

WRITTEN STATEMENT OF

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2009 ANNUAL REPORT TO CONGRESS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

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Chairman Lewis, Ranking Member Boustany, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify today to describe some of the most serious problems taxpayers face in their dealings with the IRS and to propose solutions to mitigate these problems, which I have also discussed in my 2009 Annual Report to Congress.¹

Before I discuss taxpayer problems, I'd like to begin by calling attention to an IRS initiative that I consider a significant achievement – the initiative to improve standards in and oversight of the return preparation industry. I began calling for preparer regulation in 2002 because I saw first-hand before I joined the government how incompetent or unscrupulous preparers harmed taxpayers who trusted them and how their actions undermined tax compliance. Since that time, there has been considerable congressional support for preparer regulation. Congressman Becerra has sponsored legislation that Chairman Lewis and other members of the Ways and Means Committee have supported,² and on the Senate side, Senator Bingaman has sponsored companion legislation that the Finance Committee twice passed on a bipartisan basis.³

The IRS could have implemented preparer regulation on its own earlier, but under prior leadership, the agency opposed preparer regulation, in part because of concern that administering such a program would require the IRS to divert resources from other areas. When Commissioner Shulman took office, he reassessed that position and concluded that preparer regulation has the potential both to protect taxpayers and to improve tax compliance. As a result, he decided to make preparer regulation one of the signature initiatives of his tenure. Since he announced the initiative at a hearing before this Subcommittee last June, the IRS has been working diligently to design it. In January 2010, the IRS issued a report setting out a blueprint of its plan,⁴ and it is now working diligently to implement it. Although the devil is in the details and there are still some important issues that need to be resolved, I believe the IRS is headed in the right direction. I further believe this initiative, when fully implemented, will improve tax administration significantly by helping taxpayers locate qualified preparers, establishing clear requirements of competence and ethics for preparers, and disciplining and even shutting down unqualified and unethical preparers. Later in my

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

² See H.R. 5716, The Taxpayer Bill of Rights Act of 2008 (110th Cong.).

³ See H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

⁴ See IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

testimony, I will provide additional detail and identify potential legislative changes to supplement the initiative.

I also want to say at the outset that I believe the IRS has done a good job overall during the last two years as it simultaneously has delivered on its core mission of providing taxpayer services and collecting taxes while administering a number of economic stimulus programs, including the issuance of economic stimulus payments in 2008 and the processing of claims for the first-time homebuyer credit in 2009.⁵

Not surprisingly, however, the combination of these challenges – performing its core work, administering social programs and economic stimulus provisions, and collecting taxes against the backdrop of the highest unemployment rate in nearly three decades⁶ – has stretched the IRS too thin in certain areas.

In my testimony today, I will provide a taxpayer perspective regarding areas where I believe the tax administration process can be improved.

1. IRS Toll-Free Telephone Service Is Inadequate to Meet Taxpayer Needs

Each year, tens of millions of taxpayers call the IRS seeking help with a wide variety of issues, including account questions and tax-filing questions. There is no single “correct” method for measuring the IRS’s effectiveness in answering taxpayer calls, but the most common measure is the Customer Account Services Customer Service Representative Level of Service, or “LOS,” which generally measures the percentage of calls that gets through to a representative among all callers seeking to do so. By this measure, the IRS answered 87 percent of its calls in FY 2004. Since that time, the LOS has been declining, plummeting to a low of 53 percent in FY 2008. In other words, IRS telephone assistants in FY 2008 were unable to answer nearly half of all calls received.

In FY 2009, the LOS rebounded somewhat to about 70 percent, and the IRS’s target for the current fiscal year is 71 percent.

While answering 71 percent of calls is a vast improvement over 53 percent, it still means the IRS is effectively setting a goal of failing to answer nearly three out of every ten calls it receives from taxpayers seeking assistance from an IRS employee. Equally disturbing, the IRS projects that among calls that do get answered, the average wait time will be nearly 12 minutes, up from just over four minutes in FY 2007. This state of affairs led me to designate the level of service on the IRS toll-free lines as

⁵ Economic Stimulus Act, Pub. L. No. 110-185, § 101, 122 Stat. 613 (2008); American Recovery and Reinvestment Act, Pub. L. No. 111-5, § 1006 in Division B, 123 Stat. 115, 316 (2009).

⁶ See Bureau of Labor Statistics, *Labor Force Statistics for the Current Population Survey* (showing the civilian unemployment rate at or over 10 percent for October, November, and December of 2009 for the first time since 1983).

the number one most serious problem for taxpayers in my 2009 Annual Report to Congress.⁷

Although hard to quantify, the impact of the IRS's inability to answer taxpayer calls is significant and has considerable downstream consequences:

- When taxpayers call the toll-free line with tax law questions and cannot get through, some will just give up and not bother to file their tax returns. Others will file inaccurate returns that require IRS follow-up action and taxpayer response.
- When taxpayers call the IRS after receiving notices proposing additional tax and they cannot get through, some will not respond to the notice, requiring the IRS to take further steps and potentially exposing the taxpayer to enforced collection action. Others will write letters to the IRS, requiring IRS employees in the Accounts Management (AM) function to respond.

In fact, many Accounts Management employees shuttle back and forth between handling paper correspondence (including the processing of amended returns) and answering telephone calls. When IRS employees dedicated exclusively to answering taxpayer calls cannot handle the call volumes, AM employees are shifted from handling paper correspondence to help out. Not surprisingly, as call volumes have increased and Accounts Management employees have been moved to answer phone calls, paper correspondence inventories have increased as well. The paper correspondence inventory rose from 480,292 at the end of FY 2007 to 775,960 at the end of FY 2009 – a 62 percent increase.⁸ At the same time, the amount of overage correspondence has varied considerably from a weekly low of 54,000 to a weekly high of more than 1.1 million.

To some degree, the combination of poor telephone service and slow correspondence processing creates a vicious cycle: Taxpayers who cannot get through to the IRS by phone send letters, causing more work for employees assigned to paper correspondence and leading to correspondence backlogs and delays in processing amended returns, while taxpayers who write to the IRS and do not receive timely responses call the IRS to try to figure out what happened.

As noted above, the sharp decline in the IRS's ability to handle call demand and timely process taxpayer correspondence is due primarily to the impact of the Economic Stimulus Act and other statutory changes that have increased the IRS's work or generated taxpayer questions. The following chart shows the level of call volumes and the IRS's success in answering calls since 2005.

⁷ See National Taxpayer Advocate 2009 Annual Report to Congress 4-16 (Most Serious Problem: *IRS Toll-Free Telephone Service Is Declining as Taxpayer Demand for Telephone Service Is Increasing*).

⁸ IRS, *Joint Operations Center Accounts Management Paper Inventory Adjustments Reports FY05, FY07, FY09* (Oct. 30, 2009).

IRS CUSTOMER ACCOUNT SERVICES (CAS) TOLL-FREE PHONE DATA⁹

Fiscal Year	CAS Net Attempts (in millions)	CAS Assistor Answered Calls (in millions)	Customer Service Representative Level of Service	Average Speed of Answer (in seconds)
2005	64.5	33.4	82.6%	258
2006	64.2	33.2	82.0%	242
2007	67.4	33.8	81.3%	268
2008	150.6	40.4	52.8%	626
2009	93.7	39.0	70.0%	526

As this chart shows, call volumes ran at a fairly steady level of between about 64 million and 67 million in the three years before the Economic Stimulus Act was passed in February 2008. During the balance of 2008 and into 2009, the IRS was flooded with stimulus-related calls, with the IRS receiving an all-time high of over 150 million calls in FY 2008. Note, too, that the IRS actually answered 20 percent more calls in FY 2008 than it had answered in FY 2007 (40.4 million vs. 33.8 million), yet the LOS declined from 81 percent to 53 percent because the overall call volume increased by 123 percent (from 67.4 million to 150.6 million).

For these reasons, the decline in the IRS's level of service is understandable from the standpoint of resources. However, it is not an acceptable state of affairs from the standpoint of the tens of millions of taxpayers seeking help. In his book, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America*, former Commissioner Charles Rossotti addressed the importance of maintaining a high level of service on the IRS's toll-free lines:

Apart from the justifiable outrage it causes among honest taxpayers, I have never understood why anyone would think it is good business to fail to answer a phone call from someone who owed you money.¹⁰

Let me be clear that I am not being critical of the IRS's handling of the increased telephone volume – it generally is applying its current resources appropriately and is seeking new ways to use those resources more productively. However, to meet taxpayer needs, to improve the ability of taxpayers to comply with tax law requirements and respond to IRS notices, and to reduce the aggregate burden on the

⁹ IRS, JOC Enterprise Telephone Data, *Snapshot & Half Hourly Adherence Reports* (Oct. 30, 2009). Some calls are handled via automation and do not require the assistance of a customer service representative. Automated calls are not shown in this chart.

¹⁰ Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 285 (2005).

IRS when taxpayers who can't get through by phone contact the IRS through multiple channels with the same question, I believe the IRS must be able to answer at least 85 percent of taxpayer calls and keep taxpayers on hold for no longer than an average of five minutes.

Recommendations

- I encourage the Subcommittee on Oversight to support sufficient additional funding for the IRS toll-free lines so that the IRS will have the resources to achieve an LOS of 85 percent and an average wait time of five minutes.
- I recommend that the IRS study its call and verification requirements to try to identify opportunities to reduce the length of calls without shortchanging taxpayers. During a recent meeting of an IRS advisory committee, for example, a practitioner reported that when he calls the IRS, more than half of the call is typically spent on authenticating his identity and the identity of the taxpayer he represents and less than half is spent discussing his question. While this observation reflects just one practitioner's experience and the IRS must not compromise the effectiveness of its authentication procedures, the IRS should assess its authentication steps to determine whether the time spent on authentication can be reduced without compromising security. For example, additional information could be verified via automation by asking taxpayers to key in certain data before an assistor gets on the line, as many businesses ask their customers to do now. If the IRS can shave off even five percent to ten percent of average call time through better screening, the resulting efficiency gain would be significant.

2. IRS Lien Filing Policies Are Unnecessarily Harming Taxpayers Without Maximizing Tax Compliance – in Violation of the Intent of RRA '98

A. Background

When a taxpayer fails to pay a tax debt, the IRS Collection function is charged with attempting to collect it. The Collection function has powerful tools at its disposal to do this – it may file a notice of federal tax lien (NFTL) against a taxpayer's property or impose a levy against wages, bank accounts, or other income sources without obtaining prior approval from a court. However, the government has a responsibility to balance the goal of ensuring that everyone pays their fair share of taxes against the reality that millions of taxpayers lose their jobs or experience financial hardships each year, and the government generally should not be causing or exacerbating financial hardships. This is always true, but it is particularly notable when the unemployment rate is high and many taxpayers with solid compliance histories are becoming delinquent on their tax liabilities for the first time.

Properly applied, the NFTL can be an effective tool in tax collection. It gives the IRS a legal claim to the taxpayer's property, such as a home or a car, as security for the payment of the tax debt and may enable the IRS to collect all or a portion of the tax debt if the taxpayer sells or refinances the property. If improperly applied, however, NFTLs have the potential to cause needless harm to taxpayers and, not insignificantly, to undermine long-term tax collection as well. Thus, the decision whether to file an NFTL requires the IRS to balance the harm the NFTL will inflict on the taxpayer and the revenue the NFTL is likely to generate.

B. Tax Liens Reduce a Taxpayer's Credit Score and Can Be Devastating to the Taxpayer's Financial Viability

Assume that the IRS files an NFTL after a taxpayer loses his job and becomes unable to pay his tax bill. The following consequences result:

- The filing of the NFTL is quickly picked up by the three credit reporting agencies (Equifax, Experian, and Trans Union) and is included on the taxpayer's credit reports.
- The initial inclusion of a tax lien reduces the taxpayer's credit score by an average of 100 points.
- The mere notation of an NFTL on a taxpayer's credit report can destroy his financial viability. Employers increasingly review credit reports in making employment decisions, and some employers, especially in the financial services industry, will not hire or retain a person with an NFTL on a credit report. Insurance companies increasingly review credit reports and use scores in determining whom to insure and in setting rates. Landlords, retail stores, utilities, and other creditors also review credit reports. Thus, an NFTL may make someone unemployable and in virtually all cases will drive up the taxpayer's other costs.¹¹
- For small business taxpayers, an NFTL can be a fatal blow. If an NFTL has been filed against a small business, it generally will not be able to obtain financing required to maintain business operations.
- The damage to a taxpayer is generally long-lasting. If the taxpayer settles a tax debt and the IRS releases the lien, the fact that the NFTL was filed and released will still be listed on the credit report for seven years.¹²
- If the taxpayer does not settle the tax debt and the lien is extinguished when the ten-year period of limitation on IRS collection action runs out, the three

¹¹ See *What Happened to Your Credit Score?*, Washington Post, Mar. 6, 2010, at E1.

¹² Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

credit rating agencies continue to include the NFTL on the report for even longer – one continues to list it for ten years, one continues to list it for 15 years, and one continues to list it indefinitely.

C. The Revenue Benefits of IRS Lien Filings Appear Limited

The IRS has increased the number of NFTL filings significantly over the past decade. From FY 1999 to FY 2009, the number of NFTLs filed each year jumped by 475 percent (from 168,000 to nearly 966,000). It is also worth noting that the IRS has increased the number of levies it has imposed against taxpayers' income and assets by about 600 percent from FY 1999 to FY 2009 (from 504,403 to 3,478,181).¹³ If liens and levies were key drivers of Collection revenue, one would expect that the amount of revenue collected by the IRS Collection function since FY 1999 would have soared. But that has not happened. To the contrary, Collection revenue has *fallen* since FY 1999 on an inflation-adjusted basis by 7.4 percent.

Most importantly, the government's role as a creditor is different from the role of a private creditor. The government must focus not merely on collecting a past tax debt but on maximizing future tax compliance. If the filing of an NFTL drives up the taxpayer's costs and renders him unemployed or underemployed, the taxpayer may be less able to pay his past tax debt and may earn less income (and therefore pay less tax) in the future. Moreover, unlike a private creditor, if IRS collection practices push a taxpayer into poverty, other parts of the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like. IRS Collection practices do not explicitly consider that trade-off, but if the government pushes a taxpayer into poverty, the taxpayer has less income and the government receives less revenue – clearly a lose-lose proposition that we should be striving harder to avoid.

D. A TAS Study Shows the IRS Cannot Accurately Measure NFTL Filing Effectiveness

The sharp increase in NFTL filings combined with an inflation-adjusted reduction in Collection revenue prompted us to ask: What is going on here? Why is the IRS destroying the credit of so many taxpayers if doing so isn't furthering revenue collection?

Initially, I asked the IRS how much revenue is collected through NFTL filings. IRS collection personnel said they didn't know.

I found this lack of knowledge disturbing, because I do not see how the IRS can establish NFTL procedures that balance its collection goals against the desire to avoid inflicting unnecessary harm on taxpayers without knowing how much revenue NFTLs are generating. For that reason, I asked my research staff to conduct a high-level research project on collection activities that, in part, attempted to assess whether NFTLs are being

¹³ As noted in a prior report, the number of levies increased by about 1,600 percent when measured from FY 2000 to FY 2007. See National Taxpayer Advocate 2008 Annual Report to Congress 20.

filed effectively to collect revenue. To make this assessment, TAS reviewed the collection history of all taxpayers who incurred balance-due tax liabilities for the first time during tax year 2002 – nearly 1.9 million transactions involving about 270,000 individual taxpayers – and against whom NFTLs were filed in subsequent years.¹⁴ The results of our research suggest that the IRS's use of NFTLs may not be furthering the agency's revenue collection objective and, equally significant, that the IRS has shown very little interest in evaluating the effectiveness of NFTLs for itself. Among our findings:

- IRS procedures require employees to code the source of payments received on delinquent accounts.¹⁵ Where the IRS received a payment after an NFTL was filed against a taxpayer's property, the IRS coded the source of payments as "miscellaneous" or did not code the payment at all in about 67 percent of the cases.¹⁶ The IRS's failure to accurately code and track the source of payments defeats the purpose of having a coding system, because it precludes the IRS from drawing useful conclusions about the effectiveness of any of its collection actions, including NFTL filings.
- Using separate transaction codes, TAS was able to reconstruct the source of payments in approximately 15 percent of the uncoded cases, with the result that TAS could identify the source of 48 percent of the payments made with respect to accounts against which an NFTL had been filed. In these cases, our analysis found that more than 95 percent of all payments and more than 80 percent of all revenue collected did not result from the NFTL filings and would have been collected anyway.¹⁷ The largest source of Collection revenue and payments on these accounts was refund offsets, which occur regardless of the existence of an NFTL (*i.e.*, the taxpayer filed a return in a subsequent tax year showing a refund due and the IRS withheld the refund to satisfy the past-due tax debt). Taking into account that nearly 52 percent of payments cannot be classified, only about \$169

¹⁴ TAS reviewed 2,065,303 transactions from 270,399 individual taxpayers. For a more detailed discussion, see National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*) and vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

¹⁵ See IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

¹⁶ IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated "miscellaneous" or "DPC indicator not present." Of the 1,257,525 transactions, 283,091 had a refund offset transaction code; leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. See also National Taxpayer Advocate 2009 Annual Report to Congress 22 (Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments in CYs 2002-2009*). The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

¹⁷ See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

million out of about \$905 million collected was clearly attributable to lien filings with respect to 2002 delinquent tax liabilities.¹⁸

While the amount of revenue collected through NFTLs remains unknown, our study suggests that the total is relatively small. In FY 2009, the IRS Collection function brought in \$27.2 billion. The majority of revenue raised by the Collection function comes through notices in cases where NFTLs have not been filed.¹⁹ Considerable revenue also comes from refund offsets and from levies, among other sources, for which NFTLs are not required. Thus, the finding that only about \$169 million was clearly attributable to NFTL filings among cases analyzed in the TAS study may not be far off the mark.

That figure was estimated based on TAS's evaluation of the 48 percent of cases arising in 2002 for which TAS could track the payment source. If that is representative of the full population, the total revenue with respect to those cases would be closer to \$340 million. To be clear, we do not know the source or amount of payments that were not coded, and we do not know whether lien filings are more or less productive with respect to tax liabilities incurred in tax years other than 2002. But based on the data we have seen, there is a strong possibility that the IRS is harming hundreds of thousands of taxpayers a year to collect \$1 billion or less. What's more, the IRS incurs considerable expense to work these cases, including the salaries of Collection personnel and the costs of NFTL-filing fees in local jurisdictions, so net revenue collection is considerably lower.

E. Legislative History Shows Congress Wanted More Managerial Review of Lien Filings, But the IRS Is Now Requiring Less Managerial Review

When Congress passed the IRS Restructuring and Reform Act of 1998,²⁰ it added IRC § 3421, which directed the Commissioner to develop and implement procedures under which any determination by an employee to file an NFTL would, where appropriate, be required to be reviewed by a supervisor before the action was taken.

The provision originated in the Senate, and the Senate Finance Committee report provided the following explanation:

Supervisory approval of liens, levies or seizures is [currently] only required under certain circumstances. . . .

The Committee believes that the imposition of liens, levies, and seizures may impose significant hardships on taxpayers. Accordingly, the Committee

¹⁸ IRS, Compliance Data Warehouse (CDW), IMF Transaction File Cycle 200913. The IRS collected \$168.6 million in payments attributable to NFTLs and \$736.7 million in payments not attributable to NFTLs in calendar years (CYs) 2002-2009.

¹⁹ Notices accounted for 55.6 percent of the total collection yield for FY 2009. IRS, *Delinquent Accounts Receivable Yield Fiscal Year Comparison Cum thru September FY 2009*.

²⁰ Pub. L. No. 105-206, Title III, § 3421, 112 Stat. 685, 758 (1998).

believes that extra protection in the form of an administrative approval process is appropriate. . . .

The provision requires the IRS to implement an approval process under which any lien, levy or seizure would be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be considered include the amount due and the value of the asset. Failure to follow such procedures should result in disciplinary action against the supervisor and/or revenue officer.²¹

The conference report generally followed the Senate amendment but provided the Commissioner with discretion "to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate."²² By negative implication, the conference report did not intend such discretion to apply outside the context of the automated collection system.

Through its procedures, the IRS has since turned on its head the congressional directive that managerial approval generally be obtained before an NFTL filing. The IRS has established a set of business rules under which liens are automatically filed and generally does not require employees to obtain managerial approval in order to file an NFTL. To the contrary, IRS procedures require all Automated Collection System employees to obtain managerial approval if they determine not to file an NFTL.²³ Any decision not to file a lien must be supported by a case history entry clearly stating the reason why filing an NFTL will hamper collection or is not proper (e.g., because of doubt as to liability).²⁴

Similarly, the IRS recently issued interim guidance requiring all Revenue Officers to obtain managerial approval to defer filing an NFTL for certain employment tax cases in which the unpaid balance is \$5,000 or more.²⁵ Thus, the IRS requires employees to take extra steps and offer additional justification to avoid filing an NFTL. What's more, it does not require employees to determine whether the filing is likely to further the IRS's revenue collection objective (e.g., verify whether the NFTL would attach to assets or undertake a

²¹ S. Rep. No. 105-174, at 78 (1998).

²² H.R. Rep. No. 105-599, at 278 (1998) (Conf. Rep.). The IRS Automated Collection System (ACS) handles balance due and nonfiler cases that require telephone contact. IRS tax examiners and customer service representatives in ACS review taxpayer data and issue notices, liens, or levies to resolve delinquent tax cases.

²³ IRM 5.19.4.5.2(10) (Apr. 26, 2006).

²⁴ IRM 5.19.4.5.2(10) (Apr. 26, 2006).

²⁵ Small Business/Self-Employed Division (SB/SE), *Interim Guidance for Approval of Lien Determinations*, Control No. SBSE-05-1208-069 (Dec. 22, 2008). The IRS issued this guidance in an attempt to implement a Government Accountability Office (GAO) recommendation to timely file NFTLs in federal employment tax cases based on an assumption that filing the NFTL will increase the likelihood of collection. See GAO-08-617, *Tax Compliance, Businesses Owe Billions in Federal Payroll Taxes* 31 (July 2008).

review of the taxpayer's financial or personal position to determine whether the NFTL filing will be productive). In essence, IRS procedures have flipped Congress's explicit presumptions. In significant categories of cases, the IRS now imposes more rigorous managerial approval requirements when an employee determines not to file an NFTL than when an employee seeks to file one.

Today, the IRS generates a majority of its NFTLs through the Automated Collection System (ACS). Just under two-thirds of NFTLs requested by ACS were made systemically,²⁶ which means that the IRS generates these NFTLs without determining whether the taxpayers have any assets or are likely to acquire any assets to which the NFTL would attach. As an example, the IRS automatically requests NFTLs for every taxpayer whose delinquency exceeds \$5,000 when the IRS determines that the liability is "currently not collectible" (CNC).²⁷ The CNC designation includes situations in which the IRS has determined that collection of the liability would create a hardship on taxpayers by leaving them unable to meet necessary living expenses.²⁸

This automated approach to lien filing makes little sense not only from a common sense perspective but also from a business perspective. For example, for taxpayers with accounts in CNC/economic hardship status, TAS Research found that:

- IRS refund offsets were responsible for nearly \$6 out of every \$10 in tax payments collected from these taxpayers; and
- NFTLs were responsible for only \$2 out of every \$10 in payments collected from these taxpayers.²⁹

One recent anecdote deeply concerns me: In a case handled by TAS, a Local Taxpayer Advocate asked a revenue officer to refrain from filing an NFTL in a sympathetic case. In response, the revenue officer said his group manager had told his work group that she would not approve any requests to defer the filing of an NFTL. The Local Taxpayer Advocate was told he would have to issue a Taxpayer Assistance Order³⁰ directing the IRS to refrain from imposing an NFTL because of the group manager's instruction.

²⁶ ACS Customer Service Activity Reports (CSAR), FY 2009 BOD report.

²⁷ IRM 5.12.2.4.1(1) (Oct. 30, 2009).

²⁸ CNC status generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. IRM 5.16.1.2.9(11) (May 5, 2009); see also IRS Policy Statement P-5-71 at IRM 1.2.14.1.14 (Nov. 19, 1980).

²⁹ National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 5 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

³⁰ IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) if a taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered. A TAO can direct the IRS to take a specific action, cease a specific action, or refrain from taking a specific action. A TAO can also direct the IRS to review at a higher level, expedite consideration of, or reconsider a taxpayer's case. Upon receipt of a TAO, the responsible official in the IRS operating division/function may either take the requested action or appeal the order to a higher level. The appeal process may cause an issue to rise to the level of the

F. The IRS Rarely Withdraws Tax Liens Despite Explicit Statutory Authorization to Do So and Despite the Fact that a Lien “Withdrawal” Is Far Less Damaging to Taxpayers than a Lien “Release”

As described above, a lien that is “released” continues to be reflected on the taxpayer’s credit record for seven years from the date of the release. However, an NFTL that is “withdrawn” is treated as if it had not been filed and is removed from the taxpayer’s credit record.

In 1996, Congress authorized the IRS to withdraw an NFTL if the Secretary makes any one of four determinations:

- (A) The filing of the notice was premature or otherwise not in accordance with IRS administrative procedures;
- (B) The taxpayer has entered into an installment agreement to satisfy the tax liability for which the lien was imposed (unless the agreement provides otherwise);
- (C) The withdrawal of the notice will facilitate the collection of the tax liability; or
- (D) With the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of the notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.³¹

Congress clearly provided these four bases for withdrawal for a reason. In one TAS case, a taxpayer working in the financial services industry lost his job because of the filing of an NFTL. In that case, the taxpayer’s employer had a policy to not employ individuals who have NFTLs filed against them. The taxpayer had paid the tax liability and owed only a small amount of interest and penalties. I personally became involved in the case and issued several Taxpayer Assistance Orders directing the IRS to withdraw the NFTL, but the Collection function declined to do so until after the taxpayer was fired.³² In a case like that, the withdrawal of the NFTL would serve the best interests of both the taxpayer and the United States because an employed taxpayer is earning income and can pay taxes while the IRS is much less likely to collect from an unemployed taxpayer.

Commissioner. The Commissioner or the Deputy Commissioner ultimately may decide to modify or rescind the order. See IRC § 7811(c)(1).

³¹ IRC § 6323(j)(1).

³² Pursuant to IRC § 6103, the IRS generally is required to keep taxpayers’ returns and return information confidential. In this particular case, however, the taxpayer provided a written consent to the National Taxpayer Advocate to disclose the facts of his case in congressional testimony.

Recommendations

On January 20, 2010, shortly after publication of the National Taxpayer Advocate's 2009 Annual Report to Congress outlining my concerns about IRS lien-filing and other collection practices, I issued two Taxpayer Advocate Directives (TADs)³³ to the Commissioners of the Wage and Investment and Small Business/Self-Employed Operating Divisions, ordering them, among other things, to:

- Immediately rescind the policy of automatic NFTL filing on currently not collectible hardship accounts;³⁴
- Immediately require managerial approval for NFTL filings in all cases where the taxpayer has no assets;³⁵
- Within 30 days of the issuance of the TAD, in consultation with the National Taxpayer Advocate, issue interim guidance requiring IRS contact employees to base a determination to file an NFTL on a thorough review of information concerning the taxpayer's assets, the taxpayer's income, and the value of the taxpayer's equity in the assets and, after weighing all the facts and circumstances, determine whether (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future;³⁶ and
- Immediately develop and issue guidance allowing, upon the request of the taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.³⁷

In response, the IRS has established a task force to undertake a comprehensive review of IRS collection practices. I applaud this effort, in which the Taxpayer Advocate Service will participate. However, the IRS is not immediately changing any of its current guidance to collection employees. Therefore, in my opinion, taxpayers continue to be needlessly

³³ Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD) to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers. IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001); *see also* IRM 13.2.1.6 (July 16, 2009). Upon receipt of a TAD, the only avenue of appeal for the IRS is to the Deputy Commissioner for Services and Enforcement. The Deputy Commissioner and the Commissioner have the authority to modify or rescind a TAD.

³⁴ Taxpayer Advocate Directive 2010-1 (Jan. 20, 2010).

³⁵ *Id.*

³⁶ *Id.*

³⁷ Taxpayer Advocate Directive 2010-2 (Jan. 20, 2010).

harmed, and future tax compliance and collection continue to be undermined, while the task force undertakes its year-long review.

- I recommend that the IRS institute a quality review of payment coding used to track the source of taxpayers' payments for tax liabilities. An accurate method of tracking payments is an essential first step in determining the impact of various collection tools on taxpayers and whether they are being used effectively.
- I recommend that Congress amend the Internal Revenue Code to:
 - Require that prior to filing an NFTL, the IRS review all the taxpayer's circumstances (including the existence and value of assets, the taxpayer's overall financial situation, the taxpayer's compliance history and reasons for noncompliance, and the existence and amount of non-tax debt) and make a determination, weighing all facts and circumstances, that (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future;
 - Allow a taxpayer to appeal any NFTL filing determinations to the IRS Office of Appeals before the NFTL is filed;
 - Provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above; and
 - Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required NFTL determination described above.
- I recommend that Congress amend section 605(a)(3) of the Fair Credit Reporting Act³⁸ to address the length of time that information about an IRS NFTL filing remains on a taxpayer's credit report after the release, withdrawal, or expiration of the NFTL or the underlying tax debt.

3. Despite IRS Commitments to Improve Accessibility of the Offer-in-Compromise Program and Assist Financially Struggling Taxpayers, the IRS Last Year Accepted the Lowest Number of Offers in a Decade

In prior National Taxpayer Advocate reports to Congress and in my testimony before this Subcommittee last year, I have continually expressed concern that the IRS has made offers in compromise less and less accessible to taxpayers, creating a category of permanent tax debtors and undermining IRS collection efforts as well. The IRS has made

³⁸ 15 U.S.C. § 1681c(a)(3).

repeated commitments to improve the accessibility of the program, but to date, tangible results are not evident.

Congress has authorized the IRS to settle a tax liability for less than the full amount owed in appropriate cases, such as where a taxpayer has lost a job or otherwise suffered a financial hardship and cannot afford to pay his or her full tax debt.³⁹ In 1998, Congress directed the IRS to make offers more accessible to appropriate taxpayers:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.⁴⁰

Offers can be a good deal for taxpayers and the government. Offers can be good for taxpayers because, while they require taxpayers to pay their tax obligations to the extent they are able, they give taxpayers the opportunity to make a fresh start, removing the threat of enforced IRS collection actions that otherwise hang over their heads for the next decade. Offers can also be a good deal for the government because they enable the government to collect as much revenue as is feasible and, very importantly, they contain a contractual term that requires the taxpayer to remain in full compliance with the tax laws for the following five-year period.⁴¹ If the taxpayer does not comply with the contract terms, the IRS may place the offer into default, which will cause the original tax liability (minus any payments made) to be reinstated in full.⁴² One study showed that about 80 percent of individual taxpayers with accepted offers remained substantially compliant for the five-year period.⁴³

³⁹ IRC § 7122. The IRS accepts offers based on three grounds – doubt as to collectibility, doubt as to liability, and effective tax administration (including equity, public policy, and economic hardship concerns).

⁴⁰ H.R. Rep. No. 105-599, at 289 (1998) (Conf. Rep.).

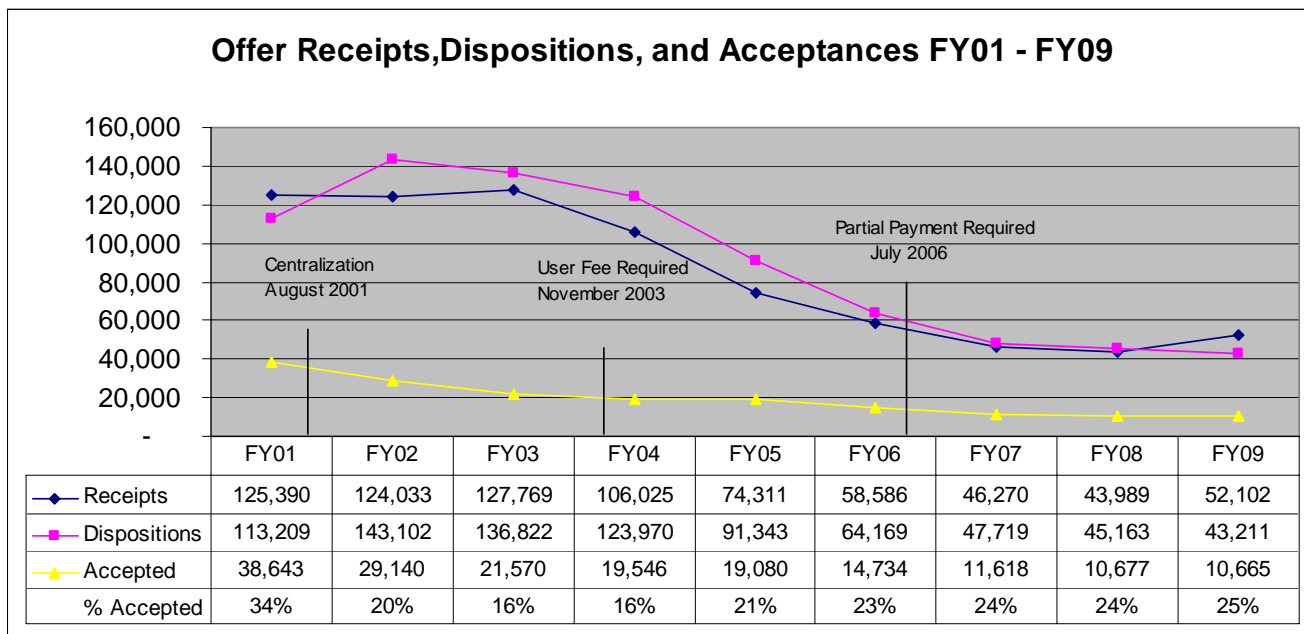
⁴¹ See IRS Form 656, *Offer in Compromise*, § V(d) (Mar. 2009).

⁴² IRM 5.19.7.3.20 (Jan. 16, 2009); IRM 8.23.3.14(3) (Aug. 28, 2009).

⁴³ Internal Revenue Service, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). As noted, offers can also be beneficial from a revenue standpoint. In FY 2007, accepted offers generated 17 cents for every dollar owed. Internal Revenue Service, *Offer in Compromise Program, Executive Summary* (Aug. 13, 2007). By contrast, IRS research indicates the IRS has historically collected only 13 cents for every \$1 owed on debts that are two years old and virtually nothing on debts that have been outstanding for three years or more. Internal Revenue Service, *Automated Collection System Operating Model Team, Collectibility Curve* (Aug. 5, 2002). An IRS study of rejected offers that subsequently were deemed “currently not collectible” (CNC) found that 27 percent of the cases involving individuals and 49 percent of the cases involving businesses were already in CNC status at the time the offers were rejected. Internal Revenue Service, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). In other words, the IRS rejected the taxpayer’s offer to pay something, and often ended up with nothing.

Yet the IRS has erected so many obstacles to the offer in compromise that fewer and fewer taxpayers are applying and fewer and fewer offers are being accepted. For example, the application form and instructions now run 50 pages,⁴⁴ and a consultant analyzing the offer process concluded that a taxpayer must take over 100 steps to complete an offer application.⁴⁵ The following chart shows the trend in offers since FY 2001:

IRS OFFER-IN-COMPROMISE PROGRAM, FY 2001 - FY 2009⁴⁶



The number of offers the IRS receives has declined sharply – from 125,390 in FY 2001 to 52,102 in FY 2009, a drop of 58 percent. The number of accepted offers has declined by even more – from 38,643 in FY 2001 to 10,665 in FY 2009, a drop of 72 percent. In FY 2001, the IRS accepted 34 percent of offers, while in FY 2009, it accepted only 25 percent of offers.⁴⁷

At the beginning of FY 2009, there were 4,001,260 taxpayers with delinquent accounts.⁴⁸ During FY 2009, the IRS accepted only 10,665 offers. That means, roughly speaking,

⁴⁴ See IRS Form 656, *Offer in Compromise*, and accompanying instructions.

⁴⁵ Siegel & Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

⁴⁶ IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-108* (FY 2001-FY 2009).

⁴⁷ The percentage of accepted offers is computed by dividing the number of offers accepted by the number of offer dispositions.

⁴⁸ IRS Small Business/Self-Employed Division, *Collection Activity Report NO-5000-2*.

that the IRS accepted one offer for every 375 taxpayers with a delinquent account. It is also worth noting that the IRS placed the accounts of 2,108,804 taxpayers into currently not collectible status last year.⁴⁹ Thus, the result of the IRS's restrictive offer policy is that the IRS did not collect *any* tax on many accounts, which undermines its revenue collection goals, and it is filing NFTLs against many of these taxpayers, which will undermine their long-term financial viability and ability to pay tax. I note that, remarkably, the IRS often files NFTLs against taxpayers while their offers are being reviewed by the IRS, which does not exactly provide an incentive for taxpayers to try to settle their tax debts and is not an appropriate way to work with taxpayers who are trying to work with us.

While some taxpayers are unresponsive to the IRS out of fear, preoccupation with other problems, or in some circumstances a willful desire to flout the law, most delinquent taxpayers are delinquent because they are struggling financially. If the IRS is collecting nothing from many of these taxpayers, surely it would be better to bring more of them back into compliance by accepting what they can afford and obtaining their pledge to remain in compliance in the future. It is a major failure of IRS collection policy that its offer-in-compromise program works with taxpayers in such a small percentage of cases. The IRS should do far more to ensure that its offer-in-compromise program is open for business to these taxpayers.

In January 2009, the IRS announced several steps to assist financially struggling taxpayers.⁵⁰ In connection with offers, it noted that “the equity taxpayers have in real property can be a barrier to an OIC being accepted,” because with the sharp drop in housing prices, “the real-estate valuations used to assess ability to pay may not be accurate.” To address these cases, the IRS announced it was “creating a new second review of the information.” To date, this “second review” has not resulted in acceptance of a single offer in which property valuations were adjusted. The unit assigned to perform these “second reviews” has reviewed 11 offers and accepted three – and it did not adjust real property valuations in any of the accepted cases.⁵¹

In February 2009, the Deputy Commissioner testified before this Subcommittee that the IRS would retain a consultant to review the offer program overall and assess what can be done to make the program more accessible to taxpayers.⁵² Since that time, the IRS has, in fact, retained two consultants to assess the offer program and identify opportunities to attract more appropriate offers. However, those commitments and the work of the consultants have not yet produced results. As noted above, the IRS actually accepted fewer offers in FY 2009 than it had accepted in FY 2008.

⁴⁹ IRS Small Business/Self-Employment Division, *Recap of Currently Not Collectable Report, NO-5000-149* (Oct. 1, 2009) (covering the period 10-01-2008 to 09-30-2009).

⁵⁰ IRS News Release, IR-2009-2, *IRS Begins Tax Season 2009 with Steps to Help Financially Distressed Taxpayers; Promotes Credits, e-File Options* (Jan. 6, 2009).

⁵¹ SB/SE response to TAS information request (as of Feb. 2010).

⁵² *IRS Assistance to Taxpayers Facing Economic Difficulties: Hearing Before the Subcomm. On Oversight of the H. Comm. On Ways and Means*, 111th Cong. (Feb. 26, 2009) (testimony of Linda E. Stiff, Deputy Commissioner for Services and Enforcement, Internal Revenue Service).

Last week, the IRS announced a new series of steps to assist financially struggling taxpayers. According to the IRS announcement:

IRS employees will be permitted to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise. Normally, the standard practice is to judge an offer amount on a taxpayer's earnings in prior years. This new step provides greater flexibility when considering offers in compromise from the unemployed. . . .

These immediate steps are part of an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers.⁵³

It is not clear what impact this announcement will have, because IRS employees already have the flexibility to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise, including where the taxpayer is unemployed. Internal Revenue Manual guidance in effect at least since 2005 states:

Some situations may warrant placing a different value on future income than current or past income indicates:

IF [a] taxpayer is temporarily unemployed or underemployed

THEN [u]se the level of income expected if the taxpayer were fully employed and if the potential for employment is apparent. Each case should be judged on its own merit, including consideration of special circumstances or [Effective Tax Administration] issues.⁵⁴

An interim guidance memorandum issued on March 10, 2010, generally retains the above language.⁵⁵ It differs from existing guidance in that it explicitly states a taxpayer's current income will be used in analyzing his or her future ability to pay and provides several new examples to illustrate the principle.

While I am pleased the IRS has issued this interim guidance and has referred in its announcement to "an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers," I remain concerned that the IRS has been unwilling to develop a more robust offer program. As I said when I testified before this Subcommittee last year, I have come to believe over years of seeing the IRS truncate this program that the Collection function possesses an institutional aversion to collection of less than 100 percent of the tax the IRS believes is owed regardless of the circumstances.

⁵³ IRS News Release, IR-2010-029, *IRS Outlines Additional Steps to Assist Unemployed Taxpayers and Others* (Mar. 9, 2010).

⁵⁴ IRM 5.8.5.6(5) (Sept. 2005).

⁵⁵ Interim Guidance Memorandum from Director, Collection Policy, *Interim Guidance for Calculation of Future Income in Offer in Compromise Cases*, Control No. SBSE 05-0310-01 (Mar. 10, 2010).

Recommendations

- I recommend that the IRS adopt seven administrative recommendations that I included in my 2009 Annual Report. These include reducing the enormous substantiation and documentation requirements currently required with the initial submission of an offer, reducing the number of steps a taxpayer must take to complete an offer application, and revising internal guidance to bring about the acceptance of a much greater number of appropriate offers.
- I recommend that Congress repeal the 20 percent down payment requirement upon the submission of an offer in compromise. H.R. 2343, the Tax Compromise Improvement Act of 2009, introduced by Chairman Lewis and Ranking Member Boustany, would accomplish that.

4. The IRS Return Preparer Initiative Is a Big Step Forward, But Several Statutory Changes Would Be Helpful

It is universally acknowledged that the internal revenue laws are complex, and as a result, about 60 percent of individual taxpayers and 80 percent of small business taxpayers hire preparers to help them prepare their tax returns. Some preparers are attorneys, CPAs, or Enrolled Agents, but many – probably most – individual returns are prepared by so-called “unenrolled preparers” – people who don’t need to have any training at all and are generally not subject to oversight.

While taxpayers pay good money to preparers with the expectation that the preparers will complete their returns correctly, the reality can be very different. Within the last few years, the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) have each performed undercover visits, posing as taxpayers, to have returns prepared by unenrolled preparation businesses, and the results have been disturbing.⁵⁶

⁵⁶ GAO had 19 returns prepared. All 19 contained errors, and the tax liability was wrong on 17 of the 19 returns. In two cases, the errors would have caused the taxpayer to overpay his tax by more than \$1,500. In five cases, the errors would have caused the taxpayer to receive up to nearly \$2,000 in excess refunds to which he was not entitled. Where the earned income tax credit (EITC) was claimed, preparers neglected to ask required “due diligence” questions in half the cases, and where a taxpayer told the preparer he earned side income, more than half the preparers did not include that income on the return. In just over 20 percent of the cases, the preparer either did not sign the return or failed to provide an identifying number. See Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 2 (Apr. 4, 2006) (statement of Michael Brostek, Director – Strategic Issues, Before the Committee on Finance, U.S. Senate). TIGTA had 28 returns prepared, and its results were not much better. Sixty-one percent contained errors. None of the seven preparers working with EITC fact patterns asked required due diligence questions. Of the errors observed, TIGTA believed that about 65 percent were inadvertent, but it felt that 35 percent were willful or reckless. Notably, one of the fact patterns TIGTA used involved a small business, and none of the business returns was prepared correctly. See Treasury Inspector General for Tax Administration, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

These studies confirm what I personally witnessed throughout my own career as a return preparer, tax attorney, low income taxpayer clinic director, and National Taxpayer Advocate. Because of the availability of tax return preparation software packages and the proliferation of ancillary products and services, such as refund anticipation loans, that can be used to finance purchases of non-tax-related products, tax return preparation is viewed as a way for certain businesses to increase their profit margins rather than as a serious profession that is key to facilitating taxpayers' compliance with the tax laws. To demonstrate just how far the tax return preparation industry has degenerated, I direct you to a slideshow my office prepared this year of various return preparation sites throughout the nation at <http://www.advocatetoolkit.com/userfiles/file/TaxReturnPreparersV2.wmv>. My personal favorite – if “favorite” is the correct term – is the dog grooming parlor that also offers tax return preparation services. I also direct you to what I consider two particularly offensive advertisements by one tax return preparation chain.⁵⁷

As noted above, in early January this year, the IRS published a report of its half-year study of federal return preparers and related issues. In most important respects, the IRS plan reflects the proposals I have made since 2002:

- In general, all return preparers will be required to register with the IRS by the end of this year.
- Registration will be valid for three-year periods and must be renewed.
- The IRS will conduct a federal tax compliance check on all registered preparers.
- During an initial three-year phase-in process, all unenrolled preparers – meaning everyone except attorneys, CPAs, and Enrolled Agents – will be required to pass an exam designed to demonstrate their knowledge of basic return preparation concepts.
- After passing the initial exam, all unenrolled preparers will be required to meet periodic continuing professional education requirements.
- After the three-year phase-in for testing, the names of all registered preparers will be made available on a public database, so all taxpayers can verify whether their preparer is properly registered.

The National Taxpayer Advocate's 2009 Annual Report to Congress identified one significant point on which it appeared the IRS and the National Taxpayer Advocate disagreed – namely, whether tax preparers who meet with and interview clients and prepare returns, but do not sign those returns, would be subject to IRS registration, testing, and continuing education requirements. In our view, failure to include these

⁵⁷ See <http://www.youtube.com/watch?v=DxA5gRiB-os> and <http://www.youtube.com/watch?v=uy7U5ztbqO0>.

“nonsigning” preparers in the regulatory regime would create a loophole that could be widely exploited. Such a loophole would have particular negative impact on low income taxpayers, who often do not know much about the tax laws and may not be able to detect when they are being given inaccurate and even illegal advice. As a result of ongoing discussions with the IRS, I am confident that this loophole will be closed when final guidance is issued.

Recommendations

The IRS plan, of course, is not self-implementing. The IRS will issue a series of regulations this year – first in proposed form to solicit public comments and then in final form – to flesh out the details and set out the requirements. Moreover, the registration and competency requirements are just one part of what must be a comprehensive strategy for improving tax return preparation and thereby increasing voluntary compliance. Such a strategy should include preparer education contacts, “shopping” visits, due diligence requirements, and enhanced penalties.

In this and previous years’ Annual Reports to Congress, we have recommended that the IRS take a “responsive regulation” approach to return preparer compliance.⁵⁸ That is, the IRS could start with “soft” compliance touches, such as notices and education visits, and progressively ramp up enforcement treatments where a preparer’s actions become more egregious.

- I recommend that the IRS implement a large-scale program of undercover preparer visits, using scenarios carefully designed to incorporate fact patterns addressing areas of substantial noncompliance, and follow up with the appropriate compliance “touch.”
- I recommend that Congress and the IRS impose due diligence requirements on preparers related to identified areas of significant noncompliance, similar to the Earned Income Tax Credit due diligence provision under IRC § 6695(g) and Treas. Reg. § 1.6695-2(b). Such requirements should require preparers to sign due diligence statements and attach the statements to the taxpayers’ returns, including e-filed returns. Requiring preparers to sign and file these statements will make those preparers who follow the “IRS will never know so you don’t need to report this income” approach have second thoughts. To be effective, Congress will have to authorize penalties for failure to meet these new due diligence requirements.
- I recommend that Congress enhance the monetary sanctions in existing preparer penalties under IRC §§ 6694(a) and (b) and IRC §§ 6695 (a) through (g) with respect to requirements for preparation of tax returns for other persons

⁵⁸ See National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*).

and extend the penalty under IRC § 6695 for failure to sign or include certain information on tax returns or claims to include “other documents” such as offers in compromise, financial information statements, and collection due process hearing requests.

5. The IRS Is Not Meeting the Needs of Low Income Taxpayers

Individuals with incomes below the poverty level make up 12.5 percent of the United States population, or 37 million people. In 2007, about 118 million individuals in the United States had incomes below 250 percent of the federal poverty level, which qualifies them for assistance and representation from low income taxpayer clinics funded by Congress through the IRS.⁵⁹ More to the point for tax administration, 44 percent (62 million) of the approximately 140 million individual returns filed for tax year (TY) 2006 reported adjusted gross incomes at or below 250 percent of the federal poverty level.⁶⁰

Notwithstanding their income levels, low income taxpayers frequently have tax problems that involve them in protracted disputes with the IRS. Specifically:

- Taxpayers who claim the EITC are more likely to be audited than other taxpayers;
- Cancellation of debt income (CODI) issues, such as automobile repossessions and credit card collection, are more likely to arise, and taxpayers cannot receive assistance with these issues at Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) sites;
- Independent contractor versus employee classification issues frequently arise, with a distinct lack of bargaining power on the part of the low income worker; and
- Liens attaching to taxpayer accounts in currently not collectible hardship status do not secure any government interest and significantly impair low income taxpayers' financial viability.

Low income taxpayers, despite their diversity, share certain common characteristics. They are more likely to be elderly, disabled, Native Americans, and have limited English proficiency than the general population of taxpayers handled by the IRS's Wage and Investment Division. They tend to be more transitory than the general population.⁶¹ They

⁵⁹ See IRC § 7526.

⁶⁰ IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2006. For a detailed discussion of the needs of low income taxpayers, see National Taxpayer Advocate 2009 Annual Report to Congress 110-133 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

⁶¹ 27.5 percent of those below the poverty level moved in 2007 compared to 15 percent of the general population. U.S. Census Bureau, *American FactFinder, 2007 American Community Survey 1-Year Estimates, Table, B07012*.

face transportation and child care challenges that not only limit their ability to earn income but also impair their ability to comply with documentation requests in tax disputes. They live in neighborhoods with limited access to banks and thus turn to expensive check-cashing services, loan sharks, or subprime lenders. And they may not have access to remedies that require money.

The IRS has done a commendable job on the taxpayer service side to try to understand the service needs of low income taxpayers, including conducting research under the Taxpayer Assistance Blueprint initiative, the EITC Program Office, and the Stakeholder Partnerships, Education, and Communication function. In the compliance and enforcement areas, however, the IRS takes a one-size-fits-all approach. For example, in EITC examinations, the correspondence examination procedures are the same for low income taxpayers as they are for higher income taxpayers, notwithstanding the demonstrable differences between these taxpayer populations with regard to functional and English literacy. The impact of these undifferentiated procedures is demonstrated by a recent TAS research study finding that where EITC taxpayers are represented in audits, they are nearly twice as likely to receive the EITC and receive almost twice the amount of EITC as unrepresented taxpayers.

The good news is that in response to concerns raised in my 2009 Annual Report to Congress, the IRS is partnering with TAS to study whether EITC examinations that are assigned to one compliance employee and conducted by correspondence or in person at IRS offices have an impact on the response rate, the agreed case rate, and the amount of EITC allowed. I believe this study will identify practices that encourage the low income taxpayer to communicate with the IRS and will result in documentation requirements that low income taxpayers can meet with minimal burden.

Recommendations

- I recommend that the IRS work with TAS to complete a post-filing needs assessment of low income taxpayers, including problems and needs in areas other than the EITC, such as worker classification disputes, collection, offers in compromise, and accessibility of the Office of Appeals. This assessment will enable the IRS to design its procedures relating to low income taxpayers so that the procedures themselves do not pose a barrier to getting the correct result.
- I recommend that the IRS collaborate with TAS and representatives of low income taxpayer clinics to develop training videos for IRS employees on working with taxpayers with special needs, especially in compliance and enforcement functions.
- I recommend that Congress support additional funding for the Low Income Taxpayer Clinics (LITCs) authorized by IRC § 7526. In FY 2010, Congress has provided \$10 million for the LITCs, yet largely because of job losses and the recession, LTC case inventories have skyrocketed. In 2008, the LITCs

collectively worked 16,374 cases. During just the first half of 2009, LITCs worked 14,382 cases.

- I recommend that Congress amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to Low Income Taxpayer Clinics receiving funding under this section. This change will allow IRS employees to refer taxpayers to specific clinics for assistance.
- I recommend that Congress authorize the IRS to promote the LITCs using paid advertising.

6. Where a Taxpayer Who Qualifies for the Earned Income Tax Credit Owes a Past Tax Debt, the IRS Withholds Up to 100 Percent of Any Current Refund, Undermining the Purpose of the EITC and Pushing the Taxpayer Deeper Into Poverty

The Earned Income Tax Credit is a refundable credit that benefits low income working individuals and families. Although the EITC enables low income working families to pay for necessities, maintain homes, repair vehicles needed to commute for work, and obtain additional education or training, the tax provision is very complex. This complexity can result in inadvertent errors by honest taxpayers and provides opportunities for cheating by dishonest taxpayers. The IRS estimates that the EITC overclaim rate falls in the range of 23 percent to 28 percent.⁶²

Characteristics of the EITC population exacerbate the problems with the statute's complex eligibility requirements. For example, approximately one-fifth of the EITC population changes each year – *i.e.*, previously eligible taxpayers become ineligible and previously ineligible taxpayers become eligible for the credit simply because of a change in life circumstances.⁶³ Thus, it is possible for a taxpayer to owe the IRS for an incorrect EITC claim in Year 1 and be eligible to receive the EITC in Year 2 due to a change in the taxpayer's circumstances.

Under IRC § 6402(a), the IRS may withhold current-year tax refunds in full to recover any past tax debts. As a consequence, some low income taxpayers who currently

⁶² The IRS has estimated that EITC erroneous payments fell in the range of \$9.6 billion – \$11.4 billion (23–28 percent) for tax year 2005. See *Reporting Improper Payments: A Report Card on Agencies' Progress: Hearing Before the Subcomm. On Federal Financial Management, Governmental Information and International Security of the S. Comm. On Homeland Security and Governmental Affairs*, 109th Cong. (Mar. 6, 2006) (written statement of Mark Everson, Commissioner of Internal Revenue). To place this noncompliance rate in perspective, Schedule C (sole proprietorship) payment noncompliance is estimated at 57 percent. See IRS News Release, IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006) (accompanying charts).

⁶³ IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2005–TY2008.

qualify for EITC assistance do not receive part or all of the EITC benefit that Congress has determined they need to provide a basic standard of living for their families.

Congress has limited the IRS's and other creditors' ability to offset or levy on Social Security and certain means-tested benefits. For example, the levy of Social Security benefits for payment of federal tax debts under the Federal Payment Levy Program (FPLP) is limited to 15 percent of the monthly benefit,⁶⁴ and as discussed below, the IRS has recently agreed to exempt low income individuals from such levies.

Recommendation

- I recommend that Congress amend IRC § 6402 to limit the portion of a tax refund attributable to the EITC that the IRS may withhold to 15 percent of the EITC benefit for the year.

7. The Treasury Department Should Conduct a Study to Determine How to Reverse the “Pay Refunds First, Verify Eligibility Later” Approach to Returns Processing

Each tax year, the IRS receives hundreds of millions of information returns, including Forms W-2 and 1099, and tax returns, notably Forms 1040. Right now, the IRS begins to process 1040s in January, but it does not receive and fully process W-2s and 1099s until well after the filing season ends. This sequence makes little sense for several reasons:

First: Millions of taxpayers each year make inadvertent overclaims that the IRS does not identify until it performs document-matching months later. As a result, these taxpayers not only receive notices assessing tax they did not know they owed and often did not save for, but they typically end up owing interest and penalties as well.

Second: On the criminal side, the IRS receives hundreds of thousands of false and fraudulent tax returns each year claiming billions of dollars in refunds. The Criminal Investigation Division tells us that a significant percentage of fraudulent claims involves income and withholding amounts ordinarily reported on a W-2 (e.g., the “taxpayer” will file a return showing a high withholding amount relative to tax liability, producing a large apparent refund). Because the IRS does not have W-2 data in its systems at the time it processes tax returns, the IRS has to devote significant resources to identifying and blocking fraudulent claims and it inevitably misses a fair number.

Third: Congress has given the IRS responsibility for administering an increasing number of social benefit programs through the tax code. The EITC has been around since the 1970's, but the Making Work Pay credit,⁶⁵ First-Time Homebuyer Credit,⁶⁶ and several

⁶⁴ IRC § 6331(h).

⁶⁵ IRC § 36A.

⁶⁶ IRC § 36.

others are new. Earlier information reporting would help to ensure that we quickly get the right amount of benefits to eligible taxpayers while minimizing the risk of fraud.

Fourth: Earlier access to information reporting data would enable the IRS to make those data available to taxpayers as they prepare their returns. Taxpayers could import the information into existing programs, the IRS could create pre-populated tax returns to reduce filing burdens for millions of taxpayers who file simple returns, or both.

For these reasons, if the IRS can get to a point where it can process information returns first, it could largely eliminate the post-filing season work of the Automated Underreporter Unit, substantially reduce opportunities for fraud, make pre-populated returns a viable option, and give the IRS better tools to administer social benefit programs when Congress directs it to do so.

Despite the obvious logic of processing information returns first, it is much easier said than done. With tax returns arriving as early as January and the IRS not completing its Information Returns Master File for the year until around August, we would have to find a way to make up about six months worth of time. Some steps could accelerate the process substantially. For example, Congress could require W-2s to be submitted directly to the IRS on January 31, when they are given to taxpayers, and might even be able to move that date up to January 15 in the future. Also with some lead time, the IRS could make systems improvements to enable it to process and match information and tax returns more quickly.

But even if these challenges are addressed, it is likely that there will still be some time gap that cannot be bridged. Put simply, if taxpayers are now entitled to submit returns in mid-January and the IRS does not even receive information returns until that time, it would be impossible to make full use of information returns unless the beginning of the filing season is somewhat delayed. Such a delay will certainly upset those early-filing taxpayers, who tend to be low income and receive large refunds. Some ways to mitigate the delay would be to more closely calibrate tax withholding to tax liability, revamp the Advance EITC, or pay out benefits ratably during the course of the year to reduce the size of refund payments. In my view, the significant benefits of real-time document-matching make it imperative that we consider such steps.

Recommendation

- I recommend that Congress direct the Treasury Department to study and report back within one year on the administrative and legislative steps that would be required to enable the IRS to receive and process information reporting documents before it processes tax returns and issues refunds. In my 2009 Annual Report to Congress, I identified key issues that would require careful study.⁶⁷ I believe the benefits of getting information returns into the system first

⁶⁷ National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

would be significant but recognize that practical challenges exist. Therefore, I suggest that Congress and the IRS aim to implement changes within five years from the time this report is completed to provide the IRS and private industry sufficient lead time to make required adjustments.

8. IRC Section 6707A Should Be Amended Expeditiously to Ameliorate the Unconscionable Impact It Is Having on Taxpayers

Section 6707A of the Internal Revenue Code imposes a penalty of \$100,000 per individual and \$200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a “listed transaction” or “substantially similar” to a listed transaction.⁶⁸ Although the penalty was originally designed to encourage the disclosure of corporate tax shelters, it has had the unintended effect of subjecting to Draconian penalties – in some cases over \$1 million – small businesses that have limited assets, derived little or no tax savings, and had no knowledge that they were entering into a corporate tax shelter. Consider the following:

- The penalty imposes “strict liability” – it applies without regard to whether the taxpayer has knowledge that the transaction has been listed and without regard to whether the transaction is reported correctly on the taxpayer’s return.⁶⁹
- The penalty applies even if the taxpayer derived no tax savings from the transaction.⁷⁰
- The penalty *must* be imposed by the IRS and cannot be rescinded under any circumstances.⁷¹
- The penalty may not be appealed in any court.⁷²

⁶⁸ For a more detailed discussion of this issue, see National Taxpayer Advocate 2008 Annual Report to Congress 419-422 (Legislative Recommendation: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*). For the definition of a “listed transaction,” see Treas. Reg. § 1.6011-4(b)(2).

⁶⁹ IRC § 6707A; Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108th Cong. at 373 (2004).

⁷⁰ *Id.*

⁷¹ IRC § 6707A(a) & (d)(1)(A). Section 6707A(a) provides that “[a]ny person who fails to [make the required disclosures] *shall* pay [the] penalty” (emphasis added). This language seems absolute, and the IRS to date has interpreted the provision as requiring it to impose the penalty in all circumstances described in the statute.

⁷² IRC § 6707A(d)(2); *Smith v. Comm’r*, 133 T.C. No. 18 (2009) (finding the court lacked deficiency jurisdiction to redetermine penalties for failure to report involvement in a listed transaction).

- The taxpayer's disclosure must initially be made twice – once with the IRS Office of Tax Shelter Analysis and again with the tax return for the year in which the transaction is first required to be disclosed.⁷³ A disclosure included with the taxpayer's filed return, no matter how detailed, will not suffice by itself to avoid the penalty. After the first year in which the transaction must be disclosed, the taxpayer must continue to make disclosures with each filed return that reflects the transaction.
- A taxpayer that discloses a transaction may be subject to the penalty if the IRS deems the disclosure to be incomplete.⁷⁴
- If a transaction is not “listed” at the time the taxpayer files a return but it becomes listed years later, the taxpayer becomes responsible for filing a disclosure statement and will be liable for this penalty for failing to do so. This is true even if the taxpayer has no knowledge that the transaction has been listed.⁷⁵
- The penalty applies to each tax return the taxpayer files.⁷⁶
- The usual three-year statute of limitations does not apply.⁷⁷

Thus, an individual who does business through a wholly owned S corporation may enter into a ten-year transaction that he believes is proper and that produces little or no tax savings – only to end up owing a penalty of \$3 million (*i.e.*, a penalty of \$200,000 on the S corporation and a penalty of \$100,000 on the individual taxpayer for each of the ten years).

This harm is not merely theoretical. This penalty has been imposed against small businesses in hundreds of cases, and as noted, the minimum amount of the penalty is now \$100,000 for an individual, and in practice, most taxpayers are facing penalties running many multiples higher. All agree this effect was unintended and is unconscionable. Further, I question whether this provision is constitutional on procedural due process grounds, because the penalty constitutes a significant deprivation and does not provide for a pre- or post-deprivation hearing. It must be fixed quickly.

⁷³ Treas. Reg. § 1.6011-4(a) & (e).

⁷⁴ Treas. Reg. § 1.6011-4(d).

⁷⁵ Treas. Reg. § 1.6011-4(e)(2). The requirement will cease to apply after the period of limitations on assessment for the final return reflecting the transaction has expired.

⁷⁶ IRC § 6707A; Treas. Reg. § 1.6011-4(e)(1); Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108th Cong. at 373 (2004).

⁷⁷ IRC § 6501(c)(10) (providing that the statute of limitations will remain open with respect to an undisclosed listed transaction until at least one year after the earlier of (i) the date on which the taxpayer provides the required disclosure or (ii) the date on which a material advisor provides the name of the taxpayer to the Treasury Department in response to a request made under IRC § 6112(b)).

On June 12, 2009, the Chairman and Ranking Member of this Subcommittee and the Chairman and Ranking Member of the Senate Committee on Finance sent a letter to the Commissioner stating their commitment to modify the law and asking that the IRS in the interim use the discretion provided with its effective tax administration authority to suspend collection of Section 6707A liabilities in cases where the tax benefits resulting from a listed transactions are less than \$100,000 for individuals and \$200,000 in other cases. In response, the Commissioner agreed to impose a temporary moratorium on collection action and has extended it twice, but faced with an operative statute that requires the IRS to assess these penalties, the IRS is unlikely to extend the moratorium indefinitely based on a stated intention to revise the statute.

Last month, the full Senate passed S. 2917, the Small Business Penalty Fairness Act, which would generally limit the penalty to a percentage of the tax savings realized. The Chairman and Ranking Member of this Subcommittee have introduced H.R. 4068, the Small Business Penalty Relief Act. To prevent untold economic calamity for hundreds of small business owners and their families across the country, I cannot overstate the importance of prompt passage of this legislation.

Recommendation

- I recommend that the House pass H.R. 4068 or, to avoid the need to reconcile differences with the Senate bill, legislation identical to S. 2917 as quickly as possible to address this most unfortunate and unintended situation.

9. Status Updates

TAS makes many recommendations in its Annual Reports to Congress and internally to the IRS that may take several years to implement. In some instances, it takes time and several discussions in the Annual Reports to Congress in order to reach an agreement that the issue is, indeed, a most serious problem for taxpayers. I am pleased that I can report significant progress on two such issues.

A. Federal Payment Levy Program

The Federal Payment Levy Program (FPLP) is an automated system that allows continuous levies to be issued for up to 15 percent of certain federal payments and 100 percent of certain federal contractor or vendor payments due to taxpayers who have unpaid federal tax liabilities.⁷⁸ While FPLP levies can attach to a variety of federal sources of income, ranging from salaries to retirement income to federal contractor payments, the bulk of FPLP levy payments have historically been related to Social Security benefits – 83 percent for FY 2008.⁷⁹

⁷⁸ IRC § 6331(h).

⁷⁹ IRS, Wage and Investment Division spreadsheet, *FPLP Monthly Counts FY 2008* (1,797,530 [total number of FPLP SSA levy payments received in FY 2008] / 2,161,974 [total number of FPLP levy payments received in FY 2008] = 83 percent).

Over the past several years, I have identified the absence of a filter for low income taxpayers subject to FPLP levies as a most serious problem.⁸⁰ This year, I am pleased to report that the IRS has agreed to implement a low income filter (LIF) for taxpayers receiving Social Security and Railroad Retirement Board benefits. The LIF, which is expected to be in place by January 2011, will exclude taxpayers from automated FPLP levies if their estimated income (based on internal IRS data) is less than 250 percent of the poverty level guideline as defined by the Department of Health and Human Services.

When the filter is implemented, fewer low income taxpayers will experience economic hardship as a result of IRS levy actions, and the IRS itself will avoid unnecessary work – having to release these levies downstream and return levy proceeds to taxpayers who cannot meet their basic living expenses. I commend the IRS for developing this filter, and I am grateful to this Subcommittee for its ongoing interest in the issue.

B. Identity Theft Procedures

Identity theft occurs in tax administration when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return or fraudulently gain employment. When these types of identify theft occur, the victim often begins an extremely frustrating journey through IRS processes and procedures that may take years to complete. I have included identity theft as a most serious problem encountered by taxpayers in four of my last five Annual Reports to Congress.⁸¹

The IRS has made several recent improvements in procedures to assist victims of identity theft. It is now marking the accounts of identity-theft victims with an electronic indicator, which will reduce taxpayer burden (because IRS will not assess the perpetrator's tax against the victim) while protecting federal revenue (by not paying out refunds on suspect returns). The IRS is also applying a series of filters – known as “business rules” – to distinguish valid returns from fraudulent ones. It has also developed and improved its Identity Theft Affidavit form, which it requires taxpayers to complete in order to authenticate their identity.

Most significantly, the IRS has established a centralized main unit dedicated to assisting identity theft victims. Over the last year, the Taxpayer Advocate Service has worked with

⁸⁰ See National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (Research Report: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*); National Taxpayer Advocate 2007 Annual Report to Congress 324-336; National Taxpayer Advocate 2006 Annual Report to Congress 110-129, 141-156; National Taxpayer Advocate 2005 Annual Report to Congress 123-135; National Taxpayer Advocate 2004 Annual Report to Congress 246-263; National Taxpayer Advocate 2003 Annual Report to Congress 206-212. For a more detailed status update on this issue, see National Taxpayer Advocate 2009 Annual Report to Congress 318-319.

⁸¹ See National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-191; National Taxpayer Advocate 2004 Annual Report to Congress 132-136.

this unit – known as the Identity Protection Specialized Unit (IPSU) – to improve its procedures in assisting victims of identity theft. The unit is serving as a central point of contact that interacts with other parts of the IRS as appropriate. In addition, the unit conducts a global account review to identify all federal tax issues related to the identity theft and ensures that the responsible IRS functions have taken the appropriate actions to resolve the victim's tax account issues.

While we are concerned that the IPSU may not have sufficient staffing to deal with the increasing numbers of identity theft cases and think the business rules can be improved, we believe that the IRS has made significant progress on this issue.⁸²

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As part of our effort to reach the growing number of taxpayers who may need help from the Taxpayer Advocate Service, we have placed numerous educational products on social media sites such as Facebook (<http://www.facebook.com/YourVoiceAtIRS>) and YouTube (<http://www.YouTube.com/TASNTA>). This material includes a series of video messages that I recorded on topics such as liens, cancellation of debt income, the Alternative Minimum Tax, identity theft, and the First-Time Homebuyer Credit. These videos also appear on the Tax Toolkit (<http://www.taxtoolkit.irs.gov>), which contains information about basic tax responsibilities for those new to the federal tax system, taxpayers with limited English proficiency, and those with disabilities. These sites represent TAS's commitment to keeping taxpayers informed and tailoring our services to their constantly changing needs. I was very pleased to note that the Committee on Ways and Means is a follower of our Twitter page (www.Twitter.com/YourVoiceAtIRS).

⁸² Identity theft cases received in the Taxpayer Advocate Service have increased by 96 percent between FY 2008 and FY 2009, from 7,147 to 14,023. A significant number of those cases resulted from unintended application of the business rules.