

Statement of
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Hearing on
Closing the Tax Gap:
Lost Revenue from Noncompliance and the Role of Offshore Tax Evasion

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Chairman Whitehouse, Ranking Member Thune, and Members of the Subcommittee:

Thank you for inviting me to appear before you today at this hearing to discuss the important issue of the federal tax gap and lost revenue attributable to noncompliance and offshore tax evasion. It feels like I have spent my entire professional career wrestling with taxpayer compliance, taxpayer rights, and the tax gap, first as an unenrolled return preparer helping individuals and small businesses comply with the tax laws, next as a tax controversy attorney representing low income taxpayers and others before the IRS and in the courts, then for 18 years as the National Taxpayer Advocate, and today, as the Executive Director of the Center for Taxpayer Rights,¹ where our focus is awareness and protection of taxpayer rights in the United States and internationally.

As National Taxpayer Advocate, I regularly made the case for increased IRS funding in order to maintain and improve tax compliance, not just for additional hiring of audit and collection employees but also those in the taxpayer service functions, the Office of Appeals, and the Taxpayer Advocate Service (TAS). I first identified the Cash Economy Tax Gap as a Most Serious Problem of taxpayers in my 2003 Annual Report to Congress, and recommended withholding on non-wage workers in that report.² I identified the tax gap as a Most Serious Problem or made legislative recommendations to address it in at least three other Annual Reports.³ As early as 2006, I submitted a legislative recommendation for revising Congressional Budget Procedures both to increase IRS funding and accountability.⁴ In my 2011 Annual Report to Congress, I identified IRS (under)funding as a Most Serious Problem, and raised that issue again in my 2012 and 2013 Annual Reports.⁵ In 2018, I made a legislative recommendation to address sustained Information Technology (IT) multi-year funding.⁶ All of these proposals are framed in the context of taxpayer rights and the fundamental principle that the government must treat the taxpayers on which it relies for its “lifeblood” with decency, respect, accuracy, and integrity.

¹ The Center for Taxpayer Rights is a 501(c)(3) corporation that promotes taxpayer rights in the United States and internationally. For more information about the Center, see <https://www.taxpayer-rights.org/>

² National Taxpayer Advocate 2003 Annual Report to Congress, Most Serious Problem: *Nonfiling and Underreporting by Self-Employed Taxpayers*, 20-25; and Legislative Recommendation: *Tax Withholding on Nonwage Workers*, 256-269.

³ National Taxpayer Advocate 2004 Annual Report to Congress, Legislative Recommendation: *Tax Gap Recommendations*, 478-489; National Taxpayer Advocate 2005 Annual Report to Congress, Most Serious Problem: *The Cash Economy*, 55-75; Legislative Recommendation, *Measures to Reduce Noncompliance in the Cash Economy*, 381-396; and National Taxpayer Advocate 2006 Annual Report to Congress, Most Serious Problem: *The Tax Gap*, 6-9.

⁴ National Taxpayer Advocate 2006 Annual Report to Congress, Legislative Recommendation: *Revising Congressional Budget Procedure to Improve the IRS Funding Decisions*, 442-457.

⁵ National Taxpayer Advocate 2011 Annual Report to Congress, Most Serious Problem: *The IRS is Not Adequately Funded to Serve Taxpayers and Collect Taxes*, 3-14; National Taxpayer Advocate 2012 Annual Report to Congress, Most Serious Problem: *The IRS is Significantly Underfunded to Serve Taxpayers and Collect Tax*, 34-41; and National Taxpayer Advocate 2013 Annual Report to Congress, Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*, 20-39.

⁶ National Taxpayer Advocate 2018 Annual Report to Congress, Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multiyear Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and is Evaluated Annually by an Independent Third Party*, 351-358.

Despite its funding challenges, the IRS has plugged on, and in many instances has performed admirably. Its issuance of three rounds of Economic Impact Payments is nothing short of miraculous. Notwithstanding this performance, in my testimony today I will describe the problems created by the current state of IRS resources, technology, and skillsets. I do this not to denigrate the IRS but to make the case that to address the tax gap we need transformational change, and that change must occur in the context of minimizing undue taxpayer burden and protecting taxpayer rights. That change also will require significant investment in new technology, leadership, employees, training, procurement skills, and funding. It requires a massive redesign of IRS systems, phased in over all IRS systems, so that they can process information and talk to one another in real time in order to keep up with current and trending issues. It requires upgrading the input systems – those that receive data and complete error processing, and it requires all systems to update quickly and be flexible. “Flexible” is not a word often applied to IRS systems today.

All of this is not going to happen overnight. And although this is a monumental undertaking, I want to emphasize that such change is possible. It will take a lot of work, in increments. It will take sustained funding, and sustained oversight. It will require additional hiring authorities, and it will require IRS leadership and personnel who are experienced and capable of overseeing and delivering a project of this magnitude. In my opinion, there really is no choice about all this – it must occur. If we do not make these investments in the IRS, we will not only *not* address the upper reaches of the tax gap, but we will actually risk *increasing* the tax gap by failing to meet the needs of taxpayers who are compliant or who are in good faith trying to comply with the law. That is a result we cannot allow to happen.

In the drive to “enforce” the tax laws, we cannot allow the emphasis on enforcement to come at the expense of taxpayer service

I first appeared before the Senate Finance Committee in February 1998, as the Executive Director of The Community Tax Law Project, the first independent low income taxpayer clinic in the country.⁷ I testified about how the Service’s drive to collect taxes and its failure to consider the facts and circumstances of individual taxpayer’s situations led to harmful overreach, especially for low income and middle class taxpayers who could not afford representation. The passage of the landmark Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)⁸ was a watershed in the advancement of taxpayer rights, equaled only by the passage of the Taxpayer Bill of Rights in 2015,⁹ and the Taxpayer First Act in 2019.¹⁰

Approximately 2 percent of the \$3.6 trillion the IRS collects each year comes from direct enforcement actions.¹¹ The remaining 98 percent comes from the indirect effect of a mixture of

⁷ *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. On Fin., 105th Cong.* 105-529, at 329-40 (1998) (statement of Nina E. Olson, Executive Director, The Community Tax Law Project).

⁸ Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 685.

⁹ Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, § 401, 129 Stat. 3040, 3117.

¹⁰ Taxpayer First Act, Pub. L. No. 116-25, 133 Stat. 981.

¹¹ IRS, 2019 Data Book, Table 1 and Table 25. (June 2020). The IRS collected a total of \$3.56 trillion in FY 2019. It reported approximately \$60.1 billion in revenue attributable to its collection activities, including \$44 billion (net

people’s fears about IRS enforcement and their desire to be compliant with the tax laws (tax morale). Even the compliance of purely wage-earning taxpayers, who are subject to reporting *and* withholding, is attributable to their employers voluntarily withholding and depositing payroll taxes. Because it is easier to measure the direct revenue effect of enforcement, however, budgets for administrations of both parties have consistently proposed increased enforcement spending, usually through the device of a program integrity cap, giving taxpayer service short shrift.¹²

The chronic underfunding of taxpayer service has led to an environment where we routinely see delays in mail handling and telephone “level of service” (LOS) performance at 50 to 60 percent, measured as the percentage of calls the IRS directs to a live assistor that actually reach a live assistor.¹³ According to the National Taxpayer Advocate, the IRS LOS on the main 1040 number plummeted to 5 percent during the current filing season, and the TAS measure of LOS actually placed it at 2 percent.¹⁴ This means 98 percent of calls to the main IRS number did not get through to a live assistor. For FY 2021, the IRS requested funding that would provide LOS at 60 percent, which Congress approved. This means we’ve accepted it is okay to *not answer four out of ten calls* from taxpayers who the IRS directs to reach a live assistor at the IRS.¹⁵

Today, much of the IRS’s compliance contacts fall in the category of what I call “unreal audits.”¹⁶ According to IRS chief counsel, they do not meet the definition of an audit, which involves an examination of the taxpayer’s books and records (IRC § 7602). Yet for millions of taxpayers each year, these unreal audits sure feel like an audit, and they can result in an assessment of additional tax (and penalties) just like an audit, even if the IRS does not include these contacts in its calculation of audit rates. Take summary assessments under IRC § 6213(b), for example, also known as “math errors.” Summary assessment authority (SAA) allows the IRS to make an immediate adjustment to a taxpayer’s return and only follow deficiency procedures (including the right to petition Tax Court before paying the tax) if the taxpayer objects within 60 days. Yet the math error notices are incomprehensible. The typical math error notice (Notice CP-11) reads as follows:

Changes to your 2019 Form 1040

after credit transfers) on balance due returns, \$1.89 billion on delinquent returns, \$289 million on offers in compromise, and almost \$14 billion on installment agreements.

¹² The National Taxpayer Advocate reports the IRS Taxpayer Service enacted appropriations provided for 28,531 full-time employees in FY 2019, 26,760 in FY 2020, and down to 25,678 for FY 2021. National Taxpayer Advocate 2020 Annual Report to Congress 32.

¹³ *Id.* at 31.

¹⁴ NTA Blog: *2021 Filing Season Bumps in the Road: Part I* (April 22, 2021) at

<https://www.taxpayeradvocate.irs.gov/news/nta-blog-2021-filing-season-bumps-in-the-road-part-1/>

¹⁵ *Id.* at 30. Of course, this LOS does not account for the calls the IRS phone tree directs away from a live assistor, even though the caller may want to talk to someone and not reach an automated line. In this way, the IRS performance measure misrepresents the taxpayer experience on the phones.

¹⁶ See National Taxpayer Advocate 2017 Annual Report to Congress, Most Serious Problem: *Audit Rates: The IRS is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*, 49-63. See also NTA Blog: “Real” vs. “Unreal” Audits and Why This Distinction Matters (July 6, 2018) at <https://www.taxpayeradvocate.irs.gov/news/ntablog-real-vs-unreal-audits-and-why-this-distinction-matters/>

We found miscalculations on your 2019 Form 1040, which affect the following areas of your return:

- Income
- Tax Computation

We changed your return to correct these errors. As a result, you owe \$xxxx.

Buried on page 3 of this 4-page notice is some language that is only marginally more helpful:

Changes to your 2019 tax return:

	Your Calculation	IRS Calculation
Adjusted Gross Income, Line 8b		
Taxable Income, Line 11b		
Total Tax, Line 16		

That’s all the information a taxpayer gets about this “error” and change. This vague language, which fails to put the taxpayer on notice of precisely what was changed on a taxpayer’s return so they can decide if the IRS is correct or not, contravenes Congress’ explicit direction to the IRS when it expanded math error authority in 1976. At that time, Congress told the IRS it would get this expansion but to address fairness concerns about removing more situations from deficiency procedures, Congress added IRC § 6213(b)(1), which requires that “[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof.” The House and Senate Committee Reports both directed the IRS to phrase the notice regarding inconsistent entries on returns in such a way as to include questions designed to show why the IRS had chosen to challenge a particular entry on the taxpayer’s return.¹⁷ It is now almost 50 years later, and IRS math error notices are as vague and imprecise as they were in 1976. This is a violation of the taxpayer’s *right to be informed, to quality service, and to challenge the IRS and be heard*.¹⁸

Upon receipt of a summary assessment/math error notice, the taxpayer has 60 days to dispute the IRS’s assessment in order to have the tax abated. In the taxpayer disputes it timely, the IRS will review the change and if the IRS believes the original assessment is correct, the IRS must issue a Notice of Deficiency, giving the taxpayer the opportunity to petition the U.S. Tax Court before having the pay the tax.

If the taxpayer calls the IRS to get clarification about the specific item that was changed pursuant to a SAA/math error notice so he can decide whether to dispute the notice, technology defeats him. IRS assistors on the phone number listed on the notice cannot see the taxpayer’s return to know what caused the problem. That assistor must fill out the dreaded Form 4442 “referral” to another IRS function.¹⁹ That function may or may not provide the taxpayer with a substantive

¹⁷ See H.R. Rep. 94-658, at 289 and S. Rep. No. 94-938(1), 94th Cong., 2d Sess. 375 (1976). The reports cited an example where the taxpayer enters six dependency exemptions, but then calculates for seven exemptions; in this case, the IRS should phrase its notices to show the taxpayer the specific discrepancy and inform the taxpayer they might be eligible for the greater number of exemptions. For a detailed discussion of math error notices, see National Taxpayer Advocate 2014 Annual Report to Congress, 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*, 163-171.

¹⁸ I.R.C. § 7803(a)(3); IRS, Publication 1, *Your Rights as a Taxpayer* (Rev. Sept. 2017).

¹⁹ See IRM 21.3.5.

answer, but it will generally send a letter saying it needs 30 days to review. And then the taxpayer will get another letter, saying it needs another 30 days to review. (This letter is referred to as a “stall letter” in IRS jargon.) By this time the taxpayer is in an anxiety-producing situation – 60 days will soon elapse and the taxpayer doesn’t know if the IRS has abated the assessment or if the taxpayer’s account will proceed to collection.

Customer service representatives and other IRS employees have no access to a 360-degree view of the taxpayers account because the IRS has no database in which all taxpayer information is stored or linked. Although the IRS has been working on an Enterprise Case Management system since at least 2015, it still has 60 separate major databases containing taxpayer information. The lack of a full picture of the taxpayer’s tax life has significant consequences not only for taxpayer assistance but also for audit selection, collection prioritization, and protection of taxpayer rights.

Dreams of the future IRS having purely digital communications with taxpayers will likely not materialize any time soon. Dealing with the IRS has consequences that don’t accrue to a bad Amazon or airline transaction. For example, over the next two years, there will be millions of taxpayers with Paycheck Protection Program loans and Employee Retention Credits, hundreds of millions reconciling Rebate Recovery Credits for two years straight, millions claiming and reconciling a new advanced child tax credit, and an influx of reporting on gig economy workers. If these taxpayers receive an IRS notice questioning their return, it is unlikely they will be comfortable with just going online to resolve the matter (if they make it through the IRS online account authentication required to open an account), especially when their bank accounts could be levied, their refunds offset, and their wages levied, all without any judicial review. Taxpayers want to know that they have been listened to and they want answers. They have the *right to be informed, the right to quality service, the right to pay no more than the correct amount of tax, and the right to challenge the IRS and be heard.*²⁰ Taxpayer service, which is so important to achieving the level of compliance we have today, must be funded to maintain that level.

Recommendation: Amend IRC § 6213(b)(1) to require any notice of assessment issued pursuant to the IRS’s summary assessment authority under that section to include a reference to the specific form and line that has been adjusted as well as a detailed explanation of the adjustment, including the amount of adjustment and the reason therefor. Further, require that the notice prominently displays on its first page the last date for requesting abatement and explain on the first page the consequences of not requesting abatement before the last day listed. Finally, require the IRS to provide the taxpayer with a dedicated fax number or email address for making the request, and require the IRS to issue an acknowledgement letter or email, informing the taxpayer the request has been received and the tax is abated pending further review.²¹

²⁰ I.R.C. § 7803(a)(3); IRS, Publication 1, *Your Rights as a Taxpayer* (Rev. Sept. 2017).

²¹ Regarding similar shortcomings of IRS notices providing taxpayers their right to a Collection Due Process hearing, see National Taxpayer Advocate 2018 Annual Report to Congress, Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*, 212-222.

The Tax Gap Does Not Equal Tax Evasion

Recent studies estimating the amount of unreported income by the highest income taxpayers, and proposals to reduce the underreporting component of the tax gap by increased information reporting, along with the Commissioner's guesstimate that the annual tax gap could be as much as \$1 trillion, have led policymakers, commentators, and the media to equate the tax gap with tax evasion.²² The ubiquitous usage of this phrase actually dilutes its meaning and impact. It also allows very different types of noncompliance attributable to very different causes to be lumped together. And framing noncompliance as tax evasion not only undermines compliance among the currently compliant, who will begin to feel naïve for complying, but it creates an environment in which tax agency personnel can feel justified in undermining if not outright ignoring taxpayer rights and protections.

I have always viewed tax noncompliance as a continuum of behavior and causes – *i.e.*, factors that influence that behavior.²³ Even as the financial, technology, and economic landscape evolves, not all noncompliance can be categorized as “tax evasion.” Take crypto-currency, for example. A wide variety of human beings use crypto-currency for a wide variety of reasons. Not all of that usage is on the dark web – some people purchase it for novelty or for investment, some people use it for every day transactions. An article about the recent Coinbase initial public offering on Nasdaq notes that one-third of small and medium-sized U.S. businesses accept crypto-currency as payment.²⁴ Not everyone understands which crypto-currency transactions constitute a realizable event for tax purposes, much less when that event generates taxable income. Indeed, the IRS only issued guidance on cybercurrency in 2014.²⁵ Yet the IRS has clearly adopted the viewpoint that mere *ownership or acquisition* of cybercurrency is an act worthy of closer scrutiny – in a prominent place on the 2020 Form 1040, Individual Income Tax Return, it asks *every taxpayer* the following question (under penalties of perjury): “*At any time during 2020, did you receive, send, sell, exchange or otherwise acquire any financial interest in*

²² See, e.g., Washington Post, *IRS chief says cheats are costing the U.S. \$1 trillion a year*, April 13, 2021 at https://www.washingtonpost.com/business/economy/irs-chief-says-cheats-are-costing-the-us-1-trillion-a-year/2021/04/13/128f1b0c-9c5d-11eb-b7a8-014b14aeb9e4_story.html; and New York Times, *Tax cheats cost the U.S. \$1 trillion per year, I.R.S. chief says*, April 13, 2021, at <https://www.nytimes.com/2021/04/13/business/irs-tax-gap.html>

²³ Professor Leslie Book described a typology of tax noncompliance, based on the work of sociologists Robert Kidder and Craig McEwen. See L. Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, in *Kansas Law Review*, vol. 51, 1145- 1195 (2003). Kidder and McEwen identified eight types of tax noncompliance: procedural, “lazy” or characteristic, unknowing, asocial, brokered, symbolic, social and habitual.

²⁴ “*It’s more than just Coinbase*”: *Crypto Giant snares \$85.8 billion valuation in Nasdaq debut*, Washington Post, Apr. 14, 2021 at https://www.washingtonpost.com/business/2021/04/14/coinbase-ipo-crypto-bitcoin/?utm_source=rss&utm_medium=referral&utm_campaign=wp_business.

²⁵ Internal Revenue Service, Notice 2014-21, at <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>. In 2013 I identified the IRS Chief Counsel’s failure to address the treatment of cryptocurrency as a Most Serious Problem of taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, Most Serious Problem: *Digital Currency: The IRS Should Issue Guidance to Assist Users of Digital Currency*, 249-255.

any virtual currency?” This question, on its face requiring the reporting of the acquisition of virtual currency, has brought almost universal condemnation as overreach.²⁶

Leaving crypto-currency aside, of the current \$441 billion gross tax gap estimate by IRS,²⁷ some portion of the underreporting gap is attributable to errors made as a result of tax law complexity (unknowing noncompliance) and others are attributable to procedural complexity and barriers – for example, where taxpayers are eligible for a deduction or credit but cannot navigate the bureaucracy on their own and cannot afford representation, so they just give up (functional or characteristic noncompliance).

Then there is that component of the tax gap attributable to underpayment, which will most assuredly increase as a result of the pandemic economy. Are the taxpayers who failed to make tax payments during this period *tax evaders* and *tax cheats* because their businesses shut down or went under during this period, or because they lost their jobs? Maybe some actively engaged in evasion, but most faced extraordinary challenges making ends meet and simply weren’t able to pay their taxes as well. Failure to differentiate between the causes of noncompliance results in the tax agency taking disproportionate actions and risks turning struggling noncompliant taxpayers into determined and intentional tax evaders. At a minimum, such a failure erodes trust, which is never good for a tax system and which research has shown is vital to achieving and maintaining voluntary tax compliance.

Lessons from the OVD settlement initiatives

As the IRS continues to focus on the tax gap attributable to offshore activities and tax havens, one can learn a lot about the risks of classifying noncompliance as tax evasion by looking at past IRS offshore initiatives. Painting everyone with one brush can lead to programs that treat a taxpayer who has simply made a mistake in the same way as a taxpayer who has engaged in complex tax planning. For example, between 2009 and 2012, the Internal Revenue Service offered a series of settlement programs for US taxpayers with unreported foreign bank accounts and income.²⁸ The initiative came in the aftermath of congressional hearings and a 2004 amendment to § 31 U.S.C. 5321(a)(5), which strengthened the penalties for underreporting the existence of foreign financial accounts, including a penalty of up to the greater of \$100,000 or 50% of the maximum account balance for the period. Recognizing that not every failure to report was willful, however, the statutory scheme provided a flat \$10,000 penalty for nonwillful failures to report and the discretion to impose no penalty at all where the failure to report had reasonable cause.

²⁶ See National Taxpayer Advocate, *NTA Blog: Wait, When Did This Virtual Currency Question Appear on My 1040 Tax Form*, March 3, 2021 at <https://www.taxpayeradvocate.irs.gov/news/nta-blog-wait-when-did-this-virtual-currency-question-appear-on-my-1040-tax-form2/>; see also Guinevere Moore, *IRS Rules on Reporting Bitcoin and Other Crypto Just Got Even More Confusing*, Forbes, March 3, 2021 at <https://www.forbes.com/sites/irswatch/2021/03/03/irs-rules-on-crypto-reporting-just-got-even-more-confusing/?sh=2a393e487850>.

²⁷ IRS, *Tax Gap Estimates for Tax Years 2011-2013*, at <https://www.irs.gov/newsroom/the-tax-gap>.

²⁸ For an extensive discussion of the IRS offshore settlement programs between 2009 and 2018, see National Taxpayer Advocate, *NTA Blogs: An Analysis of Tax Settlement Programs as Amnesties: Part 1, Part 2, and Part 3* (March 14, 21, and 30, 2018).

The IRS’s 2009 Offshore Voluntary Disclosure Program (OVDP), on the other hand, provided for taxpayers to pay a flat 20% penalty of the highest account balance over a 6-year period as well as all other tax and interest on the unreported income, and a 20% accuracy-related penalty. The IRS simultaneously made clear that failure to enter the OVDP could result in an extensive audit and could also lead to criminal investigation. The 2009 OVDP thus failed to differentiate between those taxpayers who had small offshore accounts for family reasons (*e.g.*, providing support for a parent who lives overseas), or those taxpayers who, although being “accidental” US citizens, had lived their adult lives without any professional nexus with the IRS and were surprised to learn they had an obligation to file returns with the IRS, and those taxpayers who were actively seeking to shelter their assets and income offshore so as to escape US taxation. Although the IRS recovered \$9.9 billion USD from these settlement programs through October 2016, the data for the 2009 OVDP paints a shocking picture of a regressive penalty structure, whereby the taxpayers with the lowest dollar accounts and least amount of unreported income paid the highest percentage rate of penalty (as a percentage of tax due on the unreported income). The 2009 initiative clearly violated the principle of proportionality, a fundamental taxpayer rights protection.

FIGURE 1, Comparison of Median Offshore Penalties to Unreported Tax by Median Account Size and Representation for the 2009 OVD Program

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	\$44,855	\$607,875	\$7,259,580
2009 OVD penalty	\$8,540	\$117,803	\$1,410,517
Additional tax, tax years 2002-2011	\$1,472	\$30,894	\$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%
Unrepresented percent	31%	11%	4%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	772%	474%	398%

Source: NTA Blog, March 21, 2018

An additional point about the offshore initiatives – they occurred during a time when the Department of Justice was successfully breaching the wall of Swiss bank secrecy. Whistleblowers were coming forward. IRS, Treasury, and Justice were all focused like a laser on offshore noncompliance. Taxpayers had a strong incentive to enter the programs. Yet when the programs ended in 2018, the IRS announced in a press release that it had collected \$11.1 billion through the programs over the period of 2009 to 2018. That is a little over \$1 billion a year, for ten years.

Enhanced Information Reporting and Data Use Can Improve Case Selection and Taxpayer Service But It Requires a Change in IRS Culture, Staffing, and Systems

Intelligent use of data can improve tax administration enormously *if* it is fit for the purpose intended and used in algorithms and other techniques that mimic human reasoning and *if* it does not displace human decision making and discretion. Data about a taxpayer’s business or family status can identify services and information taxpayers need to meet their tax obligations and lead to more tailored and relevant communications; this information can minimize errors by enabling taxpayers to access their own information and download that information into return preparation programs;²⁹ it can identify taxpayers who are eligible for certain tax provisions such as the childless worker EITC and compute and refund credits when taxpayers fail to claim them; and it can identify questionable refund claims while at the same time minimize false positives and false negatives. Data also can ensure the IRS selects the most appropriate cases to audit.³⁰ IRS also can, and should, identify taxpayers at risk of economic hardship so the IRS does not take harmful collection action against them. However – and this is a big however – because there is so much pressure on the IRS to collect revenue, there is a risk the IRS will not deploy the data intelligently or effectively, and instead use enhanced information reporting to go after the lowest hanging fruit.³¹

Today, IRS data use is mired in the 1980s, with some notable exceptions. There is heavy emphasis on data-matching and rule-based systems, instead of pattern/network recognition algorithms that include feedback loops. The IRS underutilizes financial account data it receives pursuant to FATCA because it cannot match much of it to existing returns. The manner in which IRS receives data can limit its effectiveness. For example, in 2015 to 2016, the IRS created a program whereby it matched Forms 1042-S associated with the 1040-NRs filed by foreign students. Because IRS systems could not accept these returns electronically, IRS employees had to keystroke in the entries on the returns, including the 18 fields on Form 1042-S. The IRS sent out thousands of letters to foreign students (most of whom were no longer in this country) notifying them they had to obtain a corrected Forms 1042-S from their educational institutions since the payor data did not match their returns. Further investigation found over 90 percent of those “errors” were actually keystroke errors attributable to IRS data entry. The IRS’s assumption that taxpayers themselves were to blame imposed undue burden on the taxpayers and educational institutions and created significant rework for the agency itself.³²

²⁹ In 2011, for example, I recommended that Congress accelerate third-party information reporting and use that data to pre-populate returns. See National Taxpayer Advocate 2011 Annual Report to Congress, Legislative Recommendation: *Accelerated Third-Party Information Reporting and Pre-populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*, 284-295.

³⁰ See National Taxpayer Advocate 2009 Annual Report to Congress, Most Serious Problem: *The IRS Does Not Have a Significant Audit Program Focused on Detecting the Omission of Gross Receipts*, 185-190.

³¹ In 2011, in the introduction to a series of Most Serious Problems about the IRS questionable refund program, identity theft filters, math error assessments, automated substitute for returns, and automated lien filing procedures, I wrote about my concerns regarding the potential of automation to lead to taxpayer abuses. See National Taxpayer Advocate 2011 Annual Report to Congress, Most Serious Problem Introduction: *As the IRS Relies More Heavily on Automation to Strengthen Enforcement, There is an Increased Risk it will Assume Taxpayers are Cheating, Confuse Taxpayers About Their Rights, and Sidestep Longstanding Taxpayer Protections*, 15-17.

³² For a detailed discussion of this issue, see National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons is Burdensome, Error-ridden, and Fails to Protect the Rights of Affected Taxpayers*, vol. 1, 80, 82-83. See also <https://www.irs.gov/newsroom/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042-s-foreign-persons-us-source-income-subject-to-withholding>.

Many IRS systems have high false positive and abatement rates. The National Taxpayer Advocate has reported that during the 2020 filing season, the IRS “refund fraud filters” selected 3.2 million returns, up 107 percent from the 2019 filing season.³³ Of those returns, the IRS approximately 66 percent of them were false positives.³⁴ *That is, two-thirds of the refund returns IRS systems labelled as potentially fraudulent turned out to be legitimate.* About 25 percent of the returns the IRS froze as potentially fraudulent took longer than 56 days to be unfrozen and released for processing and appropriate refund issuance.³⁵ While some of the delay may be attributable to closures during the pandemic, this high false positive rate associated with non-identity theft refund fraud filters has persisted for years – including 72 percent for the 2019 filing season.³⁶ These are very high rates, and they are exacerbated by the inadequate staffing and assistance to taxpayers who try to demonstrate the legitimacy of their returns. As a consequence, this issue has been #1 among case receipts for the Taxpayer Advocate Service for the last four years.³⁷

Clearly, archaic data practices create burdens for taxpayers of all types and are especially harmful for the lowest income taxpayer who depend on their refunds to meet basic living expenses. Moreover, these systems label legitimate returns as “potentially fraudulent,” which has consequences with respect to how IRS employees view these taxpayers and the quality of assistance provided them. This points to the culture change necessary before the IRS can utilize data and advanced systems effectively.

The IRS also does not use data proactively to alleviate burden and prevent harm to taxpayers. I have advocated and written extensively about the need for IRS to use its taxpayer income data and the allowable expense guidelines developed under IRC § 7122(d)(2) to identify taxpayers who may be at risk of economic hardship.³⁸ The IRS can use this data both as part of its case selection and assignment criteria and as a tool to prompt its collection employees to gather sufficient financial information when a taxpayer calls or is contacted, in order to make an actual determination as to the taxpayer’s ability to pay a tax debt while paying for basic living expenses. The IRS has stubbornly refused to adopt this approach, asserting it does not have sufficient information to identify those risks.³⁹ This, of course, is simply not a credible assertion.

³³ The Pre-Refund Wage Verification Program, a component of RRP and administered by the Return Integrity Verification Operation (RIVO), freezes returns claiming refunds while the IRS attempts to verify wages and withholding claimed on the return. National Taxpayer Advocate, 2020 Annual Report to Congress, 230. RIVO utilizes “an obsolete case management and screening system called Return Review Program Legacy Component (RRPLC) (or Electronic Fraud Detection System), which the IRS has been planning to replace for more than a decade.” *Id.* at 156.

³⁴ *Id.* at 151, note 19.

³⁵ *Id.* at 231. 18 percent took longer than 120 days for refund issuance.

³⁶ *Id.* at 151.

³⁷ *Id.* at 148.

³⁸ See, e.g., Nina E. Olson, *Procedurally Taxing: My IRS Wishlist for 2021, Part 2: The Economic Hardship Indicator*, at <https://procedurallytaxing.com/my-irs-wishlist-for-2021-part-2-the-economic-hardship-indicator/>; National Taxpayer Advocate 2018 Annual Report to Congress, *Most Serious Problem: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*, 228-239.

³⁹ See, e.g., IRS response to the Most Serious Problem, cited at note 35, in National Taxpayer Advocate FY 2020 Objectives Report to Congress, vol. 2, 93-94.

Financial institutions and debt collection agencies make assessments like this every day with far less financial information than the IRS has at its figurative fingertips.

The shortcomings of a pure “matching” program without attendant intelligent programming are evidenced by the IRS’s approach to math errors relating to dependent Taxpayer Identification Numbers (TINs). IRC § 6213(g)(2) authorizes the IRS to summarily assess additional tax by disallowing dependent exemptions, EITC, child tax credit, and the child and dependent care credit where the qualifying child’s TIN does not match Social Security or other records. In 2011, a research study conducted by my former office showed the IRS abated, at least in part, 55 percent of the summary assessments related to incorrect TINs, and in 56 percent of those returns with abatements, the IRS possessed internal information that would clearly show the source of the error (*e.g.*, systemically reviewing past year returns to identify the taxpayer merely keystroked and inverted digits on the child’s TIN in the current year).⁴⁰ The failure to do something so simple as an historical systemic review of taxpayer data on-hand demonstrates a disturbing lack of concern on the IRS’s part with imposing undue and significant burden on taxpayers, who have to call or write the IRS to obtain their legally owed refunds. That the IRS has been aware of this problem (and its solution) since 2011 and has not prioritized fixing it, even when it is in the IRS’s own best interests (because the programming will reduce phone calls and correspondence) is troubling indeed.

I raise these examples not as an objection to proposals for more information reporting, but rather to make clear that in addition to modernized technology and data integration and design, including a 360 degree taxpayer account, the IRS must have a culture shift about how it approaches data – including using it proactively to assist taxpayers, and guarding against labelling taxpayer returns as “potentially fraudulent” before it has conclusive evidence of fraud. Most taxpayer error is not fraud. Repeat as needed.

Recommendation: Require the IRS to use to tax return and other information reports to proactively identify taxpayers who may be at risk of economic hardship.

Recommendation: Clarify the IRS may use its summary assessment authority under IRC § 6213 to make assessments with respect to refundable credits, such as the childless worker EITC, and similar items for which it has information that enable it to determine eligibility with sufficient accuracy and issue refunds accordingly.

Recommendation: Require the IRS, as a prerequisite to using summary assessment authority for an addition to tax, to utilize historical and other taxpayer account data to minimize the use of the summary assessment procedures.

⁴⁰ National Taxpayer Advocate 2011 Annual Report to Congress, Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*, vol. 2 at 113-144.

Artificial intelligence systems that lack transparency and displace human decision-making and discretion may violate privacy, human, and taxpayer rights: case studies from other countries

There are lessons to be learned from other countries' experiments with data use and artificial intelligence systems to identify fraud in welfare and tax credits. Data and AI can improve detection of noncompliance, but human intervention must be retained and these systems must adhere to basic principles of human dignity and privacy. Moreover, intelligent systems must not be designed as black boxes – they must be transparent and explainable.

In 2016 the Australian government announced the Online Compliance Intervention (OCI), an automated debt recovery system that matched data from Centrelink with averaged income data from the Australia Tax Office.⁴¹ As a result of several Parliamentary inquiries and several legal challenges, the program was scrapped in May, 2020, after it was alleged that 470,000 welfare recipients were wrongfully issued debt notices and paid these nonexistent debts in full. In June 2020, the Prime Minister apologized, and the government agreed to pay \$720 million to the individuals who received the incorrect collection notices and paid the tax on the incorrect bill. In November 2020, the amount the Australian government committed to resolving the wrongful collection under this program expanded to \$1.2 billion AUD to include settlement of a class action lawsuit.⁴²

In 2020, the Hague District Court, reviewing a civil complaint filed by several nongovernmental organizations, found that the System Risk Indicator (SyRI), a system established by the Dutch government to use 17 types of data, including tax, assets, and social benefits, to identify various types of fraud in government programs, violated the European Convention on Human Rights Article 8 which provides a right to the protection of private life, including the protection of personal data.⁴³ Although this right may be interfered with in the interests of society, the court found that there was no balance between those interests because the system was not transparent – there was no information available about how it worked or what data was actually used, (i.e., it was a black box) and there was no notification of the person when a person was flagged as a “fraudster” and information was passed on to prosecutors and police. This created a risk of discriminating and profiling against certain vulnerable groups of persons.

Finally, in January, 2021, the entire government of The Netherlands resigned after it was disclosed that a separate government initiative to investigate welfare fraud, including sharing and matching income information with other authorities, had resulted in parents being labeled as fraudsters and incurring thousands of euros in fines for simple mistakes, including missing signatures on forms. Moreover, the Dutch Data Protection Authority found the program was

⁴¹ Centrelink is a system that is administered by Services Australia, a government agency. Centrelink delivers payments and services for retirees, the unemployed, families, carers, parents, people with disabilities, Indigenous Australians, and people from culturally and linguistically diverse backgrounds.

⁴² The Guardian, *Robodebt Class Action: Coalition Agrees to Pay \$1.2bn to Settle Lawsuit*, Nov. 16, 2020 at <https://www.theguardian.com/australia-news/2020/nov/16/robodebt-class-action-coalition-agrees-to-pay-12bn-to-settle-lawsuit>.

⁴³ See *Nederland Juristen Comite Voor De Mensenrechten v. The State of The Netherlands*, Hague District Court (05 Feb. 2020) (English translation at <https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBDHA:2020:1878>)

discriminatory against dual nationality citizens. The government announced that nearly 10,000 families will receive 30,000 euros (about \$36,500) in damages.⁴⁴

Recommendation: To ensure AI systems comport with privacy and taxpayer rights protections and have the requisite level of transparency, the IRS should follow the practices recently recommended by the U.S. Administrative Conference of the United States.⁴⁵

Proposals to Expand Information Report Are Promising but Should be Accompanied by Additional Taxpayer Protections

With respect to specific proposals for expanded information reporting, I note that the information reporting proposal, Shrink the Tax Gap, from former Commissioner Rossotti targets the largest component of the tax gap – underreported unincorporated business income, and the related self-employment tax – and leverages information already compiled by financial and other institutions for issuance of a new information report, Form 1099-NEW.⁴⁶ Further, the proposal explicitly states it is not a “matching” proposal. Instead, it requires the highest income taxpayers in this category to reconcile their aggregate financial account deposits and withdrawals (reported on Form 1099-NEW) to the income and expenditures reported on their returns, and for the IRS to use this reconciliation to score returns based on a mapping of the reconciliation categories to audit results for those categories. Further, those taxpayers with incomes above a certain threshold and below the “reconciliation” threshold will still receive a Form 1099-NEW reporting their deposits and withdrawals. This form will put taxpayers on alert that the IRS has this information, and the IRS can use this information for real-time scoring of returns not subject to the reconciliation and use the results to identify potential noncompliance and to provide more detailed communication (non-audit) with taxpayers.⁴⁷

One of the challenges with this proposal is the IRS’s ability to execute it – the IRS today lacks the expertise and systems to achieve this level of sophisticated tax administration. It requires a sustained investment in leadership, technology, employees, training, and procurement. It is not really a matter of if the IRS can make these changes in its culture, because to fulfill its mission of collecting revenue and administering social benefit programs in the 21st century, it simply must change. All of this is achievable. The question is when and how it will make that change. Congress, through appropriations and oversight, including setting goals for the agency, is key to effecting this change.

There is a second challenge with this proposal. As noted above, it seeks to identify taxpayers who are underreporting their gross receipts of business income. Perhaps to target information

⁴⁴ New York Times, *Government in Netherlands Resigns After Benefit Scandal*, Jan. 15, 2021 at <https://www.nytimes.com/2021/01/15/world/europe/dutch-government-resignation-rutte-netherlands.html>

⁴⁵ See Administrative Conference of the U.S., *Administrative Conference Statement #20: Agency Use of Artificial Intelligence* (Dec. 16, 2020) at <https://www.acus.gov/recommendation/agency-use-artificial-intelligence>

⁴⁶ See Shrink the Tax Gap proposals at <https://shrinkthetaxgap.com/>

⁴⁷ Shrink the Tax Gap, Appendix E: Taxpayer Impact (April 7, 2021) at <https://shrinkthetaxgap.com/appendix-e-burden-model/>.

reporting to the group most able to accommodate the administrative burden, it proposes that Form 1099-NEW reporting will be limited to business accounts, and related pass-throughs, of taxpayers reporting unincorporated business income whose adjusted gross income (AGI) is in the top quartile, currently about \$92,000. The difficulty with this approach is that targeting information reporting in this way may imply, in many people's minds, the presumption that these taxpayers are evading tax. The other drawback to this approach is it relies on taxpayers' own self-reporting of gross receipts to identify taxpayers who are not properly reporting their gross receipts.

In 2007, as the National Taxpayer Advocate, I recommended that Congress require information reporting on all bank accounts as a measure to address cash economy noncompliance.⁴⁸ The IRS already received 1099 forms indirectly reporting the existence of interest or dividend bearing accounts. What was missing were the accounts that were non-interest bearing. We believed the mere requirement of reporting the existence of these accounts would have a direct compliance effect, because taxpayers would know the IRS could, if it wanted to, look at the deposits in the minimal or non-interest bearing accounts.

Thus, to avoid the appearance and implication that a targeted group of taxpayers whose account deposits and withdrawals are subject to information reporting are in some way *prima facie* noncompliant or tax cheats, I recommend Congress require financial institutions to report deposits and withdrawals on all accounts designated by the taxpayer as used for business, regardless of AGI levels. In this way the IRS can identify those taxpayers whose tax returns report income below the threshold in the Shrink the Tax Gap proposal but whose financial accounts show deposits significantly above that threshold.⁴⁹

But I would not stop there, because if the IRS received this mother lode of data, it would be too tempting for it to resist falling back on its income matching techniques rather than utilizing the data in a more sophisticated and targeted way. If it did that, the IRS would be focusing its efforts on the lowest hanging fruit and not using the data to identify the most serious noncompliance, thereby defeating the entire purpose of the information reporting. Bank account information alone will not identify who the IRS should look more closely at, nor is it *prima facie* evidence of underreporting. Therefore, if Congress authorizes bank account information reporting, I recommend that it also restrict the IRS's use of this data by prohibiting it from utilizing it in the Automated Underreporter Program. While this restriction may seem counter-intuitive, I believe it is necessary to change the IRS's approach to the use of data and to bring it into the 21st century.

Finally, as noted earlier, many of the IRS's adjustments to returns occur outside of the traditional "audit" context. In FY 2019, the IRS closed 1.96 million automated underreporter assessments, and 365,000 automated substitute for return assessments.⁵⁰ These assessments historically have

⁴⁸ National Taxpayer Advocate 2007 Annual Report to Congress, Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy*, 490-502.

⁴⁹ Some taxpayers, of course, will avoid designating accounts as business accounts and thus escape detection. There will always be these types of actors (asocial noncompliance). As noted above, no one proposal will address all forms of noncompliant behaviors. The Shrink The Tax Gap proposal will help close some of the unincorporated business underreporting tax gap, if not all.

⁵⁰ IRS, FY 2019 Data Book, Table 22.

experienced high abatement rates. One reason for AUR and ASFR abatements is that these adjustments are made based on third-party information reports, which may contain errors or be the result of identity theft (as in the recent case with pandemic-related unemployment insurance scams). Normally, the IRS's Notice of Deficiency (NOD) receives the presumption of correctness and taxpayers bear the burden of disproving it in Tax Court. Since 1991, however, federal courts have consistently held that in court proceedings where a taxpayer disputes a proposed assessment based solely on a third-party document, the presumption that the subsequent NOD is correct does not automatically apply. This position is incorporated in IRC § 6201(d), which provides in any court proceeding the taxpayer "asserts a reasonable dispute" of the accuracy of an information reporting document and the taxpayer "fully cooperates" with the IRS, the government shall have the burden of producing "reasonable and probative information" concerning the proposed deficiency, beyond the information reporting document. There is, however, no complimentary provision to IRC §6201(d) that requires an IRS audit employee to take on the burden of running down the underlying information where the taxpayer raises a reasonable dispute about an information document and cooperates in a "real" or "unreal" audit. Thus, I recommend that Congress extend IRC § 6201(d) to apply to IRS examination and matching activities, to ensure the proper use and application of expanded information reporting and to avoid unnecessary litigation.

Recommendation: If information reporting is expanded to require financial institutions to report on the aggregate deposits and withdrawals for business accounts of sole proprietors and other pass-through entities, the use of this data in the IRS Automated Underreporter Program should be prohibited.

Recommendation: Amend IRC § 6201(d) to require the IRS in examinations and in information document matching compliance programs to support a proposed assessment with "reasonable and probative information" beyond the information document, where the taxpayer has raised a reasonable dispute about that information document(s) and cooperated with the examination.⁵¹

To ensure the effective use of data and the protection of taxpayer rights, Congress should require the IRS to conduct a rights-based administrative burden assessment of each new initiative, overseen by the Office of the Taxpayer Advocate

⁵¹ For a discussion of a compelling case that makes clear just how important such protections are at the administrative level, see John A. Clynch and Scott A. Schumacher, *Procedurally Taxing, Oral Persuasion: Taxpayer Testimony and the Burden of Proof* at <https://procedurallytaxing.com/oral-persuasion-taxpayer-testimony-and-the-burden-of-proof/>. Congress should amend IRC § 7430 to provide for an award of attorney fees where the IRS fails to comply with its obligation under the amended IRC § 6201(d), even if the position of the IRS in Tax Court is "substantially justified." If the taxpayer has tried his or her best to provide information at the administrative level and is forced to keep providing it or to go to court because the exam and appeals level are not listening, then the taxpayer should be compensated.

In the course of its operations, the IRS must comply with various federal statutes designed to minimize administrative burden, including the Regulatory Flexibility Act,⁵² the Paperwork Reduction Act,⁵³ the Privacy Act⁵⁴, and the Privacy Impact Assessment (PIA).⁵⁵ There are limitations for each of these regimes. The IRS has generally failed to make the flexibility analysis required by the RFA or perfunctorily stated that it need not conduct the analysis since it had determined the regulations would not have a significant impact on a substantial number of small businesses.⁵⁶ The PRA requires agencies to estimate the amount of time it takes to comply with a request for information, such as a Form 1040, but the definition of “time” is very narrow – it ignores other types of costs and other types of burdens, for example, downstream burdens including audits, summary assessments, and collection actions. With respect to the Privacy Act, IRS disclosure laws trump the Privacy Act in many instances, so compliance with the Act is difficult to measure. The Privacy Impact Assessment, on the other hand, is a system of guiding program owners through a process of assessing privacy risks during the early stages of development as well as through the life cycle of the system. The PIA can go beyond just assessing the “system” itself and consider the “downstream” effects on people who are affected in some way by the proposal. The PIA, however, does not explicitly address the taxpayer rights implications of a proposed program or system.

To address this gap, in an upcoming article Professors Leslie Book and Keith Fogg and I are proposing a rights-based framework for assessing the excessive administrative burden and taxpayer rights impact of a given IRS initiative or system.⁵⁷ Our framework acknowledges that

⁵² 5 U.S.C. §§ 601 et seq. The Regulatory Flexibility Act requires government agencies to make an initial flexibility analysis prior to publishing regulations for public comment, and a final regulatory flexibility analysis when publishing the final rule. In conducting these analyses, the agency must describe the effect of the rule on small business, analyze alternatives that might minimize adverse economic consequences, and make their analyses available for public comment. Agencies are relieved of performing this analysis if the agency “certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities.” 5 U.S.C. § 605(b).

⁵³ 5 U.S.C. §§ 3501 et seq. The PRA seeks to “ensure the greatest possible public benefit from and maximize the utility of information created, collected, maintained, used, shared and disseminated by or for the Federal Government” and to “improve the quality and use of Federal information to strengthen decision-making, accountability, and openness in Government and society.” 44 U.S.C. § 3501. To satisfy PRA requirements, prior to information collection agencies must (1) provide the public with an opportunity to comment on the information gathering activity; and (2) submit the proposal for collection of information to the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB). 44 U.S.C. § 3502(1).

⁵⁴ 5 USC §552a. The Privacy Act establishes “fair information practices” requiring the IRS to (1) maintain in its records only such information “about an individual that is relevant and necessary to accomplish a purpose of the agency required to be accomplished by statute” (5 USC § 552a(e)(1)); (2) “collect information to the greatest extent practicable directly from the [taxpayer]” (5 USC § 552a(e)(2)); and (3) maintain the records it uses in making a determination concerning a taxpayer “with such accuracy, relevance, timeliness and completeness as is reasonably necessary to assure fairness to the individual in the determination.” (5 USC § 552a(e)(5)).

⁵⁵ Pub. L. No 107-347, § 208(b), 116 Stat. 2922 (2002).

⁵⁶ In a Government Accountability Office (“GAO”) review of 200 tax regulations issued from 2013 to 2015, only two preambles included an RFA analysis. GAO-16-720, Regulatory Guidance Processes: *Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance* 22 (2016). In approximately half of the regulations reviewed by GAO Treasury and the IRS claimed that the “RFA’s requirements for a regulatory impact analysis did not apply because the regulation does not impose a collection of information requirement on small entities.” *Id.* at 22

⁵⁷ A working draft of this article, *Administrative Burdens, Sludge, and Taxpayer Rights*, is available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3545357

where there is evidence of broad based, systemic noncompliance, developing programs which increase upfront administrative burdens on taxpayers in order to facilitate downstream compliance may be justified in order to protect program integrity (and even enable continuation of the program). However, where a program impacts a significant number of individuals, even one with a superficially large monetary impact, but one where the incidence of noncompliance occurs within a small percentage of taxpayers, the problem may not justify a solution which imposes a disproportionate administrative burden on all taxpayers.

The rights-based administrative burden framework requires the Service to expand its horizon and think more holistically about how it interacts with taxpayers. It focuses on the relationship between the Service and the taxpayer, and requires the IRS to consider the distributional impact of the burdens it imposes, minimizing the risk that its actions are arbitrary. Under this analysis, the critical questions are, did the Service consider taxpayer rights in taking this action or designing this system? And, is the Service ignoring taxpayer rights by *not* taking an action?

An initial challenge with this approach is how to require the Service to be more cognizant of how its actions impose excessive administrative burden and harm on particular taxpayer populations and sub-populations *before and during* program design and implementation.¹²⁶ Building on elements present in the PRA, the Privacy Act, and the PIA, we recommend the IRS conduct a Taxpayer Rights Impact Statement (TRIS) with respect to all prospective programs. Additionally, we propose a method for systematic review of existing programs. By adopting the Privacy Act's approach to transparency, the Taxpayer Rights Impact Statements (TRIS) resulting from these reviews should be required to be posted on a dedicated, public webpage on the agency's website. Finally, the application of the framework requires the Service to measure different impacts from its current practices, which in turn will require the Government Accountability Office (GAO) and the Treasury Inspector General for Taxation (TIGTA) to shift their audit focus.

While this approach seeks to protect all taxpayers from excessive administrative burdens, it must look at those *disproportionately* impacted which may result in an analysis for a particular subset of taxpayers. If the IRS is proposing an initiative that affects 75 to 100 percent of overseas taxpayers and few domestic taxpayers, the overall program may appear appropriate yet it has a disproportionate impact. An example here might occur if the Service does not have any toll-free overseas lines, does not allow email communications, and does not allow overseas taxpayers to establish online accounts. This creates an excessive administrative burden given the characteristics of the population of overseas, and violates the right to quality service, the right to challenge the IRS and be heard, and the right to a fair and just tax system, among others. The TRIS would require the IRS to identify these gaps and propose mitigation strategies prior to implementing the initiative.

Under our proposal, the Service would conduct this rights-based administrative burden assessment for both customer service and compliance programs and systems. We define compliance programs and systems as broad in scope – including notices, refund claim freezes, automated matching compliance programs, audits, collection actions, collection alternatives, public filings of notices of federal tax liens, and passport denials. Customer service programs

include online self-service, automated and live telephone assistance, in-person assistance as well as outreach and education initiatives, including notices. At the outset, we anticipate this analysis to be conducted on programs that operate across the entire program areas of the Service; where regional or local programs propose deviations from the broader program approach, they will be required to conduct a similar review.⁵⁸

We recommend placement of the design and oversight of the TRIS process within the Office of the Taxpayer Advocate. This arrangement would ensure the process is driven by the external, taxpayer-oriented perspective of the NTA. We envision the TRIS process working as follows:

1. When an IRS function proposes a new initiative, the IRS program owner will complete a questionnaire that assists the agency in identifying whether there is a significant likelihood the program's administrative burden will deprive the protected taxpayer segment of a fundamental taxpayer right, including undermining the public policy goal for the program.
2. The completed questionnaire will be circulated to appropriate agency personnel, including the Office of the Taxpayer Advocate and the Office of Chief Counsel, as well as operating divisions that are affected both upstream and downstream by the program proposal.
3. All comments will be addressed by the program owner, with attendant internal discussions as necessary.
4. Where the NTA determines the IRS has not addressed the concerns she or others have identified, the initiative will not go forward until these concerns are addressed. Functions will be able to appeal the NTA's determination to the Commissioner or appropriate Deputy Commissioner.⁵⁹
5. The taxpayer rights and administrative burden analysis, including the risks to fundamental taxpayer rights and discussions of mitigations, will be documented in a Taxpayer Rights Impact Statement that is posted to the agency's dedicated webpage for public viewing, similar to the public posting of Privacy Impact Assessments.⁶⁰

The framework and approach discussed above accomplishes several things. First, it requires the Service, *before programs are implemented*, to identify under-resourced populations that are affected by its actions; to articulate how the design of agency programs may undermine taxpayer protections or access to benefits, based on the specific characteristics of the taxpayer segment; and to make recommendations to mitigate those burdens. Second, it requires that the Service's assessment – the Taxpayer Rights Impact Statement and the related questionnaire – is posted on the agency's website so the public, Congress, and IRS oversight agencies can see how the

⁵⁸ In our article, we set forth a procedure for applying the framework to already programs already in existence.

⁵⁹ This approach is consistent with that enacted by Congress in I.R.C. § 7803(c)(5)(A) and (B), which provides a process for appeal to the Commissioner of any Taxpayer Advocate Directive issued by the National Taxpayer Advocate and rescinded or modified by the Deputy Commissioner. The approach is also modelled on the IRS processes for Privacy Impact Assessments, which are overseen by the Office of Privacy, Government Liaison, and Disclosure. See IRM 10.5.2.2 for the requirements for IRS Privacy and Civil Liberties Impact Assessments.

⁶⁰ The IRS's Privacy Impact Assessments are available at <https://www.irs.gov/privacy-disclosure/privacy-impact-assessments-pia>.

Service is conducting the rights-based administrative burden framework. This transparency will enable stakeholders to raise concerns where the analysis provided by the Service has fallen short, and it provides an important tool to conduct ongoing oversight of the agency. Third, and most important, it is the first step in driving a culture change in the agency, where it recognizes its dual mission as both a revenue collector and a social benefits administrator. The framework analysis will require the Service to establish different measures of program success, which in turn will require the agencies auditing its performance to shift their audit focus of these programs solely from measures of revenue collected to measures of taxpayer burden and rights impaired.

Recommendation: Amend the Internal Revenue Code to require the National Taxpayer Advocate to develop a rights-based administrative burden analysis process; require the IRS to follow that procedure with respect to the development and implementation of major initiatives; and require posting of such analysis and the accompanying Taxpayer Rights Impact Statement on a dedicated public webpage.

Additional recommendations to protect taxpayer rights in an environment of increased information reporting

In addition to the recommendations mentioned above, I recommend that Congress enact or amend the following the provisions so taxpayers can ensure the IRS administers these new technologies and sources of data appropriately, in accordance with taxpayer rights and not arbitrarily and capriciously.

1. *Clarify certain timeframes are claims processing deadlines and not jurisdictional.* The United States Tax Court has consistently held that certain statutory time periods for seeking judicial review are jurisdictional; thus, if the taxpayer misses the deadline for filing by one day, even where the lateness is due to good cause or even no fault of the taxpayer's, the Tax Court will dismiss the case for lack of jurisdiction.⁶¹ The United States Supreme Court has held, in other contexts, that jurisdictional timeframes must be explicitly described as such in the statute; otherwise the timeframes should be treated as claims processing rules, subject to equitable tolling.⁶² I recommend that Congress amend the Code to make clear that except where explicitly stated, the time periods for seeking judicial review or seeking relief from the IRS are not jurisdictional but are claims processing rules subject to equitable tolling if the taxpayer has good reason for missing the deadline. This clarification is particularly important in the context of IRC § 6213(a) (deficiency jurisdiction); IRC § 6015 (relief from joint and severability); and IRC §§ 6320 and 6330 (collection due process hearings).⁶³

⁶¹ See, e.g., *Castillo v. Commissioner*, Docket No. 18336-19L (order dated Mar. 25, 2020) (notice of determination mailed by IRS to taxpayer's last known address but never delivered by post office – case dismissed for lack of jurisdiction due to untimely petition) (appeal pending at Second Circuit, Docket No. 20-1635). The Center for Taxpayer Rights has filed an *amicus* brief in this appeal.

⁶² See *Henderson v. Shinseki*, 131 S. Ct. 1197, 1203 (2011) (indicating a preference that claim-processing rules, which require parties to take certain steps by certain times in order to promote the orderly progress of the matter, should not be treated as jurisdictional.)

⁶³ For a detailed discussion of this issue, see Bryan Camp, *New Thinking About Jurisdictional Time Periods in the Tax Code*, 77 *Tax Lawyer* 1 (2019).

2. *Extend certain timeframes by 60 days when the taxpayer is outside of the United States at the time of notice issuance.* IRC § 6212 extends the deadline for filing a petition in the Tax Court by 60 days where the taxpayer is outside of the United States. There are many other provisions providing taxpayers the right to administrative and judicial review where such an extension for international taxpayers would protect those rights, including petitions to appeal IRS denials of relief from joint and several liability under IRC § 6015(e) and petitions to appeal from IRS Collection Due Process Determinations under IRC § 6330(d)(1).
3. *Repeal the “full-pay” requirement for refund litigation in federal district courts and the U.S. Court of Federal Claims.* In *Flora v. United States*, 362 U.S. 145 (1960), the United States Supreme Court held that, with a few exceptions, taxpayers must fully pay a tax liability before filing a refund suit in a U.S. district court or the U.S. Court of Federal Claims under IRC § 7422. This rule deprives taxpayers who cannot full pay, including taxpayers who the IRS has determined to be “currently not collectible” because of economic hardship, of the opportunity to press their refund claims in court. Moreover, taxpayers who do fully pay under lengthy installment agreements will not be able to recover all their payments if they ultimately prevail in court, because under IRC § 6511(b)(2)(B), such refunds are generally limited to those payments made within two years before the date of filing the refund claim. Further some assessable penalties, which are not subject to deficiency procedures, may be so large that the prepayment requirement deprives a taxpayer of any ability to challenge the penalty in court.

In the event full repeal is not possible, I recommend Congress adopt the National Taxpayer Advocate’s recommendations to address this issue:⁶⁴

- Amend IRC § 6212 to expand the deficiency process to cover all penalties in Title 26, including the penalties located in Chapter 68, Subchapter B, and those located in Chapter 61, so that taxpayers can obtain judicial review by the Tax Court before they are assessed.
 - Clarify that a person is not required to fully pay before filing suit in a U.S. district court or the U.S. Court of Federal Claims under 28 U.S.C. § 1346(a)(1) (*i.e.*, repeal the *Flora* Court’s full payment rule).
 - Amend IRC §§ 7442 and 7422 to give the Tax Court jurisdiction to determine liabilities in refund suits to the same extent as the U.S. district courts and the U.S. Court of Federal Claims, without regard to how much of the liability has been paid.
4. *Amend IRC § 3401(p)(3) to explicitly authorize voluntary withholding agreements between independent contractors and service-recipients.* According to the IRS, the portion of the tax gap attributable to underpayment is \$50 billion.⁶⁵ The requirement that

⁶⁴ See National Taxpayer Advocate 2018 Annual Report to Congress, Legislative Recommendation: *Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, 364-386. See also, National Taxpayer Advocate 2020 Purple Book, *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, 82-84.

⁶⁵ IRS, *Tax Gap Estimates for Tax Years 2011-2013* at <https://www.irs.gov/pub/irs-pdf/p5365.pdf>

platforms must now issue a Form 1099-K where payments to a service provider is \$600 or more per year will bring surface previously unreported income. Allowing independent contractors and service providers to voluntarily agree to withholding on payments will avoid increasing the underpayment tax gap even as the underreporting tax gap is reduced.

5. *Allow certain contests of regulations outside of case specific contexts.* In other areas of law, interested parties generally have the opportunity to litigate the application of the Administrative Procedure Act (APA)⁶⁶ to rules and regulations before the agency enforces those rules against the public. The ability to generate prompt court review helps ensure that agencies comply with the APA by appropriately seeking and applying input from the public when promulgating rules that have the force and effect of law.

Tax law, however, differs from this norm. Because of the Anti-Injunction Act (AIA),⁶⁷ parties only generally have an opportunity to judicial review of IRS APA compliance during enforcement proceedings or in refund litigation. Those proceedings can arise years after the guidance is promulgated. Any challenge requires disobeying the rules or complying with the rule, paying any associated taxes and penalties, and seeking a refund.

The tax system's limited opportunity for court review means that taxpayers and third parties may not have a meaningful opportunity to challenge IRS actions. While there is litigation pending before the Supreme Court in the case of *CIC Services v Commissioner* that may create some additional pre-enforcement opportunities to challenge certain rules or regulations, Congress should provide a uniform legislative path to prompt court review. That would allow for earlier efficient resolution of possible disputes and help ensure that IRS actions are consistent with the APA before taxpayers and third parties are placed in the difficult of either 1) complying with a rule that may be in conflict with the APA or 2) failing to comply with a rule and subjecting themselves to penalties for that noncompliance.

In the last few years, academics have highlighted this problem and offered legislative solutions. For example, in the article *Restoring the Lost Anti-Injunction Act*, Professor Kristin Hickman and Gerald Kerska propose legislation that would allow an opportunity for parties or persons affected by agency rules or regulations to seek court review to ensure compliance with the APA in a defined, prompt and orderly manner. They propose a legislative amendment to the AIA that would allow judicial review of IRS rules or regulations in both the pre-enforcement and enforcement context.⁶⁸ This legislative

⁶⁶ 5 U.S.C. §§ 500 *et seq.*

⁶⁷ IRC § 7421.

⁶⁸ Kristin E. Hickman & Gerald Kerska, *Restoring the Lost Anti-Injunction Act*, 103 Va. L. Rev. 1683 (2017); Stephanie Hunter McMahon, *The Perfect Process Is the Enemy of the Good Tax: Tax's Exceptional Regulatory Process*, 35 Va. Tax Rev. 553 (2016).

The legislative amendment Hickman and Kerska propose is as follows:

Notwithstanding section 7421(a), not later than 60 days after the promulgation of a rule or regulation under authority granted by this title, any person adversely affected or aggrieved by such rule or regulation may file a petition for judicial review of such regulation with the United States Court of Appeals for the District of Columbia or for the circuit in which such person resides or has their principal place of business.

change would help ensure that the IRS acts lawfully and in a manner that appropriately seeks and reflects public input. I recommend Congress adopt the Hickman-Kerska proposal.