

Volume 2

TAS RESEARCH AND RELATED STUDIES

**IRS Should Use Its Internal Data to
Determine If Taxpayers Can Afford to
Pay Their Tax Delinquencies**

IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies¹

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INTRODUCTION

The IRS collection division is charged with collecting taxes from taxpayers with balances due from various tax obligations. In general, taxpayers are required to pay the delinquency in full, if the taxpayer has the means to do so. While the IRS seeks an immediate complete satisfaction of an outstanding liability, some taxpayers are not able to immediately pay their tax debts. In such cases, the IRS offers payment arrangements for taxpayers to satisfy their debts through an installment agreement (IA).² In recent years, the IRS has expanded the time period for IAs so that a taxpayer may pay liabilities up to \$50,000 on a monthly basis over six years.³ Nevertheless, some taxpayers cannot afford to either fully satisfy or make payments on their liability. To validate these claims the IRS has developed Allowable Living Expense (ALE) standards to determine whether a taxpayer does have the ability to make payments on their tax liabilities.⁴

The ALE standards determine how much money taxpayers need for basic living expenses based on family size and where they live. When compared with taxpayer income, the ALE standards determine the taxpayer's ability to pay his or her tax debt and at what level. The ALE analysis will, however, show that some taxpayers do not currently have the ability to make payments on their outstanding liability, and meet their basic living expenses. In these instances, the IRS will report any outstanding liabilities as currently not collectible CNC-Hardship.

As it stands now, the IRS generally assigns all delinquencies⁵ remaining unsatisfied to Taxpayer Delinquent Accounts (TDA) status, after it sends the taxpayers a series of three to four notices requesting that the liability be paid either immediately or through monthly installments. The National Taxpayer Advocate would like to determine if the IRS could use internally available information on the taxpayer's financial status to decide if it should code the liability CNC-Hardship prior to its continuation as a TDA. The IRS would save significant resources by not continuing to attempt collections on these cases. The discontinuation of IRS collection actions would also not further burden the taxpayer.

The ALE Standards, also known as Collection Financial Standards, provide for a taxpayer's and his or her family's health and welfare and/or production of income. These expenses must be reasonable in amount for the size of the family and the geographic location, as well as any unique individual circumstances. The total necessary expenses establish the minimum a taxpayer and family needs to live.⁶ However, if a taxpayer qualifies for an IA, which does not require financial analysis, the taxpayer may voluntarily enter into an IA even if a comparison of the taxpayer's income and their ALE show the taxpayer is unable to meet the terms of the IA. In this situation, the taxpayer may fail to make the necessary payments and

2 In 1998, Congress generally required the IRS to enter into so-called "guaranteed" IAs if the taxpayer owed \$10,000 or less, had a clean compliance history, was financially unable to pay the liability timely, and would repay the liability within three years under the agreement. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3467, 112 Stat. 685 (1998) (codified at IRC § 6159(c)). This legislation codified the IRS's standard practice. Conf. Rep. No. 105-599, at 292-93 (1998).

3 Per Internal Revenue Manual (IRM) 5.14.1.4.1, *Six-Year Rule and One-Year Rule* (1/1/16), <http://irm.web.irs.gov/Part5/Chapter14/Section1/IRM5.14.1.asp#5.14.1.4.1> (accessed 12/19/16).

4 For more information, see the 2016 Most Serious Problem: *The IRS Is Failing to Properly Evaluate Taxpayers' Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford*.

5 Some small liabilities may be shelved because the IRS determines that further resources should not be expended on the liabilities. Additionally, the IRS will prioritize the liabilities, and assign some low priority cases to the collection queue until resources are available for assignment to collection personnel.

6 IRM 5.15.1.7, *Allowable Expense Overview*, <http://irm.web.irs.gov/Part5/Chapter15/Section1/IRM5.15.1.asp#5.15.1.7> (accessed 6/2/16).

thereby default the IA or the taxpayer may continue with the IA, but be unable to meet what the IRS has determined are basic living expenses.

BACKGROUND

The IRS sends a series of notices to taxpayers with new unpaid tax liabilities requesting either immediate payment or resolution of the liability through an online payment arrangement or by contacting IRS personnel. Online payment agreements must satisfy the liability within 72 months, and require the taxpayer to provide no financial information. If a taxpayer contacts the IRS regarding the delinquency, the taxpayer may also enter into a “streamlined” payment arrangement, which requires no financial information. If the taxpayer is unable to meet the terms for IAs not requiring financial information, the taxpayer may still enter into an IA if a comparison of the taxpayer’s income and the ALE substantiate the payment amount. In some cases, the comparison of a taxpayer’s income to ALE shows that the taxpayer has no ability to pay. In these instances, the IRS places the unpaid liability in CNC-Hardship status. While in this status, active collection will not resume until the IRS detects an increase in income indicating that the taxpayer could make payments after considering the ALE. However, the IRS will offset any future refunds due the taxpayer until the delinquent liability is satisfied.

The IRS assigns most taxpayers with unpaid delinquencies after the notice stream to its Automated Collection System (ACS). The ACS is a computerized inventory system and telephone call center that maintains balance-due accounts and return delinquency investigations.⁷ Customer Service Representatives (referred to as “Collection Representatives”)⁸ work ACS cases and primarily respond to phone calls from taxpayers who call in response to IRS enforcement actions (*e.g.*, levies or liens) or additional collection notices. Alternatively, the IRS generally assigns cases to Collection Field function (CFF) when the taxpayer has accrued significant liabilities, or when the ACS is unable to resolve the case. Upon assignment to the CFF, a revenue officer (RO) will actively work the case, attempting to contact the taxpayer and collect the information necessary to determine how to resolve the delinquency. The IRS may also assign cases to the collection queue to await assignment to a revenue officer in accordance with the priority the IRS assigns to the case and when CFF inventory levels permit the assignment of a new case.

When financial analysis is required, the IRS utilizes its ALE standards. In 1995, using the Bureau of Labor Statistics’ Consumer Expenditure Survey data, Collection developed national standards for apparel and services, food, housekeeping supplies, personal care products and services, and miscellaneous expenses. The IRS designed the ALE to help ensure that the IRS afforded taxpayers the opportunity to meet basic living expenses and to ensure that the IRS applied consistent financial analysis to all taxpayers, regardless of location and collection jurisdiction. We provide a detailed explanation of ALE in the Methodology section of this report. We also discuss our concerns with the current ALE standards in the Most Serious Problem: ALE Standards in Volume I of this Annual Report to Congress.

7 IRM 5.19.5.2.1, *ACS Security* <http://serp.enterprise.irs.gov/databases/irm.dr/current/5.dr/5.19.dr/5.19.5.dr/5.19.5.2.htm>, (accessed 6/2/16).

8 IRM 21.1.1.6, *Customer Service Representative (CSR) Duties* (10/1/16).

METHODOLOGY

We examined TDAs closed in calendar year (CY) 2014. Taxpayers may have full paid the account, or have entered into an IA. Otherwise, the IRS has reported the account as CNC-Hardship.⁹ Full pay accounts may have occurred because of taxpayer payments, refund offsets or the abatement of the liability. We describe specific details about how we identified each type of TDA closure below.

Determining Closures in 2014

Full Pay

TAS Research used the Accounts Receivable Dollar Inventory (ARDI) database on the Compliance Data Warehouse (CDW) to select modules reaching full pay status during 2014.¹⁰ We matched these cases back to the ARDI file to determine which modules were a TDA by only selecting those assigned to ACS or Cff.¹¹

Installment Agreements

TAS Research used the ARDI database to select modules with an unresolved record type, but with the IA collection status code input during 2014.¹² We matched these cases to the ARDI file to determine which ones the IRS had assigned to ACS or Cff.

CNC-Hardship

TAS Research used ARDI on CDW to select unresolved modules reported as uncollectible due to hardship during 2014.¹³ We matched these cases to the ARDI file to determine which ones the IRS had assigned to ACS or Cff.

We then matched these cases to the Individual Return Transaction File (IRTF) Form to obtain their Total Positive Income (TPI)¹⁴ and the number of exemptions, state, ZIP code and age for tax year 2014. The ZIPCODE table was used to identify the counties from the ZIP code data.

Allowable Living Expense (ALE) Data

The ALE data is published every year by Small Business/Self Employed Finance, Research and Strategy (SB/SE FR&S). TAS Research calculated the ALE amounts for each of the TDA taxpayers with a TDA closure in 2014 as a Full Pay, IA or CNC-Hardship. The following data describes the computation of each of the ALE standards.

9 We did not examine other possible dispositions of TDAs including a pending offer in compromise or suspension of collection action due to an insolvency proceeding.

10 The ARDI denotes full paid cases with a record type (Rectype1) equal to 'R'.

11 TDAs in ACS have a Master File collection status code of 22, while TDAs in Cff have a Master File collection status code of 26.

12 Installment Agreements have a Master File collection status code of 60.

13 The IRS places a TC 530 closing code 24 to closing code 32 on TDAs, which are reported CNC because of financial hardship.

14 TPI is calculated by summing the positive values from the following income fields from a taxpayer's tax year 2014 individual tax return: wages; interest; dividends; distribution from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero.

Health

The 2014 ALE for the health care standard is as follows:

FIGURE 4.1, Health Care Standard¹⁵

| Age Category | Expense per person per month |
|--------------|------------------------------|
| Under 65 | \$60 |
| 65 and Older | \$144 |

TAS Research used the date of birth from the IRTF to calculate the age for the primary and secondary taxpayers. If either the primary and/or secondary taxpayer is 65 or older, then their expense is \$144. For all other members of their household (exemptions), their expense is \$60.

General

The 2014 ALE for the general (national) standard is as follows:

FIGURE 4.2, General (National) Standard¹⁶

| Exemptions | Total |
|----------------|-----------|
| One | \$583 |
| Two | \$1,092 |
| Three | \$1,249 |
| Four | \$1,482 |
| More than four | add \$298 |

Research used the number of exemptions to calculate the general (national) standard. This amount is allowed for food and other necessary incidentals.

Housing

A sample of the 2014 ALE for housing is included below.

¹⁵ Allowable Living Expenses Project, SB/SE FR&S, August 2014.

¹⁶ *Id.*

FIGURE 4.3, Housing Standard (Sample)¹⁷

| State Initials | County | Family Size | | | | |
|-------------------|-----------------------------------|-------------|---------|---------|---------|---------|
| | | 1 | 2 | 3 | 4 | 5 |
| AK | Aleutians East Borough | \$1,146 | \$1,346 | \$1,418 | \$1,581 | \$1,607 |
| AK | Aleutians West Census Area | \$1,852 | \$2,175 | \$2,292 | \$2,556 | \$2,597 |
| AK | Anchorage Municipality | \$1,904 | \$2,237 | \$2,357 | \$2,628 | \$2,670 |
| AK | Bethel Census Area | \$1,386 | \$1,628 | \$1,715 | \$1,912 | \$1,943 |
| AK | Bristol Bay Borough | \$1,714 | \$2,013 | \$2,121 | \$2,365 | \$2,403 |
| AK | Denali Borough | \$1,399 | \$1,643 | \$1,731 | \$1,930 | \$1,961 |
| AK | Dillingham Census Area | \$1,577 | \$1,852 | \$1,952 | \$2,176 | \$2,212 |
| AK | Fairbanks North Star Borough | \$1,798 | \$2,112 | \$2,225 | \$2,481 | \$2,521 |
| AK | Haines Borough | \$1,443 | \$1,695 | \$1,786 | \$1,991 | \$2,024 |
| AK | Hoonah-Angoon Census Area | \$1,396 | \$1,640 | \$1,728 | \$1,927 | \$1,958 |
| AK | Juneau City and Borough | \$2,034 | \$2,389 | \$2,517 | \$2,806 | \$2,852 |
| AK | Kenai Peninsula Borough | \$1,430 | \$1,680 | \$1,770 | \$1,974 | \$2,005 |
| AK | Ketchikan Gateway Borough | \$1,731 | \$2,033 | \$2,142 | \$2,388 | \$2,427 |
| AK | Kodiak Island Borough | \$1,942 | \$2,280 | \$2,403 | \$2,679 | \$2,723 |
| AK | Lake and Peninsula Borough | \$1,697 | \$1,993 | \$2,100 | \$2,342 | \$2,379 |
| AK | Matanuska-Susitna Borough | \$1,625 | \$1,908 | \$2,011 | \$2,242 | \$2,278 |
| AK | Nome Census Area | \$1,277 | \$1,499 | \$1,580 | \$1,762 | \$1,790 |
| AK | North Slope Borough | \$1,248 | \$1,465 | \$1,544 | \$1,722 | \$1,749 |
| AK | Northwest Arctic Borough | \$1,323 | \$1,554 | \$1,637 | \$1,825 | \$1,855 |
| AK | Petersburg Census Area | \$1,464 | \$1,720 | \$1,812 | \$2,020 | \$2,053 |
| AK | Prince of Wales-Hyder Census Area | \$1,288 | \$1,513 | \$1,594 | \$1,777 | \$1,806 |
| AK | Sitka City and Borough | \$1,795 | \$2,108 | \$2,221 | \$2,476 | \$2,516 |
| AK | Skagway Municipality | \$2,160 | \$2,537 | \$2,673 | \$2,980 | \$3,029 |
| AK | Southeast Fairbanks Census Area | \$1,394 | \$1,637 | \$1,725 | \$1,923 | \$1,954 |
| AK | Valdez-Cordova Census Area | \$1,622 | \$1,906 | \$2,008 | \$2,239 | \$2,275 |
| AK | Wade Hampton Census Area | \$818 | \$960 | \$1,012 | \$1,128 | \$1,147 |
| AK | Wrangell City and Borough | \$1,464 | \$1,720 | \$1,812 | \$2,020 | \$2,053 |
| AK | Yakutat City and Borough | \$1,250 | \$1,468 | \$1,547 | \$1,725 | \$1,753 |
| AK | Yukon-Koyukuk Census Area | \$1,175 | \$1,380 | \$1,454 | \$1,621 | \$1,647 |

The housing allowance provides for a monthly rental or mortgage payment, utilities, and other expenses associated with maintaining a home. TAS Research used the county data, obtained from the ZIPCODE file and the number of exemptions to determine the amount of ALE for each taxpayer.

Transportation

The 2014 ALE for transportation has two parts. First, the ownership costs are as follows:

¹⁷ Allowable Living Expenses Project, SB/SE FR&S, August 2014.

FIGURE 4.4, Ownership Costs for Transportation Standard¹⁸

| Number of Cars | Ownership Costs |
|----------------|-----------------|
| One Car | \$517 |
| Two Cars | \$1,034 |

To decide number of cars, TAS Research determined if the taxpayer entity included both a primary and a secondary filer.¹⁹ When there was no secondary filer, then the entity was allowed \$517. If there was a secondary filer present, the entity was allowed \$1,034.

In addition to ownership costs, the transportation standard also includes operating costs. These are based on Metropolitan Statistical Area (MSA).²⁰

FIGURE 4.5, Operating Costs for Transportation Standard²¹

| Operating Costs | One Car | Two Cars |
|----------------------|---------|----------|
| Northeast Region | \$278 | \$556 |
| Boston | \$277 | \$554 |
| New York | \$342 | \$684 |
| Philadelphia | \$299 | \$598 |
| Midwest Region | \$212 | \$424 |
| Chicago | \$262 | \$524 |
| Cleveland | \$226 | \$452 |
| Detroit | \$295 | \$590 |
| Minneapolis-St. Paul | \$217 | \$434 |
| South Region | \$244 | \$488 |
| Atlanta | \$256 | \$512 |
| Baltimore | \$250 | \$500 |
| Dallas-Ft. Worth | \$277 | \$554 |
| Houston | \$312 | \$624 |
| Miami | \$346 | \$692 |
| Washington, D.C. | \$277 | \$554 |
| West Region | \$236 | \$472 |
| Los Angeles | \$295 | \$590 |
| Phoenix | \$291 | \$582 |
| San Diego | \$301 | \$602 |
| San Francisco | \$306 | \$612 |
| Seattle | \$192 | \$384 |

18 Allowable Living Expenses Project, SB/SE FR&S, August 2014.

19 Since there was no available data to determine the number of cars that the taxpayers had, TAS Research used the CDW Form 1040 database to determine the number of primary and secondary taxpayers. If there was only a primary taxpayer then the household was allotted the expenses for one car, if there was a primary and secondary taxpayer, the household was allotted the expenses for two cars.

20 The counties that make up each MSA can be found at <https://www.irs.gov/businesses/small-businesses-self-employed/local-standards-transportation> (accessed 6/2/16).

21 Allowable Living Expenses Project, SB/SE FR&S, August 2014.

TAS Research used the county data from the ZIPCODE table on CDW to determine the ownership costs and the corresponding operating costs for each taxpayer entity.

Total ALE

To determine the total ALE amount for each taxpayer, TAS Research added up the four standards (Health, general (national), housing, and transportation) and then multiplied them by twelve to get their annual ALE amount. We then compared this amount to the taxpayer's total positive income to determine if the disposition of the TDA was consistent with a comparison of the taxpayer's ALE and their TPI. We also compared multiples of the poverty level to TPI to determine if some multiple of a poverty level could be used as a proxy for when a taxpayer was unable to resolve their TDA through full payment or an IA. We used the 2014 poverty guidelines from the Health and Human Services website to determine whether they were a simpler determination of collectibility.²²

In some instances, taxpayers had multiple TDAs, which were satisfied differently. For example, a taxpayer may have satisfied one TDA, but the IRS classified any remaining TDAs as CNC-Hardship. If the IRS classified at least one TDA as CNC-Hardship, we considered that taxpayer a CNC taxpayer. If the IRS did not report a TDA as CNC-Hardship and the taxpayer entered into an IA to satisfy the outstanding TDAs, we considered the TDA resolution as an IA. We considered taxpayers who full paid all TDAs resolved in 2014 as full pay taxpayers.

LIMITATIONS, DATA ISSUES, AND RESOLUTIONS

Total Positive Income (TPI) was used to represent a taxpayer's total income. TPI does not consider actual losses; however, we chose this amount as a conservative estimate of taxpayer's income. There were also a number of taxpayers whose TDAs were closed in 2014 as a Full Pay, IA or CNC (hardship) but did not file a return for TY 2014. For the taxpayers that did not file a return in TY 2014, we used the Form W-2 and Form 1099 income information, when available. In other cases where TPI was present for TY 2014 but the Form 1099 income was actually higher, we used the Form 1099 income in place of TPI.²³

For the taxpayers that did not have any exemptions or did not have a state present for TY 2014, TAS Research used the lowest amount for each standard, as follows:

FIGURE 4.6, Minimum ALE Standards for Non-Filers²⁴

| Standard | Minimum |
|----------------|---------|
| Health | \$60 |
| Housing | \$720 |
| General | \$583 |
| Transportation | \$192 |

22 <https://aspe.hhs.gov/2014-poverty-guidelines>, accessed 7/11/16.

23 We used the Information Returns Master File documents for Form W-2: *Wage and Tax Statement*; Form 1099-INT: *Interest Income*; 1099-DIV: *Dividends and Distribution*; 1099-MISC: *Miscellaneous Income*; 1099-R: *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*; 1099-SSA: *Social Security and Equivalent Railroad Benefits*.

24 Allowable Living Expenses Project, SB/SE FR&S, August 2014.

There were also a number of taxpayers who filed but did not have ZIP code information available. Therefore it was not possible to get the county for the Housing standard. For these cases, the taxpayer received the minimum ALE amount for the state. Finally, to determine a taxpayer's relationship to the poverty level, the taxpayers that did not have an exemption were considered to have a household size of one.

FINDINGS

TAS Research identified 3,442,645 taxpayers with full pay, IA, or CNC-Hardship TDA closures in CY 2014. We classified these taxpayers by the type of their TDA closure as indicated in the methodology section. The following figure shows the breakout of the taxpayers:

FIGURE 4.7, Counts of Full Pay, IA, and CNC-Hardship Taxpayers

| | |
|----------|-----------|
| Full Pay | 2,149,748 |
| IA | 1,127,658 |
| CNC | 165,239 |

We performed our analysis of the TDAs at the taxpayer level as indicated. However, as previously mentioned, some taxpayers had modules resolved through more than one method as indicated in the following figure:

FIGURE 4.8, Modules Identified by Full Pay, Installment Agreement and CNC-Hardship

| | |
|--|-----------|
| Full Pay Only | 3,008,417 |
| IA Only | 1,931,378 |
| CNC-Hardship Only | 422,615 |
| Full Pay and IA | 148,138 |
| Full Pay and CNC-Hardship | 21,393 |
| IA and CNC-Hardship | 16,901 |
| Full Pay, Installment Agreement and CNC-Hardship | 525 |

Total Positive Income vs. ALE

The following figure shows the taxpayers with TDA closures in CY 2014 and their method of closure (Full Pay, Installment Agreement or CNC). This figure also shows the breakout of how the TPI compares to the ALE for each of the groups:

FIGURE 4.9, Breakout of All TDA Closures in CY 2014 (By Taxpayer)

| All Taxpayers with TDA closures in 2014 | All Cases | Full Pay | Installment Agreement | CNC Hardship |
|---|------------------|------------------|-----------------------|----------------|
| Count | 3,442,645 | 2,149,748 | 1,127,658 | 165,239 |
| TY2014 Filers | 3,179,158 | 1,930,639 | 1,097,525 | 150,994 |
| TY 2014 Nonfilers | 263,487 | 219,109 | 30,133 | 14,245 |
| % Nonfilers | 7.70% | 10.20% | 2.70% | 8.60% |
| TPI Mean | \$78,051 | \$80,595 | \$78,966 | \$38,855 |
| TPI Median | \$44,390 | \$42,136 | \$51,755 | \$23,594 |
| ALE Mean | \$42,259 | \$41,796 | \$44,663 | \$36,044 |
| ALE Median | \$37,464 | \$36,252 | \$41,496 | \$28,980 |
| Count of taxpayers with $TPI \leq ALE$ ^a | 1,442,025 | 926,165 | 412,171 | 103,689 |
| Percent of taxpayers with $TPI \leq ALE$ | 45.40% | 48.00% | 37.60% | 68.70% |
| Median TPI of taxpayers with $TPI \leq ALE$ | \$22,181 | \$21,461 | \$25,402 | \$16,520 |
| Median ALE of taxpayers with $TPI \leq ALE$ | \$42,276 | \$44,028 | \$44,700 | \$32,376 |
| Count of taxpayers with $TPI > ALE$ | 1,737,133 | 1,004,474 | 685,354 | 47,305 |
| Percent of taxpayers with $TPI > ALE$ | 54.60% | 52.00% | 62.40% | 31.33% |
| Median TPI of taxpayers with $TPI > ALE$ | \$74,125 | \$74,029 | \$75,763 | \$53,192 |
| Median ALE of taxpayers with $TPI > ALE$ | \$39,120 | \$38,532 | \$42,312 | \$30,792 |

a Excludes the 263,487 nonfilers.

The above figure shows:

- The median TPI for the Full Pay taxpayers was almost twice as high as taxpayers whose TDAs were reported CNC-Hardship.
- Taxpayers whose accounts were reported CNC-Hardship actually had a smaller percentage of nonfilers than taxpayers who full paid their liabilities. The nonfiling rate is understandably low for IA taxpayers as filing required returns is a requirement for continuing with the payment plan.
- When considering full pay taxpayers, the percentage of those with TPI less than or equal to ALE is considerably lower than for CNC-Hardship taxpayers (48.0% vs 68.7%).
- The median TPI is over three times higher for taxpayers with TPI greater than their ALE compared to taxpayers whose TPI is less than or equal to their ALE.

We would expect that taxpayers with income in excess of their ALE would likely be able to either full pay their liability or enter into an installment agreement. Although the IRS only classified three percent of taxpayers with TPI in excess of their ALE, as CNC-Hardship, these taxpayers represented nearly one-third of all taxpayers, which the IRS classified as CNC-Hardship. The IRM instructs collection personnel to make allowances for expenses in excess of stated allowable standards when circumstances warrant.²⁵ Therefore, we are not surprised that some taxpayers with incomes above their ALE actually have their delinquencies reported CNC-Hardship.

25 IRM 5.15.1.10, *Other Expenses* (11/17/14).

Analysis of Taxpayers With ALE Equal to or in Excess of Their TPI Whose TDAs Were Completely Satisfied

Over 60 percent of those taxpayers (926,165) with incomes below their ALE paid their TDA liability. Since the IRS may be concerned that systemically reporting these taxpayers as CNC would result in significant revenue loss, we performed additional analysis regarding the resolution of the liability. To determine why these taxpayers were able to satisfy their TDAs even though they had income below their ALE, we further explored the circumstances resulting in the full pay. An analysis of these TDA accounts shows that in many cases, the IRS abated all or most of the liability. Another reason that taxpayers satisfied these liabilities is because of refund offsets. Accordingly, we removed taxpayers whose accounts had the following characteristics:²⁶

- Abatements that were at least 50 percent of the balance;²⁷
- Refund offsets that were at least 95 percent of the balance; and
- Cases where the IRS classified a taxpayer CNC-Hardship prior to satisfaction of the outstanding TDAs.

After removing taxpayers with these criteria, about 32 percent of the taxpayers with TPI below their ALE paid their liability without abatement, refund offset, or the IRS determining that the taxpayer should be classified as CNC-Hardship. The following figure describes the TPI, ALE, and balance due of these taxpayers.

FIGURE 4.10, Remaining Full Paid With TPI Less Than ALE After Removals

| | |
|--|----------|
| Total Number of Full Pay Taxpayers with $TPI \leq ALE$ | 926,165 |
| Remaining Number of Taxpayers with TPI less than ALE that Full Paid (after any abatements or refund offsets) | 297,203 |
| Average Balance Due (after any abatements or refund offsets) | \$6,887 |
| Median Balance Due (last Status 22) | \$1,543 |
| Average TPI for TY 2014 | \$26,402 |
| Median TPI for TY 2014 | \$24,128 |
| Average ALE for TY 2014 | \$45,681 |
| Median ALE for TY 2014 | \$45,708 |

Figure 10 shows that these taxpayers often owe only small liabilities. More than half owe less than \$1,550 and even at the 75th percentile, these taxpayers owe about \$5,000 or less. On average, these taxpayers also have total incomes, which are less than 60 percent of their ALE. While it is admirable that these taxpayers are satisfying their liabilities, doing so is likely creating an extreme financial hardship. Systemically reporting these TDAs as CNC-Hardship would not prevent these taxpayers from voluntarily paying their liabilities, but with such a classification; these taxpayers might not feel compelled to pay these liabilities, since doing so would likely create financial hardship.

²⁶ The total balance due minus refund offsets was used to calculate the percentage of abatements.

²⁷ The IRS only abates assessed amounts, which cause the accrued penalty and interest to be abated automatically. Therefore a complete abatement represents a much smaller percent of the total balance due (which includes accrued penalty and interest). Some abatements occurred because the statutory period to collect the tax expired.

Further analysis of these accounts shows that about 14 percent of these taxpayers have assets, which the taxpayer might be able to use to satisfy the liability.²⁸ Therefore, after removing taxpayers with the assets to potentially satisfy their TDAs, the IRS's use of available tax return and information return data to systemically report cases as CNC-Hardship would result in about 28 percent of the taxpayers who directly paid their liabilities being placed in CNC-Hardship status.

Analysis of Taxpayers With ALE in Excess of Their TPI Who Entered into an IA to Pay Their TDA

Another 28.6 percent of taxpayers (412,171) with incomes below their ALE entered into an IA to pay their TDA liability. Again, to determine why these taxpayers were able to satisfy their TDAs even though they had income less than their ALE, we further explored the circumstances resulting in the full pay. An analysis of these TDA accounts also shows that in many cases, the IRS abated all or most of the liability or the taxpayer's refund offset satisfied the liability. In some other cases, the IRS determined that the taxpayer did not have the wherewithal to meet the terms of the IA and classified the TDA as CNC-Hardship. Accordingly, we removed taxpayers whose accounts had the following characteristics:

- Abatements that were at least 50 percent of the balance;²⁹
- Refund offsets that were at least 95 percent of the balance; and
- Cases where the IRS classified a taxpayer as CNC-Hardship after the IA was entered into in 2014; and
- The IA defaulted and the TDA remains unresolved.

After removing taxpayers with these criteria, slightly over two-thirds of the taxpayers with TPI not in excess of their ALE continued to meet the terms of their IA without an abatement, refund offset, the IRS determining that the taxpayer should be classified as CNC-Hardship, or the default of the IA with no new resolution. The following figure describes the TPI, ALE, and balance due of these taxpayers.

FIGURE 4.11, Remaining Full Paid With TPI Less Than ALE After Removals

| | |
|--|----------|
| Total Number of Installment Agreement Taxpayers with $TPI \leq ALE$ | 412,171 |
| Remaining Number of Taxpayers with TPI less than ALE that Full Paid (after any abatements or refund offsets) | 286,141 |
| Average Balance Due (after any abatements or refund offsets) | \$6,761 |
| Median Balance Due (last Status 22) | \$2,615 |
| Average TPI for TY 2014 | \$28,049 |
| Median TPI for TY 2014 | \$25,917 |
| Average ALE for TY 2014 | \$44,949 |
| Median ALE for TY 2014 | \$43,476 |

Figure 11 shows that these taxpayers often owe only small liabilities. Around half owe about \$2,600 or less, and as a whole, these taxpayers only owe an average amount of \$6,761. On average, these taxpayers

28 Although a taxpayer may have assets, they may not be liquid. Furthermore, the assets may be needed for the production of income. An actual financial analysis may be required to determine if the taxpayer can actually use his assets to assist with the satisfaction of the tax delinquency.

29 The IRS only abates assessed amounts, which cause the accrued penalty and interest to be abated automatically. Therefore a complete abatement represents a much smaller percent of the total balance due (which includes accrued penalty and interest).

also have total incomes that are less than two-thirds of their ALE. While these taxpayers are trying to satisfy their liabilities, doing so is likely creating a financial hardship. Again, systemically reporting these TDAs as CNC-Hardship would not prevent these taxpayers from voluntarily paying their liabilities, however, with that classification the taxpayer might not feel compelled to pay these liabilities, since by the IRS standard, these taxpayers' payments would likely create financial hardship.

Further analysis of these accounts shows that about 18 percent of these taxpayers have assets, which the taxpayer could possibly use to sustain them while making the IA payments.³⁰ Therefore, after removing taxpayers with the assets, the IRS's use of available tax return and information return data to systemically report TDAs as CNC-Hardship when taxpayers' TPI is less than or equal to their ALE would result in about 57 percent of these taxpayers with an existing IA being reported CNC-Hardship.

The IRS had already classified another seven percent of the taxpayers with TPI equal to or less than their ALE as CNC-Hardship. Therefore, we did not perform additional analysis on these taxpayers. We also did not perform additional analysis on those taxpayers with TPI in excess of their ALE, since the taxpayers would be unaffected by a systemic classification of TDA taxpayers as CNC-Hardship.

Analysis of the Federal Poverty Level as a Proxy for the ALE Analysis

We compared multiples of the poverty level to the results of our ALE analysis to determine if some multiple of the poverty level could be used as a proxy (*i.e.*, in lieu of computing the ALE and comparing it to TPI) to determine when a taxpayer might be unable to resolve their TDA through full payment or an IA. We determined that over 80 percent of the taxpayers with TPI equal to or less than their ALE had TPI at or below 250 percent of the poverty level.

CONCLUSIONS

- When considering taxpayers who full paid their TDAs or who entered into an IA that is still in effect even though their ALE is greater than or equal to their TPI, over 55 percent of the time the IRS classified the taxpayer as CNC-Hardship; the liability was satisfied because of refund offsets or abatements; or the IA defaulted.
- Those taxpayers, who were able to directly satisfy their TDAs even though their TPI was not in excess of their ALE, generally had only small liabilities and their TPI was well below their ALE.
- Over 80 percent of the taxpayers with TPI equal to or less than their ALE had TPI at or below 250 percent of the poverty level.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Consider the development of a filter which would use internal IRS data to classify taxpayer delinquencies as TDA hardship if their TPI is less than or equal to their ALE. This procedure could both save IRS resources and reduce taxpayer burden.
2. Require collection personnel to determine if taxpayers can actually afford the payment amount in all types of IAs.

³⁰ Although a taxpayer may have assets, they may not be liquid. Furthermore, the assets may be needed for the production of income. An actual financial analysis may be required to determine if the taxpayer can actually use his assets to assist with the satisfaction of the tax delinquency.