SOME OBSERVATIONS ON TAX ADMINISTRATION AND THE DIGITAL REVOLUTION

Nina E. Olson

National Taxpayer Advocate, United States Internal Revenue Service

ATAX Conference, 05 April 2018

Sydney, Australia

As the National Taxpayer Advocate at the United States Internal Revenue Service (IRS), I lead the Taxpayer Advocate Service (TAS), an organization charged by Congress with helping taxpayers resolve their problems with the IRS and making administrative and legislative recommendations to mitigate those problems.[1] It is my job to think about tax administration from the perspective of the taxpayer and through the lens of taxpayer rights protections. That doesn't mean I am insensitive to the agency's resources constraints – constraints that show up in budgetary, technology, regulatory, and political contexts. It just means that my focus, first and foremost, is how an initiative will affect taxpayers – large and small, business and individual – and how it will enhance or undermine taxpayer rights.

Over the years, my office has done significant research into the impact of the digital age on tax administration. Our work has focused not only on understanding the taxpayer service needs and preferences of US taxpayers,[2] but also how the traditional audit, control, and collection techniques affect taxpayers' understanding of the tax law, their relationship and attitudes to the tax administrator, and their subsequent compliance behavior.[3] In addition to our research studies and surveys and focus groups, in 2016 I travelled the breadth and depth of the US and convened 12 Public Forums on Taxpayer Needs and Preferences, in conjunction with Members of the US House of Representatives and the Senate. The complete transcripts of these fascinating public meetings are available on our website.[4] I have also convened two International Conferences on Taxpayer Rights, with the third one coming up in Amsterdam in May of this year.[5]

All of this work has led me to many observations and recommendations, and to a few conclusions. But before I get into the fullness of my remarks, I must state that what I say here is my view, mine alone,

---

[1] *See* 26 USC 7803(c).

[2] *See, e.g.*,*A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs* (2017 National Taxpayer Advocate Annual Report to Congress, hereinafter "ARC"); *Taxpayers' Varying Abilties and Attitudes toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups* (2016 ARC); *Understanding the Hispanic Underserved Population* (2015 ARC); *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics* (2014 ARC).

[3] *See, e.g.*, *Audits, ID Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey* (M. Kaspar, S. Beer, E. Kirchler, and B. Erard, 2017 ARC); *Audit Impact Study* (S. Beer, B. Erard, E. Kirchler, and M. Kaspar, 2015 ARC); *Estimating the Impact of Audits on The Subsequent Reporting Compliance of Small Business Taxpayer: Preliminary Results* (2015 ARC); *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?* (2013 ARC*); Small Business Compliance: Further Analysis of Influential Factors* (2013 ARC); *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results* (2012 ARC); *Subsequent Compliance Behavior of Delinquent Taxpayers: A Compliance Challenge Facing the IRS* (2009 ARC)

[4] *See* https://taxpayeradvocate.irs.gov/news/national-taxpayer-advocate-public-forums.

[5] *See* www.TaxpayerRightsConference.com for paper, videos, and more information about the conference.

and not that of the US Government, the Treasury Department, or the IRS. Those views, however, do happen to be identical to the views of the National Taxpayer Advocate. I encourage you to check out my Annual Reports to Congress, my congressional testimony, my blogs for the wealth of data that backs up my statements.

Moving taxpayers to digital platforms is not as easy, nor as desirable, as it first appears.

First, from the IRS's perspective, its "Future State" initiative is all about moving taxpayers to digital interactions. Although it regularly states that there will always be taxpayers who want to talk on the phones or come to field assistance sites, and we need to be there for them, the underlying assumption is that those stragglers will eventually die out or get with the program. The IRS wants this because it views digital interactions with taxpayers and digital "self-service" options as less expensive than talking on the phone or in person with taxpayers. The IRS also maintains taxpayers want digital interactions.

It turns out that those pesky taxpayers have very different ideas. For starters, TAS research surveys of a representative sample of active US individual taxpayers found that 41 million taxpayers do not have broadband access in their homes, and 14 million individual taxpayers do not have <u>any</u> internet access in their homes. Now, 41 million is not a trivial number, when you have about 150 million individual US returns filed each year. The irs.gov website has over 140,000 webpages, sure to increase with the recent passage of tax reform. Try searching those pages on a smartphone with limited pay-as-you-go data usage, sitting in a coffee shop. Think about signing on to your online account, containing all your and your family's personal financial data, with strangers sitting next to you in the library or on buses or in coffee shops, just because you don't have good internet in your home.

It is not just taxpayers with limited or no internet access who have concerns about using digital platforms for their taxes. Our surveys found that *over half of the taxpayer respondents were not comfortable sharing their personal financial information on the internet, and nearly forty percent did not like sharing personal information with the government.* These concerns cut across all income and even some age levels; they appear to have more to do with concerns about fear and privacy. I think if we conducted this survey today those fears would be heightened, given recent breaches involving hundreds of millions of individuals personal data.

Cybersecurity, in fact, may prove to be the most significant impediment to broad digital usage in the US tax system. The IRS databases constitute several of the major "assets" of the federal government. Rightfully so, the IRS has stringent restrictions on electronic access. IRS employees are not able to email taxpayers about their account issues; our email screens routinely stop outgoing emails that contain 9-digit numbers for fear they might be social security numbers. In order to create an IRS online account (that provides you access to only rudimentary information about your life as a taxpayer), the taxpayer must pass 3-factor authentication. As a result, only about 30 percent of taxpayers who try to create an online account are successful in doing so. A recent 9-month TAS pilot offering email and digital document uploading capabilities to over 750 low income taxpayers under audit or experiencing levies resulted in <u>fewer than 10</u> taxpayers creating an account. Not surprisingly, IRS online accounts today are in the thousands, as compared to over 150 million U.S. taxpayers.

But leaving aside the security concerns, taxpayers are inherently suspicious of the IRS vision of its "Future State" because, as one member of the audience stated at a Public Forum, it smacks of "Big Brother." As a means of explaining to taxpayers what the Future State vision entailed, the IRS published four "vignettes" – showing how the digital environment would work, including with individual and small business taxpayers under audit. Another audience member at a different Public Forum noted that, "I found it funny that in both scenarios, there's more taxes. I thnik that reflects the idea that this model is about the IRS finding new ways to use technology for their benefit, and not for the taxpayer purposes."[6]

It is that motivation – to save resources by not talking to taxpayers -- that keeps showing up in study after study, and in the design of compliance initiatives. A recent IRS study of the impact of different messages in IRS collection notices is very telling about the agency motives – conscious or unconscious – for moving to digital.[7] In the study, the IRS tested the use of various messages on a collection letter that was issued to taxpayers who had a tax debt but for whom the IRS could not identify any levy sources. The original letter had been used for years to encourage these taxpayers to call the IRS and enter into payment arrangements, since the IRS couldn't find any wages or bank accounts to garnish or seize. (I have commented elsewhere on the harmful policy of the IRS levying first and talking later.) In the study, the IRS redesigned several of the test notices that "were engineered specifically to reduce inbound telephone calls." The notices "encouraged taxpayers to use self-service channels" and "reduced the visual prominence of the telephone contact number on the printed notice."

So what happened? Not surprisingly, when the online account link is prominently displayed on the notice and the correct phone number is hidden, taxpayers are more likely to use self-service channels. But, but, but . . . "the results of the test pilot suggest that when the telephone contact number is not highly visible, taxpayers use other methods to locate an IRS telephone number that they can call for assistance . . . . all [test letters] resulted in more telephone calls to numbers not printed on the notice compared to the Control Group . . . . In fact, four of the redesigned notices generated more inbound mail than the Control notice, all of which were statistically significant results." The study found that notices that threatened more compliance actions tended to generate more phone calls and mail correspondence.

It is just baffling to me why the IRS doesn't want to talk to people who are getting things wrong on their tax returns or who owe us money. I just don't understand it, and, as the IRS study shows, it doesn't really save resources after all. Of course no one wants to engage in a conversation with the tax agency if they don't have to. But if you have to, then, from the agency's perspective, this is an opportunity to educate the taxpayer, and learn about the taxpayer's perspective, confusion, life or business circumstances – all of which can have an effect on the taxpayer's tax position and liability. The opportunity for a dialogue and for education are so much greater in person-to-person conversations.

---

[6] Audience comment, *National Taxpayer Advocate Public Forum on Taxpayer Needs and Preferences*, Portland, OR (August 18, 2016), transcript at 39 at https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/PortlandOR_Transcript_081816.pdf.

[7] Internal Revenue Service, ACS Optimization/RAAS, *ACS LT16 Notice Redesign: Test Pilot Report* (September 27, 2017).

And taxpayers know that. Our and others' survey data show that taxpayers prefer digital interaction for relatively simple tasks like checking your account balance, the status of transactions and the like. But when they receive a notice or have a problem, they want to talk to someone. Their frustration with the phones is primarily that they can't get through, or the assistor couldn't help them.

That's where the limitations of technology come in. The IRS's system of storing taxpayer data is not a central database(or even a few databases) containing all transactions and information about that taxpayer. The IRS has, depending on how you measure it, from 60 to 200 case management systems, all of which contain bits and pieces of the taxpayer's life. In fact, according to the Government Accountability Office, IRS individual and business taxpayer data are maintained on the two oldest databases in the federal government! There is no 360 view of the taxpayer, with the taxpayer as the center of the universe. So when a taxpayer calls for assistance, or signs on to the rudimentary online account, only a bit of information is available. IRS customer service assistors do not have access to significant amounts of taxpayer information – and because of that, their ability to assist is limited. The IRS is now in the process of finally planning an "Enterprise Case Management System" that will adopt a 360 view of the taxpayer, but that system is as yet not fully funded, and it relies on funding and development of links to major underlying systems. Until the ECM and related systems come on line – which will be years away – there is no "Future State," and we are stuck in last quarter 20th century technology even as we approach the second quarter of the 21st century.

The law itself – or the interpretation of it – also undermines the move to digital communication. As I discussed in my preface to the 2017 Annual Report to Congress and in a recent blog posting, IRS Counsel has declined to apply the "mailbox rule" to digital communications. Under the statutory mailbox rule, if a taxpayer timely submits certain legally important documents – say, a tax return – to the post office with the proper postage and proper address, the date of mailing will control rather than the date the IRS actually receives the document.[8] If the IRS wants to encourage digital communication, one would think it would apply the mailbox rule to those communications. That is, if the taxpayer can prove the date of successful submission of documents by fax, or by email, then that date would control, regardless of the date (or whether) the IRS received the documents. But the IRS has declined to do so, on advice of Counsel, because it believes taxpayers will manipulate the date of fax machines and emails. The implicit bias – that taxpayers will all cheat and cannot be trusted – rears its ugly head. Thus, tax professionals filing documents on behalf of their clients submit them in hard copy to gain the protection of the mailbox rule. A self-defeating policy, to say the least.

Artificial Intelligence, Decision Trees, and Big Data are mixed blessings

Another thing that puzzles me greatly is why the IRS does not use technology to help taxpayers get to the right answer as well as help itself (ostensibly) save resources. This is particularly true in devising tools and utilizing "Big Data" or artificial intelligence to identify compliance issues or automate workstreams. In 2002 or so, the IRS created a decision-tree tool cause the "Reasonable Cause Assistor" or RCA. This tool is a question-and-answer path that allows low-level IRS customer service

[8] 26 USC 7502.

representatives as well as high-level agents to determine whether a civil penalty should be abated for reasonable cause. As with any good decision tree, which is only as good as the knowledge and skill of the experts designing it, the tool has a built-in override function so employees can grant relief in unanticipated (and unprogrammed) situations. The problem is, at the same time the IRS created the tool, it stopped training its people on the legal basis for reasonable cause. So, an IRS study of customer service representatives applying the tool showed that in <u>every</u> situation where the RCA provided the wrong answer and should have been overridden, the assistor did not do so. Why? Because the assistor didn't know the answer was wrong! Herein lies the danger of tools such as this – we forget that the human being, as flawed as it is, is still vitally necessary in these feedback loops. If we make the human being ignorant, he or she won't be able to catch when the tool isn't working correctly; he or she will assume the tool is right, and great and repeated harm will be done.

As I said earlier, programming is only as good as the people behind it. A few years ago, in one of my Annual Reports to Congress, I identified "Policy through Programming" as one of the most serious problems for taxpayers. (The title was much more mundane, but that's what I called it ….) We pointed out that when the IRS issues written instructions to its staff, that guidance goes through a review process that allows different departments of the IRS and TAS and Chief Counsel to review and comment on it before publication. And the Freedom of Information laws of our country generally require all instructions to staff to be publicly available, including in an electronic reading room. But if policy is programmed into a computer system, whether as decision tool steps or conclusions, or as filters or business rules, there is no such comprehensive review. There are no checks and balances, particularly for taxpayer rights violations, implicit bias, or just plain legal accuracy.

We found an example of this with the Reasonable Cause Assistor. The IRS instituted a policy that it will abate the failure to pay or failure to file penalty once every three years if the taxpayer has otherwise been compliant during those three years, even if the taxpayer did not have reasonable cause (as defined in regulations and case law) for the lateness. TAS had a case – which the taxpayer has agreed to let me discuss in general terms – where the husband received the late penalty in year 1, before he was married and when he had filed a single return. In year 2, the husband and wife married and filed a joint return. In year 3, the husband died. There was a late payment penalty for year 2, and the wife/widow came in asking for penalty abatement. The RCA decision tool said no, because she had received First Time Abatement in Year 1. Never mind that <u>her husband as a single taxpayer</u> had received the abatement and <u>she</u> had never received that abatement before. The machine looked only at the husband's account and ignored her – the requestor – entirely.

Now, we got that fixed, but it makes my point. If we don't know what is in these rules and machines, if the assumptions and rules aren't subject to the same comprehensive review as written public guidance, well, we have secret law. And if our employees who use these tools aren't trained in the underlying principles and law so they can identify when the machines and tools are incorrect, well, the fairness and integrity of the tax system is fully undermined. The risk of these tools is we turn tax agency employees into automatons.

Global tax administration requires global taxpayer rights protections

Today we are witnessing a transformation of tax administration in light of the vast array of information that is now available to tax agencies globally. International exchange agreements and other global standards allow agencies in one part of the world to obtain data collected by another agency in a different part of the world. While this is enormously helpful in identifying offshore evasion, there are also enormous risks to taxpayer rights. Three recent blog posts of mine show the problems that occur when the availability of this data is combined with the implicit bias that everyone and anyone who has accounts overseas is a "bad actor."[9] The principle of proportionality of penalties is thrown out the window, among other things. Even more importantly, there is to date no effective global mechanism for dispute resolution – so with the exchange of information between multiple jurisdictions, a taxpayer may find him/her/itself defending in multiple countries, and ultimately be forced to accede simply because of the cost.

And then there are the privacy risks associated with this exchange of information. The U.S. has significant taxpayer protections relating to disclosure and use of taxpayer information. Yet the U.S. is in the process of entering into information exchange agreements where it acknowledges the other country/party does not have the same level of cybersecurity protections as the IRS has. The IRS has identified this as a risk, identified mitigations, and determined that it is a risk it can accept. This is astonishing – because it proceeds from a false assumption that the risk is something that belongs to the IRS. In fact, we are talking about <u>taxpayer</u> data here, it is the <u>taxpayer's</u> information that is at risk, and therefore the <u>taxpayer</u> should be informed that the IRS is placing his/her/its data at risk. There should be public notice and comment for information exchange agreements, and public notification of the security risks associated with the proposed agreement. And, with few exceptions, there should be individual notice to the taxpayer when his/her/its data has, in fact, be shared.

Concluding thoughts ….

So why does all this matter? We all use technology every single day, indeed almost every moment of the day, and we benefit greatly from the profound advances in the digital world in last year or two, let alone in my lifetime. But, as I've outlined above, there are downsides and risks in this world and if we aren't alert to them and design our systems to protect against those risks, we will harm taxpayers.

That is why I am a proponent of talking <u>with</u> the taxpayer, of designing systems that do not dumb down human intelligence but actually require us to exercise our intelligence in the course of operating them, of creating full transparency when programming policies and business rules, of creating effective global dispute resolution systems for participants in information exchange agreements, and for never forgetting, in this digital age, that at its most fundamental level, taxation deals with the vagaries of human existence -- "life in all its fullness." If we ignore that, we will erode the will to comply and we will lose our legitimacy as tax administrators.

---

[9] *See NTA Blog: An Analysis of Tax Settlement Programs as Amnesties (3 parts),* (March 14, 21, 30, 2018) at https://taxpayeradvocate.irs.gov/news/tax-news.