WRITTEN STATEMENT OF

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HEARING ON

THE NATIONAL TAXPAYER ADVOCATE'S 2014 ANNUAL REPORT TO CONGRESS

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT OPERATIONS

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

APRIL 15, 2015

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Chairman Meadows, Ranking Member Connolly, and distinguished Members of this Subcommittee:

Thank you for holding today's hearing on the National Taxpayer Advocate's 2014 Annual Report to Congress.[1] By statute, the report is required to describe at least 20 of the most serious problems encountered by taxpayers in their dealings with the Internal Revenue Service, to recommend administrative and legislative changes to mitigate the problems, and to identify the ten most litigated issues for each category of taxpayers.[2]

In my testimony today, I will begin by providing an overview of the functions of the Taxpayer Advocate Service (TAS), which I lead, and the National Taxpayer Advocate's Annual Report to Congress. I will discuss in some detail the following key points:

1. The IRS is currently failing to meet taxpayer needs, which erodes taxpayer trust in the system and undermines voluntary compliance.

2. The IRS's administration of the Affordable Care Act has gone well overall, but some glitches have arisen.

3. Accelerated third-party information reporting and matching will reduce opportunities for error and fraud, including identity theft.

4. The IRS can do more to prevent tax-related identity theft and to assist victims.

5. The IRS is failing to provide relief to victims of tax preparer fraud.

6. In response to a congressional directive, the IRS must change its existing approach to small-business victims of payroll service provider fraud and give special consideration to offers in compromise requested by these victims.

7. More can be done to reduce improper payments of the earned income tax credit (EITC) and other refundable credits without unduly burdening taxpayers and undermining taxpayer rights.

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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. The National Taxpayer Advocate's Annual Reports to Congress and congressional testimony requested from the National Taxpayer Advocate are 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] IRC § 7803(c)(2)(B)(ii).

8. Delegating authority to the Treasury Department to expand the IRS's math error authority could lead to inaccurate tax assessments and undermine taxpayer rights.

9. The IRS is undertaking a review of its approach to tax compliance and service delivery, but greater transparency and congressional oversight would improve taxpayers' confidence and trust in the tax system.

As you know, I lead the Taxpayer Advocate Service (TAS), which predominately has two functions – "case advocacy" and "systemic advocacy." It is with respect to the systemic advocacy side that I appear today.[3] TAS identifies problems that are harming groups of taxpayers, and we make administrative and legislative recommendations to mitigate those problems. Any person – from inside the IRS or outside – may suggest issues for us to consider as systemic advocacy projects by submitting them online through the Systemic Advocacy Management System (SAMS).[4] By statute, I am required to submit two annual reports to the congressional tax-writing committees each year, and I describe the "most serious problems" facing taxpayers in my December 31 report.

The focus of my 2014 Report to Congress was taxpayer rights. Between 1988 and 1998, Congress passed three landmark pieces of legislation establishing taxpayer rights protections and providing remedies for violations of those protections.[5] I thought it would be a useful exercise to assess the extent to which the IRS has or has not implemented those protections as envisioned. The report contains a discussion of twenty-three "Most Serious Problems" facing taxpayers, and in each case, we identify protections that, in our view, have not been adequately implemented.

There are many reasons for the IRS's failure to adequately implement the taxpayer protections. In some cases, legal interpretation has diluted the original legislative goal.[6]

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[3] On the case advocacy side, TAS is charged with helping taxpayers resolve their problems with the Internal Revenue Service. Over the last three years, we have handled a little under 250,000 cases annually, including almost all cases referred to the IRS by congressional offices. By statute, we maintain at least one office in each state. We serve as a *de facto* "safety net" to help taxpayers who are experiencing financial hardships as a result of the way the IRS is administering the tax code and to help all taxpayers who are falling through the cracks of the bureaucracy. Nearly 90 percent of TAS's budget and personnel are dedicated to case advocacy.

[4] Taxpayers and other stakeholders can submit issues at irs.gov/sams.

[5] *See* Technical and Miscellaneous Revenue Act, Pub. L. No. 100–647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights 3" or TBOR 3).

[6] *See*, *e.g.*, the following most serious problems discussed my report*: Audit Notices: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability; Correspondence Examination: The IRS has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers; Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate*

In other instances, the tax system itself has changed so much that provisions enacted nearly three decades ago no longer fit today's administrative processes.[7] Sometimes, implementation has been delayed or cannot be achieved because of the design of the IRS's technology systems.[8] In all instances, we make recommendations for how the IRS can improve its administration of these provisions so they provide substantive protection to U.S. taxpayers.

Also of note, the three taxpayer rights bills created what I view as important but discrete taxpayer rights. None of the bills established a thematic, principles-based Taxpayer Bill of Rights, modeled on the U.S. Constitution's Bill of Rights. Since 2007, I have been recommending that Congress codify a true Taxpayer Bill of Rights because I believe a Taxpayer Bill of Rights is critical to building and maintaining taxpayer trust in the fairness of the IRS and tax administration – particularly in light of public concern over the IRS's use of political-sounding names to screen applicants for tax-exempt status. During the last Congress, the House approved the legislation I proposed, but the Senate did not take it up. Therefore, in my 2013 Annual Report to Congress, I urged the IRS, in the absence of enacted legislation, to adopt the Taxpayer Bill of Rights on its own. On June 10, 2014, the IRS formally did so.[9]

In my 2014 report, I followed the Taxpayer Bill of Rights as my "North Star." I linked almost all of the issues discussed in the report's major sections – the Most Serious Problems Encountered by Taxpayers, Legislative Recommendations, and Most Litigated Issues – to one or more of the foundational rights taxpayers have under the Taxpayer Bill of Rights. My purpose was to demonstrate that, even for an enforcement agency like the IRS, fundamental taxpayer rights can and should guide our every action in tax administration.

But the work toward creating a vital system of taxpayer rights with enforceable remedies for violations of those rights is not yet done. In my report, I have described areas where taxpayer rights protections are weak or nonexistent under current law and other areas where the IRS has resisted Congress's direction in past legislation. Thus, my #1 Legislative Recommendation is that Congress enact landmark taxpayer rights legislation this year, which would include codification of the Taxpayer Bill of Rights and

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Office Contact Information on the Face of the Notices; and Managerial Approval for Liens: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98.

[7] *See, e.g.,* Most Serious Problem*: Access to the IRS: Taxpayers are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues.*

[8] *See, e.g.,* Most Serious Problem: *Virtual Service Delivery: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services.*

[9] Internal Revenue Service, News Release IR-2014-72, *IRS Adopts "Taxpayer Bill of Rights;" 10 Provisions to be Highlighted on IRS.gov, in Publication 1* (June 10, 2014), *at* http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSgov,-in-Publication-1.

adoption of the taxpayer rights legislative recommendations my office and others have made since 1998.[10]

Passage of a taxpayer rights bill would accomplish several things that are desperately needed in today's environment. First, it would create a vehicle for a meaningful discussion about taxpayer rights, the role they play in promoting voluntary compliance, and what mechanisms exist to instill the protection of taxpayer rights into every nook and cranny of tax administration. Second, by codifying the Taxpayer Bill of Rights and creating enforceable remedies for violations of rights enunciated in the Taxpayer Bill of Rights, the United States would become the model for the world in the protection of taxpayer rights. Third, and most importantly, this combination of rights and remedies would begin to restore U.S. taxpayers' trust in the tax system.

Since I understand the focus of this subcommittee is on government performance rather than the specifics of tax legislation, I will not go into greater detail about the Taxpayer Bill of Rights in this testimony. I note, however, that the Ways and Means Committee, on a bipartisan basis, approved legislation last month to codify the Taxpayer Bill of Rights,[11] and I have encouraged the Committee to consider adding additional taxpayer protections.

In the remainder of my testimony, I highlight a few areas discussed in my report that I believe warrant close and continued oversight by Congress. As I note in the preface to my report, while I believe the IRS needs more funding to accomplish its mission, it should not be given a blank check. The IRS needs to demonstrate to Congress and U.S. taxpayers that it is allocating resources appropriately and wisely. Congress in turn should conduct the necessary oversight into the nuts and bolts of tax administration to ensure the IRS is treating taxpayers fairly and is undertaking actions that promote long-term voluntary compliance, not just "quick hits."

I. The IRS Is Currently Failing to Meet Taxpayer Needs, Which Erodes Taxpayer Trust in the System and Undermines Voluntary Compliance.

In my 2014 Annual Report to Congress, I designated inadequate taxpayer service as the #1 most serious problem for our nation's taxpayers. This year, taxpayers are receiving the worst levels of taxpayer service since at least 2001, when the IRS implemented its current performance measures. In fact, the levels of service are the lowest I have witnessed in my 40 years of working in the field of taxation.

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[10] For a summary of these legislative proposals aligned with the rights they protect, see National Taxpayer Advocate 2014 Annual Report to Congress 275-310 *(*Legislative Recommendation: *Taxpayer Rights: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections).*

[11] *See* Taxpayer Bill of Rights Act of 2015, H.R. 1058,114th Cong. (2015) (as amended by H. Comm. on Ways & Means, March 25, 2015).

The tax code as it stands today is overwhelming in its complexity and thus poses a significant compliance barrier for taxpayers. Large numbers of taxpayers contact the IRS for assistance. In addition to publishing forms and instructions, the IRS now typically receives more than 100 million telephone calls,[12] ten million letters,[13] and five million visits from taxpayers each year.[14]

For tax year 2013, more than 63 million tax returns, or about 45 percent of the individual tax returns filed, reported incomes below 250 percent of the federal poverty level.[15] This is the level below which Congress has determined taxpayers are low income so that they qualify for assistance from federally funded Low Income Taxpayer Clinics.[16] As we report this year in our study, *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*, person-to-person assistance is vital for this population's ability to comply with their tax obligations and resolve tax disputes.

The IRS reached its high-water mark in providing taxpayer service in fiscal year (FY) 2004, when it answered 87 percent of the calls it received from taxpayers seeking to speak with an assistor and hold times averaged 2.5 minutes;[17] it responded to a wide range of tax-law questions from taxpayers both on its toll-free lines and in its roughly 400 walk-in sites; it prepared nearly 500,000 tax returns for taxpayers who requested help, particularly low income, elderly, and disabled taxpayers;[18] and it maintained a robust outreach and education program, estimating that its outreach efforts touched 72 million taxpayers.[19]

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[12] IRS, Joint Operations Center, *Snapshot Reports*: *Enterprise Snapshot* (final week of each fiscal year for FY 2008 through FY 2014).

[13] IRS, Joint Operations Center, *Adjustments Inventory Reports*: *July-September Fiscal Year Comparison (FY 2008 through FY 2014).*

[14] IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2014, Nov. 6, 2014).

[15] IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2013) (computation based on "total positive income" for income and number of exemptions for household size and includes returns filed through Oct. 2014 and based on 250 percent of HHS poverty levels for 2013).

[16] Low Income Taxpayer Clinics (LITCs) generally provide free or nominal fee representation to taxpayers in tax disputes with the IRS. IRC § 7526. At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the Federal Poverty Level (FPL). *See* IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines for the Federal Register each year, which are used to establish the 250 percent FPL thresholds. For the 2015 FPL thresholds, see 80 F.R. 3236 (Jan. 22, 2015).

[17] IRS, Joint Operations Center, *Snapshot Reports*: *Enterprise Snapshot* (Sept. 30, 2004).

[18] This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

[19] IRS Data Book, FY 2004, Table 23.

By comparison, the IRS's performance in meeting taxpayer needs during the current filing season can be summarized as follows:

- The IRS has been unable to answer even 40 percent of the telephone calls it has received from taxpayers seeking to speak with a telephone assistor.[20]

- For taxpayers who have managed to get through, wait times have averaged more than 20 minutes[21] and have run considerably longer during peak periods.

- For the filing season to date, there have been 6.8 million upfront "courtesy disconnects," more than seven times the number at this point last year.[22] This means almost seven million calls were not allowed to enter the phone queue because the IRS anticipated that it could not handle the volume.

- The IRS has answered a far narrower range of tax-law questions than it used to. During the filing season, it did not answer any tax-law questions except "basic" ones. After the filing season, it will not answer any tax-law questions at all, leaving the roughly 15 million taxpayers who file later in the year unable to get answers to their questions.[23]

- The IRS has eliminated return preparation service for taxpayers.[24]

- The IRS reduced its training funds by 83 percent from FY 2010 through FY 2014, leaving employees less equipped to do their jobs properly.[25]

The following chart shows the IRS's performance in handling telephone calls from January 1 – April 4, 2015, and the comparable period during 2014:

[20] IRS, Joint Operations Center, *Snapshot Reports*: *Enterprise Snapshot* (April 4, 2015).

[21] *Id.*

[22] IRS, Joint Operations Center, Custom Report 2015-1487 (April 6, 2015).

[23] IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *available at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources. These restrictions were implemented in 2014.

[24] *Id.*

[25] IRS Chief Financial Officer, Corporate Budget.

Figure 1: IRS Telephone Performance – Jan. 1–April 4, 2015[26]

Line	2014 Net Attempts*	2014 Assistor Calls Answered	2014 ASA (minutes)	2014 CSR LEVEL OF SERVICE	2015 Net Attempts*	2015 Assistor Calls Answered	2015 ASA (minutes)	2015 CSR LEVEL OF SERVICE	2014 to 2015 Change LOS Change (percentage point)	2014 to 2015 Change ASA Change (minutes)
Accounts Management (AM) - Sum of 29 Lines	**39,539,366**	**8,479,548**	**14.1**	**71.2%**	**42,581,832**	**6,227,620**	**23.4**	**37.6%**	**-33.7%**	**9.4**
Individual Income Tax Line TAX -1040	6,181,160	1,616,173	15.4	74.1%	8,126,217	1,030,189	22.5	25.8%	-48.3%	7.0
Refund Hotline (1954)	16,790,374	87,319	18.6	51.7%	14,127,576	66,773	23.1	26.1%	-25.7%	4.5
W&I Individual Customer Response Line	1,845,877	588,140	15.8	60.4%	2,274,801	348,135	22.7	26.3%	-34.2%	6.9
NTA (4778)	206,621	104,745	5.7	70.8%	307,600	87,052	19.7	38.2%	-32.7%	14.0
Practitioner Priority Service (PPS)	492,410	314,851	20.0	74.9%	524,960	198,189	46.7	43.9%	-31.0%	26.7
Identity Protection Specialized Unit (IPSU)	747,791	458,101	12.0	82.2%	1,297,000	440,016	25.8	53.7%	-28.5%	13.8
Taxpayer Protection Program (TPP) (through Mar 28, 2015)	**170,791**	**135,152**	**8.1**	**81.6%**	**2,563,048**	**375,069**	**29.3**	**14.4%**	**-67.2%**	**21.2**

The official measure of IRS telephone performance is based on calls made to the "Accounts Management" telephone lines. So far this year, the IRS has answered only 38 percent of calls from taxpayers gated to speak with a telephone assistor, and wait times for those who got through averaged 23 minutes.[27] That is an extraordinary decline from last year, when the IRS answered about 71 percent of its calls, with an average wait time of 14 minutes for the comparable period.

All rows other than the Taxpayer Protection Program row show important telephone lines that are subsets of the Accounts Management total. The TPP information stands alone and is not included in the AM lines. Notably:

- The Taxpayer Protection Program (TPP) is designed to help taxpayers whose returns the IRS has suspended because of suspected but unconfirmed identity theft. When an IRS filter stops a return, the IRS sends the taxpayer a letter asking him or her to either call the TPP phone number or visit the Out Of Wallet (OOW) website to verify his or her identity. So far in this filing season (through April 4, 2015), the TPP has received more than 2.5 million calls and provided a

[26] IRS, Joint Operations Center, *Snapshot Reports*: *Enterprise Snapshot* (week ending April 4, 2015) (source of data for all lines except the Taxpayer Protection Program phone line); IRS, Joint Operations Center, *FY 2015 Weekly TPP Snapshot* (week ending April 4, 2015) (source of data for the Taxpayer Protection Program phone line).

[27] The percentage of calls answered from taxpayers who choose phone tree prompts that put them in the queue to speak with a customer service representative is referred to as the Customer Service Representative Level of Service, which is abbreviated as "CSR LEVEL OF SERVICE" on the above chart. The wait time for callers who get through to a customer service representative is referred to as the Average Speed of Answer, which is abbreviated as "ASA (minutes)" on the above chart. In both cases, we have rounded to the nearest whole numbers, but the LOS change and ASA change columns were computed using decimals and therefore do not all total exactly.

dismal 14 percent level of service. In other words, only about one of seven callers reached an IRS assistor.[28]

- The Identity Protection Specialized Unit (IPSU) phone lines assist victims with most types of IDT issues, including both tax-related and non-tax-related identity theft. Through March 28, approximately 1.3 million calls came into the IPSU line, and 54 percent of those attempting to reach an assistor succeeded.[29]

- The Practitioner Priority Service (PPS) phone line is used by tax professionals who are trying to reach the IRS to assist their clients. Here, too, the majority of calls have not been answered, and in those that have been, practitioners had to wait on hold an average of 47 minutes before speaking with an assistor. The term "Priority" has provided a small measure of comic relief for extremely frustrated tax attorneys, CPAs, and Enrolled Agents, who must decide whether and how much to charge their clients for the time they spend waiting on hold.

- The Taxpayer Advocate Service (NTA) phone line, staffed by Wage & Investment (W&I) employees, is used by taxpayers who believe they are experiencing financial or economic burden and seek the assistance of my office. TAS is intended to be the safety net for taxpayers. It adds insult to injury when most calls from taxpayers who have already experienced IRS problems can't get through, and those who succeed must wait an average of 20 minutes on hold.

The IRS's ability to timely process taxpayer correspondence has also been declining. The following chart shows open inventory levels and the percentage of inventory not handled within established timeframes for two key programs run by the Accounts Management function:

Figure 2: IRS Correspondence Performance – Jan. 1–April 4, 2015[30]

	Week of 04/05/2014			Week of 04/04/2015			2014 to 2015 Change	
Key AM Programs	Total	Overage	Percentage Overage	Total	Overage	Percentage Overage	Overage Change	Overage Change (percentage point)
Individual Taxpayer Correspondence	136,192	37,780	27.7%	180,963	78,777	43.5%	40,997	15.8%
Amended Returns/ Duplicate Filing	189,467	49,567	26.2%	168,566	57,232	34.0%	7,665	7.8%

[28] IRS, Joint Operations Center, Snapshot Reports, *FY15 TPP Snapshot* (week ending April 4, 2015).

[29] IRS, Joint Operations Center, Snapshot Reports, *Product Detail Reports* (week ending April 4, 2015).

[30] IRS, Customer Account Services Accounts Management Paper Inventory Reports, *Inventory Age Report – All Programs* (week ending April 4, 2015).

In both programs, more than one-third of the inventories are overage (*i.e.,* have not been handled within established timeframes), which represents a substantial increase over last year's already-high levels. These lengthy backlogs often lead to adverse taxpayer impact. For a taxpayer who owes additional tax, interest charges and penalties generally will continue to accrue. For a taxpayer who has overpaid, a delay in processing correspondence may translate into a delay in receiving a refund.

Overall, the decline in the IRS's taxpayer service levels results from a combination of more work and reduced resources. On the workload side, the IRS is receiving 11 percent more returns from individuals,[31] 18 percent more returns from business entities,[32] and 70 percent more telephone calls (through FY 2013) than a decade ago.[33] Implementation of the Patient Protection and Affordable Care Act[34] during the current filing season will add considerable new work.

On the funding side, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms since FY 2010.[35] As a consequence, the IRS has already cut its workforce by nearly 12,000 employees,[36] and projects it will have to cut several thousand additional positions during FY 2015.[37]

I believe the IRS, like any agency, can operate more effectively and efficiently in certain areas, and in my 2014 report and in this testimony, I make many recommendations to improve IRS performance and treatment of taxpayers.[38] However, I do not see any

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[31] *See* IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; *see* IRS Publication 6292, Fiscal Year Return Projections for the United States 2014-2021, at 4 (Fall 2014).

[32] *Id.*

[33] The majority of the additional calls were handled by automation. The increase in calls seeking to speak with a customer service representative was 23 percent. *See* IRS, Joint Operations Center, *Snapshot Reports*: *Enterprise Snapshot* (final week of fiscal years 2005 and 2013) (indicating that the number of calls gated to a representative on the Account Management telephone lines increased from about 40.4 million to about 49.8 million). The percentage increase in calls gated to an assistor likely would have been considerably higher absent IRS policies that have increasingly restricted personal service options.

[34] Pub. L. No. 111-148, 124 Stat. 119 (2010).

[35] In FY 2010, the agency's appropriated budget stood at $12.1 billion. In FY 2015, its budget was set at $10.9 billion, a reduction of about 9.9 percent. Inflation over the same period is estimated at about 9.4 percent. Adjusting for the interactive effects of these cuts and the impact of the federal pay freeze, we estimate the inflation-adjusted reduction in funding was about 17 percent.

[36] IRS Chief Financial Officer, Corporate Budget. This reduction represents actual full-time equivalent employees realized through appropriated dollars.

[37] Email from Commissioner Koskinen to All Employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014). The IRS anticipates it can make these reductions through attrition.

[38] *See, e.g.,* National Taxpayer Advocate 2014 Annual Report to Congress, 79-93, 112-122, 154-162, 172-196 (Most Serious Problems: *Offshore Voluntary Disclosure (OVD): The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights; Workload Selection: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy; Virtual Service Delivery: Despite a Congressional Directive,*

substitute for sufficient personnel if the IRS is to provide high-quality taxpayer service. The only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of taxpayer letters is to have enough employees to read the letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

The requirement to file a tax return and pay taxes is generally the most significant burden a government imposes on its citizens. The government has a duty to make compliance as simple and painless as possible. I am deeply concerned that the government is largely turning its back on the significant number of taxpayers who require personal assistance to comply with their tax obligations.

I believe that Congress and the IRS have a shared responsibility to ensure that the taxpayers who pay our nation's bills receive the assistance they need when they seek to meet their tax obligations. As I wrote in my recent report, I do not think it is acceptable for the government to tell millions of taxpayers who seek help each year, in essence, "We're sorry. You're on your own."

Recommendations

I recommend that Congress:

- Over the short term, carefully monitor taxpayer service trends and ensure that the IRS receives the oversight and funding it requires to meet the needs of U.S. taxpayers.

- Over the longer term, enact comprehensive tax reform to reduce the complexity of the Internal Revenue Code and reduce compliance burdens on taxpayers and the IRS alike.

II. The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen.

Overall, the IRS has done a commendable job implementing the Patient Protection and Affordable Care Act of 2009 (ACA), including developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies.[39]

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the IRS Has Not Maximized the Appropriate Use of Videoconferencing and *Similar Technologies to Enhance Taxpayer Services; and Notices: Refund Disallowance Notices Do Not Provide Adequate Explanations).*

[39] Patient Protection and Affordable Care Act of 2009, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010 (HERCA), Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

IRS ACA implementation efforts were rigorously tested during this filing season, with the rollout of the Individual Shared Responsibility Payment (ISRP) [40] and the Premium Tax Credit (PTC) on tax year (TY) 2014 federal income tax returns.[41] At the same time, the IRS received and processed a significant number of new information returns from insurers and exchanges.[42]

The level of service on the ACA telephone hot line (800-919-0452) was over 68 percent this calendar year through the week ending March 28, 2015, which far exceeds the approximately 37 percent LOS on the Accounts Management toll-free lines.[43] However, as the filing season unfolded, we identified the following concerns.

Taxpayers Potentially Received First-Time Penalty Abatement Relief Rather Than Appropriate Penalty Relief Under Notice 2015-9.

Commendably, the IRS is providing limited relief for taxpayers who have a balance due on their 2014 income tax returns as a result of reconciling advance payments of the premium tax credit (APTC) against the PTC allowed on the tax return. Under Notice 2015-9, the IRS will abate the penalty under IRC § 6651(a)(2) for late payment of a balance due and the penalty under IRC § 6654(a) for underpayment of estimated tax.[44] However, we are concerned that some taxpayers received penalty relief for late

[40] IRC § 5000A. Taxpayers filing tax year (TY) 2014 federal income tax returns were required to report that they have "minimum essential coverage" or were exempt from the responsibility to have the required coverage. If the taxpayer did not have coverage and was not exempt, he or she was required to make a shared responsibility payment (SRP) when filing a return.

[41] The Premium Tax Credit is a refundable tax credit paid either in advance or at return filing to help taxpayers with low to moderate income purchase health insurance through the marketplace. IRC § 36B. The amount of the credit paid in advance is based on projected income, while the amount a taxpayer is actually eligible for is based on actual income. Many taxpayers were required to reconcile the Premium Tax Credit (PTC) amounts they received in advance with the amounts to which they were actually entitled.

[42] The Health Insurance Marketplace also called the "Exchange," is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or who buy insurance on their own. *See* http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace. IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. Section 6056 requires annual information reporting by applicable large employers relating to the health insurance that the employer offers (or does not offer) to its full-time employees. IRS Notice 2013-45, 2013–31 I.R.B. 116, provides transition relief from the information reporting required under IRC §§ 6055 and 6056, but the IRS has encouraged entities to voluntarily provide information returns for coverage provided in 2014, which was due to be filed and furnished in early 2015.

[43] The AM level of service of approximately 37 percent is a combined figure representing 29 customer service lines. The ACA LOS may be due, in part, to the fact that demand in the ACA hotline was significantly less than the IRS anticipated. The ACA line had over 400,000 attempted calls, as compared to almost 40 million on the Accounts Management toll-free line, during that period. IRS, Joint Operations Center, *Product Detail Report* (week ending March 28, 2015); IRS, Joint Operations Center, *Snapshot Report*s (week ending March 28, 2015.

[44] IRS Notice 2015-9, I.R.B. 2015-6 (Feb. 9, 2015).

payment under IRC § 6651(a)(2) pursuant to the first-time abatement administrative waiver, which is available only once every three years, rather than the relief provided under the notice.[45] As a consequence, some taxpayers who otherwise would qualify for penalty relief during the succeeding three-year period may not receive it. Our office will investigate this matter to determine the extent to which taxpayers received the inappropriate type of penalty relief.

Lack of Exchange Data Results in Premium Tax Credit Returns Held in Error Resolution System (ERS) Suspense with No Explanations Provided to Taxpayers.

On February 25, 2015, the IRS issued an alert reporting that the Marketplace had not provided all of the data the IRS needed to match PTC claimed against third-party data provided by the Department of Health and Human Services (HHS).[46] Pending receipt of such data, the IRS suspended the processing of returns it was unable to match. In the alert, the IRS advised employees to tell taxpayers calling about these returns to allow an additional 45 days for processing and review, and instructed employees not to say anything to the taxpayer about the data not being received or that it relates to the ACA or PTC.[47] After I raised concerns that this IRS directive jeopardized taxpayers' *right to be informed*, the IRS updated the alert on March 6, directing employees to tell taxpayers that their return was under review and may take an additional 45 days.[48] However, I am concerned that the IRS is continuing to hold returns and is looking solely to electronic data matching before releasing refunds, ignoring paper documentation that supports the taxpayer's claim and thereby harming taxpayers.

Exchanges Made Errors on Forms 1095-A, Leading to IRS Resolution to Reduce Taxpayer Burden.

The Centers for Medicare and Medicaid Services (CMS) announced in February 2015 that about 20 percent – or 800,000 -- of the tax filers who purchased health insurance from the federal Marketplace received Forms 1095-A, *Health Insurance Marketplace Statement*, with errors in the second lowest cost Silver plan information. The Marketplace issued corrected Forms 1095-A. In response, the Centers for Medicare & Medicaid Services (CMS) asked those taxpayers who (1) received an incorrect Form 1095-A from either the federal or state exchanges and (2) had not yet filed to wait

[45] First-time abatement applies if the taxpayer does not have a failure to pay, failure to file, or failure to deposit penalty in the prior three years of the assessment year. For more information on the first-time abatement administrative waiver, see IRM 20.1.1.3.6.1, *First Time Abate (FTA)* (Aug. 5, 2014).

[46] Specifically, the IRS did not receive complete data on the amounts of premiums, the second lowest cost silver plan (SLCSP), and advanced payment of the PTC reported from both the federal and state exchanges.

[47] IRS, Servicewide Electronic Research Program (SERP) Alert 15A0141, *Returns Reporting a Premium Tax Credit Being Held In Error Resolution System (ERS) Suspense* (Feb. 25, 2015).

[48] SERP Alert 15A0171, *Taxpayer Refund Inquiries with ERS Status Code 249, 349, or 449* (Mar. 6, 2015).

until receiving the corrected forms.[49] Treasury informed those taxpayers who had already filed, based on the incorrect forms, that there is no need to file an amended return. Treasury further stated that the IRS will not pursue collection of any additional taxes from these individuals based on the updated information in the corrected forms. The IRS later extended this relief to all taxpayers, not just those who had previously filed.[50] On April 10, 2015, the IRS issued Notice 2015-30, providing penalty relief for incorrect or delayed Forms 1095-A.[51] However, we remain concerned about the impact the corrected forms had on taxpayers. For example, some may be eligible for a refund but will not amend their returns because they do not understand the meaning of the corrected Form 1095-A, are afraid of being audited, or cannot afford the additional preparation fees involved in amending the return.

III. Accelerated Third-Party Information Reporting and Data Matching Will Reduce Opportunities for Error and Fraud, Including Identity Theft.

Third-party information reporting promotes voluntary tax compliance.[52] It also helps the IRS identify requests for refund that are questionable. Because of delays in receiving third-party information reports, however, the IRS cannot match them with tax return data until long after it has released any associated refunds.[53] If the IRS could match the information before issuing refunds, it could identify and resolve inaccurate income reporting soon (or immediately) after the return is filed and halt erroneous refunds.

In 2009, I recommended that Congress establish a timeframe for the IRS to develop a strategy and timeline for accelerating third-party information report processing and providing taxpayers with electronic access to such data.[54] More recently, a study in my 2013 Annual Report presents a strategic framework and recommendations to better

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[49] CMS, *What Consumers Need to Know About Corrected Form 1095-As* (Feb. 20, 2015) *available at http://blog.cms.gov/2015/02/20/what-consumers-need-to-know-about-corrected-form-1095-as/.*

[50] SERP Alert 15A0147, *Responding to Taxpayer Inquiries about Corrected Forms 1095-A, Health Insurance Marketplace Statements* (Feb. 26, 2015, revised April 6, 2015); U.S. Department of Treasury, Press Center, *Statement from a Treasury Spokesperson on CMS Announcement Last Week about 1095-A Forms* (March 20, 2015).

[51] IRS Notice 2015-30, I.R.B. 2015-17 (Apr. 27, 2015).

[52] For example, workers who are classified as employees have little opportunity to underreport their earned income because it is subject to both information reporting on Forms W-2 and tax withholding. IRS data show that taxpayers report about 99 percent of their wages and salaries. IRS, *Tax Gap for Tax Year 2006 Overview*, Chart 1 (Jan. 6, 2012).

[53] For a more detailed discussion of the IRS's processes to review refund returns, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-131 (May 13, 2013).

[54] National Taxpayer Advocate 2009 Annual Report to Congress 338-345; National Taxpayer Advocate 2011 Annual Report to Congress 284-295; National Taxpayer Advocate 2012 Annual Report to Congress 180-191.

structure the filing season to reduce fraud and protect the interests of both the government and taxpayers.[55]

In addition, accelerated information report processing and upfront matching would substantially improve taxpayer service and reduce taxpayer burden by:

- Providing taxpayers with direct electronic access to the third-party information report data to assist in tax preparation and reduce errors;[56]
- Improving taxpayers' ability to answer questions about an underlying economic transaction because the IRS would identify the mismatch right away, rather than a year or more after the fact;
- Avoiding IRS collection actions long after taxpayers have spent the refunds;
- Avoiding the long-term accrual of penalties and interest on unintentionally omitted or under-reported items; and
- Reducing vulnerability to identity-theft related refund fraud.[57]

The IRS has acknowledged the benefits of accelerated third-party information report processing and upfront matching, and has begun planning for them.[58] However, progress has been slow. To stimulate serious consideration and discussion of the issue, we offered the following administrative and legislative recommendations to achieve a system that allows the IRS to perform upfront matching to protect government revenue and improve taxpayer service.

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[55] National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96.

[56] For more information on the benefits of electronic access to third-party data and the experience of international tax administrations, *see* National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96.

[57] *See* William Hoffman, *IRS Oversight Board Brainstorms Real-Time Tax System, ID Theft Initiatives*, Tax Notes Today (May 2, 2013); IRS, PowerPoint, *Real Time Tax System Initiative, Public Meeting* 1 (Dec. 8, 2011), *available at* http://www.irs.gov/file_source/pub/irs-utl/rtts_deck.pdf. For more information on identity-theft refund fraud, see National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers)*; National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*).

[58] For written and oral statements of panelists at the two IRS Real Time Tax System Initiative public meetings, see http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative (last visited Feb. 13, 2013). Internal IRS discussions concerning its Compliance Capability Vision (CCV), which it has incorporated into its Concept of Operations or ConOps, seem to adopt most of the Real Time Tax System vision. IRS, Compliance Capabilities Vision – Draft Blueprint (June 16, 2014) and Compliance Capabilities Vision Revised CONOPS (Oct. 21, 2014) (both on file with the National Taxpayer Advocate).

Recommendations

I recommend that Congress:

- Require the IRS and Treasury, in consultation with the National Taxpayer Advocate, to prepare (and publish) a plan and timeline to achieve an accelerated third-party report processing system, and enact legislation necessary to achieve such a system.[59] This system, at a minimum, should:
  - Provide taxpayers with electronic access to real-time transcripts of third-party information reporting data to aid in return preparation.
  - Provide a platform from which taxpayers and preparers could download third-party data directly into commercial tax return preparation software, Free File, and Free Fillable Forms.
  - Develop and implement a one-year pilot to determine if the IRS can screen Form W-2 data as effectively as the Social Security Administration, thereby accelerating the processing of such data.
  - Require all information reports, whether electronically filed or filed on paper, to be due at the end of February and possibly earlier. Because almost 98 percent of all information reports are already electronically filed, eliminate the March 31 deadline for e-filed information reports.[60]
  - Create a $50 *de minimis* threshold for corrections, which would eliminate the need to file an amended or corrected third-party information report for any adjustments to income below $50.
  - Further increase electronic filing by reducing the 250 report threshold in IRC § 6011(e) to 50 reports and offer 2D bar code technology for those who cannot e-file.
  - Delay issuance of direct deposit and other electronic refunds until April 30 and paper checks until May 31 so the IRS has time to check refund claims against third party documents and identify questionable claims.

[59] National Taxpayer Advocate 2009 Annual Report to Congress 338-345; National Taxpayer Advocate 2011 Annual Report to Congress 284-295; National Taxpayer Advocate 2012 Annual Report to Congress 180-191; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 91-92.

[60] IRS Pub. 6961, *2014 Update: Calendar Year Projections of Information and Withholding Documents for the United States and Campuses*, Tables 2-4 (Of the 2,096,171,769 information reports received in calendar year 2013, 2,048,682,325 were received electronically).

IV. The IRS Can Do More to Prevent Tax-Related Identity Theft and to Assist Victims.

The 2014 Annual Report to Congress is the ninth Annual Report in which I have discussed and made recommendations about IRS processes with respect to identity theft and tax administration.[61] Identity theft (IDT) is an ongoing problem that has significant impact on taxpayers and the IRS alike. Each year, the IRS modifies its fraud detection filters as it discovers new schemes. Notwithstanding these improvements, motivated criminals will figure out ways to get around and through the best-developed filters. I believe the only way to systemically protect both taxpayers and the federal fisc is to fundamentally change our tax filing system as I describe in the previous section; namely, by accelerating the deadline for third-party information reporting and delaying the issuance of refunds.

In our current system, the IRS processes the bulk of individual tax returns between February and April of each year, and does a generally excellent job of issuing refunds to the more than 78 million individual taxpayers who are due a refund.[62] While this is good for taxpayers who have grown accustomed to receiving their refunds quickly, it provides an opportunity for identity thieves to exploit. The IRS does not wait to verify the reported earnings and withholding amounts before issuing the refunds – and criminals know this. By the time the true return is filed and the IRS knows there is a problem, the perpetrator is long gone.

Anecdotally, we have heard of organized criminals who have given up drug trafficking to engage in the much easier, safer, and just-as-lucrative endeavor of tax refund fraud. The potential benefits seemingly far outweigh the potential risk, despite the IRS's Criminal Investigation Division and the Department of Justice's increased focus on prosecuting individuals charged with fraudulent tax refund schemes.

In addition to accelerating third-party information reporting, another potential solution is to require a second form of authentication when filing a tax return. Today, anyone can,

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[61] *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, *Identity Theft Case Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014* 52; National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180-191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133-136 (Most Serious Problem: *Inconsistence Campus Procedures*).

[62] IRS Filing Season Statistics for week ending March 27, 2015, *available at* www.irs.gov. The IRS issued 78,769,000 individual refunds through April 4, 2015.

with minimal effort, obtain all of the information required to file a return purporting to be from another person. SSNs are bought, borrowed, and stolen like a commodity. The IRS started issuing Identity Protection PINs (IP PINs) to some victims of identity theft, and is conducting a pilot program in several states where taxpayers could ask for an IP PIN. Once this unique number is assigned, the taxpayer must provide it in conjunction with his or her SSN (or other taxpayer identification number) for the IRS to process the return.

The IRS could expand the issuance of IP PINs to anyone who requests them, regardless of whether they have been victims of IDT. This approach would require more effort on the part of both taxpayers and the IRS, but I think this is an option that should be seriously considered, even as it explores other less costly methods of authenticating taxpayers at the point of filing. Attempts by those who steal SSNs with the intention of filing falsified tax returns would generally be thwarted because unlike SSNs, IP PINs would be used exclusively for tax filing and would not be vulnerable to theft in the context of non-tax activities.

In the meantime, the IRS can improve its processes for assisting victims of identity theft. In prior testimony and in my reports to Congress, I have pointed out many ways in which the IRS creates rework for itself. For example, in my 2014 Annual Report, I included the results of a case review conducted by the Taxpayer Advocate Service that analyzed a statistically valid sample of IDT cases closed by the IRS.

The results of this case review not only confirmed my suspicion that identity theft cases are complex, but also revealed glaring inefficiencies in current IRS procedures. Overall, about two-thirds (67 percent) of all IDT cases reviewed in our sample were either (1) worked in more than one function, or (2) reassigned to another assistor within a function.[63] When a case is transferred or reassigned, it delays resolution and adds to the frustration of the victim. We found 42 percent of the cases analyzed in our sample had periods of inactivity (*i.e.*, times when no work was done on the case for more than 30 days).[64] In fact, although the IRS states its identity theft cycle time is 120 days, our representative sample of cases had an average cycle time of 179 days, or almost two months longer. Even this 179-day measure likely understates the true cycle time, in part because, as described below, the IRS closed 22 percent of the cases in our sample prematurely, leaving matters unresolved. In other cases, the timeframes could be understated because the IRS measured only one module or tax year, not all those associated with the taxpayer.

I have recommended that for complex identity theft cases that require the victim to deal with multiple IRS functions, the IRS should designate a sole contact person with whom

[63] *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, at 52 (*Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014)*.

[64] *See id*.

the victim can interact for the duration of the case.[65] I believe that not only will this put the victim more at ease, but will stop these cases from falling through the cracks, adding to the cycle time.

Another finding from this case review was that the IRS's global account review procedures are ineffective. Before closing an identity theft case, the IRS completes an account review to ensure all related issues have been fully addressed. Yet in 22 percent of the cases in our sample, the IRS had closed a case without fully resolving the account.[66] That is, in more than one-fifth of closed identity theft cases, unaddressed account issues remained – for example, a victim had not yet received a refund, or the IRS had failed to update the victim's address to receive an IP PIN. Clearly, the global account review process is not working as it should, which leads to rework when the taxpayer contacts the IRS again to address the lingering issues.

Recommendations

I recommend that Congress:

- Require the IRS to conduct comprehensive global account reviews upon receipt of an identity theft case to determine whether the case involves multiple issues or years.
- Assign IDT victims with multiple issues to a sole IRS contact person who will interact with them throughout the pendency of the case and oversee its resolution, regardless of how many different IRS functions need to be involved behind the scenes.
- Conduct a comprehensive global account review prior to closing an IDT case to ensure all issues and years relating to identity theft have been fully resolved.

V. The IRS Is Failing to Provide Relief to Victims of Tax Preparer Fraud.

Many taxpayers enlist the aid of paid return preparers to meet their increasingly complex tax filing obligations.[67] Unfortunately, a small percentage of these preparers betray their clients' trust by inflating income, deductions, credits, or withholding without

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[65] *See* National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, *Identity Theft Case Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014* 52.

[66] *See id*. at 53.

[67] I discuss this issue in the Case Advocacy section of my 2014 Annual Report to Congress. *See* National Taxpayer Advocate 2014 Annual Report to Congress 543-544; National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78 and National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (*Most Serious Problem: Regulation of Return Preparers*: *Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers).*

their clients' knowledge or consent. They then pocket the entire refund, or the difference between the revised refund amount and the amount the taxpayer expected, by diverting all or part of the direct deposit refund to a bank account under the preparer's control. Other preparers just outright steal taxpayers' refunds by changing the bank account routing number to an account under the preparer's control.

Even though there is little difference between the plight of identity theft victims and victims of preparer fraud, the IRS treats these situations very differently. While victims of identity theft will ultimately receive the refund to which they are entitled, the IRS has no procedures that allow its employees to issues refunds to victims of preparer fraud.

What's frustrating is that return preparer fraud is not a novel issue. The IRS has known about this problem and its severe impact on victims for many years. Since 2000, the IRS has received four legal opinions from its Office of Chief Counsel that, when read together, permit the IRS to (1) disregard the altered return filed by the preparer, (2) accept an unaltered return signed by the taxpayer, and (3) issue a refund to the victim even if a payment had already been made to the preparer.[68] In 2014, Chief Counsel reaffirmed to me and to the IRS Commissioner that the IRS is not prohibited from issuing refunds to victims of preparer fraud.

In March 2014, the Commissioner made the decision that the IRS will issue refunds to victims of preparer fraud who can show that they were not complicit in the preparer's fraud. Under the Commissioner's approach, the victim will be required to provide a copy of an incident report filed with local law enforcement (*i.e.*, a police report) before the IRS issues a replacement refund to alleviate the IRS's concern about collusion between the preparer and taxpayer.

It has now been over a year since the Commissioner made this decision, and the IRS still has no procedures in place to implement this policy. The IRS has not even circulated draft procedures for TAS to review and comment upon. Unfortunately, the little the IRS has told us about its intentions makes clear that many taxpayer-victims will still be denied their refunds, because the IRS has ruled out issuing refunds to taxpayers whose bank account routing numbers were changed by the preparer. Given that some taxpayers have been waiting patiently for refunds from their 2008 and 2009 tax returns, this is beyond embarrassing. It is unconscionable.

The IRS's refusal to decide to make victims of preparer fraud whole, and its failure to act on that decision, once made, for more than a year, show an utter lack of empathy and is a breach of trust to these victims. As the National Taxpayer Advocate, I have done everything within my power to get relief for these taxpayers. I have personally issued more than 25 Taxpayer Assistance Orders to IRS Commissioners (appointed

[68] Field Service Advice 200038005 (June 6, 2000); IRS Office of Chief Counsel Memorandum, *Horse's Tax Service,* PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer,* POSTN-145098 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return,* PMTA 2011-20 (June 27, 2011).

and acting), along with two Taxpayer Advocate Directives. All of these have been rescinded by the Deputy Commissioner for Services and Enforcement.

As a result of the IRS's inaction, in December 2014, I personally wrote to each of the over 200 taxpayers whose return preparer fraud cases were in TAS, encouraging them to speak with Low Income Taxpayer Clinics to obtain representation and discuss their options, including the possibility of filing suit in federal court for their refunds, even as TAS continues to advocate on their behalf.

Recommendations

I recommend that Congress:

- Require the IRS to issue replacement refunds to taxpayers who have demonstrated with credible evidence that they are victims of return preparer fraud, including the alteration of bank account routing numbers.

VI. In Response to a Congressional Directive, the IRS Must Change Its Existing Approach to Small Business Victims of Payroll Service Provider Fraud and Provide Special Consideration to Offers in Compromise.

Outsourcing payroll and related tax duties to third-party payroll service providers (PSPs) is a common business practice, especially for small business owners. PSPs can help employers meet filing deadlines and deposit requirements by withholding, reporting, and depositing employment taxes with state and federal authorities on behalf of the employer. If a PSP mismanages or embezzles funds that should have been paid to the IRS or state tax agency, the client-employer remains responsible for unpaid tax, interest, and penalties. PSP incompetence or fraud often results in significant hardship for the business, which (from its perspective) must pay the amount of tax twice – once to the failed PSP, and again to the IRS.

For the past decade, including in this year's report, I have recommended numerous administrative and legislative actions to assist victims of payroll service provider (PSP) failures.[69] Congress recently enacted legislation that incorporates two of these recommendations. The Consolidated Appropriations Act of 2014 requires the IRS to:

[69] *See* National Taxpayer Advocate 2014 Annual Report to Congress 218-24 (Most Serious Problem: Offers in Compromise: *The IRS Needs to Do More to Comply With the Law Regarding Victims of Payroll Service Provider Failures*); National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and

2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud by a third-party payroll tax preparer.[70]

Dual Address Change Notices Can Alert Employers of Potential PSP Fraud.

Unscrupulous PSPs may change their clients' addresses of record with the IRS without their clients' knowledge, which could keep an employer from learning it has delinquent tax deposits for months or even years. To prevent such an occurrence, I recommended in my 2012 Annual Report to Congress that the IRS promptly issue dual address change notices to alert employers when a PSP initiates a change.[71] The notice would be sent to the taxpayer's new and old addresses, giving the employer an opportunity to contact the IRS if it did not initiate the change. That way, the employer would receive IRS correspondence about any penalties and interest that result from the PSP failing to make timely payments.

I am pleased that the IRS has implemented dual notices and began issuing Notices CP 148A and CP 148B, *We Changed Your Address*, to both the employer's former and new addresses beginning on January 23, 2015.[72] Even though TAS is monitoring the process and is looking into minor issues with these notices,[73] I commend the IRS for executing this programming change to respond to the congressional mandate.

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[70] *See* Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).

[71] National Taxpayer Advocate 2012 Annual Report to Congress 444 ("establish ascertainable timeframes for beginning the use of dual address change letters alerting employers that a PSP has initiated a change of address, including email or text message notifications to taxpayers who so consent in a special field on employment tax returns"). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 341 ("establish a procedure to send duplicate notices to the employer and the third party payer" and "notify affected employers when it becomes aware of a defunct third party payer").

[72] IRS, SERP Alert 15A0001 (Jan. 2, 2015).

[73] Certain taxpayers who should have received CP 148A and CP 148B notices in English instead receive Spanish version CP 848A and/or CP 848B notices. IRS SERP Alert 15A0113 (Feb. 10, 2015). These notices also generated with every address change, no matter how small the change to the mailing address field. For example, the adding of a suite number generated the notices. The IRS has corrected the issue. IRS, SERP Alert 15A0173 (Mar. 9, 2015).

The IRS Needs to Adhere to a Congressional Mandate and Broadly Embrace Its Authority to Compromise the Tax Liability of Victims of PSP Failure, Based on Effective Tax Administration Principles.

As stated above, employers remain liable for unpaid payroll taxes when a PSP diverts employers' funds without paying the IRS the taxes due. When this occurs, employers that have complied with the tax laws by paying withholding and payroll taxes to their PSPs will be required, through no fault of their own, to pay the amount of taxes a second time to the IRS, along with interest and penalties. Some small businesses may be unable to recover from such a setback and be forced to shut down and lay off employees.

In this year's and several prior annual reports to Congress, I recommended that the IRS promote the use of offers in compromise based on effective tax administration (ETA) as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances.[74] In practice, the IRS has not embraced its ETA OIC authority and has consistently underutilized this tool to provide relief to victims. For example, in fiscal years 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.[75] The IRS does not track the number of PSP victims, but even considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, [76] accepting 54 non-economic hardship ETA offers over the past two years is hardly the "flexible" use that Congress intended.

During the summer of 2014, TAS worked with the IRS to develop an interim guidance memorandum (IGM) that supplements its Internal Revenue Manual (IRM) section on OIC and provides Collection employees much more flexibility to use ETA authority in these cases.[77] From the outset, the IGM acknowledges that these taxpayers are victims

[74] Offers in compromise based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS can accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or when "compelling public policy or equity considerations" are identified by the taxpayer. *See* Treas. Reg. § 301.7122-1(b)(3)(ii). *See also* National Taxpayer Advocate 2014 Annual Report to Congress 220; National Taxpayer Advocate 2012 Annual Report to Congress 444; National Taxpayer Advocate 2007 Annual Report to Congress 342.

[75] *See* IRS response to TAS information request (Aug. 8, 2014); IRS response to TAS information request (Aug. 11, 2014); IRS response to fact check (Dec. 8, 2014). While the IRS does not systemically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in FY 2013 and 57 in FY 2014. *See* IRS response to fact check (Nov. 26, 2014).

[76] *See* Lorraine Mirabella, *Payroll Firm Accupay Is Investigated for Allegedly Stealing Clients' Tax Payments*, Balt. Sun, Mar. 4, 2013, *available at* http://articles.baltimoresun.com/2013-03-04/business/bs-bz-accupay-investigation-20130304_1_tax-payments-tax-collectors-potential-victims; Angus Loten, *Tax Surprises Can Follow When Payroll Firms Implode*, Wall St. J., Apr. 24, 2013, *available at* http://online.wsj.com/news/articles/SB10001424127887324743704578442901672516758.

[77] Memorandum from Rocco A. Steco, Acting Director, Collection Policy, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in IRM 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors* (Sept. 23, 2008), IRM 5.8.11.5, *Documentation and Verification* (Sept. 23, 2008), IRM 5.8.4.22.1,

of a crime and generally takes a more taxpayer-favorable approach than before in discussing how to determine if the victims acted in a reasonable manner in selecting a PSP. Most significantly, the Collection function has backed away from requiring full payment of the outstanding tax balance (exclusive of penalty and interest) as the minimum offer amount. In other words, the IRS will compromise tax under certain conditions – which shows a significant commitment to treating taxpayers harmed by PSPs as victims. Once the Collection employee has determined the PSP victim acted reasonably and its failure to comply is directly due to the actions of a third party, the IGM provides an expanded set of factors to consider in determining a reasonable offer amount to accept.

Notwithstanding this progress, I continue to have concerns about both the substance and implementation of the new guidance, as discussed above. However, I am pleased that the IRS leadership is committed to working with TAS to change the culture of the organization to provide special consideration of OICs for victims of PSPs.[78] The Small Business/Self-Employed division (SB/SE) will work with TAS on revising the guidance and incorporating relevant factors and better descriptions in the IRM, along with better examples of when an ETA OIC could be granted. The IRS has agreed to develop and deliver comprehensive training to its staff, including all Revenue Officers and Centralized OIC employees, in collaboration with TAS. TAS will work with the IRS on how to systemically identify the victims and better capture which employers are clients of a particular PSP. TAS also will continue to advocate on behalf of victims of payroll provider fraud or embezzlement on a case-by-case basis, including by issuing Taxpayer Assistance Orders when necessary.

Trust Fund Liabilities (May 10, 2013), and IRM 5.8.8.4, *Closing a Case as an Acceptance* (Aug. 8, 2014), and will be incorporated into the next revision of these IRM sections.

[78] National Taxpayer Advocate meeting with the Commissioner of Internal Revenue, Deputy Commissioner for Services and Enforcement, and Commissioner, SB/SE (Mar. 30, 2015).

Recommendations[79]

I recommend that Congress:

- Require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees.

- Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS, and impose a penalty for the failure to file absent reasonable cause.

- Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.

VII. More Can Be Done to Reduce Improper Payments of the Earned Income Tax Credit (EITC) and Other Refundable Credits Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights.

Enacted as a work incentive in the Tax Reduction Act of 1975,[80] the Earned Income Tax Credit (EITC) has become one of the government's largest means-tested anti-poverty programs. The EITC is frequently identified as a significant source of improper payments, with Treasury estimating them as averaging about 25 percent of EITC claims over the last five years.[81] Although the improper payment rate is often presented as a

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[79] For additional information, see National Taxpayer Advocate 2014 Annual Report to Congress 392-95 (Legislative Recommendation: *The National Taxpayer Advocate Should Determine Whether an Offer in Compromise Is "Fair and Equitable"*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection from Third Party Payer Failures)*; National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*). Third party payer recommendations initially had included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. *See* Interim Guidance Memorandum *SBSE-05-0711-044, Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 01, 2011) (also incorporated in IRM 5.1.24.5.8 (Aug. 15, 2012)). *See also* S. 1321, 109th Cong. § 321 (2005) (introduced by Senator Santorum), S. 3583, 109th Cong. (2006) (introduced by Senator Snowe), S. 1773, 110th Cong. (2007) (introduced by Senator Snowe), and S. 900, 113th Cong. (2013) (introduced by Senator Mikulski), each of which included portions of third-party payer recommendations we have made.

[80] *See* Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975) (codified at IRC § 32).

[81] Department of the Treasury, *Fiscal Year 2014 Agency Financial Report* 197 (Nov. 17, 2014) ("The most recent projection is based on a tax year 2010 reporting compliance study that estimated the rate of

worsening problem, it may actually be less severe than in tax year (TY) 1999.[82] For context, EITC overclaims account for just seven percent of gross individual income tax noncompliance, while business income underreported by individuals accounts for 51.9 percent.[83] Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

Some Improper Payments Result from Structuring the EITC as a Refundable Credit – A Structure That Minimizes Administrative Costs and Maximizes Uptake.

Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of caseworkers and local agencies. According to the IRS, EITC administration costs are less than one percent of benefits delivered, as compared to other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 42 percent of program expenditures, as shown on the table on the following page. Moreover, a front-end application process would not eliminate improper payments. To assess how well the EITC stacks up against other social benefits programs, the sum of each program's overhead costs and improper payments should be considered (rather than just overhead costs or improper payments in isolation).

It should also be noted that the EITC has a far higher participation rate than most other anti-poverty programs – the percentage of eligible individuals and families who receive the EITC is estimated to be about 79 percent.[84] The following chart (Figure 3: Costs and Benefits of Federal Payment Programs) provides some context for how EITC costs (both program and overclaims) and participation rates compare to other benefits programs.

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improper over claims for fiscal year 2014 to range between 24.9 percent (lower bound) and 29.4 percent (upper bound). This amounts to between $16.2 and $19.1 billion of approximately $65.2 billion in total program payments... [these estimates are] consistent in magnitude with the five-year average 25 percent error rate."). *See also*, Government Accountability Office (GAO), *Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals*, GAO-15-482T 4 (Mar. 16, 2015) (suggesting that for FY 2014 there were $17.7 billion in improper EITC payments, representing an error rate of 27.2 percent). For a list of other refundable tax credits, see, *e.g.*, IRM 4.19.14 (Jan. 1, 2014).

[82] *See* IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 3 (Feb. 28, 2002) ("Of the estimated $31.3 billion in Earned Income Tax Credit (EITC) claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that between $8.5 and $9.9 billion (27.0 percent to 31.7 percent) should not have been paid.").

[83] IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates $235 billion in individual income tax underreporting for tax year (TY) 2006 with $122 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2014 Agency Financial Report* 197 (Nov. 17, 2014). The IRS provided a lower bound estimate of $16.2 billion in EITC overclaims for TY 2014 ($16.2 billion / $235 billion is about seven percent).

[84] IRS, *EITC Participation Rate by States*, *at* http://www.eitc.irs.gov/EITC-Central/Participation-Rate.

Figure 3: Costs and Benefits of Federal Payment Programs

Program	SNAP	WIC	SSI	TANF	HUD	CHIP	Medicaid	School Lunch	EITC
Year	FY 2013	FY 2010	FY 2012	FY 2011	FY 2013	FY 2012	FY 2013	FY 2013	FY 2014
Number of Recipients	47.6 mil	9.1 mil	8.3 mil	4.6 mil	4.7 mil	8.1 mil	60.1 mil	30.7 mil	27.8 mil
Number of Eligible Persons	51.9 mil	14.6 mil	13.0-14.3 mil	12.2-14.4 mil	9.1 mil	11.8-12.2 mil	76.0-80.6 mil	49.2 mil	22.7 mil
Participation Rate (# of Recipients/ # of Eligible Persons)	79.0%	62.6%	58.0%	32.0%	49.3-51.5%	66.9 - 68.8%	68.2%	54.3-64.3%	78.8%
Year Participation Rate Measured	FY 2011	CY 2010	1998	2009	2013	FY 2012	2009	2012	TY 2009
Total Benefits Paid Out	$76.1 bil	$4.6 bil	$51.1 bil	$15.2 bil	$30.9 bil	$8.5 bil	$248.3 bil	$11.3 bil	$60.3 bil
Average Benefit per Recipient	$133.07	$500.86	$6,156.54	$3,300.84	$6,574.47	$1,047.64	$4,514.55	$368.39	$2,384.32
Overhead Costs	$3.9 bil	$1.9 bil	$3.8 bil	$1.5 bil	$4.3 bil	$3.1 bil	$11.7 bil	$1.2 bil	$0.6 bil
Overhead Costs as % of Total Benefits Paid Out	5.1%	41.8%	7.4%	9.7%	13.8%	36.3%	4.7%	10.3%	1.0%
Improper Payments	$2.6 bil	$0.04 bil	$4.7 bil	$2.3 bil	$1.3 bil	$0.7 bil	$14.4 bil	$1.8 bil	$14.5 bil
Improper Payments as a % of Total Benefits Paid	3.4%	1.0%	9.2%	15.0%	4.3%	8.2%	5.8%	15.7%	24.0%
Overhead Costs + Improper Payments	$6.5 bil	$1.9 bil	$8.5 bil	$3.8 bil	$5.6 bil	$3.8 bil	$26.1 bil	$3.0 bil	$15.1 bil
Overhead Costs + Improper Payments as a % of Total	8.5%	42.8%	16.6%	24.7%	18.1%	44.5%	10.5%	26.0%	25.0%

This table demonstrates that for a program of such significant size, administered at a federal level, the EITC reaches an extraordinary number and percentage of eligible taxpayers at a modest cost, when overhead and overclaims are considered together.[85] Assuming we want the intended beneficiaries to receive the benefits enacted by Congress, this data shows the EITC is an effective, and even efficient, anti-poverty program.

This is not to say we should just accept the annual issuance of at least $14.5 billion in improper payments. I have previously recommended a number of measures to address improper payments that do not undermine taxpayer rights or the benefit of administering the EITC as a tax credit. I discuss some of these below. *[86]*

Accelerate information reporting deadlines.

National Research Program (NRP) data show that income misreporting is by far the most common type of EITC error.[87] Sixty-five percent of EITC overclaim returns show some income misreporting, and it is the *only* error on 50 percent of overclaim returns. The average overclaim on income-error-only returns is $658.[88] Thus, although the average amount of this type of overclaim is relatively modest, if the IRS could identify the income misreporting upfront, it could eliminate a significant number of overclaims. By accelerating third-party information reporting and delaying refund issuance, as I described above, the improper payments attributable to this type of error would be significantly reduced.

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[85] Unless otherwise noted, the amount of benefits is taken directly from or imputed from the federal government's improper payment website (see endnotes). Administrative costs were often difficult to determine, and it is not clear that they are computed uniformly by each agency. The figures in the chart were computed by TAS Research from publicly available sources. See Endnotes, *infra,* for more details on the sources of data for each program as well as other information and caveats regarding the data.

[86] For further explanation of these recommendations, see, *e.g.,* Hearing before the Subcomm. on Oversight of the H. Comm. on Ways and Means, *Improper Payments in the Administration of Refundable Tax Credits,* 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate), at www.irs.gov/pub/irs-utl/testimony-written-wm_oversight-improper_payments-5-25-2011.pdf; Hearing Before the H. Subcomm. on Financial Services and General Government Committee on Appropriations, *Internal Revenue Service Oversight,* 112th Cong. (Feb. 26, 2014) (Statement of Nina E. Olson, National Taxpayer Advocate), at http://www.irs.gov/pub/tas/nta_testimony_housepprops_oversight_022614.pdf.

[87] The IRS uses the NRP to meet its need for current compliance information. The IRS established the NRP office in 2000 as part of its efforts to develop and monitor strategic measures of compliance. The program seeks to increase public confidence in the fairness of the tax system by helping the IRS identify voluntary compliance problems. Information from NRP intranet site, *available at:* http://nrp.web.irs.gov/default.aspx.

[88] IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Feb. 12, 2014) (unpublished).

Establish minimum standards of competence for unenrolled preparers.

Return preparers play a significant role in EITC compliance, and can facilitate either compliant or noncompliant taxpayer behavior.[89] Congress has recognized this role by imposing on paid return preparers a Due Diligence penalty if they fail to comply with due diligence requirements imposed by the IRS.[90] As the figure below shows, paid preparers prepared over half of all returns claiming various refundable credits in recent years.

Figure 4: Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage, Tax Years 2010-2013[91]

Tax Credit	Tax year	Number of Taxpayers	Average Claim	Total Claims (in thousands)	Preparer Returns
Earned Income Tax Credit	2013	27,829,617	$2,384	$66,355,593	55.4%
Additional Child Tax Credit	2013	20,026,251	$1,345	$26,935,206	60.7%
First Time Homebuyer Credit	2010	373,880	$6,893	$2,577,155	53.8%
Adoption Credit	2013	50,871	$4,960	$252,312	55.5%
Making Work Pay Credit	2010	106,381,764	$514	$54,784,234	53.6%
American Opportunity Tax Credit	2013	10,106,303	$889	$8,981,840	52.6%

Unenrolled preparers – who are not attorneys, certified public accountants, or enrolled agents – account for more than three-fourths of EITC returns handled by a paid preparer. This figure is conservative, given significant anecdotal evidence that some paid preparers do not sign the returns they prepare (despite a statutory requirement to do so) and thus are not visible to the IRS.

Moreover, the NRP Compliance Study found 68 percent of returns claiming the EITC showed the involvement of a preparer, compared to 55 percent of individual returns not claiming the EITC.[92]

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[89] National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 74-116 44-74 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility, and Competence*); National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, 44-74 (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*).

[90] IRC § 6695(g). This duty also extends to determining the correct amount of credit allowed. *Id*.

[91] IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Individual Master File, TY 2010 (through Mar. 2013) and Tax Year 2013 (through Feb. 2015).

[92] IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 4 (Feb. 12, 2014) (unpublished).

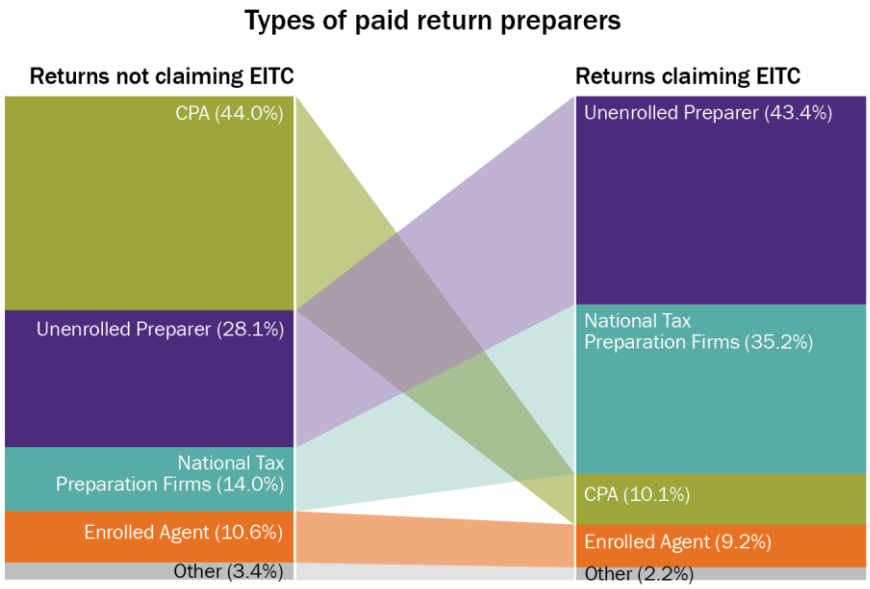
Figure 5: Preparation of EITC Claims by Unenrolled Preparers in TY 201013[93]

Tax Year	EITC Paid	Count	Total Preparers	Unenrolled Preparers	Percent Unenrolled
2010	$58,573,186,452	27,627,852	16,464,493	12,430,967	75.5%
2011	$61,109,934,146	27,816,576	16,549,166	12,198,085	73.7%
2012	$62,981,818,983	27,081,228	15,132,562	11,523,814	76.2%
2013	$66,355,593,000	27,829,617	15,427,656	11,589,238	75.1%

The NRP Compliance Study found 68 percent of returns claiming the EITC showed the involvement of a preparer, compared to 55 percent of individual returns not claiming the EITC.[94]

EITC returns also differ from non-EITC individual returns in the type of preparer. As the graphic below shows, unaffiliated unenrolled preparers and those in national tax preparation firms are disproportionately active in EITC returns, in contrast with non-EITC returns.

Figure 6: Types of Preparers Handling EITC and Non-EITC Returns[95]



[93] IRS, Compliance Data Warehouse Individual Returns Transaction File; IRS, Individual Returns Transaction File; IRS, Return Preparer and Provider Database (through Nov. 2013) (note that the amounts allowed by the IRS during return processing may have been subsequently disallowed in audits).

[94] IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 4 (Feb. 12, 2014).

[95] Totals do not always add to 100 percent due to rounding.

Interestingly, the NRP Compliance Study found no statistically significant difference between all self-prepared returns and all paid-preparer returns in terms of the likelihood or magnitude of EITC error. However, variation does exist within preparer types. Unaffiliated unenrolled preparers (*i.e.,* unenrolled preparers who are not affiliated with a national tax preparation firm) are most prone to error, and the difference is statistically significant in some comparisons. Specifically, 49 percent of the EITC returns prepared by unaffiliated unenrolled preparers contain overclaims averaging 33 percent of the amount claimed.[96]

Simply stated, unenrolled preparers of EITC returns, especially those who are unaffiliated with national tax preparation firms, are the make-and-break point for all EITC compliance strategies. Preparers account for the majority of returns submitted to the IRS with EITC claims, and unenrolled preparers account for three-quarters of preparer EITC returns. Unenrolled, unaffiliated preparers have the highest error rate of all types of preparers. If a single unenrolled preparer plays fast and loose with EITC eligibility rules, tens if not hundreds of taxpayers' returns could be in error.

The recently strengthened regulations and increased EITC due diligence penalty under IRC § 6695(g), coupled with a robust preparer compliance initiative and vigorous preparer prosecutions, should shift some preparer compliance behavior. But so long as anyone can purchase off-the-shelf software and hang out a shingle declaring himself or herself a return preparer without any demonstration of competency or any set of ethical rules to adhere to, we will not bring about significant change in EITC compliance.

The low income population is particularly vulnerable to unskilled and unethical preparers. The size of the refund is attractive to payday lenders and others interested only in what fees they can charge, not to mention criminal opportunists. Preparers in this category have no professional responsibility to the tax system. Yet, as numerous studies have shown, they operate in the areas and communities where low income persons reside.[97]

The single most useful step Congress can take to improve EITC compliance and reduce improper payments is to grant the IRS authority to require unenrolled preparers who prepare returns for a fee to demonstrate minimum levels of competency by passing an initial test and then to take annual continuing education courses (including ethics).[98]

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[96] IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 4 (Feb. 12, 2014).

[97] For a chilling inventory of studies showing the predatory practices and abuses in this area, *see* Brief of Amici Curiae, National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants, *Loving v. Internal Revenue Service*, No. 13-5061 (D.C. Cir. 2014.)

[98] Support for preparer regulation as a means both to protect consumers and to improve return accuracy has been broad and bipartisan. The Senate Finance Committee has twice approved legislation to authorize preparer regulation, and the full Senate passed it on one occasion with broad bipartisan support. On the House side, the Ways and Means Committee has not considered preparer regulation, but its Oversight Subcommittee held a hearing in 2005 at which numerous preparer groups testified in support of such regulation. In 2010, the IRS began to implement preparer regulation on its own, but the

I have been recommending such a system beginning with my 2002 Annual Report to Congress, and I reiterated this proposal most recently in my 2014 report.[99] The IRS cannot audit this EITC noncompliance out of existence – audits occur after the noncompliance has occurred and, in many instances, after the dollars have already gone out the door. Preparer regulation would be prophylactic and efficient.

Recommendations

I recommend that Congress:

- Authorize the IRS to require unenrolled return preparers to take a competency test and fulfill annual continuing education requirements as a condition of preparing tax returns for compensation.

- Require the IRS, upon implementation of the testing and education regime, to conduct an extensive taxpayer-consumer education campaign so taxpayers know there is a bright-line test for choosing competent preparers.

Simplify the EITC by separating work and family credits.

The EITC is determined based on a combination of family size and income. Other tax provisions also depend on family size, including filing status, dependency exemptions, the child tax credit, and the child care credit. I have recommended separating the worker portion of the EITC from the portion of the EITC attributable to family size, and then consolidating all family-related benefits.[100] The earnings component of a worker's

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Court of Appeals for the District of Columbia recently invalidated the regulation as exceeding the agency's authority in the absence of authorizing legislation. *See Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014). Authorizing legislation would allow the IRS to resume the program that was already underway.

[99] See National Taxpayer Advocate 2014 Annual Report to Congress 299 (Legislative Recommendation: *Taxpayer Rights: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections).* For more detailed discussions on regulation of return preparers, *see* National Taxpayer Advocate 2013 Annual Report to Congress 61-75 (Most Serious Problem: *Regulation of Return Preparers*: *Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers);* National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

[100] *See* National Taxpayer Advocate 2012 Annual Report to Congress, 507-511 (Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children);* National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75, 90 (Research Study: *Running Social Programs through the Tax System*); National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions)*.

credit could be more easily verified through income reporting, leaving the more difficult family status eligibility verification to an isolated family credit. A refundable family credit would be available to all taxpayers, not just low income ones, thereby eliminating the relatively discriminatory audit focus on low income taxpayers that exists today, where taxpayers claiming the EITC are about twice as likely to face audits as non-EITC taxpayers.

Recommendation

I recommend that Congress:

- Simplify the EITC by separating the worker portion of the EITC from the portion of the EITC attributable to family size, and then consolidating all family-related tax benefits.[101]

Redistribute the Responsibility for Administering the EITC Between Agencies: A Modest Proposal.

As noted above, one of the reasons the EITC is successful in delivering benefits to the eligible populations is that the application process is via the income tax return. This approach eliminates the stigma associated with applying for traditional welfare or income-support programs. Moreover, the IRS already has the applicant's income information and has access to some government data about family relationships, if not actual household composition.

The relative ease of the EITC's application process, however, is also its downside. *Anyone* can apply, which puts the burden on the IRS to stop the dollars going out the door before it has a chance to determine whether the taxpayer actually meets the complex EITC eligibility requirements. To avoid this problem, while retaining much of the relative ease of the application process, we might consider the approach taken by Australia with respect to its Family Tax Benefit (FTB).[102]

In 2000, Australia established the Family Assistance Office under a memorandum of understanding between the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) and the Australian Taxation Office (ATO). The Family Assistance Office (FAO) administers the FTB, which is composed of two parts: one

[101] *See* National Taxpayer Advocate 2012 Annual Report to Congress, 507-511 (Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children);* National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75, 90 (Research Study: *Running Social Programs through the Tax System*); National Taxpayer Advocate 2008 Annual Report to Congress 363 (Legislative Recommendation: *Simplify the Family Status Provisions)*.

[102] This discussion is based on briefings for the National Taxpayer Advocate by the Australia Tax Office (ATO) between 2008 and 2015; *see also Family Tax Benefit,* presentation to the National Taxpayer Advocate by ATO, 25 March 2008, on file with the National Taxpayer Advocate.

based on family income and the age and number of dependent children, and the other based on income of the lower income earner only.

Claimants can apply for the benefit through the ATO at neighborhood offices of the Department of Human Services. (Either ATO or FAO is the source of issuance, depending on the type of payment.) Claimants are able to receive the credit as income is earned, either as regular biweekly payments or on an annual basis. Ninety percent of the beneficiaries receive their payments every two weeks, based on estimated family taxable income for the year. To administer the program more efficiently, Australia has established a central repository of information, Centrelink, which receives data from ATO as well as data from other programs like Medicare Australia.

The tax office makes available all FAO forms and receives and processes all FAO claim forms, including the end-of-year reconciliation for advance payments. ATO then submits claim form data, including claimant and spousal income, to Centrelink. ATO also makes additional payments (where the benefit was underclaimed during the year) and recovers overpayments through the income tax system.

However, Centrelink personnel are responsible for determining eligibility for and the correct amount of the FTB entitlement, and they handle all FTB disputes. That is, Centrelink, not the tax agency, makes all substantive decisions about a claimant's eligibility for the FTB.

The United States already has in place certain components of this approach. As a result of the Affordable Care Act, the federal government and many states are now operating exchanges to which millions of individuals apply for insurance and the Advanced Premium Tax Credit. The assistors in the exchanges make the substantive determination regarding eligibility for the APTC and certain exemptions from the Individual Shared Responsibility Payment, most notably the hardship exemption. The exchanges notify the IRS about applicants' household composition, and the IRS verifies household income to the exchange. The IRS also receives the end-of-year reconciliation forms and third-party information reports regarding coverage. It also refunds any unclaimed PTC due to the taxpayer and collects PTC overclaims.

The IRS has estimated that about 27 percent of the EITC eligible population is also eligible for the PTC.[103] It is worth considering whether we should build upon the Exchange structure, which includes locally-based assistors to enroll claimants and removes the IRS from having to make intrusive, personal inquiries into family composition. The IRS would then revert to its traditional tax collection function.

[103] Brookings Institution, *Connecting EITC Filers to the Affordable Care Act Premium Tax Credit, available at: http://www.brookings.edu/research/reports2/2015/03/eitc-filers-affordable-care-act-tax-credit-kneebone-williams-holmes*.

VIII. Delegating Authority to the Treasury Department to Expand the IRS's Math Error Authority Could Lead to Inaccurate Tax Assessments and Undermine Taxpayer Rights.

While I have offered many proposals to minimize improper payments, I believe Congress should not address the problem by delegating to the Treasury Department the authority to expand the IRS's power to summarily assess additional tax liabilities, at least not without sufficient limits and oversight.[104] The IRS is currently authorized to assess tax to correct math errors – arithmetic mistakes and the like – under summary assessment procedures that bypass procedural taxpayer rights protections.[105] The Administration has proposed legislation that would delegate authority for the Treasury Department to expand the IRS's summary assessment (or "math error") authority to other "correctable" errors (by regulation) where:

1. The information provided by the taxpayer does not match the information in government databases;

2. The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or

3. The taxpayer has failed to include with his or her return documentation that is required by statute.[106]

I have expressed my concerns about the IRS's administration of its math error authority since my first Annual Report to Congress, and I did so again in this year's report.[107]

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[104] Hearing Before the U.S. Senate Committee on Finance, *Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform* (Mar. 10, 2015) (statement of Keith Fogg, Professor of Law and Director of Low Income Tax Clinic, Villanova Law School) ("This [correctable error] proposal raises concerns because it focuses on the back end of the return process rather than the front end and it removes rather than expands rights of low income taxpayers.… taxpayers who may have a legitimate claim which may get lost in the new shorter process."); Les Book, *President's Budget Proposes Major Procedural and Administrative Changes*, Procedurally Taxing Blog (Mar. 5, 2014), http://www.proceduralltaxing.com/presidents-budget-proposes-major-procedural-and-administrative-changes/ (last visited Mar. 27, 2015).

[105] *See* IRC § 6213(b), (g).

[106] Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 245-246 (Feb. 2015), available at http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx. The administration has included proposals to expand math error authority every year since FY 2013. *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals* 229-230 (Mar. 2014); Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals* 200-201 (Apr. 2013); Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals* 168-169 (Feb. 2012).

[107] For a discussion of significant problems with the IRS's existing math error authority, see, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress163; National Taxpayer Advocate 2011 Annual Report to Congress 74; National Taxpayer Advocate 2006 Annual Report to Congress 311; National Taxpayer Advocate 2003 Annual Report to Congress 113; National Taxpayer Advocate 2002 Annual

In my opinion, summary assessment authority is appropriate in only one of the instances described above; namely, where there can be no doubt that the taxpayer has claimed amounts in excess of a lifetime limitation, income cap, or age requirement.[108] For example, in cases where it is clear on the face of the return that a taxpayer has claimed a credit in excess of a statutory limit, such as overclaiming the American Opportunity Tax Credit (AOTC), then the summary assessment process may be appropriate. The AOTC is a partially-refundable credit for qualified post-secondary education expenditures that is available only for the first four years of a student's post-secondary education.[109] Because the number of years claimed for each student is apparent on the face of current and past income tax returns, allowing the IRS to use math error procedures to stop the improper payment of capped claims may be appropriate and cost effective, although probably not as cost effective as alerting the taxpayer to the problem at or before filing (as described above).[110]

Without adequate safeguards and congressional oversight, however, significant expansion of the IRS's math error authority could permit the IRS to take property without adequate due process, as described below. It may also violate taxpayer rights, discourage eligible taxpayers from claiming EITC and other credits, and waste resources by requiring taxpayers to contact the IRS to correct the IRS's errors and inaccurate inferences. In the face of such risks, Congress should not grant the IRS broad discretion to use its summary assessment authority.

Report to Congress 25, 186; National Taxpayer Advocate 2001 Annual Report to Congress 33. *See also Hearing on Improper Payments in the Administration of Refundable Tax Credits Before the Subcommittee on Oversight, Committee on Ways and Means,* 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Hearing on Complexity and the Tax Gap, Making Tax Compliance Easier and Collecting What's Due Before the Committee on Finance,* 112th Cong. (June 28, 2011) (statement of Nina E. Olson, National Taxpayer Advocate).

[108] Congress originally intended to limit the IRS's authority to summarily assess math errors to situations involving such unambiguous errors. *See* H.R. Rep. No. 69-1, at 10-11 (1926); S. Rep. No. 94-938(I), at 375 (1976); H.R. Rep. No. 94-658, at 289 (1976). *See also*, National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*); National Taxpayer Advocate 2011 Annual Report to Congress 524 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

[109] *See* IRC § 25A(i).

[110] *See Improper Payments in the Administration of Refundable Tax Credits, Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means* (May 25, 2011). Both the GAO and TIGTA have recommended expanding math error authority to correct returns claiming the Hope credit (now called the American Opportunity Tax Credit) in more years than allowed by law. *See* GAO, *IRS Met Many 2009 Goals, but Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved*, GAO-10-225 (Dec. 2009); TIGTA, *Improvements Are Needed in the Administration of Education Credits and Reporting Requirements for Educational Institutions*, Ref. No. 2009-30-141 (Sept. 30, 2009).

The Right to Judicial Review Before Paying an Audit Assessment is the Cornerstone of Due Process in the U.S. Tax System.

Under current law, if the IRS during an audit proposes a deficiency, the IRS must issue a Statutory Notice of Deficiency (SNOD), also known as a "90-day letter."[111] This letter explains the basis for the proposed deficiency and gives the taxpayer 90 days to file a petition with the Tax Court to contest the proposed deficiency.[112] A taxpayer who misses this deadline for filing a Tax Court petition can only seek judicial review by paying the assessment and filing a claim for refund. If the claim is denied or if no action is taken on the claim within six months, the taxpayer may file a refund suit in the federal district court or the Court of Federal Claims within the limitations period.[113] Low income taxpayers are less likely to be able to afford to pay the assessment before disputing it or navigate these more complicated procedures.

Empowering taxpayers to seek judicial review in a prepayment forum (*i.e.*, before they pay) protects them from arbitrary administrative actions by the IRS, which might otherwise unjustly deprive them of property without due process. Taxpayers who cannot understand the IRS's position, determine if they agree or disagree, and respond appropriately within the 30- and 90-day periods may be deprived of this key right. Therefore, even under normal deficiency procedures, confusing IRS correspondence, illiteracy, language barriers, and unequal access to competent tax professionals can cause taxpayers – particularly low income taxpayers – to miss these deadlines and lose access to judicial review in a prepayment forum.[114]

Math Error Assessments Place the Burden on Taxpayers to Ask for the Right to Petition the Tax Court, Rather than Automatically Receiving that Right Under Normal IRS Procedures.

IRC §§ 6213(b) and (g) authorize the IRS to use its math error authority to summarily assess and immediately collect tax without first providing the taxpayer the right access to the Tax Court. If the taxpayer wants to preserve her right to petition the Tax Court,

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[111] Prior to the issuance of the SNOD, the IRS will generally issue a 30-day letter giving the taxpayer the opportunity to file a protest with Appeals.

[112] IRC § 6213. The 90-day period becomes 150 days if the notice is mailed to a person outside of the United States or the address on the notice is a foreign address. *Id*.

[113] IRC §§ 6511, 6532, 7422. For a discussion of the resulting burdens, see, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 91-92.

[114] A 2007 TAS study found a discrepancy between actual EITC ineligibility and "flunking" an IRS audit, concluding:

> Overall, more than one-quarter of taxpayers receiving an [EITC] audit notice did not understand that the IRS was auditing their return. An even larger percentage, almost 40 percent, of the respondents did not understand what the IRS was questioning about their [EITC] claim. Similarly, only about half of the respondents felt that they knew what they needed to do in response to the audit letter.

National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, at 100, 103-104.

she must request an abatement of the assessment within 60 days. Although initially limited to situations involving mathematical errors (*e.g.*, 2+2=5),[115] Congress expanded math error authority to address "clerical errors" (*e.g.*, inconsistent entries on the face of the return),[116] and other circumstances where a return is clearly incorrect (*e.g.*, omits a required Taxpayer Identification Number, uses an SSN that does not match the one in the Social Security Administration's Numident database, or claims tax credits in excess of statutory maximums).[117]

Math Error Adjustments Are Intended to Allow Correction of Unambiguous Errors That Are Easy to Explain.

As I noted in my 2014 report, Congress was concerned about removing more situations from the deficiency procedures and placing them under the summary assessment procedures, particularly in the case of complicated errors.[118] If taxpayers do not understand the supposed error, they may have difficulty deciding whether to request an abatement (assuming they understand that requesting an abatement is an option), and they are less likely to request an abatement within the shorter 60-day period applicable to summary assessments. Accordingly, Congress enacted IRC § 6213(b)(1), requiring that "[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof."[119]

In legislative history, Congress provided an example of how simple it expected math error notices to be, which we have paraphrased below:

> **Example from Legislative History**: You entered six dependents on line x but listed a total of seven dependents on line y. We are using six. If there is one more, please provide corrected information.[120]

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[115] National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making it Difficult for Taxpayers to Understand and Exercise their Rights*); Revenue Act of 1926, enacting IRC § 274(f); H.R. Rep. No. 69-1, at 10-11 (1926).

[116] Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2).

[117] IRC § 6213(g).

[118] JCS 33-76, at 372 (1976) (*Assessments in Case of Mathematical or Clerical Errors, sec. 1206 of the Act and sec. 6213 of the Code)*. *See also* H.R. Rep. No. 94-658, at 289 and S. Rep. No. 94-938(I), at 375 (1976). Although the IRS originally had the authority to assess EITC overpayments without providing taxpayers an opportunity for judicial review in a pre-payment forum (under former IRC § 6201(a)(4)), Congress specifically granted taxpayers this right in 1988. *See* Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100–647, § 1015(r)(1), 102 Stat. 3342 (1988).

[119] Pub. L. No. 94-455, § 1206(a), 90 Stat. 1520 (1976).

[120] *See* H.R. Rep. No. 94-658, at 289 (1976); S. Rep. No. 94-938(I), at 375 (1976). *See also* JCS-33-76, at 372 (1976). (*Assessments in Case of Mathematical or Clerical Errors sec. 1206 of the Act and sec. 6213 of the Code)*.

Although the IRS has been working to simplify these notices for nearly 40 years, even its current notice on this very issue (*i.e.*, inconsistent number of dependents on the return) does not identify the discrepancy as clearly as Congress envisioned. The notice states:

> **Current Math Error Notice:** "We changed your total exemption amount on page 2 of your tax return because there was an error in the number of exemptions provided on lines 6a, 6d, and/or computation of your total exemption amount."[121]

Other math error notices are inscrutable. The IRS's problem with math error notice clarity is a serious, longstanding, and well-documented problem that disproportionately affects low income taxpayers – the very taxpayers that Congress intends to claim the EITC and similar credits.[122] Moreover, unclear math error notices jeopardize the taxpayer's *rights to be informed, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum*.

The Sufficiency of Documentation Can Be Ambiguous and Difficult to Explain.

The "correctable error" proposal contains a broad grant of authority to the IRS to use summary assessment procedures where a required form or schedule is not attached to the return. It is unclear from the proposal whether these procedures will be used to deny benefits due to a lack of *sufficient* documentation, as opposed to *no* documentation at all.

A recent example illustrates why this distinction matters. Congress authorized the IRS to use math error authority to deny the First-Time Homebuyer Credit (FTHBC) to taxpayers who did not attach a "settlement statement," as required.[123] Initially, the IRS accepted a settlement statement as sufficient only if it showed all parties' names and signatures, the property address, sales price, and date of purchase. After learning that not all states required a settlement statement to include a complete address or both parties' signatures, the IRS reversed its position.[124] Clearly, the use of math error authority in this circumstance would have been unwise. To make this and other

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[121] IRS, *Document 6209* (2014), TPNC 200.

[122] *See, e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 163.

[123] *See* Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, § 11, 123 Stat. 2984, 2989 (2009), *amending* IRC § 36(d); IRC § 6213(g)(2)(P)(iii).

[124] The IRS's handling of FTHBC issues in the 2011 filing season delayed processing of an estimated 128,000 returns and led to a sharp increase in related TAS cases (from 669 through April 30 of fiscal year 2010 to 4,299 for the same period in FY 2011. National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-32. IRS SERP Alert 100290 (May 25, 2010); IRM 21.6.3.4.2.11.6 (6) (Servicewide Electronic Research Program (SERP) update Apr. 18, 2011). *See also* IRS SERP Alert 100066 (Feb. 12, 2010); IRS Instructions for Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit* 2 (March 2011) (acknowledging that not all taxpayers will have a signed HUD-1). *See also* National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-36 *Filing Season Review.*

determinations about the sufficiency of a settlement statement, an IRS employee had to read papers attached to the return and explain any problems to the taxpayer (or summarily assess the liability without providing a good explanation). Accordingly, I recommended the use of math error authority only when a return does not contain a document that purports to be a settlement statement (*i.e*., a simple yes/no determination) and leaving the facts-and-circumstances determination of the *sufficiency* of the settlement statement to normal deficiency procedures.[125]

A related problem arises from the differences between e-filed returns and paper returns. Running counter to Congress's and the IRS's efforts to increase e-filing, taxpayers required to provide documentation to substantiate a return position generally must file paper returns. A modest investment in the IRS's systems to allow taxpayers to file required documentation electronically instead of on paper would go a long way toward improving tax compliance while still preserving taxpayer rights. The IRS has processes for handling incomplete paper returns and could develop similar ones for e-filed returns. If an incomplete return were e-filed, the IRS could simply reject it at the outset, alerting the taxpayer or preparer immediately that more information is needed and allowing the taxpayer to cure the defect. The proposal to expand math error authority (or "correctible" errors) in this context is like the tail wagging the dog and is driven by the IRS's 20th century technology. We should be designing tax administration looking forward, not backward.

Recommendations

I recommend that Congress:

- Decline to authorize the IRS to use summary assessment procedures with respect to documentation that must be attached to a return.

- Appropriate funds and establish deadlines for the IRS to develop and implement the ability for taxpayers to attach required documents to their electronically filed returns.

Government Databases Can Be Unreliable for Tax Purposes, Such That Accurate Returns May Appear Inconsistent with Third-Party Data.

I have recommended the IRS not use math error authority to correct discrepancies between information shown on a return and information from government databases that are not sufficiently reliable for tax purposes. For example, the IRS has the authority to assess math errors against EITC returns that are inconsistent with the Federal Case Registry of Child Support Orders (FCR) database – where a person listed as a

[125] National Taxpayer Advocate 2011 Annual Report to Congress 524-530 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

noncustodial parent in the FCR database claims the child.[126] However, it has declined to do so because a study, which Congress mandated be undertaken with my office, showed that the FCR was not sufficiently reliable for purposes of verifying a child's residence. The study found that almost 40 percent of the cases selected relying solely on FCR data were incorrect.[127]

Moreover, applying data collected for nontax purposes to tax claims is akin to relying on the addresses shown in a telephone directory to deny the home mortgage interest deduction. Even if virtually all of the entries in a directory were accurate, they were compiled for a different purpose, do not disprove eligibility under the tax law, were compiled at a prior date and may not be current, and should not deprive a taxpayer of a due process right to present his or her own facts.

As another example of inconclusive data that the IRS may soon rely upon, health insurers and self-insured employers are required to use the new Form 1095-B to report the names and TINs of all covered individuals and the months for which the covered individuals had minimum essential coverage.[128] If these forms are inaccurate, covered individuals could receive notices imposing the penalty under IRC § 5000A for failing to maintain qualifying coverage or be denied a premium tax credit. The IRS has declined to expand existing TIN verification programs to allow Form 1095-B issuers to check the name/TIN combinations of covered individuals.[129] Thus, many Form 1095-B filers may not have accurate name/TIN information.

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[126] IRC § 6213(g)(2)(M). For parents filing separately, only the parent with whom the child resides could claim the child. IRC §§ 32(c)(3), 152(c).

[127] *See* IRS, Federal Case Registry Final Report, Project 5-02-12-3-005 (CR-39) (Sept. 2003). In 2001, Congress authorized the IRS to use of summary assessment procedures to deny EITC, beginning in 2004, where data from the Federal Case Registry (FCR) of Child Support Orders indicates the taxpayer claiming a child is actually the noncustodial parent. *Economic Growth and Tax Relief Reconciliation Act of 2001*, Pub. L. No. 107-16, § 303(g), 115 Stat. 38 (2001) (codified at IRC § 6213(g)(2)(M)). The House Conference Report requested a study of the FCR database by the Department of Treasury, in consultation with the National Taxpayer Advocate, of the accuracy and timeliness of the data in the FCR; the efficacy of using math error authority in this instance in reducing costs due to erroneous or fraudulent claims; and the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data. H.R. Conf. Rep. 107-84 at 147 (2001).

[128] Notice 2013-45, 2013-31 I.R.B. 116; T.D. 9660, 2014-13 I.R.B. 842 (Mar. 10, 2014). Reporting entities will not be subject to penalties for failure to comply with the IRC §§ 6055 and 6056 reporting requirements for coverage in 2014 (including the provisions requiring the furnishing of statements to covered individuals in 2015 with respect to 2014). Accordingly, a reporting entity will not be subject to penalties if it first reports beginning in 2016 for 2015 (including the furnishing of statements to covered individuals).

[129] Michael M. Lloyd and S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, 142 Tax Notes 424 (Jan. 15, 2014). The current e-Services TIN Matching Program (TMP) allows participating payers of reportable payments subject to backup withholding under IRC 3406(b), to match the TIN and name of payees subject to potential backup withholding with IRS records prior to filing the information report. IRM 5.19.3.4.1.6, *e-Services Taxpayer Identification Number (TIN) Matching Program* (April 23, 2014). Using the TMP helps payers avoid penalties under IRC §§ 6721 and 6722 for submitting incorrect TINs on information returns. *See* IRC § 6724 (reasonable cause exception).

In my 2014 report, I note that as long as this is true, it would be problematic for the IRS to use math error authority in this area.[130] Yet, because these data from Forms 1095-B are entered into a government database, under the correctable error proposal, after promulgating regulations, the IRS could use summary assessment procedures to adjust returns inconsistent with the data.

The definition of what constitutes a "government database" is itself problematic. The "correctible error" proposal has been touted as reducing EITC improper payments, but it is unclear to me how it can do that unless "government databases" include the IRS's Dependent Database (DDb), a compilation of business rules and different datasets.[131] Each return that claims a dependent or other family-status benefit (like the EITC) is run through the DDb. While some of the underlying data is reliable (*e.g.*, Kidlink, which contains Social Security Administration information linking a child's SSN to its mother's SSN, and in many instances, the father's SSN), other data – like the FCR – are unreliable.

The DDb has value -- it is a collection of *circumstances* from which the IRS is inferring the likelihood of error. But it is not a binary (yes/no) determination that makes it suitable for summary assessment authority. TAS has seen instances where a taxpayer's return has broken all of the rules contained in the DDb and the taxpayer is still eligible for the exemption or credit claimed. The results derived from the DDb are probabilistic in nature. It is unprecedented to give the IRS summary assessment authority based on some unstated *probability* that it is correct. To undermine taxpayers' right to petition the Tax Court based on a probability is equally unprecedented.

My concerns about the unreliability of IRS "government databases" are founded in experience. In FY 2013, the IRS delayed over one million refunds, nearly 30 percent of which it should have paid in full.[132] I am concerned that if the IRS rejects returns with valid refund claims or adjusts returns using math error-like procedures, it may prevent

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[130] *See* National Taxpayer Advocate 2014 Annual Report to Congress 67, 75-76 (Most Serious Problem: *Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers*).

[131] The Dependent Database (DEPDB) addresses non-compliance relevant to the Earned Income Tax Credit (EITC) and other tax benefits related to the dependency and residency of children. DEPDB consistently applies the tax laws to a return claiming EITC as other tax issues, such as dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, are addressed concurrently. DEPDB is a 'Rules Based' system that examines EITC tax returns and applies a set of rules and SRA Model to determine residency and relationship issues. Tax returns are examined in a pre-refund environment stopping money before the refund is sent. The DEPDB system incorporates data (Health and Human Services, Social Security Administration & IRS) to more accurately validate refunds to which a taxpayer is entitled, thus allowing the IRS to enforce laws passed by Congress more effectively. DEPDB incorporates a scoring model and DEPDB developed Precertification logic to better target egregious EITC claims. Combination of methods (rules, model, and precert-logic) has dramatically lowered the overall 'no change' rate. The DEPDB has been expanded to address issues related to: Adoption Credit, First-time Homebuyer credit, ID Theft, Frivolous Filers, and various other credits.

[132] *See* National Taxpayer Advocate 2013 Annual Report to Congress 173,180 (Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds*).

taxpayers from receiving the refunds to which they are entitled. Inconsistencies between a return and data that is not sufficiently reliable or determinative may indicate the IRS should do further research or initiate an audit, but should not automatically trigger summary assessment procedures, which unnecessarily burden taxpayers and the IRS.[133]

For these reasons, I recommended in 2011, and again in my 2104 report,[134] that Congress (1) confine the IRS's use of math error authority to instances that are not factually complex, (2) permit the IRS to use math error authority only in conjunction with databases that are reliable and accurate, (3) restrict math error authority in situations with a high abatement rate, and (4) require the Department of the Treasury, in consultation with the National Taxpayer Advocate, to evaluate and report to Congress on whether any proposed expansions satisfy these criteria.[135] I also recommended that the report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs such as those for audit reconsideration and TAS intervention, and rigorously analyze the proposed expansions for accuracy and suitability. The GAO has proposed similar safeguards.[136] As noted above, Congress mandated a similar study before the effective date of the IRS's math error authority to address FCR data mismatches, a study that the IRS would not have undertaken without the mandate.

Recommendations

I recommend that Congress:

- Before allowing the IRS to apply summary assessment authority to mismatches between the return and any other data, require it to publish a study, in consultation with the National Taxpayer Advocate, that shows the data meets minimum standards of accuracy, timeliness, and efficacy, as established by Congress, and rigorously analyzes the downstream consequences (including abatements, audit reconsiderations, and TAS cases).

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[133] *See* National Taxpayer Advocate 2002 Annual Report to Congress 185 (Legislative Recommendation: *Math Error Authority*).

[134] *See* National Taxpayer Advocate 2014 Annual Report to Congress 284 (Legislative Recommendation: *Taxpayer Rights: Codify Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections)*

[135] National Taxpayer Advocate 2011 Annual Report to Congress 524 (Legislative Recommendation: *Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

[136] GAO, *Enhanced Prerefund Compliance Checks Could Yield Significant Benefits*, GAO-11-691T 9 (May 25, 2011) ("To ensure IRS continues to use MEA only in these limited circumstances [*i.e.*, where the error is "virtually certain"] if given broader authority, Congress could, for example, require IRS to submit a report to it or an entity it designates on a proposed new use of MEA. The report could include how such use would meet the standards or criteria outlined by Congress. The report could also describe IRS's or the National Taxpayer Advocate's assessment of any potential effect on taxpayer rights.").

The IRS Should Attempt to Resolve Minor Inconsistencies with Third-Party Data Before Burdening Taxpayers and Issuing Math Error Notices.

Not every return that contains a typo or similar error contains an understatement. For example, the IRS should not automatically conclude that a taxpayer does not have a qualifying child just because the taxpayer identification number of the child listed on the return does not match a TIN in the IRS's database. Such mismatches can be typos.

TAS studied a statistically valid sample of tax year 2009 accounts in which the IRS reversed its dependent Taxpayer Identification Number (TIN) math error corrections.[137] *The IRS ended up abating all or part of the math error in 55 percent of the returns. Further, the study found that the IRS could have resolved 56 percent of these errors using information already in its possession (e.g., the TIN listed on a prior year return), rather than charging a math error and asking the taxpayer to explain the apparent discrepancy.* [138] In other words, the IRS imposed a burden on taxpayers in a large percentage of math error cases, generating phone calls and letters it could not timely handle, rather than investing a few minutes of research at the front end.

Based on this study, I recommended that even if it finds a mismatch between the return and a reliable database, the IRS not use summary assessment procedures before taking additional steps to reconcile the mismatch.[139]

Recommendation

I recommend that Congress:

- Require the IRS to try to reconcile apparent mismatches before allowing it to apply math error authority.

IX. The IRS Is Undertaking a Review of Its Approach to Tax Compliance and Service Delivery, But Greater Transparency and Congressional Oversight Would Improve Taxpayers' Confidence and Trust in the Tax System.

The best way for Congress to hold the IRS accountable for how it allocates resources and makes decisions is through active, consistent oversight. After Congress passed the IRS Restructuring and Reform Act of 1998, it held annual joint hearings to review, among other things, the IRS's progress in meeting its objectives and improving taxpayer

[137] National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents)*.

[138] National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 119-120 (Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued on Claimed Dependents*).

[139] *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 74, 92; National Taxpayer Advocate 2011 Objectives Report to Congress 70-71; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 113.

service and compliance.[140] Each hearing was conducted jointly by majority and minority members of the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight and the Senate Committees on Finance, Appropriations, and Governmental Affairs. However, the hearings were discontinued because the legislation only required them to be held for five years.

I believe it would be helpful for Congress to resume these joint oversight hearings – not just on the issue *du jour,* but on the routine work the IRS does. Focusing on current tax administration challenges, these hearings could address issues such as how the IRS is making decisions related to taxpayer service, whether the IRS is effectively using existing resources to collect past due liabilities, whether the IRS's administration of penalties promotes voluntary compliance, and whether IRS employees have appropriate training to deal with diverse taxpayer populations. The hearings would provide a useful vehicle for multiple committees of Congress to review the IRS's progress, examine whether the IRS is meeting the needs of particular taxpayer segments and protecting taxpayer rights, gain a better understanding of potential problem areas, and help the IRS by passing legislation or providing additional funding where the IRS can demonstrate sufficient need.

The IRS is currently developing its Concept of Operations (CONOPS) for the type of tax administration it wants to transform itself into over the next few years. As I discussed in my 2014 and past annual reports, it is unclear what methodology the IRS is using to make resource allocation decisions with respect to tax service or enforcement.[141] Thus, now is the appropriate time for Congress to conduct oversight to ensure that the IRS is creating a plan that not only works for itself, but also for taxpayers – the full diversity of our taxpayer base. Conducted in a respectful way, in full recognition of the important service the IRS provides to this nation and the serious challenges its employees face every day in fulfilling the IRS mission, the hearings can help restore trust and foster a shared sense of purpose between the IRS and Congress, and thus enhance the confidence of taxpayers as well.

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[140] *See* Pub. L. No. 105-206, § 4001, 112 Stat. 685, 783 (1998). The statute refers to a "joint review [to] be held at the call of the Chairman of the Joint Committee." The legislative history, however, makes clear that there was to be "one annual joint hearing" before June 1 of each of the succeeding five calendar years. H.R. Rep. No. 105-599, at 328 (1998) (Conf. Rep.).

[141] *See* National Taxpayer Advocate 2014 Annual Report to Congress 26-30 (Most Serious Problems: *Taxpayer Service: Due to the Delayed Completion of the Service Priorities Project, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*: *IRS Local Presence: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*; and *Appeals: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*). *See also* National Taxpayer Advocate 2013 Annual Report to Congress, Volume 2, Research Studies*: The Service Priorities Project: Developing a Methodology for Optimizing the Delivery of Taxpayer Services; and A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies.*

Recommendation

I recommend that Congress:

- Reinstate joint oversight hearings to review the IRS's progress in meeting its objectives and improving taxpayer service, enforcing the tax laws, and promoting voluntary compliance.

X. Conclusion

The Federal government is currently failing badly to meet the service needs of its taxpayers. To address this problem, the IRS will need more resources to answer taxpayer telephone calls, process and respond to taxpayer correspondence, and assist taxpayers who seek assistance in its walk-in sites. The IRS can also take steps to improve its resource-allocation decisions and achieve greater efficiencies.

To be blunt, several incidents over the last few years have reduced the confidence of many Members of Congress in the leadership of the IRS. The IRS has undergone several leadership changes since that time, and I believe it is critical that Congress and the IRS now work together to find a better way forward. The IRS must take steps to rebuild congressional trust and Congress must respond by providing the IRS with the funding it needs to do its important work of helping taxpayers meet their tax obligations and collecting the revenue on which the rest of government depends. In this testimony, I have tried to offer some recommendations to help in this regard.

ENDNOTES:

Sources of Information for Benefits Programs Listed in Figure 3

Supplemental Nutrition Assistance Program (SNAP)
The number of recipients, benefits paid, average benefit, and overhead costs are from *Supplemental Nutrition Assistance Program Participation and Costs (March 6, 2015*). The number of improper payments and their percent of benefits paid are from https://paymentaccuracy.gov/about-improper-payments (last visited April 3, 2015). The participation rate is from *Supplemental Nutrition Assistance Program Participation Rates: Fiscal Years 2010 and 2011* (Feb. 2014)

Women, Infants, and Children (WIC)
WIC recipients, eligible, and participation rate are from *Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Eligibles and Coverage – 2010*: *National and State Level Estimates of the Population of Women, Infants, and Children Eligible for WIC Benefits Executive Summary* (Jan. 2013). Benefits are from: WIC Program Food Cost (March 6, 2015). Overhead costs are from*: WIC Program: Nutrition Service and Administrative Costs* (March 6, 2015). Improper payments: *Nutritional Assistance Program Report Series, Special Supplemental Nutrition Program for Women, Infants, and Children (WIC).* Erroneous Payments to Vendors: *Annual Estimates for FY 2010 Office of Research and Analysis Report No. WIC-12-EP2010WIC.*

Temporary Assistance for Needy Families (TANF)
The recipients, overhead costs (includes administration and systems costs), and participation rate are taken from U.S. Department of Health and Human Services, Administration for Children and Families Office of Family Assistance, *Temporary Assistance for Needy Families Program (TANF) Tenth Report to Congress.* The benefits are from the report to Congress, Appendix Table 1:1. HHS has not estimated TANF improper payments because the program is administered by the various states that distribute federal funds and the states have not performed improper payment reviews. The improper payment rate shown has been estimated by the *Federal Safety Net, available at:* http://federalsafetynet.com/tanf.html. HHS claims there is a statutory prohibition against requiring states to report improper payments. In 2007, HHS did a study in three states with the improper payment rate ranging from 11.5 percent to 40 percent. The 15 percent estimate is from a private source (Federal Safety Net). The participation rate is based on families, not individuals. Overhead costs do not include other expenditures on non-assistance, which are defined as, "benefits are those that do not fall within the definition of assistance, and include expenditures such as child care, transportation, and other work supports provided to employed families, non-recurrent short-term benefits, work subsidies to employers, and services such as education and training, case management, job search, and counseling." The administrative expenses portion of non-assistance was tabulated as the overhead expense of the program.

Supplemental Security Income (SSI)
Recipients are from *Table IV.B9.—SSI Recipients with Federally-Administered Benefits in Current-Payment Status as of December, 1974-203*6. The benefits are imputed from the FY 2012 improper payments and improper payment rates at https://paymentaccuracy.gov/about-improper-payments (last visited April 3, 2015). The participation rate is from Kathleen McGarry, University of California, Los Angeles and NBER, and Robert F. Schoeni University of Michigan, *Understanding Participation in SSI,* Prepared for the 16th Annual Joint Meeting of the Retirement Research Consortium (Aug. 7-8, 2014). The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants are assumed eligible and are thus divided by the range of eligible participants to form the upper bound. Overhead costs are from the Social Security Administration's 2012 Annual Report of the SSI Program Table IV.E1., available at http://www.ssa.gov/OACT/ssir/SSI12/IV_E_AdminCosts.html.

Department of Housing and Urban Development (HUD)
The number of recipients (households) is taken from HUD, *Rental Assistance Reform Frequently Asked Questions* (Mar. 2013). The total benefits are from improper payments and improper payment rate for FY 2013 from the federal government's improper payment website, *available at*: https://paymentaccuracy.gov/about-improper-payments. The overhead costs are from the National Health Care for the Homeless Council compilation of items in the *Enacted Funding Levels FY2011-FY2013* (Mar. 2013). The number of households in poverty is used as a benchmark to compute the participation rate; however, the actual formula to compute eligible families involves the determination of average income and housing prices on a county-by-county basis. The number of 2013 households in poverty is from a U.S. Census Bureau Current Population Survey report, Carmen DeNavas-Walt and Bernadette D. Proctor*, Income and Poverty in the United States: 2013* (Nov. 2014). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Therefore, this is only an estimated participation rate range.

Children's Health Insurance Program (CHIP)
The total benefits are imputed from improper payments and improper payment rate for FY 2012 from the federal government's improper payment web site, *available at:* https://paymentaccuracy.gov/about-improper-payments (last visited April 3, 2015). The recipients and participation rate are taken from "CHIPRA Mandated Evaluation of the Children's Health Insurance Program: Final Findings Harrington and Kenney, et al. 2014..." Mathematica Policy Research, report submitted to the Office of the Assistant Secretary for Planning and Evaluation. Ann Arbor, MI (Aug. 2014). This report shows benefits paid as $9.2 billion instead of the $9.1 billion imputed from the federal improper payment website. All participants are assumed eligible and are thus divided by the sum

of the participants and the number of children eligible, but still uninsured (3.7 million: see *CHIPRA Mandated Evaluation* report cited above) to form the upper bound estimate of the participation rate. The lower bound participation rate estimate reduces the number of participants by the quotient obtained from dividing improper payments by the average benefit to obtain the average number of ineligible participants and the result is divided by the estimated eligible participants and the number of eligible, but uninsured children. The range of eligibles is computed at the lower bound by dividing the number of participants by the sum of the number of participants and the number of eligible, but uninsured children (see above). At the upper bound, the number of participants is reduced by the quantity of the dividing improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the lowest estimated participation rate. The Overhead Costs are taken from *Medicaid Financial Management Report net CHIP Expenditures FY 2012* and include the National Health Insurance Technology (HIT). The HIT costs for FY 2012 were divided by the FY 2012 imputed benefits.

Medicaid

The numbers of recipients is from the Kaiser Family Foundation, *Medicaid Enrollment: June 2013 Data Snapshot, available at:* http://kff.org/report-section/medicaid-enrollment-june-2013-data-snapshot-total-enrollment. The paper goes on to state that Medicaid enrollment is expected to increase as a result of the Affordable Care Act. In fact, Medicaid enrollment has increased to over 60 million in 2014, according to *Medicaid/CHIP Participation Among Children and Parents,* Medicaid / CHIP FY 2014 September enrollment data, with the number of CHIP participants subtracted from the total. The participation rate is from the highest recent rate cited in *Understanding Participation Rates in Medicaid: Implications for the Affordable Care* Act: Ben Sommers, Rick Kronick, Kenneth Finegold, Rosa Po, Karyn Schwartz, and Sherry Glied (Mar. 2012), *available at* http://aspe.hhs.gov/health/reports/2012/MedicaidTakeup/ib.shtml. The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants are assumed eligible and are thus divided by the participant range to form the upper bound. The improper payments, total benefits paid, and improper payment rate are from the Federal government website: https://paymentaccuracy.gov/about-improper-payments (last visited April 3, 2015).The overhead costs are from *Medicaid's National Health Expenditures* administrative costs for FY 2013.

School Lunch Program

The recipients are from *National School Lunch Program: Total Participation* (FY 2013). The total benefits, improper payments, and improper payment rate for FY 2013 are from the federal government's improper payment website: https://paymentaccuracy.gov/about-improper-payments. The amount of improper payments and the improper payment rate also come from this source. There is a slight

discrepancy between the amount of imputed payments and the amount in a 2014 GAO report ($0.1 billion difference). The eligibles are determined from the National Center for Educational Statistics, Table *216.60 Number and Percentage of public school students eligible for free or reduced price lunch by school level, locale and student race/ ethnicity 2011-12*, *available at*: https://nces.ed.gov/programs/digest/d13/tables/dt13_216.60.asp (last visited April 9, 2015). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Census data indicate more children may receive free lunches than are entitled to do so, but this should be reflected in improper payments. Overhead costs are determined from the Federal Register's *National School Lunch Program: School Food Service Accounts Revenue Amendments Related to the Healthy-Hungry Free Kids Act* (2010), *available at:* https://www.federalregister.gov/articles/2011/06/17/2011-14926/national-school-lunch-program-school-food-service-account-revenue-amendments-related-to-the-healthy#t-7. The report is from school year 2005 and 2006 and reports a percentage only. The percentage is applied to the benefits paid in FY 2013.

Earned Income Tax Credit (EITC)

The number of EITC recipients is from IRS Compliance Data Warehouse, *Individual Returns Transaction File for Tax Year 2013*. The benefits are from the FY 2014 improper payments and improper payment rates at https://paymentaccuracy.gov/about-improper-payments (last visited April 3, 2015). The amount of improper payments and the rate of improper payments are also from this source. The EITC participation rate and number of eligibles is from the CARRA Working Paper Series, *Working Paper #2014-04 Changes in EITC Eligibility and Participation, 2005—2009,* Maggie R. Jones, U. S. Census Bureau Center for Administrative Records Research and Applications (2009), *available at:* http://www.eitc.irs.gov/EITC-Central/Participation-Rate. This site only provides the percent eligible and not a number of eligibles. The overhead costs are from GAO testimony, GAO/T-GGD-97-105, *Tax Administration Earned Income Noncompliance* (May 8, 1997).