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Accessible Reliable Tax Advice

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ACCESSIBLE RELIABLE TAX ADVICE

Emily Cauble*

Unsophisticated taxpayers who lack financial resources are disadvantaged by a shortage of adequate tax advice. The IRS does not have the resources to answer all questions asked, and the IRS's informal advice comes with no guarantee as to its accuracy and offers the taxpayer no protection when it is mistaken. Furthermore, non-IRS sources of advice have not sufficiently filled the void left by a lack of satisfactory IRS guidance. These biases against unsophisticated taxpayers have been noted by existing literature. This Article contributes to existing literature by proposing several novel reform measures to assist unsophisticated taxpayers.

First, with respect to certain key provisions intended to benefit low-income taxpayers, such as the earned income tax credit, Congress should act to provide unsophisticated taxpayers the protection offered by more formal types of guidance. In order to implement this first proposal, Congress should direct the IRS to verify and stand behind the accuracy of tax software that addressed key provisions, such as the earned income tax credit. The government would stand behind its guarantee of accuracy in two respects. First, if a taxpayer provided accurate information when operating the software and the software indicated, wrongly, that the taxpayer was entitled to certain tax benefits, the IRS would not later assess additional tax liability, interest, or penalties against the taxpayer. Second, if a taxpayer provided accurate information when operating the software, the software indicated, wrongly, that the taxpayer was not entitled to certain tax benefits, and the taxpayer discovered this error after the typical limitations period for filing an amended return had expired, then Congress would grant the taxpayer additional time to amend his or her tax return to claim the benefits to which he or she was, in fact, entitled.

Second, this Article proposes that states should require that certified public accountants either provide a minimum number of hours of pro bono services annually or donate a minimum amount annually to support Volunteer Income Tax Assistance sites. Third, Congress should implement a new procedure for assessing penalties and interest against taxpayers whose incomes are below a certain threshold. Under this new procedure, if the taxpayer's return was prepared by a paid preparer, any penalties and interest that would otherwise be assessed against the taxpayer should be assessed, instead, against the preparer, unless the preparer could prove either that he or she sought adequate information from the taxpayer and tax consequences were reported correctly based on the information provided by the taxpayer or that the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer. In addition, if a preparer did obtain a waiver, the preparer would be precluded from offering any type of audit insurance

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(or, stated another way, if the preparer did offer any type of audit insurance, doing so would nullify the waiver).

INTRODUCTION	590
I. SHORTCOMINGS OF IRS GUIDANCE	594
II. LACK OF ALTERNATIVES	601
III. PROPOSED SOLUTIONS	603
A. <i>More Reliable IRS Guidance</i>	605
B. <i>Pro Bono Requirements</i>	611
C. <i>New Penalty Procedures</i>	614
CONCLUSION	619

INTRODUCTION

Given the complexity inherent in tax law, determining the tax consequences of various events and preparing tax returns can be onerous tasks for anyone. For taxpayers who possess financial resources, ready assistance is available. For unsophisticated taxpayers who lack financial resources, however, accessible and reliable tax guidance is in short supply.

In some cases, sophisticated taxpayers might seek advice from the IRS. For example, a sophisticated taxpayer might seek a private letter ruling from the IRS. When existing tax authority does not provide clear guidance regarding the tax consequences of a contemplated transaction, a taxpayer may, in some circumstances, request a private letter ruling. As a practical matter, only sophisticated taxpayers obtain private letter rulings, in part because applying for one is no simple matter. To obtain such a ruling, the taxpayer must pay a filing fee and the taxpayer must prepare and submit a detailed ruling request that describes all of the relevant facts, the questions on which the taxpayer seeks a ruling, relevant legal authority, and how the authority applies to the taxpayer's facts.¹ A taxpayer who receives a private letter ruling can generally rely upon it as long as the taxpayer provided complete and accurate facts in the request. If the IRS later discovers that the ruling reached an incorrect result because it was based upon the IRS's incorrect interpretation of legal authority, the IRS's general practice is to not revoke the ruling retroactively.²

1. Rev. Proc. 2017-1, 2017-1 I.R.B. 1.

2. See Treas. Reg. § 601.201(d)(5) (as amended in 2002) ("Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued . . . if (i) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not

Rather than seek advice from the IRS, a sophisticated taxpayer might obtain an opinion from a tax expert which can, in some cases, provide protection against penalties if the IRS later challenges successfully the tax consequences reported by the taxpayer.³ A sophisticated taxpayer who desires even more robust protection might obtain transactional tax risk insurance from an insurance company. If the IRS successfully challenges tax results claimed by the taxpayer with respect to a specific transaction, transactional tax risk insurance will reimburse the taxpayer for any resulting increase in tax liability, interest, or penalties.⁴

For unsophisticated taxpayers who lack financial resources, the task of accurately determining and reporting tax consequences is much more daunting. For such taxpayers, the cost of seeking a private letter ruling forecloses the possibility of obtaining such a ruling as a practical matter.⁵ Therefore, if an unsophisticated taxpayer who lacks financial resources obtains any IRS guidance, it is likely to be informal advice, such as oral advice provided by an IRS representative via the IRS helpline.⁶

Although taxpayers can typically rely on formal advice such as private letter rulings, taxpayers generally cannot rely on informal IRS guidance.⁷ For example, a taxpayer might be informed by an IRS helpline representative, incorrectly, that he or she can claim a given tax credit. If the IRS later audits the taxpayer and assesses additional tax liability, interest, and penalties, the taxpayer will not

materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was originally issued with respect to a prospective or proposed transaction, and (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment.”).

3. For recent discussion of the extent to which opinions offer protection against penalties and for a proposal to limit this protection, see Calvin H. Johnson, *Ending Reliance on Tax Opinions of the Taxpayer's Own Lawyer*, 141 TAX NOTES 947 (2013). For discussion of how the ability to rely on expert advice disproportionately benefits the wealthy, see, for example, William A. Drennan, *Strict Liability and Tax Penalties*, 62 OKLA. L. REV. 1, 28 (2009) (“An exception for reliance on a tax advisor poses distributive justice problems because it greatly benefits the rich. Tax advisors need to charge fees for their services, and rich taxpayers with big tax dollars at stake are more likely than the working class or the poor to purchase tax opinions to provide penalty immunity.”).

4. For further discussion of this insurance, see, for example, Kyle D. Logue, *Tax Law Uncertainty and the Role of Tax Insurance*, 25 VA. TAX REV. 339, 388 (2005) (“The policies typically cover the amount of the tax deficiency as well as any interest and penalties that are assessed up to the limits of the policy. . . . As do virtually all commercial liability insurance policies, tax indemnity policies include a substantial deductible . . .”).

5. In addition, the IRS will not address many of the types of questions asked by such taxpayers in a private letter ruling. For further discussion, see Emily Cauble, *Detrimental Reliance on IRS Guidance*, 2015 WIS. L. REV. 421, 464.

6. See *infra* notes 31–33 and accompanying text.

7. See *infra* notes 23–26 and accompanying text.

be able to rely on the informal advice received by phone to avoid paying the underlying tax liability and interest.⁸ The taxpayer might avoid paying penalties but only if the taxpayer can prove that he or she reasonably relied on the advice.⁹ Similarly, an IRS helpline representative might inform a taxpayer, incorrectly, that he or she cannot claim a given tax credit. If the taxpayer later discovers that he or she could have claimed the credit but makes this discovery after the limitations period for amending his or her earlier return has expired, the taxpayer will not be able to use reliance on the IRS's advice as a basis for obtaining extra time to amend his or her return.¹⁰

When unsophisticated taxpayers who lack financial resources look beyond the IRS for assistance, they fare no better. Some of these taxpayers rely on Volunteer Income Tax Assistance sites for aid in preparing their tax returns.¹¹ Many more utilize the services of paid professionals.¹² However, the advice provided by volunteers and paid preparers is also prone to error.¹³ And while sophisticated taxpayers may obtain transactional tax risk insurance that indemnifies them against all costs of mistaken advice (in particular, penalties, interest, and underlying tax liability), the market does not make available to unsophisticated taxpayers a similarly comprehensive option. Large commercial tax return preparers do offer insurance.¹⁴ Typically, the insurance offered covers penalties and interest if the IRS challenges the return because of a mistake made by the return preparer.¹⁵ However, unlike transactional tax risk insurance, the insurance does not cover the additional underlying tax liability assessed by the IRS.¹⁶ Furthermore, tax return preparers may not always fulfill their promises to compensate unsophisticated taxpayers for interest and penalties.¹⁷

Tax law is, by no means, alone in terms of benefiting wealthy individuals. In many areas of law and of life, people possessing greater financial resources will obtain superior advice and fare better than their less wealthy counterparts. However, despite the prevalence of societal advantages for sophisticated, wealthy individuals, the existence of such preferences in tax law is especially

8. For further discussion, see Cauble, *supra* note 5, at 431–37.

9. For further discussion, see *id.* at 431–32.

10. For further discussion, see *id.* at 437.

11. See *infra* note 91 and accompanying text.

12. See *infra* note 92 and accompanying text.

13. See *infra* notes 59–61 and accompanying text.

14. See *infra* note 63 and accompanying text.

15. See *infra* note 64 and accompanying text.

16. See *infra* note 64 and accompanying text.

17. See *infra* note 63 and accompanying text.

problematic. Objections to the advantages that are bestowed upon wealthy individuals by other areas of law are often met with the response that redistribution should be relegated to the tax system.¹⁸ For example, those arguing for rules that facilitate economically efficient outcomes in contractual relationships will often contend that the manner in which the benefit of a contract is divided between the parties need not be addressed by contract law because any desired redistribution should be accomplished through the tax system.¹⁹ Because other areas of law dodge criticisms of bias in this manner, tax law must be less tolerant of bias against unsophisticated individuals who lack financial resources.

The biases against unsophisticated taxpayers have been noted by existing literature. This Article proposes several novel reform measures to assist such individuals. First, with respect to certain key provisions intended to benefit low-income taxpayers, such as the earned income tax credit, Congress should act to provide unsophisticated taxpayers the protection offered by a private letter ruling. In order to implement this proposal, Congress should direct the IRS to verify and stand behind the accuracy of tax software that addressed key provisions, such as the earned income tax credit (“EITC”), a tax credit designed to provide economic relief to the working poor.²⁰ The government would stand behind its guarantee

18. See Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821, 822–25 (2000); Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 667–68 (1994); David A. Weisbach, *Should Legal Rules Be Used to Redistributed Income?*, 70 U. CHI. L. REV. 439, 439 (2003).

19. See, e.g., Kaplow & Shavell, *Should Legal Rules Favor the Poor?*, *supra* note 18, at 822–25; Kaplow & Steven Shavell, *Why the Legal System is Less Efficient Than the Income Tax in Redistributing Income*, *supra* note 18, at 667–68; Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 125 (2002); Weisbach, *supra* note 18, at 439.

20. A full discussion of the EITC is beyond the scope of this Article. For further discussion of the EITC, see Ann L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533 (1995); Leslie Book, *The IRS’s EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351 (2002) [hereinafter Book, *Taxpayers Caught in the Net*]; Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 WIS. L. REV. 1103 [hereinafter Book, *Preventing the Hybrid from Backfiring*]; 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 (2014); Francine J. Lipman, *The Working Poor Are Paying for Government Benefits: Fixing the Hole in the Anti-Poverty Purse*, 2003 WIS. L. REV. 461; Jonathan P. Schneller, *The Earned Income Tax Credit and the Administration of Tax Expenditures*, 90 N.C. L. REV. 719 (2012); Jonathan P. Schneller, Adam S. Chilton & Joshua L. Boehm, *The Earned Income Tax Credit, Low-Income Workers, and the Legal Aid Community*, 3 COLUM. J. TAX L. 176 (2012); Susannah C. Tahk, *The Tax War on Poverty*, 56 ARIZ. L. REV. 791, 797–803 (2014); David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 997–1012 (2004); Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867 (2005).

of accuracy in two respects. First, if a taxpayer provided accurate information when operating the software and the software indicated, wrongly, that the taxpayer was entitled to certain tax benefits, the IRS would not later assess additional tax liability, interest or penalties against the taxpayer. Second, if a taxpayer provided accurate information when operating the software, the software wrongly indicated that the taxpayer was not entitled to certain tax benefits, and the taxpayer discovered this error after the typical limitations period for filing an amended return had expired, then Congress would grant the taxpayer additional time to amend his or her tax return to claim the benefits to which he or she was, in fact, entitled.

Second, this Article proposes that states should require that certified public accountants either provide a minimum number of hours of pro bono services annually or donate a minimum amount annually to support Volunteer Income Tax Assistance sites.

Third, Congress should implement a new procedure for assessing penalties and interest against taxpayers whose incomes are below a certain threshold. Under this new procedure, if the taxpayer's return is prepared by a paid preparer, any penalties or interest that would otherwise be assessed against the taxpayer should be assessed, instead, against the preparer. However, if the preparer could prove either that he or she sought adequate information from the taxpayer and tax consequences were reported correctly based on the information provided by the taxpayer or that the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer, then the IRS would not assess against the preparer any penalties or interest owed by the taxpayer. In addition, if a preparer did obtain a waiver, the preparer would be precluded from offering any type of audit insurance (or, stated another way, if the preparer did offer any type of audit insurance, doing so would nullify the waiver).

This Article proceeds as follows. Part I describes the obstacles faced by unsophisticated taxpayers who seek advice from the IRS at the tax reporting stage. Part II describes the barriers to obtaining alternative sources of advice. Finally, Part III proposes and evaluates reforms intended to assist unsophisticated taxpayers.

I. SHORTCOMINGS OF IRS GUIDANCE

An unsophisticated taxpayer who faces uncertainty about tax law might turn to the IRS for assistance. Unfortunately, unsophisticated

taxpayers who lack financial resources disproportionately seek informal IRS guidance,²¹ upon which taxpayers cannot rely.²² Thus, an unsophisticated taxpayer could be led astray by the IRS, and the taxpayer, alone, would bear the risk of receiving faulty advice. Furthermore, in recent years, the IRS has scaled back on the extent to which it will provide informal advice at all. Therefore, unsophisticated taxpayers' prospects of receiving any IRS guidance are dwindling.

Taxpayers generally cannot rely on informal IRS guidance, the type of advice disproportionately sought by unsophisticated taxpayers.²³ The IRS answers a number of questions about tax return filing received by phone. Taxpayers who call the IRS helpline could be misled by either unduly favorable advice or unduly unfavorable advice. In either case, the taxpayer cannot use the guidance as a basis for claiming relief.

Consider first a taxpayer who receives unduly favorable advice. For instance, an IRS helpline representative might incorrectly inform a taxpayer that he or she is entitled to a particular tax credit or deduction when, in fact, the taxpayer is not. The taxpayer completes his or her tax return relying on this advice and, consequently, reports less tax liability than what he or she in fact owes. During a later audit, the IRS discovers the error and assesses additional tax liability plus interest and potentially penalties. The fact that the taxpayer relied on advice provided by phone will not immunize the taxpayer from the requirement to pay the underlying tax liability and interest.²⁴ The taxpayer might avoid paying penalties but only if he or she can prove reasonable reliance on the advice, a difficult task for an unsophisticated taxpayer.²⁵ Moreover, even the prospect of paying the underlying tax liability could be quite detrimental to a taxpayer who has since made financial decisions based on the assumption that his or her tax liability was substantially lower.

A taxpayer who calls the IRS helpline could, instead, receive unduly unfavorable advice. For example, he or she might be counseled to not claim a credit to which he or she is, in fact, entitled. The taxpayer will then fail to claim the credit, reporting more tax liability than what he or she in fact owes. The taxpayer might later discover the error but not in time to amend the earlier tax

21. See *infra* notes 31–32 and accompanying text.

22. See *infra* notes 23–26 and accompanying text.

23. For further discussion, see Cauble, *supra* note 5.

24. See *id.* at 431–37.

25. See *id.* at 431–32.

return. If the taxpayer argues that the limitations period for filing an amended return ought to be extended because his or her error was induced by reliance on advice from an IRS employee, his or her argument will almost certainly fail.²⁶

Although taxpayers cannot rely on informal advice received by phone, taxpayers generally can rely on more formal types of advice such as private letter rulings. When existing tax authority does not provide clear guidance regarding the tax consequences of a contemplated transaction, a taxpayer may, in some circumstances, request a private letter ruling.²⁷ A taxpayer who receives a private letter ruling can generally rely upon it as long as the taxpayer provided complete and accurate facts in their request for the ruling.²⁸ If the IRS later discovers that the private letter ruling reached an incorrect result because it was based upon the IRS's incorrect interpretation of legal authority, the IRS's general practice is to not revoke the ruling retroactively.²⁹ Therefore, although the taxpayer might be subject to less favorable tax consequences in future years (if the transaction has ongoing tax effects), for prior years, the taxpayer retains the benefit of tax treatment that is more favorable than what a correct interpretation of tax law would have allowed. But, as a practical matter, the cost of seeking a private letter ruling forecloses the possibility of obtaining such a ruling for unsophisticated taxpayers.³⁰

While private letter rulings are not a viable source of guidance for unsophisticated taxpayers, data indicates that lower-income taxpayers may be more likely to utilize channels of informal guidance. For instance, in a 2014 Taxpayer Attitude Study conducted by the IRS Oversight Board, 88% of taxpayers with incomes between \$15,000 and \$40,000 reported that they were very or somewhat likely to use the IRS toll free telephone service, and 80% of taxpayers with incomes equal to \$75,000 or more reported that they were very or somewhat likely to use this service.³¹ Regarding informal advice provided by IRS walk-in centers, 76% of taxpayers with incomes

26. See *id.* at 437.

27. Rev. Proc. 2017-1, 2017-1 I.R.B. 1.

28. Donald L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View from Within*, 46 DUQ. L. REV. 323, 347-49 (2008).

29. See Treas. Reg. § 601.201(d)(5) (as amended in 2002).

30. In addition, the IRS will not address many of the types of questions asked by such taxpayers in a private letter ruling. For further discussion, see Cauble, *supra* note 5, at 464.

31. IRS OVERSIGHT BD., 2014 TAXPAYER ATTITUDE SURVEY 14 fig.19 (2014), <http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf>.

between \$15,000 and \$40,000 reported that they were very or somewhat likely to use this service compared to only 63% in the case of taxpayers with incomes equal to \$75,000 or more.³²

Moreover, the prospect of taxpayers suffering harm as a result of receiving inaccurate, informal IRS advice is real because IRS guidance provided via the IRS helpline is not infallible. In July 2005, the United States General Accounting Office (GAO) provided a report to Congress on the quality of service provide by the IRS.³³ This report indicated that, for the 2005 filing season, IRS telephone assistance accuracy was estimated at 87%.³⁴ According to the same report, this 13% error rate represented an improvement over the prior year's 24% error rate.³⁵ In April 2001, the GAO provided a similar report stating that, in 2000, the IRS estimated that it provided correct answers to questions about tax law received by phone 73% of the time.³⁶ This 27% error rate, in turn, was lower than the error rate in earlier years.³⁷ Furthermore, recent cuts to the IRS's resources available for training employees may have an adverse effect on the quality of advice going forward.³⁸ This is particularly

32. *Id.* at 13 fig.18.

33. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-782, TAX ADMINISTRATION: IRS NEEDS BETTER STRATEGIC PLANNING AND EVALUATION OF TAXPAYER ASSISTANCE TRAINING (2005).

34. *Id.* at 1. The report does not describe the methodology for measuring IRS accuracy. However, an earlier report explains that the IRS measures accuracy by placing anonymous calls to the IRS telephone assistance line and monitoring the answers provided by IRS employees to a number of test questions. U.S. GEN. ACCOUNTING OFFICE, GAO/GGD-90-36, TAX ADMINISTRATION: MONITORING THE ACCURACY AND ADMINISTRATION OF IRS' 1989 TEST CALL SURVEY 1 (1990). This earlier report notes some initial disagreement between the IRS and the GAO regarding how to measure accuracy. *Id.* at 8. In particular, at least initially, the IRS categorized certain responses as correct even when they were incomplete and potentially misleading because the IRS representative had not asked sufficient questions to obtain all information necessary to provide a correct answer. *Id.* at 6–8.

35. See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 33, at 1.

36. U.S. GEN. ACCOUNTING OFFICE, GAO-01-189, IRS TELEPHONE ASSISTANCE: QUALITY OF SERVICE MIXED IN THE 2000 FILING SEASON AND BELOW IRS' LONG-TERM GOAL 2 (2001).

37. *Id.* These statistics provide a sense of the frequency with which taxpayers may receive incorrect advice from the IRS helpline. They do not, however, indicate how often taxpayers, in fact, follow incorrect advice when completing their tax returns. Cauble, *supra* note 5, at 427 (“Measuring the frequency of that occurrence is difficult because an examination of litigated cases may not provide a complete picture –taxpayers may not raise reliance on informal advice as the basis for relief given that no relief will be granted. Nevertheless, the issue has arisen in some cases.”) For further discussion, see, for example, Cauble, *supra* note 5, at 431–37.

38. For discussion of budget reductions, see 1 TAXPAYER ADVOCATE SERV., NATIONAL TAXPAYER ADVOCATE: 2013 ANNUAL REPORT TO CONGRESS 21 (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/IRS-BUDGET-The-IRS-Desperately-Needs-More-Funding-to-Serve-Taxpayers-and-Increase-Voluntary-Compliance.pdf> (“The IRS training budget has been slashed from about \$172 million in FY 2010 to about \$22 million, a staggering 87 percent reduction.”).

true in light of the IRS's increased workload resulting from newly enacted tax legislation.³⁹

Not only is informal advice unreliable, but the volume of informal advice provided is also dwindling. In 2012, for instance, the IRS received approximately 109 million phone calls, and only 61% of callers seeking to reach a customer service representative succeeded in doing so.⁴⁰ In more recent years, the percentage of callers receiving advice is even lower. According to the 2016 National Taxpayer Advocate Report, for fiscal year 2015, the IRS answered 38.1% of the approximately 101.5 million calls that it received, and, in fiscal year 2016, the IRS answered 53.4% of the approximately 104 million phone calls that it received.⁴¹ In addition, as highlighted by the 2014 National Taxpayer Advocate Report, in fiscal year 2014 “the IRS significantly reduced core taxpayer services it had long provided . . . [I]t substantially stopped answering tax-law questions from taxpayers, limiting the scope of questions it answered during the filing season ending on April 15 and answering no tax-law questions at all after that date. It also terminated its longstanding practice of preparing tax returns for certain populations of taxpayers.”⁴²

Finally, some might incorrectly assume that the IRS is unlikely to audit lower-income taxpayers, and, as a result, such taxpayers do not bear the cost of underreporting tax liability based on mistaken IRS advice. The truth and this assumption, however, lie far apart from each other. For instance, during 2000 to 2003, about half of all individual income tax audits focused on EITC issues, even though returns on which taxpayers claimed the EITC constituted less than 20% of all individual income tax returns.⁴³ More recently, in 2010, about 37% of all individual income tax audits focused on EITC tax returns, even though returns on which taxpayers claim the EITC constituted 17% of all individual income tax returns.⁴⁴

39. See Editorial Bd., *Don't Cheer as the I.R.S. Grows Weaker*, N.Y. TIMES (Dec. 29, 2017), <https://www.nytimes.com/2017/12/29/opinion/dont-cheer-as-the-irs-grows-weaker.html>.

40. 1 TAXPAYER ADVOCATE SERV., NATIONAL TAXPAYER ADVOCATE: 2013 ANNUAL REPORT TO CONGRESS, *supra* note 38, at 20.

41. TAXPAYER ADVOCATE SERV., NATIONAL TAXPAYER ADVOCATE: 2016 ANNUAL REPORT TO CONGRESS 43 (2016), https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1_TaxpayerRightsAssessment.pdf.

42. TAXPAYER ADVOCATE SERV., NATIONAL TAXPAYER ADVOCATE: 2014 ANNUAL REPORT TO CONGRESS 6 (2014), <http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2014-Annual-Report/TAXPAYER-SERVICE-Taxpayer-Service-Has-Reached-Unacceptably-Low-Levels.pdf>.

43. Zelenak, *supra* note 20, at 1884–85 (2005).

44. Francine J. Lipman, *Access to Tax Injustice*, 40 PEPP. L. REV. 1173, 1195 (2013).

When lower-income taxpayers are audited, their ability to successfully respond to the audit is hampered by several factors. When the IRS challenges the EITC claimed by a taxpayer, it typically does so through a correspondence audit.⁴⁵ In a correspondence audit, the IRS will send a written request to the taxpayer seeking additional information and documentation. Because of a number of practical barriers, EITC claimants often do not respond at all or respond ineffectively to such requests. One such practical obstacle is the fact that EITC claimants move frequently and, as a result, may not receive correspondence from the IRS.⁴⁶ In addition, if they do receive it, they may not understand what documentation is required⁴⁷ or may have a difficult time providing the necessary documentation.⁴⁸ For example, in the 2000 tax filing season, the

45. See, e.g., Book, *Taxpayers Caught in the Net*, *supra* note 20, at 374 (“The IRS audited approximately 617,765 individual taxpayers in fiscal year 2000, with just over 237,500 taxpayers in face-to-face audits at a taxpayer’s place of business or at an IRS office, and the rest through the mail from an IRS Service Center in what is called a correspondence audit. Of the 380,204 correspondence audits, 325,654 of the correspondence audits related to EITC claims investigated by the IRS, resulting in the IRS recommending hundreds of millions of dollars in reversed EITC.”) (footnotes omitted).

46. See, e.g., Book, *Taxpayers Caught in the Net*, *supra* note 20, at 393 (“One of the biggest issues affecting many low-income taxpayers and their relationship with the IRS is their tendency to be transient or even temporarily homeless. Low-income taxpayers move often, and may not leave forwarding addresses with the post office, or send a change of address to the IRS.”) (footnotes omitted); Lipman, *Access to Tax Injustice*, *supra* note 44, at 1192 (“Not surprisingly, low-income taxpayers—who . . . are much more likely to be transitory and working irregular hours—are challenged to respond to IRS correspondence.”); Schneller, Chilton & Boehm, *supra* note 20, at 188 (“For several important reasons, a mail-based audit system is ill suited for low income taxpayers. First, EITC claimants are much more likely than other taxpayers to be transient or homeless.”)

47. See, e.g., Book, *Taxpayers Caught in the Net*, *supra* note 20, at 396–401 (discussing barriers to complying with correspondence audits including literacy issues and a lack of understanding of the EITC); Drumbl, *supra* note 20, at 136 (“The Taxpayer Advocate Service conducted a research study of ‘audit barriers’ to better understand EITC audit outcomes. Among the interesting findings, the study revealed that the letters used in correspondence audits were not clear to the recipients: more than 25% of the EITC taxpayers it surveyed ‘did not understand the [Service] was auditing their return’; 39% ‘did not understand what the [Service] was questioning about their EI[T]C claim’; and only 50% ‘felt they knew what they needed to do in response to the audit letter.’”) (footnotes omitted); Lipman, *Access to Tax Injustice*, *supra* note 44, at 1192 (“Even for sophisticated taxpayers, who are much more likely to be represented by tax professionals, IRS correspondence is intimidating, inaccessible, and confusing. Not surprisingly, low-income taxpayers—who are more likely to have language barriers, basic literacy as well as financial literacy challenges, and are much more likely to be transitory and working irregular hours—are challenged to respond to IRS correspondence. In a study of EITC taxpayers, more than 70% stated that IRS examination correspondence was difficult to understand.”) (footnote omitted); Schneller, Chilton & Boehm, *supra* note 20, at 188–89.

48. See, e.g., Book, *Taxpayers Caught in the Net*, *supra* note 20, at 395 (“Consider the challenges associated with attempting to prove a qualifying child’s residency, the most common EITC error. Frequent moves may lead to documentation like school or medical records indicating one or more addresses different than that on the tax return. Without further detailed

IRS estimated that approximately 75% of EITC claimants who received correspondence audits failed to respond or responded inadequately to the IRS's initial audit letter.⁴⁹ By contrast, response rates in face-to-face audits are much higher, yielding an 85% response rate by one estimate.⁵⁰ If EITC claimants fail to respond or provide insufficient documentation, they may not receive the benefit of the EITC. In some cases, taxpayers may be denied the EITC even when they were entitled to it. By one estimate, 25% of the EITC claims that are denied as a result of correspondence audits are wrongfully denied.⁵¹

The IRS's approach to auditing EITC claimants could be contrasted with the more cooperative approach that it uses in dealing with some sophisticated taxpayers. Perhaps bearing out the adage that the squeaky wheel gets the grease, IRS efforts to engage in cooperative regulation have focused on sophisticated taxpayers because they are notoriously difficult to catch by traditional means. For instance, in 2005, the IRS introduced the Compliance Assurance Process (CAP), a program under which large businesses and the IRS can resolve tax issues before taxpayers file tax returns.⁵² In other words, instead of the IRS raising issues for the first time on audit, the IRS and taxpayers who participate in the program can

explanation, this documentation would be insufficient to establish eligibility. In any event, an explanation without documentation is not sufficient, as IRS examiners are instructed not to accept, as proof, statements that are not accompanied by corroborating documentation.") (footnote omitted); Schneller, Chilton & Boehm, *supra* note 20, at 188–89.

49. Book, *Taxpayers Caught in the Net*, *supra* note 20, at 390 ("Of the roughly 325,000 taxpayers receiving EITC-correspondence audits in the 2000 filing season, the IRS itself has estimated that almost 70% of the taxpayers chosen for an EITC correspondence examination either fail to respond or respond inadequately to the IRS's initial letter."); cf. Lipman, *Access to Tax Injustice*, *supra* note 44, at 1192 ("[T]he response rate to EITC correspondence examinations is a low 30%.").

50. Lipman, *Access to Tax Injustice*, *supra* note 44, at 1192 ("Alternatively, when EITC examinations are conducted face-to-face, the IRS has achieved an 85% response rate.").

51. Book, *Taxpayers Caught in the Net*, *supra* note 20, at 391 ("There is a growing awareness that IRS compliance efforts are causing the IRS to prevent payment of or recover a previously paid EITC to a significant number of otherwise eligible taxpayers. The current National Taxpayer Advocate, speaking before her appointment, estimated that approximately twenty-five percent of taxpayers denied the EITC through IRS compliance actions are in fact entitled to the EITC.") (footnotes omitted). For another statistic suggesting that taxpayers' failure to respond to correspondence audits may result in wrongful denial of EITC benefits, see Lipman, *Access to Tax Injustice*, *supra* note 44, at 1192 ("Notably, the 43% of taxpayers who sought reconsideration of unfavorable EITC examinations and were successful received, on average, 96% of the amount of EITC claimed on their original filing.").

52. For further discussion of CAP, see, for example, Rachel Y. Holmes, *Forcing Cooperation: A Strategy for Improving Tax Compliance*, 79 U. CIN. L. REV. 1415 (2011); Susan Cleary Morse, *The How and Why of the New Public Corporation Tax Shelter Compliance Norm*, 75 FORDHAM L. REV. 961, 1012–13 (2006); Leigh Osofsky, *Some Realism About Responsive Tax Administration*, 66 TAX L. REV. 121 (2012); Dennis J. Ventry, *Cooperative Tax Regulation*, 41 CONN. L. REV. 431 (2008).

come to agreement on the tax treatment of transactions before tax returns are filed.⁵³ The program is part of an effort to use a less adversarial and more cooperative approach to tax enforcement in the hopes of improving tax compliance.⁵⁴ The IRS's change in approach is a reaction to the inability to deter sophisticated taxpayers by traditional means, in part, because the IRS lacks the resources and expertise to detect the aggressive tax strategies used by sophisticated taxpayers.⁵⁵

II. LACK OF ALTERNATIVES

As discussed above, when unsophisticated taxpayers need assistance with their tax law questions, the IRS is not a promising source for that assistance. Opportunities to receive IRS guidance have been depleted in recent years, and even those taxpayers who do receive answers from the IRS are not protected if the answers prove to be inaccurate.

The IRS, of course, is not the only source of guidance about tax law. Taxpayers may also seek assistance from other tax experts. Unfortunately, the plight of unsophisticated taxpayers who lack financial resources is exacerbated because they also suffer from a lack of access to equally good non-IRS sources of tax expertise. A sophisticated taxpayer who plans to engage in a transaction and does not want to seek a private letter ruling (or cannot do so because the IRS will not rule on the issues raised by the transaction) can, instead, obtain a tax opinion from his or her tax counsel. If the IRS later successfully challenges the claimed tax consequences, the taxpayer will owe tax due but, at least in some cases, may be protected from owing penalties.⁵⁶ If the taxpayer wants even more protection, the taxpayer could obtain transactional tax risk insurance—a product offered by insurance companies that reimburses a taxpayer for not only penalties but also the underlying tax liability

53. See, e.g., Osofsky, *supra* note 52, at 132–36.

54. See *id.* at 122–23 (The program is part of “[t]he new, self-declared, IRS ‘revolution’ in large business tax administration” which is “characterized by a more extensive shift in mentality, away from . . . [an] adversarial approach and toward cooperative compliance partnerships”).

55. See, e.g., Holmes, *supra* note 52, at 1422 (“[W]hen dealing with [Large Business Entities] in the current tax regime, direct enforcement efforts that rely on the traditional deterrence model do not work. Low detection rates, combined with inadequate penalties, and enormous information asymmetries, leave the IRS at a vast disadvantage in attempts to restrain taxpayers from taking overly aggressive or abusive positions on their tax returns.”); Ventry, *supra* note 52, at 456–57.

56. See Drennan, *supra* note 3, at 28; Johnson, *supra* note 3.

due if the IRS successfully challenges tax consequences claimed by the taxpayer with respect to a specific transaction.⁵⁷

The non-IRS sources of guidance are more limited in the case of unsophisticated taxpayers who lack financial resources. Many of these taxpayers do utilize the services of paid professionals or Volunteer Income Tax Assistance sites for aid in preparing their tax returns. In 2001, 67% of lower-income taxpayers claiming the EITC used paid preparers.⁵⁸ The filing advice provided by these experts is also not error-free. In order to provide a metric of the accuracy of such advice, Professor Leviner studied compliance rates with respect to various items reported on tax returns.⁵⁹ The compliance rates were determined by comparing items reported on the original return with items determined by IRS auditors.⁶⁰ In this study, Professor Leviner found that the IRS adjusted the EITC claimed by taxpayers 51% of the time when the return was prepared by the taxpayer, 45.2% of the time when the return was prepared by a certified public accountant or attorney, 46.3% of the time when the return was prepared by a large national tax preparation chain, and 46.9% of the time when the return was prepared by a Volunteer Income Tax Assistance program or similar volunteer site.⁶¹ The need to make adjustments could be caused by a number of factors, including inadvertent error or unscrupulous behavior on the part of a paid tax preparer who has an incentive to obtain a large refund for the client so that the client will use other services provided by the preparer.⁶² As a result of errors, taxpayers could lose out on tax benefits (if the errors result in the taxpayer reporting too much tax liability) or the taxpayer could owe an unexpected sum to the IRS plus interest and penalties (if the errors result in the taxpayer reporting too little tax liability).

Furthermore, while sophisticated taxpayers may obtain transactional tax risk insurance that provides protection against penalties and underlying tax liability, a similarly robust option does not exist

57. See, e.g., Logue, *supra* note 4, at 388.

58. Book, *Preventing the Hybrid from Backfiring*, *supra* note 20, at 1115; see also Lipman, *The Working Poor Are Paying for Government Benefits*, *supra* note 20 (discussing the extent to which lower-income taxpayers lose portions of the EITC because they must pay for assistance in filing to claim it).

59. Sagit Leviner, *The Role Tax Preparers Play in Taxpayer Compliance: An Empirical Investigation with Policy Implications*, 60 *BUFF. L. REV.* 1079 (2012). For additional discussion of EITC error rates in returns prepared by a paid preparer, see Michael A. O'Connor, *Tax Preparation Services for Lower-Income Filers: A Glass Half Full, or Half Empty?*, 90 *TAX NOTES* 231 (2001).

60. Leviner, *supra* note 59, at 1085.

61. *Id.* at 1111 tbl.5.

62. See, e.g., Book, *Preventing the Hybrid from Backfiring*, *supra* note 20, at 1139.

in the case of unsophisticated taxpayers. Large commercial tax return preparers do offer some insurance either for an additional charge or as part of their standard service package.⁶³ The insurance offered typically covers penalties and interest if the IRS challenges the return because of a mistake made by the return preparer.⁶⁴ Unlike transactional tax risk insurance, however, the insurance does not cover the additional underlying tax liability assessed by the IRS.⁶⁵ Furthermore, the tax return preparers may not always stand behind the insurance provided. For instance, Jackson Hewitt, a company that provides services to many lower-income taxpayers, offers audit insurance as part of its standard service package.⁶⁶ But Better Business Bureau complaints and class action lawsuits suggest that Jackson Hewitt may not always be responsive to customers when they are audited and seek Jackson Hewitt's assistance under the terms of the audit insurance.⁶⁷

III. PROPOSED SOLUTIONS

As discussed above, unsophisticated taxpayers who lack financial resources are burdened by a shortage of adequate tax advice. The IRS does not have the resources to answer all questions asked, and the IRS's informal advice comes with no guarantee as to its accuracy and offers the taxpayer no protection when it is mistaken. Furthermore, non-IRS sources of advice have not adequately filled the void left by a lack of sufficient IRS guidance. Therefore, in order to provide assistance to unsophisticated taxpayers, Congress and the states should enact several reform measures.⁶⁸

63. See, e.g., Sarah B. Lawsky, *Fairly Random: On Compensating Audited Taxpayers*, 41 CONN. L. REV. 161, 176–77 (2008).

64. Logue, *supra* note 4, at 377 (“Conspicuously absent from the standard tax preparer warranty is coverage for underpaid taxes. That is, they cover penalties and interest but not the underpaid taxes themselves.”).

65. *Id.*

66. Lawsky, *supra* note 63, at 176–77.

67. *Id.*, at 177–78.

68. Measures that have been proposed elsewhere could also assist unsophisticated taxpayers. For instance, simplification of the substantive law governing the EITC could aid taxpayers in their attempts to comply with the EITC's requirements. For further discussion, see, for example, Jonathan Barry Forman, *Simplification for Low Income Taxpayers: Some Options*, 57 OHIO ST. L.J. 145, 183–84 (1996) (proposing various measures to simplify the EITC); George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225, 267–74 (1994) (proposing various simplification measures). In addition, other scholars have proposed instituting less adversarial judicial proceedings to determine EITC-eligibility. See, e.g., Schneller, *supra* note 20, at 775–82; Schneller, Chilton & Boehm, *supra* note 20, at 202–03. Furthermore, other scholars have proposed use of more cooperative and accessible audit procedures when challenging

First, with respect to certain key provisions intended to benefit low-income taxpayers, such as the EITC, Congress should act to provide unsophisticated taxpayers the protection offered by a private letter ruling. Second, states should require that certified public accountants either provide a minimum number of hours of pro bono services annually or donate a minimum amount annually to support Volunteer Income Tax Assistance sites. Third, Congress should implement a new procedure for assessing penalties and interest against taxpayers whose incomes are below a certain threshold. Under this new procedure, if the taxpayer's return is prepared by a paid preparer, any penalties or interest that would otherwise be assessed against the taxpayer should instead be assessed against the preparer, unless the preparer could prove either that he or she sought adequate information from the taxpayer and tax consequences were reported correctly based on the information provided by the taxpayer or that the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer. In addition, if a preparer did obtain a waiver, the preparer would be precluded from offering any type of audit insurance (or, stated another way, if the preparer did offer any type of audit insurance, doing so would have the effect of nullifying the waiver). Each of these proposals is discussed below.

EITC claimants. *See, e.g.*, Book, *Taxpayers Caught in the Net*, *supra* note 20, at 418–19 (“IRS-generated publicity [of Low Income Taxpayer Clinics (“LITCs”)] could be especially helpful in reaching taxpayers whose adjudications are conducted by correspondence. Because the EITC is the most important substantive provision for low-income taxpayers as a class, it is a natural fit for the IRS to encourage low-income taxpayers subject to compliance procedures to use LITC services. Many states are required to advise welfare recipients of local legal service organizations when they discontinue or reduce benefits. For example, Pennsylvania’s state welfare regulations require that local legal service organizations’ names and addresses be listed on many welfare notices. In its correspondence examinations, the IRS should provide a toll-free phone number that would allow taxpayers to determine if a local LITC exists.”) (footnotes omitted); Schneller, Chilton & Boehm, *supra* note 20, at 200–02 (proposing various ways to reform the procedures for auditing EITC claimants). Also, various reform measures could be implemented to assist taxpayers who might be led astray by informal IRS advice provided via the IRS helpline. For further discussion, see Cauble, *supra* note 5, at 429 (proposing that “first, the IRS ought to warn callers that they cannot rely on advice provided by phone. Second, the IRS ought to refrain from assessing penalties against unsophisticated taxpayers (perhaps using income as a proxy for sophistication) when they report items consistently with IRS advice provided by phone. The IRS ought to do this on its own initiative rather than waiting for the taxpayer to raise the phone call as a penalty defense. Third, Congress should extend the limitations period for filing an amended return for a taxpayer whose failure to file a correct return results from reasonable reliance on any form of advice provided by the IRS.”).

A. More Reliable IRS Guidance

Congress should act to provide unsophisticated taxpayers with protection that is functionally equivalent to the protection offered by a private letter ruling with respect to certain key provisions intended to benefit low-income taxpayers, such as the EITC. As discussed above, a taxpayer who receives a private letter ruling can generally rely upon it as long as the taxpayer provided complete and accurate facts in the request.⁶⁹ In order to provide unsophisticated taxpayers with the same type of protection, the IRS ought to verify the accuracy of tax software that, at a minimum, addressed the EITC and other key provisions intended to benefit low-income taxpayers.⁷⁰

This software, much like existing commercial tax return preparation software, would employ “skip logic” functionality—in other words, it would route users through only questions that were relevant given their answers to previous questions. In addition, information available to the IRS from third party reporting could be automatically included for the taxpayer to review and verify rather than input independently.⁷¹

Some information would have to be supplied by the taxpayer. In some cases, the IRS does not receive all of the relevant information from third parties or from the taxpayer’s prior returns. For example, information about which individuals constitute “qualifying children” with respect to a taxpayer could be found only on a taxpayer’s prior tax returns, and those returns might not provide sufficient information because the relevant facts change from year to year. Also, the taxpayer may not have filed a return in prior years that included information relevant to determining the EITC because whether someone claims the credit can change from one year to the next. For example, almost 30% of the taxpayers who claimed the EITC in 2001 did not claim it in 2000.⁷² In addition, to compute

69. See *supra* note 2 and accompanying text.

70. For recommendations that the IRS become more involved in verifying the accuracy of tax return preparation software more generally, see, for example, Rodney P. Mock & Nancy E. Schurtz, *The TurboTax Defense*, 15 FLA. TAX REV. 443, 509 (2014) (“Thus, it seems that the IRS should perform some kind of testing of the software to assess the risks of error in the software. In the alternative, the IRS should hire third-party experts who can assess the accuracy of the software in a comprehensive and systematic way.”); Joshua D. Rosenberg, *A Helpful and Efficient IRS: Some Simple and Powerful Suggestions*, 88 KY. L.J. 33, 43–48 (1999). Because the IRS might not have sufficient time before filing season to verify the proper implementation of all relevant tax law changes, it might be necessary to limit the scope of the software to the EITC and a small number of other key provisions.

71. For a similar recommendation, see Joseph Bankman et al., *Using the “Smart Return” to Reduce Tax Evasion*, 69 TAX L. REV. 459 (2016).

72. See Book, *Preventing the Hybrid from Backfiring*, *supra* note 20, at 1121.

the EITC, the IRS would need information about the taxpayer's self-employment income that, in many cases, can be provided only by the taxpayer.

This software would phrase all questions in plain language, and any requirements that depend upon legal classification would be broken down into their underlying factual components. For example, a taxpayer may not claim the EITC if the taxpayer's investment income exceeds a threshold amount.⁷³ For 2016 the threshold amount was \$3,400.⁷⁴ Rather than asking, "Did your investment income for 2016 exceed \$3,400?" (which would require a taxpayer to reach a legal conclusion as to whether or not different items of income constitute "investment income") the program might, instead, state: "You earned the following items of income in 2016: (1) \$7000 in wages or salary from Company B and (2) \$6 interest income from Y Bank. Other than the items of income listed above, did you earn any additional income in 2016?"⁷⁵ The software program would determine that if all of the facts provided by the taxpayer are true, the taxpayer is entitled to claim an EITC of \$X. If all of the facts are true, then the IRS cannot later challenge the taxpayer if he or she claims an EITC of \$X.

Schneller, Chilton & Boehm make a similar proposal regarding the EITC.⁷⁶ Their proposal involves implementing a "ReadyReturn" system with respect to the EITC, where the IRS would use information it possessed to prepare a draft return that it sent to the taxpayer for the taxpayer to verify and revise as necessary.⁷⁷ The modification to their proposal made by this Article is the addition

73. I.R.C. § 32(i) (2012).

74. IRS, DEP'T OF THE TREASURY, PUBLICATION 596: EARNED INCOME CREDIT (EIC) 5 (2016).

75. The requirements for an individual to constitute a "qualifying child," similarly, would be decomposed into underlying facts. Thus, the request would not state: "Bob Smith is your qualifying child as defined in Section 152(c), determined without regard to paragraph (1)(D) thereof and section 152(e)." The request would, instead, include facts such as "Bob Smith is your son," "Bob Smith lived with you for more than one half of 2016," "Bob Smith's birthdate is June 6, 2011," "Bob Smith is not married," and so forth.

76. See Schneller, Chilton & Boehm, *supra* note 20, at 199.

77. *Id.* (discussing their proposal and describing the California "ReadyReturn" program on which it is modeled). In a somewhat related vein, Schneller also proposed an optional pre-certification process for taxpayers eligible for the EITC. Schneller, *supra* note 20, at 784. Likewise, making a related proposal, Professor Forman argues,

If the government is truly interested in helping individual income taxpayers and in simplifying the tax system, then the IRS should be allowed to directly assist taxpayers in the preparation of their returns. In particular, it would make sense to let the IRS prepare returns for those low-income taxpayers who claim the earned income credit. Virtually all welfare programs help individuals apply for benefits, and the earned income credit clearly provides a welfare-like benefit. Why not let the IRS prepare returns so that eligible low-income individuals can claim their earned income credit refunds?

of a private letter ruling-like guarantee. In particular, if all facts provided by the taxpayer or specified by the IRS and verified by the taxpayer are correct, the IRS will not challenge the tax consequences determined by the software if it turns out that the results dictated by the software were incorrect in a manner that was unduly favorable to the taxpayer. In addition, if the software provides a result that is unduly unfavorable to the taxpayer (indicating, wrongly, that the taxpayer was not entitled to a given credit, for instance) and if the taxpayer discovers the error after the expiration of the typical limitations period for filing an amended return, the taxpayer would be granted an extended period of time to file an amended return.

Furthermore, the IRS should identify taxpayers who could conceivably be entitled to the EITC based on the amount of income earned by each taxpayer that is reported to the IRS by third parties. Each year, the IRS ought to mail information to these taxpayers to alert them to the availability of the software, and the IRS ought to refer them to Volunteer Income Tax Assistance sites that could guide them through the software if they lack computer access or other necessary skills to utilize it independently.⁷⁸ This system would not result in all eligible taxpayers receiving the EITC because the IRS would not be able to reach all such taxpayers.⁷⁹ However, the system would increase access to the EITC for some taxpayers and would provide taxpayers who claim the EITC with more security.

Regarding feasibility, the upfront costs of implementing this proposal, admittedly, would not be negligible. However, at least two factors could help ameliorate the cost. First, once the initial system

Forman, *supra* note 68, at 177–78 (footnotes omitted). For further discussion of ReadyReturn, see, for example, Joseph Bankman, *Simple Filing for Average Citizens: The California ReadyReturn*, 107 TAX NOTES 1431 (2005).

78. Congress might have to take action to assure the IRS that it is allowed to refer taxpayers to specific Volunteer Income Tax Assistance sites given that the IRS espouses the view that government ethics rules prevent it from doing so. See, e.g., Schneller, Chilton & Boehm, *supra* note 20, at 193–94. For a similar proposal regarding outreach by the IRS generally, see Yin et al., *supra* note 68, at 264–65 (“The Service could also be required to increase its outreach efforts to the targeted population. It already provides EITC information to those tax return filers who do not claim the EITC but appear to be eligible for it. Greater efforts, however, could be made towards informing non-filers about the credit. For example, the Service already communicates with millions of non-filers who, because of their low incomes, likely owe no tax. It could send information about the EITC to those persons.”) (footnote omitted).

79. For a discussion of the obstacles faced when trying to reach the population of taxpayers entitled to the EITC, see, for example, Book, *Taxpayers Caught in the Net*, *supra* note 20, at 393–405.

and programs were put into place, the process could be largely automated. Second, the upfront costs might save costs later on by streamlining the process of verifying EITC eligibility after taxpayers have claimed the credit.

As to the merits of the proposal, one might question the value of providing a private letter ruling-like guarantee.⁸⁰ If the software is correct, then the taxpayer will have reported the correct tax consequences so the guarantee has no effect. However, even if the software reaches the correct result, the guarantee could be valuable because it may have provided an incentive to ensure that the software does, indeed, yield accurate results. In addition, having a guarantee will allow unsophisticated taxpayers to make financial decisions without fearing that their tax liability could turn out to be higher than the software indicated.

One might also object to this proposal on the grounds that, if the result reached by the software is incorrect in a taxpayer-favorable manner, allowing the taxpayer to rely on the software results in the taxpayer receiving a windfall—in other words, a greater tax benefit than what is granted by the substantive tax provisions adopted by Congress. However, the same could be said under current law of sophisticated taxpayers who obtain private letter rulings. Yet, taxpayers are generally allowed to rely on rulings.

Allowing reliance on rulings might be justified for two reasons.⁸¹ First, the IRS has an opportunity to thoroughly review guidance contained in a private letter ruling before issuing it. Second, given the opportunity for thorough review, a private letter ruling that reaches an incorrect result is likely to, nevertheless, reach a result that is reasonable in light of existing authority. Taxpayers who claim a result that is based on a reasonable interpretation of applicable law are likely claiming a result successfully claimed by many other taxpayers and, thus, their treatment cannot fairly be characterized as a windfall. Given that the IRS would have adequate opportunity to vet the software, the same arguments could support allowing reliance on the results produced by the software.⁸²

80. One might also argue that existing tax software already adequately addresses any issues that would be addressed by this proposal. However, many unsophisticated taxpayers may lack effective access to existing software. The proposed IRS-verified software would be available through Volunteer Income Tax assistance sites, and the IRS would alert taxpayers to the availability of the software.

81. For further discussion of the rationales that may justify greater reliance on some forms of IRS guidance, see Cauble, *supra* note 5.

82. Furthermore, this Article proposes that Congress adopt rules allowing taxpayers to rely on the software. Therefore, taxpayers who receive an unduly favorable result from use of the software do not receive a greater benefit than what Congress intended.

Furthermore, when the software does not yield accurate results, the guarantee ensures that the cost of any error will not be borne by a low-income taxpayer who is not in a position to bear such a cost. Consider, for instance, a taxpayer who is incorrectly informed by the software that he or she is entitled to a given tax credit. Assume that the taxpayer relies on the software and claims the credit. If this taxpayer is later audited, a requirement to pay a substantial additional sum to the IRS could be quite onerous in light of financial decisions that the taxpayer may have made in the intervening time period, such as signing a lease for a new apartment. In such a situation, it may be better for the cost of software error to be borne not by this particular taxpayer, for whom the resulting consequences would be quite dire, but instead by the public generally in the form of reduced tax revenue.⁸³

In some ways, this proposal could be viewed as a means of providing potential EITC claimants with the option of pre-certification. In the realm of government spending programs, pre-certification is the norm.⁸⁴ In other words, before receiving many government benefits, potential recipients must meet with a representative of the relevant government agency and provide necessary information and documentation. In the case of the EITC, taxpayers claim the credit without any upfront verification on the part of the IRS, and the IRS, instead, audits some claimants after the fact.

As others have observed, utilizing a mandatory pre-certification process to implement the EITC would bring with it a number of potential disadvantages. First, the rate of eligible taxpayers who

83. Furthermore, assuming the IRS outsources development of the software, the IRS could, and should, agree contractually with the developer that the IRS would have a right of recourse against the developer for any tax underpayments resulting from the software producing results that were inconsistent with the description of tax rules provided to the developer by the IRS.

84. See, e.g., Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145, 1191–92 (2003) (“Other social service programs require greater upfront contact between applicants and administrators. Consider, for example, the food stamp application and recertification process. Households that may be eligible for food stamps typically apply at local offices. Applicants are required to supply detailed information about the household, including its composition, expenses, income and assets. Administrators often ask for verification of information in the application, often resulting in applicants visiting the food stamp office more than once and often traveling to third parties (frequently other government offices) to get requested documentary evidence. The average application takes approximately five hours of client time and results in out of pocket costs (largely transportation costs) of approximately \$10.31.”) (footnotes omitted); Zelenak, *supra* note 20, at 1867 (“[T]he administration of the EITC resembles that of the rest of the income tax, and differs from that of other transfer programs, in that it is generally based on self-declared eligibility rather than on a bureaucratic determination of eligibility prior to the making of payments.”).

claim the EITC is higher than the participation rate by eligible beneficiaries of some spending programs.⁸⁵ For example, by one estimate, the EITC participation rate is 89% of eligible individuals while the Food Stamps Program participation rate is only 70% of eligible individuals.⁸⁶ Some have attributed this higher participation rate to the lack of mandatory pre-certification in the case of the EITC, arguing that pre-certification carries with it stigma and other costs that discourage participation.⁸⁷ Second, the cost of administering the EITC is lower because the IRS does not have to individually

85. Schneller, Chilton & Boehm, *supra* note 20, at 182 (“[T]he EITC boasts a higher participation rate than other social programs that provide support for low-income families.”); Tahk, *supra* note 20, at 829 (“[P]oor individuals are more likely to file tax returns to get benefits than to apply for benefits through other agencies.”); *see also* Book, *The Poor and Tax Compliance*, *supra* note 84, at 1192 (“For example, between 1994 and 1997, with a greater emphasis on national food stamp quality control largely revolving on increased recertification vigilance, national food stamp participation fell from 71% to 62.5%, and, by 1998 among working families, food stamp participation hovered at approximately 50%. Among all eligible households that failed to participate in the food stamp program, approximately 15% cited the costs of participation as the most important factor.”).

86. Schneller, Chilton & Boehm, *supra* note 20, at 182.

87. *See, e.g.*, Book, *The Poor and Tax Compliance*, *supra* note 84, at 1190–91 (“Prescreening or precertifying EITC eligibility raises some rather difficult issues. [E]xpansion of the certification program will likely entail significant taxpayer costs. First, the relatively high EITC participation rates are dependent, in part, upon the simplicity of tax return filing and the lack of stigma that accompanies other benefit programs’ application process. Certification may place additional burdens on taxpayers, which may result in decreased participation and possibly higher costs associated with receiving the EITC.”); Schneller, Chilton & Boehm, *supra* note 20, at 182 (“Scholars generally attribute this increased participation rate to the EITC’s use of self-certification, which does away with time-consuming and potentially humiliating visits to welfare offices. However, it should be noted that there is a lack of empirical work definitely connecting the EITC’s pre-certification regime to its participation rate: it is possible, for instance, that the EITC enjoys high levels of participation because it targets low-income workers, who may be more likely to have the skills and initiative to apply for benefits than do those who are both destitute and unemployed.”); Tahk, *supra* note 20, at 828–29 (“Another commonality of anti-poverty tax programs is that they carry less social stigma than nontax programs. To procure a benefit that derives from any of the provisions of the tax code, a benefit-seeker merely files his annual tax return and then receives a refund (insofar as he is eligible). In contrast, most direct-spending programs require participants to fill out a separate application with a distinct agency and (in many cases) to undergo an interview or some other prescreening process. The relative absence of stigma with tax-based anti-poverty measures is due to the fact that almost every citizen at some point in his or her life has to pay taxes or file returns. A low-income taxpayer who primarily uses the tax system to get benefits has the same experience of a higher-income taxpayer. Both fill out the same form, often with help from a return preparer, both hope to get a large refund, and both likely get at least some refund. . . . Perhaps because filing for tax benefits is less stigmatizing, poor individuals are more likely to file tax returns to get benefits than to apply for benefits through other agencies.”); Yin et al., *supra* note 68, at 252–53 (“The EITC program does not involve any bureaucracy that the claimant must encounter face-to-face in order to obtain the benefit. False Finally, the pool of EITC eligibles must all be in the labor force to receive the benefit, and therefore may be a little better educated and have a little greater familiarity with available government benefits than those eligible for other government transfer programs for the poor. For these reasons, expectations for the rate of EITC participation should be

certify every taxpayer's eligibility.⁸⁸ The potential advantage of pre-certification is that it could increase accuracy—fewer ineligible taxpayers would claim the EITC and face potential hardship when the EITC was later denied.⁸⁹

This Article's proposal can be viewed as an attempt to harness the advantages of pre-certification while mitigating its disadvantages. In particular, by effectively giving taxpayers the option to seek pre-certification, taxpayers who choose to do so can avoid the risk of a later denial. In addition, by automating the process of pre-certification, this proposal mitigates the administrative costs of pre-screening taxpayers. Finally, the fact that the process does not involve face-to-face meetings and the fact that it is optional⁹⁰ may reduce any resulting stigma and thereby avoid any dampening effect on participation rates.

B. *Pro Bono Requirements*

As proposed above, Congress should provide unsophisticated taxpayers the protection offered by a private letter ruling with respect to certain key provisions intended to benefit low-income taxpayers, such as the EITC. In particular, Congress should require the IRS to verify the accuracy of tax software that, at a minimum, addressed

ambitious."); Zelenak, *supra* note 20, at 1887–88 (“Precertification may be quite effective in preventing overpayments, but it may also lead to substantial underpayments as eligible persons are discouraged from applying by the time and effort required of them.”).

88. See, e.g., Book, *The Poor and Tax Compliance*, *supra* note 84, at 1190–91 (“Prescreening or precertifying EITC eligibility raises some rather difficult issues . . . [including] a likely significant increase in the government’s administrative costs.”); Drumbl, *supra* note 20, at 122–23 (“On the other hand, the costs for administering the benefits are also disparate. The CBO cites the example of SNAP as having . . . an administrative cost that is more than 9% of the total cost of the program. In contrast, . . . the cost to administer the [EITC] . . . is less than 1% of the total cost of the EITC to the government”) (footnotes omitted); Schneller, Chilton & Boehm, *supra* note 20, at 182 (“[A]nother putative advantage of self-certification is the EITC’s relatively low administrative costs when compared to traditional welfare programs.”).

89. See, e.g., Drumbl, *supra* note 20, at 122–23 (“[B]ecause other spending programs have more direct contact with their recipients, their overpayment rates are much lower than the Service’s overpayment rate. . . . The CBO cites the example of SNAP as having a typical overpayment rate of less than 5% In contrast, the EITC has an estimated overpayment rate of approximately 25%”).

90. For a similar observation, see Schneller, *supra* note 20, at 784 (“Thus, the use of intake centers for the EITC could substantially alter the face of the program and help address many existing problems. Needless to say, such a proposal may have uncomfortable implications for those who value the EITC’s decentralized reliance on self-certification. However, if such an effort were undertaken with attention to the EITC’s programmatic goals, it would not necessarily undermine self-certification. Such offices could serve as optional, rather than mandatory, means for interested taxpayers to receive assistance in composing a tax return that accurately reflects their income and family circumstances.”).

the EITC and other key provisions intended to benefit low-income taxpayers. Taxpayers who use this software should be immune from later challenge by the IRS if all of the information supplied by the taxpayer is accurate and complete. The IRS should identify taxpayers who could conceivably be entitled to the EITC based on the amount of income earned by each taxpayer that is reported to the IRS by third parties. Each year, the IRS ought to mail information to these taxpayers to alert them to the availability of the software and their potential eligibility for the EITC.

These reform measures alone will not ensure that all eligible taxpayers receive the benefit of the EITC because some eligible taxpayers will lack computer access or other necessary skills to utilize the software independently. Therefore, many EITC claimants will need to rely on expert advice for assistance in using the software.

Currently, only a small fraction of low-income taxpayers utilize free tax return preparation services provided by Volunteer Income Tax Assistance sites. By one estimate, only slightly more than 2% of individual income tax returns were prepared by a Volunteer Income Tax Assistance site or similar service in 2012.⁹¹ Many EITC claimants turn, instead, to paid preparers. For instance, in 2001, 67% of lower-income taxpayers claiming the EITC used paid preparers.⁹² Thus, low-income taxpayers lose a portion of the economic benefit of the EITC by paying third parties in order to receive it. As Professor Lipman observes, “Tax practitioners exact significant fees and costs for providing these services. . . . An estimated \$1.75 billion of the EITC intended to benefit low-income working families and their neighborhoods has been shifted to profitable paid tax practitioners.”⁹³

Furthermore, those taxpayers who do obtain free assistance through Volunteer Income Tax Assistance sites may receive misleading advice. As an indicator of the accuracy of the advice received, Professor Leviner found that the IRS adjusted the EITC claimed by taxpayers 46.9% of the time when the return was prepared by a Volunteer Income Tax Assistance program or similar volunteer site.⁹⁴

91. See, e.g., Drumbl, *supra* note 20, at 124.

92. See Book, *Preventing the Hybrid from Backfiring*, *supra* note 20, at 1115; see also Lipman, *The Working Poor Are Paying for Government Benefits*, *supra* note 20 (discussing the extent to which lower-income taxpayers lose portions of the EITC because they must pay for assistance in filing to claim it).

93. Lipman, *The Working Poor Are Paying for Government Benefits*, *supra* note 20, at 466–67.

94. Leviner, *supra* note 59, at 1111 tbl.5.

To increase the availability and, potentially, the quality of free advice, states should require that certified public accountants either provide a minimum number of pro bono service hours annually or donate a minimum amount each year to support Volunteer Income Tax Assistance sites.⁹⁵ Such requirements would increase the availability of free tax return preparation assistance. In addition, to the extent that certified public accountants provided pro bono services, the requirements might increase the quality of free service by increasing the level of expertise of those providing free advice. Improved accuracy is certainly not guaranteed, however, available data contained in a study by Professor Leviner suggests that accuracy might improve.⁹⁶ In particular, when studying the relative accuracy of returns prepared in different ways, Professor Leviner found that the accuracy rate of returns prepared by certified public accountants was slightly greater than the accuracy rate of returns prepared by Volunteer Income Tax Assistance sites. Specifically, while the IRS adjusted the EITC claimed by taxpayers 45.2% of the time when the return was prepared by a certified public accountant or attorney, the IRS adjusted the EITC claimed by taxpayers 46.9% of the time when the return was prepared by a Volunteer Income Tax Assistance program or similar volunteer site.⁹⁷ In addition, Professor Leviner found that the dollar amount of the errors on returns prepared by certified public accountants were lower than the dollar amount of the errors on returns prepared by Volunteer Income Tax Assistance sites. In particular, the weighted average change to the EITC claimed on returns prepared by certified public accountants or attorneys was \$497, compared to \$539 for returns prepared by Volunteer Income Tax Assistance sites and similar services.⁹⁸ Moreover, to the extent that some errors currently made by certified public accountants represent intentionally aggressive reporting positions driven, in part, by a desire to compete for client business, it is possible that such errors would be less likely to arise when services were provided free of charge.

95. This proposal could complement proposals for increased government funding of Volunteer Income Tax Assistance sites. For such a proposal, see Lipman, *The Working Poor Are Paying for Government Benefits*, *supra* note 20, at 469 (“A fourth solution to the loss of anti-poverty benefits for the working poor is to fund government sponsored volunteer income tax assistance (VITA) programs.”). A similar requirement for lawyers may be desirable for other reasons—in particular, to increase the availability of legal representation for low-income individuals more generally. However, such a proposal is not the focus of this Article given that it would likely have only a small effect of the availability of tax return preparation services.

96. Leviner, *supra* note 59.

97. *Id.* at 1111 tbl.5.

98. *Id.* at 1110.

C. New Penalty Procedures

Low-income taxpayers might rely less on paid tax return preparers if they had access to IRS-vetted software that addressed key provisions such as the EITC and if the supply of volunteer income tax assistance increased because states required certified public accountants to provide pro bono services or financial support to Volunteer Income Tax Assistance sites. Even if these proposals were implemented, however, some low-income taxpayers nevertheless would utilize the services of paid tax return preparers. Many paid preparers dispense accurate advice and stand behind any audit insurance that they provide. However, experience has shown that some low-income taxpayers are exploited by unscrupulous paid tax preparers who take overly aggressive reporting positions in order to obtain large refunds for their clients so that their clients use other services provided by the preparers.⁹⁹ In addition, although many paid preparers will offer insurance that covers penalties and interest resulting from IRS challenges, some preparers might not always honor claims made under those insurance policies.¹⁰⁰

In order to protect low-income taxpayers from harms caused by unethical paid preparers, Congress should implement a new procedure for assessing penalties and interest against taxpayers whose incomes are below a certain threshold. Under this new procedure, if the taxpayer's return is prepared by a paid preparer, any penalties or interest that would otherwise be assessed against the taxpayer should be assessed, instead, against the preparer, unless the preparer could prove either (1) he or she sought adequate information from the taxpayer and the tax consequences were reported correctly based on the information provided by the taxpayer or (2) the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer.¹⁰¹ In order to demonstrate that he

99. See *supra* note 62 and accompanying text.

100. See *supra* notes 63–67 and accompanying text.

101. Implementing this new procedure in the context of the EITC would require some additional tinkering with the types of penalties that are assessed. In particular, under Internal Revenue Code Section 32(k), in some cases, a taxpayer will be precluded from claiming the EITC for some period of time as a penalty for improperly claiming the credit, due to either fraud (in which case the time period is 10 years) or reckless or intentional disregard of the rules and regulations that does not rise to the level of fraud (in which case the time period is 2 years). I.R.C. § 32(k) (2012). In order to implement a procedure under which penalties could be assessed against the preparer, Congress could eliminate the penalties contained in Section 32(k) and rely upon monetary penalties instead. Alternatively, Congress could require that the preparer would pay a monetary amount estimated to be the present value equivalent of the penalties that would be borne by the taxpayer under Section 32(k), and the taxpayer could then claim the EITC notwithstanding Section 32(k) as long as the amount

or she sought adequate information from the taxpayer, the preparer would be required to show that the taxpayer attested to all relevant facts phrased in plain language. Preparers could not meet the necessary burden by showing that taxpayers attested to legal conclusions.¹⁰² For example, a taxpayer may not claim the EITC if the taxpayer's investment income exceeds a threshold amount.¹⁰³ In 2016, for instance, the threshold amount that would prevent claiming the EITC was \$3,400.¹⁰⁴ Rather than stating, "My investment income for 2016 did not exceed \$3,400," the representation signed by the taxpayer might, instead, state: "I earned the following items of income in 2016: (1) \$7,000 in wages or salary from Company B and (2) \$6 interest income from Y Bank. Other than the items of income listed above, I earned no additional income in 2016."

The new penalty procedure would apply unless the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer. In order to prove an effective waiver, the preparer would be required to supply a written waiver separately signed by the taxpayer that explained, in plain language and in conspicuous writing, the effects of signing the waiver. If a preparer does obtain a waiver, the preparer would be precluded from offering any type of audit insurance (or, stated another way, if the preparer did offer any type of audit insurance, doing so would have the effect of nullifying the waiver).

This new procedure would offer several advantages. First, it would effectively result in automatic enforcement of the audit insurance typically offered by many preparers. Under current law, when a low-income taxpayer is audited, that taxpayer must contact his or her preparer to insist upon coverage under the terms of the audit insurance provided. This task could be difficult because the taxpayer may be unaware of the existence or terms of the coverage. In addition, if the low-income taxpayer lacks sufficient bargaining power, the preparer may be unresponsive or unhelpful. In such a situation, the low-income taxpayer would be required to take the further onerous step of seeking legal representation in an attempt to obtain payment or pursue similarly burdensome options in an

claimed did not exceed, in present value terms, the monetary penalty that had been assessed against the preparer.

102. In a similar vein, Circular 230 requires that tax practitioners providing written tax advice may not rely upon representations of their clients when doing so would be unreasonable. 31 C.F.R. § 10.37(a)(2)(iv) (2017).

103. I.R.C. § 32(i) (2012).

104. IRS, DEP'T OF THE TREASURY, PUBLICATION 596, *supra* note 74, at 5.

attempt to persuade the preparer to honor the terms of the insurance, such as filing a complaint with the Better Business Bureau or otherwise drawing public attention to the preparer's shortcomings. Under the procedure proposed by this Article, the IRS would automatically enforce the terms of the insurance in the course of auditing the taxpayer. Some preparers may choose to not offer audit insurance. Under the new procedure, that option would continue to be available because such preparers could obtain written waivers from their clients.

Second, assuming that the taxpayer provided complete and accurate information and the preparer did not obtain a waiver, the new procedure has the effect of placing the return preparer, rather than the low-income taxpayer, in the position of contesting penalties assessed by the IRS. Given the preparer's greater tax expertise, the preparer likely could be in a better position to contest unjustified penalties. By contrast, the taxpayer, who lacks tax expertise, might simply accept any penalties assessed without challenge even when a defense to penalties would be available.¹⁰⁵ Furthermore, it is not the case that the IRS refrains from assessing penalties against low-income taxpayers. By one estimate, in 2000, the IRS assessed penalties in connection with approximately 17,300 deficiency notices involving the EITC.¹⁰⁶

Third, assuming the preparer has not obtained a waiver, the preparer, rather than the low-income taxpayer, would be subject to penalties and interest if the mistake resulted from the preparer's failure to seek complete information from the taxpayer. This feature of the proposal is advantageous because, given the complexity of the requirements for eligibility for the EITC and other tax credits and deductions, the return preparer will oftentimes be better positioned than the taxpayer to know what information is relevant.¹⁰⁷ Placing the burden upon preparers to solicit relevant information will provide the incentive to obtain the information to

105. See, e.g., Drumbl, *supra* note 20, at 115 (“[F]or all of these reasons—lack of experience, lack of knowledge, and relative lack of education—the taxpayer is unlikely to have the knowledge or resources to raise the very defense [against penalties] that is meant to protect an unsophisticated taxpayer.”); *id.* at 147 (“[T]he reasonable cause defense presents a conundrum for the very taxpayers it is meant to benefit: if one is inexperienced, has little to no knowledge of tax law, and has relatively little formal education, how would that person know to invoke the reasonable cause defense?”).

106. See, e.g., Drumbl, *supra* note 20, at 148 (quoting TAXPAYER ADVOCATE SERV., NATIONAL TAXPAYER ADVOCATE: 2001 ANNUAL REPORT TO CONGRESS 90 (2001)) (citing the statistic that, in the year 2000, the IRS “issued approximately 17,300 EITC deficiency notices involving accuracy-related penalties”).

107. For a somewhat similar proposal involving information gathering, see Book, *Preventing the Hybrid from Backfiring*, *supra* note 20, at 1109 (proposing “shifting additional compliance costs to commercial tax-return preparers in the form of heightened reporting

the party who is capable of doing so and will penalize the party who is blameworthy when the information is not obtained.

Imagine that a low-income taxpayer seeks the assistance of a paid preparer at tax time. As part of the tax return preparation process, the preparer incorrectly determines that the taxpayer can claim a given credit. The preparer neglects to ask probing questions that would have revealed facts indicating ineligibility for the credit, and the taxpayer does not spontaneously volunteer the information because he or she is unaware of its relevance. Relying on the preparer's advice, the taxpayer claims the credit, reducing his or her tax liability significantly.

Two years later, the IRS sends the taxpayer a notice indicating that the taxpayer improperly claimed the credit and now owes the IRS additional tax liability plus interest and potentially penalties. Under current law, the burden of the underpaid taxes, interest and penalties would fall upon the taxpayer. Under the proposed new procedure, the preparer would be liable for the interest and penalties, assuming the preparer did not obtain a waiver from the taxpayer. Given the preparer's superior knowledge of the requirements for claiming the tax credit, the preparer was better able than the taxpayer to avoid the error by making more thorough inquiries. Therefore, the preparer, rather than the taxpayer, ought to bear the cost of the mistake.

Several objections to the new procedure might be raised. However, the procedure is designed to mitigate each of the potential concerns. First, one might express the concern that the procedure simply reverses the parties' positions—as a result of the new procedure, we will see paid preparers being exploited by unscrupulous low-income taxpayers rather than low-income taxpayers falling victim to unethical paid preparers. In particular, taxpayers might game the system by providing misleading information to preparers or pressuring preparers to take overly aggressive reporting positions, knowing that the preparer, rather than the taxpayer, will bear any resulting penalties. The new procedure, however, is designed to prevent this type of manipulation by taxpayers. If the tax results are reported accurately based on information provided by the taxpayer, the taxpayer, rather than the preparer, owes any resulting interest and penalties. Therefore, taxpayers who provide misleading information to their preparers will continue to be responsible for paying

and due diligence rules"); *id.* at 1146 (“[I]ncreasing the requirements on preparers to inquire, record, retain, and report information—while significantly raising the penalty for failing to do so—has the potential to address all three sources of errors [preparer dishonesty, taxpayer dishonesty, and preparer incompetence].”).

interest and penalties. In addition, if a taxpayer does pressure a preparer to take an overly aggressive reporting position, the preparer can refuse to do so, or the preparer can do so only on the condition that the taxpayer signs a waiver so that the preparer avoids liability for any penalties or interest that would otherwise be assessed against the taxpayer (although the preparer would still be subject to any applicable preparer penalties).

Second, one might question the effectiveness of the new procedure. In particular, one might speculate that it will not actually assist low-income taxpayers because paid preparers will simply pass increased costs on to taxpayers by raising their tax return preparation fees. In order to address this concern, it is helpful to observe that the new procedure merely results in automatic enforcement of the audit insurance already offered by many paid preparers, and those preparers who do not offer audit insurance can avoid the new procedure by obtaining waivers from their clients. Therefore, to the extent that the new procedure results in any change, it merely has the effect of enforcing audit insurance policies that already exist. In the case of preparers who already intend to honor their audit insurance policies, the fees currently charged should already incorporate the associated insurance premium, and fees should not increase merely because the insurance will now be enforced. If a preparer does not intend to honor its existing insurance policies, the fees currently charged might not include the full amount of the associated insurance premium, and such preparers might increase their fees once the insurance policies become automatically enforceable. However, clients of such preparers will still be better off as a result of the change. They might pay marginally higher fees, but they will receive all of the services that the preparer purports to offer in exchange for the fees that are charged.

Third, one might predict that the new procedure will have no real effect because paid preparers will routinely obtain waivers from their unsophisticated clients and resort to offering whatever terms they traditionally offer. The new procedure, however, is designed to protect taxpayers from this possibility. First, a waiver would only be effective if it was separately signed by the taxpayer and explained, in plain language and in conspicuous writing, the effects of signing the waiver. Thus, taxpayers would be protected from the possibility of unknowingly granting waivers. Second, if a preparer did obtain a waiver, the preparer would be precluded from offering any type of audit insurance (or, stated another way, if the preparer did offer any type of audit insurance, doing so would have the effect of nullifying the waiver). Thus, preparers could not ask taxpayers to waive

the preparers' liability while, at the same time, purporting to offer audit insurance that they have no intention of honoring. If a preparer offers audit insurance, the preparer is unavoidably subject to automatic enforcement of the insurance. As a result, the preparer's clients will receive what they believe they have paid to obtain.

CONCLUSION

Unsophisticated taxpayers suffer from an inability to receive satisfactory tax advice. Informal advice provided by the IRS, the type of advice that unsophisticated taxpayers disproportionately seek, is generally not reliable, and alternative sources of advice are also inadequate. To remedy the failings of the current system, unsophisticated taxpayers should be provided with the protection offered by private letter rulings with respect to certain key provisions, which benefit low-income taxpayers, such as the Earned Income Tax Credit. In addition, states should require that certified public accountants either provide a minimum number of hours of pro bono services annually or donate a minimum amount each year to support Volunteer Income Tax Assistance sites. Finally, Congress should implement a new procedure for assessing penalties and interest against taxpayers whose incomes are below a certain threshold. Under this new procedure, if the taxpayer's return is prepared by a paid preparer, any penalties or interest that would otherwise be assessed against the taxpayer should be assessed, instead, against the preparer—unless the preparer could prove either that he or she sought adequate information from the taxpayer and tax consequences were reported correctly based on the information provided by the taxpayer or that the taxpayer knowingly waived the right to have penalties and interest assessed against the preparer. If a preparer obtained a waiver offering any type of audit insurance would nullify the waiver.