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Problems with Agency

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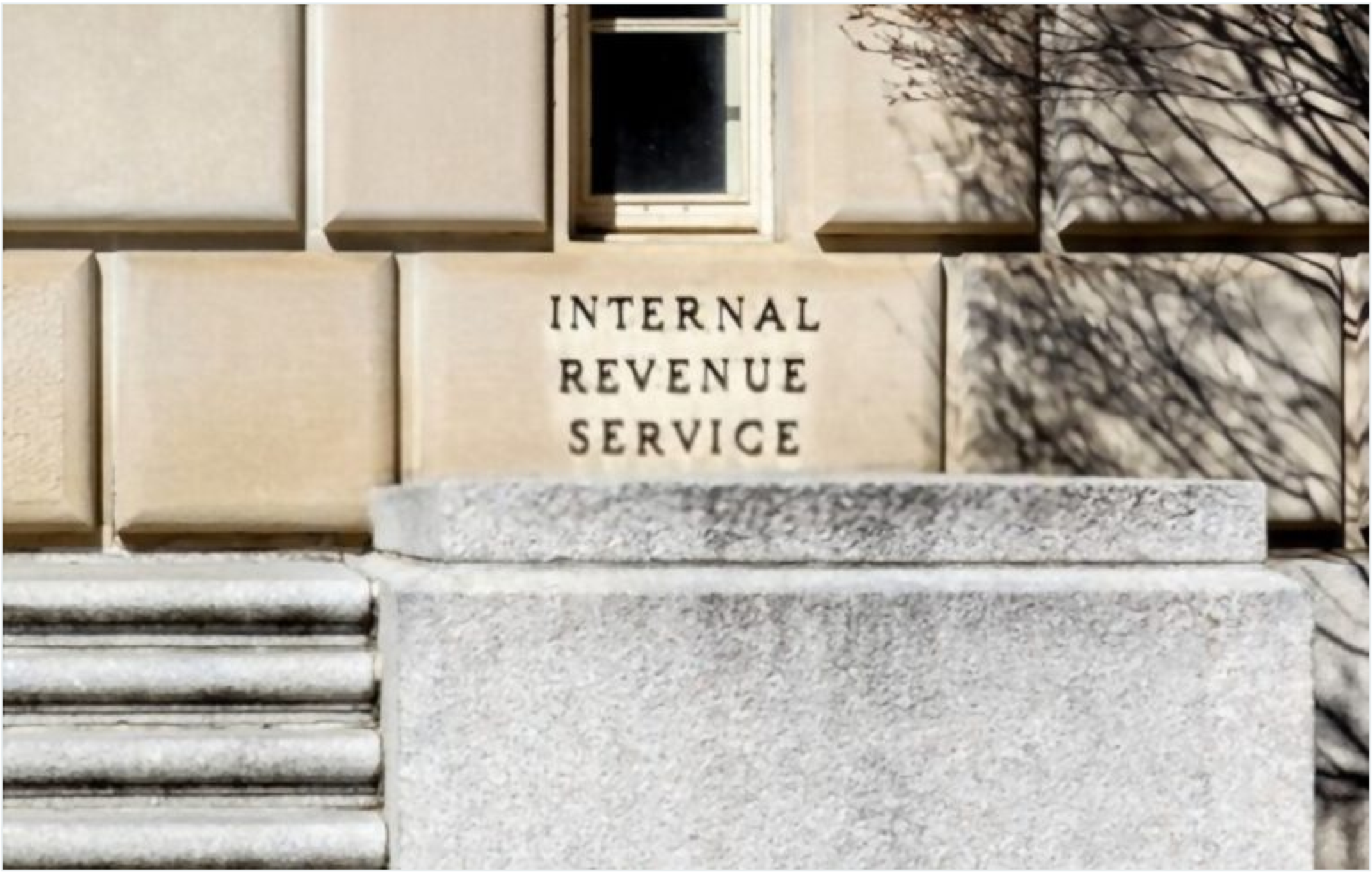
Isaac M. O'Bannon • Jan. 10, 2024



National Taxpayer Advocate Erin M. Collins released her 2023 Annual Report to Congress on January 10, describing 2023 as a year of "extraordinary transition for the IRS and therefore for taxpayers."

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pandemic," Collins wrote in the report's preface. The report says the IRS virtually eliminated its backlog of unprocessed original individual income tax returns (Forms 1040) and substantially improved telephone service.

Taxpayer service challenges

"When I released the National Taxpayer Advocate's 2020 report, I wrote that the IRS in most cases 'can effectively handle whatever it can automate,' and when I released our 2021 report, I wrote that 'paper is the IRS's kryptonite,'" Collins said in releasing the new report. "Those observations continued to hold true in 2023. The areas in which taxpayers continued to experience delays were primarily those that required employees to process tax returns and taxpayer correspondence."

Extraordinary delays in assisting victims of identity theft. At the end of fiscal year (FY) 2023, nearly half a million taxpayers with cases pending in the IRS's Identity Theft Victims Assistance (IDTVA) unit were waiting an average of almost 19 months for the agency to resolve their identity theft problems. "If it weren't for the significant number of challenges affecting larger groups of taxpayers, this would be headline news, and it should be," Collins wrote. "Many taxpayers depend on their tax refunds to meet their living expenses, particularly low-income taxpayers who receive Earned Income Tax Credit (EITC) benefits that [approached] $7,000 for tax year 2022." Noting that 69% of taxpayers whose identity theft cases the IDTVA unit

returns stood at 0.5 million. By comparison, the backlog as of late October 2023 was 1.9 million – nearly four times as much. Taxpayer correspondence and related cases more than doubled over the same period, from 1.9 million to 4.3 million. In addition, the percentage of correspondence cases classified as "overage" in 2023 reached its highest level in recent years, with nearly 70% of pending cases exceeding normal processing times as of late October. Delays in processing amended returns and correspondence harm taxpayers because processing delays cause delays in issuing refunds.

The report attributes much of the paper inventory backlog to the Treasury Department's decision to prioritize answering telephone calls over processing amended returns and correspondence. Both tasks are performed by IRS customer service representatives (CSRs) in the agency's Accounts Management (AM) function. For the 2023 filing season, Treasury set a goal of achieving an 85% "Level of Service" (LOS) on the IRS's toll-free telephone lines, and that required staffing the telephone lines at levels capable of handling most calls during peak periods. However, the report says that meant CSRs often were "simply sitting around waiting for the phone to ring." During the 2023 filing season alone, CSRs spent 1.27 million hours (34% of their time) waiting to receive calls. That translates to more than 650 unproductive staff years in which these employees could have been processing paper and reducing response times for amended returns and correspondence.

"The IRS cannot easily shuffle employees back and forth between answering phones and processing correspondence, so unproductive employee time was the price it had to pay to improve telephone service levels," Collins wrote. "Going forward, the IRS needs to find a way to move employees between those two functions more nimbly. For present purposes, however, we need to keep in mind that backlogs in processing tax returns and taxpayer correspondence drive much of the phone volume. I encourage the IRS to put more emphasis on reducing its paper processing backlog in

The IRS maintains dozens of distinct telephone lines, and averages can mask significant variations among key lines. The report says service for tax professionals was below average, with a reported LOS of 34% in FY 2023 and an average wait time of 16 minutes before reaching a CSR. "Roughly 500,000 tax professionals prepare tax returns for more than 85 million taxpayers, so the IRS derives considerable benefit from working collaboratively with the pool of tax professionals," the report says. "Requiring tax professionals to call back repeatedly and wait on hold not only inconveniences them but often results in additional costs to taxpayers for the time their tax professionals bill for waiting on hold." The report recommends the IRS prioritize improving service on the practitioner telephone line. It also recommends the IRS develop better performance measures so it not only measures access to a CSR but also measures call quality (*e.g.*, the percentage of taxpayer issues resolved with a single telephone call).

Employee Retention Credit (ERC) processing. Employers who file eligible ERC claims are often waiting six months or longer to receive their credits or refunds. TAS has received several thousand ERC cases, and some have involved non-profit organizations that provide medical or other critical services and are depending on ERC refunds to stay afloat. As of early December, the IRS had a backlog of approximately one million ERC claims. The IRS has said many of the submitted claims are fraudulent or otherwise non-qualifying.

The report acknowledges the IRS is between a rock and a hard place in handling ERC claims. "If it pays claims quickly without adequate review, it could pay billions of dollars to nonqualifying persons. If it takes the time to review claims carefully, eligible employers will experience significant delays in receiving the credit, and in extreme cases, employers who need the funds immediately could go out of business," the report says.

Administrative recommendations

potential to be the most transformative and should receive the highest priority. However, the report says, online accounts must be significantly improved so more taxpayers will see the benefits of using them, and the IRS must do a much better job of promoting them. During 2023, individual taxpayers filed more than 160 million income tax returns, yet only 16.8 million users accessed individual online accounts. That's just over 10%.

"To better serve these taxpayers and persuade the other 90% of taxpayers to consider creating and using online accounts, the IRS should aim to provide online accounts through which taxpayers and tax professionals, among other things, can see full information about their accounts, receive and respond to IRS notices, and elect to receive payment reminders," the report says. "That will enable taxpayers and tax professionals to keep fully informed about federal tax matters and to interact more smoothly with the agency, and it will substantially reduce the volume of telephone calls and mail the IRS receives."

2. Improve the IRS's ability to attract, hire and retain qualified employees. The report says the IRS continues to struggle to hire qualified candidates in many key areas. It says three of the main reasons are failure to advertise positions to the optimal target audience by job series, the slow pace of the hiring process and non-competitive pay. The report recommends the IRS devote more effort to identifying and conducting outreach to target audiences by job series, work to continue to shorten the clearance and onboarding process for selected applicants, and work with the Office of Personnel Management and Congress to obtain more pay flexibility for hard-to-fill positions.

3. Ensure all IRS employees – particularly customer-facing employees – are well-trained. The report says the IRS has historically faced challenges providing adequate training to customer-facing employees, partly due to the complexity of the tax system and lack of funding. However, those challenges are greater when the agency is staffing up, as it is currently doing. Results from the recently concluded 2023 Federal

notice, letter, telephone conversation or visit. The report says that is "great news" for taxpayers. Once the documents reach the IRS, however, they are still processed as if they came in on paper. All documents go to a central location and then must be parceled out to the appropriate function for processing and response. As part of its Paperless Processing Initiative, the IRS said that "[h]alf of paper-submitted correspondence, non-tax forms, and notice responses will be processed digitally" by the 2025 filing season. Digital processing will shorten response times and enable the IRS to reassign employees to other high priority areas. The report recommends the IRS continue its efforts to digitize the processing of more taxpayer submissions and create back-end processes for DUT submissions.

5. Enable all taxpayers to e-file their federal tax returns. While the significant majority of taxpayers e-file their tax returns, the IRS still received more than 11 million individual returns and 15 million business returns on paper last year. The processing of paper returns causes delays in delivering refunds and increases administrative costs for the IRS. Some taxpayers may prefer to file on paper, and the report says the IRS should continue to improve the filing experience for paper filers. But many taxpayers who would prefer to e-file their returns cannot do so for a variety of reasons. For example, about 150 to 200 IRS forms still are not eligible for e-filing. The report describes the main barriers to e-filing and recommends steps the IRS can take to remove them.

6. Extend eligibility for first-time penalty abatement to all international information return penalties. U.S. persons who receive gifts or inheritances from foreign persons or who own interests in certain foreign partnerships and corporations and engage in cross-border business activities are potentially subject to a wide range of U.S. reporting requirements. The report says many of these reporting requirements are obscure and complex, and they sometimes apply to lower-income taxpayers and immigrants who may not be aware of them. Yet taxpayers who do not comply with applicable reporting requirements are subject to penalties that "are

Legislative recommendations: The "Purple Book"

The National Taxpayer Advocate's 2024 Purple Book proposes 66 legislative recommendations intended to strengthen taxpayer rights and improve tax administration. Among the recommendations:

1. Require the IRS to timely process claims for credit or refund. Millions of taxpayers file claims for credit or refund with the IRS each year, yet under current law, there is no requirement that the IRS pay or deny them. It may simply ignore them. The taxpayers' remedy is to file a refund suit in a U.S. district court or the U.S. Court of Federal Claims. For many taxpayers, that is not a realistic or affordable option, as full payment of the disputed amount is generally required, and there can be sizeable litigation fees. "The absence of a processing requirement is a poster child for non-responsive government," the report says. While the IRS generally does process claims for credit or refund, the claims can, and sometimes do, spend months and even years in administrative limbo within the IRS. TAS recommends Congress require the IRS to act on claims for credit or refund in a timely manner and impose certain consequences for failing to do so.

2. Authorize the IRS to establish minimum standards for paid tax return preparers and revoke the identification numbers of sanctioned preparers. The IRS receives over 160 million individual income tax returns each year, and most are prepared by paid tax return preparers. While some tax return preparers must meet licensing requirements (*e.g.*, certified public accountants, attorneys and enrolled agents), most preparers are not credentialed. Numerous studies have found that non-credentialed preparers disproportionately prepare inaccurate returns, causing some taxpayers to overpay their taxes and others to underpay, which may lead to penalties and interest charges. In FY 2022, the IRS estimated the improper payments rate attributable to improper EITC claims was 32%, amounting to $18.2 billion. Among tax returns claiming the EITC prepared by paid tax return preparers, 94% of the total dollar amount of EITC audit adjustments was attributable to returns prepared by

3. Expand the U.S. Tax Court’s jurisdiction to adjudicate refund cases. Under current law, taxpayers who owe tax and wish to litigate a dispute with the IRS without paying the tax first can go to the U.S. Tax Court, while taxpayers who have paid their tax liability and are seeking a refund must sue in a U.S. district court or the U.S. Court of Federal Claims. Although this dichotomy between deficiency cases and refund cases has existed for decades, TAS recommends Congress give taxpayers the option to litigate both deficiency and refund disputes in the U.S. Tax Court. Due to the tax expertise of its judges, the Tax Court is often better equipped to consider tax controversies than other courts. It is also more accessible than other courts to unsophisticated and unrepresented taxpayers because it uses informal procedures, particularly in disputes that do not exceed $50,000 per tax year or period.

4. Extend the “reasonable cause” defense for the failure-to-file penalty to taxpayers who rely on return preparers to e-file their returns.A taxpayer who files a tax return after the filing deadline is subject to a penalty of up to 25% of the tax due unless the taxpayer can show the failure was due to “reasonable cause.” Most taxpayers hire tax professionals to prepare their returns, and tax professionals sometimes fail to meet filing deadlines without notifying the taxpayer. In 1985, when all returns were filed on paper, the Supreme Court held that a taxpayer’s reliance on a preparer to file a tax return did not constitute “reasonable cause” to excuse the failure-to-file penalty. In 2023, a U.S. Court of Appeals extended that holding to e-filed returns.

For several reasons, it is often much more difficult for taxpayers to verify that a return preparer has e-filed a return than to verify that a return has been paper-filed. “Penalizing taxpayers who engage preparers and do their best to comply with their tax obligations is grossly unfair and undermines the congressional policy that the IRS encourage e-filing,” the report says. “Under the recent Court of Appeals’ ruling, astute taxpayers would be well advised to ask their preparers to give them paper

income taxpayers and taxpayers who speak English as a second language. When the LITC grant program was established in 1998, the law limited annual grants to a maximum of $100,000 per clinic. The law also imposed a 100% "match" requirement (meaning a clinic cannot receive more in LITC grant funds than it is able to obtain from other sources). The nature and scope of the LITC program has evolved considerably since 1998, and those requirements are limiting the number of taxpayers the program is able to assist. While the Consolidated Appropriations Act, 2023, raised the per-clinic cap to $200,000 for one year and that provision may be carried forward into 2024, TAS recommends that Congress remove or substantially increase the per-clinic cap permanently and allow the IRS to reduce the match requirement to 25% where doing so would expand coverage to additional taxpayers.

Research studies

On or about January 31, TAS will publish two research studies and detail the design of a third study on the Taxpayer Advocate Service page.

Two-year bans on eligibility for refundable tax credits are often imposed without following required procedures. The tax code authorizes the IRS to ban a taxpayer from claiming the EITC, the Child Tax Credit, and the American Opportunity Tax Credit for two years if it determines the taxpayer claimed the credit recklessly or with intentional disregard of rules and regulations. It is a harsh sanction because it means a taxpayer cannot receive credits in the two years after an improper claim even if the taxpayer otherwise qualifies for the credits in those years. TAS found that the IRS often did not follow its own procedures in imposing the ban. Employees failed to secure managerial approval in 76% of cases where managerial approval was required, and it failed to provide an adequate explanation to the taxpayer regarding why the ban was imposed 81% of the time.

A review of online accounts offered by state and foreign tax agencies can help the

burden.

IRS procedures for withholding tax refunds in suspected identity theft cases may be harming legitimate taxpayers. Each year, the IRS freezes several million refunds claimed on tax returns flagged by IRS filters for possible identity theft. However, the filters have false positive rates that generally exceed 50% overall. When the IRS flags a return, it sends a single letter to the taxpayer explaining why it has stopped the refund and informing the taxpayer that he or she must authenticate their identity before the IRS will release the refund. In most years, more than half of the taxpayers receiving this letter do authenticate their identities and receive their refunds, but if no response is received from a taxpayer, the IRS takes no further action. Given the risk of undelivered mail and the relatively low rate of response to IRS letters, TAS is concerned that some taxpayers are not receiving refunds for which they are eligible. TAS has mailed outreach letters to a significant number of taxpayers who did not receive a tax year 2020 refund because they did not respond to an IRS letter. TAS is offering to help these taxpayers complete the identity verification process. TAS plans to report on the results of this study later in 2024.

Other report highlights

The report contains a taxpayer rights and service assessment that presents performance measures and other relevant data, a description of TAS's case advocacy and systemic advocacy operations, a summary of key TAS advocacy accomplishments and a discussion of the 10 federal tax issues most frequently litigated in court last year. The report also includes a section titled "At a Glance," which provides concise summaries of the 10 "most serious problems." It is intended to give readers a quick overview of each issue so they can decide which ones they want to read about in depth. Visit Taxpayer Advocate annual report 2023 for more information.

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