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The State of Tax Administration

*By Christopher Bergin —
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Over the last 40-plus years, Tax Analysts has worked diligently to promote fair and more open tax administration. Believing that sunshine is the best disinfectant, we have ''convinced'' (often requiring the courts) the IRS that transparency matters. One result of this effort over the years is the release of more information essential to tax practitioners and taxpayers on how to interpret and comply with the increasingly complex tax laws, looking to ensure a level playing field for all taxpayers.

We believe that the IRS performs one of the nation's most critical functions — collecting taxes to provide the revenue needed to run the federal government. Unfortunately, the IRS has been tasked with a hodgepodge of non-tax-collection duties, such as administering the earned income tax credit. Some would argue that the IRS is also weighed down with responsibility for the healthcare mandate, playing a key role in pension regulation, promoting new sources of energy, and regulating the nonprofit sector. We believe this focus away from the agency's true mission is hampering the performance of its primary role. And all of this is occurring in an environment of severe budget constraints at the IRS.

One of the members of our distinguished board of directors is former IRS Commissioner Lawrence Gibbs. At a recent directors' meeting, Larry and the other board members challenged us to explore the impact of having the IRS perform so many duties beyond its original scope.

First, we asked ourselves, just how much is this change in the IRS's responsibilities affecting the administration of taxes? Then we decided to reach out to a few current and former IRS leaders, private practitioners, and scholars for their thoughts, each addressing a different aspect on this topic. We think you will find what they have to say extremely relevant and informative — so much so that we have bound all of it into this special edition. We hope you enjoy reading it as much as we enjoyed putting it together.

Through the Looking Glass Of Tax Administration

By Ariel S. Greenblum — ariel.greenblum@taxanalysts.org

The IRS's role in tax administration has become synonymous with audits, examinations, and collection. But while the agency performs functions necessary to maintain the nation's government, how it does that work matters. The Beatles were not the first and won't be the last to vilify the tax man, but in the hopes of combating that image, *Tax Notes* asked experts to discuss the IRS's varied responsibilities, debate what its role should be, and offer recommendations for what would improve it.

National Taxpayer Advocate Nina Olson reminds us that the IRS can do more than enforce tax laws (p. 7). She believes that exam and collection are really just functions of the IRS's overarching job to educate taxpayers about how to comply with the law. A fair tax system depends on that and not simply a scary, deterrence-wielding machine, she says.

Kristin Hickman quotes from the IRS's mission statement, emphasizing that the agency should help taxpayers ''understand and meet their tax responsibilities.'' Hickman questions how the IRS can accomplish that when Congress continues to heap onto it other tasks such as administering social welfare programs (p. 36). Congress has set the IRS up to fail, and it should transfer some of its obligations elsewhere within the government, argues Hickman.

Lawrence Gibbs paints a more detailed solution to Hickman's concern about the IRS doing too much (p. 14). Gibbs acknowledges the IRS's role in detecting refund fraud and other nontraditional tax collection roles and suggests that the Department of Health and Human Services screen applicants for welfare assistance via the earned income tax credit program. After applicants are deemed to qualify, HHS should send their names and relevant information to the IRS, he says. That strategy would improve the way the government tackles this type of refund fraud and take some of the burden away from the IRS, he writes.

A fair tax system should be framed in terms of adequate funding for the IRS, Leandra Lederman argues (p. 19). When Congress cuts the IRS's budget, its educational outreach suffers and those who rely on that the most, frequently taxpayers in lower-income groups, will pay more taxes than they should, she says. Further, because enforcement also goes down as a result of a decreased IRS budget, savvier and wealthier taxpayers will be able to use tax shelters more, she writes.

By focusing on the effects of the IRS's decreased educational outreach, T. Keith Fogg and Leslie Book illustrate that Congress is turning tax collection into an inefficient exercise (p. 24). They emphasize that the IRS must take actual taxpayers — not the taxpayers it wishes it had — into account in deciding how to most productively serve them and that it must have the resources to do that.

Highlighting a strategy that the IRS should apply to all its divisions, Samuel Maruca applauds the IRS Large Business and International Division for promoting recent changes to the way it develops cases, in a departure from its old focus on sheer volume (p. 17). Strategically selecting issues for development means that LB&I managers must be trained in how to apply the relevant tax law, Maruca says.

Michael Dolan cautions that the new plan for LB&I must include practical avenues for business taxpayers to deal directly with IRS agents (p. 33). Achieving the greatest return on investment of resources depends on open channels between the IRS and taxpayers, such as those in the prefiling agreement program, he says. Heather Maloy adds that updating that program, as well as the compliance assurance process, would offer taxpayers and the IRS the opportunity to address questions before a return is filed (p. 40).

Although deterrence may not be the central role of the IRS, Mark Matthews argues that it is central to the agency's Criminal Investigation Division and for that reason, the unit is the most vulnerable to decreased funding (p. 10). Whereas other areas of enforcement are ripe for automation, investigating taxpayers and discovering unpaid tax bills require research, he says. That work is done by special agents, and Matthews reports that the number of those employees is at a historic low.

Stopping identity theft is a responsibility that requires a particularly high level of resources, Kevin Brown and Beth Tucker write (p. 30). They cite the success of the Security Summit Initiative, a collaborative effort between the IRS and the private tax industry, including tax return preparation software companies, but they remind us that as tax thieves use increasingly sophisticated means of stealing information, more resources are needed to prevent it.

The Future of Tax Administration

By Nina Olson

Nina Olson

Nina Olson is the national taxpayer advocate.

Olson provides an overview of the following eight articles that discuss the current state of the IRS; she concludes that the IRS is understaffed and lacks the focus needed to serve taxpayers.

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The articles in this special issue of *Tax Notes* paint a portrait of the IRS in great flux — dealing with an ever-increasing and expanding workload in a climate of funding constraints, a world where the global economy and global tax compliance present new challenges, the taxpayer base is extraordinarily diverse, and the threat of cybercrime is constantly present. Leandra Lederman's article succinctly chronicles how we got to this state, and Larry Gibbs describes the impact of expanding IRS duties to include delivering social programs, especially for the low income. In response to where it finds itself today, the IRS is attempting to put forward a vision of its ''future state.'' Meanwhile, taxpayers are just trying to figure out what they need to do to comply with the laws.

Professors Les Book and Keith Fogg discuss, I believe correctly, the justification for tax administration processes that focus on the needs of specific taxpayer populations. Book notes that this focus is especially important given the major role the IRS plays in delivering benefits to low-income and other taxpayer populations that have particular challenges navigating the tax system. In fact, not so long ago, the IRS embraced this approach. The first guiding principle for the 1998 IRS reorganization was ''Understand the customer's point of view and use this understanding to prevent and solve problems and provide quality service.'' An IRS report from that time noted, ''This principle . . . represents a significant shift in emphasis . . . from an internal focus to a customer focus.''[1]

The role of the IRS as a provider of service and assistance as opposed to an enforcer runs throughout these articles and has been with the IRS since its inception. This dual-personality dilemma is reflected in the IRS's current mission statement. In its original form, adopted immediately after enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98), it read: ''Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.'' This formulation acknowledged the primary role of taxpayer service in promoting voluntary compliance. Somewhere along the line, the last clause in the mission statement was changed, without any fanfare, to ''*by enforcing* the tax law with integrity and fairness to all'' (emphasis added). The insertion of ''enforcing the tax law'' thus not-so-subtly overturned all the work done to reform the culture of the IRS in the late '90s and early 2000s. This change in emphasis is reflected throughout the goals of subsequent IRS strategic plans and even the future state. For example, in none of the future state themes are the words ''outreach,'' ''education,'' ''assistance,'' or ''taxpayer rights'' present. Words matter. What you say is what you get.

There is only one true enforcement arm of the IRS, and that is Criminal Investigation. I fully agree with Mark Matthews that CI's mix of work needs to be rebalanced to focus primarily on criminal violations of the tax law. But I also think that the definition of what constitutes a tax crime is no longer as pure as we might like it to be — the Internet age has truly blurred the lines between categories of criminal activity. In fact, I think the argument should be made (and Matthews has done so, well) for more funding for CI precisely because it needs to do *both* traditional tax work *and* the nontax cases.

If CI is the only enforcement arm of the IRS, what is the role of exam and collection? To my mind, exam and collection derive from the requirement that the IRS assist taxpayers in complying with the law. Its job is to educate, not just deter. The rights to privacy and to a fair and just tax system underpin those functions: that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and the tax agency will consider facts and circumstances that might affect taxpayers' underlying liabilities, ability to pay, or ability to timely provide information. Yet, as many of the authors included herein note, the IRS is using measures that drive production and counting rather than future voluntary compliance, or as Heather Malloy puts it, ''change in long-term compliance behavior.'' If you think about the IRS as a processing agency, you will end up with performance measures that value output (number of

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[1] Publication 3329, *Modernizing America's Tax Agency* (1999).

audits closed, and dollars assessed or collected) rather than outcome (future voluntary compliance).

Malloy suggests that the IRS adopt an auditing approach similar to that used in financial statement assurance audits. She says that instead of looking for ''large, unusual or questionable items (LUQs) or mistakes that taxpayers with complex business structures inevitably make,'' the IRS should ensure that multinationals have strong compliance practices and controls, and should focus only on anomalies. This approach applies as much to individuals and small businesses as it does to large corporations — if the taxpayer is willing to comply and is attempting to do so, why are we penalizing mistakes instead of educating taxpayers, given the complexity of our lives and the law?

The Large Business and International Division's current reorganization effort attempts to adopt aspects of this approach. But as the erosion of the post-RRA '98 focus on taxpayer service has demonstrated, cultural change takes a long time and will fail if not sustained and supported by focused, technically adept leadership that is willing to push up its sleeves and get involved in the day-to-day work of its employees. Samuel Maruca correctly observes that the cultural resistance to this involvement and the lack of technically skilled managers may be the shoals on which the LB&I reorganization founders.

As Book notes, the trend of large bureaucracies is to move toward procedures that allow them to process the volume of their work efficiently, at least superficially. However, an effective tax system is not a monologue by the government; it is a conversation between the government and its taxpayers. This dialogue is all but absent in the IRS of today, with the possible exception of those ''lucky'' large entities, high-income individuals, and the serially noncompliant who get the benefit of ''concierge level,'' one-to-one attention in field exam and collection. Fogg laments the IRS's failure to talk with taxpayers who have tax debts about their financial situations and about what they are actually able to pay in light of that situation. It is ironic that one of the primary worries about the use of private debt collectors is that taxpayers will think they are scammers because the IRS has been promoting an anti-scam message that it doesn't make outgoing calls to taxpayers in collection matters. Say what now? What kind of world do we live in where the fact that the tax agency *doesn't* pick up the phone and talk with a taxpayer about a collection matter is considered a good thing?

Calling in to the IRS these days is not much fun for taxpayers or their representatives, especially if one's return has been compromised by identity theft or flagged as a questionable refund. Beth Tucker clearly lays out both the challenges and the risks of identity theft and other cybercrimes for the IRS. No one understands the risk of identity theft to the tax system, and its role in eroding taxpayer confidence in that system, better than I do. (I first raised the issue of identity theft in my 2005 annual report to Congress and was pretty much ignored by the IRS.) To my mind, the IRS's response to victim assistance and minimizing taxpayer burden has been woefully inadequate. For example, a few weeks ago, the level of service on the phone line that taxpayers are directed to call in order to authenticate their identity was at 6 percent. In other words, only six out of 100 calls were put through. I have never seen anything like that number in my entire career. Moreover, although for the 2015 calendar year the IRS stopped 4.8 million suspicious returns and 1.4 million identity theft returns, thus preventing $8 billion in fraudulent refunds, its false positive rate for its fraud detection filters ran from 31 to 36 percent. It is simply unacceptable to ask taxpayers who have filed legitimate returns to have to work through abysmal telephone service to have their legitimacy verified. This is not just a matter of throwing more bodies at the problem: There is something wrong with the IRS filters and processes, and until they are improved, the IRS is creating victims, not assisting them.

Michael Dolan and Fogg both reference how the IRS was organized in pre-RRA '98 days. Dolan notes that ''as the IRS shifted its structure for district-based operations to centralized national operating divisions, it became more difficult for frontline taxpayers to access informal voluntary resolution routes.'' Fogg points out that revenue officers in the field knew about the economic and other conditions that taxpayers in a particular locale faced and how that affected their ability to pay taxes, and he contrasts that with the approach of the Automated Collection System in which employees in remote, centralized sites receive calls from taxpayers throughout the nation in response to IRS automated notices, levies, and liens.

In planning for its future, the IRS should reconsider its drive toward centralization and make the case to Congress for more funding for local posts of duty. It should also think deeply about how to integrate geographic focus and structure into functions organized around taxpayer segments. In fact, today, the only two populations that have functions focused on them are LB&I and the Tax-Exempt and Government Entities Division. The names ''Wage and Investment'' and ''Small-Business/Self-Employed'' do not accurately describe the work done by these divisions. SB/SE conducts almost all audits except for the earned income tax credit, and all collection. Wage and Investment is pretty much

overtaken by return processing and refund fraud/ identity theft. The focus on the specific needs of individual and small-business taxpayers is largely gone.

I believe the IRS can overcome its challenges, but it must first acknowledge that the causes of some of them have nothing to do with funding or too much work. Through its centralization over the last decade and its virtual absence in the community, the IRS has isolated itself from the very taxpayers it serves. This isolation has made it easy for U.S. taxpayers to believe the worst about the IRS and its employees. If we are not careful, the only time taxpayers will have personal contact with an IRS employee is when the IRS is going to do something bad to them — assess more tax or collect their money or property. This is not a good state of affairs for any of us.

Each of the articles in this special issue, in its own way, calls for the IRS to make its primary focus the vast majority of taxpayers — those who are willingly trying to comply with the tax laws — regardless whether they make mistakes. These articles contain important insights and suggestions. I'm hoping the IRS will listen.

This article originally appeared in Tax Notes*, Mar. 14, 2016, p. 1315.*

IRS Criminal Investigation: A National Asset Being Damaged

By Mark E. Matthews

Mark E. Matthews

Mark E. Matthews is a member of Caplin & Drysdale, Chtd. He has served in several senior tax administration positions at the Treasury and Justice departments, including chief of the IRS Criminal Investigation division, IRS deputy commissioner for services and enforcement, and deputy assistant attorney general.

Matthews explains how recent congressional budget cuts are damaging the effectiveness and long-term vitality of the IRS's criminal tax enforcement capacity, and he discusses the critical tax deterrence message CI must maintain.

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IRS Criminal Investigation is the most critical component in maintaining the relatively high U.S. tax compliance rate, the envy of the world and a linchpin of our democratic system. The superb financial investigative abilities of its special agents are an important national security asset when those skills are in demand for other important needs, including terrorist financing matters. Yet the congressional squeeze on the IRS budget is reducing this national asset to a size that endangers its viability.

This article explores that impact. Recent congressional and public pressure to redirect CI resources to identity theft cases and the continuing demand for CI services in combating terrorism and for use in complex international fraud cases like the FIFA corruption case, combined with a dramatic drop in agent resources, are decreasing the resources available to pursue traditional tax fraud cases. The low agent numbers are now at a point that puts retention and the critical roles of training and skills transfer in peril.

Background

CI is the only enforcement agency pursuing investigations of potential criminal violations of the IRC. There are two key aspects of its work from a tax enforcement perspective. First, unlike IRS civil audit activity, CI's cases are public. CI publicizes its cases to send a message far beyond the individual taxpayer being prosecuted — to more than 300 million taxpayers. The message has two components: (1) the threat to those tempted to cheat that there is a great risk to tax evasion, and (2) the assurance to those paying their fair share that they are not chumps and that those not paying it are not getting a free pass, or are at least risking their liberty. Second, the prospect of incarceration is a principal motivator to those tempted to cheat. If the only sanction for tax violations were civil penalties, many more would play the audit lottery more aggressively, especially as congressional budgets drive the audit rate lower each year. Yet even the slight prospect of a loss of liberty in one of our federal correctional institutions causes many to focus when they sign the perjury jurat on their returns.

CI is the most dramatic example of the concept of general deterrence. Tax offenses are the one federal felony that every American confronts each year. We are not all tempted to sell drugs; we are not all in the securities industry or in a position to commit an environmental crime. But we all file returns. Therefore, the IRS must maintain a strong compliance message for the country's 300 million taxpayers, and it has — in recent history, with as few as 1,500 criminal tax prosecutions each year. Even that low number, however, is dropping. That is far below the number of narcotics prosecutions brought by the federal government in attempting to deter a far smaller group of potential violators. Hence, CI needs publicity to achieve even a minimum enforcement presence.

The CI chief, Richard Weber, recently made the same point in a conversation with the author: ''Taxpayers voluntarily comply because they know it is the right thing to do, but they also want those who cheat the government to be held accountable. They want a level playing field. When they see that criminals get away with not paying their fair share, there is a direct impact on the voluntary compliance rate and the confidence in our entire system begins to erode. IRS-CI restores that confidence by ensuring that we all play by the same rules.''

Declining Resources and New Obligations

In 1995 CI hit the historical high-water mark in special agent strength: 3,363 agents. When I had the privilege of leading CI, that number had fallen below 3,000; the current level is 2,288. Worse, the already built-in budget declines indicate agent strength will likely fall to 2,000 agents by 2017 and below 2,000 thereafter. At the same time, the professional staff has fallen from 1,720 to less than 900.

Criminal investigations inevitably involve intensive and detailed individual agent time and significant management oversight — as we all would want. Despite best efforts, it's difficult to automate

or make dramatic efficiency gains in those investigations. In the civil arena, the IRS has made great gains in efficiency with electronically filed returns, automated correspondence exams, and automatic underreporter programs, for example. But that simply cannot and should not be attempted in a criminal context.

The inevitable result of CI budget declines is a decline in CI's core product — criminal cases and convictions. The most recent enforcement statistics released by the IRS show the number of investigations initiated dropping from 5,314 in 2013 to 3,853 in 2015 and convictions dropping from 3,865 to 3,208. But even those numbers mask the true drop in tax cases. Those numbers include not only tax and tax-related matters but also other categories of cases: money laundering, narcotics, terrorist financing, and identity theft, which has grown massively. While it is true that CI is reimbursed through the Organized Crime Drug Enforcement Task Forces program for most of its money-laundering- and narcotics-related work, there has been no increase in resources to deal with the explosion in identity theft cases.

CI has included the more than 1,000 identity theft cases in recent years in the tax and tax-related categories of cases even though they relate to tax in only the broadest sense. There are no tax issues in those cases; the wrongdoings at issue are pure fraud schemes. No experts would conclude that identity theft cases advance traditional tax enforcement. Those cases are directed at a form of ''street white-collar'' crime, and they do nothing to deter average citizens from considering tax evasion. They do, however, respond to the obvious public and congressional concern about identity theft. There is little that is more frustrating than learning your refund has been stolen by some unknown criminal. While that is important work, the IRS should either get additional resources from Congress to do it or use other law enforcement agencies to do it until a systematic fix is in place.

The declining numbers mask yet further damage to this valuable government workforce. When special agent numbers drop this low, it is difficult to maintain a consistent recruitment program and even harder to maintain an effective training program. When I was CI chief, we ran as many as 12 training classes per year at the Federal Law Enforcement Training Centers. Now they are lucky to have a class or two annually. That leads to degradation in the all-important training environments. Moreover, because special agents are eligible to retire as early as age 50, CI loses many of its most experienced and skilled agents each year. As the numbers drop, the number of agents and the amount of time available for field-level training diminish. There are many of us who already doubt whether the IRS could still conduct an old net-worth-type prosecution, and no one has seen one in years. Those are valuable skills that the agency is losing.

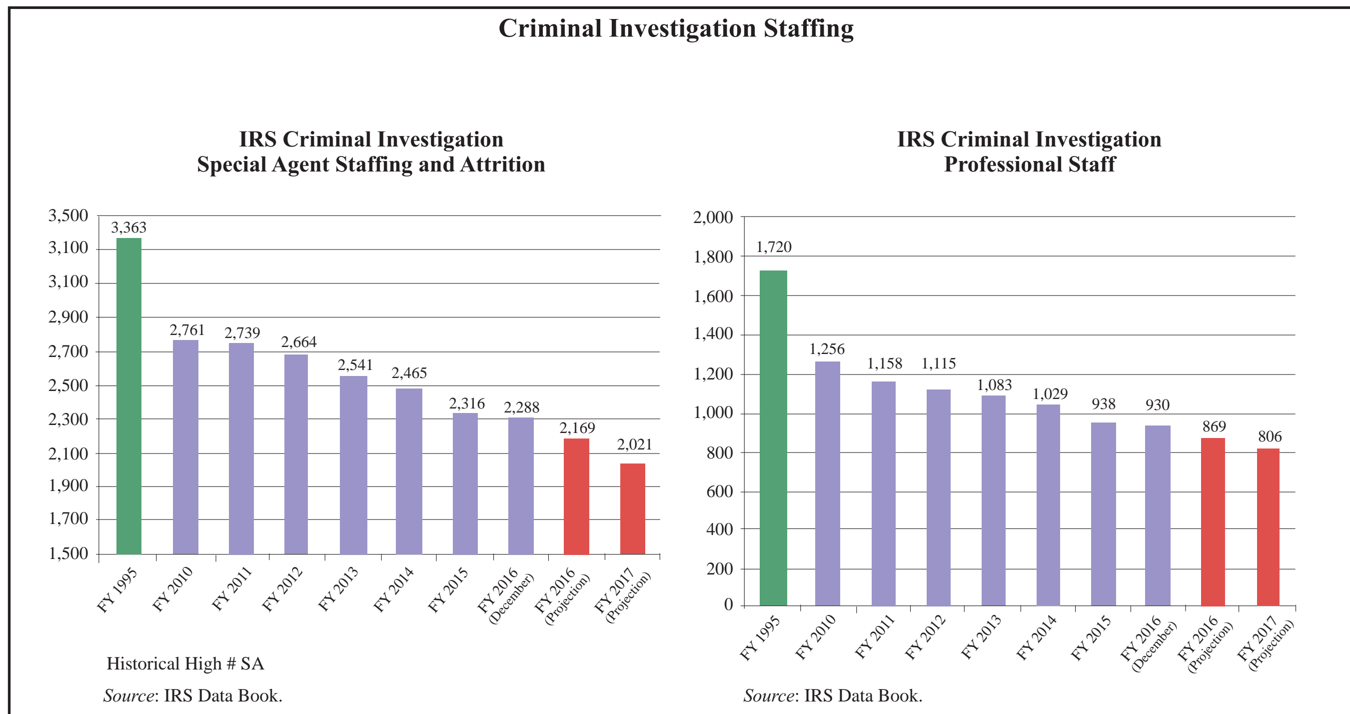
Given the increasingly international nature of the cases CI works, such as the recent offshore banking cases or a case like FIFA's, CI must station agents abroad. If the Foreign Account Tax Compliance Act and the common reporting standard work, there will be an even greater need for CI's boots on the ground abroad, but the budget trends will not allow that.

Another challenging development for all law enforcement, but particularly CI given the role of computers in the crimes it pursues, is the need to have sufficient agents trained in a cyber environment. As Weber described it to the author: ''As criminals continue to become more sophisticated in the way that they defraud the government, we must do all we can to stay one step ahead of them. Cyber platforms are the new playing field for today's criminals. We must invest in the tools to ensure that the country's best financial investigators are properly trained and equipped to do battle with today's criminals in the cyber world — whether it is a complex tax case, sophisticated stolen identity refund fraud case, or a terrorist financing case, IRS-CI needs to lead this effort to ensure that taxpayers can have confidence in their financial system.''

The Enforcement-Deterrence Impact

CI already struggles to maintain a consistent enforcement message in multiple media outlets. It maintains a significant and detailed presence on the IRS website featuring data and summaries of publicly available information on hundreds of convictions, separated by various subprogram categories (https://www.irs.gov/uac/Criminal-Enforcement-Statistical-Data). But it needs to get these criminal convictions reported not only in the tax press and national papers but also in local newspapers, on websites, and in nightly news reports. That is where the enforcement battle is really won — in hundreds of regional newspapers and local television markets.

To maintain a reasonable coverage in 50 separate states and hundreds of distinct media markets, CI should be bringing thousands of cases each year. If you start with 3,853 total investigations being initiated in 2015 but eliminate identity theft cases (776), narcotics cases (955), and money-laundering cases (1,436), you reach a number reflecting that very few traditional tax cases are being initiated — even if you concede there is some double counting in those numbers. The IRS statistics report 1,202 general tax fraud case initiations in fiscal 2015, but when you consider that in recent years only about two-thirds of the initiations have been prosecuted, you see that



traditional tax cases prosecuted per year have dropped significantly. Plus, some of those cases fall into other program areas like healthcare fraud and bankruptcy fraud. The number of traditional criminal tax cases being pursued — when the only violation involved is a tax crime — has fallen to a dangerously low level.

Loved Too Much

One of CI's biggest historical issues is that the agents and their skills are sought after for so many different roles. It seems that every decade or so, there is a blue-ribbon study of the IRS, and each time it bemoans the shifting of CI resources to other investigative priorities. The most recent report in 1999, known as the Webster Commission report, described this as "mission drift" and strongly urged the IRS commissioner to put CI back in the tax enforcement business.

FY 2015 Statistics			
	FY2013	FY2014	FY2015
Investigations initiated	5,314	4,297	3,853
Prosecution recommendations	4,364	3,478	3,289
Informations/indictments	3,865	3,272	3,208
Total convictions	3,311	3,110	2,879
Conviction rate	93.1%	93.4%	93.2%
Total sentenced	2,812	3,268	3,092
Percent to prison	80.1%	79.6%	80.8%
Average months to serve	44	42	40

The largest unreimbursed non-tax-related drain on CI's resources is identity theft cases. As indicated above, in recent years, CI has initiated more than 1,000 such cases each year, and those cases have consumed as much as 18 to 20 percent of an agent's time available for investigative work on average. The good news is that there were only 776 cases initiated in fiscal 2015, and CI tries to work these cases in conjunction with other law enforcement agencies, reducing the drain on special agent resources. This is one of those areas in which Congress wants to have it both ways — speedy refunds and no fraud. Yet the two demands are in direct competition with each other: The faster the refund, the fewer the anti-fraud checks and controls. Hopefully, the IRS will develop and implement changes in the fraud detection systems that will catch more of that activity before refunds are issued. Alternatively, those cases — if so important to the public and to Congress — should be a key basis for additional funding for CI.

National Security Imperative

If you are not already convinced that the tax enforcement mission is important enough to save CI, there is another compelling reason. Unknown to many is the critical role IRS special agents play when the best financial investigative skills are needed in the world of terrorist financing cases. I was the chief of CI on September 11, 2001, and within a few hours of the terrorist attacks, we received a request from an individual very high up

in the U.S. national security establishment for special agents to be on the ground in the Middle East immediately to start following the money trail. We asked for six volunteers and, as you would expect, received too many responses. One of these days, maybe we can tell the story about where they went and what they did.

Another little-known fact is that more than 100 special agents volunteered to serve and did serve as air marshals after 9/11, even though that work was pretty far afield from the mission for which they signed up. During the Hurricane Katrina flooding, it was the special agents who remained at or actually moved toward flooding IRS offices to secure them as much as possible. IRS Commissioner Charles O. Rossotti referred to them as the ''marines of the IRS,'' and that always seemed to capture it perfectly.

For all the reasons stated above, Congress should not allow this talented and critical group of agents to wither to numbers that eviscerate their worth to our country. Too much is at stake. The maintenance of our still-laudable tax compliance rate is essential to our functioning democracy. CI (and a fully funded IRS) is a relatively small price to pay. If our compliance rate started to fall because of perceived lack of enforcement, it would be much more expensive (and painful) to restore the status quo.

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Identity Theft and Refund Fraud At the IRS: A Partial Solution

By Lawrence B. Gibbs

Lawrence B. Gibbs

Lawrence B. Gibbs is a member at Miller & Chevalier Chtd. He served as IRS commissioner from 1986 to 1989 and is on Tax Analysts' board of directors.

In this article, Gibbs discusses the fiscal impact and potential for increased fraud within the socioeconomic programs that the IRS administers through refundable credits, especially the earned income tax credit. He proposes administrative reform of those programs.

The views expressed herein are solely the author's and do not necessarily reflect the views of Tax Analysts.

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Our federal fiscal system depends on the IRS not only to raise revenue to fund government operations but also to administer the funding of Medicare and Social Security, which are our governmental healthcare and retirement entitlement programs, and to administer a variety of other socioeconomic programs that have become part of our tax law in the last 25 years or so. These include affordable healthcare, welfare, education, energy, housing, and economic stimulus programs.[1] The impact of the refundable credits in converting the tax collection system to a tax spending system may be seen by focusing on the earned income tax credit, child tax credit, child care and dependent care assistance exclusion, education tax credits, premium assistance tax credits, low-income housing tax credit, new markets tax credits, work opportunity and empowerment zone tax credits, and tax subsidies for antipoverty organizations, as explained and discussed in a remarkable article by Susannah C. Tahk, titled "The Tax War on Poverty."[2]

All of these more recent programs are government spending programs that are being run through our tax system.[3] Treasury has estimated that the tax cost of the major family and education credits for 2016 will approach $145 billion and will benefit almost 56 million families.[4]

The IRS today appears to be viewed by many as a financial intermediary for a growing number of governmental support programs.[5] For example, to politicians and economists, it seems to make more sense for the tax system to administer the funding of certain federal welfare programs than to have the IRS collect taxes and then have the Department of Health and Human Services use a portion of those taxes to administer the welfare programs. The IRS does this primarily through the EITC,[6] which is one of many refundable tax credits. In other words, the IRS — not HHS — makes direct payments to welfare recipients and enforces compliance with the requirements of the welfare laws that are now part of the code. This approach makes some sense, because the amount of income of taxpayers who claim to be eligible for the EITC is information that

[1]For refundable credits, see, *e.g.*, sections 24(d) (child tax credit), 25 (home mortgage interest credit), 25A (HOPE scholarship, lifetime learning, and American opportunity credits), 25B (IRA savings credit), 25C (nonbusiness energy credit), 25D (residential energy efficiency credit), 32 (earned income credit), 35 (health insurance credit), 36 (first-time home buyer credit), and 36B (health insurance premium assistance credit); *see also* the Economic Stimulus Act of 2008, P.L. 110-185. For nonrefundable tax credits, see, *e.g.*, sections 21 (employment-related household and dependent care expenses credit), 23 (adoption expenses), 30B (alternative motor vehicle credit), 30C (alternative fuel vehicle refueling property credit), sections 38-52 (34 business and investment-related tax credits), and sections 54-54AA (eight bond-related tax credits), all of which represent tax spending to subsidize various business and investment activities by lowering the after-tax cost to invest in each activity.

[2]56 *Ariz. L. Rev.* 791 (2014).

[3]For another excellent article (also by Tahk) that explains the change in the tax area over the last 50 years from revenue raising to spending through the tax code and that describes the role and intended impact of the refundable credits, see "Everything is Tax: Evaluating the Structural Transformation of U.S. Policymaking," 50 *Harv. J. Legis*. 67 (2013); *see also* David Kamin, "Reducing Poverty, Not Inequality: What Changes in the Tax System Can Achieve," 66 *Tax L. Rev.* 593 (2014); *see generally* Edward D. Kleinbard, "The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes," 36 *Ohio N. U. L. Rev.* 1, 18 (2010) (This article is a reprint of Kleinbard's 2009 Woodworth Lecture in which he stated: "Tax subsidies (that is, tax expenditures in the narrow sense used here) permit a marvelous muddling of budget terminology: they increase government spending in economic terms but can be presented as 'targeted tax cuts.' By relying on tax expenditures, Congress can pander to important constituencies that for the last three decades have agitated for lower taxes and smaller government, while giving us what we actually want — more discretionary spending and, implicitly, larger government.").

[4]*See* Treasury, "Families Benefiting From Major Family and Education Tax Credits and From Expansion Under American Recovery and Reinvestment Act, Tax Year 2016" (July 23, 2015).

[5]*See* Fred R. Goldberg, "From FDR to W: The IRS as Financial Intermediary," 29 *Ohio N. U. L. Rev.* 1 (2002-2003) (This article is a reprint of former IRS Commissioner Fred Goldberg's 2002 Woodworth Lecture).

[6]Section 32; *see* Margot L. Crandall-Hollick, "The Earned Income Tax Credit (EITC): Administrative and Compliance Challenges," Congressional Research Service (2015).

the welfare recipients are required to report annually to the IRS in order to be eligible to claim EITC benefits.

However, this approach has had the following consequences. The prior actions that federal agencies like HHS used to take to initially qualify welfare recipients as eligible to receive welfare benefits have been eliminated. Instead, the dollar amounts of those benefits, like the EITC, are now paid to the recipients if their income tax returns indicate that they are eligible to claim refundable tax credits that provide those benefits. In other words, the monetary benefits are paid out to the recipients before it is determined whether and to what extent they are eligible to receive them. Because of its lack of expertise and particularly its lack of resources, the IRS does not have adequate compliance capabilities to properly administer and enforce these government support programs.

As a result, today's approach of shifting the burden of administering these socioeconomic benefit programs to the IRS has introduced significant, ongoing risks of fraud into our tax revenue system — risks that economists and politicians rationalize on the basis that there would have been fraud even if HHS had continued to administer the welfare programs. The speed of the IRS's refund payments to payees, combined with the fact that the IRS has no capability to determine whether the recipients are entitled to those payments, has proven irresistible to the crooks. One of the fastest growing programs at the IRS is to assist taxpayers whose identities and tax refunds have been stolen.

IRS Commissioner John Koskinen has confirmed that large, sophisticated organized crime syndicates in the United States and around the world have become involved in the identity theft and refund fraud.[7] The fraud has been persistent and growing. Every time there is a hacking incident in the public or private sector involving theft of Social Security numbers, the potential for identity theft and refund fraud increases.

Today, although the IRS is working on a number of ideas about how to detect and deter refund fraud, its systems and processes have thus far been unable to effectively interdict many of the payments of fraudulent refund claims based on bogus refundable credits. Most of the low-income income tax returns claiming refundable EITCs are filed in January and February each year. Traditionally, the payer wage and investment tax information (on forms W-2 and 1099) used by the IRS to verify the accuracy of those returns is not provided to the IRS by the payers in time for it to match that payer information against the filed refund returns until after the filing season. Fraudsters have taken advantage of this by filing returns of identify theft victims before the IRS has the capability to match the payer information with the information shown on the fraudulent returns. The IRS, with recent help from Congress,[8] has been investigating various possible remedies, including an acceleration of the due date for employer and payer information and the IRS's matching capability, and a possible delay in payment of the refunds until a matching capability can be accomplished. However, so far both alternatives have proved problematic for a variety of reasons.

No one knows how big this refund fraud problem really is or may become.[9] Clearly, it is in the multi-billions of dollars each year. It is large enough that the Government Accountability Office last year added tax refund fraud due to identity theft to its government-wide list of "high risk" programs.[10] Congress has held hearings,[11] criticized the IRS for

[7]*See* Laura Saunders, "Combating Tax Identity Theft," *The Wall Street Journal*, June 20, 2015, at B8 ("The IRS is 'dealing with more and more organized crime syndicates here and around the world,' Mr. Koskinen said in Senate testimony earlier this month.").

[8]*See* section 201 of the Protecting Americans From Tax Hikes Act of 2015; division Q of the Consolidated Appropriations Act, 2016, P.L. 114-113 (Dec. 18, 2015) (requiring some payers of income in the form of compensation to file forms W-2, W-3, and 1099 MISC with the IRS before the end of January following the year in which the compensation so reported was earned, and giving the IRS more time to pay refunds attributable to the earned income credit and the child care credit in order to better address identity theft and refund fraud).

[9]*See, e.g.*, Treasury Inspector General for Tax Administration, "There Are Billions of Dollars in Undetected Tax Refund Fraud From Identity Theft," 2012-42-480 (July 19, 2012). The national taxpayer advocate expressed similar concerns about refund fraud in her "2013 Annual Report to Congress," vol. 1, 42-67 (Dec. 31, 2013); and in her "2012 Annual Report to Congress," vol. 1, 173-181 (Dec. 31, 2012). *See also* TIGTA, "Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions," 2015-40-027 (Mar. 27, 2015) (discussing revenue losses from other misapplications of refundable credits).

[10]*See* GAO, "High-Risk Series: An Update," GAO-15-290 (Feb. 11, 2015).

[11]*See, e.g.*, Tax-Related Identity Theft and Fraudulent Tax Returns Tax, Hearing Before Senate Budget Committee, 113th Cong. (Aug. 26, 2015); Fraud and Tax ID Theft: Moving Forward With Solutions, Hearing Before Senate Finance Committee, 112th Cong. (2013); Identity Theft and Income Tax Preparation Fraud, Hearing Before House Judiciary Subcommittee on Crime, Terrorism, and Homeland Security, 112th Cong. (2012); and Hearing on Identity Theft and Tax Fraud, Joint Hearing

(Footnote continued on next page.)

failing to halt refund fraud, and developed proposed legislation[12] to ameliorate some aspects of the fraud. Most recently, the IRS announced an ongoing, collaborative effort with state tax administrators, return preparation and software firms, and payroll and financial product processors to try to combat refund fraud.[13] It remains to be seen how effective the new efforts will be in detecting and deterring identity theft and refund fraud.

Proposed Solution

At least a partial[14] potential solution to the identity theft and refund fraud problem at the IRS would be for HHS to initially screen and qualify applicants for welfare assistance under the EITC program. Once applicants were so qualified, their names and identifying information could then be forwarded to the IRS by HHS. If a taxpayer claimed an EITC and he had not been certified by HHS as eligible to become a welfare recipient, the IRS would be able to stop any refund payment to that person before it was made. Further, anyone wishing to become a welfare recipient would have to surface in some manner in dealing with HHS before being able to claim an EITC on an income tax return, which itself would be a likely deterrent. The additional HHS cost could be offset by the present revenue loss attributable to fraudulent refunds as well as the cost savings to the IRS of not having to continue to administer its entire identity theft and refund fraud programs as they exist today.

The point is that the welfare program we refer to as the EITC does not have to be administered by the IRS, and certainly not in its entirety. Indeed, before 1975, HHS administered the program. The Ford White House proposed that the program be moved from HHS to the IRS, at the urging of HHS officials and with the support of economists who contended that it would be more ''efficient'' for the IRS to administer the program.[15] Little thought about the potential for identity theft and refund fraud in the magnitude present today was ever raised and or considered.[16] The adverse fiscal impact of the EITC and other socioeconomic programs that now make well over $100 billion payments annually — and the bipartisan pressure to continually increase the number of these types of programs and the dollar amounts to be paid by each such program — before verifying that recipient-payees are the intended beneficiaries of the programs are significant and growing. It therefore would seem appropriate to reconsider how these programs should be administered and what agency or agencies should be involved in their administration.

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Before the House Ways and Means Subcommittee on Oversight and Subcommittee on Social Security, 112th Cong. (2012).

[12]*See* S. 676, ''Identity Theft and Fraud Prevention Act of 2015,'' introduced by Sen. Bill Nelson, D-Fla., on March 9, 2015, now pending in the Finance Committee.

[13]IRS, ''IRS, Industry Take New Steps Together to Fight Identity Theft, Protect Taxpayers,'' IR-2015-87 (June 2015).

[14]The growth of identity theft and refund fraud has been exacerbated by some unlicensed, unregulated commercial tax return preparers who are deliberately and repeatedly preparing and filing fraudulent income tax returns claiming excessive EITCs and other tax benefits to which they know their clientele are not entitled. If the taxpayer for whom the commercial tax return preparer is preparing a fraudulent return has been certified by HHS as an eligible welfare recipient, any intentionally overstated EITC would not be caught under my proposal. Proposed legislation that would enable the IRS to regulate commercial tax return preparers in an attempt to better detect and deter refund fraud appears to be stalled in the Senate Finance Committee. *See* Luca Gattoni-Celli, ''Return Preparer Bill Stalled Despite AICPA Dropping Objections,'' *Tax Notes*, Jan. 25, 2016, p. 402.

[15]*See* section 204 of the Tax Reduction Act of 1975, P.L. 94-12 (adding the EITC to the Internal Revenue Code of 1954, as amended).

[16]I was the assistant commissioner (technical) of the IRS at the time. I recall discussions with then-IRS Commissioner Donald C. Alexander, who unsuccessfully opposed the transfer of responsibility for the welfare program from HHS to the IRS, in part because it assigned the IRS the responsibility of administering a program for which the IRS had no background, expertise, capability, or resources.

LB&I — The Case for a New Management Paradigm

By Samuel M. Maruca

Samuel M. Maruca

Samuel M. Maruca is a Washington tax lawyer who served as the first director of transfer pricing operations in the IRS Large Business and International Division.

In this article, Maruca discusses LB&I's new strategy for issue selection and development, which appears to promote quality over quantity. He argues that changing what it means to be a manager in LB&I would increase the likelihood of success in implementing this welcome new strategy.

The IRS Large Business and International Division must be commended for the steps it is taking to align the examination workforce with the daunting realities of limited resources and growing demands. The steps include the focus on strategic issue selection, especially in the international area; the development of more sophisticated training programs; and the creation of a practice group structure for issue management (through which the executive team will have greater visibility into specific examinations). Those efforts should better position LB&I to improve enforcement credibility and program efficiency overall. This approach stands in stark contrast to the status quo ante, in which virtually all large-company returns were staffed up and processed without much forethought about actual risk exposure — and without much guidance from the leadership, which viewed its role as "being there to support the team." And it suggests that LB&I is pivoting from a "volume game" (when case closure is the all-important metric) to a more targeted, quality-oriented approach regarding issue selection and development, with different measures of success.

But in tax administration as in golf, it's the follow-through that counts, and the leadership team will need to pursue these new objectives aggressively and relentlessly if real and lasting change is to occur. Moreover, if LB&I is to be a successful, knowledge-based organization that is able to hold its own in the big company enforcement arena, LB&I should reconsider what it means to be a manager in the division. The old volume game put a premium on administrative skills rather than programmatic elements, such as (but not limited to) technical tax expertise. The more quality-oriented approach envisioned in the new business model demands a different kind of manager who is focused on different objectives. Specifically, the LB&I management team, up and down the chain, should be reasonably skilled in issue selection and development, capable of performing quality control functions, and able to provide mentoring for more junior personnel.

That is not to say that the current LB&I management team is inherently deficient in those areas. Rather, the current orientation results from either an institutional choice of management models, simple inertia, or some combination of the two. Put otherwise, LB&I managers are trained to do the wrong things. The IRS's historical approach has been to produce mostly internally grown managers, who are by design "fungible" in the sense that they are prepared to take on a leadership assignment anywhere in the agency. Consequently, executive training has emphasized administrative skills that include how the agency is organized, how it operates, how to pull the bureaucratic levers, employment matters, and budgeting. There is little or no instruction on timely tax topics, strategic issue identification, or improving case development.

This might be appropriate training for some operating divisions or for some administrative roles within LB&I itself, but it is not well suited to execute the plan now envisioned for the program side in LB&I. The institution needs to make a different choice, which implies a reinvention of the management training regime, retraining for existing managers, and the recruitment of experienced tax practitioners from outside the agency, as well as from within, to augment and refresh the management ranks.

Given that LB&I seems to be moving towards a practice group structure, it follows that the management team within each group should have a solid grasp of the technical aspects of the issues for which the group is responsible. This means not that they should be required to master all the nuances of the law (counsel can help with that) but rather that they should be capable of asking the kinds of questions and providing the kind of guidance that will foster the best use of resources. That means smart issue selection, "strategic abandonment" of less worthy issues, and effective use of the transaction-based audit tools that have been developed in recent years. Those include the international practice units and the transfer pricing audit roadmap, for example.

Other desirable qualities should be inculcated in LB&I managers (qualities that are often lacking in those large organizations). Mentoring skills are critical to ensure perpetuation of the knowledge

base and to create the next generation of leaders. Teamwork is important, as is a sense of independence and empowerment. LB&I is a very hierarchical, lockstep organization. This can have the effect of blunting initiative, encouraging conformity, and institutionalizing a fear of failure. Those characteristics are not conducive to the kind of debate and experimentation required for success in a business, like that of LB&I, that is fundamentally an intellectual one. The issues carry high stakes and can be very complex. If it is to compete with the best and brightest in the private sector, LB&I is going to have to bring its ''A'' game. That requires well-trained and motivated people *acting collectively* and feeling that they are safe from retribution when inevitable mistakes are made. Conversely, impeding free discussion or ''going it alone'' should be strongly discouraged.

In the new LB&I model, it will be important to clarify roles and responsibilities. The priority of program managers should be the program! To the maximum extent feasible, the administrative aspects of program delivery should be addressed by others trained for that role. Currently, executive assistants (EAs) for operations are charged with making the trains run on time. But in my experience, program executives often cannot avoid spending inordinate time on nonprogram matters. To be sure, it isn't always easy to distinguish between the substantive program and program administration. And there is no escaping the need for managers to perform personnel reviews for their reports, among other things. Rigorous training and empowerment for EAs, together with more explicit task allocations, would be immensely helpful, though, in freeing up program managers to concentrate on optimizing LB&I's basic work product, which is the quality examination.

The typical management structure in a different sort of knowledge-based organization — a university — could provide a useful analog for building a more effective LB&I management team. Like the precursor LB&I practice groups of recent years (transfer pricing operations and the foreign payments practice), the program side at a university usually features a team of managers who are all, to some degree, experienced in their field and engaged in the substantive work and report to more senior and more experienced practitioners. The dean of the faculty is the senior program officer, followed by department heads, other full professors, junior professors, instructors, and teaching assistants. The more senior faculty (by design, at least) provide guidance, mentoring, and quality control to junior faculty: learning occurs both up and down the chain. On the other side of the house is the business operation, headed by a chief business officer to whom administrative department heads report. The role of the business operation is to ensure that the budget, the physical plant, and other administrative functions fully support the program activities including teaching, research, and performance art.

Transfer pricing operations brought a new way of doing business to LB&I, with an experienced management team that effectively connected senior leadership with a field operation embedded in examination teams across the country. The success of that type of model depends on the personal involvement of management in the scoping and delivery of the work. One hopes that LB&I can leverage that experience and re-engineer the management role so that it aligns with the expanded practice group structure envisioned for the reorganized examination function.

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The IRS, Politics, and Income Inequality

By Leandra Lederman

Leandra Lederman

Leandra Lederman is the William W. Oliver Professor of Tax Law at the Indiana University Maurer School of Law. This article grew in part out of research for a longer article to be published in a coming issue of the *Columbia Journal of Tax Law*: "IRS Reform: Politics as Usual?" The author is grateful for the many helpful comments she received on drafts of that article, to Danshera Cords and Denvil Duncan for comments on earlier drafts of this article, to Prasad Krishnamurthy for helpful discussions, and to Mike Tenenboym and Sean Hamner for research assistance.

In this article, Lederman suggests that supporters of progressive taxation use the fight against rising income inequality as a rhetorical tool to help the IRS receive more balanced treatment from Congress.

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Introduction

The IRS is in crisis. Its image was badly damaged by accusations, starting in 2013, that it targeted Tea Party and other conservative nonprofit organizations,[1] although federal investigations found no criminal activity.[2] Over the past six years, the IRS has experienced budget cuts that have prompted cutbacks in service and enforcement and put the agency under tremendous pressure. In 2014, the Internal Revenue Service Advisory Council said, "In IRSAC's view, the IRS is in the midst of an existential funding crisis."[3] Yet Congress cut the IRS's budget for 2015 and for 2016 kept its budget below the 2014 level.[4] Some in Congress have said that the budget cuts are a punishment.[5]

Tax collectors generally are not well-liked.[6] Accordingly, politicians can score easy political points by bashing the IRS.[7] Underfunding may make the IRS more likely to make mistakes, potentially creating a vicious cycle. Yet, a tax collector such as the IRS is essential because it administers our federal tax system, and "taxes are the life blood of government."[8] Congress's inadequate funding of the IRS is thus a very serious problem.[9]

To have adequate funding for the many tasks Congress gives it, the IRS needs congressional support. Of course, some in Congress may always revile the IRS, although collecting the taxes called for by law is a way to reduce the federal deficit. Some may even attack the IRS in an effort to undermine the progressive income tax.[10] However, there may be others who support progressive taxation and who could provide greater support to the IRS when it faces the prospect of largely one-sided hearings or punishing budget cuts. This article suggests that supporters of progressive taxation use

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[1]*See* Federalist Staff, "DOJ: Lois Lerner Won't Get Charged for Targeting Conservative Groups," Federalist.com, Oct. 23, 2015.

[2]*See* Devlin Barrett, "Criminal Charges Not Expected in IRS Probe," *The Wall Street Journal*, Jan. 13, 2014 (FBI found only mismanagement, not criminal behavior); and letter from Assistant Attorney General Peter Kadzik to leaders of the House Ways and Means Committee (Oct. 23, 2015) ("We found no evidence that any IRS official acted based on political, discriminatory, corrupt, or other inappropriate motives that would support a criminal prosecution.").

[3]IRS, "Internal Revenue Service Advisory Council 2014 Public Report" (Nov. 19, 2014), at 9.

[4]The IRS's budget for 2014 was $11.291 billion. *See* Treasury, "The Budget in Brief (FY 2015)." Its budget for 2015 was $10.945 billion. IRS, "Program Summary by Appropriations Account and Budget Activity" (Feb. 2, 2015). Congress increased the IRS's 2016 budget by $290 million over its 2015 budget, putting the 2016 budget at $11.235 billion. *See* Consolidated Appropriations Act, 2016, P.L. 114-113, Tit. IV, Div. E, Tit. I, section 113; *see also* House Appropriations Committee, FY 2016 Omnibus-Financial Services Appropriations.

[5]*See* House Ways and Means majority staff report, "Doing Less With Less: IRS's Spending Decisions Harm Taxpayers" (Apr. 22, 2015) ("As a result of the IRS's blatant misconduct, Congress significantly reduced the agency's budget.").

[6]*See* Samuel D. Brunson, "Watching the Watchers: Preventing I.R.S. Abuse of the Tax System," 14 *Fla. Tax Rev*. 223, 224-225 (2013) ("Taxpayers dislike and distrust tax collectors. These feelings transcend time and culture.").

[7]Ryan J. Donmoyer, "Three Days of Hearings Paint Picture of Troubled IRS," *Tax Notes*, Sept. 29, 1997, p. 1655, 1658 ("Pollster Frank Luntz . . . observed that 'nothing guarantees more applause and more support than the call to abolish the IRS.'").

[8]*Matter of Appeal of N.Y. State Realty & Terminal Co.*, 121 A.2d 21, 24 (1956).

[9]The national taxpayer advocate identified insufficient IRS funding as the most serious problem in 2011 and 2014. Taxpayer Advocate Service, "2014 Annual Report to Congress Vol. I" (Jan. 14, 2015); and TAS, "Special Report to Congress, Political Activity and the Rights of Applicants for Tax-Exempt Status" (June 26, 2013).

[10]For example, during the 1997 IRS hearings, former Rep. Bob Riley, R-Ala., stated, "The IRS has too much muscle, too much money, and too little oversight. . . . In my view, we should overhaul — if not eventually abolish — the IRS. Then we should scrap the Tax Code and replace it with one that is fairer and flatter." 143 *Cong. Rec*. E2306-2401 (daily ed. Nov. 10, 1997) (remarks of Riley).

Fiscal Year	IRS Budget (absolute dollars, in thousands)	IRS Budget (2015 dollars, in thousands)[a]
2009	$11,522,598[b]	$12,729,979
2010	$12,146,123[c]	$13,202,286
2011	$12,121,830[d]	$12,772,706
2012	$11,816,696[e]	$12,198,741
2013	$11,198,611[f]	$11,393,782
2014	$11,290,612[g]	$11,304,014
2015	$10,945,000[h]	$10,945,000
2016	$11,235,000[i]	$11,235,000

[a]Inflation calculations were performed using US Inflation Calculator, *available at* http://www.usinflationcalculator.com.
[b]Treasury, ''Budget Documents: FY 2011, Internal Revenue Service,'' *available at* https://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/IRS%20FY11%20508.pdf, at 1.
[c]*Id.*
[d]Treasury, ''FY 2013 Budget Documents, Internal Revenue Service,'' *available at* https://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf, at 1.
[e]*Id.*
[f]Treasury, ''IRS Oversight Board, FY 2015 IRS Budget Recommendation Special Report,'' *available at* https://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf, at 19 (fiscal year 2013 budget after sequestration).
[g]Treasury, ''FY 2015 Budget Documents, Treasury 2015 Budget in Brief,'' *available at* https://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/Treasury_FY_2015_BIB.pdf, at 61.
[h]IRS, ''Program Summary by Appropriations Account and Budget Activity,'' 1 (2015), *available at* https://www.irs.gov/PUP/newsroom/IRS%20Budget%20in%20Brief%20FY%02016.pdf.
[i]*See* House Appropriations Committee, ''FY 2016 Omnibus — Financial Services Appropriation,'' *available at* http://appropriations.house.gov/uploadedfiles/12.15.15_fy_2016_omnibus_-_financial_services_-_summary.pdf.

the fight against rising income inequality as a rhetorical tool to help the IRS get more balanced treatment by Congress.

IRS Budget Cuts and Politicking

In 2010 ''Congress really began piling on the acronymic workload: PPACA (the official acronym for Obamacare) and FATCA (the Foreign Account Tax Compliance Act, which required the IRS to start investigating taxpayer foreign bank accounts).''[11] In 2011 the press reported that the IRS was auditing five donors of section 501(c)(4) organizations who hadn't paid gift tax on the transfers.[12] After Congress inquired whether the audits were politically motivated, although then-Commissioner Douglas Shulman said they were not, the IRS dropped the audits.[13] In early 2012 Senate Democrats wrote to Shulman threatening to introduce legislation if the IRS didn't issue guidance restricting excessive political activity by section 501(c)(4) organizations.[14] Around the same time, Senate Republicans wrote Shulman to inquire whether the IRS was applying heightened scrutiny to the section 501(c)(4) applications of Tea Party and other conservative groups.[15] In 2013 the controversy exploded.[16]

Congress's approach to the allegations that the IRS mistreated Tea Party and other conservative nonprofits was often quite partisan.[17] House Speaker John Boehner, R-Ohio, asked, ''Who is going to jail over this scandal?''[18] The House Committee on Oversight and Government Reform, then chaired by Rep. Darrell Issa, R-Calif., held particularly contentious hearings.[19] Democrats accused Issa of engaging in ''witch hunts,''[20] and the ranking Democrats

[11]Bryan Camp, ''Overlooked Costs of IRS Budget Cuts Will Hit Taxpayers Hardest,'' *The Conversation*, Apr. 14, 2015.

[12]''IRS Formally Ends Gift Tax Probe of 501(c)(4) Contributors,'' *Fed. Taxes Weekly Alert* (July 14, 2011), at art. 5.

[13]*Id.*

[14]Sen. Charles Schumer press release, ''Senate Democrats Urge IRS to Impose Strict Cap on Political Spending by Nonprofit Groups — Vow Legislation If Agency Doesn't Act'' (Mar. 12, 2012).

[15]''New Controversy Over IRS Investigations of 501(c)(4) Organizations and Their Donors,'' *Fed. Taxes Weekly Alert* (Mar. 22, 2012), at art. 5.

[16]*See* Treasury Inspector General for Tax Administration, ''Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review,'' 2013-10-053 (May 14, 2013), at i (''The IRS used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign intervention.''); and Barrett, *supra* note 2 and accompanying text.

[17]*See* Tom Cohen, ''Partisan Views of IRS Targeting: Political Conspiracy or Overzealous Scrutiny,'' *CNN* (June 4, 2013).

[18]Sam Stein, ''IRS Scandal Hearings Put Inspector General in the Spotlight,'' *Huffington Post*, July 17, 2013.

[19]*See* Lily Kahng, ''The IRS Tea Party Controversy and Administrative Discretion,'' 99 *Cornell L. Rev*. 43A n.13 (2013) (''Circus ringmaster Darrell Issa's relentless attacks on the IRS and willful ignorance of any facts that might undermine his witch hunt have been truly impressive.'').

[20]*See* Rebekah Metzler, ''Democrats Accuse Rep. Darrell Issa of McCarthyism During Panel Vote on Lerner,'' *U.S. News*, June 28, 2013.

on the committee wrote an editorial in *The Washington Post* stating, "For nearly three months, Republicans have engaged in a sustained and orchestrated campaign to accuse the White House and the Obama administration of using the IRS to target the president's political enemies — without any evidence to support their claims."[21]

By June 2013, four committees had held a total of five hearings.[22] IRS Commissioner John Koskinen testified in March 2014 that "over the last eight months . . . more than 250 IRS employees have spent nearly 100,000 hours working directly on complying with the [committee] investigations, at a cost of nearly $8 million," in addition to $6 million to $8 million spent on related information technology infrastructure.[23]

During this period, Congress also cut the IRS's budget, slashing it by more than $1.2 billion between 2010 and 2015.[24] The cuts began in 2011, as the table on the previous page shows.

In inflation-adjusted dollars, the IRS's 2016 budget is approximately 19 percent lower than its 2010 budget.[25] In fact, in inflation-adjusted dollars, the IRS's budget is similar to that of 1998,[26] the year of the Internal Revenue Service Restructuring and Reform Act (RRA '98), which followed theatrical congressional hearings accusing the IRS of massive abuses by its collections agents.[27]

These cuts have severely hurt the IRS. It offered employee buyouts[28] and imposed an "exception-only" hiring freeze[29] that resulted in one hire for every five departures.[30] Between 2010 and 2014, the IRS reduced frontline enforcement by 9,500 positions, and its total workforce declined by about 13,000 full-time employees.[31] The size of the IRS workforce dropped to the lowest it has been since the early 1980s.[32]

Also, the IRS's per-employee expenditure on training in 2014 was less than 18 percent of what it was in 2010, in constant dollars.[33] Operating with a smaller and less-trained workforce may increase the likelihood of errors. Further, the IRS is also struggling with outdated technology[34] and combating a wave of identity theft tax refund fraud.[35]

Not surprisingly, the budget cuts have hurt both the IRS's enforcement and service functions. Regarding enforcement, the cuts have reduced tax collections[36] and case closures by revenue officers.[37] Following an uptick in enforcement during the 2009 through 2011 fiscal years, enforcement statistics have been declining as well.[38] Enforcement statistics are below where they were in the mid-1990s, before the RRA '98.[39]

Current audit rates are low and are generally declining. For example, the 2014 overall audit rate for individuals was only 0.86 percent.[40] That number is both low as an absolute matter (less than a 1 percent chance an erroneous return will even be examined[41]) and in comparison to the individual audit rate historically. Before IRS reform in 1998, the individual audit rate was above 1 percent, and it was closer to 2 percent in 1995 and 1996.[42] Similarly, the IRS audited only 1.3 percent of all C corporation

[21]Elijah E. Cummings and Sander M. Levin, "Reform the IRS, But Leave Politics Out of It," *The Washington Post*, Aug. 12, 2013.

[22]Josh Hicks, "Five and Counting: Yet Another IRS Hearing," *The Washington Post*, June 4, 2013.

[23]IRS, "Written Testimony of IRS Commissioner John A. Koskinen Before the House Oversight and Government Reform Committee on IRS Operations" (Mar. 26, 2014).

[24]TIGTA, "Reduced Budgets and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected," 2015-30-035 (May 8, 2015), at 1.

[25]TAS, "2015 Annual Report to Congress Vol. I" (2015), at 5 n.7.

[26]*See* IRS, "Written Testimony of IRS Commissioner John A. Koskinen Before the Senate Finance Committee on IRS Budget and Current Operations" (Feb. 3, 2015).

[27]*See* Lederman, "Tax Compliance and the Reformed IRS," 51 *Kan. L. Rev*. 971, 979 (2003).

[28]*Id.* at 2.

[29]*Id*.

[30]*See* Treasury, "IRS Oversight Board, FY 2015 IRS Budget Recommendation Special Report," *available at* https:// www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf.

[31]*See* TIGTA, *supra* note 24, at 2.

[32]IRS, "Prepared Remarks of John A. Koskinen, Commissioner, Internal Revenue Service, Before the National Press Club" (Mar. 31, 2015).

[33]David Cay Johnston, "The Cost of the Shrinking IRS Budget," *Tax Notes*, June 1, 2015, p. 1043 ("Adjusted to 2014 dollars, the IRS spent $1,926 on training per employee in 2010, but just $339 last year.").

[34]*See* Jeanne Sahadi, "IRS Says It's Using Technology From JFK's Time," *CNN Money*, Feb. 3, 2015 (much of the IRS's technology expenditures are still used for upgrades to systems built in the 1950s and 1960s).

[35]*See* IRS, "IRS Intensifies Work on Identity Theft and Refund Fraud; Criminal Investigation Enforcement Actions Underway Across the Nation," IR-2014-50 (Apr. 10, 2014).

[36]*See* TIGTA, *supra* note 24, at 8.

[37]*Id.* at 13, 16.

[38]*See* IRS, "IRS Data Book," Table 9a (2012) (individual spreadsheets for 1998-2014).

[39]*See id.*; Lederman, "IRS Reform: Politics As Usual?" 7 *Colum. Tax J*. __ (coming 2016) (reporting statistics that show this comparison).

[40]*See* IRS Data Book, *supra* note 38 (fiscal 2014 statistic).

[41]The low audit rate is not offset by sufficiently high penalties to make gambling on not getting caught economically irrational. *See* Lederman, "The Interplay Between Norms and Enforcement in Tax Compliance," 64 *Ohio St. L.J.* 1453, 1457-1460 (2003).

[42]*See* "SOI Tax Stats Archive — 1863 to 1999 Annual Reports and IRS Data Books" (Table 11 in each of the 1995 through 1997

(Footnote continued on next page.)

returns in 2014 but 2.67 percent in 1997.[43] Further, in 2015, the IRS announced that because of budget constraints, it was winding down the coordinated industry case program, under which large multinational companies were under continuous audit, and would institute more streamlined audits.[44]

Regarding taxpayer service, the Treasury Inspector General for Tax Administration reported that the budget cuts have reduced IRS service to taxpayers.[45] The IRS's telephone response rate had plummeted,[46] and in 2013, because of the IRS's shrinking resources, the IRS decided that its telephone assistors and employees at Taxpayer Assistance Centers (TACs) would only answer ''basic'' tax questions and would not answer any tax questions after April 15.[47]

The IRS has also reduced the number of TACs[48] and has reduced staff at those sites.[49] In 2013, the IRS stopped preparing tax returns at TAC sites.[50] Previously, TAC employees would prepare returns for people seeking assistance, who generally were low-income, disabled, or elderly.[51]

Together, these figures reflect a substantial decline in services the IRS offers taxpayers. Although a wide range of taxpayers may feel the effects on IRS services of the reduction in its workforce,[52] cuts in IRS services may have a greater effect on those who face barriers to preparing their returns and communicating with the IRS other than in person[53] or who lack the resources to obtain tax assistance elsewhere.[54]

Reduced enforcement of the tax laws also has perverse effects. First, fraudsters benefit more than those who are trying to comply. Second, income not subject to information reporting (as wages, interest, and dividends are) has a much higher rate of noncompliance, which benefits those who receive nontransparent forms of income.[55] Third, higher-income and wealthier taxpayers, including corporate taxpayers, have more ability to enter into potentially abusive tax shelters. Finally, those with more tax liability to evade — generally higher-income taxpayers — benefit more.

In 2005, the United States rose to among the highest levels of income inequality in developed countries.[56] Economists Anthony B. Atkinson, Thomas Piketty, and Emmanuel Saez have shown that the concentration of income and wealth at the very top of those distributions is increasing.[57] A progressive tax system, such as the U.S. federal tax system,[58] can help reduce income inequality.[59] However, if the tax laws are not adequately enforced, the net effect of a progressive tax system

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Data Books, showing overall individual audit rates for 1995, 1996, and 1997 as 1.67 percent, 1.67 percent, and 1.28 percent, respectively).

[43]*See id.* (Table 11 in the 1997 Data Book); and IRS Data Book, *supra* note 38 (fiscal 2014 spreadsheet).

[44]Eric Kroh, ''IRS Division Revamp Will Streamline Large-Business Audits,'' *Law360*, Oct. 2, 2015.

[45]*See* TIGTA, *supra* note 24, at 10.

[46]*See* Government Accountability Office, ''Deteriorating Taxpayer Service Underscores Need for a Comprehensive Strategy and Process Efficiencies,'' GAO-16-151 (Jan 14, 2016), at 11, Figure 3 (reporting 38.1 percent IRS telephone response rate for fiscal 2015). In addition, in fiscal 2015, the average wait time for calls that did get through increased to about 31 minutes, from about 10 minutes in 2010 and under 20 minutes in 2014. *Id.* at 11, Figure 3.

[47]*See* 2014 Annual Report, *supra* note 9, at 17 (citing IRS, ''Some IRS Assistance and Taxpayer Services Shift to Automated Resources'' (Dec. 20, 2013)).

[48]*Id.* at 20 n.68.

[49]*See* GAO, *supra* note 46, at 16.

[50]*See* 2014 Annual Report, *supra* note 9, at 21.

[51]*Id.* The number of returns the IRS prepared at these centers had declined over time, dropping from 308,000 during the 2004 filing season to 125,000 in the 2013 filing season, a decline of 59 percent. *Id.* Those figures do not include returns the IRS prepared after April 15, which amounted to 168,000 returns in 2004. *Id.*

[52]For example, ''Tax practitioners are starting to complain that they cannot serve their clients when the IRS lacks enough staff to resolve problems.'' *See* Johnston, *supra* note 33.

[53]*See* 2014 Annual Report, *supra* note 9, at 22.

[54]*See* Chuck Marr, Joel Friedman, and Brandon DeBot, ''IRS Funding Cuts Continue to Compromise Taxpayer Service and Weaken Enforcement,'' Center on Budget and Policy Priorities (Sept. 30, 2015) (''These cuts threaten low-income and other vulnerable taxpayers in particular.'').

[55]*See* IRS, ''Tax Gap for Tax Year 2006 Overview'' (Jan. 6, 2012) (finding an estimated 1 percent net misreporting percentage on wage and salary income, an 8 percent net misreporting percentage on income subject to substantial information reporting, and a 56 percent net misreporting percentage on income subject to little or no information reporting).

[56]*See* Atkinson, Piketty, and Saez, ''Top Incomes in the Long Run of History,'' 49 *J. Econ. Lit*. 3, 45, Table 6 (2011); and Leonard E. Burman, ''Taxes and Inequality,'' 66 *Tax L. Rev*. 563, 566, Figure 2 (2013) (illustrating top income shares of various countries using the Atkinson, Piketty, and Saez data).

[57]Atkinson, Piketty, and Saez, *supra* note 56, at 6-7.

[58]Overall the U.S. federal tax system is progressive, with the individual and corporate income taxes particularly so. Burman, *supra* note 56, at 569, 573.

[59]*See* Denvil Duncan and Klara Sabirianova Peter, ''Unequal Inequalities: Do Progressive Taxes Reduce Income Inequality?'' IZA Discussion Paper No. 6910, at 3-4, 12-13 (Oct. 2012). In OECD countries, taxation does about one-fourth of the work in reducing income inequality and transfers do the remainder. OECD, ''Income Inequality and Growth: The Role of Taxes and Transfers,'' OECD Econ. Dept. Policy Notes, No. 9 (Jan. 2012).

may be to *increase* income inequality.[60] This alone should be enough reason for some politicians to support a vigorous IRS.

Conclusion

The IRS is going through a difficult period, in large part because of budget cuts, but also because of inflammatory congressional hearings. The IRS receives plenty of oversight, but it lacks vocal defenders, particularly in Congress. No one should encourage mismanagement or wrongdoing, but voices calling for a balanced look or a bipartisan analysis of IRS issues would benefit tax administration. Congressional supporters of progressive taxation should therefore reframe partisan attacks on the IRS as potentially increasing this country's already high levels of income inequality.

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[60]Duncan and Peter, *supra* note 59, at 3-4, 34-35.

Problems at the IRS in Attempting To Provide Service to Taxpayers

By T. Keith Fogg and Leslie Book

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In this article, Fogg and Book discuss the implications of the IRS's reduction in telephone service and face-to-face contact with taxpayers.

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As we join efforts to comment on problems at the IRS, we look at two different parts. This article first addresses problems concerning the review of returns that seek benefits Congress has chosen to deliver through the tax code. We now have a few decades of experience with the use of the tax code to deliver benefits in the form of refundable credits, and it seems like we continue to cover the same ground as the IRS struggles to use its audit resources to deter the improper use of those credits while swiftly moving them into the hands of deserving individuals. The second part of this article addresses a problem created over 30 years ago, when the IRS sought to keep up with its growing inventory of collection cases. By gradually withdrawing its people presence among taxpayers and relying more and more on automated collection sites, the IRS may have retreated to the point of losing touch and opportunities.

In looking at the IRS's efforts in both administering benefit programs and collecting taxes, we suggest a more personal approach to tax administration. However, such an approach requires a Congress that is willing to appropriate funds to address the problem rather than merely summon the IRS leadership for hearings about what the agency does wrong.

Problems Using Tax System to Deliver Benefits

Although the individual income tax is still the workhorse of the tax system in terms of accounting for revenues,[1] over the past few decades Congress has fallen deeply in love with using the income tax system to deliver all sorts of benefits.[2] Some of those benefits have been short term (think first-time home buyer credit), while others seem here to stay — such as the earned income tax credit (added to the code in 1975) and the credits associated with the Affordable Care Act. Refundable credits are part of our brave new world in which Congress tasks the IRS with ensuring not only that the coffers are full but also that some Americans receive essential benefits through the tax system.

Observers of the IRS's administration of refundable credits and the EITC in particular have leveled one main criticism: The IRS has been unable to reduce stubbornly high error rates.[3] Congress has focused attention on this problem with many legislative initiatives, including unprecedented (for the tax system) penalties for improper claims, special due diligence rules for preparers submitting returns with specific refundable credits, and a reduction of the pre-assessment right to judicial review of rejected returns claiming refundable credits. In this article, we shift our attention to the IRS's poor service to claimants, an issue both related to and distinct from error rates.[4]

We change the focus here because the research suggests that most Americans who claim refundable credits are compliant. To be sure, Congress and

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[1]*See* Center on Budget and Policy Priorities, ''Policy Basics: Where Do Federal Tax Revenues Come From?'' (Mar. 11, 2015) (noting that almost 46 percent of federal revenue comes from the individual income tax).

[2]*See* Congressional Budget Office, ''Refundable Tax Credits,'' at 1 (Jan. 2013); *see also* Michelle Lyon Drumbl, ''Those Who Know, Those Who Don't, and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns,'' 11 *Pitt. Tax Rev.* 113 (2013).

[3]The EITC has received the most attention. There are two main measures of EITC noncompliance: improper payments and overclaims. Improper payments are an annual measure of the amount of the credit erroneously claimed net of what the IRS recovers through enforcement. Overclaims do not reflect IRS enforcement actions. For a useful summary of the compliance problem with the EITC, see Margot L. Crandall-Hollick, ''The Earned Income Tax Credit (EITC): Administrative and Compliance Challenges,'' Congressional Research Service (Jan. 22, 2015) (discussing how Treasury releases information on improper payments annually but the IRS has only periodically reported on gross overclaims, with the last overclaim studies being released in 1999 and 2014). The IRS estimates that in fiscal 2013, the improper payments ranged from 22 to 26 percent — that is, $13.3 billion to $15.6 billion annually. IRS Publication 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* (Aug. 2014).

[4]For an excellent discussion of the administrative and legislative challenges associated with reducing the EITC error rate, as well as the nature of the compliance problem, see Crandall-Hollick, *supra* note 3.

the IRS must consider ways to reduce the stubbornly high error rates, and we and others have discussed those efforts — including the possibility of additional oversight of the unlicensed return preparers who prepare a disproportionately high number of incorrect returns. But in designing approaches to reduce noncompliance, it is important to note that most tax return filers intend to file returns that accurately reflect their income, expenses, payments, and credits. Most Americans, either on their own or increasingly with the assistance of software or commercial preparers, navigate the filing season with few hiccups. For most, the return goes in through the cloud and a refund of excess withholdings or refundable credits comes out, increasingly through a direct deposit to a bank account.

Millions of Americans are not as lucky, however. Sometimes they do not understand the law, despite their best efforts. Sometimes they are missing key facts concerning their tax situation, perhaps as a result of a life disruption or a move. Sometimes they have received a letter from the IRS that they do not understand, including letters suggesting that a prior year's return was incorrect or missing some needed information. Some do not have a bank account and must rely on old-fashioned paper checks, which may involve high fees to convert a refund to cash.[5]

For all taxpayers, the IRS is in the customer service business. When it comes to service, key external variables undoubtedly influence how the IRS will perform in any filing season. Those include money and the timing of when Congress's law changes. Of course, resources are critical. The last few years have seen Congress cut IRS funding considerably, reducing it by 10 percent compared with fiscal 2010, even with a slight uptick in fiscal 2016 compared to fiscal 2015. Congress has also often made eleventh-hour legislative decisions that have affected the upcoming filing season.[6]

But focusing on budget issues and late-enacted legislation can dilute the importance of the IRS's establishing service goals based on the characteristics of the taxpayers for whom Congress expects it to manage various programs. Although Congress may not give the IRS as much money as it would like and may enact legislation that sends it scrambling to make forms and related information available, it is safe to say that the IRS has sufficient lead time to learn about the taxpayer characteristics likely associated with particular issues.[7] It is incumbent on the IRS to understand the taxpayer population as is, to know the characteristics of that population, and to build a tax system that meets the needs of those taxpayers — not a system equipped to serve taxpayers who have the resources to pay third parties, unfettered access to the Internet, and the necessary literacy levels to self-navigate a complex tax system.

A recent Government Accountability Office report on the 2015 filing season reflects deep dissatisfaction with the IRS's levels of service.[8] The report has lots of data, and we will not in this article refer extensively to the detailed findings (for those who want to be depressed about the state of our tax system, we encourage a reading). The report provides a useful listing of the ways the IRS interacts with taxpayers during the filing season in the following main areas:

- answering telephone calls;
- correspondence with taxpayers;
- delivering online services;
- face-to-face interactions; and
- return processing.

The IRS has significant room for improvement in all those areas. This article focuses on two of them: telephone calls and face-to-face interactions. The IRS reduced by over one-third the number of people answering telephone calls (assisters) between fiscal 2010 and fiscal 2015. Although the number of calls the IRS received decreased by about 6 percent over that five-year period (from roughly 54.3 million to 51.1 million), the reduction in assisters "contributed to the lowest level of telephone service in fiscal year 2015 compared to recent years," according to the GAO. It reported that "the IRS answered about 50 percent fewer calls from taxpayers seeking an assistor during the same period, while about 73 percent more calls were abandoned, disconnected by IRS, or met with a busy signal (from about 32.4 million to 56.2 million)." Wait times increased substantially (almost tripling from 11 minutes in fiscal 2010 to 30 minutes in fiscal 2015), and only 38 percent of people who wanted to reach an assister were able to do so.

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[5]*See* Nina E. Olson, "National Taxpayer Advocate 2015 Annual Report to Congress," vol. 1, at ix (Dec. 31, 2015); and Chi Chi Wu and Michael Best, "Taxpayer Beware: Unregulated Tax Preparers and Tax-Time Financial Products Put Taxpayers at Risk," National Consumer Law Center (Mar. 2015) (referencing how more than 21 million taxpayers in 2014 paid $848 million in refund anticipation check and other assorted ancillary return preparation fees, in addition to sizable direct preparation fees).

[6]Government Accountability Office, "2015 Tax Filing Season: Deteriorating Taxpayer Service Underscores Need for a Comprehensive Strategy and Process Efficiencies," GAO-16-151 (2015), at 5-6.

[7]*See* Olson, *supra* note 5, at 235 (discussing characteristics of the population receiving the EITC with summary information).

[8]GAO, *supra* note 6.

The GAO also painted a not-so-pretty picture when it came to face-to-face visits:

> As a result of budget cuts, IRS officials said IRS reduced staff devoted to face-to-face assistance at walk-in sites and directed customers to self-service options. IRS reduced staff at walk-in sites by about 4 percent in fiscal year 2015 compared to the previous year (from 1,938 to 1,867 [full-time equivalent employees]). However, the percentage of customers at walk-in sites waiting for longer than 30 minutes for service increased by 7 percentage points in fiscal year 2015 (from about 25 to 32 percent) during the same period.

To partially reflect the challenges the IRS believes it has in staffing walk-in sites, the agency has attempted to move much of its service to an online environment "by providing fewer forms, instructions, and publications at walk-in sites and encouraging taxpayers to get them online instead," the GAO observed. The reliance on volunteer walk-in sites through programs such as volunteer income tax assistance increased, with volunteer sites preparing about 3.8 million tax returns in fiscal 2015, up 3 percent from fiscal 2014.

Reducing telephone service and face-to-face contacts with taxpayers seems to be part of the IRS's long-term strategy. The 2015 national taxpayer advocate report to Congress discusses the broad outline of the IRS's "future state" plan to improve customer service. That plan, the taxpayer advocate notes, has the laudable goal of "creating online taxpayer accounts through which taxpayers will be able to obtain information and interact with the IRS."[9] A world in which taxpayers can seamlessly interact with the IRS to avoid problems before they file tax returns is a terrific idea in theory. Congress has been facilitating that idea by pushing up the deadlines for third parties to file information returns with the IRS, and there is little doubt that the agency can improve the return filing experience by enhancing access to taxpayer-related information it possesses.

However, the taxpayer advocate has raised two broad concerns with the IRS's future state plan: (1) it reflects a desire by the IRS to reduce resources for fielding phone calls and in-person service; and (2) it is likely that the IRS will rely on third parties such as preparers and return preparation software companies to deliver that information, resulting in increased compliance costs for taxpayers.[10]

Although this article focuses on issues raised by the IRS's decrease in phone and in-person service, we have deep concerns about additional costs that may be passed on to taxpayers. The national taxpayer advocate, through extensive third-party research, has indicated that the taxpayers who increasingly rely on the IRS to deliver needed benefits — especially lower-income taxpayers — are the very ones most likely to need to access the IRS in person or by telephone.[11]

If the IRS is trying to build a tax system that can deliver information and services to taxpayers, it must consider the characteristics of the taxpayers themselves rather than the characteristics it would like all taxpayers to share. The reality is that there is no single tax system today; rather, there are differing systems that correspond to the programs found within the tax code. Various programs such as the EITC have their own unique challenges that depend not only on the characteristics of the claimants but also on access to information that helps the IRS and the claimants determine eligibility for the programs.

An upcoming article by Leslie Book draws on the research of scholars who have examined the way other agencies interact with individuals who rely on them to deliver benefits, as well as the main reasons why they often provide inadequate service when delivering benefits.[12] One of the key insights in that article is that agencies perform many multiple tasks when delivering benefits.[13] Consider the following ways agencies generally interact with individuals receiving benefits and how those tasks might trigger demands on the IRS:

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[9]Olson, *supra* note 5, at 3. Last month, the national taxpayer advocate sponsored a public forum on the IRS's future state plans, and she will be conducting forums on the issue in many cities this year. For a link to the testimony of me and the other witnesses who provided important perspectives at the inaugural hearing, see http://www.taxpayeradvocate.irs.gov/news/nta-forum-wdc. *See also* Book, "National Taxpayer Advocate Forum on Future State Highlights Challenges IRS Faces in Building A Modern Tax System," Procedurally Taxing (Mar. 4, 2016), *available at* http://www.procedurallytaxing.com/national-taxpayer-advocate-forum-on-future-state-highlights-challenges-irs-faces-in-building-a-modern-tax-system/.

[10]*See id.* at 3-14.

[11]*See id.* at 5-8; and Olson, "Procedural Justice for All: A Taxpayer Rights Analysis of IRS Earned Income Credit Compliance Strategy," in John Hasseldine (ed.), 22 *Advances in Taxation* 10 (2015).

[12]Book, "Bureaucratic Oppression and the Tax System," (69 *Tax Law.* ___ (coming 2016).

[13]The insight and the list of tasks itself derive from David A. Super's article considering the relative roles of the private and public sectors in the delivery of benefits to the poor. Super, "Privatization, Policy Paralysis, and the Poor," 96 *Cal. L. Rev.* 393 (2008). An upcoming National Tax Association-American Tax Policy Institute conference this spring will directly consider the increasing role of the private sector in tax administration, including in the context of refundable credits.

> 1. prospective claimants require some assistance in applying for the program;
>
> 2. someone must set eligibility criteria and procedures;
>
> 3. someone must determine whether each claimant meets those eligibility criteria and procedural requirements;
>
> 4. someone must keep records of those eligibility decisions;
>
> 5. someone must issue benefits to claimants found eligible;
>
> 6. someone must resolve disputes with claimants concerning eligibility and issuance; and
>
> 7. someone must review performance at each of these steps to protect the program's integrity.

As discussed in that article, the "someone" in most of those tasks is the IRS. In those areas, agencies make numerous policy and value choices. Agencies that tackle those tasks without a careful consideration of the qualities and characteristics of the very individuals they are charged with serving will likely fall short in meeting the needs of the public. The implication for the IRS goes beyond that of a specific failure to deliver quality service for a given taxpayer in a given year. The taxpayer advocate connects the IRS's shortcomings with the broader issue of procedural justice:

> "Procedural justice" (or fairness) is a concept that considers how a taxpayer is treated by the IRS. It looks to more than just the outcome of the interaction; it also considers if the interaction was "nonjudgmental, polite, and respectful of the individual's rights." Procedural justice is an important concept to consider when discussing EITC cases because a taxpayer's perception of procedural fairness will affect his or her perception of the agency's fairness and legitimacy, as well as his or her willingness to comply with the tax laws.[14]

With that in mind, as the IRS moves forward in modernizing its approach to delivering services to taxpayers, it should appreciate that not all taxpayers are alike and that those who come to rely increasingly on the tax system to meet essential needs will likely require more assistance. Efficiency is no doubt important, but a system that is efficient at not providing basic levels of service to those who need the most help is not a system that should be part of a 21st-century tax administration.

Problems at the IRS in Trying to Collect Taxes

Most taxpayers pay on time or even overwithhold through their payroll system. When taxpayers do not pay on time, the IRS must take affirmative steps to collect the unpaid tax. Like most other parts of the IRS, the collection division suffers from underfunding and inadequate training. The underfunding has created large gaps in the hiring of new collection personnel over the past several years. The lack of consistent hiring and training leads to gaps in leadership and will put enormous pressure on training when the IRS finally gets to replenish its ranks. Even more important, however, is the potential loss of citizens' faith in the system — not only the faith of citizens from whom the IRS must collect but also that of citizens from whom it does not need to take enforced collection measures because of their ongoing compliance.

Today's collection division places much less judgment in the hands of the persons who collect taxes and in most cases has removed those people from the communities in which the taxpayers live. Until 1980, revenue officers played the primary role in collecting taxes. They existed in field offices throughout the United States. Together with revenue representatives who staffed the walk-in field offices, revenue officers formed the backbone of the IRS's collection efforts. Because of their integration in the local community, they served as a visible IRS presence and acted like cops on the beat. With the changes in the role of government brought about by President Reagan, the IRS basically stopped hiring revenue officers and revenue representatives in sufficient numbers to replace those leaving and to keep up with increasing workloads. There came a point at which revenue officers carried so many cases in their inventory that they had only enough time to monitor statutes of limitation and put out fires. They did not have enough time to work most of the cases in their inventory.

Because the government did not want to hire more tax collectors and because the system of assigning revenue officers a pro rata share of the delinquent inventory created an unworkable situation, the IRS explored solutions and found one in the creation of the Automated Collection System (ACS).[15] ACS was consistent with other solutions

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[14]Olson, "Procedural Justice for All," *supra* note 11, at 10.

[15]GAO, "Computer Technology at IRS: Present and Planned," GAO-83-103 (1983), at 127. Of all cases sent for collection, 70 percent are routed to ACS. *See* GAO, "IRS Case Selection: Automated Collection System Lacks Key Internal Controls Needed to Ensure the Program Fulfills Its Mission," GAO-15-744 Sept. 2015), at 12-13. *See also* Internal Revenue Manual section 5.19.5.2, "What is ACS?" (Aug. 20, 2013). The 2015 GAO report offers an overview of the ACS function. *See* GAO-15-744, *supra*, at 38.

the IRS found in automation.[16] It took pressure off the revenue officers, allowing them to focus on the cases with the greatest problems and carry a manageable inventory of cases. At about the same time, the IRS created the Queue — a place where it could shelve cases in which the current collection potential did not warrant attention.[17] With the safety valves of ACS and the Queue, IRS executives no longer had to lose sleep wondering how to cover all the cases in the agency's burgeoning inventory. They also lost the ability, or at least the incentive, to press to maintain the cadre of revenue officers and revenue representatives at the level that existed when ACS and the Queue were created, even though those programs came into existence not because the work of the revenue officers lost importance but because the pace of hiring them failed to keep up with the inventory of cases.

In the early 1990s, Congress *sua sponte* increased the collection statute of limitations from six to 10 years. Sounds like a great idea — until you examine the amount of money collected in the out years. If the IRS cannot collect the money in the first two years, its chances of ever collecting it plummets to about 15 percent.[18] So, although Congress may have thought that it created a solution to the IRS's failure to hire people to collect on delinquent accounts, the extended statute of limitations actually put even more pressure on the collection division because its uncollected inventory was now shown as almost twice what it was before 1990, thus causing even more scrutiny of the IRS's failure to collect the tax.

In response to this, the IRS created the offer in compromise program.[19] While the agency's legal authority to compromise can be traced to the 1860s, as a practical matter, it compromised on tax debts only in extremely rare circumstances.[20] The addition of the OIC program, too, placed additional pressure on the IRS collection division. These cases were initially assigned to revenue officers to resolve, and the officers had little or no guidance on what to accept. Over time the IRS has moved this program out of the hands of revenue officers and into the hands of offer specialists. Those specialists have significantly more guidance on what to consider than did the revenue officers in the early 1990s, but the resources devoted to the OIC program further diluted the resources available to hire revenue officers.

Meanwhile, Congress began paying a lot of attention to all the problems the IRS had collecting taxes and to all the complaints taxpayers were lodging about the IRS. It does not seem coincidental that the complaints that led to legislative efforts escalated to the point of spurring Congress to action within a reasonably short time after the IRS introduced ACS and moved away from local collection officials. In 1988, 1996, and 1998, Congress enacted taxpayer bill of rights legislation primarily targeting the collection division.[21] Some of that legislation provided long-needed relief for problems created by the tax system, but almost all the provisions established new rules by which IRS collectors had to play. This, in turn, further reduced their efficiency. As all these changes occurred, no one seemed to ask whether the collection division could have avoided much of the scrutiny and problems if it had received adequate staffing and training or had left in place the same number of revenue officers and revenue representatives.

Rather than constantly failing to fund the collection division and then criticizing it for failing to provide world-class service, we should take a step back and look at what collection system would work best for the United States, including for the people who always pay and those who do not. Rather than sliding into a world where more and more cases move to ACS and the Queue without thinking about the consequences, we need to consider systems and laws that would allow the IRS to operate efficiently in collecting taxes. We want all taxpayers to pay their taxes and to do so as painlessly as possible. By removing IRS personnel from localities around the country — individuals who understand the community and want to make it work — we have created a collection system in which the person in Boston who needs to pay his

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[16]*See* Bryan Camp, "Theory and Practices in Tax Administration," 29 *Va. Tax Rev.* 227 (2009).

[17]IRM section 5.3.1, "ENTITY Case Management System (ENTITY)" (Aug. 13, 2013).

[18]*See* Olson, "National Taxpayer Advocate 2015 Annual Report to Congress," vol. 2, at 33-66 (Dec. 31, 2015).

[19]*See generally* Joseph Dugan, "Compromising Compliance? The IRS Offer in Compromise Program and Opportunities for Reform" (Jan. 31, 2016), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2725480.

[20]Recent legislative history of section 7122: Internal Revenue Code of 1954, ch. 736; Tax Reform Act of 1976, P.L. 94-455, Title XIX, section 1906(b)(13)(A); Taxpayer Bill of Rights 2, P.L. 104-168, Title V, section 503(a) (1996); Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, Title III, section 3462(a) and (c)(1); Tax Increase Prevention and Reconciliation Act of 2005, P.L. 109-222, Title V, section 509(a) and (b); Tax Relief and Health Care Act of 2006, P.L. 109-432, div. A, Title IV, section 407(d); and Tax Increase Prevention Act of 2014, P.L. 113-295, div. A, Title II, section 220(y).

[21]The first TBOR was part of the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647. The second TBOR was a stand-alone measure. TBOR 2, P.L. 104-168. The final piece of legislation in this trilogy, and the most important, was the Internal Revenue Service Restructuring and Reform Act of 1998, H.R. 2676, 105th Cong., 2d Sess., section 1002, P.L. 105-206.

taxes talks to an ACS site worker in Fresno, California, with no understanding of the taxpayer's community and little time for empathy and understanding. Let's work to restore revenue officers and collection walk-in sites to our communities so that taxpayers with a problem can find answers in a knowledgeable and accessible local resource. We still need ACS and the Queue for some cases, but we also need humans who reside among us and can relate to the issues facing their neighbors.

Conclusion

In reading about the challenges the IRS faces, a common theme emerges: The IRS needs to know who it is serving. That applies whether the IRS is helping ensure taxpayers meet their filing responsibilities, trying to request information in an audit, or collecting an assessed liability. The efficiency gains the IRS is making (or has been forced to make in light of budget cuts) come with serious costs, especially for taxpayers who are unequipped to manage on their own or who lack the resources to delegate those responsibilities. Over time, continued levels of poor service not only place the interests of taxpayers at risk but also have the potential to undermine respect for and confidence in the tax system.

It is not easy to administer a tax system in any country. Add into the mix a country as diverse as ours with a tax system that serves multiple functions, and you have a system that needs constant care and attention just to perform at an adequate level.

The last few years have been very difficult for the IRS, whether performance is measured in statistics or qualitatively. It is time for both the IRS and Congress to explicitly recognize the agency's role in administering and delivering benefits. Congress and the IRS have come a long way through last year's legislative adoption of a formal TBOR.[22] The adoption of rights without a concomitant appreciation and recognition of the administrative challenges that the IRS faces in implementing those rights can render them more illusory than real. As the IRS hopefully moves away from the crisis mode of the past few years, it will have to smartly dedicate resources to address its many challenges. In all instances, that effort requires a careful consideration of the sources of its problems as well as how proposed solutions mesh with the very taxpayers it is required to serve.

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[22]Consolidated Appropriations Act, 2016, P.L. 114-113, section 401 (2015).

Identity Theft Challenges And the IRS

By Kevin Brown and Beth Tucker

Kevin Brown is the co-leader and Beth Tucker is a managing director of PwC's tax controversy and regulatory services team. Brown and Tucker previously served as the IRS acting commissioner (2007) and IRS deputy commissioner (2010-2013), respectively.

In this article, Brown and Tucker discuss the IRS's most recent efforts to combat tax-related identity theft.

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A. Introduction

Tax-related identity theft is a complicated and widespread problem for millions of individual and business taxpayers and for the IRS. It usually involves the unauthorized use of a taxpayer's personal or business information to fraudulently claim a tax refund. Most taxpayers are unaware that they are victims until they receive notice from the IRS or another federal or state agency.

Individual taxpayers are the most common target of tax-related identity theft, but business taxpayers are also at significant risk because identity thieves will steal employee information and other sensitive business information, such as employer identification numbers, either to file fraudulent business returns or to generate fraudulent individual income tax refunds by reporting false income and withholding on fictitious Forms W-2.

Fighting identity theft is increasingly challenging for the IRS, as thieves continue to develop more sophisticated ways of stealing personal and business information through a variety of data breaches and database intrusions targeting both the public and private sectors. Recent high-profile data security breaches involving the theft of hundreds of millions of customer payment cards, the breach of federal employee employment records, and other successful cyberattacks further illustrate the high-stakes business risks associated with cybercrime.

Identity theft cases are among the most complex for the IRS to handle, but even during times of budget constraints, the agency has looked for creative ways to improve its efforts on detection and prevention, provide assistance to victims, and successfully pursue criminal investigations.

B. IRS Detection and Prevention Efforts

1. Security Summit Initiative. The most collaborative effort to address tax-related identity theft is the Security Summit Initiative, a partnership between the IRS, state tax administrators, and the tax industry, including tax return preparation firms, tax software vendors, and payroll and tax financial product processors. This public-private partnership was launched in March 2015 to establish new safeguards to protect taxpayer information and the integrity of federal and state tax systems.[1]

Key initiatives for the 2016 filing season include:

- *Taxpayer authentication.* The tax industry is sharing with the IRS and state tax administrators more than 20 new data elements captured at the time tax returns are filed to help authenticate taxpayers, validate tax return information, and detect identity theft refund fraud.
- *Fraud identification.* The entire tax industry (previously a portion of the industry) is sharing with the IRS and state tax administrators aggregated information of suspected identity fraud and analytics to identify fraud schemes and locate indicators of fraud patterns.
- *Information assessment.* The IRS, state tax administrators, and the tax industry are looking to establish a formalized Refund Fraud Information Sharing and Assessment Center to more aggressively and efficiently share information between the public and private sectors to help stop the proliferation of fraud schemes and reduce the risk to taxpayers.
- *Cybersecurity framework.* The tax industry (now including all software companies) is aligning with the IRS and state tax administrators under the high standards of the National Institute of Standards and Technology cybersecurity framework to promote the protection of the tax-related information technology infrastructure.
- *Taxpayer awareness and communication.* The IRS, state tax administrators, and the tax industry created the ''Taxes. Security. Together.'' campaign to raise awareness among taxpayers regarding the protection of sensitive personal, tax, and financial data.

2. Security requirements for tax software accounts. Private sector tax software vendors have implemented new security requirements to protect taxpayers using tax software accounts to prepare their tax returns. The new protections — intended to ensure that only authenticated taxpayers can access their accounts — include eight-digit alphanumeric

[1] IR-2015-87.

passwords, security questions, lockout features, and methods to verify email addresses associated with the accounts.

3. Form W-2 anti-fraud initiatives. Each filing season, the IRS receives millions of returns from individuals requesting refunds based on wages and tax withholding reported on Forms W-2. The agency, however, does not receive the Form W-2 information from the Social Security Administration (SSA) until well after the peak filing season; as a result, it does not have real-time Form W-2 information during the period most returns are processed. Identity thieves routinely exploit this information gap by filing fraudulent refund claims early in the filing season using false income documents from authentic employers.

The IRS recently announced that 15 payroll service providers have sent the IRS copies of Forms W-2 for approximately 750,000 employers (more than 10 percent of U.S. employers) under an antifraud initiative that includes approximately 21 million Forms W-2. This initiative is designed to enhance the agency's ability to quickly detect fraudulent individual tax returns filed with stolen Forms W-2 and to protect legitimate Form W-2 recipients from becoming victims. This new partnership with payroll service providers further supplements an existing, more limited IRS fraud prevention program in which the IRS asked several large employers to voluntarily provide employee payroll records early in the filing season to enhance Form W-2 validation.

The Protecting Americans From Tax Hikes Act, enacted at the end of 2015, accelerates the due date for filing Forms W-2 with the SSA to January 31, effective for Forms W-2 filed in 2017 regarding wages paid in 2016. The new January 31 due date for Forms W-2 will make information available to the IRS sooner, thereby reducing the risk that fraudulent tax returns and refund claims will be processed.

4. Identity theft data models and filters. The IRS continues to increase the number and effectiveness of the identity theft data models and filters it uses to identify potentially fraudulent returns. The agency reports that these pre-refund filters prevent the processing of the vast majority of fraudulent returns. The IRS rejected or suspended the processing of 4.8 million suspicious returns and stopped 1.4 million identity theft returns, totaling $8 billion in fraudulent refunds, for calendar year 2015.[2]

5. Return Review Program (RRP). The RRP, the new IRS system to detect electronic identity theft returns, was pilot tested in 2014 and 2015. The IRS intends for the RRP to eventually replace the legacy systems it currently uses to detect identity theft.

The 2014 RRP pilot had positive results, detecting 25 percent more fraudulent returns than the existing systems, and so the IRS increased the number of returns RRP processed in 2015. However, a Treasury Inspector General for Tax Administration analysis of the 2015 results found that the RRP failed to detect a significant number of fraudulent returns that the current legacy systems discovered.[3] According to the IRS, the detection gaps were a result of the RRP's selection models not having been fully implemented and the program being designed to detect newer identity theft schemes rather than older ones more easily detected by the systems already in place. The IRS is working to ensure that the RRP will detect identity theft as effectively as existing systems before it is fully implemented.

6. Limited number of direct deposit refunds. Several years ago, the IRS discovered identity theft patterns by noticing that thousands of tax refunds would sometimes be routed or deposited into a single bank account. The IRS response to this fraud was to set a limit of no more than three direct deposit refunds that could be deposited to a single financial account or prepaid debit card. Fourth and subsequent valid refunds must be mailed in the form of paper checks to the taxpayer.

C. Victim Assistance Efforts

1. New identity theft assistance organization and funding. The IRS recently consolidated most of its identity theft victim assistance efforts into a newly created identity theft victim assistance organization, which it operates in conjunction with its prevention and remediation efforts. The IRS hopes the organization will enhance its ability to provide consistent treatment of identity theft cases and to reduce the significant backlog in resolving them. Nonetheless, reports of taxpayer frustration with the time it takes to resolve identity theft cases continue. The current IRS budget includes additional funding earmarked to enhance identity theft detection and assistance.

2. Identity protection personal identification number (IP PIN) program. The identity theft victim assistance organization is also managing the IP PIN program, the IRS's main tool for protecting taxpayers against ongoing identity theft. The agency annually assigns an IP PIN to victims of identity theft who confirm their information with the agency and whose cases have been resolved. Primary and secondary taxpayers and their dependents enter the

[2]FS-2016-1.

[3]TIGTA, "Continued Refinement of the Return Review Program Identity Theft Detection Models Is Needed to Increase Detection" (Dec. 11, 2015).

unique, six-digit identifier on their federal income tax returns to avoid delays in the filing of their returns and the receipt of their refunds.

The IRS has issued 1.5 million IP PINs and is offering the opportunity to opt into the IP PIN program to approximately 1.7 million taxpayers whom the agency has identified as having been potentially affected by identity theft. The IRS will continue allowing taxpayers who filed returns from Florida, Georgia, and the District of Columbia to opt into the program as those jurisdictions have among the highest incidence of identity theft in the country. The debate continues regarding the potential benefits and costs of expanding IP PINs to all taxpayers.

The IRS recently enhanced the IP PIN program by implementing an online process through its website that allows taxpayers who have lost or forgotten their IP PIN to create an account and retrieve it online.

3. Specific identity protection services not subject to income inclusion. Employers and other organizations frequently provide free identity protection services to individuals whose personal information may have been compromised in connection with a data breach involving the employer or another organization's record-keeping systems. The IRS reaffirmed in Announcement 2016-2[4] its position in Announcement 2015-22[5] that it will not include the value of identity protection services in an individual's gross income. Announcement 2016-2 expands this noninclusion treatment to cover the value of identity protection services provided to individuals in anticipation of a potential data breach.

D. Criminal Investigatory Efforts

Identity theft topped the fiscal 2015 list of investigative priorities for the IRS Criminal Investigation division, the IRS arm authorized to investigate potential criminal violations of the IRC. CI reported that it initiated 776 identity-theft-related investigations, resulting in 774 sentencings, for fiscal 2015.[6] CI continues to be active in more than 70 multiregional task forces or working groups including state, local, and federal law enforcement agencies.

The Identity Theft Clearinghouse (ITC) continues to develop and refer identity theft refund fraud schemes to CI field offices for investigation. ITC has received more than 10,750 individual identity theft leads involving 1.72 million returns with more than $11.4 billion in refund claims since its inception in fiscal 2012.[7]

The nationwide Law Enforcement Assistance Program (LEAP) provides for the consensual disclosure of federal tax return information associated with the accounts of known and suspected identity theft victims. More than 1,100 state and local law enforcement agencies from 48 states participate in LEAP.[8]

E. Continuing Challenges

The IRS has made substantial progress in its efforts to combat identity theft, but significant challenges remain as identity thieves employ new strategies to obtain sensitive information. The agency stated in February 2016 that identity thieves successfully used automated software to attack its systems in an attempt to generate e-file PINs to use with Social Security numbers stolen from other sources to electronically file fraudulent returns and refund claims. The IRS reported that 101,000 of the 464,000 unauthorized attempts were successful.[9] The agency also stated in recent congressional testimony that aging computer systems, many placed in service in the early 1960s, are vulnerable to escalating cyberattacks and that additional funding is needed to shore up their ability to fend off these attacks.

The IRS has implemented many new strategies to fight identity theft, but this most recent attack is another example of the ever-evolving and increasingly sophisticated means identity thieves are using to attack IRS systems. The latest incident should be a warning for all individual and business taxpayers, including the largest corporations, about the importance of protecting sensitive information, as individual SSNs and business EINs are critical components that identity thieves use to unlock IRS systems and commit refund fraud.

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[4]2016-3 IRB 283.

[5]2015-35 IRB 288.

[6]CI, "IRS-CI Fiscal Year 2015 Annual Business Report" (Dec. 2015).

[7]FS-2016-1.

[8]*Id.*

[9]IRS statement (Feb. 2016).

Envisioning LB&I's 'Future State'

By Michael P. Dolan

Michael P. Dolan

Michael P. Dolan is KPMG LLP's national director of IRS policies and disputes resolution.

In this article, Dolan argues that even though the new design for the IRS Large Business and International Division may give the agency more control over its resources, it may have left taxpayers with fewer options for remediating errors, securing certainty, and obtaining penalty relief.

The information contained herein is of a general nature and based on authorities that are subject to change. Its applicability to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author only, and does not necessarily represent the views or professional advice of KPMG LLP.

Much has been written about the way budget reductions have affected IRS performance. Whether evidenced by the taxpayer or practitioner who gets ''courtesy disconnected'' trying to call the IRS or by the taxpayers frustrated because their audits are repeatedly reassigned to new agents, it is undeniable that our tax administration systems are under stress. While not all that stress flows directly from the shrunken budgets, much of it does. To look behind the cuts is to understand that they are the product of various forces. On one level, the IRS earned some of the cuts the old fashioned way — the agency messed something(s) up and the appropriators have used the budget to demand change. On another level, some of the budget woes reflect nothing more than the time-honored reality that criticism of the IRS rarely loses votes.

Expecting budget pressures to persist, each IRS operating division was charged by the commissioner with reexamining its organization with the goal of reconciling its concepts of operation with the budget reality and of imagining what the IRS will look like in five years and beyond, its ''future state.'' The Large Business and International Division was the first out of the gate: It announced its new design at the close of 2015, and the organizational structure through which it intends to operate became effective in early February 2016.

At a high level, LB&I intends to transition from its historical focus on comprehensive audits of the largest businesses to a new approach focused primarily on centrally identified tax compliance risk issues. The comprehensive, enterprise-wide audits will not go away entirely, but they will ultimately comprise a smaller percentage of LB&I's work. Under the new approach, once a risk issue is identified (centrally), campaigns and treatments will be designed to address the risks. We don't yet have any real examples of these new campaigns (and some may involve the development of regulations or other guidance rather than enforcement strategies), so it will take time to evaluate their impact. Taxpayers will be especially interested in understanding the practical implications of being selected for a campaign audit or other treatment.

To implement its new focus, LB&I has restructured itself into nine practice areas. The practice areas come in two types. Four are organized based on geography, and the other five are oriented to specific subject matters. As this new structure goes live, one of the overarching questions concerns how the geographic and subject matter organizations will intersect at the level of an individual taxpayer. According to LB&I's master plan, the subject matter organizations are to be deeply involved in identifying and addressing the ''risk'' issues. At the same time, the geography-based practice areas are to be responsible for the ''examination process'' and reportedly will include personnel who are most skilled in the examination processes and procedures. For the individual taxpayer, the natural questions are going to be: Who is really in charge of my audit? Will I have access to the technical specialists who are advising the local agents? Is it likely that a taxpayer will effectively be embroiled in multiple, even overlapping issue-focused audits for the same tax year? If so, won't it be more difficult to get a year closed?

The new design is built on a sound concept. Taxpayers and the IRS should spend their time on significant technical issues rather than haggling over temporary or otherwise immaterial issues. However, as straightforward as the shift from enterprise to issue focus might seem, it comes with significant cultural implications for LB&I. For decades, LB&I has focused on the largest enterprises. The highest pay grades and organizational prestige have attached to those that led and worked on the large case teams. It appears that the future state will value technical expertise most highly. Presumably the intent is for the higher grades and prestige to accrue to those who are technical experts and thought leaders and who are willing to coach, mentor, and lead other personnel. LB&I does not anticipate any significant near-term hiring. Therefore, the success of the new approach will depend on its ability to transform its workforce into one that is more technically oriented and issue-focused.

Without the infusion of new talent and training dollars, this metamorphosis will require great skill and resolve. And perhaps more than a little time.

A reported driver of the new design is LB&I's desire to exercise more control over how it spends its resources. Rather than automatically committing staffing to recurring cycles of the same large case audits, the new approach is geared to make LB&I more agile and strategic in addressing emerging compliance risks no matter where they exist. If the design works as planned, agents and specialists will be assigned to campaigns and treatments that concentrate on an inventory of specific centrally identified risk issues. While agents will not be precluded from identifying additional issues during an issue-focused audit, the implication is that the additional issue will have to be material in order to expand the audit.

LB&I leadership predicts it will take up to four years for the new concepts of operations to fully evolve. Collateral issues will surely arise throughout implementation. One issue is the potential that the new design could make it more difficult for taxpayers to self-initiate voluntary mitigation of compliance risks.

Before the IRS's last major reorganization following the Internal Revenue Service Restructuring and Reform Act of 1998 (when the agency was structured along geographic lines with districts), it was relatively common for taxpayers and their advisers to approach the IRS in order to voluntarily correct an error or omission. If district personnel considered it in the best interests of tax administration, they would accept the taxpayer's ''disclosure,'' collect any additional tax due, and work with the taxpayer to resolve potential penalty or amended return issues. In large part, this culture of local problem solving was a byproduct of strong institutional relationships built between district personnel and the local taxpayer and tax practitioner communities.

As the IRS shifted its structure from district-based operations to centralized national operating divisions, it became more difficult for frontline taxpayers to access informal voluntary resolution routes. In today's environment, it is very difficult for taxpayers to find IRS personnel who have the authority and willingness to field a voluntary compliance request unless that taxpayer already happens to be under audit.

Given the IRS's desire to control its resources by concentrating its staffing on the highest-risk issues, it may become even more difficult for a taxpayer to self-initiate corrections. While taxpayers can always amend a prior return, that will not be the optimum answer for many. Setting aside the state implications of amending a federal return, the amended return process provides no opportunity for taxpayers and the IRS to deal proactively with mitigating penalties or other procedural burdens. When an amended return is filed, it is usually only after several months and a string of notices that a taxpayer gets access to a live IRS representative.

To be sure, the IRS has created some notable national voluntary disclosure programs like the offshore voluntary disclosure program and the voluntary classification settlement program. These programs, while effective, generally involve substantially more process and bureaucracy than was typically the case with district-level resolutions.

Another example of a national initiative that provides taxpayers and the IRS a somewhat lower-profiled and streamlined way to deal proactively with significant issues is the prefiling agreement (PFA) program.[1] Under the PFA program taxpayers can request that the IRS examine an issue before it actually goes on the relevant tax return. Generally a PFA benefits both parties insofar as it facilitates contemporaneous access to the key people and records associated with a significant transaction. The outcome of a successful PFA is before-the-fact agreement on the appropriateness of a specific return position. A PFA eliminates the need for any later audit of the issue and obviates the taxpayer's setting up a financial reserve for any otherwise uncertain tax position. Taxpayers who have successfully concluded PFAs likely wonder what will happen to the process in the IRS's future state.

On the other end of the ''helpfulness'' spectrum is LB&I's almost automatic, nationalized approach to international information reporting penalties for forms like Form 5471[2] or Form 5472.[3] The environment surrounding these penalties has changed markedly in recent years. Not that long ago taxpayers, with the awareness and at least implicit acquiescence of the IRS, could annotate corporate income tax returns to reflect that international transaction information was ''available upon request,'' and penalties would generally not be assessed for inadvertent failures in which the taxpayers had substantially complied and also had strong internal procedures. Fast-forward to today where the penalty regime calls for assessment of $10,000 penalties for *every* missing or late form 5471 or 5472. Further, because the penalties are ''assessable,'' they are automatically assessed without any of the taxpayer

[1]Rev. Proc. 2009-14, 2009-3 IRB 324.

[2]Form 5471, ''Information Return of U.S. Persons With Respect to Certain Foreign Corporations.''

[3]Form 5472, ''Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.''

notice and response features that accompany ''deficiency'' assessments. Often a taxpayer's first interaction with an IRS representative doesn't come until the assessed penalty is already in the hands of IRS collection personnel. Further, the automatic $10,000 penalty is routinely assessed even if there is no tax due on the related income tax return. When you combine an automatic penalty regime with the lack of taxpayer opportunity to proactively disclose, explain, and mitigate the consequences of potential noncompliance, you run a risk of undermining the very behavior — self-correction — that is most essential in a system reliant on voluntary compliance.

Given what is known thus far, it is unclear whether the new LB&I design will further narrow the self-initiated resolution options for taxpayers that are not otherwise under coordinated industry case (CIC) audit or specifically identified for an issue-focused treatment. For example, taxpayers that were previously within the CIC program but are only subject to campaign-based audits are going to miss having the ability to use the provisions of Rev. Proc. 94-69, 1994-2 C.B. 804. That revenue procedure allows taxpayers under continuous audit to disclose return corrections at the beginning of an audit and thereby achieve ''qualified amended return'' treatment for penalty purposes without the need for formally amending the federal return.

Even some taxpayers that remain within the CIC program may find their opportunities to correct return positions via informal claims truncated. Under a published draft revision of Publication 5125, *Large Business & International Examination Process*, informal claims will be limited to those submitted within the first 30 days of the audit. Claims identified after that will have to be submitted as formal amended returns.

As previously suggested, taxpayers could also soon find it more difficult to obtain PFAs in the new environment. While at its peak the PFA program has only entertained a modest number of applications per year, many taxpayers have embraced a PFA to achieve early tax return and financial statement certainty on significant issues. Historically the IRS has been most willing to enter into PFAs when agents were already assigned to the requesting taxpayer's audit. Conversely, it has been more difficult to secure a PFA when agents were not already assigned to a taxpayer. As LB&I conducts fewer CIC audits and is more concerned with controlling how it spends its resources, PFA applications may well be declined for ''lack of resources.''

Make no mistake: It is both prudent and important for the IRS to invest its resources in ways that produce the best return on its investment (ROI). Enhanced compliance is presumably the ultimate measure of that return. Unfortunately, the easiest piece of the compliance puzzle to measure — proposed audit adjustment dollars — is, at best, only a partial measure of that return. In reality, the ROI is greatest when IRS action prompts wholesale positive change in compliance behaviors. ROI is also improved when compliance risks are addressed early rather than after they have become more insidious.

The LB&I redesign wisely envisions use of a spectrum of treatments in addition to audits. Toward that end, compliance clearly benefits when taxpayers come forward voluntarily to disclose and resolve potentially uncertain issues. The challenge for the IRS will be to create avenues and metrics within its ''future state'' that not only drive its issue-focused agenda but, as important, accommodate the interests and needs of responsible taxpayers who want to do the right thing.

The national taxpayer advocate and others have argued passionately that individual taxpayers require and deserve better access than the IRS currently provides. As correct and compelling as those arguments are, similar issues exist for LB&I's constituents — large businesses whose operations and attendant tax obligations implicate some of the most complicated provisions of the code. Any future IRS state that doesn't include practical opportunities for business taxpayers to voluntarily declare, clarify, disclose, and remedy compliance risks will miss a powerful opportunity to enhance the overall return on IRS investment in improved compliance.

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The IRS's Multi-Mission Mismatch Problem

By Kristin E. Hickman

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In this article, Hickman argues that Congress should spin off some of the IRS's social welfare functions and regulatory programs so that the agency can return its focus to its primary role of collecting taxes.

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The IRS is stretched too thin across too many missions, which are often in tension with one another and take the agency far beyond its core competency. As it has done for decades, and increasingly so, Congress uses the IRS to implement social welfare and regulatory programs with, at best, a tangential relationship to the agency's traditional mission of raising revenue and enforcing the tax laws. This multi-tasking is taking its toll, pushing the IRS to a breaking point that threatens to undermine the viability of its primary role as the nation's tax collector.[1] It is time to explore spinning off some of the IRS's many functions, so as to segregate revenue collection from the biggest and most politically fraught social welfare and regulatory programs that currently fall within the IRS's jurisdiction but not its expertise.

The IRC has always reflected nontax policy goals. Since practically the beginning of the modern income tax, Congress has used the tax system to regulate corporate activity through the corporate income tax;[2] combat societal inequality through progressivity;[3] and subsidize charities, state and local governments, and homeowners through itemized deductions,[4] to name just a few examples.

In the past few decades, however, Congress has increasingly situated government regulatory and spending programs in the tax system. Tax expenditures have become ''the dominant instruments for implementing new discretionary spending policies''[5] targeted at the environment, education, welfare, and other nontax policy concerns. Some tax expenditures integrate easily with the tax laws — for example, goosing the economy by allowing businesses to expense new equipment purchases under section 179. Others are more challenging. The IRS is now one of the federal government's principal anti-poverty agencies, because Congress uses refundable tax credits like the earned income tax credit and the child tax credit, rather than direct subsidies, to support working families.[6] The Affordable Care Act and ERISA assign the IRS a key role in healthcare and pension regulation. And the IRS is the principal federal regulator of an enormous nonprofit sector, because the IRS evaluates applications for tax-exempt status and monitors continued compliance with eligibility requirements.

Many or even most tax expenditures are small.[7] Other social welfare or regulatory programs that Congress has assigned to the IRS, like the EITC or tax-exempt status for charities, started small and grew substantially larger and more complex over

[1]This thesis is explored more fully in two law review articles: Kristin E. Hickman, ''Pursuing a Single Mission (or Something Closer to It) for the IRS,'' 7 *Colum. J. Tax L.* __ (coming June 2016); and Hickman, ''Administering the Tax System We Have,'' 63 *Duke L.J.* 1717 (2014). Thanks to Nick Bednar for helping me condense ideas from those articles into this one.

[2]*See*, *e.g.*, Steven A. Bank, *From Sword to Shield: The Transformation of the Corporate Income Tax, 1861 to Present* 43-44 (2010) (acknowledging secondary regulatory goals of the corporate income tax); Reuven S. Avi-Yonah, ''Corporations, Society, and the State: A Defense of the Corporate Tax,'' 90 *Va. L. Rev*. 1193, 1217-1220 (2004) (citing historical evidence in justifying the continuation of the corporate income tax on regulatory grounds).

(Footnote continued in next column.)

[3]*See, e.g.*, Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem in Fiscal Policy* 15-19 (1938) (discussing income tax progressivity); Meredith R. Conway, ''Money, It's a Crime — Share It Fairly, but Don't Take a Slice of My Pie!: The Legislative Case for the Progressive Income Tax,'' 39 *J. Legis*. 119, 130-132 (2013) (describing redistributive goals of income tax progressivity).

[4]*See, e.g.*, Allan J. Samansky, ''Nonstandard Thoughts About the Standard Deduction,'' 1991 *Utah L. Rev*. 531, 540-543 (describing rationales for itemized deductions).

[5]Edward D. Kleinbard, ''The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes,'' 36 *Ohio N.U. L. Rev*. 1, 3 (2010).

[6]*See, e.g.*, Francine J. Lipman, ''Access to Tax InJustice,'' 40 *Pepp. L. Rev.* 1173, 1180-1184 (2013) (describing the history of the EITC as a program to alleviate poverty); Michelle Lyon Drumbl, ''Those Who Know, Those Who Don't, and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns,'' 11 *Pitt. Tax Rev*. 113, 120-123 (2013) (discussing the history of refundable credits with examples).

[7]*See generally* Senate Budget Committee, ''Tax Expenditures: Compendium of Background Material on Individual Provisions'' (Dec. 28, 2012) (detailing 250 separate tax expenditures, including their relative size, and acknowledging that the list is not exhaustive).

time. Still other programs have been large and complicated from the outset, like the ACA. But even small programs can add up to a large burden if there are enough of them — and the tax system handles hundreds of tax expenditures.

In short, Congress has moved the IRS from a mission-driven agency that collects taxes to an omnibus agency that must do many things. As Pamela Olson, former Treasury assistant secretary for tax policy, observed in 2010:

> The continual enactment of targeted tax provisions leaves the IRS with responsibility for the administration of policies aimed at the environment, conservation, green energy, manufacturing innovation, education, saving, retirement, health care, child care, welfare, corporate governance, export promotion, charitable giving, governance of tax exempt organizations, and economic development, to name a few.[8]

As a result, even if the IRS maintains tax collection as its primary focus, it must dedicate substantial resources to those additional programs and functions. From 2008 through 2012, roughly 30 to 40 percent of Treasury regulations generated addressed tax expenditures and other social welfare and regulatory matters, rather than more traditional tax issues.[9] Importantly, those regulations are not merely technical, focusing on the mechanics of this or that deduction or credit; rather, they are substantive, for example, defining who is eligible for government subsidies or determining what services insurance companies must support.[10]

Using an existing agency such as the IRS to administer new programs is not unique in American government. When adopting a new government program, Congress often taps an existing agency to administer it, even when the new program is not entirely germane to the agency's original or core mission. Establishing a new agency is time-consuming and expensive. Even when programmatic goals are not especially aligned with an existing agency's primary function, creating a new agency may make little sense if the existing agency's expertise is at least close enough to believe it can handle the additional responsibility.[11] Nevertheless, when Congress tasks an existing agency with a new program or function, the general understanding is that the new program or function may take a back seat to the agency's core mission.[12] As a result, the new program or function may be run somewhat less well or be somewhat less effective than might have been the case had Congress established a new agency. When an agency's multiple missions are in tension with one another, the agency may be particularly hard-pressed to accomplish both equally well.

No agency or government program design is perfect, and life and government both often require trade-offs. But congressional decisions to assign new programs or functions to the IRS are surely no different. Legal scholars have analyzed and explained structuring social welfare and regulatory programs as tax deductions or credits largely by reference to whether tax expenditures are more efficient economically and administratively than direct spending programs.[13] Undoubtedly, the IRS has relevant expertise in measuring income and in designing the mechanics of large-scale credits and deductions. Yet the IRS's capacity to administer any *one* regulatory or social welfare program effectively (or at least effectively enough) does not automatically equate with a capacity to administer *many, many* of these programs simultaneously.

The integration of social welfare programs into the tax system has had a substantial effect on the profile of the people likely to have to engage in a meaningful way with IRS personnel. People whose only contact with the IRS was the rote annual task of filling out a relatively simple Form 1040 or even a Form 1040-EZ must now grapple with extra forms and instructions to avail themselves of various benefit programs. Mistakes lead to enforcement and penalties.[14] At least anecdotally, the Tax Court has

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[8]Pamela Olson, ''And Then Cnut Told Reagan . . . Lessons From the Tax Reform Act of 1986'' (Woodworth Lecture, May 6, 2010), in 38 *Ohio N.U. L. Rev*. 1, 12-13 (2011) (citations omitted).

[9]Hickman, ''Administering the Tax System We Have,'' 63 *Duke L.J*. 1717, 1746-1750 (2014) (showing 30 to 40 percent of regulations concerned nontax social welfare and regulatory matters).

[10]*See*, *e.g.*, T.D. 9578 (addressing, among other issues, mandatory contraceptive coverage and accommodations for religious organizations that object thereto).

[11]*See*, *e.g.*, David A. Weisbach and Jacob Nussim, ''The Integration of Tax and Spending Programs,'' 113 *Yale L.J*. 955, 987-990 (2004) (discussing the role of expertise in organizational design).

[12]Rachel E. Barkow, ''Prosecutorial Administration: Prosecutor Bias and the Department of Justice,'' 99 *Va. L. Rev*. 271, 307-312 (2013); *see also* David B. Spence and Frank B. Cross, ''A Public Choice Case for the Administrative State,'' 89 *Geo. L.J*. 97, 119 (2000) (''That agencies are systematically more loyal to their basic mission seems persuasive, even obvious.'').

[13]*See*, *e.g.*, Weisbach and Nussim, *supra* note 11, at 1023-1026 (analyzing the EITC in these terms); Eric J. Toder, ''Tax Cuts or Spending — Does It Make a Difference?'' 53 *Nat'l Tax J*. 361 (2000) (analyzing tax expenditures versus direct spending programs).

[14]*See*, *e.g.*, Drumbl, *supra* note 6, at 132-139 (detailing the high audit rate for recipients of social welfare credits and the inappropriateness of traditional IRS enforcement methods for these taxpayers).

seen a significant shift in its docket toward unsophisticated, pro se taxpayers trying to sort out their eligibility for tax benefits. Taxpayers do not distinguish problems over their eligibility for the EITC or an ACA subsidy from difficulties over paying taxes on their income. Cumulatively, these negative interactions with the IRS can only serve to discourage voluntary compliance with the tax laws.

Culturally, the IRS is oriented toward raising revenue, maximizing collections, and protecting the fisc. Its mission statement emphasizes compliance, helping taxpayers ''understand and meet their tax responsibilities'' and ensuring that taxpayers ''pay their fair share.''[15] IRS personnel have tremendous capacity to process and evaluate hundreds of millions of taxpayer filings and collect the taxes owed. But they are not typically social workers, environmental scientists, health policy experts, or First Amendment scholars. Consequently, however talented IRS employees may be at pursuing the IRS's traditional revenue-raising mission, they may not be as good at addressing the needs of socioeconomically disadvantaged persons, promoting new sources of energy, remaking the healthcare system, or recognizing when administrative decisions implicate politically sensitive values like freedom of speech or religion.[16]

Meanwhile, some of these regulatory and social welfare programs have drawn the IRS into political waters it is ill-suited to navigate. Last year's *King v. Burwell*[17] decision showed the IRS dragged into a highly politicized controversy over taxpayer eligibility for ACA subsidies, a subject the Supreme Court recognized as outside the IRS's expertise.[18] Even if one is inclined to give the IRS the benefit of the doubt when it comes to its past handling of section 501(c)(4) exemption applications, only the most partisan ideologues think the IRS handled that controversy adeptly and escaped undamaged in the eyes of the average taxpayer.[19] Agencies like the Environmental Protection Agency or the National Labor Relations Board may be expected to pursue partisan priorities. The IRS, by contrast, relies heavily on its reputation for fairness and impartiality, and it cannot afford to be perceived otherwise.

In short, Congress has set the IRS up to fail. And, in response to the IRS's inevitable slips, stumbles, and blunders, Congress has demonized the agency and cut its budget — even as politicians from both parties call for adding to the IRS's burden by adopting even more programs for it to administer. Something, somewhere, has got to give.

It is undoubtedly impossible to extricate the revenue-raising function from all other social welfare and regulatory goals. Again, the IRC has never been completely value neutral, and attempting to make it so is a fool's errand. Nevertheless, the IRS is hardly the first agency to find itself overburdened with conflicting missions or tasks that turn out to be a poor fit. As agencies and times have changed, and government programs have evolved and expanded, Congress has often acted to restructure agencies, such as by reassigning functions or by splitting up an agency altogether.

One good example of this is what happened with the Interstate Commerce Commission (ICC), which was assigned a small, secondary task that grew too large and needed to be reassessed and reassigned. In 1910 Congress gave the ICC the responsibility of regulating telephone and telegraph services.[20] The agency's primary expertise lay in the area of transportation services, but Congress perceived important commonalities between regulating railroads and regulating telephone companies. But the ICC's personnel remained primarily focused on railroads.[21] As the telephone industry grew in size and complexity, the limitations of ICC oversight became more apparent.[22] So Congress decided to spin off telephone regulation to the Federal Communications Commission, a new agency created specifically for that purpose.

A similar restructuring occurred with the Immigration and Naturalization Service (INS) after it was assigned tasks that while seemingly related, functioned at cross-purposes with one another and undermined the agency's ability to accomplish either. For decades the INS regulated immigration more or less comprehensively, acting as both an

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[15]IRS, ''The Agency, Its Mission and Statutory Authority,'' *available at* https://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority.

[16]*Cf*. Jane H. Aiken and Stephen Wizner, ''Law as Social Work,'' 11 *Wash. U. J.L. & Pol'y* 63, 64-67 (2003).

[17]135 S. Ct. 2480, 2486-2487 (2015).

[18]*Id.* at 2489 (declining to apply the *Chevron* review standard to the IRS's interpretation of the Affordable Care Act because the IRS ''has no expertise in crafting health insurance policy'').

[19]*Compare*, *e.g.*, Lily Kahng, ''The IRS Tea Party Controversy and Administrative Discretion,'' 99 *Cornell L. Rev. Online* 41 (2013) (detailing the controversy, describing the IRS's ''ineptitude'' and ''bureaucratic bungling,'' and concluding that the incident ''inflicted needless damage on the IRS'').

[20]Mann-Elkins Act, ch. 309, section 7, 36 Stat. 539, 544-545 (1910).

[21]*See*, *e.g.*, Kenneth A. Cox and William J. Byrnes, ''The Common Carrier Provisions — A Product of Evolutionary Development,'' in Max D. Paglin (ed.), *A Legislative History of the Communications Act of 1934*, 25-30 (1989) (comparing and contrasting congressional and ICC regulation of railroads and telephones).

[22]*Id.* at 30 (''By 1934, interstate communications had risen to a level of importance requiring greater public attention than the ICC, still very busy with regulating railroads, was able to give it.'').

enforcement agency charged with border control and deportations, and as a service agency tasked with processing naturalization and visa applications.[23] Culturally, the INS prioritized its enforcement functions, cultivating an enforcement mentality in training its employees, often resulting in apathy, suspicion, and hostility toward applicants for immigration benefits.[24] Yet the INS relied on service fees as a key part of its budget, complicating its pursuit of enforcement goals.[25] After the bipartisan U.S. Commission on Immigration Reform advised assigning the INS's enforcement and service functions to different agencies, Congress disbanded the INS and divided its functions among three new agencies — U.S. Citizenship and Immigration Services, U.S. Immigration and Customs Enforcement, and U.S. Customs and Border Protection.[26]

Perhaps the time has come for a similarly radical restructuring of IRS functions. I have no precise blueprint in mind but suggest drawing from historical examples such as those mentioned above. For example, even if Congress wants to continue using tax credits and deductions rather than direct subsidies to accomplish social welfare goals, another agency could determine and monitor eligibility, handle enforcement of eligibility requirements, and then coordinate with and rely on the IRS to process the credits or deductions. Social workers with expertise in the issues faced by socioeconomically disadvantaged persons — rather than tax experts — could determine and monitor eligibility for the EITC, removing those responsibilities from the IRS's jurisdiction. Perhaps Congress could spin off exempt organization determinations and monitoring wholesale and have the responsible agency just provide the IRS with a list of approved entities. If the IRS suspects a problem with a particular entity, it could refer the matter back to the responsible agency.

Congress has burdened the IRS with too many secondary social welfare and regulatory programs, most of which have little to no relation to its primary function: collecting taxes. These secondary functions divert too many resources from the IRS's core mission. The IRS and its personnel lack the expertise to assess the political consequences of many of the day-to-day administrative decisions that must be made. Politically controversial decisions upset taxpayers and give rise to skepticism regarding the fairness and legitimacy of the tax system, thus imperiling tax compliance. Spinning off some of the largest and most politically fraught non-revenue-raising functions from the IRS, such as exempt status determinations or health policy administration, would allow the IRS to avoid this political turmoil and return its focus to its core expertise.

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[23]*See, e.g.*, Daniel W. Sutherland, ''The Federal Immigration Bureaucracy: The Achilles Heel of Immigration Reform,'' 10 *Geo. Immigr. L.J.* 109, 113 (1996) (summarizing INS functions); Bennett J. Lee, ''The Immigration and Naturalization Service: In Search of the Necessary Efficiency,'' 6 *Geo. Immigr. L.J.* 519, 521-522 (1992) (same).

[24]*See, e.g.*, Deborah Sontag and Stephen Engelberg, ''Insider's View of the I.N.S.: 'Cold, Rude and Insensitive,''' *The New York Times*, Sept. 15, 1994, at A1 (describing INS employee training as ''inculcate[ing] an intrinsic suspicion of immigrants'' that ''often translates into rudeness and even vindictiveness'').

[25]*See, e.g.*, Sutherland, *supra* note 23, at 127-128 (documenting INS reliance on user fees).

[26]Homeland Security Act, P.L. 107-296, 116 Stat. 2135 (2002); *see also* Deepa Iyer and Jayesh M. Rathod, ''9/11 and the Transformation of U.S. Immigration Law and Policy,'' 38 *Hum. Rts.*, no. 1, at 10 (Winter 2011).

Can a Change in LB&I Approach Improve Taxpayer Compliance?

By Heather Maloy

Heather Maloy

Heather Maloy, tax controversy leader for EY's National Tax Department, is a former commissioner of the IRS Large Business and International Division.

In this article, Maloy argues that in light of significant changes in the way multinational corporations view compliance risk, LB&I should consider shifting its limited resources away from large examinations and toward activities designed to provide more certainty.

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In the past, there were long periods between significant changes for the IRS, whether broad revisions to the tax code or changes in the overall operations of the agency itself. Those days are long gone, and change has become the order of the day. Even as taxpayers work to comply with ever-evolving tax laws and reporting requirements, the IRS — including the Large Business and International Division — is faced with well-catalogued administrative challenges: decreased budgets, a dwindling workforce, and a technology gap, along with increased complexity and growing administrative responsibilities resulting from the Affordable Care Act, the Foreign Account Tax Compliance Act, and more.

But challenges can also bring opportunity. The big question is whether the IRS, in response to these pressures, can retool its approach to compliance by leveraging the significant changes taking place in the way multinational corporations view tax compliance risk.

Some Background on the Compliance Challenge

When budget levels remain relatively constant year after year, the way organizations go about their business may not change much, especially a government organization in which making a profit is not a factor in driving innovation and change. But when budget shortfalls meet increasing global complexity, there may be an opportunity for significant change. At this juncture, the IRS could rethink its approach to compliance, especially for the world's largest businesses.

Historically, the IRS has addressed large business tax compliance through its large case examination program. In that program, known today as the coordinated industry case program, LB&I places the largest corporations in the United States under continuous audit, with examination teams stationed at the corporate headquarters of the taxpayer. Over the years, the success of this program has been measured in a number of ways: the percentage of taxpayers audited within particular asset groupings (coverage rate); the amount of time it takes to perform the audit (cycle time); and the dollar amount of the adjustment proposed, not sustained, by the examination team (proposed adjustment). Notably, by using metrics like the coverage rate, the IRS is not selecting returns because they necessarily include issues of suspected noncompliance; rather, it is auditing the taxpayers year after year because they are the largest.

When the large case examination program started, business technology was in its infancy. The economy was largely bricks-and-mortar-based, and the concept of virtual storefronts and global commerce through intangible assets was just a twinkle in the eye of some Silicon Valley self-starters. There was no online access to general ledgers and no e-filing of corporate tax returns. In that context, the IRS had limited tools available to identify, much less predict, noncompliance.

The compliance landscape has changed significantly over time, both in the United States and globally. Technology has made corporate financial data much more accessible. More data are available to tax authorities through the electronic filing of tax returns and electronic business records. The reporting of tax positions is more vigorous as a result of disclosure requirements like Financial Accounting Standards Board Interpretation No. 48 (now Accounting Standards Codification Topic 740) and Schedule UTP (uncertain tax position statement).

The tax affairs of multinational corporations are also becoming more transparent, whether as a result of the OECD's base erosion and profit-shifting initiative and similar efforts by individual tax jurisdictions, or the unregulated efforts of journalists and citizen groups. In the United States, whistleblower laws have been strengthened to make it more lucrative for business insiders to provide information to the IRS regarding a company's questionable tax positions. Tax exposure is no longer just a financial risk; it is also being considered a risk that could tarnish the public reputation of a global franchise or brand. Being seen as a good corporate citizen is more important for multinationals today

than ever before, particularly when it comes to tax compliance. Whatever their genesis, all these changes have contributed to a significant shift in the way large businesses approach tax compliance.

How the IRS Can Meet Its Challenges

LB&I spends much of its compliance resources on large case examinations, working to ensure compliance one taxpayer at a time. The results of these examinations rarely drive wide-scale change in the future filing positions of the largest taxpayers. Moreover, determining and defending filing positions on issues that are uncertain under the law is inefficient, risky, and resource-intensive for both taxpayers and the government. At the same time, with increased global transparency and reputational risk, many large taxpayers in the United States crave tax certainty.

In a time of limited resources, actions taken by the tax administrator should be designed to have a multiplier effect — to change the behavior of as many taxpayers as possible. The best way to achieve that effect is to resolve most if not all of the uncertainty in the law before a taxpayer files a return. Shifting resources away from large examinations and toward activities designed to provide more certainty would be a significant change to the way the IRS allocates its resources. However, that shift would lead to more efficient and effective tax administration, generating what could be thought of as a compliance annuity — dollars collected each year through the filing of compliant returns well into the future.

The IRS already uses several innovative programs that have embraced the concept of providing certainty. Among them are the compliance assurance process, which resolves material issues with a real-time audit conducted before the filing of a return; the industry issue resolution program, which issues guidance designed to resolve frequently disputed or burdensome tax issues that affect a significant number of business taxpayers; and the prefiling agreement program, which enables taxpayers and the IRS to resolve, before the filing of a return, the treatment of issues otherwise likely to be disputed in post-filing audits. The question now is what the next generation of those and other innovative programs will look like.

To free up resources, the IRS could consider moving away from performing audits that tie a taxpayer's general ledger to its tax return, or that look for large, unusual, or questionable items or for mistakes that taxpayers with complex business structures inevitably make. Instead, the IRS could focus its resources on confirming which multinationals have strong internal controls and tax compliance practices in order to be comfortable that those large businesses no longer need to be under continuous audit. The IRS could then reallocate those resources to auditing only anomalies. This approach to compliance would be similar to the approach used in financial statement assurance audits. Although it may not find every possible adjustment, this change could address a large portion of material filing issues and be the next generation of the CAP program.

This potential new CAP program, coupled with significant efforts to devote resources to making the law more certain, could lead to increases in efficiency and compliance. None of the current audit measures determines success on the basis of change in long-term compliance behavior by individual taxpayers or groups of taxpayers. Admittedly, it is much more difficult to measure the impact of activities designed to increase future filing compliance, and adopting metrics designed to gauge success could be a challenge in making these changes. Changes in filing behavior before and after guidance is issued are one potential gauge. External indications of tax compliance, such as changes in UTP reporting, could also be a gauge of success.

Given the environment of increased transparency and reputational risk for multinationals, more certainty should bring more compliance. Determining a taxpayer's compliance risk profile through factors other than continuous audit should allow the IRS to shift its examination resources to areas where the greatest compliance risk exists.

A Few Final Words

These are challenging times for the IRS. A great deal has changed over time, including the stable predictability of "business as usual." The key to future success may well be in changing the longstanding approach, culture, and metrics that have defined the IRS for decades. Can the IRS take advantage of all the changes to forge a new way to address and ensure compliance? That remains to be seen. But both sides of the taxpaying equation should remain hopeful.

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