

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.¹ 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.

¹ 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.

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.² 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.³ 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.⁴ 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.

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.

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.

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.

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.⁵

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