

**Statement of Janet Spragens
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before the
IRS Oversight Board
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Panel 1: Leverage

Mr. Chairman and Members of the Board:

Thank you for inviting me to testify today on issues relating to how the IRS can better work with its stakeholders to educate taxpayers and improve taxpayer compliance. You have also asked the panel to address what professional organizations can contribute to protect the integrity of our tax administration system

As you know, I am a tax professor at the American University Washington College of Law, and the Director of the American University Federal Tax Clinic. This is my fourth opportunity to testify before the Oversight Board. Our Clinic, which is staffed by 10 third year student-attorneys each semester, provides pro bono assistance to low income taxpayers in the Washington DC metropolitan area. The principal activity of the Clinic is not filing assistance but rather post-filing legal representation for our clients: *i.e.*, help with audits, litigation, and collections. Our Clinic is also part of the network of tax clinics around the country that participates in the IRS Low Income Taxpayer Clinic (“LITC”) program. In that capacity, the IRS has awarded our clinic a monetary matching grant every year since the LITC program was begun in 1998.

Introduction

My testimony today will focus on low income taxpayers, a group which includes more than 20 million people in this country, and the role of LITCs in serving these taxpayers. Despite their numbers, this group, and their issues and needs, are frequently overlooked when it comes to decisions and policies involving tax administration.

Panel 2 today, as you know, will consider issues of streamlining tax enforcement processes to enhance compliance efforts. Despite the fact that these enforcement issues will be discussed by another panel, I have also devoted a significant part of my written testimony to them since I believe that fair – in addition

to fast – process within the agency is inextricably tied to achieving tax compliance in this income demographic.

In that connection, I and others in the tax clinic movement are particularly concerned with the negative impact that IRS Modernization (the reorganization of the Service that began in 1998 and continues even today) has had on low income taxpayers; and what measures the agency can take to address some of the problems the reorganization has created.

IRS Modernization, which was designed to move the agency into the information age and toward an electronic interactive world of tax administration, was intended to reduce taxpayer burden, increase service, and make the agency more taxpayer friendly and efficient. Unfortunately, for low income taxpayers, exactly the opposite has happened. Dealing with the reorganized agency and its centralized functions has almost uniformly become more difficult, impersonal, frustrating, and costly for these taxpayers. A principal reason is that these taxpayers, many of whom have limited or no proficiency in English, are generally not part of the information age. They are not Internet connected, do not have ready access to Web sites, fax machines, email messaging – or even bank accounts. They tend to be helped better through local walk-in offices and opportunities for face-to-face meetings than with an organizational structure based on specialization of function, remote offices, mailed documents, telephone phone trees with automated selections, and electronic transfers.

As I will explain in more detail in the body of this testimony, for these taxpayers, the efficiency gains under Modernization, and the Service’s increasing use of specialized offices and computer generated notices, have often come at the expense of fair process. An interesting outgrowth of the reorganization has been the regularity with which low income taxpayers have been falling out of the regular controversy resolution processes, and their increasing reliance on alternative “back door” problem solving avenues to get to the right result in their cases after the case is in Collections. These alternative processes include Audit Reconsideration, Offers-in-Compromise (based on “doubt as to liability”), Currently-Non-collectible (“CNC”) status, “equivalent” Collections Due Process (“CDP”) hearings, and hardship appeals to the office of the National Taxpayer Advocate.

But a substantive review of a case once it is in Collections is not the same as receiving fair treatment during the initial audit of the case. Moreover, it is not clear what will happen to these cases once Internal Revenue Code section 6306 (involving outsourcing of debt collections) becomes operational, and these taxpayers’ names are forwarded to private debt collectors with limited information about (or interest in) the correctness of the original return.

My testimony concludes that the LITCs play a critical role in helping the IRS educate taxpayers about their tax responsibilities and rights, and in moving the entire system toward the goal of a highly compliant taxpayer population. But the LITC program is underfunded and needs the support of this Board. Moreover, the Board needs to look closely at the problems low income taxpayers are experiencing under the modernized IRS. When taxpayers are denied fair process in dealing with the agency, the integrity of the entire system is undermined as well as are the goals outlined by this Board.

The Role of the Tax Clinics as Stakeholders

As a group, the LITCs have been a critical stakeholder resource for the Service both in educating taxpayers about their tax obligations and in protecting low income taxpayer rights in their post-filing interactions with the agency. Experience has shown that a clinic's presence in a case almost always has the result of enhancing taxpayer satisfaction that the case has been resolved on a fair basis. Having an attorney who is professionally competent and who understands the tax controversy process gives the client a sense of empowerment and the feeling that he or she is getting fair treatment from the system. The importance of this contribution cannot be underestimated in a tax system based on voluntary compliance. In addition to taxpayer assistance, the clinic's involvement in controversy cases normally assists timely resolution of the matter. Although the IRS was initially concerned when clinics first came on the scene that the clinics would prolong the controversy process and "take every case to the Supreme Court", both the IRS and the Tax Court have repeatedly acknowledged that in fact the opposite is true, and that their processes have been enhanced and streamlined when Clinic attorneys are involved.

The most important impetus toward the growth and development of the tax clinic movement was the enactment of Internal Revenue Code section 7526 in the Restructuring and Reform Act of 1998, a provision which created a matching grant program for LITCs that provide controversy assistance or LEP educational services to low income taxpayers. This program, now in its seventh year and administered by the office of the National Taxpayer Advocate, has resulted in a proliferation of new tax clinics across all parts of this country. There are now over 135 such funded tax clinics in the United States.

Clinic Contributions to Orderly Tax Administration

Tax Clinic attorneys make numerous contributions to the efficient administration of the post-filing process, the most important of which is helping to ensure that fair results are reached for taxpayers at all income levels. Clinic attorneys advance the process of justice by explaining legal procedures and rules to their clients, and deciphering IRS communications for them in ways that the clients can understand. (Many clinics have bilingual staff and/or access to translators.) The clinics also regularly help taxpayers in gathering relevant documentation, which surprisingly taxpayers are often unable to do on their own. In the appeals process, the attorneys help frame legal issues, advise clients about their options under the law, and assist clients in negotiating fair settlements. Should the case go to trial, clinic attorneys represent their clients in court proceedings.

If the cases are resolved with outstanding deficiencies, clinics also help clients with collections alternatives, which may involve filing an Offer-in-Compromise, putting the client in Currently-not-Collectible status, or getting the client on an installment payment plan.

For clients who come to the clinic after audit opportunities have been defaulted and the case is in Collections – which is an increasingly common occurrence – clinic attorneys help their clients in pursuing review through Audit Reconsideration, filing an Offer-in-Compromise (“OIC”) based on doubt as to liability, or requesting hardship relief from the office of the National Taxpayer Advocate.

Finally, even in cases where the client has clearly made a mistake in claiming a particular tax benefit (taking a deduction for commuting expenses, for example), the clinics serve an important “second opinion” role by conferring with the client and explaining that pursuing the matter will simply result in the build-up of interest when the case is ultimately resolved. In these circumstances, IRS attorneys can give the client the same information, but clients tend to be distrustful of information from this source.

Whether the clients win, lose or settle these cases, their sense that they have had a fair hearing and resolution contributes significantly to their view of the tax system as a whole. Their view of the system, and some of the general advice they receive from the clinics, is also inevitably passed on to their communities.

Because of these contributions to the process, IRS personnel working with LITCs and their clients have sometimes referred to the clinics as their “partners”. Indeed they have also published posters showing the IRS and the clinics as partners with joined hands. Although the sentiment is a flattering one, this actually is a serious misnomer and needs to be corrected. Although the clinics in many instances do advance the goals of orderly tax administration, they are taxpayers’ representatives and they are *not* the IRS’s partners. It is critical that this distinction be recognized at every level of the IRS. As the representatives of their taxpayer-clients, the clinics are the IRS’s *adversaries* in the controversy process. Because this is a matter of professional and ethical responsibility, it is vital that the role of clinics and clinic personnel be understood and properly indicated by the agency.

Clinic Contributions to Education

It is our anecdotal experience that most of our clients want to be compliant with the system. The overwhelming majority of EITC recipients have their tax returns professionally prepared, even though it is expensive for them to do so. They also do not want to take positions on their income tax returns that would draw the agency’s attention to them. We have represented clients who, having been successful in defending a claim of the earned income tax credit on their return for one year, decline to claim it again in subsequent year – *even though they are entitled to do so* – because they fear another traumatic audit and having to engage again with the IRS.

Despite their desire to comply with the rules, the overwhelming complexity of the Code often makes it hard for them to do so, or to understand when a tax preparer whom they have trusted has made a mistake. It seems obvious that individuals cannot comply with the law if they cannot understand what it is and what is expected of them. Complexity takes a toll on everyone in the system, but taxpayers who

have low literacy and education levels, and who may or may not speak English as their first language, are especially at risk.

One aspect of complexity is the difficulty that low income taxpayers often have in deciphering IRS notices or letters sent to them. They also have difficulty distinguishing such notices from similar notices they have received that look exactly the same except that they refer to a different tax year. In many cases, taxpayers have disregarded such notices at their peril, only to find out later that they have given up valuable rights.

Tax law complexity also often leads to underclaims of tax benefits. In the last several years, overclaim issues in the earned income tax credit have been frequently publicized. It is less well known that there is also a substantial *underclaim* rate – maybe as high as 25%. The IRS has recently established an EITC Program Office. To its credit, the Program Director in his public speeches has consistently acknowledged the underclaim issue in regard to the credit and views part of his mission as working to enhance participation rates. Some of the clinics are also participating in this activity through their educational efforts with taxpayer groups.

The clinics that handle tax controversy work for clients are not principally organized around an educational mission, although taxpayer education is often an important by-product of their activities. For example, clinics regularly advise their clients about their rights and responsibilities under the law including record keeping, avoiding cash transactions, and filing timely returns. They explain IRS procedures to their clients as well as Tax Court process, the availability of free return preparation through VITA, TCE, military, Free File, and TACs as well as the requirements of numerous provisions of the Internal Revenue Code. They give clients advice about dealing with tax preparers, and advise them to avoid preparers they may have previously used if the return contains significant mistakes. They may also discuss with them their responsibilities as citizens toward the tax system.

The Clinics are also representing low income taxpayers' issues in legislative and policy debates, a different form of education. Tax clinic attorneys have been asked to testify before Congress as well as before this Board on low income taxpayers issues. Clinic attorneys have submitted written comments to and testified before the IRS on administrative matters. They hold conferences and write scholarly articles on low income taxpayer issues. And they have had a material impact on “democratizing” the tax policy debates and bringing the problems and concerns of low income taxpayers to the attention of policy makers and the rest of the tax profession. Since the clinics have been in existence Congress has written numerous provisions that focus on low income taxpayers. Clinic attorneys regularly participate in providing information and feedback in these processes and improving the resulting legislation.

Needs of the Tax Clinics

In my judgment and in the judgment of many, Internal Revenue Code section 7526 and the IRS LITC program, which supports tax clinics with matching grants, have been an unqualified success story and

the program contributes in a significant way toward the goal of educating and assisting low income taxpayers to understand and comply with their tax obligations as citizens. The need *for* tax clinics seems obvious. But the clinics also have needs of their own and it is the needs *of* the tax clinics that this Board should carefully consider as well as its stakeholder contributions.

What are these needs?

First, the LITC program is underfunded. No clinic in the past several years has received the maximum statutory grant amount of \$100,000 as IRS tries to divide up the section 7526 budget appropriation between more and more clinics that apply for funding. In addition, despite the fact that the number of clinics in the country is growing each year, there still are not nearly enough clinics to service the intended population. Today there is a tax clinic in almost every state in the country, a favorable comparison with the legal landscape as it existed a decade ago. However, many states, such as Alaska or Tennessee, with wide territorial expanses have only one clinic. In addition, there are many *cities* in this country with enough taxpayers to support more than one clinic. Moreover, not all of the clinics handle controversy work; some are simply LEP tax preparation clinics or education clinics, so controversy assistance is more sparsely distributed than the number of clinics would indicate.

Second, it continues to be a problem that some IRS offices do not publicize a local clinic to taxpayers involved in disputes with the agency, and will not inform such taxpayers of a local clinic's existence, despite requests from the clinic to do so. In light of the fact that the agency is currently spending \$7.5 million per year on this program, IRS personnel should be instructed to hand out clinic brochures, clinic notices, and other information about the clinics' existence and services. It is not necessary for the IRS employee to endorse the clinic, or make any judgment to the taxpayer about the quality of clinic's services. It is enough for the agency simply to inform taxpayers that the clinics exist and that they may qualify for pro bono clinic services.

Third, there have been occasional instances where IRS personnel, in connection with oversight of the program, have visited clinics and asked to inspect taxpayer files (with identifying client information blacked out). The Board should instruct all employees in the LITC program that this is a gross overstepping of the oversight function, and it would be a violation of the attorney-client privilege for any clinic to comply with such a request.

Fair Process for Taxpayers

As is implied in the above discussion, contrary to the popular stereotype, low income taxpayers do not all have simple, audit-proof returns consisting essentially of wage and salary income subject to wage withholding, and the standard deduction. Many of these taxpayers claim the earned income tax credit, which can be an economic lifeline but also an audit magnet. Returns of low income wage-earners also contain a variety of other items with audit potential, such as the child credit, dependent care credit,

lifetime learning credit, head of household filing status, income from disability pensions, in-kind charitable contributions, premature IRA distributions, and gambling losses – to name a few.

Moreover, many low income taxpayers are entrepreneurs with their own small businesses – *e.g.*, as food service providers, taxi drivers, hairdressers, roofers, merchants, child care providers, or carpet installers – and as a result are required to file quarterly returns, pay self employment taxes and claim their business deductions on schedule C. Oftentimes, these self employed low income taxpayers have only the most rudimentary understanding about their recordkeeping and tax filing requirements.

A growing number of low income taxpayers are non-English speaking and face huge language barriers in understanding their tax obligations and in resolving challenges to their return positions. Many of these taxpayers seek help with their tax obligations from professional preparers, but their inability to communicate in English often leads them to seek out preparers who speak their language without checking their credentials or training in taxation. The advice they get from these preparers can range from excellent to incompetent to totally fraudulent. If the taxpayers are undocumented workers, they may become embroiled in issues with the IRS involving erroneous social security numbers and /or identity theft.

Resolution of these types of cases on a fair basis have traditionally involved cultural, communication, language and other barriers for the Service that are different from those raised in cases involving high income taxpayers. But these problems have been significantly exacerbated in recent years as a result of IRS Modernization. The primary theme of that reorganization, as you know, has been specialization and concentration of functions around national taxpayer groupings, as well as increased reliance on computers rather than human contact for tax administration. There is also an emphasis on fast resolution of cases, with minimum resources expended.

But speedy resolutions do not always produce fair results, particularly in this income demographic. A few examples illustrate some of the problems.

Example 1: Assume a taxpayer receives an audit notice challenging her entitlement to the earned income tax credit and requesting documentation – *e.g.*, school records, medical records, birth certificates – that the taxpayer's child was related to her and lived with her for more than ½ of the year. The letter asks for a response within 30 days, the information to be sent to one of the IRS campuses. Assume further that it takes some time for the taxpayer to collect the information, but the taxpayer does so and sends it to the agency on the 29th day. However, before the taxpayer's information is forwarded to the person working the case, the IRS computer, which generated the original notice and which has been programmed to act on the 30th day, sends the taxpayer a notice of deficiency by return mail. The taxpayer is understandably confused since it is unclear why the documentation has been turned down and/or whether it even has been considered. However, because the taxpayer has received a notice of deficiency, the

taxpayer must file a Petition in the Tax Court within 90 days to keep the case open. If the taxpayer does not do so, the case will be assessed and sent to IRS Collections. Since most taxpayers default on the 90 day letter and do not file in the Tax Court, our taxpayer, who correctly claimed the credit, will be effectively denied any substantive review of the proposed deficiency and the case will show up in IRS statistics as a misclaim of the credit.

Example 2: *The second taxpayer also receives the computer generated notice asking for documentation of the credit, but this taxpayer responds on the 15th day. However, this taxpayer, who is a recent immigrant to this country, cannot produce all the information the IRS has requested, e.g., he does not have a birth certificate for the child who was born in Sierra Leone. Nonetheless, the taxpayer states that he is willing to testify or submit affidavits (as are others) about the child. Without any attempt to contact the taxpayer, the IRS denies the claim and sends the taxpayer a notice of deficiency, and this taxpayer too winds up in Collections, even though the claim of the credit was accurate.*

Example 3: *The third taxpayer, after having being sent a notice of deficiency by the campus, files a timely Petition in the Tax Court and successfully defends his entitlement to the credit. After decision documents are entered, however, and the taxpayer is inquiring when he will receive his refund, he learns that he will not be receiving it at all because six months earlier he had received another notice of deficiency – comparable to the one for the year before the court except for an unremarkable notation that it was for the year subsequent to the year in dispute. Thinking it was simply a duplicate of the first notice, the taxpayer threw it away, and did not file a Tax Court Petition for that year. As a result, the second year has been treated as defaulted and sent to Collections. The refund won in the Tax Court will be used against the supposed deficiency for the second year.*

Clinics are seeing these stories – and many others – repeated all over the country, as automated, centralized and streamlined processing of cases becomes more pervasive and taxpayer opportunities to challenge IRS errors are reduced.

In her 2004 Annual Report to the Congress, the National Taxpayer Advocate discussed a study her office recently completed which confirmed what the clinics anecdotally had been observing for years: that many eligible tax benefits claimed by low income taxpayers on their returns which are defaulted, are actually correctly claimed; that low income taxpayers need multiple mailings, phone calls and/or other communications or contacts to obtain information, documents and other proof supporting their deductions, credits and other tax return positions.

The study looked at 339 earned income tax credit cases pending in Audit Reconsideration. It concluded that the large majority of such cases involved meritorious claims in whole or in part.

Moreover it also demonstrated that the expenditure of additional staff time and effort in reaching the taxpayers involved had a material impact on getting to the right result. On average, the study showed, Taxpayer Advocate case workers made 5 phone calls to the taxpayer in each case, a significantly higher number than is usually made by Exam, Appeals, or Audit Reconsideration in the normal course of review. This increase in the number of phone contacts had a direct impact on the taxpayers receiving some or all of the claimed credit. The study showed that with zero phone calls to the taxpayer, 38% of taxpayers in the study were determined eligible for the credit; but with three or more phone calls 67% received the credit.

We all recognize, I believe, that IRS Modernization, and the changes in tax administration that it has brought about in the structure of the IRS, are now deeply rooted. At this juncture, it is not possible to turn back the clock. But as the Service moves forward toward its goal of an electronic interactive world of tax administration, it needs to keep in mind and make provision for the needs of taxpayers who do not function well in that world. That may include slowing down computer response times, staffing offices with a larger human workforce, increasing the number of phone or mail attempts to reach taxpayers before their cases are defaulted, providing clearer notices, and authorizing examiners with more discretion to accept alternative forms of proof.

Such changes will no doubt cost the agency additional money in terms of human resources. However, it is not at all clear that today's automated case resolutions are saving the agency money since these taxpayers, once in Collections, are simply putting pressure on other IRS offices to correct errors in their cases. Moreover, on a more abstract level, when the agency denies fair process, it necessarily pays a huge price in taxpayer confidence that the system can deliver justice.

In the Preface to her 2004 Annual Report, the National Taxpayer Advocate echoed these sentiments:

The IRS constantly feels the press of having to do too much with too little. As budget constraints limit its ability to hire new collection and examination employees and to replace retiring employees, the IRS tries to create workforce savings and efficiencies by eliminating or minimizing processes that require human intervention or contact. This approach is appropriate for programs involving submission and correspondence processing, where e-filing and correspondence imaging improve both accuracy of tax return data – eliminating errors attributable to keystrokes – and processing times. But in the Examination and Collection functions, the movement away from direct human interaction can create problems for the tax system as well as for taxpayers.

Privatization of Debt Collection

The current enforcement trends, which I have described in the preceding section of this testimony, have very serious implications for the Service's impending program involving outsourcing of debt collection that was authorized by Congress in the *American Jobs Creation Act of 2004*. Commentators have

discussed many of the problems inherent in this program, which include balancing taxpayer rights with tax collection, controlling overreaching by the private debt collectors whose income is directly tied to the revenue produced, and insuring taxpayer privacy in respect of their tax returns and return information. But it also seems predictable that as the Service moves forward with the transfer of collections accounts to private debt collectors – particularly if they are located in foreign countries, have no understanding of the controversy resolution processes, and are operating solely through electronic means of communication – that many low income taxpayers may find themselves caught in a crossfire as they simultaneously try to deal with these collectors and to correct errors in their cases. It will be important to see how the IRS and the debt collectors will distinguish taxpayers with true debts from those who do not owe additional tax but who have simply been denied process.

Conclusion

Thank you for the opportunity to provide this testimony and for the privilege of speaking on behalf of a class of taxpayers who comprise an important part of our society.

It is important that the Service recognize that in too many instances the needs of low income taxpayers are not being well served under Modernization. As the reorganization moves forward, those missteps need to be addressed. More particularly, the goal of efficiency in processing cases should not be allowed to override the need to provide fair results to taxpayers at all income levels. To the extent those two goals collide, fairness should be given a clear priority.

The Clinics are a vital stakeholder group in insuring that that occurs.