

## IMPROVE ASSESSMENT AND COLLECTION PROCEDURES

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### Legislative Recommendation #9

## Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail

### SUMMARY

- *Problem:* Each year, the IRS sends millions of “math error” notices to taxpayers that propose to adjust their tax liabilities. These notices often do not explain the reasons for the adjustments, and some are never received by the taxpayer. The IRS is not required to inform taxpayers that they must dispute the adjustments within 60 days if they disagree or generally forfeit their right to do so.
- *Solution:* Require that all math error notices provide a clear explanation of the error alleged, be sent via certified or registered mail, and inform taxpayers they have 60 days from the date of the notice to request the math error adjustment be abated or the adjustment generally will become final.

### PRESENT LAW

Under IRC § 6213(b) the IRS may make a summary assessment of tax arising from a mathematical or clerical error, as defined in IRC § 6213(g). Summary assessment is often referred to as “math error” authority. When the IRS makes a math error adjustment, IRC § 6213(b)(1) requires it to send the taxpayer a notice describing “the error alleged and an explanation thereof.” By law, the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated.<sup>1</sup> If the taxpayer does not make an abatement request within 60 days, the assessment becomes final, and the taxpayer has generally lost their right to challenge the IRS’s position in the U.S. Tax Court. If the taxpayer requests abatement within the 60-day period, the IRS must abate the summary assessment. If the IRS continues to believe the taxpayer owes the tax, it may audit the taxpayer and propose an adjustment by issuing a notice of deficiency. If the IRS does so, the taxpayer will have the right to challenge the IRS’s position in the U.S. Tax Court.

### REASONS FOR CHANGE

Many taxpayers do not understand that the failure to respond to an IRS math error notice within 60 days means they have conceded the adjustment and, except in limited circumstances, have forfeited their right to challenge the IRS’s position in Tax Court. Notably, the law does not specify how the IRS must describe the math error or require the IRS to inform taxpayers they have 60 days to request that the math error assessment be reversed. Further, unlike a statutory notice of deficiency, which carries consequences similar to that of a math error notice (*i.e.*, assessment of tax that may result in future collection actions), IRC § 6213 does not require the IRS to send a math error notice by certified or registered mail.<sup>2</sup>

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<sup>1</sup> IRC § 6213(b)(2)(A).

<sup>2</sup> IRC § 6212(a) (“If the Secretary determines that there is a deficiency in respect of any tax imposed ... he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.”).

Although the statute requires the IRS to “set forth the error alleged and an explanation thereof” in a notice, the descriptions the IRS provides are often very general. Some notices provide taxpayers with a list of possible errors and do not specify which one the IRS believes the taxpayer committed – sometimes leaving the taxpayer uncertain why the IRS made the adjustment. Other notices indicate a taxpayer understated their adjusted gross income but do not specify which item of gross income was understated.

It is unclear whether the IRS’s explanation of alleged errors satisfies the statutory requirement when it makes a general statement or states that the error is due to one of multiple possible causes, as the statute does not describe the degree of specificity required. However, it is clear that the omission of the 60-day language from math error notices does not invalidate the notices because IRC § 6213(b) does not require the IRS to tell taxpayers they have 60 days to request an abatement. While the IRS generally provides this information, the practice should not be discretionary. During calendar year 2021, the IRS neglected to include language informing taxpayers they have 60 days to request an abatement in over 5 million math error notices.<sup>3</sup> Although the IRS later corrected this omission by sending taxpayers letters explaining the 60-day period, many taxpayers were left confused about what they needed to do, if anything.

Amending IRC § 6213(b) to require that the IRS specifically describe the error giving rise to the adjustment and inform taxpayers they have 60 days to request that the summary assessment be abated would help ensure taxpayers understand the adjustment and their rights. Requiring that the notice be sent by either certified or registered mail would underscore the significance of the notice and provide an additional safeguard to ensure that taxpayers are receiving this critical information.

## RECOMMENDATION

- Amend IRC § 6213(b)(1) to require that:
  - All math error notices must provide a detailed explanation of the specific error, including the line number on the return or the line number on the schedule (whichever is more specific) on which the alleged error was made.
  - All math error notices must include a statement that the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated and must prominently display at the top of the notice the date on which the 60-day period expires.
  - All such notices must be sent by either certified or registered mail.<sup>4</sup>

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<sup>3</sup> Erin M. Collins, Math Error, Part II: Math Error Notices Aren’t Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information>.

<sup>4</sup> For legislative language generally consistent with this recommendation, see Internal Revenue Service Math and Taxpayer Help Act, S. 4549 and H.R.8067, 118th Cong. (2024).

**Legislative Recommendation #10****Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute****SUMMARY**

- *Problem:* The tax law generally requires the IRS to follow "deficiency procedures" when it determines a taxpayer owes additional tax, and deficiency procedures give taxpayers the right to challenge the IRS determination in the U.S. Tax Court. However, the law also gives the IRS the authority to provisionally bypass deficiency procedures and summarily assess tax when a tax return contains one of 22 categories of "mathematical or clerical errors" (often referred to as "math errors"). On several occasions, the Department of the Treasury (Treasury) has requested that Congress grant it the authority to add new categories of math errors by regulation. This change could have the effect of depriving taxpayers of deficiency procedures (and thus the right to challenge the IRS's position in the Tax Court) in a wider range of circumstances.
- *Solution:* Congress should retain the sole authority to revise categories of math errors and not give Treasury the authority to add new categories of math errors by regulation, and it should impose additional safeguards regarding when the IRS may use math error authority.

**PRESENT LAW**

Before the IRS may assess a deficiency, IRC § 6213(a) ordinarily requires that it send the taxpayer a "notice of deficiency" that gives the taxpayer 90 days (or 150 days if addressed to a taxpayer outside the United States) to challenge the IRS's position by filing a petition with the U.S. Tax Court (known as "deficiency procedures"). The taxpayer's ability to appeal a deficiency determination to the Tax Court before paying the tax is central to the taxpayer *right to appeal an IRS decision in an independent forum*.<sup>1</sup>

As an exception to standard deficiency procedures, IRC § 6213(b)(1) authorizes the IRS to summarily assess and collect tax without first providing the taxpayer with a notice of deficiency or access to the Tax Court when addressing "mathematical and clerical" errors (known as "math error authority"). If a taxpayer contests a math error notice within 60 days, IRC § 6213(b)(2)(A) requires that the IRS abate the assessment. If the IRS abates the assessment, it must follow deficiency procedures if it wishes to reassess the tax. If taxpayers fail to respond to a math error notice timely, they lose their right to challenge the liability in court prior to assessment. The IRS may summarily assess deficiencies arising from 22 types of mathematical or clerical errors, which IRC § 6213(g)(2), subparagraphs A-V, codifies.

**REASONS FOR CHANGE**

Congress generally requires the IRS to follow deficiency procedures, which provide taxpayers with notice and a reasonable opportunity to challenge the IRS's tax adjustment, most importantly by giving them an opportunity to dispute an adverse IRS determination in an independent judicial forum (*i.e.*, the U.S. Tax Court) before being required to pay additional tax. Congress authorized math error authority, which provides fewer taxpayer protections, as a limited exception to regular deficiency procedures. It allows the IRS to make adjustments in cases of clear taxpayer error, such as where a taxpayer incorrectly adds numbers or incorrectly

<sup>1</sup> See IRC § 7803(a)(3)(E) (identifying the *right to appeal an IRS decision in an independent forum* as a taxpayer right).

transcribes a number from one form to another. If a taxpayer who receives a math error notice does not ask the IRS to abate the tax within 60 days, the taxpayer loses the right to Tax Court review before the IRS makes the assessment.

Math error procedures are cheaper and simpler for the IRS than deficiency procedures. For that reason, Treasury has previously requested that Congress grant it the authority to assess tax without issuing a statutory notice of deficiency where the information provided by the taxpayer does not match the information contained in government databases or other third-party databases Treasury specifies in regulations – what it refers to as “correctable errors.”<sup>2</sup>

The National Taxpayer Advocate is concerned about the impact on taxpayer rights of giving Treasury broad authority to add new categories of math error by regulation. The National Taxpayer Advocate’s Reports to Congress have documented numerous circumstances in which the IRS has used math error authority to address discrepancies that have undermined taxpayer rights.<sup>3</sup>

If the IRS uses math error authority to address more complex issues that require additional fact finding, its assessments are more likely to be wrong, and the IRS’s computer-generated notices, which confuse many taxpayers in the simplest of circumstances, are likely to become even more difficult to understand.<sup>4</sup>

Math error authority is appropriate for the IRS to use where required schedules are omitted or where annual or lifetime dollar caps have been exceeded. It is also appropriate to use where there is a discrepancy between a return entry and data available to the IRS from certain reliable government databases, such as records maintained by the Social Security Administration. But Treasury and the IRS should not be the sole arbiters of that reliability. Rather, Congress should retain the authority to determine whether the administrative “efficiency” of using math error authority in specific instances outweighs the loss of the significant taxpayer protections deficiency procedures provide.

## RECOMMENDATIONS

- Refrain from giving Treasury the authority to add new categories of “correctable errors” by regulation. Because the deficiency procedures created by Congress provide important taxpayer protections, Congress should retain the sole authority to determine whether and when to create exceptions to deficiency procedures by adding categories of mathematical or clerical errors.

2 See, e.g., STAFF OF J. COMM. ON TAX’N, 116TH CONG., DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2020 BUDGET PROPOSAL 62, 64, JCS-1-19 (July 8, 2019), <https://www.jct.gov/CMSPages/GetFile.aspx?guid=7375e9d9-b13c-4692-a667-7e66ec7234e9>; Dep’t of the Treasury, *General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals* 245-246 (Feb. 2015) <https://home.treasury.gov/system/files/131/General-Explanations-FY2016.pdf>.

3 See, e.g., National Taxpayer Advocate 2018 Annual Report to Congress 164 (Most Serious Problem: Post-Processing Math Error Authority: The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18\\_Volume1\\_MSP\\_11\\_PostProcessing.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18_Volume1_MSP_11_PostProcessing.pdf); National Taxpayer Advocate 2018 Annual Report to Congress 174 (Most Serious Problem: Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18\\_Volume1\\_MSP\\_12\\_MathError.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18_Volume1_MSP_12_MathError.pdf).

4 The National Taxpayer Advocate also recommends that Congress require the IRS to improve the specificity of math error notices and make them easier to understand. See *Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail*, *supra*. Bipartisan legislation has recently been introduced that would generally adopt this recommendation. See Internal Revenue Service Math and Taxpayer Help Act, H.R. 8067 & S. 4549, 118th Cong. § 2 (2024). See also Erin M. Collins, Math Error, Part I, NATIONAL TAXPAYER ADVOCATE BLOG (July 28, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-i/>; Erin M. Collins, Math Error, Part II: Math Error Notices Aren’t Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

- Amend IRC § 6213(b) to permit an assessment arising out of mathematical or clerical errors only when the IRS has researched all information in its possession that could help reconcile the discrepancy.
- Amend IRC § 6213(g) to authorize the IRS to exercise its existing (and any new) authority to summarily assess a deficiency due to “clerical errors” only where: (i) there is a discrepancy between a return entry and reliable government data; (ii) the IRS’s notice clearly describes the discrepancy and how to contest it; (iii) the IRS has researched all information in its possession that could help reconcile the discrepancy; and (iv) the IRS does not have to evaluate documentation to make a determination.
- Amend IRC § 6213 to provide that the IRS is not authorized to use any new criteria or data to make summary assessments unless Treasury, in consultation with the National Taxpayer Advocate, has evaluated and publicly reported on the reliability of the criteria or data for that intended use.<sup>5</sup>

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5 For a more limited recommendation, see National Taxpayer Advocate 2015 Annual Report to Congress 329 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15\\_Volume1\\_LR\\_02\\_Math-Error-Authority.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_LR_02_Math-Error-Authority.pdf).

**Legislative Recommendation #11**

## **Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans**

**SUMMARY**

- *Problem:* Refundable credits, including the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), can be a lifeline for many low-income families, accounting for a high percentage of their household incomes. To deter improper claims, the law requires the IRS to ban taxpayers who make improper claims from receiving these credits under certain circumstances in future years – even if the taxpayers otherwise meet all eligibility requirements in those future years. Because a multiyear ban against receiving these tax credits can have financially devastating consequences, it is critical that there be adequate administrative and judicial safeguards to ensure they are only imposed in appropriate cases.
- *Solution:* Require IRS managerial approval of multiyear bans and clarify that the Tax Court has jurisdiction to review the imposition of a ban for the years in which the ban is imposed.

**PRESENT LAW**

IRC §§ 24(g), 25A(b), and 32(k) require the IRS to ban a taxpayer from claiming the CTC, the Credit for Other Dependents (ODC), the American Opportunity Tax Credit (AOTC), and the EITC for two years if the IRS makes a final determination that the taxpayer improperly claimed the credit with reckless or intentional disregard of rules and regulations. The duration of the ban increases to ten years if the IRS makes a final determination that the credit was claimed fraudulently. These code sections refer to the years for which the ban is imposed as the “disallowance period.”<sup>1</sup>

IRC § 6214 grants the Tax Court jurisdiction to redetermine a deficiency for the tax year(s) before the court, but it does not grant the Tax Court jurisdiction to redetermine deficiencies for other tax years.

**REASONS FOR CHANGE**

Congress directed the IRS to impose multiyear bans on CTC, ODC, AOTC, and EITC eligibility to deter and penalize certain taxpayers who improperly claim these credits. These multiyear bans are unique in tax law because they prevent taxpayers from receiving credits in future years, even if they otherwise satisfy all eligibility requirements in those years.

Refundable credits can be a lifeline for low-income taxpayers. A 2019 TAS study found that, on average, the amount of disallowed EITC accounted 23 percent of eligible taxpayers’ adjusted gross incomes.<sup>2</sup> Thus, it is critical that there be adequate safeguards to ensure both that the IRS imposes a ban only when a taxpayer acts with the requisite improper intent and that a taxpayer has access to meaningful judicial review of an IRS ban determination.

<sup>1</sup> IRC §§ 24(g)(1)(A), 25A(b)(4)(A)(i), 32(k)(1)(A).

<sup>2</sup> National Taxpayer Advocate 2019 Annual Report to Congress vol. 2, at 239, 250 (Research Study: *Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19\\_Volume1\\_TRRS\\_02\\_EITCban.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19_Volume1_TRRS_02_EITCban.pdf).



## Written Managerial Approval

In most ban cases, IRS procedures require a manager to review the case independently and approve the assertion of a ban in writing.<sup>3</sup> However, the IRS's internal rules allow the agency to impose two-year bans automatically in some EITC cases,<sup>4</sup> and the IRS expanded its practice of automatically imposing bans to include the refundable portion of the CTC (referred to as the Additional Child Tax Credit, or ACTC).<sup>5</sup> Three TAS research studies of two-year ban cases found that managerial approval, even where required, is often lacking.<sup>6</sup> Moreover, because the IRS's policy of requiring managerial approval of multiyear bans is administrative the IRS may eliminate or weaken the requirement at any time.

The National Taxpayer Advocate does not believe that multiyear bans should ever be imposed by automatic or systemic means. The law provides for imposition of the two-year ban only in cases where the IRS determines a taxpayer acted recklessly or with intentional disregard of rules and regulations, and it provides for imposition of the ten-year ban only in cases where the IRS determines a taxpayer's claim was fraudulent. Notably, the law does not permit the IRS to impose a multiyear ban when an improper claim is due to inadvertent error, or even due to negligence.

A computer is not capable of assessing a taxpayer's state of mind and therefore cannot determine whether an improper claim was due to reckless or intentional disregard of rules and regulations. This determination requires an independent facts-and-circumstances investigation by an employee. In light of the potentially harsh financial impact of multiyear bans, managerial approval should be required in all cases before they are imposed.

## Tax Court Jurisdiction

Although a taxpayer should be able to obtain independent Tax Court review of a multiyear ban, it is not clear whether, or when, the Tax Court has the jurisdiction to reverse a multiyear ban. That is because the imposition of a ban and the effect of a ban on a taxpayer's tax liability occur in different tax years.

The Tax Court may not have jurisdiction to reverse a ban in the year it is imposed. IRC § 6214 generally limits the Tax Court to determining the amount of tax owed in the tax year(s) before it. By its nature, a ban against claiming tax credits in future years will affect the taxpayer's tax liability in future years – not in the year in which it is imposed.<sup>7</sup>

The Tax Court may also lack jurisdiction to reverse a ban in the years in which the ban is in effect. By operation of law, a ban automatically denies benefits in future years. If a taxpayer challenges the IRS's

3 Internal Revenue Manual (IRM) 4.19.14.7.1(2), 2/10 Year Ban – Correspondence Guidelines for Examination Technicians (CET) (Jan. 3, 2023), [https://www.irs.gov/irm/part4/irm\\_04-019-014r](https://www.irs.gov/irm/part4/irm_04-019-014r).

4 IRM 4.19.14.7.1.5, Project Codes 0027 and 0028 – EITC Recertification with a Proposed 2 Year EITC Ban (Jan. 3, 2023), [https://www.irs.gov/irm/part4/irm\\_04-019-014r](https://www.irs.gov/irm/part4/irm_04-019-014r).

5 The American Rescue Plan Act, Pub. L. No. 117-2, § 9611, 135 Stat. 4, 144 (2021), made the CTC fully refundable for tax year 2021. See Treasury Inspector General for Tax Administration, Ref. No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* 8 (2021) (reporting that “IRS management stated that, starting in Processing Year 2021, systemic processes will assess the two-year ban for the ACTC.”), <https://www.tigta.gov/sites/default/files/reports/2022-02/202140036fr.pdf>.

6 See National Taxpayer Advocate 2023 Annual Report to Congress, 2023 Research Reports, at 27, 34 (Research Study: *Study of the Two-Year Bans on the Earned Income Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC-2023\\_TAS-Research-Report\\_WEB\\_FINAL.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC-2023_TAS-Research-Report_WEB_FINAL.pdf); National Taxpayer Advocate 2019 Annual Report to Congress vol. 2, at 239 (Research Study: *Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19\\_Volume1\\_TRRS\\_02\\_EITCban.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19_Volume1_TRRS_02_EITCban.pdf); National Taxpayer Advocate 2013 Annual Report to Congress 103 (Most Serious Problem: *Earned Income Tax Credit: The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2013-ARC\\_VOL-1\\_S1-MSP-9.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2013-ARC_VOL-1_S1-MSP-9.pdf).

7 Compare *Garcia v. Comm’r*, T.C. Summ. Op. 2013-28 (holding, in a nonprecedential case, that a ban did not apply), with *Ballard v. Comm’r*, No. 3843-15S (T.C. Feb. 12, 2016) (declining to rule on the application of IRC § 32(k), noting that the application of the ban had no effect on the taxpayer's federal income tax liability for the year before it).

deficiency determination in a year in which the ban denies tax credits, the year in which the ban was initially imposed generally will not be before the court. It is not clear whether the court may reach back to the earlier year to determine whether the ban was properly imposed.

Transparency is a critical element of taxpayer rights and fairness, and taxpayers should understand clearly when they may seek Tax Court review of an adverse IRS determination. In most cases, the law is clear. Here, the law is not clear, and there appear to be four possible outcomes: (i) the Tax Court may have jurisdiction to review a ban both for the year in which it is imposed and for the year in which it is effective; (ii) the Tax Court may have jurisdiction to review a ban for the year in which it is imposed but not for the year in which it is effective; (iii) the Tax Court may not have jurisdiction to review a ban for the year in which it is imposed but may have jurisdiction to review it for the year in which it is effective; or (iv) the Tax Court may not have jurisdiction to review a ban at any time. These procedural uncertainties undermine a taxpayer's *rights to appeal an IRS decision in an independent forum and to a fair and just tax system*.

In general, the Tax Court's jurisdiction to adjust CTC, ODC, AOTC, or EITC claims is based on its deficiency jurisdiction.<sup>8</sup> As noted above, the determination to subject a taxpayer to a multiyear ban does not itself create a deficiency in the current tax year. Therefore, the National Taxpayer Advocate recommends that Congress amend IRC § 6214 to grant the Tax Court jurisdiction to determine whether the ban was properly imposed during a proceeding involving a deficiency created by the imposition of the ban (*i.e.*, during the two years in which the credits are denied rather than the initial year in which the ban was imposed).

## RECOMMENDATIONS

- Amend IRC §§ 24(g), 25A(b), and 32(k) to require independent managerial review and written approval based on consideration of all relevant facts and circumstances before the IRS may assert a multiyear ban.<sup>9</sup>
- Amend IRC § 6214 to clarify that the Tax Court has jurisdiction (i) to review the IRS's final determination to impose a multiyear ban under IRC §§ 24(g), 25A(b), or 32(k) in any proceeding involving the years in which the notice of deficiency disallows CTC, ODC, AOTC, or EITC on the basis of a multiyear ban, and (ii) to allow the affected credit if it finds a multiyear ban was improperly imposed and the taxpayer otherwise qualifies for the credit.

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<sup>8</sup> IRC §§ 6213(a), 6214(a).

<sup>9</sup> The National Taxpayer Advocate is not proposing to amend IRC § 6751(b) because determinations made by electronic means are exempt from the requirement of supervisory approval under IRC § 6751(b)(2)(B). As discussed above, the determination of the application of a multiyear ban should not be determined electronically and should be reviewed and approved by the supervisor of the employee who makes the determination.



**Legislative Recommendation #12****Give Taxpayers Abroad Additional Time to Request Abatement of a Math Error Assessment****SUMMARY**

- *Problem:* U.S. taxpayers abroad generally need more time to respond to IRS notices than taxpayers living within the United States. The tax code gives taxpayers abroad an additional 60 days to respond to a notice of deficiency, but it does not give taxpayers abroad additional time to respond to a math error notice – even though failure to respond to a math error notice within 60 days means the IRS may assess the tax and the taxpayer generally forfeits the right to challenge the IRS’s assessment in the U.S. Tax Court.
- *Solution:* Give taxpayers abroad an additional 60 days to respond to math error notices.

**PRESENT LAW**

IRC § 6213(b) authorizes the IRS to make a “summary assessment” of tax arising from mathematical or clerical errors as defined in IRC § 6213(g), thus bypassing otherwise applicable deficiency procedures. Under IRC § 6213(b)(2)(A), however, a taxpayer has 60 days after a math error notice is sent to request that the summary assessment be abated. If the taxpayer makes an abatement request within 60 days, the IRS must abate the summary assessment and then follow deficiency procedures under IRC § 6212 if it wishes to reassess an increase in tax. If the taxpayer does not submit an abatement request within 60 days, the taxpayer generally forfeits the right to dispute the IRS’s assessment by filing a petition in the U.S. Tax Court. No additional time is allowed to request an abatement when the math error notice is addressed to a taxpayer outside the United States.

By contrast, a taxpayer outside the United States who receives a notice of deficiency is given additional time to respond. In general, a taxpayer may file a petition in the Tax Court for a redetermination of a deficiency within 90 days from the date the notice is mailed. However, when the notice of deficiency “is addressed to a person outside the United States,” IRC § 6213(a) provides that the taxpayer has 150 days from the date the notice is mailed to file a Tax Court petition. The Tax Court has construed this language broadly, concluding among other things that the 150-day period for filing a petition applies not only when a notice of deficiency is mailed to an address outside the United States, but also when a notice of deficiency is mailed to an address within the United States, provided the taxpayer is located outside the United States.<sup>1</sup>

**REASONS FOR CHANGE**

The U.S. State Department has estimated that the number of U.S. citizens residing abroad is about nine million, including students, members of the military, taxpayers working abroad, and retirees.<sup>2</sup> Taxpayers abroad (either temporarily or permanently) often require more time to respond to IRS notices than

1 See, e.g., *Levy v. Comm’r*, 76 T.C. 228 (1981) (holding that the 150-day rule is applicable to a U.S. resident who is temporarily outside the country when the notice is mailed and delivered); *Looper v. Comm’r*, 73 T.C. 690 (1980) (holding that the 150-day rule is applicable when a notice is mailed to an address outside the United States); *Lewy v. Comm’r*, 68 T.C. 779 (1977) (holding that the 150-day rule is applicable to a foreign resident who is in the United States when the notice is mailed but is outside the United States when the notice is delivered); *Hamilton v. Comm’r*, 13 T.C. 747 (1949) (holding that the 150-day rule is applicable to a foreign resident who is outside the United States when the notice is mailed and delivered).

2 See U.S. DEP’T OF STATE, BUREAU OF CONSULAR AFFS., CONSULAR AFFAIRS BY THE NUMBERS (Jan. 2020), <https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf>. TAS is not aware of a more recent government study.

taxpayers living in the United States. Mail delivery takes longer in both directions – in some cases substantially longer. In addition, persons temporarily abroad often do not have access to their tax or financial records, making it difficult for them to respond immediately.

By giving taxpayers abroad 60 additional days to file a petition in the Tax Court in response to a notice of deficiency, Congress recognized that holding overseas taxpayers to the same deadlines as taxpayers located in the United States would be unreasonable. The same logic applies to math error notices. In fact, the need for additional time is arguably greater in the case of math error notices because the standard response deadline is 60 days (as opposed to 90 days for filing a Tax Court petition in response to a notice of deficiency).

## **RECOMMENDATION**

- Amend IRC § 6213(b)(2)(A) to allow taxpayers 120 days to request an abatement of tax when a math error notice is addressed to a person outside the United States.

## Legislative Recommendation #13

## Give Taxpayers Abroad Additional Time to Request a Collection Due Process Hearing and to File a Petition Challenging a Notice of Determination in the Tax Court

### SUMMARY

- *Problem:* Taxpayers abroad often experience long delays in receiving mail from the IRS and generally need more time to respond to notices than taxpayers living in the United States. The tax code allows an additional 60 days for taxpayers abroad to challenge a notice of deficiency, but it does not allow additional time to challenge Collection Due Process (CDP) notices. As a result, taxpayers abroad may lose critical administrative, due process, and judicial rights.
- *Solution:* Amend the tax code to allow an additional 60 days for taxpayers abroad to request a CDP hearing and to challenge a CDP notice of determination in the Tax Court.

### PRESENT LAW

IRC § 6320(a) requires the IRS to give taxpayers notice and an opportunity for a hearing after it files a Notice of Federal Tax Lien (CDP lien notice).<sup>1</sup> IRC § 6330(a) generally requires the IRS to give taxpayers notice and an opportunity for a hearing before it issues a levy (CDP levy notice).<sup>2</sup> In both cases, taxpayers have 30 days to request a CDP hearing.<sup>3</sup>

The hearing allows for review of a filed Notice of Federal Tax Lien or a proposed levy and is conducted by an impartial officer of the Independent Office of Appeals (Appeals). It allows a taxpayer the opportunity to raise defenses, challenge the appropriateness of a lien or levy, and propose collection alternatives.<sup>4</sup> A taxpayer may also dispute the existence or amount of the underlying tax liability at a CDP hearing if the taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.”<sup>5</sup> If the parties cannot otherwise resolve the issues, Appeals issues a notice of

<sup>1</sup> A CDP lien notice must be sent not more than five business days after the filing of the notice of lien.

<sup>2</sup> A CDP levy notice must be sent not less than 30 days before the day of the first levy unless an exception under IRC § 6330(f) applies.

<sup>3</sup> IRC §§ 6320(a)(3)(B), 6330(a)(3)(B). Taxpayers will still be allowed an Appeals hearing if the request is late, but it is an “equivalent” hearing, not a CDP hearing, and the taxpayer cannot challenge the Appeals determination in Tax Court. Treas. Reg. §§ 301.6320-(1)(i)(1), 301.6330-1(i)(1). Thus, taxpayers lose the right to judicial review if they miss the 30-day response deadline in IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B). In *Organic Cannabis Found., LLC v. Comm’r*, 161 T.C. 13 (2023), the Tax Court held that the 30-day period for requesting a CDP hearing may be equitably tolled when the circumstances warrant it. However, equitable tolling is applied only sparingly and when taxpayers seeking tolling establish that (i) they pursued their rights diligently and (ii) extraordinary circumstances prevented them from filing timely. See, e.g., *Cunningham v. Comm’r*, 716 F. App’x. 182, 183-184 (4th Cir. 2018) (unpublished) (holding that equitable tolling was not appropriate under the test articulated in *Menominee Indian Tribe of Wis. v. United States*, 577 U.S. 250 (2016), when a taxpayer missed the deadline for responding to a CDP levy notice by one day because she misunderstood the letter).

<sup>4</sup> IRC §§ 6320(c), 6330(c)(2)(A).

<sup>5</sup> IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties, additions to tax, and statutory interest. *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).

determination, which allows the taxpayer 30 days to request judicial review of the IRS's determination in the Tax Court.<sup>6</sup> This 30-day period is statutory.<sup>7</sup>

The time periods provided to request a CDP hearing or to challenge a notice of determination in the Tax Court do not allow additional time for taxpayers abroad to complete these actions. By contrast, IRC § 6213(a) gives taxpayers residing outside the United States an additional 60 days (150 days total) to challenge a deficiency determination under IRC § 6213(a).

## REASONS FOR CHANGE

The U.S. State Department has estimated that the number of U.S. citizens residing abroad is about nine million,<sup>8</sup> including students, members of the military, taxpayers working abroad, and retirees. Mail sent from the United States to taxpayers abroad often takes several weeks to arrive, as does mail sent by taxpayers abroad to the United States. Further, taxpayers abroad often do not have ready access to their tax and financial records and often are unable to obtain assistance from advisors or the IRS.<sup>9</sup> For these reasons, taxpayers outside the United States frequently need additional time to respond to IRS notices.

Many IRS notices with significant legal consequences impose tight response deadlines that taxpayers abroad cannot meet easily, if at all. In the deficiency context, Congress recognized that the regular 90-day response period set forth in IRC § 6213(a) is not sufficient for taxpayers outside the United States, and it afforded them an additional 60 days (a total of 150 days) in which to challenge a deficiency determination with the Tax Court. In the CDP context, however, taxpayers are only given 30 days to request a CDP lien or levy hearing or to seek judicial review of an adverse IRS determination with the Tax Court. Such an abbreviated timeframe is prejudicial for these taxpayers.

Consistent with the extra 60 days taxpayers abroad have been given to respond to notices of deficiency, we recommend taxpayers abroad be given an extra 60 days to respond to CDP notices. In practice, the need for extra time for taxpayers abroad is even greater for CDP notices; meeting the standard 90-day response deadline for notices of deficiency is at least plausible, while meeting the standard 30-day response deadline for CDP notices generally is not.

## RECOMMENDATION

- Amend IRC §§ 6320(a)(3)(B), 6330(a)(3)(B), and 6330(d)(1) to allow 90 days (*i.e.*, an additional 60 days) (i) to request a CDP hearing after the issuance of a CDP lien or levy notice and (ii) to file a petition for review in the Tax Court after the issuance of a notice of determination if the notice is addressed to a person outside the United States.

<sup>6</sup> IRC §§ 6320(c), 6330(d)(1).

<sup>7</sup> IRC § 6330(d)(1). In *Boechler, P.C. v. Comm'r*, 596 U.S. 199 (2022), the Supreme Court held that the 30-day time limit is not jurisdictional and may be equitably tolled when the circumstances warrant it. However, equitable tolling is applied only sparingly and when taxpayers seeking tolling establish that (i) they pursued their rights diligently and (ii) extraordinary circumstances prevented them from filing timely. See *Menominee Indian Tribe of Wis. v. United States*, 577 U.S. 250, 255 (2016).

<sup>8</sup> See U.S. DEP'T OF STATE, BUREAU OF CONSULAR AFFS., CONSULAR AFFAIRS BY THE NUMBERS (Jan. 2020), <https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf>. TAS is not aware of a more recent government study.

<sup>9</sup> For a discussion of the challenges faced by taxpayers abroad, see National Taxpayer Advocate 2023 Annual Report to Congress 116 (Most Serious Problem: *Compliance Challenges for Taxpayers Abroad: Taxpayers Abroad Continue to Be Underserved and Face Significant Challenges in Meeting Their U.S. Tax Obligations*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC23\\_MSP\\_09\\_Compliance-Abroad.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC23_MSP_09_Compliance-Abroad.pdf).

**Legislative Recommendation #14****Provide That Assessable Penalties Are Subject to Deficiency Procedures****SUMMARY**

- *Problem:* To judicially challenge an “assessable penalty,” a taxpayer must pay the penalty in full and then bring suit in a U.S. district court or the U.S. Court of Federal Claims to recover the payment. The inability of taxpayers to obtain judicial review prior to assessment and the requirement they pay the penalties in full to obtain judicial review after assessment can effectively deprive taxpayers of the right to judicial review.
- *Solution:* Give taxpayers an opportunity to challenge assessable penalties in the U.S. Tax Court before assessment by making these penalties subject to deficiency procedures.

**PRESENT LAW**

IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days for notices addressed to a person outside the United States) to review the IRS determination.

IRC § 6671(a) authorizes the IRS to assess some penalties without first issuing a notice of deficiency.<sup>1</sup> These penalties are generally subject to judicial review only if taxpayers first pay the penalties and then incur the costs of filing suit in a U.S. district court or the Court of Federal Claims to recover the payments.<sup>2</sup> These courts generally impose higher filing fees than the U.S. Tax Court, and due to the complexities of their rules and formalities of their procedures, taxpayers usually have to retain an attorney to dispute the assessment.

In addition, some assessable penalties are subject to the “full payment rule.” In *Flora v. United States*,<sup>3</sup> the U.S. Supreme Court held that, with limited exceptions, a taxpayer must fully pay an assessment before filing suit in a U.S. district court or the Court of Federal Claims to obtain judicial review of an adverse IRS determination.<sup>4</sup> Penalties requiring full payment have historically included foreign information reporting penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D, and penalties relating to reportable transactions under IRC §§ 6707 and 6707A.<sup>5</sup>

Although IRC § 6671(a) authorizes the IRS to immediately assess “assessable” penalties and specifically references only the “penalties and liabilities provided by this subchapter” (*i.e.*, IRC Chapter 68, Subchapter B), the IRS takes the position that various international information return (IIR) penalties contained in Chapter 61, Subchapter A, Part III, Subpart A of the tax code are also immediately assessable without the issuance of a notice of deficiency, including the penalty under IRC § 6038 for failure to file Form 5471, Information

1 These “assessable” penalties are generally ones that are due and payable upon notice and demand. Unlike penalties subject to deficiency procedures, assessable penalties carry no rights to a 30-day letter, agreement form, or notice requirements prior to assessment. Internal Revenue Manual 20.1.9.1.5(2), Common Terms and Acronyms (Jan. 29, 2021), [https://www.irs.gov/irm/part20/irm\\_20-001-009](https://www.irs.gov/irm/part20/irm_20-001-009).

2 See IRC § 7422 for requirements relating to refund suits.

3 362 U.S. 145 (1960).

4 One exception to the full payment rule applies to “divisible” taxes. In the case of divisible taxes, a taxpayer may pay only a fraction of the tax and judicially challenge the penalty. These penalties include the trust fund recovery penalty under IRC § 6672(a).

5 Courts ruled that full payment was required prior to a judicial challenge of the IRC § 6707 penalty in *Pfaff v. United States*, 117 A.F.T.R.2d 2016-981 (D. Colo. 2016), and *Diversified Grp., Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016).

Return of U.S. Persons With Respect to Certain Foreign Corporations. When applicable, penalties under these sections can be substantial.<sup>6</sup>

## REASONS FOR CHANGE

The IRS's systemic assessment of these assessable penalties creates hardships for taxpayers, causes substantial inequities and inefficiencies in tax administration, and rests on a questionable legal foundation.<sup>7</sup> The IRS's position is that the penalties in Title 26, Subtitle F, Chapter 61, Subchapter A, Part III are not subject to deficiency procedures. The National Taxpayer Advocate's position, consistent with the U.S. Tax Court's holding in *Farhy v. Commissioner*, is that the tax code does not contain or cross-reference language authorizing the IRS to treat these penalties as assessable, and therefore the Department of Justice must institute a civil suit to recover the penalties.<sup>8</sup>

The U.S. Court of Appeals for the D.C. Circuit reversed the Tax Court's decision in *Farhy*, holding that "the statute's text, structure, and function" indicate the penalties are assessable.<sup>9</sup> But the Tax Court is only required to follow that decision in cases appealable to the D.C. Circuit.<sup>10</sup> In a case appealable to the U.S. Court of Appeals for the Eighth Circuit, the Tax Court maintained its position that the IIR penalties at issue are not assessable, which could result in a split opinion between circuits.<sup>11</sup> In the meantime, it appears the IRS is not changing its litigation position, leaving taxpayers in a quandary on how to proceed while it continues to assess these penalties. It remains to be seen how the Tax Court will rule, and if it denies the IRS's motion, whether the IRS will appeal to the Eighth Circuit, which could result in a split opinion between circuits.

To protect taxpayer rights, the National Taxpayer Advocate recommends Congress clarify that these penalties cannot be assessed before the IRS issues a notice giving taxpayers the right to judicial review. Taxpayers who are savvy enough to request an abatement based on reasonable cause or a conference with the IRS Independent Office of Appeals frequently obtain relief from assessable penalties, particularly where the IRS imposes a penalty systemically (rather than imposing it manually during an audit). For the most frequently assessed IIR penalties (IRC §§ 6038 and 6038A), TAS has found that across calendar years 2018-2021 the abatement percentage of those systemically assessed as measured by number of penalties was 74 percent and as measured by dollar value was 84 percent, averaged.<sup>12</sup>

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- 6 The amount of the penalty under IRC § 6038 for failure to file Form 5471 with respect to certain foreign corporations and partnerships is \$10,000 for each accounting period. IRC § 6038(b). An additional "continuation penalty" of up to \$50,000 can be added to each penalty if the failure continues for more than 90 days after the IRS sends notice of the failure. IRC § 6038(b)(2). The amount of the penalty under IRC § 6707 for failure to furnish information regarding reportable transactions, other than listed transactions, is \$50,000. IRC § 6707(b)(1). If the penalty is with respect to a listed transaction, the amount of the penalty is the greater of (i) \$200,000 or (ii) 50 percent of the gross income derived by the material advisor with respect to aid, assistance, or advice provided before the date the information return is filed under IRC § 6111. IRC § 6707(b)(2). In *Diversified Group*, the penalties assessed under IRC § 6707 for failure to register its tax shelter totaled \$24.9 million. *Diversified Grp., Inc. v. United States*, 123 Fed. Cl. 442, 445 (Fed. Cl. 2015), *aff'd*, 841 F.3d 975 (Fed. Cir. 2016).
  - 7 See National Taxpayer Advocate 2020 Annual Report to Congress 119 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20\\_MSP\\_08\\_International.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_MSP_08_International.pdf).
  - 8 See *Farhy v. Comm'r*, 160 T.C. 399 (2023), *rev'd and remanded*, 100 F.4th 223 (D.C. Cir. 2024).
  - 9 *Farhy*, 100 F.4th at 236 (D.C. Cir. 2024).
  - 10 See *Golsen v. Comm'r*, 54 T.C. 742 (1970).
  - 11 *Mukhi v. Comm'r*, 162 T.C. No. 8, (Apr. 8, 2024), *adhered to on recons.*, 163 T.C. No. 8 (Nov. 18, 2024).
  - 12 IRS, Compliance Data Warehouse (CDW), Business Master File. Because of such factors as the broad penalty relief provided in IRS Notice 2022-36, 2022-36 I.R.B. 188, Penalty Relief for Certain Taxpayers Filing Returns for Taxable Years 2019 and 2020, and processing delays due to COVID-19, penalty data in any given recent year may not be illustrative of long-term trends. For this reason, we are presenting a four-year average. See also National Taxpayer Advocate 2023 Annual Report to Congress 101, 111 (Most Serious Problem: *International: The IRS's Approach to International Information Return Penalties is Draconian and Inefficient*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC23\\_MSP\\_08\\_International.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC23_MSP_08_International.pdf). The abatement percentage of those penalties manually assessed as measured by number of penalties was 27 percent and as measured by dollar value was 16 percent. IRS, CDW, Individual Master File (Sept. 2023).



Specifying that deficiency procedures apply would prevent the systemic assessments the IRS often abates, a process that imposes undue burdens on taxpayers and unnecessarily consumes resources for the IRS. Additionally, requiring full payment puts judicial review out of reach for many if not most taxpayers. It is simply wrong to require taxpayers to pay penalties that can be disproportionate to the tax owed without first giving them an opportunity to obtain independent judicial review of the IRS's determination. This is particularly important for taxpayers who face large penalties but have limited resources.

Making assessable penalties subject to deficiency procedures would put pre-assessment judicial review of penalties in the hands of the Tax Court, which has several benefits. Due to the tax expertise of its judges, the Tax Court is generally better equipped to consider tax controversies than other courts. The Tax Court is more accessible to less knowledgeable and unrepresented taxpayers than other courts because it uses informal procedures, particularly in disputes that do not exceed \$50,000. Taxpayers litigating in Tax Court are generally offered the option to receive free legal assistance from a Low Income Taxpayer Clinic or *pro bono* representative. Thus, the Tax Court in most instances is the least expensive and easiest-to-navigate judicial forum for low-income taxpayers.

As noted above, *Farhy* was reversed by the D.C. Circuit but remains applicable to cases appealable to other circuits, thus leaving considerable uncertainty regarding the legal status of Chapter 61, Subchapter A, Part III, Subpart A IIR penalties and resulting in the potential for taxpayers to be treated differently depending on the circuit in which they reside. Congressional action would resolve ambiguity in this area and provide important due process protections for taxpayers.

## RECOMMENDATION

- Amend IRC § 6212 to require the Secretary to establish procedures to send a notice of IIR penalties to the taxpayer by certified mail or registered mail for adjudication with the U.S. Tax Court prior to assessing any IIR penalty or other IIR penalty listed in Chapter 61, Subchapter A, Part III, Subpart A of the IRC.

**Legislative Recommendation #15****Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship****SUMMARY**

- *Problem:* The IRS routinely takes collection actions against taxpayers (through levies and liens) and routinely enters into installment agreements (IAs) with taxpayers without first undertaking a financial analysis to determine whether the taxpayer can afford to make payments. IRS collection actions can have a devastating impact on financially vulnerable taxpayers, potentially leaving them without sufficient funds to pay basic living expenses for themselves and their families. The IRS also wastes resources by pursuing these cases because, among other things, it may later have to reverse collection actions or deal with defaulted IAs.
- *Solution:* Direct the IRS to implement an automated economic hardship screen, similar to the one developed by TAS, to identify taxpayers who are at risk of economic hardship and may qualify for relief under existing tax code provisions.

**PRESENT LAW**

The tax code contains several provisions that protect taxpayers experiencing economic hardship from IRS collection actions. IRC § 6330 authorizes a taxpayer in a Collection Due Process hearing to propose collection alternatives, which may be based on an inability to pay the tax due to economic hardship.

IRC § 6343 requires the IRS to release a levy if the IRS determines the levy “is creating an economic hardship due to the financial condition of the taxpayer.” Under Treasury Regulation § 301.6343-1(b)(4), economic hardship exists when an individual is “unable to pay his or her reasonable basic living expenses.”

IRC § 7122(d) requires the IRS to develop and publish schedules of national and local allowances (known as “allowable living expenses” or ALEs) to ensure that taxpayers entering into offers in compromise are left with “an adequate means to provide for basic living expenses.”

**REASONS FOR CHANGE**

In general, the IRS is required to halt collection actions if taxpayers demonstrate that they are in economic hardship. However, the IRS does not proactively seek to identify taxpayers at risk of economic hardship before taking collection actions to ensure that such taxpayers understand their rights and take steps to find out if they qualify for relief.<sup>1</sup> Further, the IRS routinely applies collection treatments that do not require any financial analysis, including entering into streamlined IAs. Because the IRS typically does not place a marker on the accounts of taxpayers who appear to be at elevated risk of economic hardship and because taxpayers are often unaware the IRS must halt collection actions if they cause economic hardship, vulnerable taxpayers may face potentially devastating consequences.

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<sup>1</sup> See National Taxpayer Advocate 2018 Annual Report to Congress 228 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18\\_Volume1\\_MSP\\_15\\_EconomicHardship.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18_Volume1_MSP_15_EconomicHardship.pdf).

TAS estimates that about 36 percent of taxpayers who entered into streamlined IAs through the IRS's Automated Collection System (ACS) in fiscal year 2024 had incomes at or below their ALEs.<sup>2</sup> To emphasize the point: More than a third of taxpayers who agreed to streamlined IAs in ACS could potentially have received the benefit of other collection alternatives, such as offers in compromise or Currently Not Collectible-Hardship (CNC-Hardship) status, if they had known to call the IRS to explain their financial circumstances.

That is not a fair result. Whether taxpayers are left with sufficient funds to pay basic living expenses for themselves and their families should not depend on the taxpayers' knowledge of IRS procedural rules.

To address this problem, the TAS Research function has developed an automated algorithm that we believe can, with a high degree of accuracy, identify taxpayers whose incomes are below their ALEs. In a 2020 study, TAS Research compared the results of its algorithm with the results the IRS reached itself when assessing over 242,000 IA applications that required financial analysis during the years 2017-2020. The TAS algorithm and the IRS's financial analysis came to the same conclusion 82 percent of the time.<sup>3</sup> If the IRS uses the TAS algorithm or develops an alternative formula that is more accurate, it could place a "low-income" indicator on the accounts of all taxpayers whom the formula identifies as having incomes below their ALEs.<sup>4</sup> The formula would not constitute a final determination of a taxpayer's financial status or ability to pay, but it would signal that a taxpayer is at risk of economic hardship, and therefore, that the IRS should take additional protective steps.

While the ALE standards represent only average expenses for taxpayers and should not be used to automatically close a case as CNC-Hardship, an ALE-based indicator would be a useful starting point for financial analysis in the collection context. The IRS could use it to alert collection employees speaking with a taxpayer over the phone of the need to request additional financial information so the IRS can analyze the specific facts and circumstances of the taxpayer's case. The IRS could also use it to trigger a notification to taxpayers entering into online IAs that informs them of their right to contact the IRS collection function for assistance if they believe they cannot pay their tax debts without incurring economic hardship. The IRS could also use it to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, selection for referral to private collection agencies, or passport certification, unless and until the IRS has made direct personal contact with the taxpayer to give them an opportunity to substantiate their financial information.

At the time Congress enacted statutory protections for financially vulnerable taxpayers from collection actions, the IRS did not have the technological capability to proactively identify at-risk taxpayers through automation. Probably for that reason, the law allows the IRS to take collection actions without considering a taxpayer's financial condition and places the burden on affected taxpayers to raise economic hardship and ask for relief.

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2 This estimate allows two vehicle ownership expenses for married taxpayers filing joint returns. TAS published a study on the feasibility of using an algorithm to identify taxpayers at risk of economic hardship in the National Taxpayer Advocate 2020 Annual Report to Congress. This study used a more conservative estimate of ALEs, allowing only one vehicle ownership expense. See National Taxpayer Advocate 2020 Annual Report to Congress 249 (TAS Research Study: *The IRS Can Systemically Identify Taxpayers at Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20\\_TRRS\\_EconomicHardship.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_TRRS_EconomicHardship.pdf).

3 National Taxpayer Advocate 2020 Annual Report to Congress 249, 257 (TAS Research Study: *The IRS Can Systemically Identify Taxpayers at Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20\\_TRRS\\_EconomicHardship.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_TRRS_EconomicHardship.pdf).

4 The IRS has internal data available to provide an initial indicator of whether a taxpayer may be at risk of economic hardship, but it uses this information in very limited circumstances. For instance, a Reduced User Fee Indicator is used to determine whether taxpayers entering into IAs are eligible for a reduced or waived user fee, but the indicator is not used to screen for potential economic hardship. See Internal Revenue Manual 5.14.1.2(11), *Installment Agreements and Taxpayer Rights* (July 2, 2024), [https://www.irs.gov/irm/part5/irm\\_05-014-001r](https://www.irs.gov/irm/part5/irm_05-014-001r).

But today, the IRS can identify taxpayers at risk of economic hardship with a high degree of accuracy. It is not in anyone's interest for the IRS to collect from taxpayers when doing so will leave them without funds to pay basic living expenses for themselves and their families.

The IRS can implement an economic hardship screen on its own, but to date, it has declined to do so. For that reason, we are recommending that Congress provide direction.

## RECOMMENDATION

- Direct the IRS to implement an algorithm that will enable it to (i) identify taxpayers at high risk of economic hardship; (ii) ask questions of taxpayers who contact the IRS regarding a balance due to identify those at risk of hardship; (iii) alert taxpayers at risk of economic hardship who seek to enter into streamlined IAs online of the resources available to them; (iv) determine whether to exclude taxpayers' debts from automated collection treatments such as the Federal Payment Levy Program, the private debt collection program, and passport certification; and (v) possibly rank cases for collection priority.<sup>5</sup>

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<sup>5</sup> For legislative language that would partially implement this recommendation, see Improving IRS Customer Service Act, S. 5280, 118th Cong. § 5 (2024).

**Legislative Recommendation #16****Provide That “an Opportunity to Dispute” an IRS-Determined Tax Liability in a Collection Due Process Hearing Includes an Opportunity to Dispute Such Liability in the U.S. Tax Court****SUMMARY**

- *Problem:* The IRS takes collection actions against some taxpayers who had their tax liability determined by the IRS but did not have an opportunity to challenge the existence or amount of that liability in the U.S. Tax Court. These taxpayers generally have no alternative but to pay the tax the IRS says they owe and then seek a refund in a different federal court, an option that many taxpayers cannot afford and that imposes additional burden.
- *Solution:* Allow taxpayers to challenge the existence or amount of an IRS-determined tax liability at a Collection Due Process (CDP) hearing in cases where they did not have a prior opportunity to dispute the liability in Tax Court.

**PRESENT LAW**

IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien or a proposed levy action. The review is provided through a CDP hearing conducted by the IRS Independent Office of Appeals (Appeals) and is subject to review by the Tax Court, which is generally the only prepayment judicial forum in which taxpayers may resolve their disputes with the IRS. In most cases, the existence and amount of a tax liability has already been conclusively determined by this point under procedures that gave the taxpayer an opportunity to seek Tax Court review of the IRS’s determination. Thus, the purpose of the CDP hearing is typically to determine whether taxpayers qualify for collection alternatives (*e.g.*, an offer in compromise or an installment agreement) based on their ability to pay.

In certain circumstances, however, taxpayers are not given an opportunity to seek Tax Court review of the IRS’s liability determination prior to a CDP hearing. Where a taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability,” IRC § 6330(c)(2)(B) provides that the taxpayer may dispute the existence or amount of the underlying tax liability at a CDP hearing.<sup>1</sup>

The IRS and the courts interpret IRC § 6330(c)(2)(B) and the Treasury regulations under IRC §§ 6320 and 6330 restrictively. They take the position that a taxpayer does not have a right to dispute the existence or amount of a liability if the taxpayer had a prior opportunity for a conference with Appeals, even if the taxpayer had no prior opportunity for Tax Court review of the liability and even if no subsequent Tax Court review of the Appeals determination is available.<sup>2</sup> For example, one court has held that a taxpayer who did not receive a notice of deficiency was not permitted to dispute his underlying liability in a CDP hearing

1 IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties, additions to tax, and statutory interest. See *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).

2 See Treas. Reg. §§ 301.6320-1(e)(3), Q&A-E2, 301.6330-1(e)(3), Q&A-E2; *Lewis v. Comm’r*, 128 T.C. 48, 61 (2007); *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Servs. II, Inc. v. Comm’r*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Enters., Inc. v. Comm’r*, 855 F.3d 773 (7th Cir. 2017). Additionally, at least one Court of Appeals has held that IRC § 6330(c)(4)(A) provides an independent basis for denying a merits hearing in the CDP process if a prior merits hearing occurred. *James*, 850 F.3d 160.

because the taxpayer previously sought to resolve the tax liability through audit reconsideration.<sup>3</sup> Because the underlying liability was not at issue in the CDP hearing, the taxpayer was precluded from disputing the underlying liability in the Tax Court proceeding.<sup>4</sup>

IRC § 6330(c)(4)(A) provides, in part, that a taxpayer is precluded from raising an issue during a CDP hearing if the issue was raised in a previous administrative hearing. This restriction has been interpreted to mean that if a taxpayer had a prior hearing at Appeals with respect to the liability, the issue of the liability cannot be raised at the CDP hearing, even if the taxpayer had no prior opportunity for Tax Court review of the liability.<sup>5</sup>

Mere notification of the right to request an Appeals conference may prevent the taxpayer from disputing the tax liability in a CDP hearing. For example, the IRS assesses some penalties without issuing a notice of deficiency.<sup>6</sup> The IRS notifies the taxpayer of the proposed penalty by sending a letter or notice. Whether or not the taxpayer requests or receives a conference with Appeals in response to the letter, the taxpayer will not be permitted to dispute the merits of the liability at a CDP hearing or in the Tax Court. To obtain judicial review of the underlying liability, the taxpayer generally must pay the full amount of the tax liability and seek a refund in a U.S. district court or the U.S. Court of Federal Claims.<sup>7</sup>

## REASONS FOR CHANGE

The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute their underlying IRS-determined liability in the Tax Court are precluded from doing so during their CDP hearing, and these taxpayers have no alternative but to pay the tax and then seek a refund, an option that not all taxpayers can afford. The National Taxpayer Advocate believes that judicial and administrative interpretations limiting a taxpayer's ability to challenge the IRS's liability determination in a CDP hearing are inconsistent with Congress's intent when it enacted CDP procedures. Compared to the burden the current rules impose on taxpayers, allowing more taxpayers to dispute their tax liabilities in CDP hearings will better protect taxpayer rights without placing undue administrative burden on the IRS or the Tax Court.

## RECOMMENDATIONS

- Amend IRC § 6330(c)(2)(B) to allow taxpayers to raise challenges to the existence or amount of an underlying IRS-determined tax liability at a CDP hearing for any tax period if the taxpayer did not receive a valid notice of deficiency for such liability, or in a non-deficiency case, if the taxpayer did not have an opportunity to dispute the liability in the U.S. Tax Court.
- Clarify that IRC § 6330(c)(4)(A) applies only to collection issues and not to liability issues, which are addressed exclusively in IRC § 6330(c)(2)(B).

3 *Lander v. Comm'r*, 154 T.C. 104 (2020). Audit reconsiderations are not subject to Tax Court review.

4 See Treas. Reg. § 301.6330-1(f)(2), Q&A-F3.

5 *Our Country Home Enters., Inc. v. Comm'r*, 855 F.3d 773, 792-93 (7th Cir. 2017); *Keller Tank Servs. II, Inc. v. Comm'r*, 854 F.3d 1178, 1199-1200 (10th Cir. 2017) (both cases holding that a taxpayer who challenged an IRC § 6707A penalty at an Appeals hearing prior to assessment was precluded from raising the issue in a CDP hearing); Treas. Reg. §§ 301.6320-1(e)(3), Q&A-E2, 301.6330-1(e)(3), Q&A-E2.

6 These "assessable" penalties are primarily found in IRC §§ 6671 through 6720C. The IRS sometimes assesses these penalties systemically (i.e., automatically by computer rather than manually during an audit). See, e.g., Internal Revenue Manual 21.8.2.20.2(1), Form 5471 Penalties Systemically Assessed From Late-Filed Form 1120 Series or Form 1065 (Oct. 1, 2024), [https://www.irs.gov/irm/part21/irm\\_21-008-002r](https://www.irs.gov/irm/part21/irm_21-008-002r).

7 Under *Flora v. United States*, 362 U.S. 145 (1960), a taxpayer must have "fully paid" the assessment before filing a refund suit. One exception to the full payment rule applies to "divisible" taxes.



**Legislative Recommendation #17****Prohibit the IRS From Withholding the Earned Income Tax Credit (EITC) Portion of a Taxpayer's Refund to Satisfy Federal Tax Liabilities****SUMMARY**

- *Problem:* Taxpayers who qualify for social welfare benefits like the Earned Income Tax Credit (EITC) generally are low-income and rely on these benefits to pay their basic living expenses. When a taxpayer eligible for the EITC has an outstanding federal tax liability, the IRS ordinarily will withhold the EITC to satisfy the tax liability, potentially leaving the taxpayer without sufficient funds to pay expenses. Reducing the amount of EITC a taxpayer receives undermines the purpose of this anti-poverty program.
- *Solution:* Prohibit the IRS from withholding the EITC portion of a taxpayer's refund to satisfy federal tax liabilities.

**PRESENT LAW**

IRC § 6402(a) generally authorizes the IRS to offset (*i.e.*, withhold) a taxpayer's refund and apply it to satisfy a prior-year federal tax liability, but it does not require the IRS to do so.<sup>1</sup> If a taxpayer can demonstrate that they will experience an economic hardship if the IRS offsets their refund, the IRS will typically "bypass" the offset (*i.e.*, pay the refund), as long as the request is made within a specific timeframe. This is referred to as an "offset bypass refund" (OBR).<sup>2</sup> During the COVID-19 pandemic, the IRS exercised its discretion to pay refunds generated by Recovery Rebate Credits (RRCs) to all eligible taxpayers in full, without reduction to satisfy outstanding federal tax debts.<sup>3</sup>

The EITC is a refundable credit for low-income working individuals and families.<sup>4</sup> It is claimed on a tax return and is included in the computations that determine whether a taxpayer is entitled to receive a refund and, if so, the amount of the refund.

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- 1 *Kalb v. United States*, 505 F.2d 506, 509 (2d Cir. 1974). The IRS is required to offset a taxpayer's refund to pay down certain liabilities, such as non-tax federal debts, past-due child support, and state income tax and unemployment compensation debts. See IRC § 6402(c), (d).
  - 2 Internal Revenue Manual (IRM) 21.4.6.5.7.1, Offset Bypass Refund (OBR) (Oct. 1, 2024), [https://www.irs.gov/irm/part21/irm\\_21-004-006](https://www.irs.gov/irm/part21/irm_21-004-006).
  - 3 In the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Congress enacted IRC § 6428, providing for RRCs, payable in advance, which would not be offset to satisfy outstanding liabilities other than past-due child support obligations. See Pub. L. No. 116-136, § 2201(a), (d)(1)-(3), 134 Stat. 281, 338 (2020). In the Consolidated Appropriations Act, 2021, Congress enacted IRC § 6428A, providing for additional RRCs, and amended section 2201 of the CARES Act to provide that only the portion of the RRCs that were paid as advance refunds were exempt from offset to satisfy outstanding liabilities other than past-due child support obligations. See Pub. L. No. 116-260, §§ 272(a), 273(b)(1), 134 Stat. 1182, 1965 (2020). At TAS's urging, the IRS exercised its discretion under IRC § 6402(a) to not offset RRCs, whether received in advance or claimed on a tax return, to satisfy outstanding tax liabilities, effective for returns filed on or after March 18, 2021. See, e.g., IRS Fact Sheet, FS-2021-17, IRS Updates 2020 Recovery Rebate Credit Frequently Asked Questions, Q&A-E2 (Dec. 2021), <https://www.irs.gov/pub/taxpros/fs-2021-17.pdf>; IRS Fact Sheet, FS-2022-04, IRS Issues Frequently Asked Questions to Assist Those Claiming the 2021 Recovery Rebate Credit, Q&A-F2 (Jan. 2022), <https://www.irs.gov/pub/taxpros/fs-2022-04.pdf>.
  - 4 IRC § 32. The Supreme Court has stated: "The earned income credit was enacted to reduce the disincentive to work caused by the imposition of social security taxes on earned income ... and to provide relief for low-income families hurt by rising food and energy prices." *Sorenson v. Sec'y of Treasury*, 475 U.S. 851, 864 (1986).

The Debt Collection Improvement Act of 1996 (DCIA) requires federal agencies to offset certain federal payments to collect outstanding non-tax debts owed to the United States.<sup>5</sup> However, the amount subject to offset is statutorily limited in some instances, and payments made pursuant to “means-tested” anti-poverty programs, such as Supplemental Security Income and Temporary Assistance to Needy Families, are exempt from offset when exemption is requested by the head of the agency administering the program.<sup>6</sup> In substance, the EITC is a means-tested benefit, but it does not meet the DCIA definition of that term.<sup>7</sup>

## REASONS FOR CHANGE

Like other anti-poverty programs, Congress created the EITC to provide financial support for low-income individuals and families, and to reduce poverty. The average adjusted gross income of taxpayers who received the EITC for tax year 2022 was \$21,020.<sup>8</sup> If a low-income taxpayer has an unpaid tax debt, however, the IRS may offset the taxpayer’s refund – including the portion generated by the EITC – to satisfy the debt. Withholding EITC benefits undermines the EITC’s anti-poverty objective.

Taxpayers can request an OBR for their refund – including the EITC portion – but the timeframe for making the request is narrow. The IRS must approve an OBR between the date the return is filed and the date the IRS assesses the tax shown on the return. This period is approximately ten to 20 days when a return is filed electronically. Additionally, the IRS does not widely publicize its OBR program. As a result, many taxpayers are unaware they can obtain an OBR or learn about the option after it is too late. In fiscal year 2024 through June, for example, just 1,160 taxpayers received OBRs.<sup>9</sup>

The IRS has exercised its discretion to not offset tax benefits to satisfy past-due federal tax liabilities in limited cases, but it has not adopted a general policy of protecting EITC refunds from offset. Consistent with congressional recognition reflected in the DCIA that offsets may impose economic hardships on recipients of federal benefits, the National Taxpayer Advocate recommends Congress prohibit the IRS from offsetting the portion of a taxpayer’s refund attributable to the EITC.

To be clear, TAS is *not* recommending that the IRS release the full amount of any refund subject to offset – just the portion of the refund that is attributable to the EITC. Programming would be straightforward, rendering it easily administrable.<sup>10</sup>

## RECOMMENDATION

- Amend IRC § 6402(a) to prohibit the Secretary from offsetting the EITC portion of a taxpayer’s refund to satisfy prior-year tax liabilities.

5 See Debt Collection Improvement Act of 1996, Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub. L. No. 104-134, § 31001, 110 Stat. 1321, 1321-358 (1996) (codified at 31 U.S.C. § 3716). The offsets are carried out through the Treasury Offset Program.

6 31 U.S.C. § 3716(c)(3)(B). “Means-tested programs” are those which base eligibility on a determination that the income and/or assets of the beneficiary are inadequate to provide the beneficiary with an adequate standard of living without program assistance. 31 C.F.R. § 285.5(e)(7)(i). The Secretary of the Treasury has the discretion to exempt payments made under programs that are not means-tested, when so requested by the payment agency. 31 U.S.C. § 3716(c)(3)(B); 31 C.F.R. § 285.5(e)(7)(ii).

7 See, e.g., Democratic Staff of H. Comm. on the Budget, *What You Need to Know About Means-Tested Entitlements* (May 1, 2017), <https://democrats-budget.house.gov/publications/report/what-you-need-know-about-means-tested-entitlements>; Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

8 IRS, Compliance Data Warehouse (CDW), Individual Return Transaction File (June 27, 2024).

9 IRS, CDW, Individual Master File Transaction History table (June 27, 2024).

10 The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients. ABA, *Proposals for Improvements in Taxpayer Service* (Apr. 5, 2022), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2022/040522comments.pdf>; ABA, *Comments Regarding Review of Regulatory and other Relief to Support Taxpayers during COVID-19 Pandemic* (Jan. 15, 2021), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2021/011521comments.pdf>.

**Legislative Recommendation #18****Eliminate Installment Agreement User Fees for Low-Income Taxpayers and Those Paying by Direct Debit****SUMMARY**

- *Problem:* Taxpayers who cannot pay their tax liabilities on time may make monthly payments through an installment agreement (IA). The IRS generally charges these taxpayers a “user fee” to manage IA payment plans. Although user fees are modest, they may discourage some taxpayers from applying for IAs and settling their tax liabilities voluntarily.
- *Solution:* Require the IRS to waive the user fee for IAs with taxpayers whose adjusted gross incomes are equal to or less than 250 percent of the Federal Poverty Level and taxpayers who enter into direct debit IAs (DDIAs).

**PRESENT LAW**

In cases where a taxpayer is unable to pay the full amount of their tax liability in a single lump sum, IRC § 6159(a) authorizes the IRS to enter into an IA under which the taxpayer will pay the liability in monthly installments. A taxpayer can apply for an IA on paper, over the phone, or in person (these three are considered “Regular IA origination”), or by using an online payment agreement (OPA).

Under 31 U.S.C. § 9701, the IRS is authorized to set user fees by regulation.<sup>1</sup> Pursuant to Treas. Reg. § 300.1, the IRS currently charges \$178 for entering into regular IAs and \$69 for entering into OPAs.<sup>2</sup> If a taxpayer authorizes the IRS to direct debit monthly payments from a bank account, the fee is reduced to \$107 for regular IAs and \$22 for OPAs. These fees are designed to enable the agency to recover the full costs of administering IAs.

For low-income taxpayers – those with adjusted gross incomes at or below 250 percent of the Federal Poverty Level – Treas. Reg. § 300.1 caps the IA fee at \$43.<sup>3</sup> In addition, IRC § 6159(f)(2)(A) waives the fee for low-income taxpayers who enter into DDIAs. Low-income taxpayers who cannot enter into DDIAs (*e.g.*, because they do not have a bank account) must pay the \$43 fee. If they make all payments required under the IA, IRC § 6159(f)(2)(B) requires the IRS to reimburse the amount of the fee. In 2018, Congress amended IRC § 6159(f)(1) to prohibit the IRS from increasing the IA user fees.

**REASONS FOR CHANGE**

Taxpayers who are low-income and cannot afford to pay their tax bills are, almost by definition, experiencing a financial hardship. Requiring them to pay upfront user fees in addition to their tax liabilities, which include interest charges and may include penalties, is likely to discourage some from entering into IAs. In addition,

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- 1 See also OFF. OF MGMT. & BUDGET (OMB), CIRCULAR NO. A-25 (revised), <https://www.whitehouse.gov/wp-content/uploads/2017/11/Circular-025.pdf> (establishing a general policy that agencies should charge user fees “against each identifiable recipient for special benefits derived from Federal activities beyond those received by the general public.”).
  - 2 The IRS fee for OPAs is lower than the amount prescribed by regulations. Treas. Reg. § 300.1(b)(2) states: “The fee is \$149 for entering into online payment agreements on or after January 1, 2017, ....” TAS has been advised that the IRS Office of Chief Counsel has initiated a project to amend the regulation to match the current fee in the Internal Revenue Manual (IRM). IRM 5.14.1.2(10), Installment Agreements and Taxpayer Rights (July 2, 2024), [https://www.irs.gov/irm/part5/irm\\_05-014-001r](https://www.irs.gov/irm/part5/irm_05-014-001r).
  - 3 In determining a taxpayer’s eligibility for these low-income provisions, the IRS determines adjusted gross income based on the taxpayer’s last filed tax return.

the cost of processing OPAs and DDIAAs is so minimal that charging a user fee could cost the government more in lost tax revenue and increased enforcement expenses than the user fee recovers.

## RECOMMENDATION

- Amend IRC § 6159 to require the IRS to waive the user fee for all IAs with taxpayers whose adjusted gross incomes<sup>4</sup> are at or below 250 percent of the Federal Poverty Level and for all DDIAAs.<sup>5</sup>

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4 Collectibility determinations should be based on the taxpayer's current financial situation – not the taxpayer's financial situation at the time the liability was incurred. The National Taxpayer Advocate supports the use of a taxpayer's current income for IA user fee waiver determinations when adjusted gross income is either unavailable or not reflective of the taxpayer's current financial situation. For a more detailed discussion of this issue, see *Require the IRS to Consider a Taxpayer's Current Income When Determining Whether to Waive or Reimburse an Installment Agreement User Fee*, *infra*.

5 For legislative language generally consistent with this recommendation, see Affordable Payment Agreements for Taxpayers Act, H.R. 2675, 118th Cong. § 2 (2023).

**Legislative Recommendation #19****Improve Offer in Compromise Program Accessibility by Repealing the Upfront Payment Requirements****SUMMARY**

- *Problem:* Financially struggling taxpayers who cannot afford to pay their tax liabilities in full may apply for an offer in compromise (OIC). Under an OIC, the IRS agrees to accept less than full payment in satisfaction of the debt. Currently, taxpayers are required to include non-refundable partial payments with their OIC applications. The Treasury Department has acknowledged that the partial payment requirement may substantially reduce access to the OIC program and has estimated that repealing the requirement would raise revenue.
- *Solution:* Repeal the requirements that taxpayers include partial payments with OIC applications.

**PRESENT LAW**

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an OIC. According to Policy Statement 5-100, the IRS will “accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.”<sup>1</sup> Taxpayers whose offers are accepted must file and pay their taxes for the next five years, as stated on IRS Form 656, Offer in Compromise. If they fail to remain in compliance for the five-year period, the IRS may seek to collect the amounts it compromised.

IRC § 7122(c)(1)(A) requires a taxpayer who would like the IRS to consider a “lump-sum” offer – payable in five or fewer installments – to include a nonrefundable partial payment of 20 percent of the amount of the offer with the application. IRC § 7122(c)(1)(B) requires a taxpayer who would like the IRS to consider a “periodic payment” offer – an offer payable in six or more installments – to include the first proposed installment with the application and to continue to make installment payments while the IRS is considering it. In addition to these upfront partial payments, Treas. Reg. § 300.3 requires that most offer applications include a \$205 user fee. IRC § 7122(c)(3) provides that taxpayers with low incomes (*i.e.*, taxpayers with adjusted gross incomes for the most recent tax year, or taxpayers with household gross monthly incomes multiplied by 12 months, that do not exceed 250 percent of the Federal Poverty Level guidelines) are not subject to the user fee or the partial payment requirement.<sup>2</sup> They may apply for a waiver on Form 656.

**REASONS FOR CHANGE**

By accepting an offer, the IRS often collects money it would not otherwise collect and may convert a noncompliant taxpayer into a compliant one by requiring the taxpayer, as a condition of the agreement, to timely file returns and pay taxes for the following five years. The Treasury Department’s General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals acknowledged the benefit of offers and proposed to repeal the partial payment requirement, explaining that the requirement “may substantially reduce access to the offer in compromise program [and] [r]educing access to the offer-in-compromise program makes it

1 Internal Revenue Manual 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992), [https://www.irs.gov/irm/part1/irm\\_01-002-001](https://www.irs.gov/irm/part1/irm_01-002-001).

2 See also Treas. Reg. § 300.3(b)(ii), (iii).

more difficult and costly to obtain the collectable portion of existing tax liabilities.”<sup>3</sup> The Treasury Department estimated that repealing the requirement would raise revenue.<sup>4</sup>

A 2007 TAS study found that taxpayers above the low-income threshold were no better able to afford to make partial payments than those below it and that those below it frequently did not obtain a waiver.<sup>5</sup> Similarly, a 2005 Treasury Inspector General for Tax Administration (TIGTA) report found that when the IRS first imposed a user fee (it was \$150 in 2003), OIC submissions declined by more than 20 percent among taxpayers at every income level, including those who were eligible for a fee waiver.<sup>6</sup> Furthermore, after the partial payment requirement was imposed, there was a 26 percent decrease in submitted offers and only a slight increase in the offer acceptance rate, suggesting that higher upfront costs deterred many taxpayers from submitting acceptable offers. Thus, upfront payments such as the user fee and the partial payment requirement likely reduce collections and increase enforcement costs.

## RECOMMENDATION

- Amend IRC § 7122(c) to remove the requirement that taxpayers include a partial payment with offer applications and to provide that any user fee that is imposed will not be required as an upfront payment but rather will be collected out of amounts otherwise due on accepted offers.<sup>7</sup>

3 Dep’t of the Treasury, *General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals* 220 (Feb. 2016) (Revise Offer-in-Compromise Application Rules), <https://home.treasury.gov/system/files/131/General-Explanations-FY2017.pdf>.

4 In the past, the IRS expressed concern that repealing the partial payment requirement or limiting the user fee might have the effect of increasing the number of frivolous offers. The tax code discourages frivolous submissions by imposing a penalty of \$5,000 on any person who submits a frivolous OIC application. See IRC § 6702(b).

5 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, at 76 (*Effect of Tax Increase and Prevention Reconciliation Act of 2005 on IRS Offer in Compromise Program*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/arc\\_2007\\_vol\\_2.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/arc_2007_vol_2.pdf).

6 TIGTA, Ref. No. 2005-30-096, *The Implementation of the Offer in Compromise Application Fee Reduced the Volume of Offers Filed by Taxpayers at All Income Levels* (2005).

7 For legislative language generally consistent with the recommendation to repeal the partial payment requirement, see Small Business Taxpayer Bill of Rights Act of 2023, S. 1177 and H.R. 2681, 118th Cong. § 17 (2023); Small Business Taxpayer Bill of Rights Act of 2022, H.R. 7033, 117th Cong. § 17 (2022). We recommend that the language in these bills be modified to avoid eliminating the exception to user fees for low-income taxpayers in IRC § 7122(c)(3). For additional background, see, e.g., National Taxpayer Advocate 2006 Annual Report to Congress 507 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2006\\_arc\\_section2\\_v2.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2006_arc_section2_v2.pdf).

## Legislative Recommendation #20

## Require the IRS to Consider a Taxpayer's Current Income When Determining Whether to Waive or Reimburse an Installment Agreement User Fee

### SUMMARY

- *Problem:* Financially struggling taxpayers who apply for an installment agreement (IA) are ordinarily required to pay a user fee, but the law requires the IRS to waive the fee, or in some cases to reimburse the fee, if a taxpayer's adjusted gross income (AGI) is at or below 250 percent of the Federal Poverty Level. Under current law, the IRS determines whether to waive the IA user fee based solely on the taxpayer's most recently filed tax return, even if the return was filed years ago and does not accurately reflect the taxpayer's *current* financial condition.
- *Solution:* Require the IRS to consider the taxpayer's *current* financial condition in determining his or her eligibility for a waiver or reimbursement of the IA user fee.

### PRESENT LAW

A taxpayer who is unable to pay a federal income tax liability in full may apply for an IA or an offer in compromise (OIC). For IAs, IRC § 6159(f)(2) provides that the user fee shall not be imposed, or in some cases will be refunded, for any taxpayer with an AGI that does not exceed 250 percent of the Federal Poverty Level “as determined for the most recent year for which such information is available.”<sup>1</sup> For OICs, IRC § 7122(c)(3) similarly provides that the user fee shall not apply to any taxpayer with an AGI that does not exceed 250 percent of the Federal Poverty Level “as determined for the most recent taxable year for which such information is available.”

### REASONS FOR CHANGE

Although the statutory provisions governing user fees for IAs and OICs are nearly identical, IRS policy in some cases treats taxpayers applying for IA fee waivers less favorably than taxpayers applying for OIC fee waivers. In calculating a taxpayer's eligibility to have an IA user fee waived, the IRS determines AGI by relying solely on the taxpayer's last filed tax return, even if the return was filed several years ago and does not accurately reflect the taxpayer's current ability to pay.<sup>2</sup>

As a general matter, tax *liability* determinations are made for the tax period at issue. By contrast, tax *collectability* determinations are made based on the taxpayer's current financial condition or, in certain circumstances, on the taxpayer's future collection potential. User fee waiver determinations should similarly be based on whether the taxpayer can afford to pay the user fee today. Relying on an old tax return to make the determination often will not produce an accurate result. If, for example, a taxpayer last filed a tax return

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1 Where a low-income taxpayer pays an IA by direct debit from their bank account, IRC § 6159(f)(2)(A) requires the IRS to waive the IA user fee. Where a low-income taxpayer does not make payments by direct debit (perhaps because the taxpayer does not have a bank account), the IRS requires the taxpayer to pay a \$43 user fee, and IRC § 6159(f)(2)(B) requires the IRS to reimburse the taxpayer upon completion of the IA. The National Taxpayer Advocate recommends the fee be waived for all low-income taxpayers. See *Eliminate Installment Agreement User Fees for Low-Income Taxpayers and Those Paying by Direct Debit*, *supra*.

2 See Internal Revenue Manual (IRM) 5.14.9.10(5), Installment Agreement User Fees: Authority and General Information (Oct. 7, 2019), [https://www.irs.gov/irm/part5/irm\\_05-014-009](https://www.irs.gov/irm/part5/irm_05-014-009) (providing that for IAs filed after April 10, 2018, a taxpayer's AGI should be considered “as reported on their most recently filed tax return”).



for 2018 and has not had a filing requirement since that time, considering only the taxpayer's 2018 return will enable the IRS to determine whether the taxpayer could have afforded to pay the user fee based on their 2018 income, but that is irrelevant to whether he or she can afford to pay the user fee today. The taxpayer's financial condition may have improved or deteriorated significantly in the intervening years.

In contrast to the IRS's policy of relying solely on the taxpayer's last filed return to make low-income fee waiver determinations for purposes of IAs, the IRS's policy for making low-income fee waiver determinations for OICs is more flexible. If the taxpayer does not qualify for a fee waiver based on the last-filed return for purposes of an OIC application, the IRS will determine whether the taxpayer qualifies for a fee waiver based on the taxpayer's current income and household size.<sup>3</sup> Thus, the OIC review process considers more current information when the taxpayer does not qualify based solely on a previous year's AGI, whereas the IA review process does not.

To protect taxpayers' *right to a fair and just tax system*, user fee waiver determinations for IAs and OICs should be consistent and based on the taxpayer's current financial condition to the maximum extent possible. We recommend Congress clarify the law to require the IRS to consider a taxpayer's current income when determining eligibility for the IA user fee waiver (or reimbursement) if no recent return has been filed (*i.e.*, if the taxpayer was not required to file a recent tax return or if the taxpayer indicates his or her financial condition has worsened).<sup>4</sup>

## RECOMMENDATION

- Amend IRC § 6159(f) to require the Secretary to consider a taxpayer's current income in addition to the AGI on their last-filed return when determining whether to waive or reimburse an IA user fee.

3 IRM 5.8.2.4.1(7), Determining Processability (June 14, 2024), [https://www.irs.gov/irm/part5/irm\\_05-008-002](https://www.irs.gov/irm/part5/irm_05-008-002). A similar issue arises in the context of the private debt collection program authorized by IRC § 6306. That statute provides that the account of a taxpayer with AGI at or below 200 percent of the Federal Poverty Level may not be assigned to a private collection agency, and it directs the IRS to make the AGI determination based on "the most recent taxable year for which such information is available." The IRS currently will look for returns going back up to ten years – which clearly do not reflect the taxpayer's current income – but will not consider information reporting documents or other current income information. For our recommendation to change that approach along the same lines as this recommendation, see *Revise the Private Debt Collection Rules to More Accurately Identify and Protect Taxpayers With Incomes Below 200 Percent of the Federal Poverty Level*, *infra*.

4 We believe existing law provides the IRS with this authority, but the IRS has not agreed. The IRS has stated in the past that it can only determine "gross income" and not "adjusted gross income" (the statutory basis for a waiver) from information reporting documents. We believe the agency can implement a common-sense alternative method to assess a taxpayer's current financial condition for purposes of the IA user fee waiver since that is the point of the statute, and the fact that the IRS is doing exactly that in the context of OIC fee waivers shows its position is not applied consistently.

**Legislative Recommendation #21****Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise****SUMMARY**

- *Problem:* The IRS Office of Chief Counsel is currently required to review and provide a legal opinion for every accepted offer in compromise (OIC) where the amount of unpaid tax is \$50,000 or more, even though the IRS determines whether to accept an OIC primarily based on an analysis of the taxpayer's financial condition and very few OICs present significant legal issues. This requirement delays OIC processing and diverts Counsel attorneys from performing their core legal work.
- *Solution:* Require Counsel review of OICs only in cases that Counsel determines present significant legal issues.

**PRESENT LAW**

IRC § 7122 authorizes the Secretary to enter into an agreement with a taxpayer that settles the taxpayer's tax liabilities for less than the full amount owed, provided the taxpayer's case has not been referred to the Department of Justice. Such an agreement is known as an OIC. Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. The regulations further define these terms and describe instances when compromise is appropriate.

IRC § 7122(b) requires the Treasury Department's General Counsel to review and provide an opinion for accepted OICs in all criminal cases and in all civil cases where the amount of unpaid tax assessed (including any interest, additional amount, addition to tax, and assessable penalty) is \$50,000 or more. This authority is exercised by the IRS Office of Chief Counsel.<sup>1</sup>

**REASONS FOR CHANGE**

The IRS receives tens of thousands of OIC applications every year. The overwhelming majority are submitted based on doubt as to collectibility (*i.e.*, the taxpayer says they cannot afford to pay the debt in full). In these cases, the IRS decides whether to accept an OIC primarily by performing a financial analysis that compares the taxpayer's ability to pay (based on income and assets) with the taxpayer's allowable living expenses. Currently, the IRS also must verify that the legal and IRS policy requirements for compromise are met prior to proposing acceptance, even though very few OICs present significant legal issues that require Office of Chief Counsel involvement. The time Counsel employees spend reviewing and learning the facts of every criminal OIC case and every civil OIC case where the amount of unpaid tax assessed is \$50,000 or more creates significant delays in OIC processing and is often duplicative of work the IRS has already performed. It also requires a significant commitment of legal resources on the part of the IRS. The Office of Chief Counsel reports that it spends over six thousand hours each year reviewing OICs.<sup>2</sup> Taxpayers would be better served if the IRS allocated those resources elsewhere.

<sup>1</sup> See Internal Revenue Manual 8.23.4.3.3, Counsel Review of Acceptance Recommendations (Apr. 7, 2022), [https://www.irs.gov/irm/part8/irm\\_08-023-004](https://www.irs.gov/irm/part8/irm_08-023-004).

<sup>2</sup> Emails from IRS Office of Chief Counsel (June 14, 2024; Nov. 29, 2021; Sept. 1, 2020; and Aug. 9, 2019) (on file with TAS).

In addition, delays in OIC processing may impede a taxpayer's ability to make other financial decisions while awaiting a response and may even jeopardize the taxpayer's ability to pay the amount offered if their financial circumstances deteriorate while the OIC is awaiting Counsel review.

The National Taxpayer Advocate believes the OIC process would be improved if Congress repeals the blanket requirement that Counsel review all OICs in civil cases where the unpaid tax assessed is \$50,000 or more and replace it with language authorizing the Secretary to determine when an opinion of the Treasury Department's General Counsel, or the Counsel's delegate, is required with respect to an OIC.<sup>3</sup>

## RECOMMENDATION

- Amend IRC § 7122(b) to repeal the requirement that Counsel review all OICs in civil cases where the amount of unpaid tax assessed (including any interest, additional amount, addition to tax, or assessable penalty) is \$50,000 or more and replace it with language authorizing the Secretary to determine when an opinion of the Treasury Department's General Counsel, or the Counsel's delegate, is required with respect to an OIC.<sup>4</sup>

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3 The Treasury Department has made a similar proposal. See Dep't of the Treasury, *General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals* 177 (Modify the Requirement That General Counsel Review Certain Offers in Compromise), <https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf>.

4 For legislative language generally consistent with this recommendation, see, e.g., Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 303 (2017); Taxpayer Bill of Rights Enhancement Act of 2015, S. 1578, 114th Cong. § 403 (2015).

**Legislative Recommendation #22****Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities****SUMMARY**

- *Problem:* The IRS is required to send billing notices to taxpayers with tax debts once a year. Private businesses typically send billing notices more frequently, often monthly. By sending infrequent billing notices, the IRS receives fewer payments from taxpayers, and as a result, more taxpayers face aggressive IRS collection actions such as levies and liens.
- *Solution:* Require the IRS to send billing notices to taxpayers with tax debts at least quarterly.

**PRESENT LAW**

IRC § 7524 requires the IRS to send taxpayers with delinquent accounts a written notice that sets forth the amount of the tax delinquency as of the date of the notice and to do so “[n]ot less often than annually.”

**REASONS FOR CHANGE**

The IRS satisfies the IRC § 7524 requirement by sending taxpayers with delinquent accounts Notice CP-71, Reminder Notice, once a year. However, the infrequency of IRS billing notices leaves collectible revenue uncollected and subjects taxpayers who would make payments if they received more frequent reminders to additional penalties and interest charges, along with harsher consequences such as wage garnishments, bank account levies, and property liens.

Sending more frequent notices after the IRS’s initial notice stream would entail additional postage and processing costs. However, private sector businesses, including credit card issuers and retailers, face the same trade-off, and almost all such creditors send billing notices more frequently than once a year. Most send billing notices on at least a monthly basis. In other words, they have found that frequent notices generate more revenue, net of costs. Many individual and business taxpayers face financial challenges and prioritize paying the bills of creditors who are sending regular notices and are top of mind.

**RECOMMENDATION**

- Amend IRC § 7524 to require the IRS to notify taxpayers of delinquent tax liabilities at least quarterly.<sup>1</sup>

<sup>1</sup> For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 201 (2018). As more taxpayers establish online accounts, the IRS will be able to transmit notices to taxpayers electronically rather than by traditional mail. For that reason, we are phrasing our recommendation broadly to allow that means of communication as an option.

## Legislative Recommendation #23

## Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins

### SUMMARY

- *Problem:* The IRS can return levy proceeds to a taxpayer in certain circumstances, or to a third party in the case of a wrongful levy if a request for return is made within two years from the “date of levy.” For paper levies, the date of levy is the date the notice of levy was served. For electronic levies, the IRS considers the date of levy to be the date on which it received the levy proceeds. This means parties subject to paper levies may not be able to recover funds that parties subject to electronic levies may recover.
- *Solution:* Allow the IRS to return levy proceeds if the funds were *received* by the IRS within the preceding two years, regardless of the date the original levy was *served*.

### PRESENT LAW

IRC § 6331 authorizes the IRS to levy on a taxpayer’s property and rights to property that exist at the time a levy is served in order to collect unpaid tax liabilities. The levy attaches to fixed and determinable obligations even if receipt of a payment arising from the obligation is deferred until a later date. A levy on a taxpayer’s salary or wages is continuous from the date the levy is first made until the levy is released.<sup>1</sup> A levy on certain specified federal payments such as Social Security benefits is also continuous<sup>2</sup> and is made electronically under the Federal Payment Levy Program (FPLP).<sup>3</sup>

IRC § 6343(b) authorizes the IRS to return money levied upon or money received from the sale of levied property (levy proceeds) to third parties when it determines the levy was wrongful if the third party requests the return within two years from the date of such levy.<sup>4</sup> The IRS may also return levy proceeds to taxpayers as if the property had been wrongfully levied upon when it determines one of the circumstances specified in IRC § 6343(d)(2) exists if the taxpayer requests the return within two years from the date of such levy.<sup>5</sup>

*Paper levies.* For paper levies delivered by hand or mail, the date of levy is the date the levy is delivered to the person in possession of the property.<sup>6</sup> In the case of a continuous levy under IRC § 6331(e), the date of levy is the date the notice of levy is first served by hand or by mail on the person in possession of the taxpayer’s salary or wages.<sup>7</sup>

1 IRC § 6331(e).

2 IRC § 6331(h).

3 The FPLP is an automated process used by the IRS to systemically levy federal payments owed to taxpayers. See IRS, Federal Payment Levy Program (Mar. 1, 2024), <https://www.irs.gov/businesses/small-businesses-self-employed/federal-payment-levy-program>.

4 Under IRC § 7426(a)(1), a third party may bring a suit against the United States to recover amounts wrongfully levied. IRC § 6532(c) requires that a wrongful levy suit be brought within two years of the date of the levy unless a timely request for return of property was made pursuant to IRC § 6343(b).

5 IRC § 6343(b), (d) permits the IRS to return specific property levied upon at any time.

6 Treas. Reg. § 301.6331-1(c).

7 A continuous levy is issued via Form 668-W, Notice of Levy on Wages, Salary, and Other Income, and is generally a “paper levy”, which is defined as “either a manual or systemic levy on Form 668-A, or Form 668-W, that is prepared and issued by [a revenue officer].” This differs from an FPLP levy, which is an automated levy. Automated levies are “levies issued through the Automated Levy Programs.” They are transmitted electronically, and the proceeds are received electronically. IRM 5.11.5.1.6, Terms/Definitions/Acronyms (June 13, 2018), [https://www.irs.gov/irm/part5/irm\\_05-011-005](https://www.irs.gov/irm/part5/irm_05-011-005).

*Electronic levies.* For electronic levies through the FPLP, the IRS has adopted a policy to return all or a portion of the levy proceeds it received during the two-year period preceding the date of the request for return without regard to the date the initial levy was delivered.<sup>8</sup> While this policy is included in the Internal Revenue Manual (IRM), the IRM is simply a set of instructions to help IRS employees do their jobs. Neither the IRS nor taxpayers may rely on it in court.

## REASONS FOR CHANGE

IRS levies on assets, such as wages, pension benefits, annuities, or Social Security benefits, may result in multiple payments over many years. The IRS has the authority to return levy proceeds to a third party or to the taxpayer if the person requests the proceeds within two years of the date of levy under certain circumstances. If a party requests return of levy payments more than two years after the date of such levy, the IRS is not authorized to return the payments.

For paper levies, the IRS can return levy proceeds if the request for return is received within two years of the date that the levy was first served. In the case of FPLP levies under IRC § 6331(h), however, the IRM provides that the IRS can return a levied payment if the payment was made within the two-year period before the date of the request for return. These differing rules cause the IRS to treat similarly situated persons differently and infringe upon a third party or taxpayer's *right to a fair and just tax system*.

*Example:* Assume the IRS issues a continuous levy to a taxpayer's employer in Year One. In Year Three, the taxpayer's living expenses increase significantly due to large medical bills, and the levy causes an economic hardship for the taxpayer. In Year Four, the taxpayer asks the IRS to release the levy and return the levy proceeds that the IRS received during the time in which the taxpayer was experiencing economic hardship. The IRS is prohibited from returning the levy proceeds to the taxpayer because more than two years have elapsed since the date the levy was served.

Contrast this result with a taxpayer whose Social Security benefits are levied under the FPLP. The IRS may return up to the last two years of levy payments even if the request occurs more than two years after the FPLP levies began.

## RECOMMENDATION

- Amend IRC § 6343(b) to strike the term “date of such levy” and substitute “the date the Secretary received such amount.”

<sup>8</sup> See IRM 5.11.7.3.7(2), Returning FPLP Levy Proceeds (July 1, 2022), [https://www.irs.gov/irm/part5/irm\\_05-011-007r](https://www.irs.gov/irm/part5/irm_05-011-007r) (providing for return within two years from the date of such levy payment); IRM 5.19.9.3.7(5), Returning SITLP Payments (June 23, 2022), [https://www.irs.gov/irm/part5/irm\\_05-019-009r](https://www.irs.gov/irm/part5/irm_05-019-009r) (providing for return within two years from the date of such levy payment).

**Legislative Recommendation #24****Protect Retirement Funds From IRS Levies, Including So-Called “Voluntary” Levies, Absent Flagrant Conduct by a Taxpayer****SUMMARY**

- *Problem:* Congress has provided significant tax incentives to encourage Americans to save for retirement. Those policies reflect a recognition that almost all workers eventually retire and require retirement savings to pay their basic living expenses and that retirees who do not have savings often end up on costly public assistance programs. Those policies are undermined when the protections for retirement savings from levy are a matter of IRS policy, rather than codified in statutes, and the IRS allows taxpayers with tax debt to agree to “voluntary” levies on their retirement accounts.
- *Solution:* Prohibit the IRS from levying on retirement accounts unless a taxpayer has engaged in flagrant conduct.

**PRESENT LAW**

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) generally authorizes the IRS to “levy upon all property and rights to property” of the taxpayer, which includes retirement savings. Some property is exempt from levy pursuant to IRC § 6334.

The IRS has taken certain steps to protect retirement savings by requiring a specialized analysis prior to levy, with the steps laid out in the Internal Revenue Manual (IRM). One step is that the IRS has decided not to levy on the assets in a taxpayer’s retirement account unless it determines the taxpayer has engaged in flagrant conduct.<sup>1</sup> The IRM does not define the term “flagrant conduct” but does provide 13 examples of such conduct.<sup>2</sup> In 2017, the IRS modified the IRM to adopt procedures that allow taxpayers to request voluntary levies on retirement accounts. If a taxpayer requests a voluntary levy, the IRS bypasses the determination of flagrant conduct.<sup>3</sup>

**REASONS FOR CHANGE**

Congress has provided significant tax incentives to encourage taxpayers to save for retirement, and the same policy considerations support shielding retirement savings from IRS levies. Almost all workers eventually retire, and they require retirement savings to pay for basic living expenses. In addition, retirees who do not have sufficient savings are more likely to experience economic hardship and qualify for public assistance, which taxpayers pay to provide.

While the IRM contains procedures to protect retirement savings by requiring a specialized analysis prior to levy, these procedures do not provide sufficient taxpayer safeguards. Since the 2017 IRM change, taxpayers who have not engaged in flagrant conduct to evade tax, and therefore would have been shielded from levies

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1 Internal Revenue Manual (IRM) 5.11.6.3(5), Funds in Pension or Retirement Plans (Mar. 14, 2024), [https://www.irs.gov/irm/part5/irm\\_05-011-006](https://www.irs.gov/irm/part5/irm_05-011-006). The IRS will also consider collection alternatives and whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (Mar. 14, 2024), [https://www.irs.gov/irm/part5/irm\\_05-011-006](https://www.irs.gov/irm/part5/irm_05-011-006).

2 IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (Mar. 14, 2024), [https://www.irs.gov/irm/part5/irm\\_05-011-006](https://www.irs.gov/irm/part5/irm_05-011-006).

3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (Mar. 14, 2024), [https://www.irs.gov/irm/part5/irm\\_05-011-006](https://www.irs.gov/irm/part5/irm_05-011-006). The IRS will still take the other steps and verify the taxpayer received collection due process rights.



on their retirement accounts in the past, may agree to voluntary levies, perhaps out of fear or anxiety, and consequently find themselves in economic hardship during retirement.

It is important to note that taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time without congressional or public input.

Because retirement accounts are critical to retirees' financial well-being, we recommend that Congress codify levy protections, rather than leaving their scope to the IRS's discretion. Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined the IRS should not levy on child support payments because doing so would likely harm children. To better protect retirement savings, the National Taxpayer Advocate recommends Congress add retirement savings to the list of exempt property, absent flagrant conduct, and define the term "flagrant conduct" in the statute.<sup>4</sup>

## RECOMMENDATIONS

- Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy unless it is determined that the taxpayer has engaged in flagrant conduct and the levy would not create an economic hardship.<sup>5</sup>
- Amend IRC § 6334 to define "flagrant conduct" as an action intended to evade or defeat any tax imposed by Title 26 or the collection or payment of any such tax.<sup>6</sup>

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4 We recognize that adopting these recommendations would impact taxpayers who might want to dip into their retirement savings to pay their tax debts and request a levy to avoid the ten percent tax that applies to early distributions from retirement accounts. On balance, however, we believe the greater protections afforded to retirement savings by our recommendations outweigh this impact.

5 In rare cases, a taxpayer with vast retirement savings may be delinquent in paying his or her tax debts without having engaged in flagrant conduct. To avoid providing an unlimited exemption from levy in these cases, Congress could make the levy exemption subject to a cap, such as \$1 million in qualified retirement savings, and index it for inflation to maintain its value in future years.

6 For legislative language generally consistent with these recommendations, see, e.g., John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 203 (2021); and Taxpayer Protection Act, H.R. 2171, 115th Cong. § 203 (2017).

**Legislative Recommendation #25****Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence****SUMMARY**

- *Problem:* One of the most severe and potentially devastating actions the IRS can take to collect a tax debt is to seize and sell a taxpayer's home. The IRS can do this in one of two ways – administratively (seizure and sale) or judicially (lien foreclosure). The law provides significant and meaningful taxpayer protections before an administrative seizure and sale may take place. However, far fewer procedural safeguards exist for taxpayers in judicial lien foreclosure suits.
- *Solution:* Provide taxpayers and their families who are subject to judicial lien foreclosure suits the same protections as taxpayers who are subject to administrative seizure and sale of their principal residence.

**PRESENT LAW**

Selling a taxpayer's principal residence to satisfy a tax liability is one of the most intrusive collection remedies the IRS can impose against a taxpayer. The IRS has two different procedures to collect delinquent taxes from a taxpayer's principal residence: (1) an administrative seizure and sale; or (2) a lien foreclosure suit. The two cannot be used concurrently. The IRS generally uses the administrative seizure and sale procedures unless there are "questions concerning title to the particular property or priorities of liens that create an unfavorable or impossible market for administrative sale" or "it may be difficult to obtain the property or to preserve its value, and the aid of the court is necessary."<sup>1</sup> In these situations, the IRS uses the lien foreclosure procedure to enhance its ability to sell the property and obtain a higher sale price.

**Administrative Seizure**

IRC § 6334(a)(13) provides that a taxpayer's principal residence is generally exempt from levy, except as provided in subsection (e). IRC § 6334(e)(1)(A) provides that a principal residence shall not be exempt from levy if a U.S. district court judge or magistrate "approves (in writing) the levy of such residence." An administrative seizure is generally subject to significant taxpayer protections. The government must show that "the taxpayer's other assets subject to collection are insufficient to pay the amount due,"<sup>2</sup> and that "no reasonable alternative for collection of a taxpayer's debt exists."<sup>3</sup> In addition, if the property is owned by the taxpayer but is used as the principal residence of the taxpayer's spouse, former spouse, or minor child, the IRS is required to send a letter addressed to or on behalf of each such person providing notice of the commencement of the proceeding. If "it is unclear who is living in the principal residence property and/or what such person's relationship is to the taxpayer," the IRS must address the letter to "Occupant."<sup>4</sup> Additionally, IRC § 6343(a) requires the IRS to release a levy under certain circumstances, including where it determines that the levy "is creating an economic hardship due to the financial condition of the taxpayer."<sup>5</sup>

1 Chief Counsel Directives Manual 34.6.2.2(1), Judicial Enforcement of the Tax Lien (Aug. 8, 2023), [https://www.irs.gov/irm/part34/irm\\_34-006-002](https://www.irs.gov/irm/part34/irm_34-006-002); see also Internal Revenue Manual (IRM) 5.17.4.8.2.1, Administrative Collection Devices Are Not Feasible or Adequate (Mar. 25, 2022), [https://www.irs.gov/irm/part5/irm\\_05-017-004](https://www.irs.gov/irm/part5/irm_05-017-004).

2 IRC § 6334(e).

3 Treas. Reg. § 301.6334-1(d)(1). This requirement in the regulations is consistent with the legislative history of IRC § 6334(e), which states that a principal residence "should only be seized to satisfy tax liability as a last resort." S. REP. NO. 105-174, at 86-87 (1998).

4 Treas. Reg. § 301.6334-1(d)(3).

5 IRC § 6343(a)(1)(D).

## Lien Foreclosure Suit

IRC § 7403 authorizes the Department of Justice (DOJ) to file a civil action against a taxpayer in a U.S. district court to enforce a tax lien and foreclose on a taxpayer's property. There is no exclusion for property consisting of a taxpayer's principal residence. As compared with administrative seizures, statutory taxpayer protections are considerably more limited in lien foreclosure suits. For example, the Supreme Court has held: "We can think of virtually no circumstances ... in which it would be permissible to refuse to authorize a sale simply to protect the interests of the delinquent taxpayer himself or herself."<sup>6</sup> A court has some discretion to refuse to authorize a sale that would impact a spouse, children, or other third parties, but even in that circumstance, the discretion is limited.<sup>7</sup> Further, there is no requirement the IRS establish that "no reasonable alternative for collection of a taxpayer's debt exists" or that the IRS notify the taxpayer's spouse, former spouse, or family unless they have an ownership interest in the property to be foreclosed.<sup>8</sup>

## REASONS FOR CHANGE

IRC § 6334(e), requiring judicial approval of the administrative sale of principal residences, was enacted as part of the IRS Restructuring and Reform Act of 1998. The Senate Finance Committee report stated that the "seizure of the taxpayer's principal residence is particularly disruptive to the taxpayer as well as the taxpayer's family," and a principal residence therefore "should only be seized to satisfy tax liability as a last resort."<sup>9</sup>

This code section provided protections to taxpayers subject to administrative seizures of principal residences but offered no such protections to taxpayers subject to judicial foreclosures of principal residences. While the IRS may prefer one procedure over the other depending on the circumstances, from a taxpayer's standpoint there is no meaningful difference between these two actions. A lien foreclosure has the same devastating impact as an administrative seizure. The result is that the taxpayer's principal residence is sold, and the proceeds are applied to his or her tax liability. Both groups of taxpayers deserve the same protections, as do their families.

At the recommendation of the Office of the Taxpayer Advocate, the IRS has written procedures into its Internal Revenue Manual (IRM) that provide additional taxpayer protections before a case may be referred to DOJ for the filing of a lien foreclosure suit.<sup>10</sup> The IRM prescribes certain initial steps the IRS must take, such as attempting to identify the occupants of a residence and advising the taxpayer about TAS assistance options. It also sets forth an internal approval process prior to referring a lien enforcement case to DOJ. However, the IRM is simply a set of instructions to IRS staff. Taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time.

Because of the devastating impact the seizure of a taxpayer's principal residence may have on the taxpayer and his or her family, the National Taxpayer Advocate believes taxpayer protections from lien foreclosure suits should be codified and not left for the IRS to determine through IRM procedures.

<sup>6</sup> *United States v. Rodgers*, 461 U.S. 677, 709 (1983).

<sup>7</sup> *Id.* at 680, 709-710.

<sup>8</sup> In *United States v. Maris*, 109 A.F.T.R.2d 2012-775 (D. Nev. 2012), the court held that the United States was required to establish that no reasonable alternative existed for collection of the taxpayer's debt before foreclosing tax liens on a principal residence. See also *United States v. Maris*, 111 A.F.T.R.2d 2013-2475 (D. Nev. 2013). However, other courts have held that the requirements for administrative seizure and sale of a principal residence are not applicable to lien foreclosure under IRC § 7403. See, e.g., *United States v. Martynuk*, 115 A.F.T.R.2d 2015-613 (S.D.N.Y. 2015) (declining to follow *Maris*) and the cases cited therein.

<sup>9</sup> S. REP. NO. 105-174, at 86-87 (1998).

<sup>10</sup> See IRM 5.17.4.8.2.5, Lien Foreclosure on a Principal Residence (Sept. 8, 2023), [https://www.irs.gov/irm/part5/irm\\_05-017-004](https://www.irs.gov/irm/part5/irm_05-017-004); IRM 5.17.12.20.2.2.4, Additional Items for Lien Foreclosure of Taxpayer's Principal Residence (Nov. 9, 2023), [https://www.irs.gov/irm/part5/irm\\_05-017-012](https://www.irs.gov/irm/part5/irm_05-017-012); IRM 25.3.2.4.5.2(3), Actions Involving the Principal Residence of the Taxpayer (Nov. 9, 2023), [https://www.irs.gov/irm/part25/irm\\_25-003-002r](https://www.irs.gov/irm/part25/irm_25-003-002r).

## RECOMMENDATIONS

- Amend IRC § 7403 to codify current IRM administrative protections, including that an IRS employee must receive executive-level written approval to proceed with a lien foreclosure suit referral.
- Amend IRC § 7403 to preclude the IRS from requesting that DOJ file a civil action in a U.S. district court seeking to enforce a tax lien and foreclose on a taxpayer's principal residence, except where the IRS has determined that:
  - (1) The taxpayer's other property or rights to property, if sold, would be insufficient to pay the amount due, including the expenses of the proceedings, and no reasonable alternative exists for collection of the taxpayer's debt;
  - (2) The foreclosure and sale of the residence would not create an economic hardship due to the financial condition of the taxpayer; and
  - (3) If the property to be levied is owned by the taxpayer but is used as the principal residence of the taxpayer's spouse, former spouse, or minor child, the IRS has sent a notice addressed in the name of the taxpayer's spouse or ex-spouse, individually or on behalf of any minor children.<sup>11</sup>

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<sup>11</sup> For legislative language generally consistent with this recommendation, see Small Business Taxpayer Bill of Rights Act of 2023, H.R. 2681 and S. 1177, 118th Cong. § 11 (2023); Small Business Taxpayer Bill of Rights Act of 2015, H.R. 1828 and S. 949, 114th Cong. § 16 (2015); and Eliminating Improper and Abusive IRS Audits Act of 2014, S. 2215, 113th Cong. § 8 (2014).

**Legislative Recommendation #26****Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions****SUMMARY**

- *Problem:* When the IRS takes collection actions against a taxpayer, the taxpayer is entitled to a Collection Due Process (CDP) hearing at which they may raise defenses, challenge the appropriateness of the collection action, and propose collection alternatives. In some cases, the IRS takes collection actions against property held by third parties, but these third parties are not entitled to a CDP hearing. Therefore, they have fewer procedural protections than the taxpayer who actually owes the tax.
- *Solution:* Clarify that affected third parties who hold legal title to property subject to IRS collection actions are entitled to CDP protections to the same extent as the taxpayer who owes the tax.

**PRESENT LAW**

When a taxpayer does not pay their federal tax due upon notice and demand, a tax lien for the unpaid amount automatically arises under IRC § 6321. The IRS may file a Notice of Federal Tax Lien (NFTL) against and levy upon (seize) all property or rights to property of “any person liable to pay any tax” who neglects or refuses to pay,<sup>1</sup> including property owned by certain third-party individuals or entities. These third parties include nominees, alter egos, and persons to whom lien-encumbered property is transferred (collectively, “affected third parties”).

The tax code also provides certain CDP rights to a taxpayer when the IRS takes collection action. IRC § 6320(a) requires the IRS to give taxpayers notice and an opportunity for a hearing after it files an NFTL. IRC § 6330(a) generally requires the IRS to give taxpayers notice and an opportunity for a hearing before it issues a levy. The IRS must provide these CDP rights to “the person described in section 6321” after filing an NFTL and to “any person with respect to any unpaid tax” before levying against property.<sup>2</sup> When the IRS takes collection actions against affected third parties, however, it does not provide CDP rights, even though it seeks to collect from their property and has thus determined they are liable with respect to the unpaid tax to the extent of such property.<sup>3</sup>

**REASONS FOR CHANGE**

Congress created CDP notice and hearing procedures to give taxpayers the right to a meaningful hearing before the IRS levies their property or immediately after the IRS files an NFTL against their property. During a CDP hearing with the IRS Independent Office of Appeals (Appeals), a taxpayer has the opportunity to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives.<sup>4</sup> If the parties

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1 See IRC §§ 6321, 6323(f), 6331(a).

2 IRC §§ 6320(a)(1), 6330(a)(1). IRC § 6321 also refers to “any person liable to pay any tax.”

3 A CDP lien notice will only be given to the person described in IRC § 6321 who is named on the NFTL. Treas. Reg. § 301.6320-1(a)(2), Q&A-A1. A CDP levy notice will only be given to the person described in IRC § 6331(a). Treas. Reg. § 301.6330-1(a)(3), Q&A-A1.

4 IRC §§ 6320(c), 6330(c)(2).

cannot resolve the issues, Appeals issues a notice of determination that allows the taxpayer to seek judicial review in the U.S. Tax Court.<sup>5</sup>

In some affected third-party circumstances, the IRS seeks to collect from specific property (*e.g.*, property that has been transferred to a third party subject to a tax lien). In other cases, the IRS seeks to collect from all of the affected third party's property (*e.g.*, an alter ego).<sup>6</sup> In both situations, the IRS may file NFTLs that identify the affected third party and levy upon property that, under state law, belongs to the affected third party. The Treasury regulations interpret the term "person" as including only the taxpayer (*i.e.*, the person upon whom the tax was imposed and who refused or neglected to pay following notice and demand) for purposes of CDP eligibility,<sup>7</sup> and the U.S. Tax Court has upheld Treasury's interpretation.<sup>8</sup> Thus, the IRS does not afford affected third parties CDP rights when the IRS takes collection actions against the property.<sup>9</sup>

The collection remedies for affected third parties are unduly burdensome and inefficient and lack adequate procedural safeguards. A third party may seek administrative review of a nominee/alter ego lien or levy determination by requesting a Collection Appeals Program (CAP) hearing through Appeals.<sup>10</sup> However, since Appeals' goal is to decide CAP cases within five days,<sup>11</sup> a CAP hearing only provides a summary review. While quick resolution is a laudable goal, an affected third party utilizing a CAP appeal may not receive a thorough review. Further, CAP decisions are final and not subject to judicial review.<sup>12</sup> The only judicial remedies require the affected third party to file suit in a U.S. district court,<sup>13</sup> which is difficult to navigate without legal representation and can be costly for all parties. Affected third parties who cannot afford the significant expense and burden of litigation may never be able to challenge an inappropriate or unlawful collection action.

In fiscal year (FY) 2024, the IRS issued 192,523 CDP notices to taxpayers; 10,829 taxpayers requested CDP hearings; and 1,116 taxpayers filed CDP petitions in the U.S. Tax Court.<sup>14</sup> By comparison, the IRS only filed 1,200 nominee and alter ego NFTLs during FY 2024.<sup>15</sup> Thus, expressly providing CDP rights to affected third parties would not impose an undue administrative burden on the IRS and would reduce litigation costs for both the government and the affected third parties.

For these reasons, the National Taxpayer Advocate believes it is incongruous and inequitable for taxpayers who originally were responsible for tax debts to receive the full protection of IRC §§ 6320 and 6330, while affected third parties holding legal title to property subject to IRS collection actions do not receive these same due process protections.

<sup>5</sup> IRC §§ 6320(c), 6330(d)(1).

<sup>6</sup> See *Oxford Capital Corp. v. United States*, 211 F.3d 280, 284 (5th Cir. 2000); Internal Revenue Manual (IRM) 5.17.2.5.7(2), Property Held by Third Parties (Jan. 8, 2016), [https://www.irs.gov/irm/part5/irm\\_05-017-002](https://www.irs.gov/irm/part5/irm_05-017-002).

<sup>7</sup> Treas. Reg. § 301.6320-1(a)(2), Q&A-A1; Treas. Reg. § 301.6330-1(a)(3), Q&A-A1.

<sup>8</sup> See *Greenoak Holdings Ltd. v. Comm'r*, 143 T.C. 170 (2014).

<sup>9</sup> See *Greenoak Holdings Ltd. v. Comm'r*, 143 T.C. 170 (2014); Treas. Reg. §§ 301.6320-1(a)(2), Q&A-A7, 301.6330-1(a)(3), Q&A-A2, 301.6320-1(b)(2), Q&A-B5, and 301.6330-1(b)(2), Q&A-B5.

<sup>10</sup> Treas. Reg. §§ 301.6320-1(b)(2), Q&A-B5, 301.6330-1(b)(2), Q&A-B5.

<sup>11</sup> IRM 8.24.1.3.8, Case Procedures under CAP (Aug. 20, 2024), [https://www.irs.gov/irm/part8/irm\\_08-024-001](https://www.irs.gov/irm/part8/irm_08-024-001).

<sup>12</sup> *Hughes v. Comm'r*, T.C. Memo. 2012-42; IRM 8.24.1.2, Distinctions Between CAP and Collection Due Process (CDP) Hearings (Sept. 28, 2021), [https://www.irs.gov/irm/part8/irm\\_08-024-001](https://www.irs.gov/irm/part8/irm_08-024-001).

<sup>13</sup> For example, if the IRS has filed an NFTL, the third party who holds the title is left with the option to bring an action to quiet title under 28 U.S.C. § 2410 in a U.S. district court. To contest a nominee, alter ego, or transferee levy, the affected third party must file a wrongful levy action under IRC § 7426 in a U.S. district court.

<sup>14</sup> Of the total hearing requests, 6,170 involved individuals and 4,659 involved business taxpayers. IRS Compliance Data Warehouse (CDW), Individual Master File (FY 2024) (through Sept. 26, 2024); IRS CDW, Business Master File (FY 2024) (through Sept. 26, 2024). This data includes FY 2024 CDP notices mailed and CDP hearings requested as indicated on the taxpayers' accounts by September 26, 2024. Actual numbers may be higher because some may not have been posted to taxpayer accounts until FY 2025. The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel. IRS, Counsel Automated Tracking System, Subtype DU. This data does not include cases on appeal.

<sup>15</sup> IRS response to TAS information request (Oct. 21, 2024).

## RECOMMENDATION

- Amend IRC §§ 6320 and 6330 to extend CDP rights to affected third parties who hold legal title to property subject to IRS collection actions.<sup>16</sup>

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<sup>16</sup> For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*), <https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/Legislative-Recommendations-The-IRS-Should-Provide-Collection-Due-Process-Rights-to-Third-Parties-Holding-Property.pdf>.



**Legislative Recommendation #27****Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions****SUMMARY**

- *Problem:* Both taxpayers and the government benefit when the IRS has an opportunity to consider a taxpayer's claim to recover damages for improper collection actions before the taxpayer files suit in court, but current filing deadlines in some cases require taxpayers to file suit in court before the IRS has a chance to consider their claims.
- *Solution:* Give taxpayers more time to file suit in court if they have filed a timely administrative claim with the IRS.

**PRESENT LAW**

IRC § 7433(a) authorizes taxpayers harmed by improper collection actions to sue the United States for damages if an IRS employee has recklessly or intentionally, or by reason of negligence, disregarded any provision of the tax code or any regulation relating to the collection of federal tax. Under IRC § 7433(d)(3) and Treas. Reg. § 301.7433-1(g)(2), the suit must be brought in a U.S. district court within two years from the date on which the taxpayer had a reasonable opportunity to discover all essential elements of a possible cause of action.

Before a taxpayer may sue the United States, IRC § 7433(d)(1) requires the taxpayer to file an administrative claim with the IRS. Treas. Reg. § 301.7433-1(d) provides that a taxpayer generally may not file suit in court until the earlier of (i) the date six months after filing an administrative claim or (ii) the date on which the IRS renders a decision on the claim. However, if the claim is filed within the last six months of the two-year period for filing suit, the taxpayer may file suit in court at any time before expiration of the two-year period.

**REASONS FOR CHANGE**

IRC § 7433(d)(1) reflects a policy decision that it is generally in the best interests of both the taxpayer and the government to allow the IRS to consider and render a decision on a taxpayer's claim before a case is brought to court. If a case is resolved at the administrative level, both parties are spared the time and expense of litigation. Treas. Reg. § 301.7433-1(d) reflects a complementary policy decision that if the IRS does not render a decision on an administrative claim within six months, taxpayers should be able to bring their cases to court without having to wait indefinitely for an IRS decision.

The existing rules, however, do not always achieve the goal of allowing the IRS to consider and render a decision before a taxpayer files suit. For example, while a claim is pending at the administrative level, the two-year period for filing suit in a U.S. district court continues to run. If a taxpayer files an administrative claim during the final six months of the two-year period, the taxpayer may be forced to file suit in a U.S. district court before the IRS has an opportunity to render a decision on the administrative claim (or else will forfeit the right to do so).

To give the IRS an opportunity to render an administrative decision while preserving the taxpayer's right to challenge an adverse decision in court, the two-year period that commences when the right of action accrues should be tied to the deadline for filing an administrative claim (rather than the deadline for filing suit).

Specifically, if the IRS renders an adverse or partially adverse decision on a timely filed administrative claim, the taxpayer should be allowed to file suit within two years from the date of the IRS's decision (*i.e.*, similar to the time allowed for filing suit after a refund claim is denied).

At the same time, to ensure taxpayers do not have to wait indefinitely for an IRS decision, a taxpayer should be permitted to file suit in a U.S. district court if a timely filed administrative claim goes unanswered for six months. These rules would ensure the IRS has a full six-month period to consider and render a decision on a taxpayer's damages claim based on an alleged improper collection action while preserving the taxpayer's right to file suit if the IRS does not render a timely decision.

## RECOMMENDATIONS

- Amend IRC § 7433(d)(1) to provide that before a taxpayer may file a civil action, the taxpayer must first file an administrative claim with the IRS within two years from the date a right of action accrues.
- Amend IRC § 7433(d)(3) to allow taxpayers to file a civil action in a U.S. district court (i) no earlier than six months from the date on which the administrative claim was filed and (ii) no later than the earlier of two years from the date on which the IRS sends its decision on the administrative claim to the taxpayer by certified or registered mail or, if the IRS does not render a decision, five years from the date the right of action accrued to file the administrative claim with the IRS.<sup>1</sup>

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<sup>1</sup> For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 201(c) (2017); and Taxpayer Bill of Rights Enhancement Act of 2015, S. 1578, 114th Cong. § 301(c) (2015). Other bills have proposed simply lengthening the period to bring an action under IRC § 7433(d)(3) from two years to five years. See, e.g., Small Business Taxpayer Bill of Rights Act of 2023, S. 1177 and H.R. 2681, 118th Cong. § 3(b) (2023); and Small Business Taxpayer Bill of Rights Act of 2022, S. 1656 and H.R. 7033, 117th Cong. § 3(b) (2022).

**Legislative Recommendation #28****Revise the Private Debt Collection Rules to More Accurately Identify and Protect Taxpayers With Incomes Below 200 Percent of the Federal Poverty Level****SUMMARY**

- *Problem:* The tax code prohibits the IRS from utilizing private companies to collect the tax debt of any taxpayer with adjusted gross income (AGI) of 200 percent or less of the Federal Poverty Level. The IRS currently determines AGI by relying exclusively on a taxpayer's last-filed tax return, going back up to ten years. However, collectability determinations are normally made on the basis of the taxpayer's current financial condition, and a tax return filed ten years ago is not a reliable measure of a taxpayer's current financial condition.
- *Solution:* Direct the IRS to determine a taxpayer's AGI based on third-party information reporting documents (*e.g.*, Forms W-2 and 1099) if no return has been filed in the last two years.

**PRESENT LAW**

IRC § 6306 directs the Secretary to enter into qualified tax collection contracts with private collection agencies (PCAs) to collect certain "inactive tax receivables."<sup>1</sup> Subsection (d) of IRC § 6306 lists categories of collection cases that are not eligible for assignment to PCAs.

The Taxpayer First Act (TFA) added the following category to the list:<sup>2</sup>

[A] taxpayer who is an individual with adjusted gross income, as determined for the most recent taxable year for which such information is available, which does not exceed 200 percent of the applicable poverty level (as determined by the Secretary).

**REASONS FOR CHANGE**

The IRS has implemented the exclusion for taxpayers with AGIs that do not exceed 200 percent of the Federal Poverty Level in a manner that fails to identify those taxpayers accurately. It has chosen to rely exclusively on a filed tax return, even if the taxpayer has not filed a recent return. Rather than using alternative means to determine the taxpayer's current AGI (*e.g.*, third-party information reporting documents like Forms W-2 and 1099), the IRS reaches back up to *ten years* to locate a return to determine AGI.

This approach produces anomalous results. A taxpayer who could afford to pay tax ten years ago may not be able to do so today – and these are the cases Congress intended to exclude from assignment to PCAs. Conversely, a taxpayer who could not afford to pay tax ten years ago might have earned additional income or acquired additional assets and might now be able to make payments.

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<sup>1</sup> IRC § 6306(a), (c).

<sup>2</sup> TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).

*Example:* A taxpayer last filed a tax return in 2015 when he earned \$60,000. In 2016, he retired due to age or disability. He did not pay his tax liability and still has a balance due. Since 2015, his income has consisted solely of Social Security benefits, and he has not had a filing obligation. Under its current approach, the IRS will look at the taxpayer's 2015 tax return, determine the taxpayer's income is above 200 percent of the Federal Poverty Level, and assign his case to a PCA. Yet this is a case the TFA sought to exclude from PCA assignment.

By contrast, if the same taxpayer earned only \$30,000 in 2015, and third-party information reports show he earned \$100,000 in 2024, the case might not be assigned to a PCA under the IRS's approach, even though the taxpayer can make payments currently.

To ensure that collectability determinations are made based on current data, the National Taxpayer Advocate has recommended that the IRS utilize information on a tax return if one has been filed in the last two years and, if not, that the IRS compute AGI from the information reporting documents the IRS receives.<sup>3</sup>

If the IRS relies on information reporting documents, it will have to use gross income rather than AGI because it may not know which adjustments the taxpayer is qualified to claim, if any. In some cases, that may have the effect of overestimating a taxpayer's AGI and therefore assigning some cases to PCAs that should have been excluded. Even so, we believe that basing collectability determinations on recent information will be far more accurate than reaching back for information up to ten years old.<sup>4</sup>

The Treasury Inspector General for Tax Administration (TIGTA) reached a similar conclusion and has similarly recommended that the IRS consider using “both last return filed information and third-party income information in its methodology to exclude low-income taxpayers from PCA inventory.”<sup>5</sup>

## RECOMMENDATION

- Amend IRC § 6306(d)(3)(F) to direct the IRS to determine an individual's AGI “for the most recent taxable year for which such information is available” by reference to the individual's most recently filed tax return if one has been filed in the preceding two years or, if not, by reference to information reporting documents described in part III of subchapter A of chapter 61 of the IRC.

3 No method will perfectly identify taxpayers with current AGIs below 200 percent of the Federal Poverty Level. If the IRS uses third-party information reporting documents to make collectability determinations, it will not take into account income not reported on those documents, such as self-employment income. But that is likely to be true even when the IRS relies on filed tax returns, as tax gap studies show most income not reported to the IRS on third-party documents is not reported on tax returns either. See IRS Pub. 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014–2016, at 20 (Oct. 2022), <https://www.irs.gov/pub/irs-pdf/p1415.pdf>.

4 A data run the IRS performed to compare the method the IRS is using with the method TAS has proposed found it would exclude roughly the same number of taxpayers. Cases assigned to PCAs as of September 12, 2019, were matched to the Individual Returns Transaction File to determine the last individual income tax return filed and to the Information Returns Master File to determine current income reported by third-party payors. For the reasons described above, we believe the TAS approach would do a better job of identifying the taxpayers whom Congress intended to exclude.

5 TIGTA, Ref. No. 2021-30-010, *Fiscal Year 2021 Biannual Independent Assessment of Private Collection Agency Performance* 20 (2020), <https://www.tigta.gov/sites/default/files/reports/2022-02/202130010fr.pdf>.