

**HEARING BEFORE THE  
SUBCOMMITTEE ON OVERSIGHT  
COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES**



**February 26, 2009**

**Washington, DC**

**The Honorable J. Russell George  
Treasury Inspector General for Tax Administration**

**STATEMENT OF**  
**THE HONORABLE J. RUSSELL GEORGE**  
**TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**  
*before the*  
**SUBCOMMITTEE ON OVERSIGHT**  
**COMMITTEE ON WAYS AND MEANS**  
**U.S. HOUSE OF REPRESENTATIVES**

“IRS Assistance for Taxpayers Experiencing Economic Difficulties”

February 26, 2009

Chairman Lewis, Ranking Member Boustany, and Members of the Subcommittee, I thank you for the opportunity to submit testimony for this hearing. My comments will focus on the Treasury Inspector General for Tax Administration’s (TIGTA) audit actions pertaining to the Internal Revenue Service’s (IRS) efforts to assist taxpayers experiencing economic difficulties.

The American economy is in the midst of an economic crisis. The economy lost 3.6 million jobs in the last 13 months, the biggest job loss since the end of the Second World War. Many experts believe unemployment could reach double digits if no action is taken. In light of this historic economic weakness, President Obama signed the American Recovery and Reinvestment Act of 2009 (ARRA 2009), a nationwide effort to create jobs and transform our economy to compete in the 21st century.<sup>1</sup> The legislation represents the most ambitious effort to stimulate the economy in our nation’s history.

According to the Administration, nearly 40 percent of the benefits of the ARRA 2009 are derived from direct relief to working and middle class families. The ARRA 2009 includes a Making Work Pay tax credit for 95 percent of workers and their families. In addition, the ARRA provides direct relief for families by expanding unemployment insurance and offering payments to Social Security beneficiaries and veterans.

The ARRA 2009 also enacted the most significant expansion in tax cuts for low- and moderate-income households ever. Under prior law, a family of four earning the minimum wage currently lived below the poverty line. Under the ARRA 2009, that family should be lifted out of poverty by a combination of an \$800 Making Work Pay tax credit and \$1,200 from an expanded child tax credit. All told, the Administration estimates that more than 2 million people would be lifted out of poverty.

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<sup>1</sup> Pub. L. No. 111-5, 123 Stat. 115.

According to Recovery.gov, tax relief accounts for approximately \$288 billion of ARRA 2009 provisions. Tax relief accounts for about one-third of the recovery benefits expected from the ARRA 2009. Therefore, the IRS plays a key role in helping to accomplish the economic recovery.

## **Filing Season<sup>2</sup>**

Each year, legislated tax law changes create challenges for both the IRS and individual taxpayers. The ARRA 2009 is no exception. However, experience has shown that the IRS can effectively meet those challenges. Last year, the IRS implemented tax law changes correctly with no significant delays in the processing of tax returns during the 2008 Filing Season.<sup>3</sup> Overall, through May 30, 2008, the IRS had received 144.2 million individual tax returns. Of those, approximately 86.7 million were electronically filed and approximately 57.5 million were filed on paper.

The 2008 Filing Season presented additional challenges for the IRS due to the late and unexpected enactment of two significant tax laws.

- The Tax Increase Prevention Act of 2007 limited the number of taxpayers who would be subject to the Alternative Minimum Tax for Tax Year 2007.<sup>4</sup>
- The Economic Stimulus Act of 2008 provided an economic stimulus payment to more than 130 million people.<sup>5</sup>

In spite of the additional challenges, the IRS generally had a successful 2008 Filing Season. Most key tax law and administrative changes were correctly implemented, and the IRS completed processing returns on schedule and issued refunds within the required 45 calendar days of the April 15, 2008, due date.<sup>6</sup>

Individual return receipts for electronic and paper returns exceeded the IRS estimates and the receipts from the same time in 2007 by more than 11 percent. The largest increase was in the number of paper U.S. Individual Income Tax Returns (Form 1040A), which increased by almost 84 percent from the same time in 2007. This increase was largely due taxpayers who do not normally file tax returns, filing returns in Tax Year 2007 in order to receive the economic stimulus payment.

However, while the IRS was able to meet the challenges of late and unexpected enacted legislation and accurately process most returns in a timely manner, TIGTA identified the following opportunities to improve the processing of some tax deductions:

- Taxpayers improperly claimed and were allowed the Qualified Mortgage Insurance Premiums deduction.

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<sup>2</sup> The filing season is the period from January through mid-April of each year when most individual tax returns are filed.

<sup>3</sup> *The 2008 Filing Season Was Generally Successful Despite the Challenges of Late and Unexpected Tax Legislation* (Reference Number 2008-40-183, dated September 30, 2008).

<sup>4</sup> Pub. L. No. 110-166, 121 Stat. 2461.

<sup>5</sup> Pub. L. No. 110-185, 122 Stat. 613.

<sup>6</sup> Internal Revenue Code Section 6611 (e) (2002).

- Taxpayers age 70½ or older improperly claimed and were allowed the Individual Retirement Account deduction.
- Taxpayers did not claim the sales tax deduction.
- Taxpayers who improperly claimed a “dual benefit” for both the tuition and fees deduction and the Education Credit are not receiving the dual benefit. However, improvements still need to be made in processing these returns.

TIGTA recommended that the IRS: identify improperly claimed deductions; inform taxpayers regarding possible eligibility for a sales tax deduction; and implement procedures to correctly address "dual benefit" education credit and deduction cases. In response to the report, the IRS plans to update computer programs to identify taxpayer returns where improper deductions may be claimed, ensure IRS employees are correctly addressing education "dual benefit" cases, and plans to add a cautionary statement on sales tax deduction eligibility to a tax form.

Given the opportunities for improvement that TIGTA identified during the 2008 Filing Season, TIGTA is committed to continued oversight of each Filing Season. As part of that oversight, TIGTA will review the implementation of tax relief provisions included in the ARRA 2009 during the 2009 and 2010 Filing Seasons.

### **Toll-free Telephone Assistance**

Each year, millions of taxpayers contact the IRS by calling the various toll-free telephone assistance lines to seek help in understanding tax laws and meeting their tax obligations. Given the tax provisions of the ARRA 2009, it is likely that some taxpayers will call the IRS for assistance with those. The tax provisions of the ARRA 2009 could significantly challenge the IRS to provide toll-free telephone assistance during the 2009 and 2010 Filing Seasons.

Over the years, the IRS has encountered issues that affect access to its toll-free telephone services, such as natural disasters and the late passage of legislation. For example, for the 2006 Filing Season, the IRS planned for more services on the toll-free telephone lines and dedicated disaster relief applications to help reduce any potential impact of callers inquiring about filing extensions related to Hurricanes Katrina and Rita.<sup>7</sup> For the 2007 Filing Season, the IRS planned for additional calls to assistors and the automated lines in anticipation of questions about the Telephone Excise Tax Refund.

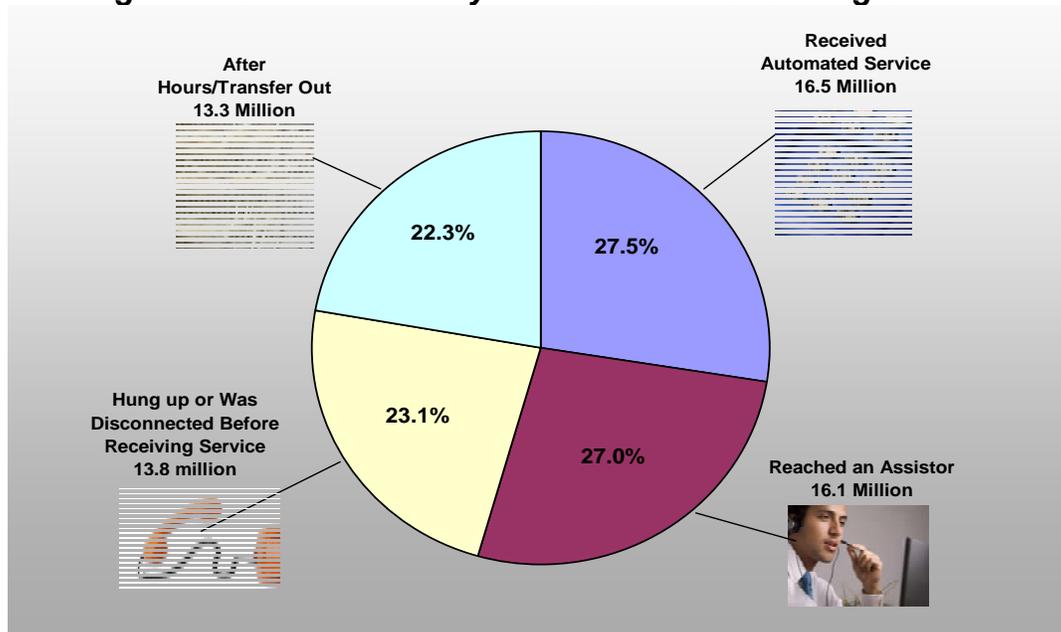
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<sup>7</sup> The toll-free telephone assistance lines are subdivided into categories called “applications,” each of which is staffed with a group of assistors who have received specialized training to assist taxpayers with specific tax issues. Assistors answer taxpayer questions involving tax law and tax account conditions such as refunds, balance-due billing activity, and changes to the amount of tax owed. For example, if an individual taxpayer calls to find out where to mail a tax return, the call would be routed to an assistor who has been trained to handle IRS procedural issues for individual taxpayers. If a business taxpayer calls to find out the taxes due on a business account, the call would be routed to an assistor who handles balance-due questions for business taxpayers.

However, the Economic Stimulus Act of 2008 was passed in February 2008, after the IRS had completed planning for the 2008 Filing Season. The Act was passed to provide economic stimulus through recovery rebates to individuals, incentives for business investment, and an increase in conforming and Federal Housing Authority loan limits.<sup>8</sup> About 130 million taxpayers were expected to receive economic stimulus payments beginning in late April and early May. During the 2008 Filing Season, the IRS averaged 69,000 rebate calls per day, with a peak volume of 208,000 in one day.<sup>9</sup>

Taxpayers rely heavily on the IRS’s toll-free telephone assistance for help with their tax obligations. During the 2008 Filing Season, taxpayers called the IRS toll-free telephone assistance lines approximately 59.7 million times.<sup>10</sup> Of these calls, about 22.2 million were made to the toll-free telephone number that taxpayers call to ask account or tax law questions (1-800-829-1040). In addition, about 6.1 million calls were made to the IRS automated TeleTax system that provides recorded tax law and tax refund information. Figure 1 shows the number of calls made to the toll-free telephone assistance lines, including about 16.1 million calls answered by customer service representatives (assistors).<sup>11</sup>

**Figure 1: Calls Handled by the IRS in the 2008 Filing Season**



Source: IRS Enterprise Telephone Data Warehouse.<sup>12</sup>

<sup>8</sup> A conforming loan is a mortgage loan that conforms to Government Sponsored Enterprise (GSE) guidelines. The Office of Federal Housing Enterprise Oversight (OFHEO) sets the criteria on what constitutes a conforming loan limit. Fannie Mae and Freddie Mac are GSEs.

<sup>9</sup> *Increased Call Volume Associated With Economic Stimulus Payments Reduced Toll-Free Access for the 2008 Filing Season* (Reference Number 2008-40-168, dated August 29, 2008).

<sup>10</sup> These calls were made to the suite of 19 telephone lines the IRS refers to as “Customer Account Services Toll-Free” and included calls made to the TeleTax system.

<sup>11</sup> Due to rounding, numbers might not always equal the sum of the totals or 100 percent.

<sup>12</sup> The Enterprise Telephone Data Warehouse is the official source for all data related to toll-free telephone assistance measures and indicators.

Call volume usually decreases after the filing season. However, due to calls about the economic stimulus payments and taxpayers repeatedly trying to call, not only did demand not decrease, it increased significantly after the 2008 Filing Season.<sup>13</sup> Because of the additional call volume associated with the economic stimulus payments, the IRS continued to struggle with extremely high call volumes after the 2008 Filing Season and did not achieve some of its fiscal year performance goals. The ability of taxpayers to access the toll-free telephone system was much lower than that in prior years. For example, the IRS had planned to achieve an 82 percent Level of Service and a 270-second Average Speed of Answer. Instead, through August 30, 2008, it achieved a 54 percent Level of Service and a 589-second Average Speed of Answer.<sup>14</sup>

Taxpayers made about 189 million calls to the IRS toll-free telephone assistance lines during Fiscal Year 2008.<sup>15</sup> The IRS received approximately 125 million call attempts after the 2008 Filing Season, with approximately 45 million (36 percent) call attempts made to the Rebate Hotline (the telephone line dedicated to calls related to the economic stimulus payments/rebates). IRS assistors answered about 17 million calls after the 2008 Filing Season; approximately 4.2 million (24.5 percent) were for those taxpayers calling the Rebate Hotline.

### **Volunteer Taxpayer Assistance Program<sup>16</sup>**

The Volunteer Taxpayer Assistance Program plays an increasingly important role in achieving the IRS's goal of improving taxpayer service and facilitating participation in the tax system. It provides no-cost Federal tax return preparation and electronic filing directed toward underserved segments of individual taxpayers, including low-income to moderate-income, elderly, disabled, and limited-English-proficient taxpayers. TIGTA has conducted annual assessments of the VITA program since 2004. The accuracy rate for returns prepared at volunteer sites has increased from 0 percent in 2004 to 69 percent in 2008. TIGTA's review of the 2008 Filing Season also found improvements to the oversight of the volunteer program.<sup>17</sup>

Although accuracy rates for tax returns prepared by volunteers have increased from those in prior years, the quality assurance process is still not consistently followed. Incorrectly prepared tax returns can increase the risk of taxpayers receiving erroneous tax

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<sup>13</sup> *Call Volume Associated With the Economic Stimulus Payments Made It Difficult to Reach the Internal Revenue Service During Fiscal Year 2008* (Reference Number 2009-40-030, dated January 26, 2009).

<sup>14</sup> Level of Service is the IRS' primary measure of providing taxpayers with access to an assistor. Average Speed of Answer is the average number of seconds taxpayers waited in the queue (on hold) before receiving services.

<sup>15</sup> These calls were made to the suite of 19 telephone lines the IRS refers to as "Customer Account Services Toll-Free" and included calls made to the TeleTax system.

<sup>16</sup> Includes the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) Programs.

<sup>17</sup> *Accuracy of Volunteer Tax Returns Continues to Improve, but Better Controls Are Needed to Ensure Consistent Application of Procedures and Processes* (Reference Number 2008-40-177, dated September 18, 2008).

refunds by not receiving credits to which they are entitled or receiving additional credits for which they do not qualify.

Posing as taxpayers, TIGTA auditors had tax returns prepared by volunteers at VITA and TCE sites sponsored by the American Association of Retired Persons. Of the 36 tax returns prepared during the course of the audit, 11 returns (31 percent) were prepared incorrectly. For the 11 tax returns incorrectly prepared, 1 or more requirements were not followed. For example:

- For 1 return (9 percent), the volunteer did not use an intake sheet when preparing the tax return.
- For 3 returns (27 percent), the volunteers did not correctly prepare the intake sheet.
- For 3 returns (27 percent), the sites had no quality review process.
- For 3 returns (27 percent) that were quality reviewed, the volunteers did not use a quality review checksheet.

Some volunteer sites also offer Refund Anticipation Loans (RAL).<sup>18</sup> However, little oversight for these loans is offered through the Volunteer Program. The IRS could not provide the number of Volunteer Program sites or a list of sites that offer RALs. In addition, the volunteers cannot input RAL indicators on taxpayer accounts for those who applied or obtained the loans, which is a requirement for commercial tax preparation companies.

Improvements are needed to the Volunteer Program. Return review procedures used to monitor effectiveness were not consistently followed from site to site. Return reviews are unannounced IRS visits to volunteer sites to evaluate tax law and tax return accuracy. In addition, TIGTA's review of 91 Return Review cases showed that 43 (47 percent) had missing or illegible documents. Therefore, TIGTA could not validate the accuracy of those tax returns. TIGTA recommended that the IRS improve documentation of its reviews, require volunteer applicants to disclose any criminal convictions, and require sites to document whether they offer Refund Anticipation Loans.

In general, the IRS agreed with TIGTA's recommendations. However, the IRS disagreed that it should ensure that volunteers are able to input a RAL indicator, citing a variety of procedural and other issues. TIGTA agreed that the IRS needs to consider the additional costs and investigate further before making a final determination. However, the IRS currently cannot determine which sites offer RALs or the number of—and/or which—taxpayers visit volunteer sites to obtain RALs. This is necessary to determine the effect of RALs on the Volunteer Program and to ensure that all procedures and regulations are followed. According to the IRS, oversight of volunteers offering RALs will be accomplished within the parameters of an existing program. TIGTA plans to follow up on this action during its 2009 Filing Season audit of the Volunteer Program.

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<sup>18</sup> RALs are short-term loans provided to taxpayers in anticipation of their current year Federal income tax refunds. The IRS stated that the RALs offered by Volunteer Program partners are lower in fees and interest than RALs offered through commercial tax preparation services.

## Refund Anticipation Loans

In times of economic hardship, more taxpayers may seek to receive their tax refunds more quickly. Already, millions of taxpayers borrow against all or part of their expected tax refunds to receive their money. This is accomplished through short-term loans that cost taxpayers fees and interest payments. However, many of these taxpayers are eligible for free tax preparation services offered by the IRS and its partners.

During the 2008 Filing Season, almost 10 million taxpayers borrowed against all or part of their expected tax refunds using RALs. A RAL is a short-term loan based on a taxpayer's expected income tax refund and is a contract between the taxpayer and a lender. The IRS is not involved in this contract, cannot grant or deny the loan, and cannot answer any questions about it. The loans last from 5 to 14 days.

TIGTA surveyed by telephone 350 taxpayers whose IRS Tax Year 2007 tax accounts contained RAL indicators. Respondents stated that they were aware they received loans and they did obtain their money more quickly. For 250 respondents who indicated that they had received RALs, 213 (85 percent) stated that they obtained their loans so they could more quickly receive their tax refunds.<sup>19</sup> The other 100 indicated they did not obtain a RAL despite what the IRS' records indicated.

Taxpayers who chose to wait and receive their tax refunds from the IRS waited from 5 days to 8 weeks, depending on how they filed and how they chose to receive their tax refunds (by check or direct deposit). For the 250 respondents who responded that they received RALs:

- 131 (52 percent) received their loans the same day of or within 2 business days of their tax return preparation.
- 213 (85 percent) stated that preparers made it clear they were receiving loans. In addition, 220 (88 percent) stated that the preparers explained the fees. However, only 85 respondents (34 percent) stated that they were provided with the interest rates for the loans.
- 167 (67 percent) preparers explained how long it would take for the taxpayers to receive their tax refunds if they chose not to obtain the loans.
- 213 (85 percent) obtained loans because they wanted faster access to their tax refunds and 185 (74 percent) used the money to pay bills. Another 14 (6 percent) used the money to buy or repair a car or for home repairs and expenses. Eight percent stated they put the money in savings.

Proponents of RAL reform have expressed concerns that preparers might be taking advantage of taxpayers by aggressively marketing the loans. More than one-half of the respondents—159 (64 percent)—had checking or savings accounts with financial institutions. In fact, 81 preparers suggested that these taxpayers accept their loan

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<sup>19</sup> The survey included 350 participants. However, only 250 respondents stated that they obtained RALs. Therefore, only those 250 survey participants were asked the 15 questions specific to the Loans.

proceeds via a direct deposit to their accounts—11 stated that they followed the preparers' suggestions. Assuming that these taxpayers could afford the tax return preparation and filing fees, they alternatively could have had the IRS directly deposit their refunds to their bank accounts in as few as five days.

Most respondents actually received their loan proceeds within five days. Fifty-two percent of respondents (131 of 250) stated that they received their loan proceeds within two days. Forty-five percent (113 of 250) of the respondents who indicated that they had received RALs stated that they would have been willing to wait less than a week to receive their tax refunds from the IRS, and 85 percent (212 of 250) stated they would have been willing to wait up to nine days to receive their tax refunds.

The IRS is actively working to reduce the amount of time required to process tax returns. By reducing the number of days required to process tax returns, the IRS will be able to issue tax refunds sooner. This will shorten the number of days between the time taxpayers receive their RALs and the time it takes the IRS to issue the tax refunds.

Additionally, TIGTA's analysis of taxpayer account data for the respondents showed that 158 (63 percent) received the Earned Income Tax Credit. The Earned Income Tax Credit has been cited by many experts as the single Federal Government program that does the most to help get working families out of poverty. However, tax return preparation and fees to obtain RALs ranged from 10 to 39 percent of the taxpayers' Earned Income Tax Credit, with the percentage generally higher for low-income taxpayers.

The majority of survey respondents would have qualified for the IRS's free tax preparation assistance. However, 81 percent (284 of 350) stated that they were unaware of these free services. Taxpayers may visit Taxpayer Assistance Centers,<sup>20</sup> VITA sites and TCE sites, or use the Free-File Program to file their tax returns for free. During the 2008 Filing Season, more than 9 million taxpayers took advantage of these services.

TIGTA recommended that the IRS use taxpayer account data for taxpayers who apply for RALs and Refund Anticipation Checks to better focus the IRS's marketing and education efforts so that more taxpayers can make use of the available free services. The IRS agreed with the recommendation.

### **Self-Assistance**

The IRS's current methods for assisting customers with *e-file* reject conditions create burdens for the customers and unnecessary expenses for the IRS, including costs for providing toll-free telephone assistance and maintaining redundant systems. The IRS noted that each system was developed for a different purpose and for a different type of

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<sup>20</sup> Taxpayer Assistance Centers are walk-in sites where taxpayers can receive face-to-face assistance to obtain answers to both account and tax law questions, as well as receive assistance in preparing their tax returns.

user. In Calendar Year 2007, the IRS spent more than \$3 million<sup>21</sup> providing customers with telephone assistance to address *e-file* reject conditions. Requiring customers to call the IRS to obtain assistance in correcting reject conditions increased the burden for the 154,986 customers who had to call the IRS for assistance with rejected *e-filed* tax returns in Calendar Year 2007.

For Tax Year 2006, the IRS received nearly 80 million *e-filed* tax returns. *E-filed* returns benefit both the IRS and taxpayers because their processing costs and error rates are lower than those for paper returns. To help achieve a high level of accuracy, the IRS's *e-file* system has automated, upfront tax return validity checks. The IRS rejects *e-filed* tax returns that do not pass its validity checks and sends the electronic files back to the customers, who are responsible for correcting the reject conditions and resubmitting the tax returns.

The information provided to a customer in the *e-file* acknowledgement does not by itself enable the customer to address the reject condition(s). Customers are required to review publications and/or contact the IRS to obtain a detailed description of what caused the reject conditions and, more importantly, how to correct the conditions.

A self-assistance option could be created.<sup>22</sup> The IRS provided TIGTA with documentation outlining a system that would give customers self-assistance options. The original request date for implementation was August 2005. However, resource constraints have prevented the system's implementation. The IRS currently has a system that could be modified to include information on how to resolve the reject conditions, and this system could be placed on IRS.gov (the public IRS Web site) as a self-assistance option. Updates to this system could provide the IRS with a short-term solution for providing self-assistance.

The IRS has already taken action in response to our concerns by adding to IRS.gov a new option that lists common reject codes along with suggested solutions. This is a first step toward providing a complete electronic self-assistance option for resolving rejected *e-filed* tax returns. For the long term, the IRS should focus on providing customers with both a description of the reject condition and information on how to resolve it by including a description of the reject condition with steps to correct the error in the *e-file* acknowledgement file. This would provide customers with one-stop self-assistance. The IRS has been moving to a new electronic platform to process *e-filed* tax returns, referred to as the Modernized *e-file* Program. IRS officials noted that expansion of the Modernized *e-file* Program to include individual tax returns will begin in Fiscal Year 2009 and will be completed by Fiscal Year 2011. The *e-file* acknowledgment file that will be generated from the Modernized *e-file* Program has the possibility of including a description of the reject conditions and information as to how to address them.

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<sup>21</sup> Amount spent was calculated by multiplying 154,986 customers assisted in Calendar Year 2007 by the \$19.46 cost per call.

<sup>22</sup> *A Self-Assistance Option Would Reduce Burden and Costs Associated With Resolving Rejected Electronic Tax Returns* (Reference Number 2008-40-128, dated June 17, 2008).

TIGTA recommended that the IRS: 1) develop a self-assistance option on IRS.gov that allows customers to obtain detailed explanations of *e-file* reject conditions, including the steps to resolve them; and, 2) develop a business case on the feasibility of providing in the *e-file* acknowledgement the information that would allow customers to resolve their reject conditions once individual tax returns are transitioned to the Modernized *e-file* Program. IRS management agreed in part with one recommendation and disagreed with the other one. For 13 *e-file* error reject codes, a self-assistance option was added to IRS.gov, which provides descriptions and suggested solutions. These commonly issued error reject codes accounted for 78 percent of the 10.2 million error reject codes issued in 2008 and 81 percent of the 9.9 million error reject codes issued during 2007. The IRS also agreed to study the feasibility of adding a more comprehensive self-assistance option to IRS.gov.

While the IRS agreed that the *e-file* acknowledgement should provide information that would allow customers to resolve their reject conditions, it does not agree that a business case to determine the feasibility of providing this functionality is necessary. According to the IRS, the Modernized *e-file* Program will provide customers with reject codes written in plain English and clear and concise explanations of the reject conditions.

## **Tax Practitioners**

In Fiscal Year 2007, the IRS, including the National Taxpayer Advocate and the Director, Office of Professional Responsibility, participated in a Return Preparer Summit, characterized as a first step toward creating an agency-wide preparer strategy. The Summit's goal was to have an organized, agency-wide strategy that would assist in making the most of IRS resources by focusing compliance and outreach efforts with tax professionals where it is most needed. Pursuing abusive preparers is part of the IRS's strategy to reduce the tax gap, which researchers estimate to be \$290 billion based on 2001 data.<sup>23</sup> In February 2007 testimony before Congress, the IRS Commissioner stated that 68 percent of the tax gap is attributed to underreported taxes for individuals. Eleven (65 percent) of the 17 incorrect tax returns prepared for our auditors fell into this category.

In Calendar Year 2007, the IRS processed approximately 83 million individual Federal income tax returns prepared by paid preparers. Anyone—regardless of training, experience, skill, or knowledge—is allowed to prepare Federal income tax returns for others for a fee. In February and March 2008, TIGTA auditors posed as taxpayers in a large metropolitan area and paid to have 28 tax returns prepared at 12 commercial chain and 16 small, independently owned tax return preparation offices. Auditors paid commercial chains approximately \$2,800, averaging \$234 per tax return, and independently owned offices approximately \$2,100, averaging \$132 per tax return.

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<sup>23</sup> IRS, U.S. Department of the Treasury, *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance* (Washington, D.C.: August 2, 2007); *The 2007 Taxpayer Assistance Blueprint Phase 2* (Washington, D.C.: 2007).

The preparers were unlicensed and unenrolled. That is, they were not practitioners (attorneys, certified public accountants, enrolled agents, or enrolled actuaries). Preparers often made substantial errors when completing tax returns and correctly prepared only 11 (39 percent) of the 28 tax returns (i.e., the tax returns showed the correct amount of taxes owed or refunds due). However, 17 tax returns (61 percent) were prepared incorrectly.

- 11 (65 percent) of the 17 contained mistakes and omissions TIGTA considered to have been caused by human error and/or misinterpretation of the tax laws.
- 6 (35 percent) of the 17 contained misstatements and omissions TIGTA considered to have been willful or reckless.

If these incorrect tax returns had been filed, the net effect to the Federal Government would have been \$12,828 in understated taxes (this is the net effect—there were instances in which tax liabilities and tax refunds were both overstated and understated).

The Internal Revenue Code includes requirements that all preparers be diligent in determining taxpayer eligibility for the Earned Income Tax Credit, sign the tax return, furnish their identification number on the tax return,<sup>24</sup> and not improperly or recklessly disclose tax return information. However, none of the seven preparers required to exercise due diligence when determining whether auditors were eligible to receive the Earned Income Tax Credit did so. In addition, two preparers did not furnish the required identification numbers on the completed tax returns.

The IRS does not have one list or database that collects information on preparers such as the preparer's name, associated identifying numbers, or whether the preparer is a practitioner or unenrolled preparer. The IRS acknowledges that it does not know how many paid preparers exist and cannot determine the full extent of noncompliance and incompetence among practitioners. This hinders the IRS's efforts to expand its outreach and education initiatives and to identify potentially problematic preparers and all the tax returns they prepared.

While taxpayers are ultimately responsible for the information reported on their tax returns, millions rely on preparers to prepare correct returns. In Fiscal Year 2007, legislation was introduced in Congress to regulate paid preparers.<sup>25</sup> A unique identification number would enable the IRS to use its current databases to identify and evaluate preparers' compliance. Being able to identify all preparers would allow the IRS to better pursue abusive or incompetent tax preparers in its stepped-up campaign against tax fraud and other forms of noncompliance. TIGTA recommended that the IRS develop and require a single identification number to control and monitor all paid preparers. The IRS agreed to study this issue.

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<sup>24</sup> Paid preparers must provide their Social Security Number, Practitioner Tax Identification Number, and/or Employer Identification Number on tax returns.

<sup>25</sup> S. 1219, Taxpayer Protection and Assistance Act of 2007, 110th Congress, 1st Session (2007).

With its current processes, the IRS cannot determine how many complaints against tax return preparers it receives, how many complaints are worked, and the total number of multiple complaints against a specific firm or preparer.<sup>26</sup> Guidelines provided to taxpayers and employees about filing a tax return preparer complaint are confusing and inconsistent. Finally, the form used to submit complaints against unenrolled preparers is not designed to provide adequate information with which complaints can be worked.

The IRS's current process for handling taxpayer complaints against preparers does not identify potential problem preparers so that the IRS can determine the extent of noncompliance, if any, or how the noncompliance should be addressed. Complaints are generally not controlled and tracked. Therefore, neither the volume of complaints received from taxpayers and worked, nor their resolutions are known. Moreover, complaints are reviewed multiple times and mailed to multiple offices before most are ultimately destroyed.

Several functions and offices are involved in the process of resolving taxpayer complaints. Complaints are not centrally recorded to identify duplicates, and many complaints are redirected to another function. Because of this, the IRS spends unnecessary time sorting and redirecting complaints. In addition, the IRS does not acknowledge all taxpayer complaints. An ineffective complaint system erodes public trust as taxpayers become frustrated with the IRS's apparent non-response.

TIGTA recommended that the IRS: 1) clarify guidance to taxpayers on the public IRS Web site (IRS.gov) regarding the preparer complaint process; and, 2) develop a form, both web-based and paper, specifically for tax return preparer complaints that routes to the correct function based on the type of tax return preparer and includes the items necessary for the IRS to appropriately evaluate the legitimacy of the complaint. Once a form is developed to ensure that sufficient information is captured about the complaint, a database(s) or tracking system should be developed to efficiently control the complaints. The IRS agreed to update guidance on IRS.gov and create a cross-functional team to develop recommended action items to identify opportunities for improvement that may include changes to forms and creation of an automated tracking system.

## **Compliance Issues**

### Automated Underreporter Program

The Automated Underreporter (AUR) Program is an important component of the IRS's efforts to ensure voluntary taxpayer reporting compliance. This Program uses third-party payer information (such as that from banks and brokers) to determine whether taxpayers have reported all of their income. Notices are sent advising taxpayers of additional tax on any unreported income. During a recent review of the AUR Program, TIGTA found that some taxpayers were negatively affected by inaccurate information on

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<sup>26</sup> *The Process Taxpayers Must Use to Report Complaints Against Tax Return Preparers Is Ineffective and Causes Unnecessary Taxpayer Burden* (Reference Number: 2009-40-032, dated February 23, 2009).

the notices.<sup>27</sup> TIGTA believes these taxpayers agreed to inaccurate assessments as a result of the confusion caused by the complexity of the notices.

The Computer Paragraph (CP) 2000 notice is the primary notice that the IRS issues to taxpayers as a result of underreporting discrepancies. During Fiscal Year 2007, the AUR Program closed approximately 1.3 million cases after sending notices to taxpayers for underreporting discrepancies identified on their Tax Year 2005 returns. TIGTA selected and analyzed a statistically valid random attribute sample of AUR Program notices sent to 138 taxpayers in Fiscal Year 2007 and found that 7 (5.1 percent) taxpayers were sent inaccurate information. Errors on CP 2000 notices resulted in taxpayers being both overassessed \$18,968 and underassessed \$1,146 in tax. Based on the analysis, TIGTA estimated that in Fiscal Year 2007, 48,669 taxpayers received CP 2000 notices with inaccurate information that might have resulted in overassessments of tax. TIGTA also estimated that an additional 19,468 taxpayers might have been erroneously underassessed tax as a result of inaccurate notices. If the number of AUR Program notices remains constant over the next five years, TIGTA estimates that 243,345 taxpayers might be overassessed tax and 97,340 taxpayers might be underassessed tax based on erroneous information in the CP 2000 notices.

While the IRS attributed the problems to employee mistakes, the complexity of the CP 2000 notices may also be a contributing factor. During Fiscal Year 2007, customer satisfaction surveys for the AUR Program indicated that, depending on the survey quarter, 24 percent to 32 percent of the taxpayers stated that their primary reason for calling the IRS was to have someone explain the CP 2000 notice to them. The complexity of the CP 2000 notice could be why some taxpayers do not question the information provided on the notice even when that information is incorrect.

In addition, although required by the Internal Revenue Manual, some of the AUR Program managers did not always comply with the requirement to submit a corrective action plan when the weekly notice quality review error rate exceeded 10 percent. During the first 7 months of Fiscal Year 2008, there were 12 occasions when corrective action plans should have been submitted to the Program Office because weekly notice error rates exceeded 10 percent. However, only 5 (41.7 percent) corrective action plans were submitted, and only 3 (25 percent) of these corrective plans were submitted within the 2-day requirement.

Although the IRS has established a quality review process for identifying employee errors on notices, AUR Program management has not ensured that managers consistently take action to address notice inaccuracies. In addition, as of September 2007, 261 (28.6 percent) of the 911 AUR Program employees had fewer than two years experience. According to the IRS, increased oversight of the quality program has led to more involvement in establishing corrective action plans, developing error tracking reports, and resolving procedural issues with their employees. However, more action is needed. The combination of inexperienced staff and managers who were not adequately

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<sup>27</sup> *Most Automated Underreporter Program Notices Are Correct; However, Additional Oversight Is Needed* (Reference Number 2008-40-180, dated September 25, 2008).

addressing employee errors has resulted in a higher rate of inaccurate CP 2000 notices being issued to taxpayers.

TIGTA recommended that the IRS: 1) ensure that AUR Program management incorporates additional information on notice review procedures and quality service expectations into its refresher training for Program employees; 2) simplify the CP 2000 notices issued by the Program; and, 3) ensure that Program management monitors compliance with requirements to submit and implement corrective action plans when notice review error rates exceed 10 percent. The IRS agreed with all of the recommendations.

### Federal Payment Levy Program

The IRS is authorized to continually levy against certain types of Federal Government payments issued to taxpayers and contractors with outstanding tax debts.<sup>28</sup> The IRS uses the Federal Payment Levy Program (FPLP) to impose systemic levies on these types of payments. However, in some cases, these systemic levies have caused hardships for taxpayers.

Congress has expressed concern that some Federal Government contractors, vendors, and employees who received Federal Government payments were delinquent in meeting their tax obligations. Accordingly, Congress amended the tax code<sup>29</sup> and authorized the IRS to continuously levy against specified Federal Government payments through the FPLP. The FPLP was created to systemically levy against these payments.

In Fiscal Year 2004, IRS collections on delinquent taxes through the FPLP totaled \$114 million. In Fiscal Year 2007, the total collections through the FPLP rose to \$345 million. The increase in collections can be directly attributed to the efforts of the FPLP in accessing additional Federal Government payment streams that were previously not available for levy. However, even with this growth, IRS management still could do more to prevent hardships on low-income taxpayers.

TIGTA identified a number of areas in the FPLP that need to be improved. Some low-income Social Security beneficiaries are experiencing hardship due to the FPLP. Initially, the IRS had an income threshold in place. If a taxpayer's overall income amount as reported on the most recently filed tax return was less than this threshold, the taxpayer was excluded from the Program. However, starting in July 2005, the income threshold began to be phased out. It was first reduced by one-half; six months later, it was completely removed. Since then, the Taxpayer Advocate Service has experienced a large increase in the number of Social Security beneficiaries claiming hardship due to the issuance of FPLP automated levies. Although the previous income threshold criteria were flawed in some respects, some method of screening is needed.

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<sup>28</sup> Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).

<sup>29</sup> Taxpayer Relief Act of 1997.

TIGTA recommended that the IRS establish specific criteria to identify and exclude from the FPLP those Social Security beneficiaries for whom a levy would create a hardship situation. The IRS partially agreed with the recommendation. The IRS agreed with the principle, but does not know if the model it currently has under development to screen low-income taxpayers for potential hardship is feasible to implement. TIGTA is concerned about the lack of a solution in place to prevent as many hardships as possible for low-income taxpayers. It has been seven years since the IRS first put in place a filter to prevent hardships. There has been more than enough time to refine and test the criteria. Delays come at the expense of low-income taxpayers who experience hardship due to levies on their Social Security payments. The IRS has an operational responsibility to reduce taxpayer burden and protect taxpayer rights.

### Bankruptcy

The United States Bankruptcy Code's automatic stay provision is designed to protect taxpayers from collection activities while they are in bankruptcy. Nonetheless, an estimated 495 potential taxpayer rights violations occurred between October 2005 and December 2007 because the IRS filed liens while taxpayers were in bankruptcy.<sup>30</sup> There were also 27,838 taxpayers at risk of having their rights violated because a bankruptcy freeze code was not posted to their accounts in a timely manner. The bankruptcy freeze code designates that the account is in bankruptcy status. The code is an important control component for protecting taxpayer rights during bankruptcy proceedings by helping the IRS and its Centralized Insolvency Operation function identify and address potential automatic stay violations.

TIGTA found that controls need to be strengthened in two areas. First, the IRS could take better advantage of reports generated from automated systems to identify and resolve potential stay violations. TIGTA identified cases in which taxpayers' rights were violated because the IRS filed liens on taxpayers' accounts while the taxpayers were in bankruptcy. TIGTA also identified taxpayers' accounts that were at risk of having their rights violated because a bankruptcy freeze code was not posted to their accounts in a timely manner.

Second, managers need to be held more accountable for initiating bankruptcy closing actions in a timely manner. Failure to initiate bankruptcy closing actions in a timely manner affects the IRS's ability to collect taxes and also can place undue hardship and burden on taxpayers by withholding refunds. As of June 28, 2008, TIGTA identified 2,442 taxpayers' accounts in which closing actions had not been initiated within 30 calendar days of the Bankruptcy Courts' closing determination.

TIGTA recommended that the IRS: 1) develop and implement guidance for the identification and correction of potential lien stay violations when establishing bankruptcy cases on the Automated Insolvency System; 2) improve the Centralized Insolvency Operation function Weekly Inventory Reports to include aging information on

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<sup>30</sup> *Additional Actions Are Needed to Protect Taxpayers' Rights and the Government's Interest During Bankruptcy Proceedings* (Reference Number 2009-30-036, Dated February 20, 2009).

taxpayers accounts; 3) enhance efforts to resolve freeze codes that do not post to accounts by ensuring that managers consistently work Potentially Invalid Taxpayer Identification Number reports; and, 4) evaluate the frequency, consistency, and effectiveness of team manager reviews of the quality and timeliness of bankruptcy closing actions in future operational reviews. The IRS agreed with the recommendations.

## **Conclusion**

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to comment on the IRS's efforts to assist taxpayers experiencing economic difficulties. Although the IRS has improved its service to taxpayers in recent years, more needs to be done. In this time of economic difficulty, the IRS must ensure that it remains sensitive to the situation of the public it serves. The IRS must effectively implement the tax relief provisions of the ARRA 2009 and assist taxpayers with filing their tax returns and meeting their tax obligations. This is an enormous challenge. TIGTA will continue to assist the IRS in meeting this challenge by providing proper oversight and audits in helping to ensure the integrity, economy, and efficiency of our tax system.