

The IRS Can Systemically Identify Taxpayers at Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford¹

EXECUTIVE SUMMARY

The majority of IRS installment agreements (IAs) with individual taxpayers are streamlined agreements,² meaning that verification of a taxpayer's financial circumstances is not required when the liability does not exceed a certain amount and can be paid within a specified number of years. To reduce taxpayer burden and minimize IRS resources when agreeing to an IA, the IRS has eased the requirements for entering into a streamlined IA.³ While streamlined IAs do not require the taxpayer to provide verification of his or her financial circumstances, unfortunately, these agreements place many taxpayers in a position where they cannot afford basic living expenses while meeting the payment required by the IA.

The IRS established allowable living expenses (ALEs) to ensure that the satisfaction of their unpaid tax liabilities does not interfere with the ability to pay for those expenses necessary for basic living.⁴ ALEs include groceries and other incidentals such as apparel or cleaning supplies, housing and utilities, transportation, and out-of-pocket health care expenses.⁵ However, with streamlined IAs, the IRS never compares the amount of these necessary expenses to the taxpayer's income. The result can be an IA that the taxpayer cannot afford while also meeting necessary living expenses.

TAS believes the IRS should establish an indicator, which shows whether a taxpayer is likely facing economic hardship. Specifically, TAS has developed an algorithm using the IRS ALEs to indicate when a taxpayer has income not in excess of their likely ALEs. In these situations, TAS believes the IRS should perform a basic financial analysis to ensure the taxpayer can afford the IA. Doing so could eliminate IRS rework when the taxpayer defaults an unaffordable IA, while also allowing the IRS to pursue other collection alternatives such as an offer in compromise or temporarily suspending collection action until the taxpayer's financial situation becomes more favorable.

This research study explores the effectiveness of an algorithm developed by TAS and based on systemically available information about the taxpayer's income and likely ALEs. The study examines non-streamlined

- 1 IRC § 7803(c)(2)(B)(ii)(XII) requires that the National Taxpayer Advocate, "with respect to any statistical information included in [this] report, include a statement of whether such statistical information was reviewed or provided by the Secretary under section 6108(d) and, if so, whether the Secretary determined such information to be statistically valid and based on sound statistical methodology." This report was submitted to IRS SB/SE Collection Inventory Delivery and Selection for review, and TAS added another table and related analysis as suggested.
- 2 IRS Collection Activity Reports (CAR) 5000-6 Fiscal Year (FY) 2017 (Oct. 11, 2017), FY 2018 (Oct. 1, 2018), FY 2019 (Sept. 30, 2019), and FY 2020 (Sept. 28, 2020).
- 3 Internal Revenue Manual (IRM) 5.19.1.6.4, Installment Agreements (IAs) (Nov. 30, 2020). Campus Collection Operations, Automated Collection System (ACS) and ACS Support employees are authorized to establish streamlined installment agreements over \$25,000 (for Individual Master File (IMF) and out of business (OOB) sole proprietors only) when the AAB (CC SUMRY) is between \$25,001 and \$50,000, and the assessed account balance will be paid within 72 months and prior to the expiration of the statute to collect the taxes.
- 4 ALEs, also known as Collection Financial Standards, provide for a taxpayer's and his or her family's, health and welfare and/or the production of income. These expenses establish the minimum amount on which a taxpayer needs to live. IRM 5.19.13.3.2.2, Allowable Living Expenses (June 6, 2019).
- 5 IRM 5.15.1.8, Allowable Expense Overview (July 24, 2019).

IAs for individuals initiated from fiscal year (FY) 2017 through most of FY 2020. While TAS's concern is with streamlined IAs, we tested the effectiveness of the algorithm with non-streamlined IAs. Since the IRS is required to conduct financial verification on non-streamlined IAs, the outcome of the algorithm is being compared to these IAs.⁶

The study shows that the algorithm agrees with the IRS determination 82 percent of the time and rises to 86 percent if no vehicle ownership expenses are allowed. The agreement rate increases to 95 percent when the taxpayer's systemically detected income exceeds \$50,000. Other conclusions from this study include:

- Agreement between an algorithm allowing taxpayers their likely ALEs and the IRS determination has increased slightly from FY 2017 to FY 2020;
- An algorithm comparing internal IRS income data to the minimum amount of ALEs provided to taxpayers has a 96 percent agreement rate with the IRS determination that the taxpayer could afford an IA; and
- An algorithm using internal IRS data to compare taxpayer's income to their likely ALEs are more likely to agree with the IRS determination when the taxpayers are elderly or when the taxpayers are married. However, the same algorithm is unlikely to agree with the IRS determination for taxpayers with systemically detected income of \$25,000 or less.

TAS believes the IRS should display an economic hardship indicator on taxpayer accounts when estimates of a taxpayer's ALEs and income indicate the taxpayer is not likely to afford a streamlined IA. If the indicator shows the likelihood of economic hardship, the IRS should perform a basic financial analysis before entering into the IA to make sure the taxpayer can afford the arrangement.

INTRODUCTION

In her 2018 Annual Report to Congress, the National Taxpayer Advocate included a most serious problem (MSP) on the need for the IRS to proactively use its internal data to identify taxpayers at risk of economic hardship during the collection process.⁷ Due to the impact of the pandemic, it is even more timely and important for the IRS to consider alternative means in working with financially distressed individuals and companies. Specifically, TAS has explored the efficacy of the IRS's use of internal income data with its ALE standards⁸ to determine whether taxpayers can afford to pay their outstanding federal tax liability. The IRS maintains internal income data from both recent income tax returns filed by the taxpayer and from third-party documents reporting income received by taxpayers, such as wages or Social Security income. The IRS develops and publishes ALE standards based on where a taxpayer lives, the age of the taxpayer and the household size. Each item can be determined from the taxpayer's income tax return.⁹

The IRS has routinely maintained that the taxpayer's exact ALE cannot be determined because some ALE standards are maximum values as opposed to an amount guaranteed to the taxpayer for that expense.

6 The IRS does not generally conduct an analysis of a taxpayer's financial situation before agreeing to streamlined IAs. Accordingly, the accuracy of the TAS algorithm cannot be tested on streamlined IAs.

7 National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*).

8 ALEs, also known as Collection Financial Standards, provide for a taxpayer's and his or her family's, health and welfare and/or the production of income. These expenses establish the minimum amount on which a taxpayer needs to live. IRM 5.19.13.3.2.2, Allowable Living Expenses (June 6, 2019).

9 *Id.*

National standards for food and other basic living necessities are solely determined by household size; however, for other expenses, such as housing or vehicle ownership expenses, the taxpayer is given their actual expense up to the amount allowed by the standard. For instance, if a taxpayer is allowed \$1,000 per month for housing and utilities based on the county of his or her residence location and family size, but the taxpayer only spends \$900 per month on housing and utilities, the taxpayer's allowable expense for housing and utilities is determined to be the lesser amount of \$900. Nevertheless, TAS is not advocating that taxpayers with incomes not in excess of their allowable expenses be immediately considered to be currently uncollectible. Rather, the IRS should be required to conduct a basic financial analysis to verify the taxpayer can actually afford payments toward the tax liability, while continuing to afford basic living expenses.

The 2018 MSP on economic hardship described TAS Research's analysis of a sample originally taken to determine how accurately the IRS followed its own ALE guidelines when performing the financial analysis required for non-streamlined¹⁰ IAs. This sample of 2018 IAs showed that a comparison of the taxpayer's income to the taxpayer's likely allowable expenses agreed with the IRS determination that the taxpayer could afford to pay towards the liability in about 95 percent of the cases. TAS discussed these findings with the IRS Small Business/Self-Employed (SB/SE) operating division. SB/SE indicated a willingness to consider implementing an indicator of economic hardship when taxpayers were unlikely to currently pay towards their federal tax liability, but requested that TAS conduct its analysis on a larger group of non-streamlined IAs, as the previous sample reviewed by TAS only included about 300 IAs.

TAS Research developed a research plan to examine all non-streamlined IAs executed during FYs 2017, 2018, and 2019. We also included an analysis of non-streamlined IAs entered into during most of FY 2020.¹¹ Non-streamlined IAs are those agreed to by the IRS after completing the collection information statement (CIS), which captures the taxpayer's income and ALE. In non-streamlined IAs, the IRS should have conducted a financial analysis to determine the taxpayer's ability to pay.¹² Conversely, in streamlined IAs, instances in which the taxpayer owes under a certain amount, and the liability can be satisfied within the required number of years, the taxpayer may establish a monthly payment amount without the IRS completing a CIS or conducting a financial analysis to determine whether the taxpayer has an ability to pay.¹³

Implementing an economic hardship indicator would not affect non-streamlined IAs, since the IRS already reviews a taxpayer's financial circumstances, including any assets which could fund repayment of the tax liability, before agreeing to these IAs. However, the viability of an algorithm that uses internal IRS data can best be tested on non-streamlined IAs because the IRS should have conducted a financial analysis of the taxpayer's ability to pay before agreeing to the IA. The use of an economic hardship indicator would prevent taxpayers from entering into streamlined IAs which they could not afford. In recent years, the number of streamlined IAs has been decreasing, possibly because taxpayers rarely have the wherewithal to even consider an amount sufficient to full-pay the liability within the number of years required to meet streamlined criteria. However, streamlined IAs still accounted for over 55 percent of all IAs with the IRS in FY 2020, representing

10 Non-streamlined IAs require the IRS to complete a financial analysis before agreeing to the IA; therefore, this group of IAs is an excellent source to test if the use of internal IRS data could accurately indicate if taxpayers entering an IA were likely to experience economic hardship. An accurate algorithm using internal data to estimate a taxpayer's income and allowable expenses should indicate that the vast majority of taxpayers with non-streamlined IAs could afford an IA.

11 We also examined non-streamlined IAs that had posted to the IMF on the Compliance Data Warehouse (CDW) by cycle 202030.

12 IRM 5.19.1.6.4.1, Determining Appropriate IA (Mar. 11, 2020). Different IRS functions have different guidelines for when a collection information statement is required.

13 *Id.*

over a million taxpayers.¹⁴ In FY 2019, a year not affected by COVID-19, over two out of every three IAs were streamlined, representing nearly two million taxpayers.

This study (report) compares how often the use of internal information to estimate both taxpayer income and allowable expenses agrees with the actual determination reached by the IRS. The report also compares the use of internal information based on various ALE assumptions, the function initiating the IA, and by other taxpayer demographics, including age and income. We reiterate that any proposed indicator of economic hardship would not require the IRS to immediately determine the tax liability as currently not collectible but would rather require the IRS to conduct a basic financial analysis to ensure the taxpayer can pay toward the liability without incurring economic hardship.

BACKGROUND

In most years, the IRS enters into about three million IAs per year. Typically, over two-thirds of those agreements are streamlined agreements, meaning the IRS does not have to take any financial information from the taxpayer. This process reduces burden for most taxpayers and saves resources for the IRS — typically a win-win situation, except for those taxpayers that entered into a streamlined IA with the desire to pay but without the ability to pay on a regular or long-term basis without negatively impacting their ability to pay basic living expenses. The following figure shows the total IAs taken by the IRS and the number and percent of these agreements that were streamlined.

FIGURE 5.1, IRS Installment Agreements During the Past Four Fiscal Years¹⁵

Fiscal Year	Total Number of IAs	Number of Streamlined IAs	Percent Streamlined
2017	2,924,780	2,236,434	76%
2018	2,883,035	2,079,743	72%
2019	2,821,134	1,931,454	68%
2020	1,825,378	1,029,314	56%

As indicated by Figure 5.1, streamlined IAs accounted for only 56 percent of the total IAs agreed to by the IRS in FY 2020. However, the decrease in streamlined IAs likely results from the new IRS Taxpayer Relief Initiative designed to help taxpayers impacted by COVID-19 settle their IRS tax debts.¹⁶ Although designed to reduce taxpayer burden, the Taxpayer Relief Initiative may actually cause taxpayers financial harm by assisting them with establishing IAs they cannot afford.

¹⁴ IRS, CAR 5000-6 FY 2020 (Sept. 28, 2020).

¹⁵ IRS, CARs 5000-6 FY 2017 (Oct. 11, 2017), FY 2018 (Oct. 1, 2018), FY 2019 (Sept. 30, 2019), and FY 2020 (Sept. 28, 2020).

¹⁶ The IRS will automatically add certain new tax balances to existing IAs, for individual and out of business taxpayers. This taxpayer-friendly approach will occur instead of defaulting the agreement, which can complicate matters for those trying to pay their taxes. To reduce burden, certain qualified individual taxpayers who owe less than \$250,000 may set up IAs without providing a financial statement or substantiation if their monthly payment proposal is sufficient. Some individual taxpayers who only owe for the 2019 tax year and who owe less than \$250,000 may qualify to set up an IA without a notice of federal tax lien filed by the IRS. The expanded IA option also removes the requirement for financial statements and substantiation in more circumstances for balances owed up to \$250,000 if the monthly payment proposal is sufficient. Additionally, qualified taxpayers with existing Direct Debit IAs may now be able to use the Online Payment Agreement system to propose lower monthly payment amounts and change their payment due dates.

In FY 2019, the 12-month default rate for all IAs was nearly 15 percent. However, the Automated Collection System (ACS), which enters into the vast majority of streamlined IAs, has a default rate of nearly 20 percent.¹⁷ The default rate for streamlined IAs has been only slightly higher than the default rate for all IAs. However, just because a taxpayer does not default on an IA does not mean it is not causing economic hardship for the taxpayer or their family. A 2016 TAS study found that less than a quarter of all streamlined IAs defaulted when the amount owed was less than \$10,000, however, the default rate rose to over 40 percent when the amount owed exceeded \$10,000.¹⁸ Taxpayers likely forego needed expenditures to keep the IA. Moreover, taxpayers with incomes not in excess of their ALEs were ten percent more likely to have filing or payment noncompliance (or both) than taxpayers with incomes in excess of their ALEs.¹⁹ Placing taxpayers in streamlined IAs they cannot afford exacerbates future noncompliance, causes additional taxpayer burdens and increases the IRS workload.

In our 2018 MSP on the need for the IRS to use internal data to create an economic hardship indicator on taxpayer accounts, TAS analyzed nearly 300 non-streamlined IAs entered into during FY 2018. TAS examined the income reported on the most recently filed tax return and income reported on information return documents by third-party payers and compared this amount to the taxpayer's ALEs. TAS Research also looked for assets that could be leveraged to pay the liability. Taxpayers with assets were considered able to afford an IA.²⁰ The sample results showed nearly 95 percent agreement between the IRS determination that the taxpayer could pay, and the determination made by either detecting an asset or showing that a taxpayer's income exceeded the likely ALEs. Of the remaining five percent of cases (14 cases) where the algorithm and the IRS reached a different conclusion, the IRS had placed a back-up currently not collectible determination on the account, if the taxpayer defaulted on the IA, suggesting that the IRS also questioned whether the taxpayer could afford to pay.

OBJECTIVES

1. Determine if an algorithm using internal IRS data on taxpayers' income, basic demographics, likely allowable expenses, and assets can effectively determine if the taxpayer can afford an IA to satisfy outstanding tax liabilities;
2. Examine the algorithm's determination of ability to pay using different assumptions for estimating the ALEs; and
3. Explore the algorithm's effectiveness at different categories of age, income, and other demographics, such as the taxpayer's state of residence.

¹⁷ IRS CAR, IA Default Report, FY2019.

¹⁸ National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, at 54-65 (Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*).

¹⁹ *Id.*

²⁰ Taxpayers reporting a deduction for home mortgage interest or property tax, or who received a third party document reporting mortgage interest paid, were deemed to have systemically detected assets. For a complete explanation of the methodology used on this sample, please see National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*).

METHODOLOGY

The algorithm for determining if taxpayers have the wherewithal to make payments toward their delinquent tax ability has three components:

1. A comparison of income to allowable expenses;
2. Detectable assets; and
3. Whether the taxpayer was claimed as a dependent by someone else.

To determine a taxpayer's income for comparison to IRS ALEs, TAS Research extracted taxpayers where the IRS entered into non-streamlined IAs during FY 2017, 2018, 2019 or 2020.²¹ Non-streamlined IAs have an IA originator code of 10, 20, 30, 50, 58, 60, 70, 72, 75, or 80.²² Information was extracted from the last federal income tax return for the tax year (TY) before the year the IA was initiated.²³ The income reported on the tax return was compared to common information documents, including wages, interest income, dividend income, stocks and bonds, retirement income, Social Security, and self-employment income reported on Form 1099 Miscellaneous.²⁴ In all instances, information from third-party income came from the TY immediately prior to the year of the installment agreement. If the taxpayer had not filed the most recently due tax return prior to entering their IA, we used the information on the return from the preceding TY. We determined the taxpayer's income to be the larger of the total positive income reported on the return or the total of the income amounts on the information return documents described. Other information from the taxpayer's income tax return was also used, including total positive income, total exemptions, elderly status, state, and ZIP Code.

The IRS publishes allowable expense standards each year for the following expense types:

- National standards;
- Housing and utilities;
- Vehicle ownership expenses;
- Vehicle operating expenses; and
- Out-of-pocket health care expenses.

National standards include expense amounts for food, personal care items, and other incidentals and are a guaranteed amount based on household size, regardless of income or other circumstances.²⁵ Housing and utilities are classified as local expenses.²⁶ These expenses are maximum allowances based on household size and the county where the taxpayer resides. In practice, the taxpayer is awarded the smaller published housing and utility standard for the county of residence or the amount actually being spent by the taxpayer.²⁷ We assign taxpayers to a county based on the ZIP Code of the taxpayer's address on the return filed in the TY prior to the initiation of the IA (or the prior year's tax return if the return for the TY immediately before the IA was not filed). We used the ZIP Code to county conversion data provided to the IRS by the United States Postal Service to determine the county where the taxpayer resides. The basic algorithm for likely ALEs allows

21 TAS extracted data from the IMF on IRS CDW as of cycle 202030 to determine which taxpayers entered into streamlined IAs during the study period.

22 IRM Exhibit 5.19.1-10, IA Originator Codes (Sept. 26, 2018).

23 A taxpayer's total positive income, filing status, age and other basic demographic information necessary for computing ALE were obtained from the Individual Returns Transaction File on the IRS CDW.

24 Third party payor information was extracted from the Information Returns Master File (IRMF) on the IRS CDW.

25 IRM 5.19.13.3.2.3, National Standards: Food, Clothing and Other Items (Apr. 3, 2020).

26 IRM 5.15.1.8, Allowable Expenses Overview (July 24, 2019).

27 *Id.*

one vehicle ownership expense, which is based on the state or metropolitan statistical area where the taxpayer resides. Married taxpayers filing a joint return are allowed two vehicle operating expenses, while all other taxpayers are allowed one vehicle operating expense. The out-of-pocket health care expenses are guaranteed to each member of the household and a higher amount is allowed if the taxpayer is aged 65 or over, under the ALE standards.²⁸ Taxpayers who had not filed either of the tax returns for the two TYs ending before the year in which the IA was initiated were awarded the lowest amounts for each of the ALE standards. The FY 2020 ALE standards appear at the end of this report, except that the housing and utility expenses are so voluminous that only an excerpt is provided.

The IRS publishes ALEs in March of each year. The appropriate ALE standards were selected by comparing the date when each year's ALE standards became effective to the IA. We then compared the taxpayer's income to an estimate of the taxpayer's ALEs.

In the Findings section of this report, we also compare the IRS determination that the taxpayer could afford an IA with different assumptions about the ALEs allowed. We examined the comparison of ALEs to income when not allowing a vehicle ownership expense and when only considering the guaranteed ALEs, which include the national standard, out-of-pocket health care allowance, and a minimum transportation allowance.²⁹

The algorithm classifies taxpayers with income in excess of their ALEs as able to afford an IA. Additionally, the algorithm classifies taxpayers with systemically detected assets as being able to pay. Finally, taxpayers claimed as a dependent on another's tax return are also classified as able to pay, since another taxpayer is providing for more than half of their living expenses.

This report also examines whether the agreement rate of the algorithm using internal data to determine if a taxpayer can afford an IA differs by age, income category, or other demographic characteristics. This information may help to refine an algorithm using IRS internal data to determine the likelihood that the taxpayer can afford an IA. It should be noted that TAS is not proposing that IAs not be taken when there is an indication of economic hardship, but rather that the IRS perform a basic financial analysis to ensure the taxpayer can afford the IA.

Figure 5.2 describes the tax year of the return and the information return reporting documents, and the ALEs used to populate the algorithm, depending on the FY and the calendar year (CY) of the IA.

28 See IRS, Collection Financial Standards, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards> (last visited Oct. 29, 2020).

29 IRS, SERP Alert 20A0136, Allowable Living Expense Standards 2020 (Mar. 30, 2020).

FIGURE 5.2, Internal Data Informing ALE Algorithm

IA FY	IA CY	TY of Return Data	TY of IRMF Data	ALE Year*
2017	2016	Most recent of TY 2014 or TY 2015	2015	2016 or 2017
2017	2017	Most recent of TY 2015 or TY 2016	2016	
2018	2017	Most recent of TY 2015 or TY 2016	2016	2017 or 2018
2018	2018	Most recent of TY 2016 or TY 2017	2017	
2019	2018	Most recent of TY 2016 or TY 2017	2017	2018 or 2019
2019	2019	Most recent of TY 2017 or TY 2018	2018	
2020	2019	Most recent of TY 2017 or TY 2018	2018	2019 or 2020
2020	2020	Most recent of TY 2018 or TY 2019	2019	

* Depends on if the IA data is before the IRS March release date of new ALE standard amounts.

LIMITATIONS

If a taxpayer had two IAs in the same FY where the same ALE standards applied, the second IA in the same FY was removed from our analysis. Taxpayers with multiple IAs beginning in different FYs or with two IAs in the same FY, with different ALE standards because of the dates the IAs began were retained in the group of non-streamlined IAs analyzed.

This analysis uses tax return data prior to the date the IRS and the taxpayer initiated the IA, so the IRS could have access to the information indicating a high probability of economic hardship when the IA was initiated. However, because of computer processing times, the algorithm may need to use data available as of an earlier date (*e.g.*, for an IA initiated in March 2020, the tax return or information return reporting data might not be available until June 2020, meaning that the algorithm would need to look back to the TY 2018 return, instead of the 2019 return).

We compute the likely ALEs from the information on the tax return the taxpayer filed for no more than two TYs prior to the year in which the IA was initiated. However, the taxpayers may have moved, changed filing status, or experienced a change in the size of the household.

Non-streamlined IAs are determined by the IA originator code. However, a previous TAS study in 2018 found that many IAs coded as non-streamlined had no financial information in the case file, calling into question whether the IA was really non-streamlined. If the IAs are streamlined, then the IRS generally never examined the taxpayer's ability to afford the IA.

FINDINGS

We deemed the IRS to have conducted a financial analysis determining the taxpayer could afford an IA for all 242,085 IAs analyzed, since these IAs were coded by the IRS as non-streamlined. To compute likely ALEs, we included:

- The national standard amount for the household size indicated on the return filed no more than two years before the year of the IA;
- The maximum housing and utility standard for the taxpayer's county of residence and household size for the address and household size indicated on the return filed no more than two years before the year of the IA;
- Vehicle ownership expense for one car;
- Vehicle operating expense amount(s) (one vehicle operating expense for all taxpayers, except for those married taxpayers filing jointly, who were allowed two vehicle operating expense amounts); and
- The amount for out-of-pocket health care, depending on taxpayer age.

When considering an algorithm for indicating likely economic hardship using internal IRS data with these ALE amounts, Figure 5.3 shows how often the algorithm agreed with the IRS determination.

FIGURE 5.3, Algorithm Agreement With IRS Determination

Agrees	Volume	Percent
No	44,707	18%
Yes	197,378	82%
Total	242,085	100%

As shown in Figure 5.3, when examining the IRS non-streamlined IAs from FY 2017 through the time data was extracted to conduct this analysis in 2020, the algorithm comparing taxpayer income and likely ALEs agreed with the IRS determination nearly 82 percent of the time. This is obviously a smaller agreement rate than the nearly 95 percent agreement rate found by TAS in its 2018 MSP about the IRS's failure to use internal data to establish when economic hardship likely exists. A significant reason for this difference is likely the fact that in its 2018 sample, TAS only used non-streamlined IAs where the case actually contained financial information. TAS omitted non-streamlined IAs where no financial information was found after reviewing the case file.

Nevertheless, the algorithm's agreement rate is still in excess of 80 percent, and TAS is not requesting the IRS forgo an IA when the economic hardship indicator suggests the taxpayer cannot afford it, but rather that the IRS should perform a basic financial analysis to ensure the taxpayer can afford the IA. Conducting this financial review is important for streamlined IAs where the IRS rarely performs any financial analysis. Although the economic hardship indicator shows that 18 percent of these IAs likely cause the taxpayer economic hardship, the purpose is to ensure the IRS performs a financial analysis when the algorithm indicates an inability to pay. Other factors may be causing the algorithm to incorrectly indicate the taxpayer is likely experiencing economic hardship and cannot afford the IA. For example, the taxpayer may have moved, and the algorithm is assigning ALEs too high or the taxpayer may have income from a cash-based business, not detectable from internal information reporting documents. The algorithm's indication of likely economic

hardship should only prompt the IRS to perform a financial analysis to ensure the IA would not cause economic hardship before entering into the agreement.

When examining the IAs by FY, we see the agreement rate with the IRS is consistent across the four FYs, but increases slightly as the FYs progress, as indicated by Figure 5.4.

FIGURE 5.4, Algorithm Agreement Rate With IRS Determination by Fiscal Year

Fiscal Year	Agreement	Count	Percent
2017	No	13,937	19.5%
	Yes	57,594	80.5%
	Total	71,531	100%
2018	No	12,611	18.8%
	Yes	54,616	81.2%
	Total	67,227	100%
2019	No	12,569	18.0%
	Yes	57,188	82.0%
	Total	69,757	100%
2020	No	5,590	16.7%
	Yes	27,980	83.3%
	Total	33,570	100%
Grand Total (All FYs)	No	44,707	18.5%
	Yes	197,378	81.5%
	Total	242,085	100%

We also explored the effect of a change in the algorithm's assumptions about the ALEs allowed. Specifically, for the IAs analyzed, Figure 5.5 depicts the agreement rate with the IRS determination if no vehicle ownership expenses are allowed.

FIGURE 5.5, Algorithm Agreement With IRS Determination When ALEs Do Not Include Vehicle Ownership Expense

Agreement	Count	Percent
No	35,023	14%
Yes	207,062	86%
Total	242,085	100%

As indicated, eliminating vehicle ownership expenses from the ALEs considered by the algorithm increases the agreement rate with the IRS determination to about 86 percent.

Finally, we examined the agreement rate with the IRS determination if the algorithm allowed the minimum amount of ALEs only. As described in the Methodology section, the amounts for the national standard, out-of-pocket health care expenses, and the minimum public transportation are always allowed in full.³⁰ Figure 5.6 shows the agreement rate with the IRS determination when the algorithm only allows the guaranteed amount of ALEs, excluding any ALE amounts not guaranteed to the taxpayer.

FIGURE 5.6, Algorithm Agreement With IRS Determination When ALEs Only Includes Guaranteed Amounts of ALEs

Agreement	Count	Percent
No	9,914	4%
Yes	232,171	96%
Total	242,085	100%

This prior figure shows that an algorithm allowing only the minimum ALEs given to all taxpayers based on age and household size would agree with the IRS determination 96 percent of the time, strongly suggesting that even an algorithm allowing only those ALE amounts could prevent thousands of taxpayers from entering into streamlined IAs they cannot afford. For the remaining analyses we will only show the agreement rate between the IRS determination and the algorithm based on the likely ALEs described initially, although it is interesting to note that a high level of agreement exists between the minimum ALE allowances and the IRS determination.

30 IRS, SERP Alert 20A0136, Allowable Living Expense Standards 2020 (Mar. 30, 2020).

We explored agreement with the IRS determination by several factors, including the function that initiated the IA, income categories, and whether the taxpayer was under age 65 or age 65 and over. First, we divided the IRS function initiating the IA into three categories: the ACS, the Collection Field function (CFF), and all other functions initiating IAs. Figure 5.7 shows that the algorithm is most likely to agree with the IRS determination in CFF cases and least likely to agree with the IRS determination in IAs originated in other functions besides ACS or CFF.

FIGURE 5.7, Algorithm Agreement With IRS Determination by Function Originating IA

			IA Function			Total
			ACS	CFf	Other	
Algorithm Agreement - Can Pay	No	Count	31,271	4,359	9,077	44,707
		% within IA function	20%	10%	22%	18%
	Yes	Count	125,879	39,352	32,147	197,378
		% within IA function	80%	90%	78%	82%
Total		Count	157,150	43,711	41,224	242,085
		% within IA function	100%	100%	100%	100%

The agreement rate between the algorithm and the IRS determination varies by the different functions originating the IA. The cause of this difference may be triggered by the different requirements of each IRS function in requiring financial data. Next, examining the non-streamlined IAs by whether the primary or secondary taxpayer is aged 65 or over for those taxpayers filing a recent³¹ federal income tax return prior to the IA produces the data in Figure 5.8.

FIGURE 5.8, Algorithm Agreement With IRS Determination by Whether the Taxpayer Is Aged 65 or Older

			Under Age 65	Aged 65 and Over	Total
Algorithm Agreement - Can Pay	No	Count	34,441	4,152	38,593
		% in Age Category	18%	12%	17%
	Yes	Count	161,509	29,915	191,424
		% in Age Category	82%	88%	83%
Total		Count	195,950	34,067	230,017
		% in Age Category	100%	100%	100%

³¹ This figure only includes the 230,017 taxpayers who filed a federal income tax return for one of the two tax years prior to the IA.

The figure shows that the algorithm agrees with the IRS determination 88 percent of the time when the taxpayers are aged 65 or over but only 82 percent of the time when the taxpayers are under age 65.

As expected, the algorithm's agreement with the IRS determination increases as income rises. When income reported on a taxpayer's return or on third-party payor documents does not exceed \$25,000, the algorithm only agrees with the IRS determination 14 percent of the time. However, when the taxpayer's income exceeds \$50,000, the algorithm agrees with the IRS over 95 percent of the time. This data is depicted in Figure 5.9.

FIGURE 5.9, Algorithm Agreement With IRS Determination by Categories of Taxpayer Income

			Income Category					Total
			Less Than or Equal to \$25,000	Greater Than \$25,000 and Less Than or Equal to \$50,000	Greater Than \$50,000 and Less Than or Equal to \$75,000	Greater Than \$75,000 and Less Than or Equal to \$100,000	Greater Than \$100,000	
Algorithm Agreement - Can Pay	No	Count	22,932	19,760	1,966	48	1	44,707
		% within income category	86%	43%	5%	0%	0%	18%
	Yes	Count	3,764	26,250	36,555	27,838	102,971	197,378
		% within income category	14%	57%	95%	100%	100%	82%
Total		Count	26,696	46,010	38,521	27,886	102,972	242,085
		% within income category	100%	100%	100%	100%	100%	100%

To further analyze the accuracy of the algorithm at different income categories, we stratified the prior figure by whether the taxpayer had filed the most recently due federal individual income tax return prior to the IA.³² This data is depicted in Figure 5.10.

32 For example, for a 2019 IA, if the taxpayer timely filed his or her 2018 tax return, then the taxpayer filed the most recent Federal Individual Income return; however, if the 2018 tax return was not filed, the taxpayer had not filed the most recently due Federal Individual Income tax return due prior to the IA.

FIGURE 5.10, Algorithm Agreement With IRS Determination by Categories of Taxpayer Income by Whether Taxpayer Filed Most Recently Due Income Tax Return Prior to IA

				Income Category					Total
				Less Than or Equal to \$25,000	Greater Than \$25,000 and Less Than or Equal to \$50,000	Greater Than \$50,000 and Less Than or Equal to \$75,000	Greater Than \$75,000 and Less Than or Equal to \$100,000	Greater Than \$100,000	
Most Recently Due Individual Income Tax Return Before IA NOT FILED	Algorithm Agreement - Can Pay	No	Count	9,329	3,608	362	11	0	13,310
			% within income category	93%	35%	4%	0%	0%	24%
		Yes	Count	732	6,830	7,688	5,644	20,960	41,854
			% within income category	7%	65%	96%	100%	100%	76%
	Subtotal			10,061	10,438	8,050	5,655	20,960	55,164
Most Recently Due Individual Income Tax Return Before IA FILED	Algorithm Agreement - Can Pay	No	Count	13,603	16,152	1,604	37	1	31,397
			% within income category	82%	45%	5%	0%	0%	17%
		Yes	Count	3,032	19,420	28,867	22,194	82,011	155,524
			% within income category	18%	55%	95%	100%	100%	83%
	Subtotal			16,635	35,572	30,471	22,231	82,012	186,921
Grand Total			Count	26,696	46,010	38,521	27,886	102,972	242,085

When a taxpayer has income of \$25,000 or less and has filed the most recently due federal individual income tax return prior to the IA, the algorithm is somewhat more likely to agree with the IRS determination compared to taxpayers who have not filed the most recently due individual income tax return (18 percent versus seven percent). However for taxpayers earning over \$25,000, but not over \$50,000, the algorithm is less likely to agree with the IRS determination when the most recently due federal individual income tax return prior to the IA has been filed compared to taxpayers who have not filed the most recently due individual income tax return (55 percent versus 65 percent). Whether or not a taxpayer has filed the most recently due federal individual income tax return prior to the IA does not satisfactorily explain why the algorithm is so much less likely to agree with the IRS determination when the taxpayer earns \$50,000 or less.

Since the algorithm's agreement with the IRS determination that the taxpayer can afford an IA is so different for taxpayers earning \$50,000 or less, we produced Figure 5.11 showing the agreement rate when the algorithm provides the lowest possible amount of ALEs only.³³

FIGURE 5.11, Algorithm Agrees With IRS Determination When ALE Only Includes Guaranteed Amounts of ALE for Taxpayers With Incomes Not Exceeding \$50,000

			Income Category		Total
			Less Than or Equal to \$25,000	Greater Than \$25,000 and Less Than or Equal to \$50,000	
Algorithm Agreement - Can Pay	No	Count	9,900	121	10,021
		% within income category	37%	0%	14%
	Yes	Count	16,796	45,889	62,685
		% within income category	63%	100%	86%
Total		Count	26,696	46,010	72,706
		% within income category	100%	100%	100%

While nearly all taxpayers earning between \$25,000 and \$50,000 have income in excess of their minimum ALEs (or a detectable asset), 37 percent of taxpayers with incomes \$25,000 or less earn less than their minimum ALEs. Reasons do exist why the ALEs could be lower, most notably because the taxpayer's household size decreased since the return used to inform the algorithm or because the taxpayer has income not easily detectable from systemic data. Nevertheless, the possibility also exists that either the IA was mistakenly coded as non-streamlined or the IRS did not allow the proper ALEs. Regardless, requiring the IRS to perform a basic financial analysis would protect taxpayers from entering into IAs they cannot afford and could reduce the IA default rate.

The agreement rate between the algorithm estimating taxpayer income and ALEs vary among the states. However, the agreement rates between the algorithm and the IRS determination for taxpayers in North Dakota, South Dakota, and Wisconsin are about ten percentage points higher than the agreement rates in the District of Columbia, Florida, or New York. The agreement rates in the United States' possessions and territories is generally low. This lower rate of agreement in the possessions and territories is to be expected, since the IRS does not publish a complete set of ALE standards for these areas and therefore the algorithm often only allows the taxpayer the lowest national ALE amount for that standard.

³³ Taxpayers are always entitled to the national standard for their household size, the full amount of the transportation standard for public transportation, and the allowance for out-of-pocket health care expenses.

We also explored the agreement rates by filing status for the approximately 230,000 taxpayers who had filed a federal income tax return in one of the two years prior to entering the IA. As Figure 5.12 indicates, the algorithm agrees with the IRS determination over 90 percent of the time for married taxpayers, but only about 75 percent of the time for taxpayers filing with the single or head-of-household filing statuses. These unmarried taxpayers have both mean and median incomes in excess of \$50,000 so the lower agreement rate between the ALE algorithm and the IRS determination is not likely related to the algorithm being less likely to determine that lower income taxpayers can afford an IA, which we discussed previously.

FIGURE 5.12, Algorithm Agreement With IRS Determination by Filing Status

Filing Status			Single	Married Filing Joint ³⁴	Married Filing Separate	Head of Household
Algorithm Agrees - Can Pay	No	Count	22,807	7,647	2,727	5,412
		% within filing status	26%	8%	15%	24%
	Yes	Count	64,500	94,184	15,365	17,375
		% within filing status	74%	92%	85%	76%
Total		Count	87,307	101,831	18,092	22,787
		% within filing status	100%	100%	100%	100%

CONCLUSIONS

- An algorithm using internal IRS data to compare taxpayer's income to their likely ALEs³⁵ agrees with the IRS determination 82 percent of the time. The agreement rate rises to 86 percent if the taxpayer's ALE does not include any vehicle ownership expense.
- Agreement between an algorithm allowing taxpayers their likely ALE expenses and the IRS determination has increased slightly from FY 2017 to FY 2020.
- An algorithm comparing internal IRS income data to the minimum amount of ALEs provided to taxpayers has a 96 percent agreement rate with the IRS determination that the taxpayer could afford an IA.
- An algorithm using internal IRS data to compare taxpayers' incomes to their likely ALEs is more likely to agree with the IRS determination when the taxpayers are elderly, when the income exceeds \$50,000, or when the taxpayers are married. However, the same algorithm is unlikely to agree with the IRS determination for taxpayers with systemically detected income of \$25,000 or less.

³⁴ Includes a small number of taxpayers filing as qualifying widow(ers).

³⁵ Likely ALEs include the national standard for the taxpayer's household size, the maximum allowance for housing and utilities based on the taxpayer's county of residence, one vehicle ownership allowance and vehicle operating expense allowance(s) (the taxpayer would be given an allowance for operating two vehicles if the taxpayer files a joint return) based on the location of the taxpayer's residence, and an allowance for out-of-pocket health care expenses.

RECOMMENDATION

The IRS should implement an economic hardship indicator on taxpayer accounts when estimates of a taxpayer's ALEs and income indicate the taxpayer is not likely to afford a streamlined IA. If the indicator shows the likelihood of economic hardship, procedures would direct the IRS to perform a basic financial analysis before entering into the IA to ensure the taxpayer can afford it without causing additional financial hardship and potentially triggering unnecessary defaults.

ALLOWABLE LIVING EXPENSES

Allowable living expenses for 2020 (which went into effect on March 30, 2020) are shown in Figures 5.13 through 5.16.

FIGURE 5.13, Allowable Living Expenses National Standards

Expense	One Person	Two Persons	Three Persons	Four Persons
Food	\$385	\$715	\$779	\$947
Housekeeping supplies	\$45	\$67	\$73	\$71
Apparel & services	\$85	\$158	\$192	\$251
Personal care products & services	\$43	\$73	\$74	\$88
Miscellaneous	\$157	\$285	\$315	\$383
Total	\$715	\$1,298	\$1,433	\$1,740

More than four persons	Additional Persons Amount
For each additional person, add to four-person total allowance:	\$378

FIGURE 5.14, Transportation Standards

Public Transportation		
National	\$224	
Ownership Costs		
Region	One Car	Two Cars
National	\$521	\$1,042
Operating Costs		
Region	One Car	Two Cars
Midwest Region	\$188	\$376
Chicago	\$188	\$376
Cleveland	\$188	\$376
Detroit	\$314	\$628
Minneapolis-St. Paul	\$178	\$356
St. Louis	\$174	\$348
Region	One Car	Two Cars
Northeast Region	\$242	\$484
Boston	\$221	\$442
New York	\$319	\$638
Philadelphia	\$282	\$564
Region	One Car	Two Cars
South Region	\$193	\$386
Atlanta	\$231	\$462
Baltimore	\$233	\$466
Dallas-Ft. Worth	\$289	\$578
Houston	\$259	\$518
Miami	\$286	\$572
Tampa	\$213	\$426
Washington, DC	\$232	\$464
Region	One Car	Two Cars
West Region	\$209	\$418
Anchorage	\$162	\$324
Denver	\$217	\$434
Honolulu	\$178	\$356
Los Angeles	\$254	\$508
Phoenix	\$225	\$450
San Diego	\$230	\$460
San Francisco	\$231	\$462
Seattle	\$250	\$500

FIGURE 5.15, Out-of-Pocket Health Care Standards

Under 65	65 and Older
\$56	\$125

FIGURE 5.16, Excerpt of Housing and Utilities Standards for Alabama

County	Housing and Utilities for a Family of 1	Housing and Utilities for a Family of 2	Housing and Utilities for a Family of 3	Housing and Utilities for a Family of 4	Housing and Utilities for a Family of 5 or more
Autauga County	\$1,256	\$1,476	\$1,555	\$1,734	\$1,762
Baldwin County	\$1,410	\$1,656	\$1,745	\$1,946	\$1,977
Barbour County	\$1,067	\$1,253	\$1,320	\$1,472	\$1,496
Bibb County	\$1,187	\$1,394	\$1,469	\$1,638	\$1,664
Blount County	\$1,193	\$1,401	\$1,476	\$1,646	\$1,672
Bullock County	\$1,126	\$1,322	\$1,393	\$1,553	\$1,578
Butler County	\$1,056	\$1,240	\$1,307	\$1,457	\$1,481
Calhoun County	\$1,147	\$1,347	\$1,419	\$1,582	\$1,608
Chambers County	\$1,064	\$1,250	\$1,317	\$1,468	\$1,492
Cherokee County	\$1,206	\$1,416	\$1,492	\$1,664	\$1,690
Chilton County	\$1,130	\$1,327	\$1,398	\$1,559	\$1,584
Choctaw County	\$1,064	\$1,250	\$1,317	\$1,468	\$1,492
Clarke County	\$1,199	\$1,408	\$1,484	\$1,655	\$1,681
Clay County	\$1,097	\$1,289	\$1,358	\$1,514	\$1,539
Cleburne County	\$1,210	\$1,421	\$1,497	\$1,669	\$1,696
Coffee County	\$1,238	\$1,454	\$1,532	\$1,708	\$1,736
Colbert County	\$1,131	\$1,329	\$1,400	\$1,561	\$1,586
Conecuh County	\$977	\$1,147	\$1,209	\$1,348	\$1,370
Coosa County	\$1,021	\$1,199	\$1,263	\$1,408	\$1,431
Covington County	\$1,071	\$1,258	\$1,326	\$1,478	\$1,502
Crenshaw County	\$1,088	\$1,278	\$1,347	\$1,502	\$1,526
Cullman County	\$1,131	\$1,329	\$1,400	\$1,561	\$1,586
Dale County	\$1,110	\$1,304	\$1,374	\$1,532	\$1,557
Dallas County	\$1,077	\$1,265	\$1,333	\$1,486	\$1,510
DeKalb County	\$1,088	\$1,277	\$1,346	\$1,501	\$1,525
Elmore County	\$1,316	\$1,546	\$1,629	\$1,816	\$1,846
Escambia County	\$1,088	\$1,278	\$1,347	\$1,502	\$1,526
Etowah County	\$1,166	\$1,369	\$1,443	\$1,609	\$1,635