Advocate's "Purple Book," a compilation of 66 legislative recommendations designed to strengthen taxpayer rights and improve tax administration.

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National Taxpayer Advocate Erin M. Collins has released her 2020 Annual Report to Congress, focusing on the unprecedented challenges taxpayers faced in filing their tax returns and receiving refunds and stimulus payments during a year consumed by the COVID-19 pandemic. The report also finds that a roughly 20% inflation-adjusted reduction in the IRS's budget since fiscal year (FY) 2010 has left the agency with antiquated technology and inadequate staffing levels to meet taxpayers' needs.

As part of the report, Collins released the fourth edition of the National Taxpayer

stimulus payments, stretching its resources even further."

The 2020 filing season and Economic Impact Payments

The report says the IRS in most cases "can effectively handle whatever it can automate," and as a result, most taxpayers were well served. As of Nov. 20, 2020, the IRS had received about 169 million individual income tax returns, including about 8.4 million that were filed solely to claim stimulus payments (referred to by the IRS as "economic impact payments" or "EIPs"). About 90% of returns were e-filed and therefore were not delayed by the pandemic. Similarly, the overwhelming majority of EIPs were issued by direct deposit or automated mailings and were successfully and timely transmitted.

However, the report says millions of taxpayers experienced major problems, including the following:

- **Refund delays due to COVID-19 processing backlogs.** About 16 million individual income taxpayers filed paper tax returns. Because the IRS could not fully staff its mail facilities, some taxpayers have waited six months or longer for the IRS to process their returns. Most taxpayers receive refunds, which in recent years have averaged more than $2,500. On Dec. 31, the IRS website indicated there were still 7.1 million unprocessed individual returns and 2.3 million unprocessed business returns as of Nov. 24.
- **Refund delays due to IRS fraud detection filters.** The IRS passes all returns claiming refunds through a series of filters designed to detect fraudulent income or identity theft-based claims. These fraud detection filters in recent years have generated "false positive" rates substantially greater than 50% (meaning that most refund claims frozen by the filters are ultimately found to be legitimate). This problem was compounded in 2020 because the IRS notifies taxpayers of refund holds by written correspondence, and the IRS was delayed both in sending notices

and in processing taxpayer responses. For about 25% of the returns flagged for

automation. Still, the IRS was unable to resolve many cases in 2020, requiring eligible individuals to wait until they file their 2020 tax returns in 2021 to receive their payments.

- **Late notices.** During 2020, taxpayers were sent more than 20 million notices bearing dates that had passed and, in many cases, response or payment deadlines that also had passed. This happened because on two occasions during the year, IRS computers automatically generated notices that the IRS did not have the capacity to mail at the time. Rather than reprint the notices with new dates, the IRS decided to include "inserts" with about 1.8 million notices explaining that taxpayers would have additional time to respond. But the IRS failed to include these inserts with other notices that should have contained them and had to issue supplemental letters informing taxpayers of additional extensions. For affected taxpayers, this caused confusion and, in some cases, undue stress and concern. Among the late notices were collection notices and math error notices, where the failure to timely respond could mean loss of rights.
- **Lack of information about backlogs, notices, and other problems.** The report says the IRS should have done a better job of keeping the public informed about COVID-19-related delays by creating a regularly updated "COVID-19 Dashboard" and issuing weekly news releases to ensure the information was widely disseminated. While the IRS did post limited information on IRS.gov during the latter part of the year, it was not well-promoted and it was not regularly updated. As mentioned above, for example, the IRS website on Dec. 31 contained an update posted on Dec. 1 that stated the numbers of unprocessed individual and business returns as of Nov. 24 were 7.1 million and 2.3 million, respectively, and that some unprocessed returns dated back to April 15. The report says the public will benefit if the IRS begins to update its backlog information weekly, and the IRS and TAS consequently will receive fewer calls from taxpayers reaching out solely to obtain that information.

Inadequate funding is the source of many (not all) taxpayer problems

- Insufficient employee hiring and retention. Since FY 2010, the IRS workforce has shrunk by approximately 20%, about even with the inflation-adjusted reduction in the IRS budget. Inadequate funding combined with weaknesses in hiring and retention strategies have created an insufficient and disproportionately aging workforce, with an estimated 26% of IRS employees eligible to retire during FY 2021. The report says insufficient experienced staffing in the IRS's Human Capital Office and hiring restrictions outside its control have left the IRS ill-equipped to handle the agency's hiring needs. TAS recommends the IRS hire additional human resource specialists to meet hiring needs, restructure internal hiring processes to reduce cycle times, and renegotiate the hiring process with the National Treasury Employees Union to allow for up to 50% of all hiring announcements to be filled externally.
- Inadequate telephone and in-person taxpayer service. In FY 2020, the IRS received more than 100 million calls on its toll-free telephone lines. IRS employees answered only about 24 million. Taxpayers who got through waited an average of 18 minutes on hold. In recent years, the IRS has been serving fewer taxpayers in its Taxpayer Assistance Centers (TACs), and the COVID-19 pandemic exacerbated that trend. The number of taxpayers the IRS has served face-to-face has declined from 4.4 million five years ago in FY 2016, to 2.3 million in FY 2019, to 1.0 million in FY 2020. To improve telephone and TAC services, TAS recommends that the IRS prioritize the expansion of "customer callback" technology and give taxpayers the option of receiving face-to-face service through videoconferencing.
- Limited functionality of online taxpayer accounts. The report says online taxpayer accounts are plagued by limited functionality. For example, taxpayers generally cannot view images of past tax returns, most IRS notices, or proposed assessments; file documents; or update their addresses or the names of authorized representatives. The inability to conduct transactions online is frustrating for taxpayers who have been conducting comparable transactions with financial

institutions for more than two decades and increases the number of telephone

Other Most Serious Problems include inadequate digital communication options; limitations on the ability of some taxpayers to e-file their tax returns; challenges in the correspondence examination process; inappropriate imposition of foreign information reporting penalties; delays in the processing of amended tax returns; and refund delays attributable to refund fraud filters.

The report says a common link among these taxpayer problems is inadequate funding to allow the IRS to administer the tax system as well as it could. "The IRS is the accounts receivable department of the federal government," Collins wrote. "In FY 2020, it collected about $3.5 trillion on a budget of about $11.51 billion, producing a remarkable return on investment of more than 300:1. For this reason, it is economically irrational to underfund the IRS."

The report says the IRS needs more funding to hire enough customer service representatives to answer taxpayer telephone calls and significant additional funding to modernize its IT systems. The IRS has developed a roadmap known as the "Integrated Modernization Business Plan" that would replace legacy systems with modern technology systems and enable the agency to provide improved service to taxpayers and deliver long-term budget efficiencies. The IRS has estimated it will require between $2.3 billion and $2.7 billion in additional funding over the next six years to implement this plan. Yet in FY 2020, the Business Systems Modernization account was funded at only $180 million. The funding level has been raised to $223 million in FY 2021, but the report calls that amount "a drop in the bucket compared to the IRS's IT funding needs."

The report points out that the IRS recently developed comprehensive multi-year plans to improve taxpayer services and modernize its IT systems, as required by the Taxpayer First Act. Included in the plans are initiatives TAS has been proposing for several years, "including customer callback, robust online accounts, a focus on resolving taxpayer issues at the earliest possible time, and the use of digital tools to

Most taxpayers hire tax return preparers to complete their returns, and visits to preparers by Government Accountability Office and Treasury Inspector General for Tax Administration auditors posing as taxpayers, as well as IRS compliance studies, have found preparers make significant errors that both harm taxpayers and reduce tax compliance. Nearly ten years ago, the IRS sought to implement minimum preparer standards, including requiring otherwise non-credentialed preparers to pass a basic competency test, but a federal court concluded the IRS could not do so without statutory authorization. TAS recommends Congress provide that authorization.

- **Expand the U.S. Tax Court’s jurisdiction to hear refund cases.** Under current law, taxpayers who owe tax and wish to litigate a dispute with the IRS must go to the U.S. Tax Court, while taxpayers who have paid their tax and are seeking a refund must file suit in a U.S. district court or the U.S. Court of Federal Claims. TAS recommends that all taxpayers be given the option to litigate their tax disputes in the U.S. Tax Court.
- **Restructure the Earned Income Tax Credit (EITC) to make it simpler for taxpayers and reduce improper payments.** TAS has long advocated for dividing the EITC into two separate credits: (i) a refundable worker credit based on each individual worker’s earned income, irrespective of the presence of a qualifying child, and (ii) a refundable child credit that would reflect the costs of caring for one or more children. For wage earners, claims for the worker credit could be verified with nearly 100% accuracy by matching income information on tax returns against income information on Forms W 2, thereby reducing the improper payments rate on those claims to nearly zero. The portion of the EITC that varies based on family size would be combined with the child tax credit into a single family credit.
- **Increase the annual award cap for Low Income Taxpayer Clinics (LITCs).** When the LITC matching grant program was established as part of the IRS Restructuring and Reform Act of 1998, Internal Revenue Code (IRC) § 7526 limited annual grants

to no more than $100,000 per clinic. The cap was not indexed for inflation, and as

Appeals Officers to include personnel from Counsel and Compliance in taxpayer conferences as a matter of routine. The report says this change undermines Congress's intent to "reassure taxpayers of the independence" of Appeals. TAS recommends that Congress require Appeals to obtain advance taxpayer consent before including Counsel or Compliance personnel in any conference between Appeals and a taxpayer.

- **Clarify that taxpayers may raise innocent spouse relief as a defense in collection proceedings and bankruptcy cases.** Congress has enacted rules to relieve "innocent spouses" from joint and several liability in certain circumstances. If the IRS denies a taxpayer's request for innocent spouse relief, the taxpayer generally may seek review of the adverse determination in the Tax Court. However, the Tax Court does not have jurisdiction over collection suits arising under IRC §§ 7402 or 7403, or over bankruptcy proceedings arising under Title 11 of the U.S. Code. Courts have reached inconsistent decisions about whether taxpayers may raise innocent spouse relief as a defense in those categories of cases, undermining the innocent spouse protections and potentially resulting in differing treatment of similarly situated taxpayers. TAS recommends Congress clarify that taxpayers may raise innocent spouse claims in all such proceedings.
- **Clarify that the National Taxpayer Advocate may hire independent legal counsel.** IRC § 7803(c) requires the National Taxpayer Advocate to operate independently of the IRS in key respects. To help ensure this independence, the conference committee report accompanying the IRS Restructuring and Reform Act of 1998 stated: "The conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate." This is similar to the statutory authority Congress has granted inspectors general to ensure their independence. Until 2015, the National Taxpayer Advocate was able to hire attorneys to advise her, advocate for taxpayers, and write key sections of her two statutorily mandated reports to Congress. But the Treasury Department at that time began to enforce a

policy that requires all attorney-advisors in the Department to report to the

data, a summary of key TAS systemic advocacy accomplishments, a discussion of the ten federal tax issues most frequently litigated during the preceding year, and a description of TAS's case advocacy operations during FY 2020. It also includes a research study that finds the IRS Collection function can and should implement an algorithm to identify taxpayers at high risk of economic hardship and spare them from entering into installment agreements they cannot afford.

Visit https://www.taxpayeradvocate.irs.gov/AnnualReport2020 for more information.

Technology