 in the case of a joint return). The amount allowable as a credit for the taxable year shall be reduced (but not below zero) by two percent of so much of the taxpayer's modified adjusted gross income as exceeds $75,000 ($150,000 in the case of a joint return). This section applies to taxable years beginning after December 31, 2008 and on or before December 31, 2010.

- **Child Tax Credit** – A taxpayer who has a dependent child under age 17 probably qualifies for the child tax credit. This credit, which can be as much as $1,000 per eligible child, is in addition to the $3,500 exemption for each dependent. A change in the way the credit is figured means that more low- and moderate-income families will qualify for the full credit on their 2008 returns. The child tax credit is not the same as the child care credit. Details on figuring and claiming the child tax credit can be found in IRS Publication 972, which is available on our web site.

- **Credit for Child and Dependent Care Expenses** – An individual who pays for someone to care for a child so he or she can work or look for work, probably qualifies for the child and dependent care credit. Normally, the child must be the taxpayer's dependent and under age 13. Though often referred to as the child care credit, this credit is also available to those who pay someone to care for a spouse or dependent, regardless of age, which are unable to care for themselves. In most cases, the care provider's Social Security Number or taxpayer identification number must be obtained and entered on the return.

- **Education Credits** – The Hope credit and the lifetime learning credit help parents and students pay for post-secondary education. Normally, a taxpayer can claim both his or her own tuition and required enrollment fees, as well as those for a dependent's college education. The Hope credit targets the first two years of post-secondary education and an eligible student must be enrolled at least half the normal full-time workload (for at least one academic period). A taxpayer can also choose the lifetime learning credit, even if he or she is only taking one course. In some cases, however, the taxpayer may do better by claiming the tuition and fees deduction instead.

An education credit and the tuition and fees deduction cannot both be claimed for the same student in the same year. Special rules, including income limits, apply to each of these tax breaks. Details on these and other education-related tax breaks are contained in Publication 970.

- **Saver's Credit** – The saver's credit is designed to help low- and moderate-income workers save for retirement. A taxpayer probably qualifies if his or her income is below certain limits and he or she contributes to an IRA or workplace retirement plan, such as a 401(k). Income limits for 2008 are:

  - $26,500 for singles and married taxpayers filing separately
  - $39,750 for heads of household and
  - $53,000 for joint filers

  Also known as the retirement savings contributions credit, the saver's credit is available in addition to any other tax savings that apply. There is still time to put money into an IRA and get the saver's credit on a 2008 return. Contributions to an IRA for 2008 can be made until April 15, 2009.

- **Other Credits Available** – IRS.gov has information on other available credits including:

  - The foreign tax credit;
  - Credit for the elderly or the disabled;
  - The adoption credit;
  - The residential energy efficient property credit; and
  - The alternative motor vehicle (including hybrids) credit.

Everyone is advised to check for eligibility for each of the credits listed above. Many individuals who have less income in 2008 than in previous years may now be eligible to claim certain tax benefits for which they were previously not eligible.

Recently Enacted Credits

Congress has recently enacted several new credits as well as other tax breaks. These include:

- **First-Time Homebuyer Credit:** Those who bought a principal residence recently or are considering buying one should take note. This unique credit provides up to $7,500 for qualified taxpayers who purchased homes after April 8, 2008 and on or before December 31, 2008 and works much like a 15-year interest-free loan. For homes purchased after December 31, 2008 and before December 1, 2009, the credit is $8,000 and does not have to be repaid provided the home remains their main residence for 36 months after the purchase date. Information and answers to commonly asked questions about this credit are available on IRS.gov.

- **The Recovery Rebate Credit:** This credit is figured like last year's Economic Stimulus Payment except that Recovery Rebate Credit amounts are based on tax year 2008 instead of 2007. Most people already received their full benefit in the form of the Economic Stimulus Payment. However, a taxpayer may qualify for the Recovery Rebate Credit if, for example, he or she did not get an Economic Stimulus Payment, had a child in 2008 or had a change in income level. If you receive this credit, it will be included in your refund and will not be issued as a separate payment.

- **Mortgage Workouts and Foreclosures:** For homeowners, mortgage workouts now may be tax-free. Eligible homeowners can exclude debt forgiven on their principal residence if the balance of the loan was less than $2 million. The limit is $1 million for a married person filing a separate return. Form 982 and its instructions have details about this program.

- **American Opportunity Tax Credit:** For taxable years beginning in 2009 or 2010, taxpayers will receive a tax credit equal to the sum of 100% of the first $2,000 of tuition and related expenses (including books) paid during the taxable year plus 25% of those expenses in excess of $2,000 up to $4,000. The credit is allowed for the first 4 years of post-secondary education. The credit is subject to a phase-out for taxpayers with adjusted gross income in excess of $80,000 ($160,000 for married couples filing jointly.)

Super Saturday

As with the EITC, the IRS is using every media opportunity to make sure that taxpayers know, and take advantage of, all available credits. We have distributed news releases, conducted interviews with various media outlets, and shared media materials with our partners throughout the country.

In an effort to maximize our promotional efforts and to assist as many taxpayers as possible, IRS will conduct a Super Saturday event on Saturday, March 21. This will be the second Super Saturday that we have conducted in the last 11 months. The first was held March 29, 2008 and focused on alerting those individuals who had not filed a tax return for 2007 that they may be eligible for the economic stimulus rebate. It was a great success.

This year, we hope to use the Super Saturday event to highlight all of the services offered by the IRS to assist taxpayers during these troubled economic times and to provide direct, hands-on-assistance to those taxpayers visiting an IRS facility on that day.

We have already identified more than 250 Taxpayer Assistance Centers that will be staffed on that day. In addition, we hope to leverage our partnerships with groups in the local community to make available literally hundreds of facilities across the country that will be open on that day and ready to assist taxpayers.

I should note that IRS has incorporated information on all individual credits and related tax law in the training curriculum and certification process for the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs. Nearly 80,000 certified volunteers are staffing approximately 11,500 sites nationwide assisting taxpayers.

For the 2009 Filing Season, IRS increased the scope of return preparation at VITA/TCE sites to allow for the inclusion of returns with Cancellation of Debt issues in a direct response to the increased number of taxpayers facing mortgage foreclosures. IRS has provided training to its employees and specific training modules for those partners who wanted to increase their scope of services to include the Cancellation of Debt issue. Our Taxpayer Assistance Centers have also expanded tax law scope of services to include Cancellation of Debt Income and First Time Homebuyers Credit.

E-File, E-Pay and Direct Deposit

The easiest way for taxpayers to receive their refund from their 2008 tax return is to file early and electronically. Electronic filing options will speed the payment of refunds to millions of taxpayers. Taxpayers who e-file and choose direct deposit for their refunds, for example, will get their refunds in as few as 10 days. That compares to approximately six weeks for people who file a paper return and get a traditional paper check. This year taxpayers could have begun filing electronically on Jan. 16.

The IRS in 2009 is again offering free tax preparation and filing through the Free File program. Anyone with an adjusted gross income up to $56,000 can use the standard Free File options this year – that is approximately 98 million taxpayers. The program is also easier to use, including a standardized set of electronic forms that are most frequently used by Free File-eligible taxpayers.

This year, the IRS and its partners are offering a new option, "Free File Fillable Tax Forms" that opens up Free File to virtually everyone, even those whose incomes exceed $56,000.

Free File Fillable Forms allows taxpayers to fill out and file their tax forms electronically, just as they would on paper. This option does not include an "interview" process like the traditional Free File offerings, but it does allow taxpayers to enter their tax data, perform basic math calculations, sign electronically, print their returns for recordkeeping and e-file their returns. It may be just right for those who are comfortable with the tax law and don't need assistance completing their returns or those who use electronic software to prepare their returns but nevertheless file using paper forms.

Both the fillable-forms option and the previously available Free File offerings are available only through IRS.gov.

1040 Central

On one last point, I request the assistance of the Subcommittee in getting one critical message out to your constituents – the fastest way to get information from the IRS or to get questions answered is IRS.gov. When taxpayers visit IRS.gov this filing season, taxpayers may notice the new "rotating spotlight" feature on the homepage. The *spotlights*, which change every few seconds, give the taxpaying public direct access to more of the vast amount of content available to them on our web site

Also on the homepage, taxpayers can click on *1040 Central* to find help preparing and filing their tax returns. Like last year, this popular section of IRS.gov has a wide range of offerings that address taxpayer needs.

Finally, the IRS is producing a number of podcasts this filing season that will be available on IRS.gov. In addition to Tax Tips, Fact Sheets and News Releases, these short audio interviews cover a wide range of topics and are a way for the IRS to reach out to a new generation of taxpayers.

Summary

Thank you again, Mr. Chairman, for the opportunity to testify this morning. The IRS is committed to assist America's taxpayers in any way it can during this difficult time. We understand that given the fragile state of the economy and the financial duress of many individuals, we may need to go even further. You have my commitment and that of Commissioner Shulman to work closely with you as we move forward.

I would be happy to respond to your questions.

Chairman LEWIS. Well, thank you very much, Ms. Stiff. Your testimony and we would look forward to ongoing relationship and continue to work with you.

Now it is my pleasure to introduce the national taxpayer advocate, Ms. Nina Olson.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

Ms. OLSON. Thank you, Mr. Chairman, Ranking Member Boustany, and Members of the Subcommittee.

Thank you for inviting me to testify today about the challenges facing financially struggling taxpayers. The IRS itself faces a difficult challenge in trying to balance its mission of collecting tax revenue with the fair and compassionate treatment of taxpayers who for whatever reason are unable to pay their tax bills. The nature of this challenge is no different in a recession, but the number of affected taxpayers is obviously much greater.

The IRS has many tools available to help these taxpayers and it is now more important than ever that it use these tools appropriately and compassionately. The general premise under which the IRS operates is that taxpayers should pay the full amount of the tax liabilities they owe, but there are times when taxpayers experience financial difficulties and can't reasonably pay their tax liabilities in full. This may happen if a taxpayer has lost a job, become disabled, or experiences some other financial setback. When this happens, the IRS' goal should be to collect as much of the tax as possible without imposing an undue financial burden on the taxpayer or the taxpayer's family.

IRS methods for establishing the priority of collection cases has traditionally placed primary emphasis on those cases with the greatest total dollar amounts of tax debts. As a result, many collection accounts do not receive adequate attention until penalties and interest equal or exceed the underlying tax due and the total tax bill is so large the taxpayer can't ever fully pay. This situation occurs against a backdrop of what I would characterize as an institutional aversion to any collection method that results in collection of less than a hundred percent of the tax the IRS believes is owed.

Consider the following. At the end of fiscal year 2008 there were more than 2.6 million taxpayers with delinquent accounts or accounts reported not collectible because the taxpayer had no current means to pay the tax liability. In that same fiscal year, the IRS accepted only 10,677 offers in compromise and entered into 22,000 partial payment installment agreements. In other words, combined, one out of every 78 taxpayers with a delinquent account was granted one of these collection alternatives. It is clearly not the case that 77 out of every 78 taxpayers with delinquent accounts were unwilling to deal with the IRS. Rather, despite explicit congressional support for collection alternatives, the IRS has made these options too inaccessible for taxpayers to obtain.

I am also concerned the IRS does not proactively identify taxpayers who may be experiencing economic hardship. Today, for example, the IRS automatically levies 15 percent of the monthly Social Security benefits of taxpayers who owe Federal taxes without any screen for low income tax payers or others who might be

harmed as a result of the levy. This year, my research function developed a model for identifying these taxpayers. Our study showed that over one-third of taxpayers subject to an ongoing Social Security levy would likely be classified as unable to pay based on current IRS allowable expense guidelines, and that more than one quarter of these taxpayers had incomes at or below poverty levels.

To minimize harm to economically distressed taxpayers and improve collection processes, I recommend that the IRS allocate resources to provide earlier intervention on delinquent accounts, make collection alternatives more accessible to appropriate taxpayers, and implement a hardship screen for Social Security levies. I also recommend that congress increase the authorization for low income tax payer clinic funding to $12 million and explicitly authorize the IRS to refer taxpayers to IRS-funded clinics, so that in these difficult times low income tax payers can obtain assistance in tax disputes.

Another important issue: taxpayers whose lender forgives their obligation to pay all or some of a debt may face serious tax consequences, since the Tax Code requires them to include the amount of debt forgiveness in gross income. There are exceptions to this cancelation of this debt income rule, including when the taxpayer is insolvent or the debt relates to certain home mortgages. But the terms of these exclusions are complex. Few taxpayers know what the word "insolvent" means, and taxpayers use their home mortgage proceeds for purposes other than buying or improving their homes; for example, to consolidated credit card debt or pay education expenses are not eligible for the recently enacted home indebtedness exclusion.

To reduce burden these rules impose on financially struggling taxpayers I recommend that congress consider adding an exclusion in sections 108(a) of the Code, which provides that taxpayers are not required to include canceled debts in gross income if the total amount of the canceled debts from all sources during the year falls below a specified threshold and we no longer require these taxpayers to file a very complex form 982.

I appreciate your interest in these issues, and I would be pleased to answer any questions you may have.

[The statement of Ms. Olson follows:]

WRITTEN STATEMENT OF

NINA E. OLSON
NATIONAL TAXPAYER ADVOCATE

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON

TAX COMPLIANCE CHALLENGES FACING FINANCIALLY STRUGGLING TAXPAYERS

FEBRUARY 26, 2009

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Chairman Lewis, Ranking Member Boustany, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today about the challenges facing financially struggling taxpayers.[1] The IRS itself faces a difficult challenge in balancing its mission of collecting the tax revenue that our government requires to function with the fair and compassionate treatment of taxpayers who, for whatever reason, are unable to pay their tax bills. The nature of the challenge is no different in a recession, but the number of affected taxpayers is obviously much greater. The IRS has tools it can use to help these taxpayers, and it is now more important than ever that it use these tools appropriately and compassionately.

I applaud Commissioner Shulman and Deputy Commissioner Stiff for the sensitivity the IRS has shown toward the challenges financially distressed taxpayers are experiencing and for announcing plans to show flexibility in certain collection matters.[2] In my testimony today, I will identify a number of obstacles that place burdens on financially struggling taxpayers, and I will propose administrative and legislative solutions.

A. Issues Affecting Financially Struggling Taxpayers

1. Early intervention in collection cases is efficient and benefits taxpayers, but IRS case assignment practices do not promote early intervention.

IRS methods for establishing the priority of collection cases have traditionally placed primary emphasis on the aggregate dollar amounts of the delinquencies.[3] For example, a taxpayer owing $100,000 will typically receive higher priority than one owing $10,000, while the latter taxpayer will generally be considered a much higher priority than one owing $1,000. While the type of tax at issue may affect the priority of a case – for example, a case involving employment taxes may receive more priority consideration than one involving income taxes – we believe that the age of the account often does not receive appropriate weight in determining its priority, which in turn plays a critical role in deciding which cases receive personal contacts from IRS collection personnel. As a result, many collection accounts do not receive adequate

[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] IRS News Release, IRS Begins Tax Season 2009 with Steps to Help Financially Distressed Taxpayers; Promotes Credits, e-File Options, IR-2009-2 (Jan. 6, 2009).

[3] IRS Small Business/Self-Employed Division, *Risk Based Collection* (Mar. 2006).

attention because the taxpayer does not owe "enough" delinquent taxes – at least not yet.

It is widely accepted in the business community that accounts receivable become much more difficult to collect the longer they remain delinquent. According to a study by Dun & Bradstreet, the probability of collecting a payment 90 days past due declines by 12 percent for each additional 30-day period.[4] A survey of members of the Commercial Collection Agency Section of the Commercial Law League of America, completed in June 2001, indicates that generally, if an account is 90 days delinquent, only 73 percent of the debt will be collected; at six months only 50 percent will be collected; at 12 months the figure falls to 25 percent; and at 24 months, only 10.5 percent will be collected.[5] In fact, the IRS has also recognized and validated this "collectibility curve" in a number of studies.[6] These studies acknowledge that on tax debts that are 24 months past due, the IRS typically collects approximately 13 cents on the dollar, and tax debts become practically uncollectible after three years.

In addition to the problem of accounts becoming stale and less likely to be collected in full, the amount of tax owed tends to "pyramid" due to the accumulation of interest and penalties the longer it is outstanding. Interest generally accrues on delinquent tax accounts at the federal short-term rate plus three percentage points, is *compounded daily*, and applies to penalties and interest as well as the outstanding tax balance itself. Failure-to-pay penalties accrue at 0.5 percent per month up to 25 percent of the delinquent balance.[7] When balance due accounts are not addressed and resolved timely, it is not uncommon for penalties and interest to equal or exceed the original delinquencies. Such additional liabilities can make it very difficult for taxpayers to pay both their delinquent taxes and their current liabilities. This situation occurs against a backdrop of unavailability of collection alternatives, as described below.

The IRS generally uses an "assembly line" approach to collection cases, starting with a preset number of automatically generated written notices, followed by assignment to the Automated Collection System, followed by placement in a queue for assignment to field personnel. However, this approach has produced less than desirable results. Consider the following:

Of all taxpayer delinquent accounts the IRS reported in "active" inventory at the end of FY 2008, 49 percent of the individual taxpayer accounts involved two or more delinquent tax years, and 39 percent of the business taxpayer accounts involved three

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[4] *See* David Shor & Martin Shor, *How to Collect Debts and Still Keep Your Customers* at 51 (1999).

[5] *Collection Trends*, *available* at www.proconsrv.com/colltrends.htm.

[6] IRS/Booz-Allen & Hamilton, *SB/SE Collections Quick Hits Approach and Preliminary Findings* 30 (Mar. 27, 2001); IRS, Automated Collection System Operating Model Team, Collectibility Curve (Aug. 5, 2002).

[7] IRC § 6651(a)(2).

or more delinquent tax periods.[8] Additionally, 80 percent of delinquent modules involved tax periods in the years 2005 and prior.[9] In light of the IRS's "collectibility curve," it is not surprising that the IRS reported nearly $20 billion as not collectible in FY 2008 – significantly more delinquent tax dollars than were collected on taxpayer delinquent accounts, installment agreements, and offers-in-compromise combined.[10] The traditional IRS inventory delivery methods for collection accounts are not delivering optimal results in the collection of delinquent revenue or in providing timely service to taxpayers with collection problems.

I recommend that the IRS allocate its resources to provide earlier intervention, in the form of personal or other meaningful contact by IRS employees, in collecting delinquent taxpayer accounts.

2. IRS procedures discourage the use of collection alternatives like offers-in-compromise and partial-payment installment agreements, even in cases where taxpayers cannot pay the full amount of their tax liabilities.

The general premise under which the IRS operates is that taxpayers should pay the full amount of the tax liabilities they owe. In my view, this general premise is correct. But there are times when taxpayers experience financial difficulties and cannot reasonably pay their tax liabilities in full – or sometimes even at all. This may happen if a taxpayer has lost a job, becomes disabled, or experiences some other major financial setback. When this happens, the IRS's goal should be to collect as much of the tax as possible without imposing an undue financial burden on the taxpayer or the taxpayer's family.

Congress has given the IRS two important collection alternatives to use in working with financially struggling taxpayers. One is the "offer-in-compromise" in which the IRS agrees to settle a tax liability for less than the full amount owed.[11] Offers based on collectibility concerns are a good deal for taxpayers because, while they require taxpayers to pay their tax obligations to the extent they are able, they give taxpayers the opportunity to make a fresh start, removing the threat of enforced IRS collection actions that otherwise would be hanging over their heads for the next decade. Offers can also be a good deal for the government because they bring in as much revenue as

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[8] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-2/242, Taxpayer Delinquent Account Cumulative Report* (Sept. 28, 2008).

[9] *Id.*

[10] *Id.* ($19,992,535,770 was reported as "currently not collectible" in FY 2008); *Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report* (Sept. 28, 2008); *Collection Activity Report NO-5000-106, Report of Offer in Compromise Activity* (Sept. 29, 2008); *Collection Activity Report NO-5000-149, Recap of Accounts Currently Not Collectible Report* (Sept. 27, 2008).

[11] IRC § 7122. The IRS accepts offers based on three grounds – doubt as to collectibility, doubt as to liability, and effective tax administration (including equity, public policy, and economic hardship concerns).

is feasible and, very importantly, they contain a contractual term that requires the taxpayer to remain in full compliance with the tax laws for the following five-year period.[12] If the taxpayer does not comply with the contract terms, the IRS may place the offer into default, which will cause the original tax liability (minus any payments made) to be reinstated in full.[13] One study showed that about 80 percent of individual taxpayers with accepted offers remained substantially compliant for the five-year period.[14] Importantly, the offer-in-compromise program also gives taxpayers confidence that the government will deal with them fairly and compassionately. It reassures the public that the government will not put them out on the street or require them to live without the ability to meet basic living expenses.

A second collection alternative is the partial-payment installment agreement.[15] Partial-payment installment agreements may be used when a taxpayer cannot fully pay a tax debt during the 10-year collection statute of limitations but has the ability to pay a portion of the debt in installments. The IRS is required to review partial-payment installment agreements every two years and may require the taxpayer to make larger monthly payments if it determines that the financial condition of the taxpayer has significantly improved.[16] Absent such a significant improvement, however, the taxpayer will continue to make payments under the agreement until the collection period expires.

Congress has made its support for collection alternatives explicit. In 1998, the conference committee report accompanying the IRS Restructuring and Reform Act made the following statement about offers-in-compromise:

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[12] *See* IRS Form 656, *Offer in Compromise*, § V(d) (Feb. 2007).

[13] IRM 5.19.7.3.20 (Jan. 16, 2009); IRM 8.23.3.13(2) (Oct. 16, 2007).

[14] Internal Revenue Service, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). As noted, offers can also be beneficial from a revenue standpoint. In FY 2007, accepted offers generated 17 cents for every dollar owed. Internal Revenue Service, *Offer in Compromise Program, Executive Summary* (Aug. 13, 2007). By contrast, IRS research indicates the IRS has historically collected only 13 cents for every $1 owed on debts that are two years old and virtually nothing on debts that have been outstanding for three years or more. Internal Revenue Service, *Automated Collection System Operating Model Team, Collectibility Curve* (Aug. 5, 2002). An IRS study of rejected offers that subsequently were deemed "currently not collectible" (CNC) found that 27 percent of the cases involving individuals and 49 percent of the cases involving businesses were already in CNC status at the time the offers were rejected. Internal Revenue Service, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). In other words, the IRS rejected the taxpayer's offer to pay something, and often ended up with nothing.

[15] IRC § 6159. Prior to 1998, the IRS administratively entered into partial-payment installment agreements. In 1998, the IRS Office of Chief Counsel issued a memorandum concluding that partial-payment installment agreements were not permissible under the law. Thus, from that time until October 22, 2004, installment agreements were available only if taxpayers paid their tax liabilities in full. In the American Jobs Creation Act, Congress authorized partial-payment installment agreements. *See* Pub. L. No. 108-357, § 843(a)(1), 118 Stat. 1418, 1600 (2004); H.R. Rep. No. 108-755 at 649 (2004) (Conf. Rep.).

[16] IRC § 6159(d).

> The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.[17]

Similarly, the House report relating to the American Jobs Creation Act made the following statement about partial-payment installment agreements:

> The Committee believes that clarifying that the IRS is authorized to enter into installment agreements with taxpayers that do not provide for full payment of the taxpayer's liability over the life of the agreement will improve effective tax administration.
>
> The Committee recognizes that some taxpayers are unable or unwilling to enter into a realistic offer-in-compromise. The Committee believes that these taxpayers should be encouraged to make partial payments toward resolving their tax liability, and that providing for partial payment installment agreements will help facilitate this.[18]

Yet despite this clear direction from Congress, the IRS Collection function possesses what I would characterize as an institutional aversion to any collection method that results in collection of less than 100 percent of the tax the IRS believes is owed. Consider the following:

- At the end of FY 2008, there were 2,600,437 taxpayers with delinquent accounts or accounts reported not collectible because the taxpayer had no current means to pay the tax liability (excluding cases received during the second half of the year).[19]
- In FY 2008, the IRS accepted 10,677 offers in compromise.[20]

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[17] H.R. Rep. No. 105-599, at 289 (1998) (Conf. Rep.).

[18] H.R. Rep. No. 108-548, pt. 1, at 307 (2004).

[19] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-2, Taxpayer Delinquent Account Cumulative Report* (FY 2007 and FY 2008). To arrive at this total, we started with the number of taxpayers with Taxpayer Delinquent Accounts at the beginning of the year, added additional cases received during the first six months of the year, and subtracted all taxpayer account dispositions except currently not collectible (CNC) hardship dispositions. For purposes of this calculation, we excluded accounts that became delinquent during the second half of FY 2008, as the IRS would not necessarily have had an opportunity to work those cases. Overall, the inventory of delinquent accounts at the end of FY 2008 stood at 4,001,260.

[20] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108, Monthly Report of Offer in Compromise Activity FY 2008 Cumulative Through September – National Total.*

- In FY 2008, the IRS entered into 22,555 partial-payment installment agreements.[21]

In other words, one out of every 244 taxpayers with a delinquent account received an offer-in-compromise, and one out of every 115 taxpayers with a delinquent account received a partial-payment installment agreement. Combined, one out of every 78 taxpayers with a delinquent account was granted one of these collection alternatives.[22]

It is clearly the case that some taxpayers are unresponsive to IRS notices out of fear, preoccupation with other problems, or in certain circumstances a willful desire to flout the law. But it clearly is not the case that 78 out of every 79 taxpayers with delinquent accounts are unwilling to deal with the IRS. Rather, the IRS has made collection alternatives too inaccessible for taxpayers to obtain.

Consider the offer-in-compromise program. In 2001, the IRS centralized the evaluation of offers-in-compromise, shifting responsibility from Collection field personnel to IRS campuses. The IRS also instituted more rigorous requirements for the processing and consideration of offers out of concern that it was receiving too many frivolous offers.[23] If the IRS's assumption that it was receiving excessive frivolous offers was correct and the procedures it instituted to reduce the number of frivolous offers were effective, one would expect that the number of offers received would have declined and the number of accepted offers would have remained relatively constant.

Yet the data tell a very different story. The number of offers the IRS receives has, indeed, declined – from 125,390 in FY 2001 to 43,989 in FY 2008, a drop of 65 percent. But the number of accepted offers, far from remaining constant, has declined even more – from 38,643 in FY 2001 to 10,677 in FY 2008, a drop of 72 percent. In FY 2001, the IRS accepted 34 percent of offers, while in FY 2008, it accepted only 24 percent of offers.[24] These data suggest that the IRS has erected so many barriers that

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[21] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report* (FY 2008).

[22] The IRS makes installment agreements easily available to taxpayers who can pay their liabilities in full. In FY 2008, the IRS granted 2.6 million installment agreements. IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-6, Installment Agreement Cumulative Report*. Thus, partial-payment installment agreements constituted less than one percent of all installment agreements granted.

[23] The IRS Form 656, *Offer in Compromise*, package is now nearly four times as long as it was before the program was centralized, increasing from 12 pages in 1997 to 44 pages today. Combined with information about the program on the IRS website, the current application and accompanying instructions measure nearly a half inch thick.

[24] The percentage of accepted offers is computed by dividing the number of offers accepted by the number of offer dispositions. See accompanying chart on page 8.

it has actually deterred valid offers at a higher rate than it has deterred frivolous offers.[25]

Legislation enacted in 2006 has further discouraged taxpayers from submitting offers.[26] Under IRC § 7122(c)(1), taxpayers requesting offers in compromise must now generally provide significant down payments at the time they submit their offers. In the case of a lump-sum offer, the taxpayer must make a down payment of 20 percent of the offered amount. In the case of a periodic payment offer, the taxpayer must make an initial installment payment with the offer and must continue to make the proposed installment payments during the pendency of the offer. Taxpayers whose incomes do not exceed 250 percent of the poverty level are eligible for a waiver from the down payment requirement.[27]

In 2007, the Taxpayer Advocate Service conducted a research study to assess the impact of the down payment requirement.[28] The study analyzed a representative sample of more than 400 offers that the IRS accepted in the months just before the 20 percent requirement took effect. Among the principal findings were that 56 percent of taxpayers whose offers were accepted and who made lump-sum payments obtained the funds from family members and friends. While family and friends may be willing to help a taxpayer get straight with the IRS, they are probably much less willing to provide funds for taxpayers to make down payments on offers that are unlikely to be accepted – and fewer than one in four offers is, in fact, accepted. Thus, not surprisingly, the number of offers received by the IRS fell by 21 percent from FY 2006 to FY 2007 as the down payment requirement took effect. The following table illustrates the sharp decline in the number of offers received and accepted.

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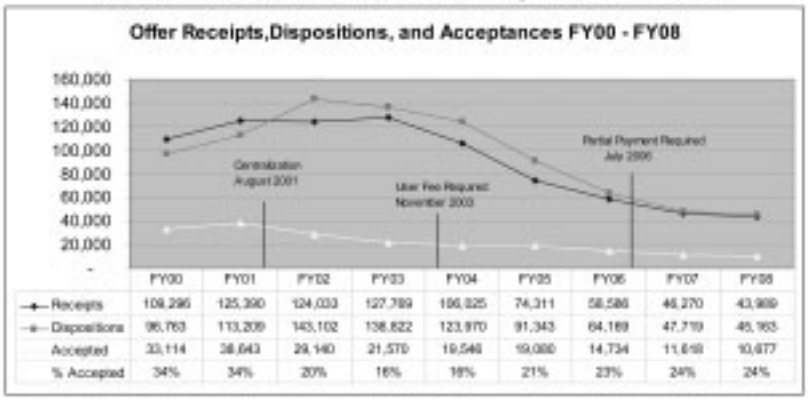
[25] In most cases, the IRS did not make a final decision to accept or reject the offer – 29 percent of offers were returned, 10 percent were determined to be not processable, and 10 percent were withdrawn or terminated. Thus, the barriers are so high that not only is it difficult to get an offer accepted, but most taxpayers who submit offers do not even receive a decision based on the merits of the case. Compare IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108, Monthly Report of Offer in Compromise Activity Cumulative through September 2001 with* IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108, Monthly Report of Offer in Compromise Activity Cumulative through September 2008*.

[26] Tax Increase and Prevention Reconciliation Act of 2005, Pub. L. No. 109-222, § 509, 120 Stat. 345, 362 (2006).

[27] *See* IRS Fact Sheet, 2007-16, *Revisions to Form 656, Offer in Compromise, available at* http://www.irs.gov/newsroom/article/0,,id=168404,00.html (last visited Feb. 23, 2009). For this purpose, the poverty guidelines issued annually by the Department of Health and Human Services are used.

[28] National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 (Research Report: *Effect of Tax Increase and Prevention Reconciliation Act of 2005 on IRS Offer in Compromise Program*).

IRS OFFER-IN-COMPROMISE PROGRAM, FY 2000 - FY 2008[29]



	FY00	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08
Receipts	109,296	125,390	124,033	127,789	106,025	74,311	58,586	46,270	43,989
Dispositions	96,763	113,209	143,102	138,822	123,970	91,343	64,169	47,719	45,165
Accepted	33,114	38,643	29,140	21,570	19,546	19,080	14,734	11,618	10,677
% Accepted	34%	34%	20%	16%	16%	21%	23%	24%	24%

As a result of the administrative and legislative obstacles that have been erected, I hear regularly from tax practitioners who say they have given up on the offer-in-compromise program as essentially a dead letter. Moreover, tax professionals tell me that given the low possibility of the IRS accepting an offer, they are advising their clients to file for bankruptcy. When that happens, the IRS generally will collect less than through the offer-in-compromise.

While the history of the partial-payment installment agreement program is much briefer, the aggregate data indicate that it, too, is not widely utilized. Indeed, most taxpayers and many practitioners are not even aware it exists.

What has the IRS done instead with respect to taxpayers with delinquent accounts? In FY 2008, it placed one million taxpayers into "currently not collectible" status – meaning that the IRS is collecting nothing at all[30] – and it took traditional enforcement actions about 3.4 million times, imposing 2,631,038 levies, placing 768,168 liens, and conducting 610 property seizures.[31]

IRS data show that greater use of traditional enforcement tools like liens and levies does not have a significant impact on overall collection. For example, the number of levies the IRS has imposed plummeted from 3,659,000 in FY 1997 just before the IRS Restructuring and Reform Act of 1998 (RRA '98), to 220,000 in FY 2000, and then

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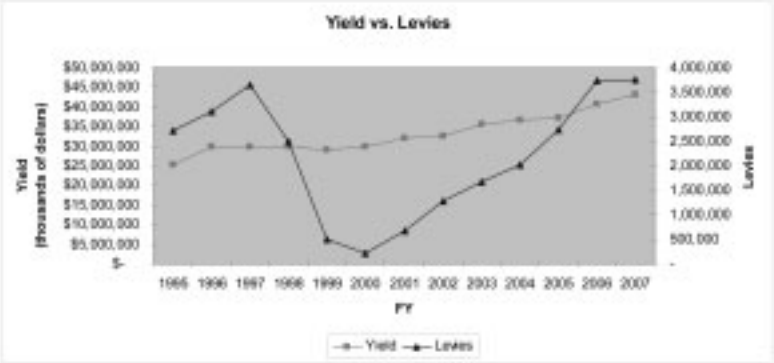
[29] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108* (FY 2000-FY 2008).

[30] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-149* (Sept. 2008).

[31] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-23* (Sept. 2008).

climbed back up to 3.76 million in FY 2007.[32] Yet the IRS collection yield has risen on a slow, relatively consistent and gradual path over that period of time with no discernable revenue loss resulting from the post-RRA '98 reduction in levies, as shown by the following chart.

TOTAL COLLECTION YIELD AND LEVIES ISSUED, FY 1995 – FY 2007



Simply stated, this chart shows no correlation between the number of levies issued and the collection yield. It also is not clear from this information whether the IRS is using its levy authority in the most appropriate instances. For example, I discuss the Federal Payment Levy Program below and address its impact on low income taxpayers. Separately, however, it is worth noting that the Treasury Inspector General for Tax Administration recently found that in order to place these levies, the IRS is paying fees to the Treasury Department's Financial Management Service (FMS) that come to 51 percent of the levy proceeds the IRS receives in certain low-dollar cases.[33]

There is no doubt that collection alternatives are a good option for financially struggling taxpayers, and some of the data I have cited suggests that collection alternatives may also be a good deal from a revenue collection standpoint. In 2001, it may have been fair to ask the question: "How can we reduce the number of frivolous offers?" But in light of what has happened with the offer program, it is now time to ask the question: "How can we increase the number of appropriate offers?"

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[32] *See* IRS Small Business/Self-Employed Division Research, *Liens, Levies, Seizures, and Total Yield: 10 Year Filing Trend* (Aug. 19, 2006); IRS Statistics of Income Data Books, Table 16 – Delinquent Collection Activities.

[33] Treasury Inspector General for Tax Administration, Ref. No. 2008-40-031, *The Federal Payment Levy Program Needs to Reduce Taxpayer Burden and Maximize Revenue* (Feb. 20, 2009).

I am pleased to report that the IRS has committed to working with my office to conduct a comprehensive review of the offer process, to revise its procedures to encourage qualified taxpayers to submit offers, and to refine its acceptance standards to accept more valid offers.

I recommend (1) that the IRS take steps to make collection alternatives more accessible to appropriate taxpayers and (2) that Congress consider suspending the 20 percent down payment requirement so that we can assess whether revamped IRS procedures can block frivolous offers while soliciting more valid offers.

3. Taxpayers are subject to levy on their Social Security benefits with no filter in place to determine whether such levies will cause economic hardship.

The Federal Payment Levy Program, which I will refer to as the FPLP, was established by Congress in 1997.[34] It enables the IRS to continuously levy up to 15 percent of certain federal payments made to delinquent taxpayers. These levies most commonly attach to Social Security Administration payments. In fact, of the more than two million FPLP levy payments the IRS received from taxpayers in 2008, more than 83 percent were from Social Security benefits.[35]

FPLP levies on Social Security benefits are not one-time attachments. FPLP levies may continue until the entire amount of the federal tax debt is repaid, other payment arrangements are made, or the debt becomes unenforceable by law.

Until 2005, the IRS used a filter to prevent low income taxpayers from being subjected to FPLP levies on their Social Security payments. However, a report published by the Government Accountability Office (GAO) in 2003 questioned the effectiveness of the low income filter,[36] which relied on the taxpayer's Total Positive Income from the last filed return as its sole measure of a taxpayer's financial situation.[37] The GAO observed that most taxpayers had not filed a recent return and that the income

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[34] Taxpayer Relief Act, Pub. L. No. 105-34, § 1024, 111 Stat. 788, 923 (1997); IRC § 6331(h).

[35] *See* IRS, Wage and Investment Division spreadsheet, *FPLP Monthly Counts*, FY 2008 [1,797,530 (total number of FPLP Social Security Administration levy payments received in fiscal year 2008) / 2,161,974 (total number of all FPLP levy payments received in FY 2008) = 83 percent].

[36] General Accounting Office, GAO 03-356, *Tax Administration, Federal Payment Levy Payment Program Measures, Performance and Equity Can Be Improved* (2003). The name of the "General Accounting Office" has since been changed to the "Government Accountability Office."

[37] Total Positive Income is calculated by adding the positive values from the following income fields from a taxpayer's most recently filed individual tax return: wages; interest; dividends; distributions from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero. For a more detailed discussion of this filter, see National Taxpayer Advocate 2005 Annual Report to Congress 123-135, National Taxpayer Advocate 2004 Annual Report to Congress 246-263, National Taxpayer Advocate 2003 Annual Report to Congress 206-212, and National Taxpayer Advocate 2001 Annual Report to Congress 202-209.

information was therefore not reliable. The GAO report also noted that the filter failed to recognize that taxpayers might have other assets that could satisfy the tax liability. As a result, the IRS stopped using the filter even though the report did not explore the effect of the FPLP levies on taxpayers who are unable to afford the levy. Since the removal of the low income filter, TAS's FPLP cases have increased by more than 500 percent.[38]

The report published in Volume Two of my 2008 Annual Report to Congress documents TAS Research's design, development, and preliminary testing of an improved screening model that could determine whether the FPLP levy will cause a taxpayer economic hardship. The new TAS model uses taxpayers' income information from filed individual income tax returns and payor documents filed with the IRS, such as Forms W-2 and Forms 1099 for pension, capital gains, dividend and interest income, to estimate the taxpayer's income.

Next, the TAS model uses other tax return data to estimate expenses routinely allowed by the IRS when determining a taxpayer's ability to pay. The TAS model then compares these two amounts to determine whether the FPLP levy on the taxpayer's Social Security benefits will cause the taxpayer to suffer economic hardship. In additional testing of the model, TAS Research looked at how results differ when the 2008 allowable living expense guidelines are used compared to results using the 2006 guidelines as well as differences that emerge when the 2008 poverty level is used as a filter in lieu of using the 2008 allowable living expense guidelines.

The TAS study also examined the availability of other assets to satisfy the tax liability. In addition to looking for the presence of real property, as suggested by the GAO, TAS Research reviewed cases for the presence of more liquid assets by estimating underlying principal amounts from reported interest, dividends, and capital gains.

TAS Research's findings show that the use of data already in the possession of the IRS appears sufficient to accurately determine whether FPLP levies will cause economic hardship to Social Security recipients. The following are some of the most significant conclusions from the report:

- Over one-third of all FPLP cases subject to an ongoing FPLP levy would likely be classified as unable to pay based on current IRS allowable living expense guidelines.

- TAS estimates that more than one-quarter of FPLP taxpayers who paid their tax liabilities, entered into installment agreements with the IRS, or were subject to an ongoing FPLP levy had incomes at or below the poverty level.

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[38] TAS FPLP cases increased from 525 in FY 2004 to 3,222 in FY 2008. Taxpayer Advocate Service, *Business Performance Management System* (Sept. 2008).

- Most taxpayers with small liabilities endured the FPLP Social Security levy even though their incomes showed an inability to pay, suggesting that they may have foregone some basic living expenses.

- Although the 2008 allowable living expense standards are typically more generous than the 2006 standards and classified more taxpayers who paid or established installment agreements as being unable to pay, our financial analysis suggests that most of these taxpayers still had incomes at or below the poverty level.

- An analysis of taxpayer assets located by a third-party data source shows that the IRS has sufficient tax data to determine if many of these taxpayers have assets that may be used to satisfy a tax delinquency.

In partnership with my office, the IRS is now in discussions with its programmers about the feasibility of implementing an allowable expense or alternative filter. Prior to implementation, I recommend that the IRS conduct a field test of the allowable expense filter we developed to determine its effectiveness in protecting low income Social Security recipients who are experiencing economic hardship from an FPLP levy while not unfairly filtering out taxpayers who have the wherewithal to pay their tax liabilities. During the test, financial information would be collected from taxpayers selected to participate. The results of this analysis could then be compared to results of the simulated financial analysis performed by the filter to determine its accuracy. If the field test verifies the accuracy of the allowable expense filter, the IRS should proceed to implement this filter to protect taxpayers from FPLP levies which would cause economic hardship.[39]

4. Taxpayers who cannot pay their debts in full may have taxable "cancellation-of-debt" income, meaning that they may obtain relief from their creditors only to find themselves faced with additional tax and a minefield of reporting obligations.

Under section 61(a)(12) of the Code, a taxpayer who is relieved of an obligation to pay all or a portion of a debt generally must include the amount of debt forgiveness in gross income. This "cancellation-of-debt" rule is subject to certain exclusions, such as where a taxpayer's debts are discharged in a bankruptcy proceeding or where (and to the extent that) a taxpayer is "insolvent," meaning that the taxpayer's total liabilities exceed the fair market value of the taxpayer's assets. In 2007, Congress added a new exclusion in the Mortgage Forgiveness Debt Relief Act. The new exclusion relieves homeowners who used mortgage proceeds to purchase, substantially improve, or

[39] The Treasury Inspector General for Tax Administration also recently recommended that the IRS reinstitute a filter to identify and exclude taxpayers for whom a levy would impose hardship. *See* Inspector General for Tax Administration, Ref. No. 2008-40-031, *The Federal Payment Levy Program Needs to Reduce Taxpayer Burden and Maximize Revenue* (Feb. 20, 2009).

refinance their principal residence from additional tax liability if all or a portion of their mortgage debt is canceled pursuant to a foreclosure or loan modification.[40] Taken together, the bankruptcy, insolvency, and mortgage exclusions are designed to provide relief from the cancellation-of-debt rules for financially struggling taxpayers.

However, two major sources of confusion prevent taxpayers from taking advantage of these relief provisions.[41] First, the terms of the exclusion are complex. Few taxpayers know what the word "insolvent" means. It is particularly difficult for taxpayers to figure out how to compute their total liabilities and the fair market value of their assets so they can determine whether they are insolvent and, if so, in what amount. Similarly, available data suggest that a majority of homeowners who have subprime mortgages used a portion of the loan proceeds for purposes other than acquiring, substantially improving, or refinancing their principal residence (*e.g.*, to pay off car loans, student loans, medical bills, credit card bills, or other consumer debt).[42] To the extent of the amount borrowed for these non-qualifying purposes, mortgage debt cancellation is not excludable from income.

Second, taxpayers who determine that they qualify to exclude an amount of debt cancellation from income must make certain basis and other tax attribute adjustments.[43] To do so, taxpayers must file Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*, with their returns. Form 982 is technically challenging, asking taxpayers to adjust, among other things, net operating losses, general business credit carryovers, minimum tax credits, net capital losses, nondepreciable and depreciable property, passive activity loss and credit carryovers, and foreign tax credit carryovers (although many non-business taxpayers do not have these tax attributes).

Unfortunately, very few taxpayers have heard of Form 982, and it is difficult to obtain assistance in filling it out. Many practitioners have never worked with the form, some tax software packages do not support it, and the subject of canceled debts is considered "out of scope" at Volunteer Income Tax Assistance (VITA) programs,

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[40] Pub. L. No. 110-142, 121 Stat. 1803 (2007).

[41] The Taxpayer Advocate Service has undertaken several initiatives to reduce this confusion and educate taxpayers and their representatives about the rules pertaining to cancellation-of-indebtedness income. First, TAS sponsored a program on this issue during the 2008 IRS Tax Forums. The program attracted so much interest that the IRS scheduled two sessions to accommodate interested practitioners. In both 2008 and 2009, the National Taxpayer Advocate recorded a series of podcasts – or "TAScasts" – on cancellation of indebtedness income. The 2008 materials are available on the electronic Tax Literacy Toolkit at http://www.taxtoolkit.irs.gov.

[42] According to a federal government report issued in 2000: "The primary purpose of over 50 percent of first lien subprime mortgages and up to 75 percent of second lien subprime mortgages is debt consolidation and/or general consumer credit, not home purchase, home improvement or refinancing the rates and terms of a mortgage." Department of Housing and Urban Development and Department of the Treasury Task Force on Predatory Lending, *Curbing Predatory Home Mortgage Lending* 26 (2000). We have not located more recent government data on this point.

[43] *See* IRC § 1017 and the regulations issued thereunder.

except with respect to the exclusion for qualified mortgage indebtedness. In tax year 2006, the IRS received at least 401,981 electronically filed returns from taxpayers with canceled debts reported on a Form 1099-C, yet only 4,571 of the returns were filed with Form 982 – just one percent.[44]

The consequences of failing to file Form 982 can be significant. When a lender cancels all or part of a debt, the lender generally is required to report the amount to the IRS on Form 1099-C, *Cancellation of Debt*. If the IRS receives a Form 1099-C and the taxpayer does not account for the amount on a tax return, the IRS's document-matching program will generally flag the disparity. If the IRS sends out notices and the taxpayer does not respond, the IRS may propose and assess tax.

To reduce the burden these rules impose on financially struggling taxpayers, I recommend that Congress (1) consider adding an exclusion in section 108(a) of the Code which provides that taxpayers are not required to include canceled debts in gross income if the aggregate amount of their canceled debts from all sources during the taxable year falls below a specified threshold and (2) make clear that taxpayers with canceled debt below the threshold amount are not required to make attribute adjustments (so that they do not have to file Form 982). I believe that many if not most taxpayers who default on consumer debts qualify under one of the existing exclusions, and even among taxpayers who do not fall within an exclusion, it is unlikely that the IRS collects much revenue from taxpayers who have just defaulted on other debts. Therefore, I believe the simplification benefits of this proposal are considerable, and I believe the revenue loss should be quite small.

5. Many taxpayers who are entitled to refunds and need them quickly do not receive them for weeks, driving them to purchase refund anticipation loans.

Federal tax refunds are a significant source of funds for many individual taxpayers, particularly low income taxpayers. For example, among taxpayers who received earned income tax credit (EITC) benefits and tax refunds in tax year 2006, the average refund amount was $3,184, and the average adjusted gross income was $15,763.[45] Thus, the average refund amounted to *20 percent* of each taxpayer's adjusted gross income. Yet if a taxpayer does not have a bank account into which a refund may be electronically deposited, the taxpayer may have to wait weeks to receive the refund. Because low income taxpayers often want or need their refunds quickly, this delay

[44] IRS Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File (Tax Year 2006); IRS E-File Report 1558 (Processing Year 2007). Note that the number of electronically filed returns actually was greater than 401,981 because the data only reflects Forms 1099-C issued to taxpayers listed with the primary taxpayer identifying number (TIN) on a tax return. It does not reflect cases where a spouse or a person whose TIN was listed as other than the primary TIN received a Form 1099-C. Note, too, that the data excludes returns filed on paper, which represent slightly less than half of all individual income tax returns filed. We could not determine how many Forms 982 were submitted with paper-filed returns.

[45] IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2006).

drives many of them to pay significant transaction fees to obtain refund anticipation loans (RALs). With a RAL, the taxpayer typically receives a loan (secured by a tax refund) within one day after the preparer files the tax return with the IRS.

If the IRS could deliver refunds more quickly, most taxpayers would probably forego RALs. According to a TIGTA survey, most taxpayers who obtained RALs would have been willing to wait seven or more days to receive their tax refunds from the IRS.[46]

For taxpayers who do not have bank accounts, I believe the IRS should issue stored value cards. The Financial Management Service (FMS) already uses stored value cards to distribute Social Security benefits, so the federal government has considerable experience working with the cards efficiently and with an eye toward preventing fraud. In addition, most states currently use debit cards to distribute unemployment benefits.[47] While using stored value cards to deliver tax refunds may require the IRS to work through additional issues, I am confident this can be done and can be done quickly. In fact, because stored value cards have routing and account numbers just like traditional checking and savings accounts, taxpayers who already have these cards for purposes of receiving their wages and salaries should be able to use them to receive tax refunds.

In addition, some taxpayers who have bank accounts do not know about the direct deposit option and also wait long periods to receive their refunds. The IRS has the capability to direct deposit refunds for problem-free returns processed through its Customer Account Data Engine system in five to seven days from the day the returns are submitted.[48] It appears that by processing returns more quickly, the IRS could steer taxpayers away from more expensive refund delivery options.[49]

I recommend that the Department of the Treasury and the IRS take the following steps:

- Evaluate the entire refund process to determine opportunities to shorten the turnaround time;

- Develop a pilot program to determine the impact on tax administration of modifying return processing procedures to release a Revenue Protection Indicator in the acknowledgement file and evaluate the feasibility of

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[46] Treasury Inspector General for Tax Administration, Ref. No. 2008-40-170, *Many Taxpayers Who Obtain Refund Anticipation Loans Could Benefit from Free Tax Preparation Services* (Aug. 29, 2008).

[47] *See* Associated Press, *States Issuing Jobless Benefits Debit Cards* (Feb. 20, 2009).

[48] IRS, Debt Indicator Report to Congress 26 (Oct. 31, 2006), as requested by H.R. Rep. No. 109-307 (2005) (Conf. Rep.).

[49] National Taxpayer Advocate 2008 Annual Report to Congress 430. Returns processed on IRS's older systems can be processed in 9-15 days. *Id.* at 427.

including such information in the current "Where's My Refund" online application;[50]

- Evaluate existing stored value card programs to distribute government benefits, with particular emphasis on the experience of FMS's Direct Express Program to distribute Social Security benefits;

- Promote and publicize the ability of taxpayers who already have stored value cards to designate those cards for receipt of refunds; and

- Develop a stored value card program to distribute refunds to individual taxpayers before the 2010 tax filing season.

I also recommend that Congress authorize the IRS to conduct an annual public awareness campaign to provide accurate information to taxpayers regarding available refund delivery alternatives, associated turnaround times, and any other pertinent information.

6. Taxpayers who are forced to tap into a retirement account because of financial hardship before age 59-1/2 face a bewildering array of rules that govern whether a hardship distribution from a particular type of retirement account is permissible and, if so, whether it is subject to the 10 percent additional tax on early withdrawals.

As more taxpayers are losing their jobs or otherwise facing financial emergencies, they are increasingly looking to tap into their retirement savings to provide for current needs. In 2006, approximately 5.1 million tax returns reported tax on such "early distributions" taken from retirement accounts.[51]

Some retirement plans allow participants to receive an early distribution in cases of financial hardship, such as a medical emergency. However, there is no uniform definition of "hardship" among the various retirement plans to enable a participant to easily determine when an early withdrawal is allowable.[52] Further, even if a plan allows for a hardship withdrawal, participants must deal with inconsistent rules for triggering the 10 percent additional tax for early withdrawal.[53]

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[50] For a detailed discussion of the proposed Revenue Protection Indicator, see National Taxpayer Advocate 2008 Annual Report to Congress 427-441.

[51] Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2006).

[52] For example, a hardship distribution in the section 401(k) context is defined in terms of the heavy financial need of the employee. *See* Treas. Reg. § 1.401(k)-1(d)(3). Compare that with a hardship distribution in the section 457 context, which is defined as a general financial hardship of the participant or beneficiary resulting from illness, accident, loss of property due to casualty, or other extraordinary and unforeseeable emergency. *See* Treas. Reg. § 1.457-6(c)(2).

[53] *See* IRC § 72(t)(1).

Assume that a 50-year-old retirement-plan participant suffers a medical emergency that will require him to miss six months of work. Assume further that he incurs $15,000 in medical expenses and estimates that his living expenses for the six months while he recovers from surgery will be $20,000. Whether he will be able to receive a hardship distribution and whether the distribution will be subject to the 10 percent additional tax on early withdrawals will depend on the type of retirement plan in which he is a participant.

If the worker was a participant in his employer's section 401(k) plan, the plan may allow a hardship withdrawal for his medical expenses, but not for his living expenses during the period when he is unable to work.[54] Hardship distributions from a section 401(k) plan generally are subject to the 10 percent additional tax for early withdrawal.[55] However, if the medical expenses satisfied certain requirements under section 213 and Treas. Reg. § 1.213-1(a)(1), the amount distributed for medical expenses would not be subject to the 10 percent additional tax.[56]

If, instead, the worker was a participant in a section 457(b) plan (which generally covers employees of state and local governments), he could make a hardship withdrawal for "unforeseeable emergencies." Severe financial hardship resulting from an illness or accident is considered to be an instance of unforeseeable emergency.[57] In contrast to section 401(k) plans, the 10 percent additional tax does not apply to a hardship withdrawal from a section 457(b) plan unless the amount distributed is attributable to a transfer from another plan.[58]

In further contrast, traditional individual retirement accounts (IRAs) can be distributed for any reason including due to hardship. A distribution taken from an IRA for medical expenses may be exempt from the 10 percent additional tax if the distribution is for medical expenses that satisfy the requirements of section 213. However, if the worker in our example withdraws funds from his IRA to pay for his living expenses while recovering from his illness, the 10 percent additional tax will apply to the amount withdrawn.

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[54] An early distribution may be made to a section 401(k) plan participant "upon hardship of the employee." *See* IRC § 401(k)(2)(B)(i)(IV). Applicable Treasury regulations provide that a distribution is made on account of hardship only if (1) the distribution is made due to an immediate and heavy financial need of the employee and (2) the distribution is necessary to satisfy the heavy need. *See* Treas. Reg. § 1.401(k)-1(d)(3)(i). An "immediate and heavy need" is determined using a facts and circumstances test under Treas. Reg. § 1.401(k)-1(d)(3)(ii). Expenses for medical care incurred by the employee, spouse, or certain dependents are included in the safe harbor definition of an immediate and heavy financial need. Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B)(1).

[55] *See* IRC § 72(t)(1).

[56] IRC § 72(t)(2)(B).

[57] Treas. Reg. § 1.457-6(c)(2).

[58] The 10 percent additional tax imposed by IRC § 72(t) does not apply to section 457(b) plans because a section 457(b) plan is not a "qualified retirement plan" as defined in IRC § 4974(c).

As this example illustrates, there is very little uniformity among the rules governing early withdrawals from retirement plans. This wide array of outcomes can seem impenetrable to taxpayers and grossly unfair. I recommend that Congress establish uniform rules regarding hardship withdrawals from retirement plans and exempt such distributions from the 10 percent additional tax.

7. Taxpayers are increasingly turning to Low Income Taxpayer Clinics for help, and increased funding for the program is needed.

Section 7526 of the Code authorizes the Secretary to make federal matching grants of up to $6 million (except if otherwise provided by specific appropriation) for the development, expansion, or continuation of qualified low income taxpayer clinics (LITCs).[59] This matching grant program was created as part of the IRS Restructuring and Reform Act of 1998 and provides a means for low income taxpayers (defined as taxpayers whose incomes do not exceed 250 percent of the poverty guidelines) to receive assistance in controversies with the IRS.[60] The program also funds LITCs to conduct tax education and outreach to taxpayers who speak English as a second language (ESL taxpayers).

The LITC Program fills a significant gap in tax administration. Through the Volunteer Income Tax Assistance (VITA) program, Tax Counseling for the Elderly (TCE), and the IRS's Taxpayer Assistance Centers, low income taxpayers have long been able to obtain free assistance in preparing their tax returns. However, these taxpayers often had nowhere to turn for help if the IRS questioned or challenged their returns.[61] The LITC Program is now in its 11th year and funds 163 clinics, with at least one in every state, the District of Columbia, and Puerto Rico.[62] The program is cost effective and provides extensive benefits to taxpayers because many of the clinics have created partnerships with local law and accounting firms that take referred cases on a *pro bono* basis. Thus, the clinics use the funding they receive not only to represent taxpayers themselves but also to expand the scope of coverage by enlisting the help of professionals in their communities who are willing to volunteer their time.

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[59] IRC § 7526 provides for matching grants of up to $100,000 per year for qualifying organizations that represent low income taxpayers involved in controversies with the IRS and that provide tax education and outreach to taxpayers who speak English as a second language. IRC § 7526 requires clinics to provide services for free or for no more than a nominal fee.

[60] The Department of Health and Human Services issues poverty guidelines each year that are used to determine financial eligibility for certain federal programs, including the LITC program. The 2009 Poverty Guidelines were recently published in the Federal Register. *See* 74 F.R. 4199 (Jan. 23, 2009).

[61] IRS Restructuring: Hearing Before the S. Comm. on Finance, 105th Cong. (Feb. 5, 1998) (statement of Nina E. Olson, Executive Director, Community Tax Law Project); Recommendations of the National Committee on Restructuring the IRS on Taxpayer Protections and Rights: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 105th Cong. (Sept. 26, 1997) (statement of Nina E. Olson, Executive Director, Community Tax Law Project).

[62] Of the 163 clinics funded for 2009, 46 provide only controversy representation, 20 provide only ESL outreach and education, and 97 provide both types of assistance. Seventy-four LITCs are located at nonprofit community-based organizations, 53 are legal aid societies, 28 are at law schools, and eight are at business or accounting schools.

A recent Taxpayer Advocate Service study demonstrates the importance of representation for low income taxpayers to enable them to obtain the correct result in an audit. A review of all EITC audits conducted by the IRS in 2004 found that taxpayers who were represented during the audit fared substantially better than unrepresented taxpayers, with nearly twice as many represented taxpayers found eligible for the EITC as compared with unrepresented taxpayers. Similarly, represented taxpayers retained, on average, 45 percent of the EITC as compared to 25 percent for taxpayers without representation – nearly twice as much.[63] This study demonstrates that representation during audits has concrete, positive results for low income taxpayers and ensures they are not denied tax benefits simply because they cannot navigate the audit process by themselves.

The current economic environment presents significant challenges because the number of taxpayers who cannot pay their liabilities is rising while available assistance from tax professionals is declining.[64] The decline in the availability of legal services is attributable to several factors. First, the decline in equity values has reduced the amount of funds that foundations and other endowments have available to distribute. Second, declining incomes and the rising need for social services have placed strains on state and local government budgets that ordinarily provide assistance for legal service programs. Third, the emphasis that law firms and lawyers traditionally place on performing *pro bono* services has declined; billable hours and surviving the next round of layoffs are the order of the day.[65]

The LITC program operates under the stewardship of the Office of the Taxpayer Advocate. TAS has established several goals for this program that it may not be able to achieve under current funding levels, including funding clinics in areas where there are significant unmet needs and establishing clinics in each state, the District of Columbia, Puerto Rico, and Guam that provide both *pro bono* controversy representation and ESL outreach. When the LITC Program was first created, Congress believed that annual funding of $6 million was sufficient to ensure that low income taxpayers had access to representation. Since the creation of the LITC Program, however, Congress has provided specific appropriations in excess of $6 million.[66]

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[63] See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 (Research Report: *IRS Earned Income Credit Audits – A Challenge to Taxpayers*).

[64] *See* Bill Myers, *Economic Collapse Will Affect Legal Aid to Poor*, The Washington DC Examiner, Feb. 17, 2009, at 4, *available at* http://www.dcexaminer.com/local/Economic-collapse-will-affect-legal-aid-to-poor-0217-39690412.html (stating that the deteriorating economy has created an "overwhelming demand for low-income legal assistance" while the challenges facing law firms are "eating away at the legal aid community's capacity to provide the services").

[65] *Id.*

[66] *See, e.g.*, Appropriations Act of 2006, Pub. L. No. 109-115, 119 Stat. 2396 (2005) (providing funding of $8 million); Consolidated Appropriations Act of 2008, Pub. L. No. 110-161, 121 Stat. 1844 (2007) (providing funding of $9 million).

To meet the increasing needs we are seeing, I recommend that Congress (1) increase the annual authorization amount specified in section 7526(c)(1) from $6 million to $12 million and (2) amend section 7526(c) to add a new provision stating that, notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section.[67]

B. Other Issues

There are four additional issues that do not relate exclusively to financially struggling taxpayers but that I believe deserve priority attention.

1. The Alternative Minimum Tax for individuals continues to baffle and frustrate taxpayers, and it is not good for taxpayers or the IRS to continue to provide one-year "patches."

I recognize that the enormous revenue consequences of repealing the AMT make its repeal outside the context of major tax reform unlikely. However, I believe strongly that the AMT is bad for the tax system, and I would be remiss if I did not raise the issue, at least in passing.[68]

The AMT concept, originally enacted in response to a report that 155 high-income taxpayers had paid no tax for the 1966 tax year,[69] now effectively requires taxpayers to compute their taxes twice – once under the regular rules and again under the AMT regime. The taxpayer is then generally required to pay the higher of the two amounts.[70]

While the AMT was originally conceived to prevent wealthy taxpayers from escaping tax liability through the use of tax-avoidance transactions, most of the significant tax loopholes that enabled taxpayers to escape tax at the time the AMT was written have long since been closed. For tax year 2006, it is estimated that 77 percent of the

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[67] The second change is needed to provide clarification in light of rules that prohibit IRS employees from referring taxpayers to specific attorneys or accountants and that prohibit all federal employees from endorsing any product, service, or enterprise. For a more complete discussion of this issue, see National Taxpayer Advocate 2007 Annual Report to Congress 551-553 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

[68] For additional information, see National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*) and prior reports cited therein.

[69] *See* The 1969 Economic Report of the President: Hearings Before the Joint Economic Comm., 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury). The forerunner of the AMT was an "add-on" minimum tax enacted in 1969.

[70] The AMT rules are contained in IRC §§ 55-59.

additional income subject to tax under the AMT was attributable not to any such loopholes, but simply to family size or residing in a high-tax state.[71]

Those factors give rise to AMT tax liability because the regular tax rules allow taxpayers to claim a deduction for each dependent (recognizing the costs of maintaining a household and raising a family) and a deduction for taxes paid to state and local governments (reducing "double taxation" at the federal and state levels), but the AMT rules disallow those deductions. Common sense suggests that Congress could not have viewed the act of having children or living in a high-tax state as a tax-avoidance technique. Yet to the chagrin of most observers, that is exactly how it has evolved.

Thus, while the concept of a minimum tax is not unreasonable, the AMT as currently structured has evolved into something that was never intended. The AMT hits taxpayers it was never intended to hit because its exemption amount has not been indexed for inflation; it penalizes taxpayers for such nontax-driven behavior as having children or choosing to live in a state that happens to impose high taxes; it takes large numbers of taxpayers by surprise – and subjects them to penalties to boot; it is very challenging to compute; it alters the distribution of the tax burden that exists under the regular tax system; it changes the tax incentives built into that system; it neutralizes the effects of changes to tax rates imposed under the regular tax rules; and it requires the IRS to divert resources from other priority work to re-program its computers each year to reflect changing exemption amounts that, as discussed immediately below, often are not set until very late in the year.

I urge Congress to repeal the Alternative Minimum Tax for individuals in the context of fundamental tax reform.

2. Late-year changes in the tax code present significant challenges for taxpayers and the IRS, particularly for low income and financially struggling taxpayers.

When Congress makes changes to the Internal Revenue Code late in the year, the IRS must scramble to reprogram its computers and take other necessary steps to implement the changes. These last-minute changes can delay the start of the filing season for a significant number of taxpayers. In general, the IRS begins to process tax returns on or about January 15. In 2006, however, the Tax Relief and Health Care Act was not signed into law until December 20, 2006.[72] This legislation affected tax benefits for more than 11 million taxpayers.[73] The IRS was not able to process returns

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[71] *See* Tax Policy Center, Tax Facts: AMT Preference Items 2002, 2004-2006 (citing unpublished tabulations from the Office of Tax Analysis, Department of the Treasury), *available at* http://www.taxpolicycenter.org/taxfacts/Content/PDF/amt_preference.pdf.

[72] Pub. L. No. 109-432, 120 Stat. 2922 (2006).

[73] For tax year 2006, IRS data show that more than 11 million taxpayers claimed the deduction for state and local sales taxes, more than 4 million taxpayers claimed the deduction for post-secondary tuition and fees, and more than 3.2 million taxpayers claimed the deduction for educator expenses. IRS

claiming those benefits until February 3, 2007, which amounted to approximately a three-week delay.[74] In 2007, the Tax Increase Prevention Act, which was not signed into law until December 26, 2007, raised the AMT exemption amounts for 2007 and extended an ordering rule that applies to personal tax credits.[75] The IRS was unable to process about 13.5 million returns claiming certain of those benefits until February 11, 2008, which amounted to approximately a four-week delay.[76]

Overall, more than 80 percent of individual taxpayers receive refunds when they file their returns,[77] and tax refunds are particularly important to low income taxpayers. Among taxpayers who received EITC benefits and tax refunds in tax year 2006, the average refund amounted to 20 percent of the taxpayer's yearly income.[78] A taxpayer for whom the refund is so significant often makes financial plans based on when he or she anticipates receiving the refund and may view the refund as a lifeline. For some taxpayers, a delay of two to four weeks in receiving the refund could mean eviction or inability to pay the high heating bills that arise during winter. Congress should be aware that delays in the start of the filing season can cause financial hardship for taxpayers who depend on receiving timely refunds, and for some taxpayers, the magnitude of the hardship can be significant.

In my 2007 Annual Report to Congress, I wrote at length about other problems associated with late-year tax-law changes.[79] In particular, I discussed data suggesting that taxpayers may miss deductions for which they qualify simply because they do not know about them. By the time the 2006 and 2007 changes discussed above were made, for example, the Form 1040 and accompanying instructions and shrink-wrapped software for the year at issue had already been finalized, and some taxpayers therefore did not find out about the changes.

The major challenges resulting from late-year tax-law changes in recent years have primarily involved the extension of expiring tax provisions. To ensure that Members of Congress understand the filing-season impact of deferring action on these so-called

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Statistics of Income, Individual Income Tax Returns (unpublished analysis as of December 2006). These deductions were authorized for Tax Year 2006 by the Tax Relief and Health Care Act, Pub. L. No. 109-432 (2006).

[74] *See* IRS News Release IR-2007-26, *IRS Begins Processing Returns Claiming Extender Deductions; Urges Taxpayers to File Electronically, Check on Phone Tax Refund* (Feb. 6, 2007).

[75] Tax Increase Prevention Act, Pub. L. No. 110-166, 121 Stat. 2461 (2007).

[76] *See* IRS News Release IR-2008-19, *IRS Successfully Processing Tax Forms Affected by AMT Legislation* (Feb. 14, 2008).

[77] In tax year 2006, the IRS received 138,893,908 Form 1040-series returns and issued 114,475,957 refunds. *See* IRS Data Book, 2007, Tables 3 and 7. Put differently, 80 percent of taxpayers had more tax withheld or paid more estimated tax than was required to satisfy their tax liabilities, and fewer than 20 percent of taxpayers owed a balance to the IRS at the time they filed their returns.

[78] IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2006).

[79] *See* National Taxpayer Advocate 2007 Annual Report to Congress 3-12 (Most Serious Problem: *The Impact of Late-Year Tax-Law Changes on Taxpayers*).

"extenders" until late in the year, I recommend that the Treasury Department and the tax-writing committees create a formal process through which the IRS's estimates of the filing-season impact of significant tax legislation are transmitted to the tax-writing committees at several points during the year, perhaps on April 30, June 30, August 31, and monthly thereafter.

3. Current budgeting rules chronically under-fund the IRS, depriving the agency of the resources it needs to close the tax gap.

In my 2006 Annual Report to Congress, I discussed in detail why I believe existing congressional budget procedures cause the IRS to be chronically underfunded.[80] In essence, existing budget procedures treat expenditures for IRS operations as they treat most other federal expenditures, without regard to the additional revenue that spending on the IRS generates. On a budget of about $11.2 billion, the IRS in FY 2008 collected about $2.74 trillion.[81] That translates to an average return on investment of about 245 to 1. While additional expenditures will not generate a 245:1 return on investment, there is widespread consensus that the IRS can make productive use of additional resources that would generate a return considerably in excess of 1:1.

In essence, the IRS is the Accounts Receivable Department of the federal government. If the federal government were a private company, its management clearly would fund the Accounts Receivable Department at a level that it believed would maximize the company's bottom line. Because the government is not a private company, maximizing the bottom line is not – in and of itself – an appropriate goal. But the public sector analogue should be to fund the IRS at a level that will maximize tax compliance, especially voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden. As the IRS has come under increasing pressure to close the "tax gap," it should be recognized that the IRS suffers from a "resources gap," and the IRS's lack of resources is a significant impediment to its ability to close the tax gap and thereby to reduce the federal budget deficit.

In the course of preparing my 2006 report and in subsequent discussions with congressional staff on the tax-writing, appropriations, and budget committees, it became clear there is broad agreement that the existing budget rules do not fund the IRS in a manner that enables the IRS to maximize tax compliance. However, there was also a sense that changing the budget-scoring rules vis-à-vis the IRS presents significant challenges that will require considerable work and collaboration to overcome. For example, either the IRS would have to be taken "off budget" or economists would have to devise a way to score the likely revenue impact of additional funding for the IRS. Neither is easily done. A decision to take the IRS off budget or

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[80] *See* National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Key Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

[81] Government Accountability Office, GAO-09-119, *Financial Audit: IRS's Fiscal Years 2008 and 2007 Financial Statements* at 21 (Nov. 2008).

come up with an alternative approach (my report suggested one) would require significant high-level attention and commitment from congressional leaders and the Office of Management and Budget, while scoring the likely revenue impact of additional funding for the IRS cannot be done with precision due to a lack of adequate data regarding the return on investment of various categories of IRS work.

These challenges are real. But if there continues to be agreement that additional funding for the IRS would enable the IRS to collect considerably more revenue, I believe we must find a way to address them. I recognize that this issue is not solely within the jurisdiction of the Ways and Means Committee, but I encourage you, as the Members of Congress who mostly closely monitor the IRS, to give the issue a closer look and to take the lead in finding a solution.

4. The IRS's ability to perform its core mission may be compromised when it is asked to take on non-core tasks; notably, the IRS's level of service on the telephone lines continues to suffer due to the Economic Stimulus Payment program.

The IRS is occasionally asked to administer programs that fall outside its core tax-collection mission. Most recently, the IRS was asked last year to administer the Economic Stimulus Payment (ESP) program. Even with the additional funding Congress provided to administer the ESP program, however, the IRS was deluged with telephone calls from taxpayers inquiring about the status of their ESPs.

The IRS has a measure, known as toll-free assistor level of service (LOS), that measures the percentage of taxpayers who speak with a telephone assister among all callers seeking to do so. The LOS has declined sharply. In FY 2007, the LOS stood at 82 percent. In FY 2008, the LOS dropped to 53 percent.[82]

While much of the decline was attributable to ESP-related calls, we are continuing to see inadequate levels of service. For the week ending February 7, 2009 (the most recent week for which complete data was available), the LOS on IRS phone lines overall was 55 percent, as compared with 79 percent last year for the comparable week.[83] On the main "1040" line that serves individual income taxpayers, the LOS was 50 percent this year, as compared with 80 percent last year.[84] And of particular concern to me, the LOS on the line that serves taxpayers seeking to reach the Taxpayer Advocate Service has fallen to 69 percent from 83 percent last year.[85]

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[82] *See* Internal Revenue Service Fiscal Year 2008 Enforcement Results 7, *available at* http://www.irs.gov/pub/irs-news/2008_enforcement.pdf.

[83] Internal Revenue Service, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Feb. 7, 2009).

[84] Internal Revenue Service, Joint Operations Center, *Snapshot Reports: Product Line Detail: Individual Income Tax Services 800-829-1040* (week ending Feb. 7, 2009).

[85] Internal Revenue Service, Joint Operations Center, *Snapshot Reports: Product Line Detail: NTA 877-777-4778* (week ending Feb. 7, 2009).

I believe the service mission of the IRS compels us to do better, particularly during economically challenging times when more taxpayers are having trouble meeting their tax obligations and may be seeking assistance. I recommend either that the IRS reassign personnel to handle the telephone lines, which may cause other work to suffer, or that Congress provide additional funding for the IRS to do the job without sacrificing in other areas.

Chairman LEWIS. Ms. Olson, thank you again for being here and thank you for your testimony.

At this time I will open the hearing for questions. I ask that each Member follow the 5-minutes rule. If the witnesses will respond with short answers, all Members should have the time to ask question.

I would like to remind Members that the Subcommittee will follow the Gibbons rule for questions. Members who were here before the gavel will be recognized in seniority order. Members arriving after the gavel are recognized by the time of arrival. Since we have so many new Members, I felt it was necessary to state that just to be reminded.

Madam Deputy Director, the IRS has given its employees greater flexibility to deal with taxpayers while struggling to pay what they owe them. Have privates debt collectors also been given more flexibility to help taxpayers?

Ms. STIFF. So we've taken a number of steps to increase the ability of our employees to resolve issues with taxpayers with minimal amounts of documentation or burden on those taxpayers in making the decision on how to handle those accounts. And the PCAs, the cases they get, those authorities that we've given to our people generally won't be necessary in the situation of the PCAs, because by definition the private debt collectors are working cases where the taxpayers can either full pay or they choose to enter into an installment agreement. And, anything beyond that, the case comes back to the IRS and the flexibilities would be applied there.

Chairman LEWIS. I thank you, Ms. Stiff.

Ms. Olson, why is it so important for taxpayers to deal directly with the IRS and not private collection agency when trying to pay their taxes?

Ms. OLSON. Well, as Ms. Stiff said, the private collection agency employees don't have the ability to place taxpayers into currently not collectible status to process an offer in compromise, to really make any decision that requires the exercise of judgment and discretion. Our screens on these cases aren't sophisticated enough to pick-up taxpayers in those circumstances, so many of the taxpayers that the private collections agencies get have to be referred back to the IRS for processing. It's a duplication of effort.

Chairman LEWIS. Let me now yield to the Ranking Member for question, Mr. Boustany.

Mr. BOUSTANY. Thank you, Mr. Chairman.

Deputy Commissioner Stiff, the taxpayer advocate sites data in her written testimony that valid offers and compromises have fallen and that her analysis suggests more valid offers were deterred rather than frivolous ones. Do you concur with that analysis?

Ms. OLSON. I know that the data would say that there's a fewer number of offers coming into the agency today, and I guess the position I'd like to take on that, and I spent a lot of time thinking about this over the weekend, because over the past four to 5 years I think Nina and the IRS have spoken numerous times to Members of this body and other Members of the Congress on the offer in compromise program. We've taken extraordinary steps and measures to improve it. Nevertheless, I think the most important fact that I focus on is the fact that last year roughly 50,000 taxpayers came in and requested to be a part of the offer in compromise process.

I think that suggests that there's a disconnect between what's available to taxpayers and what they're availing themselves of, so I've asked our staff last night. I said I think it's appropriate that we're going to bring in a third party to do an assessment of how we're doing our work to help us figure out where we may be putting impediments or barriers that we're not even recognizing. And, more importantly, I want to bring in a third party who can help us determine, who are. That's what they do for a living is determine how to reach a customer base or a taxpayer's base and figure out how we can improve our communications, how we can improve what we're doing at each step so that an offer in compromise becomes a viable collection tool, not just for IRS employees, but in the minds of taxpayers and preparers.

So I think what I'd like to say here today is that we've been talking about this for a long time and I think it's time now to take another step and bring in some outside expertise to help us expand and see if we can't let the American public see the offers in compromise are a viable option in the appropriate circumstances.

Mr. BOUSTANY. Thank you, and Ms. Olson in your testimony you discussed your research on the affect of the 2006 legislation which required taxpayers making an offer to make a downpayment of 20 percent of the offered amount. As a result, the number of offers fell 21 percent based on your testimony. I see that the receipt from offers also fell by roughly the same amount.

The Joint Committee on Taxation estimated that this legislation would raise 160 million in the first fiscal year after its enactment. Were there some other actions or events that could have contributed to this decline in offers, or was the fall caused solely by the legislation?

Ms. OLSON. I actually think that that fall was caused by the legislation. If you look at the table we have in our testimony, the number of accepted offers between 2000 and 2008 fell by 72 percent. And the first fall was attributable to what I believe are the IRS' burdensome procedures. Then we imposed a user fee and then this 20 percent down requirement came in. And we did a study that found that the taxpayers who submitted good offers—offers that were accepted right before the legislation was passed—in 56 percent of those cases taxpayers got their money for the offer for people other than themselves, from their family, from friends, from

churches, from employers. So the legislation itself, nobody's going to give somebody money to put down on an offer that you don't know is going to be accepted or not. It's only when you know it's going to be accepted that you'll give that money. So we lost out.

Mr. BOUSTANY. Would you expect receipts from offers to return to previous levels if we suspended that 20 percent downpayment? In other words, do we have 30 million per year as a revenue raiser on our hands?

Ms. OLSON. I think it has to be coupled with a vigorous outreach campaign. And, I have to add this: I personally don't think we need an outside expert to tell us how to run the offer program. We have models how to run the offer program correctly. Most practitioners believe that the offer program is dead, and so they go to bankruptcy for the clients rather than going into the offer in compromise program. And we lose money. So it has to be eliminating the 20 percent down and vigorously telling taxpayers we want to get good offers, and then changing our procedures so we receive good offers. We don't stop them at the door like we are now.

Mr. BOUSTANY. Thank you.

Deputy Commissioner, would you like to respond?

Ms. STIFF. I believe as I said earlier that there are literally millions of accounts receivables, taxpayers owing delinquent debts. Only 50,000 came in last year to apply for the offer program. I think that the program we have works. I think we're actually granting as many offers pro ratably that we've ever granted.

I think the issue for me is there's a gap between taxpayers that are availing themselves of the program, and that suggests to me two things: one, that perhaps we're not introducing the program or making it available in a way that it resonates; and, two, that I need to be doing something that touches the hearts and minds of taxpayers so they realize the program is there and they can use it.

Mr. BOUSTANY. Thank you.

I yield back.

Chairman LEWIS. I am pleased to recognize Mr. Etheridge for questions.

Mr. ETHERIDGE. Thank you, also, for having this hearing and for our witnesses for joining us today.

Madam Deputy Commissioner, I applaud your efforts to aid the taxpayers that are facing economic difficulty in light of the current economy, because it really is tough as you indicate in your testimony. And over the last several years there's really been a sharp increase in the fund anticipation loans that people have taken out anticipating a loan.

So with that and with the current recession being even deeper, there may be even more taxpayers who borrow against those expected tax refunds to save their money a little quicker. And my question to you, are you seeing an increase in these types of loans already this year or can you tell yet. Is it too early to know?

Ms. STIFF. It's too early for me to definitively say that there are more or less RAU ones. I do think in the first few weeks of the filing season we had a slight increase in the number of returns file claiming EITC credits, and generally speaking, that's where you see the RAU activity. But it's so early that the increase isn't statistically suggestive or to be relied on at this time.

Mr. ETHERIDGE. The reason I asked that question is because I feel that some of these loans create a problem for some of these taxpayers, so my question is this. Are there steps that the IRS is taking or can take that might minimize the number of taxpayers who choose to participate in these refunds, anticipate the loans that will help the taxpayer. Because that's really what it's about; that they don't wind up with less than they could have had because they've had to participate in these programs.

Ms. STIFF. I absolutely agree with you. It's a sad state. Unfortunately, it occurs where taxpayers actually are willing to engage in the loan and pay the interest on the loan so that they can have the money instantaneously. We are trying to modernize our systems so that we will be able to accelerate the timeframe for refunds.

If you file electronically, you'll get your refund within seven to ten days. Our CADE system, which is our new modernized platform, processed last year roughly 35 million of the 140 million individual returns on that new system, and it provides the refund in roughly four to 6 days. Sadly, there are still taxpayers for whom four to 6 days is longer than they're willing to wait, and so they still avail themselves of the RAUs.

Mr. ETHERIDGE. I thank you, because I think this is an area where we can have as much impact on people who really have the greatest need, probably anything we can do to speed this up and minimize that drag time certainly puts money in the pocket of taxpayers quickly.

Ms. Olson, do you have a comment on that?

Ms. OLSON. Yes, I think that what Ms. Stiff said about the CADE is very important and I think if congress authorized the IRS to do an advertising campaign that informed taxpayers of the different options, because right now there's so much advertising about these immediate loans, us simply saying it in a press release is not going to be enough to get the message across.

Secondly, I think the government needs to create stored value cards for taxpayers. We do it with Social Security, and 26 some odd states do it for unemployment compensation where taxpayers who don't have bank accounts can get what is essentially an ATM card. They can go to any bank and could get their refund downloaded. We already have the technology, and I think we just need to do something like that. There are taxpayers working at large companies that get their payroll on these stored value cards. They could write that information in and we could get their refund out very quickly within these four to 6 days.

Mr. ETHERIDGE. I thank you.

And Mr. Chairman, I think this is an area where we can have a real impact on a lot of folks who have tremendous needs and it will be a hug savings. In the little time I have left, let me ask one final question. Are there more taxpayers calling IRS for assistance now than there were last year at this time? And is it increasing? And I guess my question would be what are taxpayers asking that we can help with.

Ms. STIFF. Okay. The answer to that question is yes. More taxpayers are calling us than they did last year, and that in itself is a significant statement, because as you know, last year we were kind of crushed with the number of phone calls calling about stim-

ulus. There are a couple of things that are impacting the calls that we're having this year. First of all is that if you were eligible, well, if you were a taxpayer and you got stimulus last year, and you got a reduced amount or you didn't get it, but over the course of the year you became eligible for more than you got, you have an opportunity this year to claim that additional amount on your tax return. It's called the rebate recovery program.

Unfortunately, because of the way the law was crafted that's a somewhat complex computation and an inordinate number of taxpayers who have tried to do that have experienced errors, and so we find them calling. Secondly, you know, in our e-file program, you can electronically file and you can submit your return; and, in the past, I'm hoping you all e-file or that someone is e-filing for you. But, if you e-filed it, then subsequently you had to send the IRS a form with your signature on it.

We made a change this year at the urging of just about everybody and anybody involved in it that you shouldn't need to send that form, that you could rely on a pin. That process of using the pin to file requires you to know your AGI or your adjusted gross income from the prior year. And, I guess, unlike myself, a lot of taxpayers don't have their prior year returns in a desk drawer and go look up their AGI. Instead, they pick up the phone and they're calling the IRS and saying can you tell me my AGI so I can e-file this year. So we've had an inordinate amount of that kind of traffic.

The third area that we're experiencing, and I think it really makes good sense and I think if I'm the taxpayers instead of the IRS I would probably do the same thing. They have been bombarded on the media, in the news, on the TV, with talk of stimulus, with talk of bailouts, with talk of checks. We have thousands of taxpayers calling us a week saying am I entitled to anything. Should I be getting something? What do I need to do to get something? And I don't think it's clear to them how that works, and so we are receiving an inordinate amount of phone calls.

Mr. ETHERIDGE. Mr. Chairman, thank you for your indulgence, and this rates as a real issue that might need to consider. They do need some money to do some advertising to help get.

Chairman LEWIS. Thank you very much.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

I yield back.

Chairman LEWIS. Well, thank you.

I think that is very helpful.

Mr. Roskam is recognized for question

Mr. ROSKAM. Thank you, Mr. Chairman.

And welcome. Thank you. It's an honor to be here.

Ms. Stiff, Chairman Lewis pointed out, I think accurately, that we're going to be getting a lot more inquiries in our district offices. More and more people are hurting. There's this looming tax liability that's out there and I represent a district in the West and Northwest suburbs of Chicago that has an expectation of what's good is good for the gander, just fair play.

I am going to ask you to comment on Secretary Geitner's treatment by the IRS, because it was a highly celebrated. Well, not celebrated. It got a great deal of attention. I'm obviously not going to ask you to comment on anything that's in a confidential file, but

the facts and figures are in the public domain. So there's an expectation that I am going to be hearing from constituents when they incur a tax liability and incur interest, and, presumably incur a penalty that they're going to be treated and sort of get the Geitner rule applied to them.

Can you comment on what their expectation is? What their expectation should be? The calculation that the IRS made as it related to Secretary Geitner's tax liability and the decision not to pursue a penalty and to let him off by simply writing a check for the tax liability and the interest. And, what is it that animates the decisionmaking at the IRS, and how does it apply to the district that I represent?

MS. STIFF. Okay. Clearly, I can't speak to any of the facts specific to Secretary Geitner's individual tax matter. What your constituents should expect, that if they owe an amount for their tax, that they're going to be charged with the amount of tax they owe. that their going to be charged with interest and penalties to the extent they're applicable.

If your taxpayers believe there's a reason that those penalties shouldn't apply that they meet the reasonable cause standard, then they should expect to be prepared to explain that to us and engage with us in a discussion, and those decisions are individual facts and circumstances based on the penalties that would apply in their case.

Then, thirdly, they should expect that once those amounts have been determined and agreed-to, that if they're experiencing difficulties in coming up with ways to pay that that they need to engage with us to talk through what payment plan options there might be, what alternatives they would have that would allow them to resolve their tax debts in a way that isn't overly burdensome to them as an individual.

Mr. ROSKAM. Okay. Let's assume for the sake of argument that someone has the ability to pay the liability as Secretary Geitner did. And let's further assume that there is a similar self-employment issue. Let's say I have a constituent that worked for the International Monetary Fund and didn't pay their taxes. Is it an expectation that that taxpayer that I represent would be treated in that same way, not pay the penalty, regardless of whether they sort of, you know, pull out a laminated hall pass that says my accountant said this even though I got a letter from the IRS. I mean, how is that?

Ms. STIFF. First of all, and I'm not trying to be coy. I'll be perfectly honest with you. I don't know the specific facts of Secretary Geitner's case, but I can tell you that if a taxpayer failed to pay self-employment tax we would expect them to report it, pay the taxes they owe. They're going to be subject clearly to the interest that flows with that. And the penalty that they may or may not be subject to will be dependent on the facts and circumstances of their case and the reasons for why they found themselves in that situation or not.

Mr. ROSKAM. Okay. Our time is coming to a close. Two questions: could you follow-up; and, I'd like to hear from you once you do know the facts of the case. And at some point in the future within the next couple of weeks, could my office hear from you on that?

That's question number one; and question number two is what is it that creates the predictability for how a taxpayer is going to be treated and is this an area that needs further inquiry into the future. Because if it's completely within the discretion of the internal revenue service and you're bound by a confidentiality that says you can't disclose, and I would submit sometimes that's handy and sometimes that's a burden. Right? And you'd even acknowledge that.

Ms. STIFF. Be happy——

Mr. ROSKAM. Let me just finish, because my time is winding up.

I think it's very important moving forward in this environment where, I think, there's going to be more and more concern about people being treated fairly in the same way in which powerful people are treated in this country.

Mr. Chairman, with that, I yield back, because my time has expired.

Chairman LEWIS. Deputy Commissioner Stiff, do you care to respond?

Ms. STIFF. I'll respond by saying we'll be happy to get back with you and I don't want to suggest that the application of interest and penalties is discretionary. It's a part of what's expected. The discretion or the judgment comes in if there's a reasonable basis that it shouldn't be applied. But we'll come back to you and we'll talk more in detail about that.

Mr. ROSKAM. I'm out of time. I'd love to engage you further. Thank you.

Chairman LEWIS. Mr. Higgins is recognized for question.

Mr. HIGGINS. Thank you very much, Mr. Chairman. First of all, Ms. Stiff, in your testimony you had indicated that the good news is in this economic contraction that working families may be eligible for the earned income tax credit which will put money in their pockets. The bad news is that as many as one in four eligible taxpayers are not claiming the credit.

You go on to talk about the initiatives the IRS is making to go into those economically distressed areas with free tax preparers, does the IRS have a goal relative to insuring that people do in fact claim the credit and is there a period of time within which that goal is anticipated to be achieved?

Ms. STIFF. Let me just provide a little bit of background to what you're saying. I mean our goal clearly would be that every taxpayer that's entitled to that credit would know it, claim it, and get the benefit of it. Having said that, the one in four number I itself, there's more behind that. There is about approximately an 86, 85 percent participation rate with the EITC credit for people who are eligible with two children. So the reason for that is at that level the value of the credit can go as high as $4800 for a family.

The participation rate for taxpayers with no children, so the averages kind of mask that, is roughly 56 percent; and, the reason for that is the credit at that amount can be as low as $430. So there's a different incentive and a different interest in making that claim, not that $430 isn't a significant amount of money at those income levels.

So where we find ourselves now is we've spent years trying to up the total participation, and what we're finding now is we need to make this remaining lift in the participation rate, that we're going to have to have targeted outreach. And it may have to be different for the 56 percent with no children than it is to get the additional 40 percent on the families with two children.

Mr. HIGGINS. What was it 5 years ago?

Ms. STIFF. I don't know the answer off the top of my head, sir. I'd have to get back to you on that.

Mr. HIGGINS. But improved?

Ms. STIFF. I think the overall rate was between 68 and 75, so the IRS has done extraordinarily well with families with children and I think what you find in what we call the childless worker population is that many of those people have marginal wages, so they may not even be getting large refunds. They may not even be filing returns; and, so, they don't even find out that they could get this $450 credit which would offset the Social Security that's taken out of their checks.

Mr. HIGGINS. Okay. Ms. Olson, what do you see as the most complex aspect of the Tax Code for individual taxpayers, particularly during this economic downturn?

Ms. OLSON. You know, that's such a hard question to answer because the law is so complex. You know, there are different things that impact different taxpayers. Again, we just had the discussion about the single worker who doesn't even know there's this benefit out there he can get.

We have in the retirement provisions people who may need to take early withdrawals from their accounts, and they may be taxed. They'll not only be taxed on those early withdrawals, but depending on the kind of retirement plan they have, they may get an additional 10 percent tax. You know, that's a real trap for the unwary.

I think that the indicator of just how complex the law is is that over 80 percent of individual taxpayers pay for assistance in preparing their returns. Over 60 percent go to paid commercial preparers and another 22 percent by software; and that's not counting the people who go and get the free tax preparation. So it's just the sheer size of complexity is just overwhelming.

Mr. HIGGINS. Yeah, well, as a taxpayers advocate, what are suggestions, you know, you would have for simplification of the process?

Ms. OLSON. Well, we have certainly recommended in the report additional simplification of the family provisions so that instead of having six different provisions that people have to wade through we really have a basic family credit and a basic worker's credit. We've recommended simplification of the education incentive so people don't have to have a degree to figure out which one's the right one for them. And, again, as I talked about the retirement incentives and I would have to say you have to eliminate the alternative minimum tax.

Mr. HIGGINS. Thank you, Mr. Chairman.

Chairman LEWIS. Among this group, Members I don't think would be in too much disagreement with that. I think that would be a proper consensus among the Members of the Committee—not

just the Subcommittee, but the Full Committee—that we must find a way to eliminate this tax; and, one day—one day—we will find the courage to do just that or find the means to do it.

Mr. KIND. We shall overcome, Mr. Chairman.

Chairman LEWIS. We shall overcome some day—someday.

Mr. Reichert is recognized for question.

Mr. REICHERT. Thank you, Mr. Chairman.

And I echo Mr. Roskam's statement in honor to be here and an honor to serve with you and the rest of the colleagues here.

Chairman LEWIS. Thank you for being here.

Mr. REICHERT. My pleasure. I wanted to follow-up if I could on Mr. Roskam's line of questioning, just with a couple of thoughts. So talking about owed tax, interest and penalties, and there's disagreements with that, then I think Ms. Stiff, you said there should be an engagement between the IRS and the taxpayer. And then hopefully you come to some agreement.

How does this process take place? Is there a mediator? What if there's no agreement? What happens? Is there a mediator that comes in that's bipartisan personality?

Ms. STIFF. I don't know that I would say that there's a mediator in the sense that you're probably referring to. If taxpayers owe us money and they want to debate the amount of money they owe as a result of an audit, they do have due process. There's an appeals process, which does bring in third-party to look at the facts of the case and reach a conclusion. Taxpayers can always exercise their options to go to court.

On a collection action, if we're proposing a lien or a levy as a result of the failure to pay, they have an ability to appeal that process. Most of where that discussion is to the reasonableness around penalties, which is the issue that he was raising, takes place at the frontline, either between the individual that's interacting with the taxpayer as to the facts and circumstances. And we recently made some systems changes and some process changes, actually, at Nina's urging in her report, to ensure that taxpayers aren't being penalized during the period of time that we're having that debate.

Mr. REICHERT. I would assume that some time in this process of discussing the disagreements that exist, someone makes the decision whether or not there's a criminal offense that's occurred. Did that sometimes happen?

Ms. STIFF. Yes, sir, we do. We have an active what we call a "fraud referral process," so that either in the collection or the examination stream, if our personnel identify what we call the badges of fraud, which are a series of indicators, then when we feel that we've got enough there. Then we'll cease on our civil activity, and we'll actually refer that case over to our criminal investigators so they can evaluate it for its criminal potential.

Mr. REICHERT. This is where the Miranda warnings then come in?

Ms. STIFF. Yes, sir, it is.

Mr. REICHERT. Thank you.

I want to just follow-up to on some comments that you mentioned there were increased calls. I'm just wondering by thousands of calls, have you asked for additional staff. Is there a need for additional staff?

Ms. STIFF. We've been very fortunate. You and your colleagues, and in particular Chairman Lewis, have taken steps to assure that the stimulus bill that you just passed included funding that is going to supplement our staff which should help in responding to some of the calls that are related to the stimulus.

Mr. REICHERT. Will there be a need for additional staff, do you think?

Ms. STIFF. It's probably too soon for me to say that. I think that what we've asked for and with the passage of an '09, the omnibus, will position us to get us out from under the CR, and it also provides for some additional funds to handle the phone traffic as a follow-up to last year's. I think when we get that money we should be positioned to respond to what's coming at us.

Mr. REICHERT. Great. Ms. Olson, you mentioned the tax gap in your testimony and that the IRS' lack of resources is significant. And it's an impediment to your ability to really get your job done and it creates this tax gap. You mentioned that the complexity of the Tax Code in your testimony for example regarding AMT.

Do you think the complexity of the Tax Code contributes to the tax gap?

Ms. OLSON. I think that it contributes to a part of it. There are so many causes for that, and in a way I believe that that goes to how we should treat taxpayers. If you have someone who is actually undertaking fraudulent activity, that's going to require a very vigorous response from the IRS in terms of enforcement action and criminal investigation action and criminal charges.

On the other hand, if you have someone who is just confused and has made a mistake you really have to look at what's the right approach for that person: clearly, educating them; making sure they don't do that again; and then making sure that they pay the tax and the interest to the extent that they're able to that gets into the penalty discussion.

You know, I recommended a few years ago the proposal that was called the one-time, stupid act penalty abatement, where you basically give people a pass the first time. Because the goal of the penalty really is to make sure that they stay in voluntary compliance, so let's educate them and say go and sin no more. You do it again, expect a penalty.

Mr. REICHERT. Thank you. Thank you Mr. Chairman.

Chairman LEWIS. Thank you very much.

Mr. Kind is recognized for question.

Mr. KIND. Thank you, Mr. Chairman.

I want to thank our two invited guests here today for your testimony and thank you for holding this very important hearing. We have a lot of important issues coming up that gives us a lot of opportunity to delve into, many of it with you, one of which is obviously the recently enacted Economic Recovery and Investment Act (ERIA). There's a lot of tax credits and deductions, exclusions, things of that nature; and Ms. Stiff, maybe we could start with you.

In regards to the type of public education awareness campaign that needs to take place so people understand this more and know what they can take advantage of now, it is somewhat complicated and I'm just wondering what steps the IRS is taking in order to help with that public education campaign.

Ms. STIFF. The IRS has actually been working feverishly in anticipation of the passage of the legislation. Clearly, it was impossible to finalize what you're going to communicate and what's the best way to communicates it 'til you knew what was there. So we were well-positioned when the bill passed to drop in, kind of, what the provisions are, the rules.

We've got to have forms. We've got to have pubs. We need to get information out to taxpayers swiftly. We're working on that and I think we're days away from being able in a number of those provisions to be fully loaded for Bear in terms of communication, not weeks or months.

Mr. KIND. And a user friendly website, I assume, will go to IRS?

Ms. STIFF. Yes, absolutely everything will go to IRS dot gov.

Mr. KIND. Is this something our offices will be able to link to, because we're already getting inquiries, my constituents.

Ms. STIFF. Yes, sir. Clearly, we're still having on some of the provisions, we're still having to flush exactly how it's going to be administered, and so we want to have the information when we get it out there, be as useful as we can. But I think given that the passage has been in recent days, I would expect that within just a very short, few days, that we'll have at least for the provisions that are affected or affect taxpayers who are trying to file their tax returns this year, we'll have that out there.

Mr. KIND. And can we assume that the various software entities that exist for tax preparation purposes are going to be able to update all that? Because we're already in tax filing season.

Ms. STIFF. Yes, sir. We have been working with them again since before the holidays to ready for this. They face that same problem we did until it was passed. They couldn't complete programming. We are talking to them multiple times a week and en masse and individually. And at this point, I think by and large we'll all be prepared to move in time to get done what needs to be done, what you've asked us to do this year.

Mr. KIND. Now, the making work pay tax provision in the recovery package, that's going to be dealt with through the employers not taking as much withholdings out of the paychecks. What do you suspect the compliance rate will be with that?

Will the employers be able to make that quick adjustment? Because this is my understanding kick in, in April already, and last throughout the rest of the year.

Ms. STIFF. I think that for that type of provision we generally find that most employers are able to respond quickly and nimbly to that and aren't expecting a lot of compliance issues there.

We expect this time next year as taxpayers are trying to reconcile what was withheld and what they owe, we may see some additional issues or questions then. But, our experience is that our employers are as a general rule prepared to respond to a change.

Mr. KIND. What about employees with multiple paychecks or multiple jobs?

Ms. STIFF. That's where it gets complex, because which withholding gets adjusted. Where, and is the employee going to be left as I said earlier at the end of this year, either having been over withheld more than they wanted or under withheld; and, part of our communication strategy will be to alert taxpayers to that. But

I'm confident that with 140 million individual filers this year, there will be some that will encounter that difficulty.

Mr. KIND. Let me ask you too. I know it's a small item, but it's one that nevertheless tends to bother me from time to time. I notice that in the tax rebate notification process last year, but it's my understanding the IRS is going to be sending out some tax withholding reports to nine million employers starting in mid-March, mailing it out.

How much is that going to cost and is it necessary to have to actually mail those reports out to nine million employers, when my guess is all of them are automated anyway and they can get this information off the Internet?

Ms. STIFF. I don't know that it's nine million or not, so I won't dispute your number. But I don't, off the top of my head, actually know.

Mr. KIND. At least that's what been reported.

Ms. STIFF. It hasn't been. Okay. I'll say two things. We will have the tables on the web, in fact, they may be on the web. I've lost track in the last few days here. We'll have the tables on the web for employers to begin accessing almost immediately.

Mr. KIND. Right.

Ms. STIFF. We also feel that we do have to distribute the tables, because there's 20 something million small businesses in this country; and, to assume all of those, particularly some of the very small, are necessarily going to use the web.

I don't think that you or anyone would want—you're intending for this money to get to these taxpayers—and we need to ensure that we equip the employers with the information they need to make that happen. I don't know the cost, but I probably can get that.

Mr. KIND. Well, I would like to follow-up with you on that, because we are in the 21st century now; and with all due respect, technology is a major part of what's going on in the economy. And it just seems, you know, nine million withholding tables being mailed out individually. It seems to be an incredible waste of resources and money.

I mean, last year, Mr. Chairman, you may recall there were two IRS notifications on the tax rebate check to the vast majority of people telling them you don't have to do anything. And it cost us a hundred million dollars to do those two mailings for that. So I'm just wondering if the IRS is thinking through this, how we can best utilize technology for cost savings; and, granted, the withholding tables may not be that expense to mail out and there may be certain segments that need that and show up in their doorstep. But I would hope that as we're moving forward, given the budget crunch, Your Honor, we try to streamline some of this.

And, finally, Ms. Olson, I couldn't agree with you more on tax simplification and would love to begin a dialog with you, especially with the education and the savings complexity in the Code right now and how we can streamline that and consolidate it. I know you and your organization has done a lot of work on that, and some of those issues where you mention it and everyone's head goes up and down in vast agreement, you've just got to start doing it.

Ms. OLSON. Thank you.

Ms. STIFF. Thank you.

Chairman LEWIS. Mr. Davis is now recognized for question.

Mr. DAVIS. Thank you, Mr. Chairman.

Ms. Stiff, unlike Mr. Roskam I don't have any constituents who work for the IMF so I won't waste your time on that. Let me though talk about something that's a little bit more relevant to my constituents. The University of Alabama runs an organization called the Center for Ethics and Social Responsibility; and the very talented young man who runs it happens to be the grandson of the former Supreme Court Justice, the late Hugo Black.

And several months ago the Center conducted a sting operation. They used law students to go to tax preparer sites in the state of Alabama. All of these tax preparer sites purported that they would help you get an anticipatory refund in very short order. Sting operation was done in these 13 sites. Virtually every single one of them was engaging in some kind of negligent practice or some kind of practice that was an outright misrepresentation—virtually every single one of the 13.

So Mr. Black has put together a legislative proposal at the Alabama legislature is currently considering, and it has several interesting components I want to get your reaction to. One of the things that this legislation would require is that for tax preparers, first of all, would have to be licensed by the state of Alabama. The second thing is that after being licensed as with lawyers, as with doctors, as I understand is the case with accountants, they would have CLE obligations. They would have to regularly take courses to update their knowledge of the shifting sands of tax law; and, in addition to that, they would have to pass a proficiency exam before they could be licensed at all to be tax preparers.

Could I get some reaction from you, Ms. Stiff, and from you Ms. Olson, as to the advisability of a legislature passing that kind of remedial action to protect people from tax preparer services? Ms. Stiff, I'll start with you.

Ms. STIFF. Yeah, I'll say a couple things. Nina will probably be in a position to respond probably more completely than you are because in the role of the IRS we generally enforce and don't advocate laws. But I will say we are concerned.

People that hold themselves out to the public and take on that fiduciary responsibility that they conduct themselves in an appropriate manner and we're taking steps to strengthen our own monitoring of that universe and where we're developing a preparer strategy in outreach, I know there's been much debate by this body and on the Senate side as well around the merits of registering of licensing of monitoring; and, I think that there's pros and cons to that.

I am confident that there's administerability issues with doing any and all of what you're saying, and I think there are folks that will say to some extent it will help. To other extent, it tends to make it more difficult for the already compliant and drive the noncompliant further underground. So I think there's a lot of debate to be had on the issue.

Mr. DAVIS. Ms. Olson, would you like to weigh in?

Ms. OLSON. Well, in 2002 one of my legislative recommendations was to do exactly what you suggested: register, test, and re-

quire continued testing of what I call unenrolled preparers; people who are not attorneys, certified public accounts or enrolled agents who already have a testing and annual continuing education proposal. That provision has been passed several times by the Senate.

Congressman Becerra had a bill last year that had the most recent version of it and I think there's actually very little debate on this at this point.

Mr. DAVIS. Unless you're in the Alabama legislature.

Ms. OLSON. Well, every single major practitioner group, including these unenrolled preparers nationally have come out in support of this proposal. There are little things around the margin that they're concerned about.

I just say to me the worst thing that could happen is to have 50 different regimes around the United States for the Federal tax law so that people who prepares from one state to another have to meet all of those requirements. This is a Federal law and I think we need to make sure that the people who are making their living by preparing returns, Federal tax returns, meet a basic level of competency; and we have to have the regime for that.

Mr. DAVIS. And I would just conclude, Mr. Chairman, by saying Ms. Olson I suspect you're right. An ideal world there would be a Federal standard in place. For various reasons that has not happened. I think it should happen and until we get to that point, it seems eminently reasonable to me that states would regulate in this area. As a matter of just common sense, it seems to me if you're preparing tax returns for people and holding yourself out by definition as someone who has expertise that you ought to have to pass some exam that says that you have that expertise.

As we've established, tax law changes constantly. This body has made changes. The last several years have been very impactful, so it seems reasonable that you ought to have to know about those things. And last comment, what has predictably happened in my state is that there was a lot of momentum around it. It was moving in a particular direction, and now a lobbying group has formed in the state of Alabama to fight for the right to prepare returns without being licensed. Not surprisingly, the lead entity in that lobbying front happens to be the company that have the most egregious violations and the sting operation that was conducted.

Thank you, Mr. Chairman.

Chairman LEWIS. Thank the gentleman, Mr. Davis from Alabama, for raising the issue. I think that concern would have been before us before, that you have this little fly by-night tax preparer that comes around during filing season, and a sort of rip-off to taxpayers. And then I've heard they sort of disappear.

Mr. Becerra, who I want to yield to has been involved in the issues. I yield.

Mr. BECERRA. Mr. Chairman, thank you very much.

Mr. Chairman, I think this type of hearing, in fact, I think informal sessions with both Ms. Stiff and Ms. Olson would be very worthwhile for us. So first thank you for being here, your testimony, your observations; and, once again, Ms. Olson, thank you for your excellent recommendations on what we could try to do.

I think much of what you said includes actions that could be taken without legislative authority; and, perhaps we could work

with you on trying to help move in that direction with some of these activities.

Mr. Chairman, Ms. Olson has in her testimony a figure that I think is important for us to note. There were more than 2,600,000 taxpayers with delinquent accounts that or non-collectible accounts in 2008. That same year, the IRS accepted about 10,600 offers in compromise, negotiated settlement, with some of these taxpayers who were delinquent. Interests have been trying to resolve it. Another 22,500 or so were taxpayers given a chance to arrange partial payment installment arrangements.

That means that only one of every 78 taxpayers, who is delinquent or has an account that's non-collectible, had an opportunity to try to resolve this without facing some further legal challenges or consequences. I am gratified to hear that the IRS is trying to do a little bit more and that recently you announced that you were going to try to deal with this situation economic distress that many taxpayers find themselves in to try to be more accommodating for those who are reasonably trying to do what they can to pay their share of taxes that they owe.

But, I have a question that I'd like to ask Ms. Stiff and Ms. Olson. Actually, let me direct it to Ms. Olson for now. Those private collection agencies that are collecting from many of the most distressed families out there, because many of the accounts that these collection agencies have are people with modest incomes whose tax obligation is quite low. But for them it's a big debt. These collection agencies don't fall into the same requirements and responsibility that IRS personnel do to try to provide taxpayers with information about what they can do to try to make it easier for them to pay their taxes owed.

Do those agencies have those same types of requirements?

Ms. OLSON. No. The only thing that those agencies can do is ask the taxpayer if they can full-pay or if they can pay within 3 years. And anything else, the case has to go back to the IRS; and, clearly, the incentive is there that you would in ever so subtle ways, you would want to keep the case, because that's what your commission is basically based on. The agency's commission is based on the collections from the full payments or the installment agreements that they bring in, not that the IRS brings it.

Mr. BECERRA. So first these private tax collection agencies are not required to inform these taxpayers that they could actually use the IRS directly to try to resolve their problems if they're wishing to try to pay their taxes.

Ms. OLSON. They are required to tell the taxpayer that they can opt-out. I do not know if that's in their scripts. It is in the first letter that the taxpayer gets. But it doesn't say that you can opt-out and talk to the IRS about an offer in compromise.

Mr. BECERRA. And are they required to tell these taxpayers of the new steps that the IRS is taking to assist taxpayers facing difficulty paying their taxes?

Ms. OLSON. Not to my knowledge.

Mr. BECERRA. And then secondly we find that these tax collection agencies earn their money. They make their profit by making sure the collection occurs.

Ms. OLSON. Right.

Mr. BECERRA. So if they get a cut of the collection, it's not in their interest to send them over to the IRS. They get no cut if they just send them over to the IRS. They are the ones that have to collect. So it's almost in their interest not to inform taxpayers of the services that the IRS provides free to try to help them make arrangements to collect their taxes, which I think is especially in this time of economic hardship just the wrong way to go.

Ms. Stiff, I know many of us have concerns with private collection agencies for quite some time in this regard, and I hope that we have an opportunity to talk more specifically with the agency about this, because I think this is the worst time for us to be having headhunters out there looking for people who might be willing to pay their taxes but aren't being given all the information that should be out there for them to try to help them deal with all their economic circumstances that they faced right now.

Mr. Chairman, I know my time has expired, but if I may just make one other point, it concerns me to no end to know that a Social Security recipient can have his or her Social Security monthly stipend levied against based on an IRS claim. Now, we're all taxpayers, and we all have to pay what we owe the government. And if it's not a voluntary system, we're in real trouble and we have to encourage people to be forthcoming and participatory.

But, I've got to believe there's a way for the IRS to work with recipients or taxpayers who are recipients of Social Security and probably for their main source of income to work with them to make sure that as we collect the debt they owe the government through taxes that we do it in a way that accommodates their need to continue living, especially if the Social Security check is their main form of income.

I know that there are limits that you can place on other types of levies, but there is apparently no limitation on at what level you can dig into the pocket of someone who receives Social Security payments. And I hope that we can examine that a little closer, because this is probably not the time to hit people who live off of Social Security to pay their taxes.

I suspect that they would be more than willing to help make their payments if we could reach some accommodation with them; and, so, if we could follow-up with that, I would very much appreciate it.

Ms. STIFF. Sure.

Chairman LEWIS. Let me just ask the two of you. If there anything that you want to tell us that you think we should know during this filing season? Do you think we have all the information that we need?

What is your greatest concern during this filing season?

Ms. OLSON. I'm going to say something, because I think Linda is in an awkward position to say this.

Chairman LEWIS. You don't think she had the courage to speak?

Ms. OLSON. I think that in her position she's not able to say very clearly the resource demands on the IRS about the last couple of years with the economic stimulus payment and now the new provisions that are coming in. And I just thought giving some information about the level of service on the phones. Last year was a record level of service meaning calls came in and essentially rough-

ly what percentage of the calls were we able actually to get to. And I'm not even talking about the wait time that taxpayers have before we can get there.

But, through February 7th of this year, their overall level of service was at 55 percent and a year ago even with the difficult filing season the same time it was at 79 percent. On the main 1040 number, through February 2nd of this year, the level of service—this is the main number for individuals—is at 50 percent, and a year ago it was at 80 percent. And my own phone number, my own toll free number for the taxpayer advocate service, where we get the cases where taxpayers are having the difficulties, you know, with these things. This is answered by another part of the IRS. It's part of the main phone system, but it's a dedicated line.

We are at 69 percent level of service and a year ago we are at 83 percent; and I think that as we look to the IRS to deliver programs, deliver stimulus to the economy, become a method for helping people with health insurance who've been unemployed, we have to really think hard about what the IRS needs and resources in order to be able to do this job. There are lots of reasons for why the IRS should do the job, because we have that contact with taxpayers.

But, on the other hand, if we're doing all these other jobs and not able to deliver our core ability to process the returns, answer tax law questions, deal with account questions, collect money when taxpayers are calling us, you know, then all of us are harmed. And I just want to make the case for perhaps this Committee weighing in with the appropriators about, you know, the need for really adequate funding for the IRS in interfacing with the taxpayers of the United States.

Chairman LEWIS. Ms. Olson, I appreciate your comments and I appreciate you sharing those with us; and, I'm sure my colleagues appreciate it and the IRS appreciate it also.

Mr. KIND. Mr. Chairman, could you yield on just that one point?

Chairman LEWIS. I assume the same applies to that low-income taxpayer clinics that are being established and the increase in demand for assistance and help with those clinics in preparation?

Ms. OLSON. Yes, and I'm so proud of their growth that we're up to 160 now, and we get applications. We do a survey, a needs assessment of United States low-income taxpayers, to identify areas where there are populations of taxpayers that we believe need the assistance. And there are many places out there that I think we could get a program started with other community groups.

Ms. STIFF. May I just insert I think there may be the issue isn't just how much or how many. The issue is that we are now on about an 18-month run of asking the workforce or the IRS to do a very heavy lift over and above what their core mission, as Nina put it, and a lot of nights, weekends, holidays, vacations sacrificed for doing that. And I think that like any business at some level when you do that for so long you just increase the risk of people's ability, their alertness, those things. So I think when you say what do we worry about, I think that's an issue that continues to be something that the Commissioner and I are both cognizant of.

Chairman LEWIS. Thank you. We appreciate it.

I want to yield and recognize the Ranking Member, Dr. Boustany, for in addition the question and statement you'd like to make.

Mr. BOUSTANY. Thank you, Mr. Chairman. And that is, Ms. Stiff, I'm glad to see that the IRS is recognizing the upheaval and uncertainty in the housing market. And there are going to be difficulties with valuations of properties, predictably as we look at the offers in compromise agreements. And in your testimony you refer to or you suggest that some of these cases will be referred to a specialized group. Could you elaborate a little bit on that?

Ms. STIFF. Yes, what we're doing is kind of instilling. I'll consider it a fail-safe for the taxpayers. It's that in an offer in compromise situation, if there's real estate involved, the valuation of that real estate, the decisions that are made, could hinge on that. And so we want to ensure that if for any reason we're denying or that our information about the valuation runs contrary to that of what the taxpayer believes it is, that those cases will go to a specialized unit of people—I think they're located in Texas—whereby, they'll take the extra step and make sure that the valuation we're relying on is based on the best facts and come back to it that way. So it provides what I would describe as the fail-safe for the taxpayer.

Mr. BOUSTANY. I thank you.

And, finally, our colleague, Mr. Roskam did raise some important questions regarding fairness and the public perception of fairness. And he referenced the case of Secretary Geitner. And I think it's important, and I think your term as he was ending his line of questioning was having a reasonable basis for not applying certain penalties, finds and so forth. It would be helpful to us to have some general guidelines on how that is carried out, particularly in high profile cases. And I'm not going to put you on the spot now with it, but if you could get back to us in writing on that, it might be helpful.

Ms. STIFF. Will do!

Mr. BOUSTANY. Thank you.

With that, Mr. Chairman, I am happy to yield back. I don't know if my colleague here has an additional question with your indulgence.

Chairman LEWIS. Yes, you are recognized.

Mr. REICHERT. Thank you, Mr. Chairman.

I won't take up the full 5 minutes but I just want to quickly comment that I do understand the difficulty in answering some of these questions. I was Sheriff in Seattle prior to coming here to Congress and I testified both as an appointed sheriff and an elected sheriff in front of my county counsel. So I understand the difference in your ability to share freely, but I am a little disappointed that that my question I asked earlier was, I think, initially addressed until the Chairman pressed it, just a little bit as far as staffing and the need for staffing additional funding and how much that might cost.

So I want to focus on comments made about the offer in compromise program. There was, I think, Ms. Stiff. You mentioned that you wanted a third party assessment and are you thinking of

process mapping effort in that program? Is that what you're looking at?

Ms. STIFF. Well, that will be part of it, but it's actually less. We've spent a good deal of time in the last 4 years re-engineering our internal processes, process mapping, looking at where the work needs to be done. And, while there remain, you know, as with any program and opportunity for improvements there, I think the bigger question for me now isn't what happens when they get in. It's increasing the number of people who are availing themselves of the program and then assuring they're being treated in a fair and equitable way once they're in.

Mr. REICHERT. What would be the cost of that, do you think?

Ms. STIFF. Of the study?

Mr. BOUSTANY. Yes, of your third party assessment?

Ms. STIFF. I don't know off the top of my head.

Mr. BOUSTANY. And so you've been talking about this for a while though. How long has this discussion in the IRS been going on?

Ms. STIFF. Oh, actually not. As I said earlier, when I was going through everything last night and looking at what we've done, we've been working with Nina. We've been working with practitioners and preparers. It's a perennial issue everywhere we go, and it occurred to me that it may be time for us to look at it differently than we've been looking at it if we're going to solve it.

Mr. REICHERT. Would this be expanded beyond the offer in compromise program? It seems to me that the IRS overall could use a third party assessment.

Ms. STIFF. I'm not sure specifically to what your question is. We have independent assessments ongoing at any given time in specific program areas. We also have ongoing oversight by GAO into specific programs.

Mr. REICHERT. Is GAO considered to be a third-party assessment for you?

Ms. STIFF. Yes.

Mr. REICHERT. Yeah. Okay, thank you, Mr. Chairman.

Chairman LEWIS. I would like to thank the IRS Deputy Commissioner and the national taxpayer advocate for the time and testimony.

The Subcommittee appreciates your views. Thank you for being here today. We look forward to seeing you again; maybe not soon, but sometime later. There's more business to come before the Committee. This hearing is now adjourned.

Thank you very much.

[Whereupon, at 11:28 a.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]

STATEMENT OF HOWARD S. LEVY, FORMER IRS TRIAL ATTORNEY

I am a former IRS attorney who has helped everyday people work through IRS economic difficulties for almost 20 years. I have seen through the eyes of the government, and have seen the faces of taxpayers in distress. I appreciate the opportunity share my observations and recommendations.

The problems of taxpayers who are *in the system* are well-documented. The IRS offer in compromise program is broken; IRS expenses allowances make obtaining installment agreements virtually impossible. Older IRS tax debt sits uncollected, leaving taxpayers in financial limbo for years.

My clients who are in the system are increasingly using bankruptcy to eliminate IRS difficulties, a course of action that cannot be good for the client, the government, or the economy.

But the weight of the 6.1 million taxpayers who are *out of the system* deserves equal attention.

I urge you to offer amnesty to the 6.1 million IRS non-filers if they come forward and pay the taxes they owe. This will strengthen, not weaken, our tax system. It will alleviate economic hardship on taxpayers. It will also bring the Treasury billions of needed dollars not just now, but into the future.

For most, *life situations lead to dropping out of the tax system*, not a desire to gain an advantage. It could be divorce, medical problems, or the challenges of a business during these hard economic times. If the taxes cannot be paid, the returns are often not filed.

Once behind, interest and penalties escalate to the point that a taxpayer can never catch up. The failure to act is magnified by the fact that interest and penalties double the original tax liability every five years. I have seen the discouraged faces of hard-working Americans—paying $100 monthly on a $20,000 tax debt—when they discover that the amount they owe is actually increasing, not decreasing, because of the interest and penalties.

For taxpayers who come forward with their taxes, provide amnesty relief from the interest and penalties if the returns are filed and the tax is paid over an agreed upon payment plan. To ensure future compliance, implement a five year probationary period to stay current on all future obligations. Those suspected of tax crimes would not be eligible.

In addition to the non-filers, there are millions of taxpayers who have filed and owe money. They badly want to repay their debt. They try to pay it, but can never break free from the weight of interest and penalties. It holds back their businesses, their lives and the economy. Provide the same relief to them.

Tax amnesty works. States offering non-filer amnesty have been highly successful raising money and bringing taxpayers back into the system. Nevada recently collected nearly $41 million between July and October, 2008 from amnesty. Oklahoma generated about twice what it expected, raising $82 million in 90 days.

If two states could generate $123 million in less than four months, imagine the benefit by including everyone back into the Federal system?

Tax debt puts lives and economies on hold for years. Employment opportunities are lost and new business ventures delayed; home ownership is an impossibility.

People want a fresh start. We as a country are now dedicated to reclaiming financial stability. To achieve that, encourage those who are out of the system to come back in. Implement IRS collection policies that encourage taxpayers who are in the system to stay there.

I would be happy to meet with Committee Members to discuss this Statement. My contact information is Voorhees & Levy, LLC, 11159 Kenwood Road, Cincinnati, OH 45242, howard@voorheeslevy.com; www.howardlevyirslawyer.com.

Howard S. Levy

STATEMENT OF INVESTMENT FRAUD VICTIM'S TAX RELIEF THROUGH IRC SECTION 165(c)(2)

Victims, taxpayers and citizens, in general, are experiencing an extraordinary chapter in American financial history. Economic challenges, budget deficits and tax implications lead the list of many issues confronting citizens and legislators. Surfacing in the midst of what appears to be mass chaos is yet another disturbing issue—victims of investment theft suffering irrecoverable losses in their life savings. One bright spot, with the uncovering of these massive investment scams, the media is finally bringing attention to the fact that there are hundreds of thousands of people across this great country who are suffering tremendously at no fault of their own.

For the last ten years, I have been fighting for financial recovery for victims of investment theft. There's been a law on the books since 1954 that helps some victims, but most often it ignores the truly needy in favor of the wealthy. Unfortunately, it also requires a monumental struggle with the IRS to get the deserved relief. The pain and suffering these issues caused demanded I shift my focus and become an advocate for victims in three ways:

Investment Fraud Prevention Through Education

Maximize Recovery Through Legitimate Sources

Changes in the Tax Code to Carry Out the Intention of the Law

PROBLEM—LACK OF CLARITY, COUNTLESS (MIS)INTERPRETATIONS & INEXPERIENCED PROFESSIONALS

The $50 billion dollar Bernard Madoff Ponzi Scheme brought this subject to the public, but sadly, and very importantly, it also surfaced so-called experts that began advising victims on the recovery option under Internal Revenue Code Section 165(c)(2). Adding to the tragedy of these losses is the fact that those same experts are supplying incorrect information. As an example: Stanford Law School and a former senior tax attorney for the IRS are both normally sources you can depend on for tax law advice. They are both valuable sources of information, but in trying to help victims of investment fraud, they recently published information that could cause more problems than they solve.

An article, *Long And Winding Path To Tax Relief For Madoff Victims*, appeared on *accountingweb.com* dated *February 19, 2009*. Stanford University provided information on the IRC 165(c)(2) tax deduction, quoting a former IRS official. This article is an example of a long list of experts serving up misconceptions, serious omissions, wrong answers and lost opportunities. Add *The Wall Street Journal, MSN, the New York Times and even the IRS* to your list of experts providing incorrect information, and you begin to understand the seriousness of the problem.

FACTS—CURRENT TAX LAW HELPING VICTIMS OF INVESTMENT THEFT

Current law includes but is not limited to, the following facts:

IRC 165(c)(2)

- Law was established in 1954 to help investment fraud victims recover a portion of their losses through tax benefits (much like that of natural disaster loss victims or casualty losses such as a destroyed automobile not covered by insurance). It was readdressed in 1984 by the Tax Reform Act, which did away with the 10 percent exclusion/$100 per item reduction.
- Deduction allows qualifying victims to take their total net loss against ordinary income in a single year.
- Deduction allows for the taxpayer to go back three years after declaring the loss in the "Year of Discovery" if a Net Operating Loss (NOL) remains, or, they can waive their right to go back, and carry the NOL forward up to 20 years.
- Deduction allows for up to a 20 year carry forward, with the exception of when the 3 year carry back is utilized, which subsequently creates the potential for a 23 year benefit.
- Losses in IRA and Pension Funds Do Not Qualify.
- The taxpayer must prove the investment was made and lost by reasons of theft as defined in the state where the transaction took place.
- Taxpayer must exhaust all reasonable means of recovery.
- Taxpayer must be able to prove privity (Private or joint knowledge of a private matter; especially:cognizance implying concurrence (Merriam-Webster) or in practical terms, there was a first hand relationship between the thief and the victim) in order to qualify. Ponzi scheme victims are generally not held to this requirement but that I'm aware, that exception is not written as fact.
- (Some) IRS agents consider any form of pending legal action (individual, class action, Federal indictments, bankruptcy or receivership) as potential recovery and will deny a claim until such time as that open pursuit of recovery is resolved.
- IRS *requires* a victim to provide proof of cost basis (copies of checks, front and back, wire transfer confirmations, disbursements, withdrawals, recovery, etc.).
- Taxes on phantom income are recoverable in full but are only allowed to be carried back 3 years. The balance (NOL) can be carried forward up to 20 years.

FICTION—MISINFORMATION COMMONLY GIVEN TO THE PUBLIC

- Before a taxpayer can claim a deduction, they must first exclude 10 percent of their Adjusted Gross Income and $100 per item—Wrong. Although originally an aspect of the deduction, this exclusion was eliminated 25 years ago by the Tax Reform Act of 1984.
- 2 Year Net Operating Loss Carry Back—Common misconception. Other than in 2002, when Congress allowed an exception allowing for 5 years, the carry

back has always been 3. The 2 year carry back does not apply to investment losses caused by theft.

- Up to 50 percent recovery of loss—Misleading. In my experience, taxpayers should expect to receive a total benefit between 10–20 percent of their loss. Although there may be an exception out there somewhere, I've never seen any victims receive even close to a 50 percent benefit.
- The deduction is taken in the year victims discover the money is gone—Maybe but not likely. Convincing the IRS of the right year to take the deduction is complicated. The big issue is the taxpayer having "exhausted all reasonable means of recovery". The "year of discovery" determination will vary from agent to agent.
- The deduction is simple to obtain—Really? It takes a knowledgeable and experienced 165 tax preparer to guide both taxpayers and the IRS agents through this process. I promise you, you should be prepared to be fully prepared. Taxpayers should expect to be reviewed carefully.

FUTURE—NEW PROPOSED LEGISLATION

For some time, I have been trying to get Congress to see the need for changes in the law. The size of the Madoff ponzi scheme helped me with my mission to get congresses attention. In doing so, they are now discovering how prevalent investment theft and ponzi schemes are in America. Congressman Kendrick Meek of Florida's 17th district moved quickly and proposed new legislation on February 24, 2009. I'm thrilled to see it happen, but it did not go far enough.

Proposed changes to current tax law.

- Will allow a 10 year carry back (or length of time in fraudulent investment, whichever is lesser) on cost basis and taxes paid on phantom income verses the current carry back of 3 years. Given the fact that a great deal of injured investors are in the retiree/elder categories and have had little to no income over the last several years, this change will hopefully increase the chance of them reaching a year where significant taxes were paid.
- Proposes to provide assistance to individuals who contributed to charitable organizations. This is a new aspect to the law and it needs to be further examined in order to determine just who gets what benefits? It's not clear on how this will work and I'll have to wait for more details before I can comment.
- New legislation uses the word "estimate" verses "ascertained". This may be a big help in the filing of the claims in a reasonable amount of time, but it is not definitive and more work needs to be done.

FUTURE—CONTINUED—QUESTIONS NOT ADDRESSED

- Will the complicated terms "Year of Discovery, Privity, Scienter, Cost Basis and Complete and Final Transaction" be defined in a way that makes it reasonable for the taxpayer to meet the requirements for filing? Regardless of what legislation is proposed or passed, unless these issues are defined in a way that tax payers, their tax professionals and the IRS alike can understand, little if any of this assistance will reach the intended recipients.
- Why is this limited to just ponzi schemes? Although certainly less publicized, other forms of investment fraud are still investment fraud and all qualifying victims should be given the same consideration, Will the new legislation actually limit the amount of time before a victim can claim the deduction and the IRS can take to approve it? The current process often takes so long that victims lose everything, including benefits, their homes and even their lives, before the help arrives.
- Will IRA and pension savings be added to the forms of acceptable losses/victims? A huge constituency of victims falls into this category and although technically they never paid taxes, they still worked hard for their money and would have paid them when the time arose. The money was withdrawn, the perpetrator was enriched and he or she should owe the taxes. Regardless of whether the IRS actually receives them, the victim should be entitled.
- Would a uniform tax rate potentially be the better and fairer way to go? Although the current proposed legislation goes far in trying to help, there are still a group of individuals that will be left helpless. As many of these individuals paid on average 15–20 percent in taxes when the money was made, it doesn't seem quite fair that they are penalized for having grown older or now having no income.

SOLUTION

I'd start with definable (and reasonable) guidelines for tax payers and professionals. Next would be setting up fair opportunities for recovery across the board,

regardless of tax bracket or age. And finally would be the creation of an organization, or an IRS qualifying exam, that sets the standards for professional services. Setting these guidelines and standards, much the same as what CPAs, doctors, attorneys, etc. must adhere to or lose their standing, would help satisfy the IRS that the claims are legitimate, would provide the relief that so far is nearly impossible to receive and insure that the professionals assisting these victims are qualified and making claims in good faith. By enacting legislation that gives the IRS authority to qualify those who represent taxpayers, they'd not only protect the victims, they'd protect all taxpayers against fraudulent or unworthy claims.

It was a breath of fresh air to finally see someone step up and try to help these people and I applaud Congressman Meek. He's taken the first step, and with a few additions, he could make this law something to be proud of.

I'd like to officially request an opportunity to discuss this issue with the individuals working on this bill and formally request the opportunity to speak before any hearing considering it. I not only can provide valuable practical information on how current legislation is affecting individuals but potentially can provide insight into aspects not yet considered that directly impact this issue.

Thank you for your time and consideration.

Moira Souza Shiver
MSS Advocacy Group
mss165.com
moira@mss165.com

STATEMENT OF COLLEEN M. KELLEY

Chairman Lewis, Ranking Member Boustany, and distinguished Members of the Subcommittee, I would like to thank you for allowing me to provide comments on IRS assistance for taxpayers experiencing economic difficulties. As President of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

Mr. Chairman, NTEU believes that in the current economic climate, it is more important than ever that taxpayers be able to deal with the IRS directly to work through any financial difficulties they may encounter. IRS employees have a wide range of tools and information at their disposal, which allow them work with taxpayers to address their financial hardships and to become compliant.

Above all else, the IRS employee's interest is in assisting struggling taxpayers to meet their tax obligations in a way that will not exacerbate their financial distress. When an IRS employee works with a taxpayer, the employee has access to all of the taxpayer's information and can answer questions and offer advice. For example, they can see whether a taxpayer has not filed a return and explain that the sooner the taxpayer makes arrangements to address filing and balance due issues the less penalty and interest they will owe. They can look at the taxpayer's records and answer questions about why they owe a balance and what they can do about it. They can also tell the taxpayer that they are not having enough taxes withheld by their employer and need to address that or that if an ex-spouse is claiming a child as a dependent they will not also be able to receive an exemption. If a simple mistake, like a math error, has occurred, they can fix it. They can provide an extension of the time period for payment. They can make a determination that the taxpayer meets the currently not collectible requirements or whether the taxpayer may be eligible for an Offer in Compromise, in which part of the balance due is foregone.

In addition to this wide-range of services, the IRS just last month announced a number of additional steps which will allow IRS workers to better assist financially distressed taxpayers. These include, providing IRS employees with greater authority to suspend collection actions in certain hardship cases where taxpayers are unable to pay; allowing skipped payments or partial monthly payments for taxpayers in existing installment agreements that have previously paid on time but are no longer able to do so due to loss of employment or some other financial hardship; easing ability of some taxpayers to get an Offer in Compromise, and speeding delivery of levy releases for homeowners who are behind on their taxes who want to refinance or sell their homes.

Mr. Chairman, while these additional flexibilities will better enable IRS workers to provide some struggling taxpayers with the assistance they require to work through their financial difficulties, some of our most vulnerable taxpayers, including

low-income taxpayers, those with language barriers, the elderly and the less educated will continue to be disadvantaged as a result of the IRS' continuing use of private collection agencies (PCAs) to pursue tax debts. Aside from the folly of turning this inherently governmental function over to the private sector, use of the PCAs to collect taxes creates a double standard and disadvantages Americans who may be in the most dire straits.

Unlike the PCAs, the IRS is able to provide special assistance to the most vulnerable in our society. IRS workers can postpone, extend or suspend collection activities for a period of time, make available flexible payment schedules that provide for skipped or reduced monthly payments or waive late penalties or postponing asset seizures.

The PCAs cannot offer taxpayers any of these authorities. They can only request full payment of taxes owed either immediately or in an installment agreement of 5 years or less. What is worse is that taxpayers who deal with PCAs are extremely unlikely to know that other options are available to them if they deal directly with the IRS, because the PCAs do not inform them.

The PCAs sole interest is to collect from a taxpayer the balance due amount they have been provided. They have no interest in whether the taxpayer owes other taxes or may not have filed required returns, nor do they have access to any other taxpayer records, so they are unable to answer any questions, provide any advice or use any tools, such as extensions or offers in compromise.

In addition, while taxpayers unfortunate enough to be assigned to the PCAs are limited to interacting with the PCAs over the phone, vulnerable taxpayers that prefer personal, face-to-face tax assistance with IRS employees can do so at the 401Taxpayer Assistance Centers (TACs) located nationwide. Taxpayers are able to visit the TACs when they have complex tax issues, need to resolve tax problems relating to their tax accounts, have questions about how the tax law applies to their individual income tax returns, or feel more comfortable talking with someone in person.

The IRS is also specially equipped to assist persons with limited English proficiency work through their financial troubles through its Multilingual Initiative (MLI). This service wide initiative provides written and oral assistance to Limited English Proficient (LEP) taxpayers in Spanish, Chinese, Vietnamese, Korean and Russian. This program ensures that non-English-speaking taxpayers who lack full command of the English language and are experiencing financial difficulties are able to take advantage of the wide array of services that the IRS can offer them.

In calling for an end to the IRS use of PCAs, Nina Olson, the National Taxpayer Advocate, an independent official within the IRS that looks out for taxpayer rights, has said that taxpayers who are unrepresented and vulnerable are disproportionately likely to be contacted by PCAs, and that the median income of taxpayers assigned to the PCAs is significantly less than that of taxpayers assigned to the IRS.

In addition, Olson has noted that no case can be turned over to a PCA in which a taxpayer is represented by a tax professional. Thus, "taxpayers who can afford representation are exempt from this initiative." Clearly, that treats lower income taxpayers more harshly than others.

Clearly, a tax system relying on public confidence that everyone is paying her or his fair share is dangerously eroded by the double standard generated when bounty hunters collect taxes from vulnerable people for profit and people who work directly with the IRS are receiving assistance that those working with debt collectors are not.

NTEU strongly supports provisions in the Omnibus Appropriations bill to cut off appropriations for PCAs and supports H.R. 796 introduced by Chairman Lewis and Chris Van Hollen that would repeal the IRS' authority to use them.

Mr. Chairman, NTEU believes that in a bleak economic landscape, with skyrocketing job losses, home foreclosures and rising credit delinquencies, the last step we should be taking is disadvantaging people who are among our most vulnerable taxpayers.

IRS employees remain committed to assisting delinquent taxpayers facing financial difficulties in the current economic climate. With access to a wide range of tools and information, the IRS can provide struggling taxpayers the flexibility and assistance they need to meet their tax obligations during the current economic downturn.

STATEMENT OF SANTA BARBARA BANK & TRUST

Dear Mr. Chairman:

On behalf of Santa Barbara Bank and Trust (SBBT), a brand of Pacific Capital Bank, N.A. and one of the nation's largest providers of tax-refund related products, I am writing to respond to testimony offered by Nina E. Olson, the National Taxpayer Advocate, at the Subcommittee's February 26th hearing to examine assistance available from the Internal Revenue Service (IRS) to taxpayers experiencing economic difficulties.

The Taxpayer Advocate's testimony focused on the tax compliance challenges facing struggling taxpayers during this tax filing season. One such challenge cited by Ms. Olson was that "[m]any taxpayers who are entitled to tax refunds and need them quickly do not receive them for weeks and this delay drives many of them to pay significant transaction fees to obtain refund anticipation loans (RALs)."[1] In fact, we believe that RALs offer a significant value to almost nine million families who use them every year to more quickly obtain access to needed funds in anticipation of their tax refunds.

For many low-income taxpayers, Federal tax refunds represent the largest sum of money they will receive at any one time in the entire year. As Ms. Olson's testimony noted, "[a]mong taxpayers who received the earned income tax credit (EITC) and tax refunds in tax year 2006, the average refund amount was $3,184, and the average adjusted gross income was $15,763. Thus, the average refund amounted to *20 percent* of each taxpayer's adjusted gross income."[2] The National Taxpayer Advocate also stressed in her 2007 Annual Report to Congress that delays in obtaining tax refunds can be particularly challenging for low-income taxpayers:

> Tax refunds are particularly important to low-income taxpayers—A taxpayer for whom the refund is so significant often makes financial plans based on when he or she anticipates receiving the refund and may view the refund as a lifeline. For some taxpayers, a delay of two to four weeks in receiving the refund could mean eviction, inability to pay the high heating bills that arise during winter, or defaulting on credit card bills from the holiday season.[3]

The length of time it takes for taxpayers to receive their tax refund depends on (1) whether or they file electronically, (2) have a bank account and can receive the tax refund through the IRS Direct Deposit program, or (3) are unbanked and would have to wait for the IRS to send their refund via paper check. For taxpayers who have bank accounts and can receive their refunds through direct deposit, the IRS has done a good job of shortening the delivery time to between 8–15 days. However, for taxpayers without bank accounts, obtaining a refund via paper check still takes up to eight weeks from the date they file their tax return.

Ms. Olson is concerned that for unbanked taxpayers, such potentially long delays "drive many of them to pay significant transaction fees to obtain refund anticipation loans (RALs)."[4] While SBBT cannot speak to the transaction fees charged by tax return preparers, we believe that our RAL fees are very reasonable and that RALs provide a valuable service by bridging the potential eight week gap that those without bank accounts would otherwise have to wait for their tax refunds.

SBBT's average RAL amount in 2008 was $3,286. For that loan, SBBT charged a total of $113 in fees, including a $31 bank account set-up fee and a finance charge of 2.5 percent of the loan amount. Other than the actual principle due the bank (typically repaid after the IRS deposits the expected refund into a customer's temporary RAL bank account), there are no other loan fees, payments or interest due from the taxpayer, even if the IRS holds the refund up (e.g., because the taxpayer's return is undergoing a compliance check) or ultimately refunds less than the expected amount. There is simply the one-time fee. We believe this is certainly a fair amount to pay to receive access to much needed funds up to eight weeks faster than the IRS can currently deliver them.

In order for SBBT to be able to offer RALs to taxpayers at a fair and reasonable price, we must develop a business plan each year for the program. This "plan" is based upon loan repayment rates, projected volume and certain fraud assumptions. The loan repayment rates are projected out over the tax season to determine the

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[1] Written statement of Nina E. Olson, National Taxpayer Advocate, before the Subcommittee on Oversight, House Committee on Ways and Means, Hearing on Tax Compliance Challenges Facing Struggling Taxpayers, February 26, 2009, p. 14.

[2] Id., p. 15.

[3] National Taxpayer Advocate's 2007 Annual Report to Congress, December 31, 2007, Volume I, p. 5.

[4] Id., p. 15.

funding curve that the bank will need to cover the loans until repayment occurs. Finally, income projections for the filing season complete the "plan," which is subsequently used to secure appropriate funding for the program. Funding agreements, sometimes obtained outside the bank, and their performance are critical to achieve profitability

This filing season, our RAL program has been thrown into disarray as a result of significant IRS delays in providing timely refunds for thousands of taxpayers who are also RAL borrowers. Our information tells us that the Service is experiencing significant processing and operational delays, in part due to added compliance checks instituted this year. As a result of these IRS processing delays, the rate of return that SBBT will earn on its RAL program will be less than what was estimated in our plan. Because our earnings will be lower than estimated, next year the cost of funds to securitize our RAL lending program will likely increase. That increase will inevitably be passed on to consumers.

Collectively, the RAL banks consider ourselves to be major stakeholders in the IRS electronic filing program. Returns associated with RALs represent 20–25 percent of all e-filed returns. RALs provide an important service every year to millions of taxpayers at a fair price. While the Taxpayer Advocate's suggestion to expand refund delivery channels is commendable, delivery of refunds for debit cards would not be a panacea for the processing and operational delays that occur in almost every tax filing season. For example, the compliance checks instituted this year would still have caused delays in refunds being loaded to debit cards for thousands of taxpayers. Conversely, thousands of taxpayers who otherwise would have had to wait (and would still be waiting) for their refunds obtained much-needed funds within 24–48 hours after filing their taxes by using RALs. Until the IRS is able to quickly and efficiently deliver all tax refunds, we believe that RALs will continue to play an important role in tax administration.

We look forward to discussing with you and the Subcommittee staff ways in which both the private and public sectors can achieve greater transparency for fees throughout the entire tax preparation process, rather than simply continue to focus on RAL fees.

Sincerely,

Joseph Sica
Senior Vice President
National Government Relations Director