TAS Research Initiatives

Tax research is an important tool in developing knowledge to identify and understand tax administration issues. This knowledge promotes informed decisions and actions and contributes to the IRS's efficiency. A primary focus of TAS Research is to better understand the consequences of IRS procedures and processes and to evaluate IRS programs by understanding and balancing IRS compliance efforts with taxpayer rights and burdens.

Discussed below are three research projects underway for the remainder of fiscal year (FY) 2020 and into FY 2021.

PROPOSED ALGORITHM FOR STREAMLINED INSTALLMENT AGREEMENTS MAY REDUCE TAXPAYERS' ECONOMIC HARDSHIP

The IRS implements over 2.8 million installment agreements per year. About 70 percent of its annual installment agreements are streamlined,[1] which means the IRS does not analyze a taxpayer's ability to afford the payment arrangement. The benefit for taxpayers is this process allows an easy and quick means to establish an installment agreement for delinquent tax liabilities without the necessity of providing financial information. The IRS benefits by reducing its staff hours while collecting the outstanding tax liability. Overall, the streamlined process takes less time and establishes a monthly payment schedule. The process can be a win-win for taxpayers and the IRS.

However, there is an obvious downside. Since the IRS does not perform a financial analysis, many taxpayers enter into installment agreements they cannot afford, which leaves both the taxpayer and the IRS in an untenable position going forward. Some taxpayers must choose between foregoing purchasing basic necessities or defaulting on their installment agreement. Once a taxpayer defaults, the IRS must spend additional resources to resolve the liability while the taxpayer incurs further penalty and interest.

TAS contends that before implementing a streamlined agreement, the IRS can use data from the taxpayer's recently filed income tax returns to accurately determine both the taxpayer's income and his or her amount of allowable living expenses (ALE), which the IRS establishes annually to represent the amount the taxpayer needs to meet basic living expenses to "provide for a taxpayer's and his or her family's, health and welfare and/or the production of income."[2]

The IRS can verify the taxpayer's income information against third-party payer documents reported to the IRS to ensure it considers the taxpayer's total income. The IRS can also check its internal data to determine if the taxpayer has assets, which could be liquidated to satisfy the delinquent federal tax liability. To validate its contentions, TAS is conducting research to determine if an algorithm it developed will prevent future defaults by verifying its accuracy on non-streamlined installment agreements.

1 See IRS, Small Business/Self-Employed Division, Collection Activity Report (CAR) No. 5000-6 for fiscal years (FYs) 2018 and 2019, which shows that streamlined installment agreements accounted for 70 percent of all installment agreements in these two years.

2 IRM 5.19.13.3.2.2, Allowable Living Expenses (June 6, 2019).

Analysis by TAS Research for a Most Serious Problem in the National Taxpayer Advocate's 2018 Annual Report to Congress study found that about 40 percent of the Automated Collection System streamlined installment agreements were with taxpayers whose maximum ALE met or exceeded their income.[3] TAS tested the algorithm it developed on a sample of about 300 cases where the IRS had entered into non-streamlined installment agreements with taxpayers, in which it conducted financial analysis before establishing the installment agreement. TAS analysis of the sample data showed that its algorithm reached the same conclusion as IRS personnel (that the taxpayer could pay) about 95 percent of the time. Of the remaining five percent of taxpayer liability cases, the IRS determined that in about a third of those cases the taxpayers could afford to pay, but it still input a backup currently not collectible (CNC) determination on their accounts. CNC status allows taxpayers in financial hardship situations to defer paying their tax bill until their situation improves. So even with those taxpayers, the IRS questioned whether they could afford an installment agreement.[4]

The IRS is considering applying TAS's algorithm to outstanding tax liabilities and if appropriate, placing an indicator on taxpayer's account when the algorithm supports an assumption that a taxpayer's allowable expenses are likely to exceed his or her income (and the taxpayer has no other systemically detected assets). This proposed indicator would alert the IRS of the taxpayer's financial situation. The indicator would trigger an inquiry for a basic financial analysis to determine if the taxpayer can afford a streamlined installment agreement, saving the IRS from reworking many cases and preventing taxpayers from agreeing to a payment they cannot afford. The indicator would inform IRS personnel of potential financial hardship since the streamlined procedure otherwise would not require financial data.

The Small Business/Self-Employed (SB/SE) Division has agreed to consider implementing this indicator but has requested that TAS test the proposed indicator's accuracy on a larger group of cases. TAS has begun a research project to test the accuracy of the TAS algorithm on all IRS non-streamlined installment agreements in FYs 2017, 2018, and 2019 and is analyzing all IRS non-streamlined installment agreements initiated in each fiscal year to determine whether the TAS algorithm also supports the taxpayer's ability to afford an installment agreement.[5] We have coordinated this research with SB/SE, which is also testing an existing financial recovery score threshold as an effective indicator of whether the taxpayer is likely to afford an installment agreement. TAS plans to complete this research and compare the results with SB/SE's analysis on this issue by early FY 2021.

3 See National Taxpayer Advocate 2018 Annual Report to Congress 260-261 (Most Serious Problem: *IRS's Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*); National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 39-52 (*A Study of the IRS's Use of the Allowable Living Expense Standards*).

4 See IRM 5.19.17.2.4, CNC Unable to Pay – Hardship (Oct. 30, 2019), which states that "[a]t times, the taxpayer, who meets hardship criteria, requests an IA rather than a CNC. In this scenario, establish the Installment Agreement (IA) or Partial Pay Installment Agreement (PPIA) with a back-up 53."

5 The IRS conducts a financial analysis in all non-streamlined installment agreements; therefore, the TAS algorithm should also show the taxpayer can afford an installment agreement.

If the research supports the use of the TAS algorithm, SB/SE may implement it for streamlined cases. Using an appropriate indicator to demonstrate taxpayers' inability to afford an installment agreement rather than setting them up for default decreases IRS collections efforts downstream. TAS and SB/SE are looking into the feasibility and benefits of this approach.

TAS STUDIES IRS POTENTIAL PROCESSING ERRORS OF FORM 4029, APPLICATION FOR EXEMPTION FROM SOCIAL SECURITY AND MEDICARE TAXES AND WAIVER OF BENEFITS

Certain religious groups qualify for Social Security tax exemption if they are recognized as being officially opposed to Social Security benefits, such as retirement, disability, and death benefits.[6] Taxpayers requesting exemption from Social Security and Medicare taxes because of religious convictions must file a Form 4029, Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits. As of the beginning of 2020, the IRS had approved about 130,000 Forms 4029 filed. TAS has identified several taxpayers erroneously assessed Social Security and Medicare taxes from which they should be exempt. Some of the same taxpayers receive these erroneous assessments in multiple years. When these erroneous assessments occur, the taxpayers must contact the IRS to abate the erroneous assessments. The taxpayers and their preparers are frustrated spending considerable time correcting these wrongly assessed taxes. Sometimes, the incorrectly assessed taxes progress to enforced collection action, creating additional burdens for the taxpayer.

TAS has determined instances where the Form 4029 approval indicator "falls off" a taxpayer's account, while in other cases, the IRS may not notice this indicator. TAS Research has begun reviewing the processing of Forms 4029 to determine why these taxpayers receive incorrect assessments and if there is a systemic problem. Once TAS determines one or more causes, it will coordinate and work with the IRS and assist in altering its return processing procedures to eliminate any future erroneous processing of returns with an approved Form 4029.

This project will include the population of taxpayers who have submitted Form 4029 and review a statistically valid sample to determine the IRS error rate when processing returns where the taxpayer has an approved Form 4029. This study will quantify:

- The number of taxpayers with a Form 4029 indicator on their accounts and whether the taxpayers are employees or self-employed;
- The number of taxpayers with approved Forms 4029 whose accounts are no longer marked as exempt from Social Security taxes;
- The number of taxpayers later assessed additional Social Security tax;
- The number of taxpayers who never disputed the incorrect assessment of additional Social Security tax; and
- The number of taxpayers who experienced an IRS enforced collection action because of the erroneous assessment.

6 Social Security Administration (SSA), Publication No. 17-018, *How Religious Exemptions Work* (Jan. 2018), https://www.ssa.gov/pubs/EN-17-018.pdf.

This study will also try to identify what factors caused the IRS to mistakenly assess Social Security and Medicare taxes against many of these taxpayers. Eliminating Form 4029 processing errors will save taxpayers the burden of correcting erroneous assessments and will save the IRS a significant amount of rework by preventing erroneous Social Security tax assessments it later abates.

TAS STUDIES WHETHER CERTAIN IRS MATH ERRORS ARE COST EFFECTIVE CONSIDERING THEIR HIGH PERCENTAGE OF SUBSEQUENT ABATEMENTS

The IRC provides the IRS with the authority to summarily assess tax in certain situations without auditing a taxpayer's return when a taxpayer commits a mathematical or clerical error.[7] When originally instituted, IRS math error authority was limited to an actual computational error on the face of the return. However, Congress later expanded math error authority to include other clerical errors, including the transposition of a taxpayer identification number or contradictory items on the tax return.[8] Regardless of the error, when the IRS exercises its math error authority, it uses a specific math error code to identify the error made on the tax return. TAS Research will study the IRS's current use of math error authority on individual income tax returns to identify certain math errors, which the IRS frequently reverses after taxpayers contact the IRS disagreeing with the assessment.

In tax year (TY) 2016, the IRS issued about 2.3 million total math errors for nearly 500 specific reasons.[9] Most of the math errors have a relatively small reversal rate; however, about 35 specific math errors have abatement rates of nearly 50 percent, and a few math errors have even higher abatement rates.[10] Math errors with high abatement rates affected about 90,000 taxpayers in TY 2016 with these taxpayers receiving incorrect assessments totaling well over $125 million.[11] This situation creates significant burden for taxpayers and rework for the IRS. The taxpayers experience the burden of correcting the erroneous math error assessment and delays in receiving their correct refund. The IRS spends resources issuing the math error, responding to taxpayers' inquiries about the math error notice, and then abating the math error assessment. A prior TAS study indicated that even where the IRS does issue a math error incorrectly, many taxpayers do not dispute it.[12] Instead of issuing certain math errors with high abatement rates, the IRS could change its procedures to correspond with taxpayers before making certain types of math error assessments.

TAS Research has completed a preliminary analysis of math errors issued by the IRS for TY 2016, including the number of math errors issued (by each specific code), the tax change, the number of IRS math error changes later reversed in full or in part, and the average percentage of the total

7 IRC § 6213.

8 IRM 21.5.4.3, General Math Error Procedures (Sept. 4, 2019).

9 IRS, CDW, IRTF Filed TY 2016 (Aug. 2018)

10 *Id*.

11 *Id*.

12 *See* National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, at 114-144 (*Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*). TAS examined a small sample of cases where the EITC disallowed by the IRS because of a missing or incorrect TIN had not been subsequently allowed. Our review of this sample showed that over 40 percent of these taxpayers appeared eligible for the credit based on IRS internal records.

adjustment reversed for each math error code.[13] We intend to update this information in the coming months to also examine math errors issued in TYs 2017 and 2018 and to isolate the effect of a specific error when the IRS issues more than one math error on a tax return.

The IRS use of math error authority is much more cost effective than auditing a taxpayer. In a 2014 Treasury Inspector General of Tax Administration report, the IRS placed the cost of math error authority at only $1.50 per return, while the cost of a correspondence audit was $238.[14] Nevertheless, for certain math errors with perennially high abatement rates, the cost may detract from revenue initially protected by the math error and may exceed the cost to the IRS of using its internal data to correct the issue without issuing the math error, or at least corresponding with the taxpayer before making the assessment. For example, the IRS cost analysis does not appear to consider subsequent IRS work to abate erroneous math error adjustments. When considered, the downstream cost to abate erroneous math error adjustments may exceed the additional tax assessed from making the correction. The taxpayer experiences unnecessary burden in responding to the math error notice, especially since the IRS often could have corrected it to prevent a change in tax without involving the taxpayer.

TAS Research intends to identify math error codes where the IRS later abates sizeable portions of tax charged through math error authority. In addition, TAS Research wants to quantify the average IRS cost of abating the erroneous assessment and whether the IRS had internal data enabling it to correct the error, allowing the return as filed with no need to contact the taxpayer.[15] We plan to complete this research by the end of calendar year 2020.

13 The IRS records up to five specific math error notice codes. Therefore, in some cases, it is not possible to determine which math error changes were reversed.

14 Treasury Inspector General for Tax Administration, Ref. No. 2014-40-093, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* 16 (Sept. 2014).

15 *See* National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, at 114-144 (*Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*). When TAS examined a sample of the returns where the math error had been subsequently reversed, TAS data showed that in 56 percent of the cases, the IRS had sufficient internal information to correct the return information.