THE NATIONAL TAXPAYER ADVOCATE'S 2009 REPORT ON THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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THE NATIONAL TAXPAYER ADVOCATE'S 2009 REPORT ON THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

TUESDAY, MARCH 16, 2010

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

The Subcommittee met, pursuant to notice, at 2:00 p.m. in Room 1100, Longworth House Office Building; the Honorable John Lewis, [Chairman of the Subcommittee], presiding.

[The advisory announcing the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

March 9, 2010

The House Ways and Means Subcommittee on Oversight today announced that it will hold a hearing on the National Taxpayer Advocate's 2009 Report to Congress on the most serious problems encountered by taxpayers. **The hearing will take place on Tuesday, March 16, 2010, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

The National Taxpayer Advocate, Nina E. Olson, will be the only witness at the hearing. Any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Office of the Taxpayer Advocate was established by the 1996 Taxpayer Bill of Rights (P.L. 104–168). The purpose of the office is to provide an independent system to assist taxpayers in resolving problems with the Internal Revenue Service (IRS), to propose changes in the administrative practices of the IRS, and to identify potential legislative changes to resolve problems affecting groups of taxpayers. The office is under the supervision of the National Taxpayer Advocate (Taxpayer Advocate) and operates independently from the IRS. The Taxpayer Advocate must submit a report each year to the House Committee on Ways and Means and the Senate Committee on Finance.

FOCUS OF THE HEARING:

The Taxpayer Advocate will highlight key issues and recommendations from her December 2009 Report to Congress. The Taxpayer Advocate's report contains sections on the most serious problems encountered by taxpayers; legislative recommendations; the most litigated tax issues; and certain research and related studies. The hearing will focus on issues raised by the Taxpayer Advocate that relate to services provided to taxpayers and fairness in the administration of our tax laws. Specifically, the hearing will review her concerns related to: the IRS's proposed tax return preparer initiative; the unmet needs of low-income taxpayers; the decline in IRS toll-free telephone assistance; and certain IRS collection policies that unnecessarily harm taxpayers. The hearing will explore legislative and administrative solutions to the problems identified. Finally, the Taxpayer Advocate will update the Subcommittee on issues included in previous annual reports.

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://democrats.waysandmeans.house.gov, select "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, submit all requested information. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, **by close of business Tuesday, March 30, 2010**. 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 or (202) 225–3625.

FORMATTING REQUIREMENTS:

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.

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

Chairman LEWIS. Good afternoon. Welcome. This is a hearing on the Taxpayer Advocate report. The hearing today is now called to order.

The National Taxpayer Advocate is a valuable resource for this Committee and we are pleased to welcome her here today. She is a voice for all taxpayers. Her office was created to help taxpayers resolve problems with the Internal Revenue Service. As we meet today, we are in the middle of the tax return filing season, and we are mindful that so many Americans are suffering during these difficult economic times.

So, it is a fitting time for us to hear from the Taxpayer Advocate. This hearing will give us a chance to learn what problems taxpayers are facing and how we can help. Calls that are not answered, penalties that bankrupt businesses and liens that harm low-income taxpayers are only a few of the problems. Other problems include making taxpayers who offer to pay their taxes over time complete 100 steps to have their offers accepted. This is not right. It almost makes no sense.

We must simplify the process to make it easier for taxpayers to meet their obligations. In some cases, the laws may need to be changed, and in other cases, the IRS may need to change its policy or rules. Either way, the time is now to address these problems. These issues are important to the Committee. They are important to the taxpayers. We must work now to address them this year; not next year, but this year.

Now, I am pleased to recognize the distinguished Ranking Member, Dr. Boustany, for his opening statement.

Mr. BOUSTANY. Mr. Chairman, thank you very much for holding this hearing and I thank you for yielding time. And, Mrs. Olson, thank you once again for appearing before our subcommittee

to represent the interest of one of the groups most in need of Washington representation, average American taxpayers.

You do a great service to our country and I thank you for your tireless advocacy on behalf of those taxpayers. We are holding this hearing today as we do every year to examine the most serious problems encountered by taxpayers in their dealings with the federal tax laws and the Internal Revenue Service. This year, however, the timing of the hearing is fortuitous in many respects, for if the House Democratic leadership is to be believed, then by the end of the week Congress might have enacted a piece of legislation that vastly expands the scope of the IRS's responsibilities and fundamentally alters the relationship between the IRS and taxpayers. That piece of legislation is H.R. 3590, the Senate passed healthcare bill.

I noticed that in this year's report, Mrs. Olson, you included an extensive discussion on the risks and challenges involved in running social programs through the tax system. Jumping off from that discussion, I would point out that the Senate Healthcare bill creates by far the largest social program ever run through the IRS. While the Senate bill delegates enforcement of numerous parts of the health insurance system to the IRS, one of the most troubling expansions of IRS power is the power to approve a taxpayer's health insurance as sufficient to meet the definition of minimum coverage required to be purchased by law. This is the so-called individual mandate.

Under the Senate's individual mandate, the IRS would be in charge of verifying that every American taxpayer has obtained acceptable health coverage for every month of the year. If the IRS determines that a taxpayer lacks acceptable insurance for even a single month, then the IRS would have the power to impose a new tax on that taxpayer, even auditing the taxpayer in assessing interest and penalties on top of the tax. This is an unprecedented new role for the IRS, one that will inject the IRS even further into the personal lives of American families.

So, in a few moments I intend to ask you, Mrs. Olson, to share your thoughts on what problems might arise both between the IRS and taxpayers and within the IRS itself, if the House Democrats decide to send the Senate Bill on to the President and make it the law of the land. Mrs. Olson, I look forward to your testimony and your responses; and, Mr. Chairman, thank you very much, and I yield back.

[The prepared statement of Mr. Boustany follows:]

Prepared Statement of Charles Boustany, Jr. (R–LA), Ranking Member, Subcommittee on Oversight

(Remarks as Prepared)

Mr. Chairman, thank you for yielding time.

And Ms. Olson, thank you once again for appearing before the Subcommittee to represent the interests of one of the groups most in need of Washington representation—average American taxpayers. You do a great service to our country and I thank you for your tireless advocacy on behalf of those taxpayers.

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Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you very much, Dr. Boustany, for your statement.

Now we will hear from the Taxpayer Advocate, Ms. Nina Olson. I ask that you limit your testimony to five minutes. Without objection, your entire statement will be included in the record. You may start.

STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Ms. OLSON. Thank you, Mr. Chairman, ranking member Boustany and Members of the Subcommittee. Thank you for inviting me to discuss the National Taxpayer Advocate's 2009 Annual Report to Congress.

First, I'd like to commend the IRS's response to one problem I identified in 2002 and again this year: the need to improve oversight of the return preparation industry. Since 2002 there has been considerable congressional support for preparer regulation including legislation sponsored by Congressman Becerra. In January 2010 under Commissioner Shulman's leadership, the IRS issued a report setting out a blueprint to do the job itself and it is now working on implementation details.

When fully implemented, I believe this initiative will improve tax administration sufficiently by helping taxpayers locate qualified preparers, establishing clear requirements of competence and ethics for preparers and disciplining and even shutting down unqualified and unethical preparers. Second, this year I designated the inability of the IRS to adequately answer taxpayer phone calls as the number one most serious problem for taxpayers.

The IRS's target for the current fiscal year is to answer only 71 percent of calls from taxpayers seeking to reach a telephone assistor. Among calls that do get answered, the IRS projects the average wait time will be nearly 12 minutes, up from just over four

minutes in fiscal year 2007. I encourage the subcommittee to support sufficient, additional funding for the IRS toll free lines so that the IRS can achieve an 85 percent level of service, an average wait time of five minutes.

Third, my report designated the IRS's lien filing policies as the second most serious problem for taxpayers. The IRS collection function has awesome powers to collect unpaid taxes, including the notice of federal tax lien. The mere notation of a federal tax lien on a taxpayer's credit report typically causes the taxpayer's credit score to drop by about 100 points, initially. It can increase borrowing, insurance and housing costs, and even impair the taxpayer's employability.

For small business tax payers, a lien can be a fatal blow. The lien notation remains on credit reports for seven years after the tax debt is paid in full. Thus, the decision to file a lien requires the IRS to balance the harm the lien will inflict on the taxpayer against the revenue the lien is likely to generate. Yet, the IRS does not require its employees to conduct that balancing. The revenue benefits of IRS lien filings actually appear quite limited. The IRS has increased lien filings by 475 percent over the last decade, while inflation adjusted collection revenue has dropped by 7.4 percent.

In fact, despite the economic downturn, the IRS filed more liens in fiscal year 2009 than in any year since fiscal year 1994. Moreover, a recent task study found that on accounts against which a lien had been filed, the largest source of collection revenue and payments were refund offsets, which occur regardless of whether or not a lien has been filed. Based on the data we've seen, there is a strong possibility that the IRS is harming hundreds of thousands of taxpayers a year to collect $1 billion or less.

The legislative history of the "Restructuring Act" shows that Congress wanted more managerial review of lien filings, but the IRS is now requiring less review. In many cases, the IRS generates liens without determining whether taxpayers have any assets or are likely to acquire any assets to which the lien would attach. For example, the IRS automatically requests liens for every taxpayer the IRS puts in currently not collectible hardship status and whose debts exceed $5,000. These are cases where the IRS itself has determined the taxpayer cannot pay basic living expenses if he or she pays the tax debt.

I recommend that Congress require the IRS to consider a number of factors prior to filing the tax lien. We should not be unnecessarily harming taxpayers and impairing their future tax compliance for the collection of very few tax dollars. Fourth, I have similar reservations about the IRS's current approach to the offers in compromise program. In the past I've expressed that concern that the IRS has made offers less and less accessible to taxpayers creating a category of permanent tax debtors and undermining IRS collection efforts as well.

Consider this my last point. At the beginning of fiscal year 2009 there were over four million taxpayers with delinquent accounts, yet during fiscal year 2009 the IRS accepted only 10,665 offers. That means roughly speaking that the IRS accepted one offer of every 375 taxpayers with a delinquent account. At the same time the IRS placed accounts of over 2.1 million taxpayers into currently

not collectible status last year. The result of the IRS's restrictive offer policy is that IRS did not collect any tax on many of these accounts. I appreciate the opportunity to raise these concerns and welcome any questions.

[The prepared statement of Ms. Olson follows:]

WRITTEN STATEMENT OF

NINA E. OLSON

NATIONAL TAXPAYER ADVOCATE

HEARING ON

THE NATIONAL TAXPAYER ADVOCATE'S 2009 ANNUAL REPORT TO CONGRESS

BEFORE THE

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COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

MARCH 16, 2010

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

Thank you for inviting me to testify today to describe some of the most serious problems taxpayers face in their dealings with the IRS and to propose solutions to mitigate these problems, which I have also discussed in my 2009 Annual Report to Congress.[1]

Before I discuss taxpayer problems, I'd like to begin by calling attention to an IRS initiative that I consider a significant achievement – the initiative to improve standards in and oversight of the return preparation industry. I began calling for preparer regulation in 2002 because I saw first-hand before I joined the government how incompetent or unscrupulous preparers harmed taxpayers who trusted them and how their actions undermined tax compliance. Since that time, there has been considerable congressional support for preparer regulation. Congressman Becerra has sponsored legislation that Chairman Lewis and other members of the Ways and Means Committee have supported,[2] and on the Senate side, Senator Bingaman has sponsored companion legislation that the Finance Committee twice passed on a bipartisan basis.[3]

The IRS could have implemented preparer regulation on its own earlier, but under prior leadership, the agency opposed preparer regulation, in part because of concern that administering such a program would require the IRS to divert resources from other areas. When Commissioner Shulman took office, he reassessed that position and concluded that preparer regulation has the potential both to protect taxpayers and to improve tax compliance. As a result, he decided to make preparer regulation one of the signature initiatives of his tenure. Since he announced the initiative at a hearing before this Subcommittee last June, the IRS has been working diligently to design it. In January 2010, the IRS issued a report setting out a blueprint of its plan,[4] and it is now working diligently to implement it. Although the devil is in the details and there are still some important issues that need to be resolved, I believe the IRS is headed in the right direction. I further believe this initiative, when fully implemented, will improve tax administration significantly by helping taxpayers locate qualified preparers, establishing clear requirements of competence and ethics for preparers, and disciplining and even shutting down unqualified and unethical preparers. Later in my

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[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] *See* H.R. 5716, The Taxpayer Bill of Rights Act of 2008 (110th Cong.).

[3] *See* H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

[4] *See* IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

testimony, I will provide additional detail and identify potential legislative changes to supplement the initiative.

I also want to say at the outset that I believe the IRS has done a good job overall during the last two years as it simultaneously has delivered on its core mission of providing taxpayer services and collecting taxes while administering a number of economic stimulus programs, including the issuance of economic stimulus payments in 2008 and the processing of claims for the first-time homebuyer credit in 2009.[5]

Not surprisingly, however, the combination of these challenges – performing its core work, administering social programs and economic stimulus provisions, and collecting taxes against the backdrop of the highest unemployment rate in nearly three decades[6] – has stretched the IRS too thin in certain areas.

In my testimony today, I will provide a taxpayer perspective regarding areas where I believe the tax administration process can be improved.

1. IRS Toll-Free Telephone Service Is Inadequate to Meet Taxpayer Needs

Each year, tens of millions of taxpayers call the IRS seeking help with a wide variety of issues, including account questions and tax-filing questions. There is no single "correct" method for measuring the IRS's effectiveness in answering taxpayer calls, but the most common measure is the Customer Account Services Customer Service Representative Level of Service, or "LOS," which generally measures the percentage of calls that gets through to a representative among all callers seeking to do so. By this measure, the IRS answered 87 percent of its calls in FY 2004. Since that time, the LOS has been declining, plummeting to a low of 53 percent in FY 2008. In other words, IRS telephone assistors in FY 2008 were unable to answer nearly half of all calls received.

In FY 2009, the LOS rebounded somewhat to about 70 percent, and the IRS's target for the current fiscal year is 71 percent.

While answering 71 percent of calls is a vast improvement over 53 percent, it still means the IRS is effectively setting a goal of failing to answer nearly three out of every ten calls it receives from taxpayers seeking assistance from an IRS employee. Equally disturbing, the IRS projects that among calls that do get answered, the average wait time will be nearly 12 minutes, up from just over four minutes in FY 2007. This state of affairs led me to designate the level of service on the IRS toll-free lines as

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[5] Economic Stimulus Act, Pub. L. No. 110-185, § 101, 122. Stat. 613 (2008); American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 1006 in Division B, 123 Stat. 115, 316 (2009).

[6] *See* Bureau of Labor Statistics, *Labor Force Statistics for the Current Population Survey* (showing the civilian unemployment rate at or over 10 percent for October, November, and December of 2009 for the first time since 1983).

the number one most serious problem for taxpayers in my 2009 Annual Report to Congress.[7]

Although hard to quantify, the impact of the IRS's inability to answer taxpayer calls is significant and has considerable downstream consequences:

- When taxpayers call the toll-free line with tax law questions and cannot get through, some will just give up and not bother to file their tax returns. Others will file inaccurate returns that require IRS follow-up action and taxpayer response.

- When taxpayers call the IRS after receiving notices proposing additional tax and they cannot get through, some will not respond to the notice, requiring the IRS to take further steps and potentially exposing the taxpayer to enforced collection action. Others will write letters to the IRS, requiring IRS employees in the Accounts Management (AM) function to respond.

In fact, many Accounts Management employees shuttle back and forth between handling paper correspondence (including the processing of amended returns) and answering telephone calls. When IRS employees dedicated exclusively to answering taxpayer calls cannot handle the call volumes, AM employees are shifted from handling paper correspondence to help out. Not surprisingly, as call volumes have increased and Accounts Management employees have been moved to answer phone calls, paper correspondence inventories have increased as well. The paper correspondence inventory rose from 480,292 at the end of FY 2007 to 775,960 at the end of FY 2009 – a 62 percent increase.[8] At the same time, the amount of overage correspondence has varied considerably from a weekly low of 54,000 to a weekly high of more than 1.1 million.

To some degree, the combination of poor telephone service and slow correspondence processing creates a vicious cycle: Taxpayers who cannot get through to the IRS by phone send letters, causing more work for employees assigned to paper correspondence and leading to correspondence backlogs and delays in processing amended returns, while taxpayers who write to the IRS and do not receive timely responses call the IRS to try to figure out what happened.

As noted above, the sharp decline in the IRS's ability to handle call demand and timely process taxpayer correspondence is due primarily to the impact of the Economic Stimulus Act and other statutory changes that have increased the IRS's work or generated taxpayer questions. The following chart shows the level of call volumes and the IRS's success in answering calls since 2005.

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[7] *See* National Taxpayer Advocate 2009 Annual Report to Congress 4-16 (Most Serious Problem: *IRS Toll-Free Telephone Service Is Declining as Taxpayer Demand for Telephone Service Is Increasing*).

[8] *IRS, Joint Operations Center Accounts Management Paper Inventory Adjustments Reports FY05, FY07, FY09* (Oct. 30, 2009).

IRS CUSTOMER ACCOUNT SERVICES (CAS) TOLL-FREE PHONE DATA[9]

Fiscal Year	CAS Net Attempts (in millions)	CAS Assistor Answered Calls (in millions)	Customer Service Representative Level of Service	Average Speed of Answer (in seconds)
2005	64.5	33.4	82.6%	258
2006	64.2	33.2	82.0%	242
2007	67.4	33.8	81.3%	268
2008	150.6	40.4	52.8%	626
2009	93.7	39.0	70.0%	526

As this chart shows, call volumes ran at a fairly steady level of between about 64 million and 67 million in the three years before the Economic Stimulus Act was passed in February 2008. During the balance of 2008 and into 2009, the IRS was flooded with stimulus-related calls, with the IRS receiving an all-time high of over 150 million calls in FY 2008. Note, too, that the IRS actually answered 20 percent more calls in FY 2008 than it had answered in FY 2007 (40.4 million vs. 33.8 million), yet the LOS declined from 81 percent to 53 percent because the overall call volume increased by 123 percent (from 67.4 million to 150.6 million).

For these reasons, the decline in the IRS's level of service is understandable from the standpoint of resources. However, it is not an acceptable state of affairs from the standpoint of the tens of millions of taxpayers seeking help. In his book, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America*, former Commissioner Charles Rossotti addressed the importance of maintaining a high level of service on the IRS's toll-free lines:

> Apart from the justifiable outrage it causes among honest taxpayers, I have never understood why anyone would think it is good business to fail to answer a phone call from someone who owed you money.[10]

Let me be clear that I am not being critical of the IRS's handling of the increased telephone volume – it generally is applying its current resources appropriately and is seeking new ways to use those resources more productively. However, to meet taxpayer needs, to improve the ability of taxpayers to comply with tax law requirements and respond to IRS notices, and to reduce the aggregate burden on the

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[9] IRS, JOC Enterprise Telephone Data, *Snapshot & Half Hourly Adherence Reports* (Oct. 30, 2009). Some calls are handled via automation and do not require the assistance of a customer service representative. Automated calls are not shown in this chart.

[10] Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 285 (2005).

IRS when taxpayers who can't get through by phone contact the IRS through multiple channels with the same question, I believe the IRS must be able to answer at least 85 percent of taxpayer calls and keep taxpayers on hold for no longer than an average of five minutes.

Recommendations

- I encourage the Subcommittee on Oversight to support sufficient additional funding for the IRS toll-free lines so that the IRS will have the resources to achieve an LOS of 85 percent and an average wait time of five minutes.

- I recommend that the IRS study its call and verification requirements to try to identify opportunities to reduce the length of calls without shortchanging taxpayers. During a recent meeting of an IRS advisory committee, for example, a practitioner reported that when he calls the IRS, more than half of the call is typically spent on authenticating his identity and the identity of the taxpayer he represents and less than half is spent discussing his question. While this observation reflects just one practitioner's experience and the IRS must not compromise the effectiveness of its authentication procedures, the IRS should assess its authentication steps to determine whether the time spent on authentication can be reduced without compromising security. For example, additional information could be verified via automation by asking taxpayers to key in certain data before an assistor gets on the line, as many businesses ask their customers to do now. If the IRS can shave off even five percent to ten percent of average call time through better screening, the resulting efficiency gain would be significant.

2. IRS Lien Filing Policies Are Unnecessarily Harming Taxpayers Without Maximizing Tax Compliance – in Violation of the Intent of RRA '98

A. Background

When a taxpayer fails to pay a tax debt, the IRS Collection function is charged with attempting to collect it. The Collection function has powerful tools at its disposal to do this – it may file a notice of federal tax lien (NFTL) against a taxpayer's property or impose a levy against wages, bank accounts, or other income sources without obtaining prior approval from a court. However, the government has a responsibility to balance the goal of ensuring that everyone pays their fair share of taxes against the reality that millions of taxpayers lose their jobs or experience financial hardships each year, and the government generally should not be causing or exacerbating financial hardships. This is always true, but it is particularly notable when the unemployment rate is high and many taxpayers with solid compliance histories are becoming delinquent on their tax liabilities for the first time.

Properly applied, the NFTL can be an effective tool in tax collection. It gives the IRS a legal claim to the taxpayer's property, such as a home or a car, as security for the payment of the tax debt and may enable the IRS to collect all or a portion of the tax debt if the taxpayer sells or refinances the property. If improperly applied, however, NFTLs have the potential to cause needless harm to taxpayers and, not insignificantly, to undermine long-term tax collection as well. Thus, the decision whether to file an NFTL requires the IRS to balance the harm the NFTL will inflict on the taxpayer and the revenue the NFTL is likely to generate.

B. Tax Liens Reduce a Taxpayer's Credit Score and Can Be Devastating to the Taxpayer's Financial Viability

Assume that the IRS files an NFTL after a taxpayer loses his job and becomes unable to pay his tax bill. The following consequences result:

- The filing of the NFTL is quickly picked up by the three credit reporting agencies (Equifax, Experian, and Trans Union) and is included on the taxpayer's credit reports.
- The initial inclusion of a tax lien reduces the taxpayer's credit score by an average of 100 points.
- The mere notation of an NFTL on a taxpayer's credit report can destroy his financial viability. Employers increasingly review credit reports in making employment decisions, and some employers, especially in the financial services industry, will not hire or retain a person with an NFTL on a credit report. Insurance companies increasingly review credit reports and use scores in determining whom to insure and in setting rates. Landlords, retail stores, utilities, and other creditors also review credit reports. Thus, an NFTL may make someone unemployable and in virtually all cases will drive up the taxpayer's other costs.[11]
- For small business taxpayers, an NFTL can be a fatal blow. If an NFTL has been filed against a small business, it generally will not be able to obtain financing required to maintain business operations.
- The damage to a taxpayer is generally long-lasting. If the taxpayer settles a tax debt and the IRS releases the lien, the fact that the NFTL was filed and released will still be listed on the credit report for seven years.[12]
- If the taxpayer does not settle the tax debt and the lien is extinguished when the ten-year period of limitation on IRS collection action runs out, the three

[11] *See What Happened to Your Credit Score?*, Washington Post, Mar. 8, 2010, at E1.

[12] Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

credit rating agencies continue to include the NFTL on the report for even longer – one continues to list it for ten years, one continues to list it for 15 years, and one continues to list it indefinitely.

C. The Revenue Benefits of IRS Lien Filings Appear Limited

The IRS has increased the number of NFTL filings significantly over the past decade. From FY 1999 to FY 2009, the number of NFTLs filed each year jumped by 475 percent (from 168,000 to nearly 966,000). It is also worth noting that the IRS has increased the number of levies it has imposed against taxpayers' income and assets by about 600 percent from FY 1999 to FY 2009 (from 504,403 to 3,478,181).[13] If liens and levies were key drivers of Collection revenue, one would expect that the amount of revenue collected by the IRS Collection function since FY 1999 would have soared. But that has not happened. To the contrary, Collection revenue has *fallen* since FY 1999 on an inflation-adjusted basis by 7.4 percent.

Most importantly, the government's role as a creditor is different from the role of a private creditor. The government must focus not merely on collecting a past tax debt but on maximizing future tax compliance. If the filing of an NFTL drives up the taxpayer's costs and renders him unemployed or underemployed, the taxpayer may be less able to pay his past tax debt and may earn less income (and therefore pay less tax) in the future. Moreover, unlike a private creditor, if IRS collection practices push a taxpayer into poverty, other parts of the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like. IRS Collection practices do not explicitly consider that trade-off, but if the government pushes a taxpayer into poverty, the taxpayer has less income and the government receives less revenue – clearly a lose-lose proposition that we should be striving harder to avoid.

D. A TAS Study Shows the IRS Cannot Accurately Measure NFTL Filing Effectiveness

The sharp increase in NFTL filings combined with an inflation-adjusted reduction in Collection revenue prompted us to ask: What is going on here? Why is the IRS destroying the credit of so many taxpayers if doing so isn't furthering revenue collection?

Initially, I asked the IRS how much revenue is collected through NFTL filings. IRS collection personnel said they didn't know.

I found this lack of knowledge disturbing, because I do not see how the IRS can establish NFTL procedures that balance its collection goals against the desire to avoid inflicting unnecessary harm on taxpayers without knowing how much revenue NFTLs are generating. For that reason, I asked my research staff to conduct a high-level research project on collection activities that, in part, attempted to assess whether NFTLs are being

[13] As noted in a prior report, the number of levies increased by about 1,600 percent when measured from FY 2000 to FY 2007. *See* National Taxpayer Advocate 2008 Annual Report to Congress 20.

filed effectively to collect revenue. To make this assessment, TAS reviewed the collection history of all taxpayers who incurred balance-due tax liabilities for the first time during tax year 2002 – nearly 1.9 million transactions involving about 270,000 individual taxpayers – and against whom NFTLs were filed in subsequent years.[14] The results of our research suggest that the IRS's use of NFTLs may not be furthering the agency's revenue collection objective and, equally significant, that the IRS has shown very little interest in evaluating the effectiveness of NFTLs for itself. Among our findings:

- IRS procedures require employees to code the source of payments received on delinquent accounts.[15] Where the IRS received a payment after an NFTL was filed against a taxpayer's property, the IRS coded the source of payments as "miscellaneous" or did not code the payment at all in about 67 percent of the cases.[16] The IRS's failure to accurately code and track the source of payments defeats the purpose of having a coding system, because it precludes the IRS from drawing useful conclusions about the effectiveness of any of its collection actions, including NFTL filings.

- Using separate transaction codes, TAS was able to reconstruct the source of payments in approximately 15 percent of the uncoded cases, with the result that TAS could identify the source of 48 percent of the payments made with respect to accounts against which an NFTL had been filed. In these cases, our analysis found that more than 95 percent of all payments and more than 80 percent of all revenue collected did not result from the NFTL filings and would have been collected anyway.[17] The largest source of Collection revenue and payments on these accounts was refund offsets, which occur regardless of the existence of an NFTL (*i.e.*, the taxpayer filed a return in a subsequent tax year showing a refund due and the IRS withheld the refund to satisfy the past-due tax debt). Taking into account that nearly 52 percent of payments cannot be classified, only about $169

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[14] TAS reviewed 2,065,303 transactions from 270,399 individual taxpayers. For a more detailed discussion, see National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers)* and vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

[15] *See* IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

[16] IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated "miscellaneous" or "DPC indicator not present." Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 22 (Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments in CYs 2002-2009*). The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

[17] *See* National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

> million out of about $905 million collected was clearly attributable to lien filings with respect to 2002 delinquent tax liabilities.[18]

While the amount of revenue collected through NFTLs remains unknown, our study suggests that the total is relatively small. In FY 2009, the IRS Collection function brought in $27.2 billion. The majority of revenue raised by the Collection function comes through notices in cases where NFTLs have not been filed.[19] Considerable revenue also comes from refund offsets and from levies, among other sources, for which NFTLs are not required. Thus, the finding that only about $169 million was clearly attributable to NFTL filings among cases analyzed in the TAS study may not be far off the mark.

That figure was estimated based on TAS's evaluation of the 48 percent of cases arising in 2002 for which TAS could track the payment source. If that is representative of the full population, the total revenue with respect to those cases would be closer to $340 million. To be clear, we do not know the source or amount of payments that were not coded, and we do not know whether lien filings are more or less productive with respect to tax liabilities incurred in tax years other than 2002. But based on the data we have seen, there is a strong possibility that the IRS is harming hundreds of thousands of taxpayers a year to collect $1 billion or less. What's more, the IRS incurs considerable expense to work these cases, including the salaries of Collection personnel and the costs of NFTL-filing fees in local jurisdictions, so net revenue collection is considerably lower.

E. Legislative History Shows Congress Wanted More Managerial Review of Lien Filings, But the IRS Is Now Requiring Less Managerial Review

When Congress passed the IRS Restructuring and Reform Act of 1998,[20] it added IRC § 3421, which directed the Commissioner to develop and implement procedures under which any determination by an employee to file an NFTL would, where appropriate, be required to be reviewed by a supervisor before the action was taken.

The provision originated in the Senate, and the Senate Finance Committee report provided the following explanation:

> Supervisory approval of liens, levies or seizures is [currently] only required under certain circumstances. . . .
>
> The Committee believes that the imposition of liens, levies, and seizures may impose significant hardships on taxpayers. Accordingly, the Committee

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[18] IRS, Compliance Data Warehouse (CDW), IMF Transaction File Cycle 200913. The IRS collected $168.6 million in payments attributable to NFTLs and $736.7 million in payments not attributable to NFTLs in calendar years (CYs) 2002-2009.

[19] Notices accounted for 55.6 percent of the total collection yield for FY 2009. IRS, *Delinquent Accounts Receivable Yield Fiscal Year Comparison Cum thru September FY 2009*.

[20] Pub. L. No. 105-206, Title III, § 3421, 112 Stat. 685, 758 (1998).

> believes that extra protection in the form of an administrative approval process is appropriate. . . .
>
> The provision requires the IRS to implement an approval process under which any lien, levy or seizure would be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be considered include the amount due and the value of the asset. Failure to follow such procedures should result in disciplinary action against the supervisor and/or revenue officer.[21]

The conference report generally followed the Senate amendment but provided the Commissioner with discretion "to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate."[22] By negative implication, the conference report did not intend such discretion to apply outside the context of the automated collection system.

Through its procedures, the IRS has since turned on its head the congressional directive that managerial approval generally be obtained before an NFTL filing. The IRS has established a set of business rules under which liens are automatically filed and generally does not require employees to obtain managerial approval in order to file an NFTL. To the contrary, IRS procedures require all Automated Collection System employees to obtain managerial approval if they determine not to file an NFTL.[23] Any decision not to file a lien must be supported by a case history entry clearly stating the reason why filing an NFTL will hamper collection or is not proper (*e.g.*, because of doubt as to liability).[24]

Similarly, the IRS recently issued interim guidance requiring all Revenue Officers to obtain managerial approval to defer filing an NFTL for certain employment tax cases in which the unpaid balance is $5,000 or more.[25] Thus, the IRS requires employees to take extra steps and offer additional justification to avoid filing an NFTL. What's more, it does not require employees to determine whether the filing is likely to further the IRS's revenue collection objective (*e.g.*, verify whether the NFTL would attach to assets or undertake a

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[21] S. Rep. No. 105-174, at 78 (1998).

[22] H.R. Rep. No. 105-599, at 278 (1998) (Conf. Rep.). The IRS Automated Collection System (ACS) handles balance due and nonfiler cases that require telephone contact. IRS tax examiners and customer service representatives in ACS review taxpayer data and issue notices, liens, or levies to resolve delinquent tax cases.

[23] IRM 5.19.4.5.2(10) (Apr. 28, 2006).

[24] IRM 5.19.4.5.2(10) (Apr. 28, 2006).

[25] Small Business/Self-Employed Division (SB/SE), *Interim Guidance for Approval of Lien Determinations*, Control No. SBSE-05-1208-069 (Dec. 22, 2006). The IRS issued this guidance in an attempt to implement a Government Accountability Office (GAO) recommendation to timely file NFTLs in federal employment tax cases based on an assumption that filing the NFTL will increase the likelihood of collection. *See* GAO-06-617, *Tax Compliance, Businesses Owe Billions in Federal Payroll Taxes* 31 (July 2006).

review of the taxpayer's financial or personal position to determine whether the NFTL filing will be productive). In essence, IRS procedures have flipped Congress's explicit presumptions. In significant categories of cases, the IRS now imposes more rigorous managerial approval requirements when an employee determines not to file an NFTL than when an employee seeks to file one.

Today, the IRS generates a majority of its NFTLs through the Automated Collection System (ACS). Just under two-thirds of NFTLs requested by ACS were made systemically,[26] which means that the IRS generates these NFTLs without determining whether the taxpayers have any assets or are likely to acquire any assets to which the NFTL would attach. As an example, the IRS automatically requests NFTLs for every taxpayer whose delinquency exceeds $5,000 when the IRS determines that the liability is "currently not collectible" (CNC).[27] The CNC designation includes situations in which the IRS has determined that collection of the liability would create a hardship on taxpayers by leaving them unable to meet necessary living expenses.[28]

This automated approach to lien filing makes little sense not only from a common sense perspective but also from a business perspective. For example, for taxpayers with accounts in CNC/economic hardship status, TAS Research found that:

- IRS refund offsets were responsible for nearly $6 out of every $10 in tax payments collected from these taxpayers; and
- NFTLs were responsible for only $2 out of every $10 in payments collected from these taxpayers.[29]

One recent anecdote deeply concerns me: In a case handled by TAS, a Local Taxpayer Advocate asked a revenue officer to refrain from filing an NFTL in a sympathetic case. In response, the revenue officer said his group manager had told his work group that she would not approve any requests to defer the filing of an NFTL. The Local Taxpayer Advocate was told he would have to issue a Taxpayer Assistance Order[30] directing the IRS to refrain from imposing an NFTL because of the group manager's instruction.

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[26] *ACS Customer Service Activity Reports (CSAR), FY 2009 BOD report.*

[27] IRM 5.12.2.4.1(1) (Oct. 30, 2009).

[28] CNC status generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. IRM 5.16.1.2.9(11) (May 5, 2009); *see also* IRS Policy Statement P-5-71 at IRM 1.2.14.1.14 (Nov. 19, 1980).

[29] National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 5 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

[30] IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) if a taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered. A TAO can direct the IRS to take a specific action, cease a specific action, or refrain from taking a specific action. A TAO can also direct the IRS to review at a higher level, expedite consideration of, or reconsider a taxpayer's case. Upon receipt of a TAO, the responsible official in the IRS operating division/function may either take the requested action or appeal the order to a higher level. The appeal process may cause an issue to rise to the level of the

F. The IRS Rarely Withdraws Tax Liens Despite Explicit Statutory Authorization to Do So and Despite the Fact that a Lien "Withdrawal" Is Far Less Damaging to Taxpayers than a Lien "Release"

As described above, a lien that is "released" continues to be reflected on the taxpayer's credit record for seven years from the date of the release. However, an NFTL that is "withdrawn" is treated as if it had not been filed and is removed from the taxpayer's credit record.

In 1996, Congress authorized the IRS to withdraw an NFTL if the Secretary makes any one of four determinations:

(A) The filing of the notice was premature or otherwise not in accordance with IRS administrative procedures;

(B) The taxpayer has entered into an installment agreement to satisfy the tax liability for which the lien was imposed (unless the agreement provides otherwise);

(C) The withdrawal of the notice will facilitate the collection of the tax liability; or

(D) With the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of the notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.[31]

Congress clearly provided these four bases for withdrawal for a reason. In one TAS case, a taxpayer working in the financial services industry lost his job because of the filing of an NFTL. In that case, the taxpayer's employer had a policy to not employ individuals who have NFTLs filed against them. The taxpayer had paid the tax liability and owed only a small amount of interest and penalties. I personally became involved in the case and issued several Taxpayer Assistance Orders directing the IRS to withdraw the NFTL, but the Collection function declined to do so until after the taxpayer was fired.[32] In a case like that, the withdrawal of the NFTL would serve the best interests of both the taxpayer and the United States because an employed taxpayer is earning income and can pay taxes while the IRS is much less likely to collect from an unemployed taxpayer.

Commissioner. The Commissioner or the Deputy Commissioner ultimately may decide to modify or rescind the order. See IRC § 7811(c)(1).

[31] IRC § 6323(j)(1).

[32] Pursuant to IRC § 6103, the IRS generally is required to keep taxpayers' returns and return information confidential. In this particular case, however, the taxpayer provided a written consent to the National Taxpayer Advocate to disclose the facts of his case in congressional testimony.

Recommendations

On January 20, 2010, shortly after publication of the National Taxpayer Advocate's 2009 Annual Report to Congress outlining my concerns about IRS lien-filing and other collection practices, I issued two Taxpayer Advocate Directives (TADs)[33] to the Commissioners of the Wage and Investment and Small Business/Self-Employed Operating Divisions, ordering them, among other things, to:

- Immediately rescind the policy of automatic NFTL filing on currently not collectible hardship accounts;[34]
- Immediately require managerial approval for NFTL filings in all cases where the taxpayer has no assets;[35]
- Within 30 days of the issuance of the TAD, in consultation with the National Taxpayer Advocate, issue interim guidance requiring IRS contact employees to base a determination to file an NFTL on a thorough review of information concerning the taxpayer's assets, the taxpayer's income, and the value of the taxpayer's equity in the assets and, after weighing all the facts and circumstances, determine whether (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future;[36] and
- Immediately develop and issue guidance allowing, upon the request of the taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.[37]

In response, the IRS has established a task force to undertake a comprehensive review of IRS collection practices. I applaud this effort, in which the Taxpayer Advocate Service will participate. However, the IRS is not immediately changing any of its current guidance to collection employees. Therefore, in my opinion, taxpayers continue to be needlessly

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[33] Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD) to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers. IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001); *see also* IRM 13.2.1.6 (July 16, 2009). Upon receipt of a TAD, the only avenue of appeal for the IRS is to the Deputy Commissioner for Services and Enforcement. The Deputy Commissioner and the Commissioner have the authority to modify or rescind a TAD.

[34] Taxpayer Advocate Directive 2010-1 (Jan. 20, 2010).

[35] *Id.*

[36] *Id.*

[37] Taxpayer Advocate Directive 2010-2 (Jan. 20, 2010).

harmed, and future tax compliance and collection continue to be undermined, while the task force undertakes its year-long review.

- I recommend that the IRS institute a quality review of payment coding used to track the source of taxpayers' payments for tax liabilities. An accurate method of tracking payments is an essential first step in determining the impact of various collection tools on taxpayers and whether they are being used effectively.
- I recommend that Congress amend the Internal Revenue Code to:
  - Require that prior to filing an NFTL, the IRS review all the taxpayer's circumstances (including the existence and value of assets, the taxpayer's overall financial situation, the taxpayer's compliance history and reasons for noncompliance, and the existence and amount of non-tax debt) and make a determination, weighing all facts and circumstances, that (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future;
  - Allow a taxpayer to appeal any NFTL filing determinations to the IRS Office of Appeals before the NFTL is filed;
  - Provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above; and
  - Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required NFTL determination described above.
- I recommend that Congress amend section 605(a)(3) of the Fair Credit Reporting Act[38] to address the length of time that information about an IRS NFTL filing remains on a taxpayer's credit report after the release, withdrawal, or expiration of the NFTL or the underlying tax debt.

3. Despite IRS Commitments to Improve Accessibility of the Offer-in-Compromise Program and Assist Financially Struggling Taxpayers, the IRS Last Year Accepted the Lowest Number of Offers in a Decade

In prior National Taxpayer Advocate reports to Congress and in my testimony before this Subcommittee last year, I have continually expressed concern that the IRS has made offers in compromise less and less accessible to taxpayers, creating a category of permanent tax debtors and undermining IRS collection efforts as well. The IRS has made

[38] 15 U.S.C. § 1681c(a)(3).

repeated commitments to improve the accessibility of the program, but to date, tangible results are not evident.

Congress has authorized the IRS to settle a tax liability for less than the full amount owed in appropriate cases, such as where a taxpayer has lost a job or otherwise suffered a financial hardship and cannot afford to pay his or her full tax debt.[39] In 1998, Congress directed the IRS to make offers more accessible to appropriate taxpayers:

> 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.[40]

Offers can be a good deal for taxpayers and the government. Offers can be good 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 hang over their heads for the next decade. Offers can also be a good deal for the government because they enable the government to collect as much revenue as 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.[41] 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.[42] One study showed that about 80 percent of individual taxpayers with accepted offers remained substantially compliant for the five-year period.[43]

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[39] 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).

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

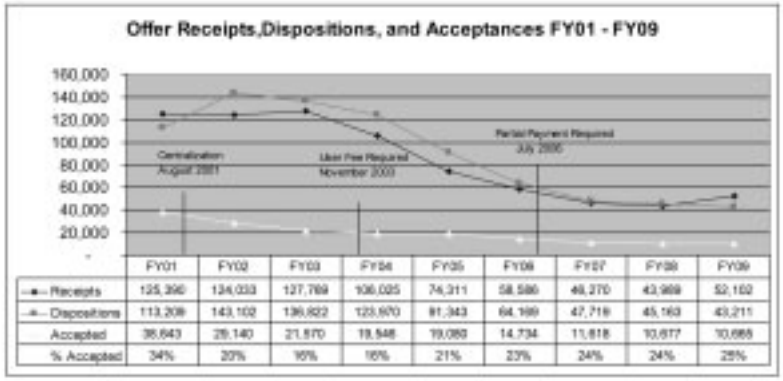
[41] *See* IRS Form 656, *Offer in Compromise*, § V(d) (Mar. 2009).

[42] IRM 5.19.7.3.20 (Jan. 16, 2009); IRM 8.23.3.14(3) (Aug. 28, 2009).

[43] 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.

Yet the IRS has erected so many obstacles to the offer in compromise that fewer and fewer taxpayers are applying and fewer and fewer offers are being accepted. For example, the application form and instructions now run 50 pages,[44] and a consultant analyzing the offer process concluded that a taxpayer must take over 100 steps to complete an offer application.[45] The following chart shows the trend in offers since FY 2001:

IRS OFFER-IN-COMPROMISE PROGRAM, FY 2001 - FY 2009[46]



	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09
Receipts	125,390	134,033	127,769	106,025	74,311	58,580	48,270	43,969	52,102
Dispositions	113,208	143,102	136,822	123,670	91,343	64,169	47,719	45,163	43,211
Accepted	38,643	28,140	21,570	19,548	19,080	14,734	11,618	10,677	10,665
% Accepted	34%	20%	16%	16%	21%	23%	24%	24%	25%

The number of offers the IRS receives has declined sharply – from 125,390 in FY 2001 to 52,102 in FY 2009, a drop of 58 percent. The number of accepted offers has declined by even more – from 38,643 in FY 2001 to 10,665 in FY 2009, a drop of 72 percent. In FY 2001, the IRS accepted 34 percent of offers, while in FY 2009, it accepted only 25 percent of offers.[47]

At the beginning of FY 2009, there were 4,001,260 taxpayers with delinquent accounts.[48] During FY 2009, the IRS accepted only 10,665 offers. That means, roughly speaking,

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[44] See IRS Form 656, *Offer in Compromise*, and accompanying instructions.

[45] Siegel & Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

[46] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108* (FY 2001-FY 2009).

[47] The percentage of accepted offers is computed by dividing the number of offers accepted by the number of offer dispositions.

[48] IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-2*.

that the IRS accepted one offer for every 375 taxpayers with a delinquent account. It is also worth noting that the IRS placed the accounts of 2,108,804 taxpayers into currently not collectible status last year.[49] Thus, the result of the IRS's restrictive offer policy is that the IRS did not collect any tax on many accounts, which undermines its revenue collection goals, and it is filing NFTLs against many of these taxpayers, which will undermine their long-term financial viability and ability to pay tax. I note that, remarkably, the IRS often files NFTLs against taxpayers while their offers are being reviewed by the IRS, which does not exactly provide an incentive for taxpayers to try to settle their tax debts and is not an appropriate way to work with taxpayers who are trying to work with us.

While some taxpayers are unresponsive to the IRS out of fear, preoccupation with other problems, or in some circumstances a willful desire to flout the law, most delinquent taxpayers are delinquent because they are struggling financially. If the IRS is collecting nothing from many of these taxpayers, surely it would be better to bring more of them back into compliance by accepting what they can afford and obtaining their pledge to remain in compliance in the future. It is a major failure of IRS collection policy that its offer-in-compromise program works with taxpayers in such a small percentage of cases. The IRS should do far more to ensure that its offer-in-compromise program is open for business to these taxpayers.

In January 2009, the IRS announced several steps to assist financially struggling taxpayers.[50] In connection with offers, it noted that "the equity taxpayers have in real property can be a barrier to an OIC being accepted," because with the sharp drop in housing prices, "the real-estate valuations used to assess ability to pay may not be accurate." To address these cases, the IRS announced it was "creating a new second review of the information." To date, this "second review" has not resulted in acceptance of a single offer in which property valuations were adjusted. The unit assigned to perform these "second reviews" has reviewed 11 offers and accepted three – and it did not adjust real property valuations in any of the accepted cases.[51]

In February 2009, the Deputy Commissioner testified before this Subcommittee that the IRS would retain a consultant to review the offer program overall and assess what can be done to make the program more accessible to taxpayers.[52] Since that time, the IRS has, in fact, retained two consultants to assess the offer program and identify opportunities to attract more appropriate offers. However, those commitments and the work of the consultants have not yet produced results. As noted above, the IRS actually accepted fewer offers in FY 2009 than it had accepted in FY 2008.

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[49] IRS Small Business/Self-Employment Division, *Recap of Currently Not Collectable Report, NO-5000-149* (Oct. 1, 2009) (covering the period 10-01-2008 to 09-30-2009).

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

[51] SB/SE response to TAS information request (as of Feb. 2010).

[52] *IRS Assistance to Taxpayers Facing Economic Difficulties: Hearing Before the Subcomm. On Oversight of the H. Comm. On Ways and Means*, 111th Cong. (Feb. 26, 2009) (testimony of Linda E. Stiff, Deputy Commissioner for Services and Enforcement, Internal Revenue Service).

Last week, the IRS announced a new series of steps to assist financially struggling taxpayers. According to the IRS announcement:

> IRS employees will be permitted to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise. Normally, the standard practice is to judge an offer amount on a taxpayer's earnings in prior years. This new step provides greater flexibility when considering offers in compromise from the unemployed. . . .
> These immediate steps are part of an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers.[53]

It is not clear what impact this announcement will have, because IRS employees already have the flexibility to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise, including where the taxpayer is unemployed. Internal Revenue Manual guidance in effect at least since 2005 states:

> Some situations may warrant placing a different value on future income than current or past income indicates:
>
> IF [a] taxpayer is temporarily unemployed or underemployed
>
> THEN [u]se the level of income expected if the taxpayer were fully employed and if the potential for employment is apparent. Each case should be judged on its own merit, including consideration of special circumstances or [Effective Tax Administration] issues.[54]

An interim guidance memorandum issued on March 10, 2010, generally retains the above language.[55] It differs from existing guidance in that it explicitly states a taxpayer's current income will be used in analyzing his or her future ability to pay and provides several new examples to illustrate the principle.

While I am pleased the IRS has issued this interim guidance and has referred in its announcement to "an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers," I remain concerned that the IRS has been unwilling to develop a more robust offer program. As I said when I testified before this Subcommittee last year, I have come to believe over years of seeing the IRS truncate this program that the Collection function possesses an institutional aversion to collection of less than 100 percent of the tax the IRS believes is owed regardless of the circumstances.

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[53] IRS News Release, IR-2010-029, *IRS Outlines Additional Steps to Assist Unemployed Taxpayers and Others* (Mar. 9, 2010).

[54] IRM 5.8.5.6(5) (Sept. 2005).

[55] Interim Guidance Memorandum from Director, Collection Policy, *Interim Guidance for Calculation of Future Income in Offer in Compromise Cases, Control No. SBSE 05-0310-01* (Mar. 10, 2010).

Recommendations

- I recommend that the IRS adopt seven administrative recommendations that I included in my 2009 Annual Report. These include reducing the enormous substantiation and documentation requirements currently required with the initial submission of an offer, reducing the number of steps a taxpayer must take to complete an offer application, and revising internal guidance to bring about the acceptance of a much greater number of appropriate offers.

- I recommend that Congress repeal the 20 percent down payment requirement upon the submission of an offer in compromise. H.R. 2343, the Tax Compromise Improvement Act of 2009, introduced by Chairman Lewis and Ranking Member Boustany, would accomplish that.

4. The IRS Return Preparer Initiative Is a Big Step Forward, But Several Statutory Changes Would Be Helpful

It is universally acknowledged that the internal revenue laws are complex, and as a result, about 60 percent of individual taxpayers and 80 percent of small business taxpayers hire preparers to help them prepare their tax returns. Some preparers are attorneys, CPAs, or Enrolled Agents, but many – probably most – individual returns are prepared by so-called "unenrolled preparers" – people who don't need to have any training at all and are generally not subject to oversight.

While taxpayers pay good money to preparers with the expectation that the preparers will complete their returns correctly, the reality can be very different. Within the last few years, the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) have each performed undercover visits, posing as taxpayers, to have returns prepared by unenrolled preparation businesses, and the results have been disturbing.[58]

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[58] GAO had 19 returns prepared. All 19 contained errors, and the tax liability was wrong on 17 of the 19 returns. In two cases, the errors would have caused the taxpayer to overpay his tax by more than $1,500. In five cases, the errors would have caused the taxpayer to receive up to nearly $2,000 in excess refunds to which he was not entitled. Where the earned income tax credit (EITC) was claimed, preparers neglected to ask required "due diligence" questions in half the cases, and where a taxpayer told the preparer he earned side income, more than half the preparers did not include that income on the return. In just over 20 percent of the cases, the preparer either did not sign the return or failed to provide an identifying number. *See* Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 2 (Apr. 4, 2006) (statement of Michael Brostek, Director – Strategic Issues, Before the Committee on Finance, U.S. Senate). TIGTA had 28 returns prepared, and its results were not much better. Sixty-one percent contained errors. None of the seven preparers working with EITC fact patterns asked required due diligence questions. Of the errors observed, TIGTA believed that about 65 percent were inadvertent, but it felt that 35 percent were willful or reckless. Notably, one of the fact patterns TIGTA used involved a small business, and none of the business returns was prepared correctly. *See* Treasury Inspector General for Tax Administration, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

These studies confirm what I personally witnessed throughout my own career as a return preparer, tax attorney, low income taxpayer clinic director, and National Taxpayer Advocate. Because of the availability of tax return preparation software packages and the proliferation of ancillary products and services, such as refund anticipation loans, that can be used to finance purchases of non-tax-related products, tax return preparation is viewed as a way for certain businesses to increase their profit margins rather than as a serious profession that is key to facilitating taxpayers' compliance with the tax laws. To demonstrate just how far the tax return preparation industry has degenerated, I direct you to a slideshow my office prepared this year of various return preparation sites throughout the nation at http://www.advocatetoolkit.com/userfiles/file/TaxReturnPreparersV2.wmv. My personal favorite – if "favorite" is the correct term – is the dog grooming parlor that also offers tax return preparation services. I also direct you to what I consider two particularly offensive advertisements by one tax return preparation chain.[57]

As noted above, in early January this year, the IRS published a report of its half-year study of federal return preparers and related issues. In most important respects, the IRS plan reflects the proposals I have made since 2002:

- In general, all return preparers will be required to register with the IRS by the end of this year.
- Registration will be valid for three-year periods and must be renewed.
- The IRS will conduct a federal tax compliance check on all registered preparers.
- During an initial three-year phase-in process, all unenrolled preparers – meaning everyone except attorneys, CPAs, and Enrolled Agents – will be required to pass an exam designed to demonstrate their knowledge of basic return preparation concepts.
- After passing the initial exam, all unenrolled preparers will be required to meet periodic continuing professional education requirements.
- After the three-year phase-in for testing, the names of all registered preparers will be made available on a public database, so all taxpayers can verify whether their preparer is properly registered.

The National Taxpayer Advocate's 2009 Annual Report to Congress identified one significant point on which it appeared the IRS and the National Taxpayer Advocate disagreed – namely, whether tax preparers who meet with and interview clients and prepare returns, but do not sign those returns, would be subject to IRS registration, testing, and continuing education requirements. In our view, failure to include these

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[57] *See* http://www.youtube.com/watch?v=DxA5gRIB-os and http://www.youtube.com/watch?v=uy7U5zlbgO0.

"nonsigning" preparers in the regulatory regime would create a loophole that could be widely exploited. Such a loophole would have particular negative impact on low income taxpayers, who often do not know much about the tax laws and may not be able to detect when they are being given inaccurate and even illegal advice. As a result of ongoing discussions with the IRS, I am confident that this loophole will be closed when final guidance is issued.

Recommendations

The IRS plan, of course, is not self-implementing. The IRS will issue a series of regulations this year – first in proposed form to solicit public comments and then in final form – to flesh out the details and set out the requirements. Moreover, the registration and competency requirements are just one part of what must be a comprehensive strategy for improving tax return preparation and thereby increasing voluntary compliance. Such a strategy should include preparer education contacts, "shopping" visits, due diligence requirements, and enhanced penalties.

In this and previous years' Annual Reports to Congress, we have recommended that the IRS take a "responsive regulation" approach to return preparer compliance.[59] That is, the IRS could start with "soft" compliance touches, such as notices and education visits, and progressively ramp up enforcement treatments where a preparer's actions become more egregious.

- I recommend that the IRS implement a large-scale program of undercover preparer visits, using scenarios carefully designed to incorporate fact patterns addressing areas of substantial noncompliance, and follow up with the appropriate compliance "touch."

- I recommend that Congress and the IRS impose due diligence requirements on preparers related to identified areas of significant noncompliance, similar to the Earned Income Tax Credit due diligence provision under IRC § 6695(g) and Treas. Reg. § 1.6695-2(b). Such requirements should require preparers to sign due diligence statements and attach the statements to the taxpayers' returns, including e-filed returns. Requiring preparers to sign and file these statements will make those preparers who follow the "IRS will never know so you don't need to report this income" approach have second thoughts. To be effective, Congress will have to authorize penalties for failure to meet these new due diligence requirements.

- I recommend that Congress enhance the monetary sanctions in existing preparer penalties under IRC §§ 6694(a) and (b) and IRC §§ 6695 (a) through (g) with respect to requirements for preparation of tax returns for other persons

[59] *See* National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*).

and extend the penalty under IRC § 6695 for failure to sign or include certain information on tax returns or claims to include "other documents" such as offers in compromise, financial information statements, and collection due process hearing requests.

5. The IRS Is Not Meeting the Needs of Low Income Taxpayers

Individuals with incomes below the poverty level make up 12.5 percent of the United States population, or 37 million people. In 2007, about 118 million individuals in the United States had incomes below 250 percent of the federal poverty level, which qualifies them for assistance and representation from low income taxpayer clinics funded by Congress through the IRS.[59] More to the point for tax administration, 44 percent (62 million) of the approximately 140 million individual returns filed for tax year (TY) 2006 reported adjusted gross incomes at or below 250 percent of the federal poverty level.[60]

Notwithstanding their income levels, low income taxpayers frequently have tax problems that involve them in protracted disputes with the IRS. Specifically:

- Taxpayers who claim the EITC are more likely to be audited than other taxpayers;
- Cancellation of debt income (CODI) issues, such as automobile repossessions and credit card collection, are more likely to arise, and taxpayers cannot receive assistance with these issues at Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) sites;
- Independent contractor versus employee classification issues frequently arise, with a distinct lack of bargaining power on the part of the low income worker; and
- Liens attaching to taxpayer accounts in currently not collectible hardship status do not secure any government interest and significantly impair low income taxpayers' financial viability.

Low income taxpayers, despite their diversity, share certain common characteristics. They are more likely to be elderly, disabled, Native Americans, and have limited English proficiency than the general population of taxpayers handled by the IRS's Wage and Investment Division. They tend to be more transitory than the general population.[61] They

[59] *See* IRC § 7526.

[60] IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2006. For a detailed discussion of the needs of low income taxpayers, see National Taxpayer Advocate 2009 Annual Report to Congress 110-133 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

[61] 27.5 percent of those below the poverty level moved in 2007 compared to 15 percent of the general population. U.S. Census Bureau, *American FactFinder, 2007 American Community Survey 1-Year Estimates, Table, B07012.*

face transportation and child care challenges that not only limit their ability to earn income but also impair their ability to comply with documentation requests in tax disputes. They live in neighborhoods with limited access to banks and thus turn to expensive check-cashing services, loan sharks, or subprime lenders. And they may not have access to remedies that require money.

The IRS has done a commendable job on the taxpayer service side to try to understand the service needs of low income taxpayers, including conducting research under the Taxpayer Assistance Blueprint initiative, the EITC Program Office, and the Stakeholder Partnerships, Education, and Communication function. In the compliance and enforcement areas, however, the IRS takes a one-size-fits-all approach. For example, in EITC examinations, the correspondence examination procedures are the same for low income taxpayers as they are for higher income taxpayers, notwithstanding the demonstrable differences between these taxpayer populations with regard to functional and English literacy. The impact of these undifferentiated procedures is demonstrated by a recent TAS research study finding that where EITC taxpayers are represented in audits, they are nearly twice as likely to receive the EITC and receive almost twice the amount of EITC as unrepresented taxpayers.

The good news is that in response to concerns raised in my 2009 Annual Report to Congress, the IRS is partnering with TAS to study whether EITC examinations that are assigned to one compliance employee and conducted by correspondence or in person at IRS offices have an impact on the response rate, the agreed case rate, and the amount of EITC allowed. I believe this study will identify practices that encourage the low income taxpayer to communicate with the IRS and will result in documentation requirements that low income taxpayers can meet with minimal burden.

Recommendations

- I recommend that the IRS work with TAS to complete a post-filing needs assessment of low income taxpayers, including problems and needs in areas other than the EITC, such as worker classification disputes, collection, offers in compromise, and accessibility of the Office of Appeals. This assessment will enable the IRS to design its procedures relating to low income taxpayers so that the procedures themselves do not pose a barrier to getting the correct result.

- I recommend that the IRS collaborate with TAS and representatives of low income taxpayer clinics to develop training videos for IRS employees on working with taxpayers with special needs, especially in compliance and enforcement functions.

- I recommend that Congress support additional funding for the Low Income Taxpayer Clinics (LITCs) authorized by IRC § 7526. In FY 2010, Congress has provided $10 million for the LITCs, yet largely because of job losses and the recession, LITC case inventories have skyrocketed. In 2008, the LITCs

collectively worked 16,374 cases. During just the first half of 2009, LITCs worked 14,382 cases.

- I recommend that Congress amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to Low Income Taxpayer Clinics receiving funding under this section. This change will allow IRS employees to refer taxpayers to specific clinics for assistance.

- I recommend that Congress authorize the IRS to promote the LITCs using paid advertising.

6. Where a Taxpayer Who Qualifies for the Earned Income Tax Credit Owes a Past Tax Debt, the IRS Withholds Up to 100 Percent of Any Current Refund, Undermining the Purpose of the EITC and Pushing the Taxpayer Deeper Into Poverty

The Earned Income Tax Credit is a refundable credit that benefits low income working individuals and families. Although the EITC enables low income working families to pay for necessities, maintain homes, repair vehicles needed to commute for work, and obtain additional education or training, the tax provision is very complex. This complexity can result in inadvertent errors by honest taxpayers and provides opportunities for cheating by dishonest taxpayers. The IRS estimates that the EITC overclaim rate falls in the range of 23 percent to 28 percent.[62]

Characteristics of the EITC population exacerbate the problems with the statute's complex eligibility requirements. For example, approximately one-fifth of the EITC population changes each year – *i.e.*, previously eligible taxpayers become ineligible and previously ineligible taxpayers become eligible for the credit simply because of a change in life circumstances.[63] Thus, it is possible for a taxpayer to owe the IRS for an incorrect EITC claim in Year 1 and be eligible to receive the EITC in Year 2 due to a change in the taxpayer's circumstances.

Under IRC § 6402(a), the IRS may withhold current-year tax refunds in full to recover any past tax debts. As a consequence, some low income taxpayers who currently

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[62] The IRS has estimated that EITC erroneous payments fell in the range of $9.6 billion – $11.4 billion (23–28 percent) for tax year 2005. *See Reporting Improper Payments: A Report Card on Agencies' Progress: Hearing Before the Subcomm. On Federal Financial Management, Governmental Information and International Security of the S. Comm. On Homeland Security and Governmental Affairs*, 109th Cong. (Mar. 6, 2006) (written statement of Mark Everson, Commissioner of Internal Revenue). To place this noncompliance rate in perspective, Schedule C (sole proprietorship) payment noncompliance is estimated at 57 percent. *See* IRS News Release, IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006) (accompanying charts).

[63] IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2005–TY2008.

qualify for EITC assistance do not receive part or all of the EITC benefit that Congress has determined they need to provide a basic standard of living for their families.

Congress has limited the IRS's and other creditors' ability to offset or levy on Social Security and certain means-tested benefits. For example, the levy of Social Security benefits for payment of federal tax debts under the Federal Payment Levy Program (FPLP) is limited to 15 percent of the monthly benefit,[64] and as discussed below, the IRS has recently agreed to exempt low income individuals from such levies.

Recommendation

- I recommend that Congress amend IRC § 6402 to limit the portion of a tax refund attributable to the EITC that the IRS may withhold to 15 percent of the EITC benefit for the year.

7. The Treasury Department Should Conduct a Study to Determine How to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Returns Processing

Each tax year, the IRS receives hundreds of millions of information returns, including Forms W-2 and 1099, and tax returns, notably Forms 1040. Right now, the IRS begins to process 1040s in January, but it does not receive and fully process W-2s and 1099s until well after the filing season ends. This sequence makes little sense for several reasons:

First: Millions of taxpayers each year make inadvertent overclaims that the IRS does not identify until it performs document-matching months later. As a result, these taxpayers not only receive notices assessing tax they did not know they owed and often did not save for, but they typically end up owing interest and penalties as well.

Second: On the criminal side, the IRS receives hundreds of thousands of false and fraudulent tax returns each year claiming billions of dollars in refunds. The Criminal Investigation Division tells us that a significant percentage of fraudulent claims involves income and withholding amounts ordinarily reported on a W-2 (*e.g.*, the "taxpayer" will file a return showing a high withholding amount relative to tax liability, producing a large apparent refund). Because the IRS does not have W-2 data in its systems at the time it processes tax returns, the IRS has to devote significant resources to identifying and blocking fraudulent claims and it inevitably misses a fair number.

Third: Congress has given the IRS responsibility for administering an increasing number of social benefit programs through the tax code. The EITC has been around since the 1970's, but the Making Work Pay credit,[65] First-Time Homebuyer Credit,[66] and several

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[64] IRC § 6331(h).

[65] IRC § 36A.

[66] IRC § 36.

others are new. Earlier information reporting would help to ensure that we quickly get the right amount of benefits to eligible taxpayers while minimizing the risk of fraud.

Fourth: Earlier access to information reporting data would enable the IRS to make those data available to taxpayers as they prepare their returns. Taxpayers could import the information into existing programs, the IRS could create pre-populated tax returns to reduce filing burdens for millions of taxpayers who file simple returns, or both.

For these reasons, if the IRS can get to a point where it can process information returns first, it could largely eliminate the post-filing season work of the Automated Underreporter Unit, substantially reduce opportunities for fraud, make pre-populated returns a viable option, and give the IRS better tools to administer social benefit programs when Congress directs it to do so.

Despite the obvious logic of processing information returns first, it is much easier said than done. With tax returns arriving as early as January and the IRS not completing its Information Returns Master File for the year until around August, we would have to find a way to make up about six months worth of time. Some steps could accelerate the process substantially. For example, Congress could require W-2s to be submitted directly to the IRS on January 31, when they are given to taxpayers, and might even be able to move that date up to January 15 in the future. Also with some lead time, the IRS could make systems improvements to enable it to process and match information and tax returns more quickly.

But even if these challenges are addressed, it is likely that there will still be some time gap that cannot be bridged. Put simply, if taxpayers are now entitled to submit returns in mid-January and the IRS does not even receive information returns until that time, it would be impossible to make full use of information returns unless the beginning of the filing season is somewhat delayed. Such a delay will certainly upset those early-filing taxpayers, who tend to be low income and receive large refunds. Some ways to mitigate the delay would be to more closely calibrate tax withholding to tax liability, revamp the Advance EITC, or pay out benefits ratably during the course of the year to reduce the size of refund payments. In my view, the significant benefits of real-time document-matching make it imperative that we consider such steps.

Recommendation

- I recommend that Congress direct the Treasury Department to study and report back within one year on the administrative and legislative steps that would be required to enable the IRS to receive and process information reporting documents before it processes tax returns and issues refunds. In my 2009 Annual Report to Congress, I identified key issues that would require careful study.[67] I believe the benefits of getting information returns into the system first

[67] National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

would be significant but recognize that practical challenges exist. Therefore, I suggest that Congress and the IRS aim to implement changes within five years from the time this report is completed to provide the IRS and private industry sufficient lead time to make required adjustments.

8. IRC Section 6707A Should Be Amended Expeditiously to Ameliorate the Unconscionable Impact It Is Having on Taxpayers

Section 6707A of the Internal Revenue Code imposes a penalty of $100,000 per individual and $200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a "listed transaction" or "substantially similar" to a listed transaction.[68] Although the penalty was originally designed to encourage the disclosure of corporate tax shelters, it has had the unintended effect of subjecting to Draconian penalties – in some cases over $1 million – small businesses that have limited assets, derived little or no tax savings, and had no knowledge that they were entering into a corporate tax shelter. Consider the following:

- The penalty imposes "strict liability" – it applies without regard to whether the taxpayer has knowledge that the transaction has been listed and without regard to whether the transaction is reported correctly on the taxpayer's return.[69]
- The penalty applies even if the taxpayer derived no tax savings from the transaction.[70]
- The penalty *must* be imposed by the IRS and cannot be rescinded under any circumstances.[71]
- The penalty may not be appealed in any court.[72]

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[68] For a more detailed discussion of this issue, see National Taxpayer Advocate 2008 Annual Report to Congress 419-422 (Legislative Recommendation: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*). For the definition of a "listed transaction," see Treas. Reg. § 1.6011-4(b)(2).

[69] IRC § 6707A; Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108th Cong. at 373 (2004).

[70] *Id.*

[71] IRC § 6707A(a) & (d)(1)(A). Section 6707A(a) provides that "[a]ny person who fails to [make the required disclosures] *shall* pay [the] penalty" (emphasis added). This language seems absolute, and the IRS to date has interpreted the provision as requiring it to impose the penalty in all circumstances described in the statute.

[72] IRC § 6707A(d)(2); *Smith v. Comm'r*, 133 T.C. No. 18 (2009) (finding the court lacked deficiency jurisdiction to redetermine penalties for failure to report involvement in a listed transaction).

- The taxpayer's disclosure must initially be made twice – once with the IRS Office of Tax Shelter Analysis and again with the tax return for the year in which the transaction is first required to be disclosed.[73] A disclosure included with the taxpayer's filed return, no matter how detailed, will not suffice by itself to avoid the penalty. After the first year in which the transaction must be disclosed, the taxpayer must continue to make disclosures with each filed return that reflects the transaction.

- A taxpayer that discloses a transaction may be subject to the penalty if the IRS deems the disclosure to be incomplete.[74]

- If a transaction is not "listed" at the time the taxpayer files a return but it becomes listed years later, the taxpayer becomes responsible for filing a disclosure statement and will be liable for this penalty for failing to do so. This is true even if the taxpayer has no knowledge that the transaction has been listed.[75]

- The penalty applies to each tax return the taxpayer files.[76]

- The usual three-year statute of limitations does not apply.[77]

Thus, an individual who does business through a wholly owned S corporation may enter into a ten-year transaction that he believes is proper and that produces little or no tax savings – only to end up owing a penalty of $3 million (i.e., a penalty of $200,000 on the S corporation and a penalty of $100,000 on the individual taxpayer for each of the ten years).

This harm is not merely theoretical. This penalty has been imposed against small businesses in hundreds of cases, and as noted, the minimum amount of the penalty is now $100,000 for an individual, and in practice, most taxpayers are facing penalties running many multiples higher. All agree this effect was unintended and is unconscionable. Further, I question whether this provision is constitutional on procedural due process grounds, because the penalty constitutes a significant deprivation and does not provide for a pre- or post-deprivation hearing. It must be fixed quickly.

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[73] Treas. Reg. § 1.6011-4(a) & (e).

[74] Treas. Reg. § 1.6011-4(d).

[75] Treas. Reg. § 1.6011-4(e)(2). The requirement will cease to apply after the period of limitations on assessment for the final return reflecting the transaction has expired.

[76] IRC § 6707A; Treas. Reg. § 1.6011-4(e)(1); Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108th Cong. at 373 (2004).

[77] IRC § 6501(c)(10) (providing that the statute of limitations will remain open with respect to an undisclosed listed transaction until at least one year after the earlier of (i) the date on which the taxpayer provides the required disclosure or (ii) the date on which a material advisor provides the name of the taxpayer to the Treasury Department in response to a request made under IRC § 6112(b)).

On June 12, 2009, the Chairman and Ranking Member of this Subcommittee and the Chairman and Ranking Member of the Senate Committee on Finance sent a letter to the Commissioner stating their commitment to modify the law and asking that the IRS in the interim use the discretion provided with its effective tax administration authority to suspend collection of Section 6707A liabilities in cases where the tax benefits resulting from a listed transactions are less than $100,000 for individuals and $200,000 in other cases. In response, the Commissioner agreed to impose a temporary moratorium on collection action and has extended it twice, but faced with an operative statute that requires the IRS to assess these penalties, the IRS is unlikely to extend the moratorium indefinitely based on a stated intention to revise the statute.

Last month, the full Senate passed S. 2917, the Small Business Penalty Fairness Act, which would generally limit the penalty to a percentage of the tax savings realized. The Chairman and Ranking Member of this Subcommittee have introduced H.R. 4068, the Small Business Penalty Relief Act. To prevent untold economic calamity for hundreds of small business owners and their families across the country, I cannot overstate the importance of prompt passage of this legislation.

Recommendation

- I recommend that the House pass H.R. 4068 or, to avoid the need to reconcile differences with the Senate bill, legislation identical to S. 2917 as quickly as possible to address this most unfortunate and unintended situation.

9. Status Updates

TAS makes many recommendations in its Annual Reports to Congress and internally to the IRS that may take several years to implement. In some instances, it takes time and several discussions in the Annual Reports to Congress in order to reach an agreement that the issue is, indeed, a most serious problem for taxpayers. I am pleased that I can report significant progress on two such issues.

A. Federal Payment Levy Program

The Federal Payment Levy Program (FPLP) is an automated system that allows continuous levies to be issued for up to 15 percent of certain federal payments and 100 percent of certain federal contractor or vendor payments due to taxpayers who have unpaid federal tax liabilities.[78] While FPLP levies can attach to a variety of federal sources of income, ranging from salaries to retirement income to federal contractor payments, the bulk of FPLP levy payments have historically been related to Social Security benefits – 83 percent for FY 2008.[79]

[78] IRC § 6331(h).

[79] IRS, Wage and Investment Division spreadsheet, *FPLP Monthly Counts FY 2008* (1,797,530 [total number of FPLP SSA levy payments received in FY 2008] / 2,161,974 [total number of FPLP levy payments received in FY 2008] = 83 percent).

Over the past several years, I have identified the absence of a filter for low income taxpayers subject to FPLP levies as a most serious problem.[80] This year, I am pleased to report that the IRS has agreed to implement a low income filter (LIF) for taxpayers receiving Social Security and Railroad Retirement Board benefits. The LIF, which is expected to be in place by January 2011, will exclude taxpayers from automated FPLP levies if their estimated income (based on internal IRS data) is less than 250 percent of the poverty level guideline as defined by the Department of Health and Human Services.

When the filter is implemented, fewer low income taxpayers will experience economic hardship as a result of IRS levy actions, and the IRS itself will avoid unnecessary work – having to release these levies downstream and return levy proceeds to taxpayers who cannot meet their basic living expenses. I commend the IRS for developing this filter, and I am grateful to this Subcommittee for its ongoing interest in the issue.

B. Identity Theft Procedures

Identity theft occurs in tax administration when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return or fraudulently gain employment. When these types of identify theft occur, the victim often begins an extremely frustrating journey through IRS processes and procedures that may take years to complete. I have included identity theft as a most serious problem encountered by taxpayers in four of my last five Annual Reports to Congress.[81]

The IRS has made several recent improvements in procedures to assist victims of identity theft. It is now marking the accounts of identity-theft victims with an electronic indicator, which will reduce taxpayer burden (because IRS will not assess the perpetrator's tax against the victim) while protecting federal revenue (by not paying out refunds on suspect returns). The IRS is also applying a series of filters – known as "business rules" – to distinguish valid returns from fraudulent ones. It has also developed and improved its Identity Theft Affidavit form, which it requires taxpayers to complete in order to authenticate their identity.

Most significantly, the IRS has established a centralized main unit dedicated to assisting identity theft victims. Over the last year, the Taxpayer Advocate Service has worked with

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[80] *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (Research Report: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*); National Taxpayer Advocate 2007 Annual Report to Congress 324-336; National Taxpayer Advocate 2006 Annual Report to Congress 110-129, 141-156; 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. For a more detailed status update on this issue, see National Taxpayer Advocate 2009 Annual Report to Congress 316-319.

[81] *See* National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-191; National Taxpayer Advocate 2004 Annual Report to Congress 132-136.

this unit – known as the Identity Protection Specialized Unit (IPSU) – to improve its procedures in assisting victims of identity theft. The unit is serving as a central point of contact that interacts with other parts of the IRS as appropriate. In addition, the unit conducts a global account review to identify all federal tax issues related to the identity theft and ensures that the responsible IRS functions have taken the appropriate actions to resolve the victim's tax account issues.

While we are concerned that the IPSU may not have sufficient staffing to deal with the increasing numbers of identity theft cases and think the business rules can be improved, we believe that the IRS has made significant progress on this issue.[82]

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As part of our effort to reach the growing number of taxpayers who may need help from the Taxpayer Advocate Service, we have placed numerous educational products on social media sites such as Facebook (http://www.facebook.com/YourVoiceAtIRS) and YouTube (http://www.YouTube.com/TASNTA). This material includes a series of video messages that I recorded on topics such as liens, cancellation of debt income, the Alternative Minimum Tax, identity theft, and the First-Time Homebuyer Credit. These videos also appear on the Tax Toolkit (http://www.taxtoolkit.irs.gov), which contains information about basic tax responsibilities for those new to the federal tax system, taxpayers with limited English proficiency, and those with disabilities. These sites represent TAS's commitment to keeping taxpayers informed and tailoring our services to their constantly changing needs. I was very pleased to note that the Committee on Ways and Means is a follower of our Twitter page (www.Twitter.com/YourVoiceAtIRS).

[82] Identity theft cases received in the Taxpayer Advocate Service have increased by 96 percent between FY 2008 and FY 2009, from 7,147 to 14,023. A significant number of those cases resulted from unintended application of the business rules.

Chairman LEWIS. Thank you very much, Ms. Olson, for your statement. At this time I will open the hearing for questions. I ask that each member follow the five-minute rule. If you, Ms. Olson, will respond with short answers, all members should have the opportunity to ask a question.

Now, Ms. Olson, the number of offers in compromise accepted by the IRS has declined by 72 percent from 2001 to 2009. You reported that taxpayers must complete over 100 steps to apply for an

offer in compromise. Are all of these steps necessary? What can be done to increase the use of offers in compromise?

Ms. OLSON. I think there's one legislative thing that we need to repeal the requirement that taxpayer's put 20 percent down before submitting an offer. Many taxpayers get their money for an offer from a source that is not the taxpayer, from a family member, from a church, from different people who will loan them money to resolve their tax debts, and they'll be unwilling to give that money up front without knowing the offer is going to be accepted.

The IRS itself needs to revise completely its offer procedures, so that what we are trying to do is get people through the door to begin a conversation about how to resolve this debt and get them back into compliance on a going forward basis. And, right now, we put too many obstacles in their way procedurally.

Chairman LEWIS. Ms. Olson, last week the Internal Revenue Service announced new flexibility for IRS employees to consider an unemployed taxpayer's current earnings and potential future earnings rather than prior year earnings. When negotiating an offer in compromise, should the IRS expand this policy for all fully-employed and under-employed individuals?

Ms. OLSON. I do believe so. This policy has been in place since the 90s so the guidance last week just encouraged IRS employees to do what was already in the provisions in their own guidance. And I think that points up the problem with the offer in compromise process, which is that many employees, I think, believe that it's an amnesty for taxpayers and they forget that we're getting a promise from taxpayers that they have to comply for five years in the future or the whole debt is reinstated. It's a win-win for everybody. We need to change attitudes in the IRS as well as the processes.

Chairman LEWIS. All right. Now you reported that the IRS can offset up to 100 percent on an EITC recipient's refunds to satisfy a debt. You believe that the IRS should not be allowed to offset the full amount of any future tax refund that is from the earned income tax credit. Why do you think an offset of up to 15 percent of the refund would be fair?

Ms. OLSON. Well, I think that Congress is already using 15 percent, has set 15 percent as the offset against Social Security benefits if taxpayers owe past tax debts. And so it seemed to me that the population is very similar that Social Security has by and large a lower income population similar to the earned income tax credit. And so 15 percent was a reasonable amount. It made no sense to me to grab the entire earned income tax credit of people we've already determined are low income and will need public assistance in other ways.

Chairman LEWIS. Thank you very much for your answer. And I turn to the ranking member for his questions.

Mr. BOUSTANY. Thank you, Mr. Chairman.

Ms. Olson, on page 87 of volume 2 of your report you state, I quote: "When social program delivery is grafted to traditional IRS activities, there arises a potential conflict with the IRS's traditional mission." Wouldn't this healthcare bill that we have before us be the largest social program ever entrusted to the IRS?

Ms. OLSON. I don't know the answer to that specific question, because I don't know its size relative to the earned income credit or some of the other programs we've been in.

Mr. BOUSTANY. But certainly substantial.

Ms. OLSON. But it is substantial, yes, sir.

Mr. BOUSTANY. And should we be concerned by that given the potential for conflict in the mission to the IRS.

Ms. OLSON. We should be concerned. That's the reason why I wrote that piece to give guidance to Congress if it wanted to give the IRS social programs, here are some things that you should consider when you're designing that program.

Mr. BOUSTANY. Thank you. I see as I look at the bill, Sections 1501, 1502, and 10106 of a bill, for example, create an individual mandate to buy health insurance and grant the IRS the authority to enforce that mandate. And given that your expertise in dealing with the relationship between the IRS and the individual taxpayer, I'd like to get your thoughts on what does this really mean.

Will it really alter the relationship? Will the IRS be that much more involved in the everyday lives of American families in trying to deal with this health insurance mandate?

Ms. OLSON. Well, we do have some experience in delivering some health insurance subsidies through the health coverage tax credit, which utilizes third parties to do the verification and state agencies to do the certification; and then the IRS is really a disbursement agent. Now, with the mandate and the penalty that's attached, the concern that I had was that we exclude people who don't have any filing requirement and don't need a relationship and don't have an otherwise relationship with the IRS. And we also make sure that we're not taking active collection actions or lien filings against these people.

And I did express those concerns to the Senate Finance Committee. I think they've been addressed at least in the Senate bill, but of course we have not seen the final legislation, nor has anyone.

Mr. BOUSTANY. Right. And of course we have concerns about whether there will be liens, you know, associated with penalties. So I take that to mean that the IRS certainly will be much more involved with the individual taxpayer at a different level now than its current mission.

Ms. OLSON. It may very well be. It's similar to where we are involved in the earned income tax credit.

Mr. BOUSTANY. Thank you. And on March 11th of this year the congressional budget office letter to Senate Majority Leader Reid estimated that the IRS budget would have to be increased by as much as $10 billion over the next decade to help administer the nation's health insurance system. And when you consider this and the fact that the new system really doesn't take effect until 2014 in many respects with regard to the mandate, that really means $10 billion over the last six years or so of the budget window.

So we're talking now about more than a billion dollars annually, if you break it out. And given that the IRS currently has a budget of roughly, I think, $12 billion, it seems to me the IRS is going to have to get much bigger, and perhaps 10 percent bigger to enforce these health insurance laws.

Ms. OLSON. I think the IRS is a victim of its own success in administering programs like make work pay or the first-time homebuyer credit, or the economic stimulus payment. And we've become identified as a very successful and efficient agency. I think from the IRS's point of view if it has flexibility in administering programs and sufficient time to plan an advance, and to your point sufficient resources, it will do what Congress tells it to do.

I think that has been the commissioner's position. My point has been that programs need to be designed in a way that we don't torment taxpayers and torment the IRS at the same time.

Mr. BOUSTANY. I believe that $10 billion, which may be an underestimate, who knows, is not included in the score of the bill. So that's another point to make. Do you think service levels will be affected by the implementation of this new function; you know, the phone calls? We already know there are some problems that we're not meeting certain benchmarks. You've talked about customer wait times and so forth. Do you have any sense of how that will play out?

Ms. OLSON. Well, it's a simple answer. If the IRS gets the resources it needs to administer this program, then the service levels in the other areas won't. If it doesn't get the resources then there's only so much we can do with the dollars that we have and other service levels will be impacted, and that's very simple.

Mr. BOUSTANY. Do you have a sense of where you think it might, what might really happen?

Ms. OLSON. Are you asking me to predict what Congress might do?

[Laughter.]

Ms. OLSON. No.

Mr. BOUSTANY. Well, if history is any guide we know that these resources are stressed. I thank you and I yield back, Mr. Chairman.

Chairman LEWIS. Thank you. Now we turn to Mr. Pascrell for his questions.

Mr. PASCRELL. Thank you, Mr. Chairman. Mr. Chairman, I need to respond to my good friend from Louisiana—how under any circumstance I am amazed that weaving in of healthcare, the healthcare debate, is interesting.

So, now that you've done that and you've set precedent in this hearing, I'll get to the IRS in a second, because you are the main target or focus of today. Your organization has done a fantastic job, and I've said that before, but we know that individual and family spending on premiums and out-of-pocket healthcare costs will increase significantly, and spending is going to jump 34 percent by 2015 and 79 percent in 2020. So what we're left with is a picture, a perception of a huge dinosaur which we call the IRS unable to climb up the stairs and get away from another dragon of sorts. And the question is we pulled these facts out of the air. You know, what you're saying makes sense, is stated in good faith.

But you need to take a look at it in context to see what we are paying, what we will pay, if we do nothing, if we start off with a blank page, and to weave that into the tax issue. I find it very interesting. I'd be more concerned——

Mr. BOUSTANY. Would my friend yield?

Mr. PASCRELL. Yes, absolutely.

Mr. BOUSTANY. Well, I think this is a consideration, because we already know based on the CBO letter that there are going to be additional costs and additional burdens placed on the IRS and I think it's critically important that those things be addressed and put out on the table. And, Ms. Olson has repeatedly testified year after year about the need for resources for IRS. We saw what happened with the implementation of stimulus.

Mr. PASCRELL. And she's been correct?

Mr. BOUSTANY. And she's been correct, and so I think if history is any guide we can expect there will be more demands and will service to the taxpayers' suffer.

Mr. PASCRELL. And if history is any guide, the numbers that I quoted will be something we need to face and we'll be facing them another thirty years from now and when the numbers are even greater. So we need to do something—not to find a perfect solution—only God is perfect. But we need to find a solution that is workable and that will bring us closer to the goal line of having people not worry about how deep their pockets are to get healthcare and not throwing them out of healthcare coverage simply because they have a malady of some sorts. And I think you believe in the same thing.

The question is how do we get to that point and that's what the debate is all about, so you can't demonize any of the health insurance bill. I mean there's enough demons out there to go around. Now, let me ask you a question, if I may.

Ms. OLSON. Certainly.

Mr. PASCRELL. I'm very concerned about the fact of foreign businesses. In fact, you make a point of that in terms of 500,000 tax returns were filed from a foreign address in 2007. I don't have the numbers for 2008. They don't understand, many of those taxpayers, that they have filing requirements, the complexity, et cetera, et cetera, et cetera. I'm really concerned about that, because how much lost revenue do you think the government is not able to take advantage of because of the fact that these folks aren't filing, filing incorrectly, or we can't catch up to them period.

Ms. OLSON. I have never seen a revenue estimate that the IRS has produced. We put those numbers out to show that U.S. taxpayers abroad, and these are U.S. citizens abroad, you know, have no way to reach the IRS without incurring substantial costs to get answers to their questions and, to your point, being confused, may think they don't have a filing requirement when in fact they do.

And when they finally figure it out, they have penalties and interest, you know, from years and years and years. And they may have been paying taxes in their own—the country that they're living in—that they didn't have to owe, and then they can't get it figured out. This is a very serious issue for us.

Mr. PASCRELL. Oh, I think it is, and in terms of lost revenue here, we're talking about hundreds of billions of dollars.

Ms. OLSON. We may very well.

Mr. PASCRELL. If you go back over 10 years, these are the things we should be trying to, you know, close loopholes, getting folks to own up to what happens. Same thing with American corporations that go offshore. I mean that's revenue. It's like some-

body on my street who owns a home and doesn't pay his property taxes. That means I have to pay more, because the town is waiting and depending upon expected revenue. If that revenue doesn't come in, then I have to pay it. This is what we should be concerned about, instead of all the time catapulting the IRS. I mean I do that enough myself. But the point of the matter is this is a very serious issue, and I think we should get estimates about how much revenue the American people have had to shoulder because of individual problems, not filing, and corporations who simply are out to shaft the American people, legally. Thank you. We'll have a second round?

[Laughter.]

Chairman LEWIS. It's possible.

Mr. PASCRELL. Thank you.

Chairman LEWIS. Now we turn to Mr. Reichert for his questions.

Mr. REICHERT. Thank you, Mr. Chairman. Well, I want to agree with my good friend Mr. Pascrell. You know, we need to focus on those things that the IRS has been doing for years, collecting revenue, closing loopholes, and going after people who aren't filing their income tax; and, of course, holding corporations accountable, too. We've seen what can happen when we're not able to do that.

Accountability and responsibility and the IRS's job absolutely key, but there are questions, though, how this new responsibility lays over all that you already have to do and how are you going to get it done. And I understand perfectly well you need more resources. If you need more dollars, you'll be able to do the job, but we're borrowing now and spending too much now. So the purpose for the questioning today, at least from our side and looking at the healthcare question, people want to know how this is going to affect me personally.

So if Ms. Olson under Section 1501 of the Senate Healthcare Bill, if a taxpayer cannot prove to the IRS that he or she has minimal essential coverage as defined by the Democrats, what action could the IRS take?

Ms. OLSON. Well, I don't know that I have the expertise to answer specifically to that bill, but what I spoke to to the Senate Finance Committee was that my personal opinion was that we should not be allowing the IRS to take levies against wages or things like that, or file liens against the taxpayers in that situation. And I think what the section says is that they can take refund offsets.

I would recommend that we carry over to that provision that you not take more than 15 percent of the earned income credit refund, because then you're robbing Peter to pay Paul. So I think that there's been restriction on IRS collection activity that would make sure that taxpayers were protected.

I also think on the issue of whether the IRS is looking whether the taxpayer has qualified health insurance, as I noted before, in the health coverage tax credit. We actually contract out that decision and a different entity makes the determination whether that policy qualifies for the current health coverage tax credit; and that provision has been around for quite some time as the result of NAFTA and a few other arrangements where United States tax-

payers lost jobs. And we really don't have a lot of complaints about that.

Mr. REICHERT. There would be an increased cost, though, to——

Ms. OLSON. Yes, that's true.

Mr. REICHERT [continuing]. Extend that program. What about, could the IRS conduct an audit of those people that don't have a healthcare plan, choose not to have?

Ms. OLSON. I have not seen, obviously, the final language of the bill, but if it's anything like the health coverage tax credit, then no. We do not have the ability to conduct an audit; nor does the taxpayer have the right to go to the tax court to challenge our determination, because all we are really doing is disbursing funds.

Mr. REICHERT. How many individual income tax returns were filed in 2008? Would you happen to know approximately?

Ms. OLSON. In 2008 I think it's about 140 million. We have 140 million individual taxpayers and about 30 million corporation taxpayers.

Mr. REICHERT. Okay. And under the bill, I'm sure you're aware that the IRS would impose the individual mandate tax penalty for every month that a taxpayer fails to show the minimal essential coverage. So does that mean that the IRS is then going to be responsible for, and this goes back to Mr. Pascrell's point, for following 140 or 150 million taxpayers a year every month?

Ms. OLSON. Well, again, I haven't seen the final bill but I think what the IRS would want, and I'm just speaking here from my own perspective, but I think what the IRS would want is flexibility as to when and how it would be making that determination. And if the bill were drafted appropriately it would be able to decide how it could best administer it without having to, you know, put the taxpayer through a lot. And the second point would be that we exclude people who have incomes so low that they have no return filing requirement at this time. We don't want to pull them into the system, and I do think that the thresholds accomplish that in the Senate bill.

Mr. REICHERT. What, if any, additional burden will small businesses bear under this plan? Additional paperwork? Time? Money?

Ms. OLSON. Well, I can only speak for the tax provisions; and, there, there is the tax subsidy for small businesses. And I'm not sure again how that would be implemented, whether that would be implemented through the payroll system or as a credit at the end of the year that they would claim in their income tax return.

Mr. REICHERT. Okay. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you. Now we turn to Mr. Higgins for his question.

Mr. HIGGINS. Thank you, Mr. Chairman.

Ms. Olson, first of all, let me say that your Western New York office has been very helpful to my office and our caseworkers in helping our constituents address issues with the IRS. We appreciate it very much. It's an essential public service that you provide and we are grateful.

On the issue of electronic filing, your report indicates that incentives are needed to increase the rate of electronic filing. A couple of things in answering that question: what is the percentage of

those who file electronically versus those manually or through the mail; and, what are the incentives that you encourage?

Ms. OLSON. Well, I think at this point it's about a 60 percent electronic filing rate and we are increasing each year. I think that one of the big incentives that occurred this year, already enacted, is the requirement that preparers who prepare over, I think, it's 11 or more returns for a fee, have to file electronically. Because today about 67 percent of taxpayers use return preparers, and in small business it's even more. So if we can get those preparers to file electronically, we can really get it up there.

Chairman LEWIS. Did you say 11 or 11 percent?

Ms. OLSON. Eleven or more returns.

Chairman LEWIS. Thank you.

Ms. OLSON. Right.

Chairman LEWIS. Thank you.

Mr. HIGGINS. Does your report reference any kind of target as to the percentage that you would like to see within a specified period of time?

Ms. OLSON. Yes, we definitely recommended that the IRS shoot for—well, Congress has set the goal of 80 percent—and we encourage that you keep that goal. It's a good incentive goal. We have looked at larger percentages. Just when Congress sets a goal, I think it organizes the IRS, even if they miss the deadline. It makes them act.

Mr. HIGGINS. 80 percent by?

Ms. OLSON. Well, I think Congress had said originally 2007, and obviously the IRS missed it. And, I think it's been extended to 2012, but I'm not sure on that.

Mr. HIGGINS. Is it a 60 percent increase?

Ms. OLSON. The goal was 80 percent to reach.

Mr. HIGGINS. Right. Is that a significant increase?

Ms. OLSON. Oh, from years ago it's a huge increase. It's actually very impressive in my mind that they got there.

Mr. HIGGINS. So progress is being made toward that goal?

Ms. OLSON. Progress is being made. I think now, and I think that you'll get a big leap with this return preparer mandate.

Mr. HIGGINS. Great. Thank you for your work. I have no more questions.

Ms. OLSON. Thank you.

Mr. HIGGINS. Thank you.

Chairman LEWIS. Thank you. Now we turn to Mr. Becerra for his question.

Mr. BECERRA. Thank you, Mr. Chairman, and we could probably hold an Oversight hearing once a week with Ms. Olson and all of us would be much the better for it; and, certainly, the taxpayers would. So, Ms. Olson, thank you for the work that you do. I'm not sure when we establish the office by statute, but it was one of the best things that Congress did, is to have an oversight. The year was 1996, Congressman Kind tells me. That's what we did to have some oversight over the IRS to not only get on top of it but also to pat it on the back when it does the right thing. We're trying to get people to voluntarily pay their taxes, so thank you so much for the work that you've done.

Ms. OLSON. Thank you.

Mr. BECERRA. The number one most serious problem you've identified is the fact that more and more people aren't getting through, at least not on a timely basis when they make a phone call to the IRS on that toll free line and part of it, we know, is because of the mass increase in volume as a result of the 2008 stimulus, the economic recovery package and so forth. So, I think we have to give the IRS some slack, because, in fact, they increased their ability to respond to calls given the increased number.

But, my understanding is that they've called for an increase in the budget to help reduce the amount of people that don't get through on the telephone, toll-free line. But, they're taking the money it seems from a very good program, or they're trying to give the money to a very good program, telephone access through the toll-free line, but they're taking it from programs that are just as valuable, if, perhaps, not more valuable. My understanding is they're taking almost half the money they're going to put to increase the ability to service calls from a program that would help provide tax counseling to our elderly.

Ms. OLSON. Right.

Mr. BECERRA. The elderly are people who are trying to do the right thing, probably on fixed incomes, may not file correctly if they don't get assistance; or, may end up having to pay exorbitant amounts to tax preparers who take advantage of them, which doesn't seem to make sense to take money out of that program to put it into another very good program. They're taking money out of the low-income taxpayer clinics, which once again help people who might be taken advantage of, exploited, and have to pay exorbitant fees to probably file simple tax returns or who may end up filing incorrect returns.

And then the voluntary income tax assistance clinics, which are oftentimes handled by law students and others, are giving a free service for Americans trying to help do the right thing. And, by the way, I understand they're taking quite a bit of money out of your office as well. Do you have any understanding why the IRS would want to take money out of an office that has been one of the champions? You go to bat for taxpayers every day, we're essentially killing the messenger.

The IRS is killing the messenger for pointing out what they have to do better or to try to do better in an area you've pointed out. I don't get it. Do you have an explanation for why the IRS would take money out of your office and other good programs to try to pay for another good service?

Ms. OLSON. I have no explanation.

Mr. BECERRA. Okay.

Ms. OLSON. I'm not sure that it's the IRS that did it. I just really, honestly, have no explanation.

Mr. BECERRA. Okay. Well, I know that we're going to have an opportunity to speak to the Commissioner soon. We'll ask him, and I know everyone's got budget constraints—and so no one needs to pre-judge. But I would certainly hope that the Commissioner will have an opportunity when he's here to explain how we can work with him to try to make sure that we figure out a way to do this without having taxpayers pay—having taxpayer Peter pay so that taxpayer Paul can get through on the phone line. It just is silly.

I hope that we can also follow-up with you on this issue of liens and offers in compromise. Give me a sense—These offers in compromise, essentially, it's a settlement. We're talking about settlements with taxpayers who are willing to come forward, willing to try to pay, but they're trying to do it under terms that they can afford. Most of the time you're talking about middle-income, modest-income families. They're saying, "Okay. You're right. I made a mistake. I want to pay. Help me come up with a schedule so I can pay." What's the problem?

Ms. OLSON. Well, again, I think that the IRS is being hidebound by rules and procedures and it's keeping people who maybe came in with the wrong offer amount; but, if you had a conversation with them and you talked to them about what we needed to see, they might find a way to come forward with that information. But the problem is that the procedures sort of keep people out.

Mr. BECERRA. How many offers in compromise were there that were accepted last year?

Ms. OLSON. 10,665, which is pitiful.

Mr. BECERRA. And how many delinquent tax accounts does the IRS have that it thinks it can collect on?

Ms. OLSON. Well, it had four million that were delinquent and it put two million last year in currently not collectible, which it gave up on. So there are millions of people that might participate if we just drop some of these bureaucratic rules.

Absolutely.

Mr. BECERRA. Thank you.

Chairman LEWIS. Now we turn to Mr. Kind for his question.

Mr. KIND. Thank you, Mr. Chairman, and thank you Ms. Olson for being here. We always look forward to your testimony and I just want to also express my personal appreciation for the work that you do and the National Taxpayer Advocate. So I have a close friend of mine, Mary Jo Warner from Lacrosse, Wisconsin, who serves on the advisory board. And I'm always calling her and asking her thoughts and advice on a whole host of issues. So we do look forward to your report as far as what efficiencies and improvements can be made. I think there's a shared interest in this Committee and throughout the Congress in doing that.

Let me just touch upon a couple of subjects just to get your feedback on. The report was clear as far as the IRS toll-free service opportunity and decline. And you have established goals on that, but another area of concern that I have is the quality of the information that's available; and, what more can be done when people who actually do get through and actually speak to someone for assistance to improve the quality of the information that they can then use without further mistakes being made. Do you have any recommendations on what more can be done?

Ms. OLSON. Well, I think that the IRS needs to be a little bit more ambitious in what it's willing to answer. It declares many issues out of scope. And so if you call, they shunt you off to someone else and each time you delay the taxpayer from getting an answer, the taxpayer may get frustrated, drop out, get the wrong answer; you know, claim the wrong answer. And I think that just takes a lot of attention. The IRS has to really commit to training its employees on more than just its core issues.

Mr. KIND. Yeah, and I think it indicated in the report an about 85 percent service level and roughly a five-minute waiting time, nothing more frustrating than calling and trying to hopefully get through, and ultimately not getting through. So it's a terrible problem that we have to address. And then the e-filing and the goal that really ramped that up as Mr. Higgins was questioning about earlier. In the area of lower-income taxpayers, what more can be done as far as outreach and assistance and education to help them take better advantage of e-filing?

Ms. OLSON. Well, I think that first of all the problem with low-income taxpayers is that e-filing is often linked with refund anticipation loans. And so I think that's where the return preparer regulation project really comes in. We have a slide show on one of our websites that shows a return preparation site that is run in a dog grooming parlor; and you just have to ask what the qualifications are.

Mr. KIND. Is it low-income tax clinics? Is that another?

Ms. OLSON. These are not a clinic. This is just a for profit business that is grooming your dogs and preparing your taxes at the same time. And you just have to say what are your qualifications for doing that, really. And these are where low-income taxpayers go to get assistance, and then they are sold these loans and these people don't know how to prepare returns properly. So we really need to get qualifications in place, for instance.

Mr. KIND. What about low-income tax clinics specifically geared for this?

Ms. OLSON. Well, the clinics do controversy representation or educate taxpayers about the rights. And the clinics, I administer that grant program. In 2008 they took 16,000 cases that were tax disputes with the IRS for low income tax payers. And in the first half of the year of 2009 they had 14,000. So you can see what the economic downturn has done in people.

You know, almost by half of the year they had almost as many cases as they did for the whole year the previous year, and we just need more VITA sites. We need additional funding for the VITA site so they can go out to communities that are hard to get to; you know, that sort of thing.

Mr. KIND. All right. Let me also just shift your focus momentarily on the tax refund processing that's going on. It's my understanding that it's basically a presumption to try to get the refund out, even before information can be checked and verified. And you're advocating in the report that we ought to shift that a little bit to a trust, but verified type of system. Is that right? Is that a fair way to describe it?

Ms. OLSON. Well, I think so. We get information returns like W2s and 1099s. They're supposed to be sent out to the taxpayer, most of them, by January 31st. But the IRS doesn't get them in a workable format until August and we're basically saying we're shipping out refunds or freezing refunds, because we think they're suspicious and holding them, when in fact if we could get the third party information in very early when the returns are coming in, we could get good refunds out, very, very quickly, and save the public fisc a lot of money by not shipping out refunds that shouldn't go out.

So it requires study, because it means we're going to have to really think through this. And so this is another one where if Congress set a deadline, Congress said IRS come back in a year. Treasury, come back in a year. Tell us what needs to be done to get this done; and then we could decide how to proceed.

Mr. KIND. Yeah, because right now you've got early preparers obviously getting their returns and anticipating a refund, but some of the information doesn't have to ultimately be in until what, the end of March or early sometime?

Ms. OLSON. That's correct. Right. That's correct.

Mr. KIND. Okay. All right. Well, thank you. Thank you again for the work that you and the group do. We appreciate it.

Ms. OLSON. Thank you.

Mr. KIND. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you. Now we return to Mr. Etheridge for his question.

Mr. ETHERIDGE. Thank you, Mr. Chairman. And Ms. Olson, thank you for being here. Let me ask you a couple of questions, because in your role as a National Taxpayer Advocate I would be interested in your comments regarding the IRS's ability to deal with the growing complexity of the Tax Code. Let me just share with you some of the things I'm thinking about, because I think we're trying to do the right thing.

We have expended the tax credits for education. We have provided credits for energy efficiency among other things; and these are very valuable. I am fully supportive of them and pushing forward for years, but I think my question to you is: are there means to help people make the decisions to go to college, to understand the credits are there; how to buy a home, or at least work with folks so they can understand that; reduce their energy use through energy efficiency means and share with us in that whole area, because your office talks to thousands of taxpayers? And my question is do you believe that most of the public is aware these credits are available to them?

And let me just layer on top of that the other question so I won't have to ask it, please share with us the steps that you're taking to make sure that people do get the credits that they really deserve that we intended then to have to make a difference in energy policy, educational opportunity and a whole long list of things.

Ms. OLSON. Well, the first thing as far as do taxpayers know about these things, I think they hear about them in the press and the media. The problem is that the media talk about them in very general ways, so taxpayers think, oh, I'm qualified for this and request them when in fact they may not, because the requirements, the eligibility requirements are very detailed. And, you know, the IRS could probably do better with provisions online where people could go in and do Qs and figure out whether they really are qualified.

Mr. ETHERIDGE. Excuse me. Do you have work sheets where you can go on and look at?

Ms. OLSON. Certainly.

Mr. ETHERIDGE. It seems to me.

Ms. OLSON. The IRS does have work sheets and we could probably do a better job of making them more electronic so that people

could get at them easily. But I think that we really, you know, this is where tax reform comes in, because sometimes the complexity of it undermines the very policy goals that Congress is trying to achieve by these provisions.

One thing we recommended in this study that we publish this year was that Congress mandate that IRS come back with a report about the effectiveness of the program. Did it do what Congress wanted it to do? And that could be it didn't do it, because taxpayers didn't know about it or were confused about it. Or IRS made it too hard to get it, or, it was just too confusing. And if Congress had that information, they could better design the credits in the future.

Mr. ETHERIDGE. Okay. Thank you, Mr. Chairman. I yield back.

Chairman LEWIS. Thank you very much. We turn now to Mr. Davis for his question.

Mr. DAVIS of Illinois. Thank you very much, Mr. Chairman. And thank you and your office, Ms. Olson, for the tremendous work that you do. I don't know how much some district offices make use of taxpayer advocates but mine certainly does. And, we are often pleased with response and pleased with the assistance that people are receiving.

One of the areas that I have some interest in is the whole business of tax lien policies. In terms of how the Internal Revenue Service is handling and implementing those policies at this point, for example, after review of a taxpayer's case, the IRS may determine that the outstanding tax liability is currently not collectible.

These cases, of course, involve taxpayers who are experiencing in many instances, serious economic hardship. Does it really make sense for the IRS to use automatic federal tax liens in these cases, even though it's already determined that the individuals are not going to be able to pay?

Ms. OLSON. Absolutely not. It makes no sense whatsoever to me. I'm not saying that the IRS might not want to file a lien in some case where somebody's maybe got a lot of real estate that they can't sell because of the economy and we want to protect the government's interest, but no one's making that determination. No one's looking at the facts. No one's looking at whether the taxpayer has been complaint. All of their life they had a heart attack. They got behind in one year and they will make it up very quickly. There is no reason to destroy somebody's credit for that, which will impair their ability to pay taxes in the future.

Mr. DAVIS of Illinois. And, I guess some of this also just relates to the question that one of my colleagues just raised relative to offers in compromise, and whether or not there is realistic in some instances acknowledgment of what those offers really are and how a situation could be resolved; and in many instances I guess they just kind of go over periods of time and ultimately the resolution, of course, is not going to be in the interest of the taxpayer, nor are they often by then in the best interest of the Internal Revenue Service, because there's no value, seemingly.

Ms. OLSON. IRS figures show that we get on average 17 cents on the dollar from an offer in compromise, whereas, we have 10 years to collect the debt in general. And in year two, we only collected about 11 to 13 cents on the dollar through our normal collection activity; and, in year three, we collect virtually nothing. So

from that perspective an offer is a very good deal for the government as well as a very good deal to give the taxpayer a fresh start.

Mr. DAVIS of Illinois. Let me ask you another question. I've been trying to understand how the differences exist in auditing the way that everybody in the country audited relative to statutes of limitation except people in the Virgin Islands who seem somehow or another to fall outside what the norm would be. Could you explain that to me or do you think that's a fair situation for them?

Ms. OLSON. Well, I think that the way the Internal Revenue Service has interpreted the statute right now, they are saying that going forward, if you file a return with the Virgin Islands, that will start the statute of limitations. But they have carved out a group of taxpayers. So it's sort of like this one group has a special statute of limitations just for them where they have no statute of limitations, essentially. And I am very troubled by that and I've written about that extensively and made some recommendations both to the IRS and to Congress to close that loop. The idea of creating just a special statue of limitations for 243 taxpayers bothers me greatly.

Mr. DAVIS of Illinois. Do you think it would require legislation to actually change that?

Ms. OLSON. Some strong encouragement to the IRS might, but it may very well require legislation, I'm afraid.

Mr. DAVIS of Illinois. Thank you very much. Thank you, Mr. Chairman.

Chairman LEWIS. Thank you. Now we turn to Mr. Roskam for his questions.

Mr. ROSKAM. Thank you, Mr. Chairman. Ms. Olson, thank you for your time today. I had a quick question. I think I wanted to return to an area of inquiry that Mr. Reichert had with you and I understand you're not completely versed on the Senate bill and all of the drama. But there are some top lines that are unambiguous that everybody that's been watching the news knows about, so I don't want to drag you into the weeds.

It's interesting because the IRS is going to have a more significant role by definition, based on the increased tax liability for noncompliance. You'd agree with that. Right?

Ms. OLSON. Hm-hmm.

Mr. ROSKAM. Okay. So it's clear that the Senate version of the bill doesn't have a criminal penalties provision, which is a good thing. It doesn't have the ability of the IRS to put a levy on property, which is a good thing, I would argue, but it doesn't completely take away all the tools that the IRS has. Could you for the benefit of the committee or the subcommittee, could you tell us what other tools the IRS has at its disposal in case of non-compliance?

Ms. OLSON. My understanding is what they're limited to doing is offsetting people's refunds. It is not clear to me whether they can file a lien. If they could file a federal tax lien I'd be concerned about that, but my understanding is they can't. So my understanding is they can only offset people's refunds. Now, 80 to 85 percent of taxpayers get refunds in their income tax returns, so if you're expecting something, you may not get it if you have a penalty on there.

Mr. ROSKAM. And sort of implicit in that, if a taxpayer came to you as the advocate and said, look. I feel like I'm being unfairly

manipulated by the IRS. I'm in fact being audited by the IRS. Wouldn't you be in a position to say, well, that sort of comes with the territory? The senate bill doesn't explicitly take away the IRS's audit authority here. And wouldn't you then recommend to the taxpayer that's not an area where we're going to concentrate on taking the IRS on?

Ms. OLSON. Well, no. I always am willing to take the IRS on anything, but I would say that it's not clear to me under the Senate bill whether the IRS has the authority to audit anybody on anything really, other than is this an eligible insurance policy, or do you have the required coverage. If you are auditing, then I think that the taxpayer does need rights to be able to challenge the IRS.

Mr. ROSKAM. I agree with you wholeheartedly, and I agree with you in terms of your interpretation; but, just to go back and sort of revisit, I think the point you were making a minute ago the IRS has. I mean, to your point, I just want to make sure I'm clear. The IRS would have the ability to have that question of whether the coverage is adequate pursuant to the code. That's an auditable question. Isn't it?

Ms. OLSON. If the bill is structured in that way, and I don't now for a fact whether it is. If Congress says IRS, you are going to make the determination, you are the determiner, and the bill doesn't take it out of the normal procedures to get tax court jurisdiction and things like that, then the IRS could audit it. It could be under some bills it could be a math error in which we say this doesn't fit the requirements; and, if you don't like it, come in and tell us and we'll put you through our normal procedures. Could be very simple, yes, no, and it's how you all write it. It's not what the IRS is going to do. The IRS will do whatever you write.

Mr. ROSKAM. Isn't the fact—and I appreciate your response. Isn't it true that since it's placed in the Tax Code, since the mandate is placed in the Tax Code that there's an implicit audit authority there? I mean it's not resident in some other part of the statutes. It's in the Internal Revenue Code.

Ms. OLSON. Unfortunately, I don't think that's true, because we have the health coverage tax credit where we have no audit authority, and that is in the Internal Revenue Code. So we don't have that. We don't audit anybody on that issue.

Mr. ROSKAM. Wouldn't you argue that in order to take away the ambiguity that has been demonstrated by this conversation for the past couple of minutes, Congress should affirmatively put in place that the IRS in fact doesn't have the authority, because at best, people like me are interpreting it and saying, well, it looks like there's authority. There's people like you that are saying, well, maybe, maybe not. Isn't the best remedy to put it in the same category of things like no criminal penalties, no liens, and no audit authority? Isn't that in fact the best way to go?

Ms. OLSON. Clarity is always helpful.

Mr. ROSKAM. Thank you. I yield back.

Chairman LEWIS. Thank you very much. Ms. Olson, I want to ask you a question. I know it's not in keeping with your report, but let me just ask you. Do you have any counterparts to your knowledge on the state level?

Ms. OLSON. There are many states that have created taxpayer advocates: California, Pennsylvania; New York has one. Every day I'm finding more taxpayer advocates throughout the United States, state advocates. And in May, I think, or September of next year, we are actually—or this year, rather. In Albany we're going to have a conference of state taxpayer advocates.

Chairman LEWIS. Well, do you know about how many states?

Ms. OLSON. At this point, I don't know. I could find out for you, sir.

Chairman LEWIS. The reason I'm raising this question, I just noticed a few days ago there was a national news report that said on the state level many states are holding up the tax refund, because they want to hold onto their money because of budget shortfalls. That doesn't seem to be fair or right.

I hope if they decide to do this, they're going to at least be prepared to pay some interest to the taxpayers. I'd just like to know, but you may not want to get involved in some other person or some other states if you have an opinion about that?

Ms. OLSON. Well I mean these are provisions. If the Internal Revenue Service proposed that I would be very unhappy and would be vocally opposing that or at least ensuring that taxpayers got their interest, you know, paid out to them. And we also have the authority and the ability to override, like refund offsets and things like that where the taxpayer has economic hardship. And so that is something you would want to occur whether it's in the healthcare penalty area or the income tax credit area, or maybe if someone were holding back a check for one reason or another, the ability to override where there is a need.

Mr. PASCRELL. Yeah.

Chairman LEWIS. Mr. Pascrell.

Mr. PASCRELL. Mr. Chairman, I just wanted to clarify. I know that there was work done to address what the gentleman just said, working on legislation to disallow the IRS to audit under these circumstances or pretense, which ever you want to call it, so we are sensitive to that issue.

I hope we are as sensitive to that issue, Mr. Chairman, as we are to 46 million people not having any coverage in the United States of America; and, the only way, having gone through several options, this Committee, right here, to begin the process of covering that many people is to make sure there is a leveling off and everybody has to have all hands on deck.

So you cannot escape the process, because we are all intimately involved with the health of this nation as I understand it. But I have another question for you which I hope that you will answer as you've done all the others responded to all the questions. Our unemployment is now 9.7 percent and it kills you. It kills me to see so many people losing their homes, struggling to pay for their children's educations at the same time to bring bread home on the table; and it's straining to put a meal for the whole family on that table. It's not an easy proposition if you're out of work.

So we find ourselves in the midst of the tax season. It could be troubling time for many. Many of us were faced with a multitude of financial difficulties, as more and more people lose homes, et cetera. One of the economic hardships many of our citizens in

working class communities, like the people I represent in the eighth district in New Jersey, are vulnerable to unscrupulous individuals who take advantage during tax season, particularly.

The report, Ms. Olson, that you presented to us notes that the IRS's collection of penalties assessed against preparers is very low. Yet, we know to the contrary examining other evidence that the amount of violations is very high. So far so good?

Ms. OLSON. Hm-hmm.

Mr. PASCRELL. So, in 2009, the IRS collected only 22 percent of the collectible preparer penalties. Why?

Ms. OLSON. I have no answer to that. I think, you know, it's silly to impose penalties if you don't collect them, and how are they going to be a disincentive against certain behavior if you don't collect them. We have said in the report that the IRS needs a robust, you know, return preparer strategy.

Mr. PASCRELL. Right.

Ms. OLSON. And needs to do shopping visits, you know, posing as a taxpayer as GAO has done and the Inspector General has done on a routine basis.

Mr. PASCRELL. Who can prepare taxes?

Ms. OLSON. Anyone.

Mr. PASCRELL. So, you don't have to have a certificate or have it be stamped or anything like that. Anybody can prepare your taxes.

Ms. OLSON. Now that is changing. The IRS has determined that it has the authority to acquire people who are not attorneys, accountants, or enrolled agents.

Mr. PASCRELL. Well, a lot of attorneys don't know how to file either.

Ms. OLSON. A lot of attorneys, I know. But we have a bar.

Mr. PASCRELL. So I mean why would we leave them out?

Ms. OLSON. Right. There's a bar to requiring them to take a test to practice before the Federal Government.

Mr. PASCRELL. Well, would you agree with me that many attorneys are not trained and are not capable of helping you, Ms. Olson, file your tax?

Ms. OLSON. Certainly. That's not their area of expertise.

Mr. PASCRELL. Okay. So there's a lot of folks that fall into that category.

Ms. OLSON. Absolutely. We think that most preparers fall into the category called "unenrolled preparers," who are anybody. You know, not an attorney, not a CPA, not an enrolled agent. And the IRS is going to start in April of next year, imposing a testing requirement, so that you have to demonstrate your competency to prepare returns before you get permission to prepare returns. And these are things that I've recommended since 2002; that we will be doing a major advertising campaign to alert taxpayers to look for those people who are registered with the IRS and have either passed a test, or are attorneys, CPAs, or enrolled agents but who are registered with the IRS before they pay any money to get a return prepared.

Mr. PASCRELL. And if I just may ask one more question, in the low-income areas, let's say a company that's been doing this for

many years; let's say, H&R Block. Can they hire anyone, even though they may not have any experience to fill out your taxes?

Ms. OLSON. Today, yes, they can, anyway.

Mr. PASCRELL. Thank you. Thank you very much, Mr. Chairman.

Chairman LEWIS. Thank you. We didn't mean to go for a second round. I want to yield now to Dr. Boustany for clarification.

Mr. BOUSTANY. Right. Thank you, Mr. Chairman. In following up on Mr. Roskam's line of questioning, you made comparisons to the healthcare tax credit, which is one being a voluntary program and the other, we're talking about, the mandatory tax, is a mandatory program. And it seems to me that if you're going to have compliance in a mandatory program, then the IRS would probably have to do a significant degree of auditing. Would you agree with that?

Ms. OLSON. Sir, any time that you need compliance you need to have somebody looking at the requirements.

Mr. BOUSTANY. I mean given that it's a mandatory program?

Ms. OLSON. Right. That's correct.

Mr. BOUSTANY. And also because of the way the program is structured with other parts of the healthcare plan, the way it's devised, it depends on that mandate. So I would beg to differ and would think again given the compliance needs, audits will be necessary. And those on our side have concerns about how this will play out with individual taxpayers.

Ms. OLSON. It's how you write the bill. Again, my point about the health coverage tax credit was actually I think there are entities that are looking at this, but the certification is being done on the state level. So the compliance is really being done at that level and the IRS, again, is just a disbursement agent. And that could also be done in terms of the penalty where someone else is making the determination, and the IRS is being told that this is not an eligible plan, and therefore all we are doing is imposing the penalty, once a determination has been made elsewhere.

That's what I was trying to say. It doesn't have to be the IRS making that determination. I cannot comment on the bill because it's not a final bill and we're trying not to do that. These are my concerns. These are the things that I've seen. I could also say that there are other countries around the world that have faced the growth of programs in the Tax Code through the Tax Code, and how they have addressed it is by specifically recognizing that what is a trend in the world tax administrations today is using tax administration, not just for core tax responsibilities, but also for these other provisions.

And in that way they're explicitly recognizing that we're using the agency that touches so many taxpayers to do these other things, and then they're funding it in that way. That is a policy decision. It is not my decision, and it really rests in you all deciding whether that's what you want to do.

Mr. BOUSTANY. And your work requirement is going to grow if this does become law.

Ms. OLSON. Certainly. Certainly.

Mr. BOUSTANY. The needs for advocacy.

Ms. OLSON. Certainly.

Mr. BOUSTANY. Thank you. I yield back.

Ms. OLSON. Thank you.

Chairman LEWIS. Ms. Olson, I'd like to thank you for your testimony, for your views, and sharing your views with us. Members of the Committee appreciate it. We wish you the best. Just before we adjourn, I think we would like to pause and say happy birthday to a young Mr. Ron Kind of Wisconsin. Today is his birthday.

Ms. OLSON. Happy birthday.

Mr. KIND. Thank you, Mr. Chairman. Thank you. It's not the years. It's the mileage, as I'm sure you're well aware.

[Laughter.]

Mr. KIND. A lot of miles on these old bones, already. So, it's an honor to serve with all of you, especially in this place at this time with the challenges that we face. Thank you.

Chairman LEWIS. Well enjoy the birthday and celebrate.

Mr. KIND. Okay.

Chairman LEWIS. There being no further business before the Committee, the Committee is adjourned.

[Whereupon, at 3:12 p.m., the subcommittee was adjourned.]

[Submission of the record follows:]

Submission for the Record: Hearing on the National Taxpayer's 2009 Report on the Most Serious Problems Encountered by Taxpayers

Cheryl J. Latos
Wood River Jct. RI 02894
March 30, 2010

I am a taxpayer facing seizure of my property for non-payment of employment taxes resulting from my ex-husband's former employment as a commercial fisherman. Although he was eventually determined by the Internal Revenue Service to be employee and not self-employed, the correspondence I receive is from the Small Business/Self-Employed branch of the IRS. I have also been told that the seizure will not require judicial approval.

I have several brief comments specifically addressing the issues raised in the Taxpayer Advocate's Testimony of March 16, 2010, and in her 2009 Report to Congress.

2C. The Revenue Benefits of IRS lien Filings appear limited.

As she states on page 7 of her testimony, "the government must focus not merely on collecting a past tax debt but on maximizing future compliance." As she states in her Report, misclassification causes the IRS to lose revenue (vol. 1, p.115). In my case, the employer has not been held liable for misclassification of his employees, but my ex-husband was made liable for the payment of employment taxes that resulted in liens on the house I now own. No employer need comply with employment tax obligations after witnessing the actions of the IRS forcing employees to pay the tax obligations of the employer.

2E. Legislative History Shows Congress Wanted More Managerial Review of Lien Filings, But the IRS is Now Requiring Less.

The Advocate notes that the IRS is requiring managerial approval to defer filing of a notice of Federal tax lien for certain employment tax cases. My case cries out for managerial review, as I am not an employer!

5. The IRS is not meeting the needs of the Low Income Taxpayer

As noted in p. 22 of her testimony, "independent contractor versus employee classification issues frequently arise, with a distinct lack of bargaining power on the part of the low income worker." Despite providing evidence to the contrary, including appeals letters and a technical memorandum, I have been told by the Revenue agent seeking to seize my property that all fishermen are self employed.

7. The Treasury Department Should Conduct a Study to Determine How to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Returns Processing

The Advocate addresses the failure of the IRS to fully process 1099s that results in false

and fraudulent claims. In her report she addresses the importance of information returns (1099s) in promoting voluntary compliance and to improve the detection of unreported income and thus help shrink the tax gap.

Notwithstanding the provisions of IRC § 6050A requiring fishing boat operators to report not only the income but the percentages of the share of the catch paid to both the boat owner and the fishing crew, the IRS refuses to apply the law or acknowledge that it exists. I was told by the Agent planning to seize my house that the reporting law does not exist.

The Tax Court

As usual, the Taxpayer's report discusses taxpayer litigation in the Tax Court. What she does not discuss, however, are the inconsistencies in the Tax Court rulings. The Tax Court ruled in my case on September 5, 2007, that IRC § 3403 does not make an employer liable for the payment of employee income tax. Yet on August 13, 2007 (Colorado Mufflers v. Commissioner) and November 26, 2007 (Ramirez v. Commissioner), the Same Court ruled that if the employer fails to withhold as required, he is liable for the amounts owed by the employee, but required to be withheld by the employer, Sec. 3403.

It's time that the Tax Court, peppered with former IRS lawyers who function to legitimize IRS abuse, be examined as well.

Cheryl J. Latos
Wood River Jct. RI 02894
March 30, 2010

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