

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION
REPORT TO THE HOUSE OF DELEGATES

Recommendation

1 RESOLVED, that the American Bar Association recommends to the Congress
2 that it provide adequate funding to the Low Income Taxpayer Clinic (“LITC”) program
3 under Section 7526 of the Internal Revenue Code of 1986.

4 FURTHER RESOLVED, that Section 7526 be amended to clarify that LITC
5 funding should be considered not only as seed money but also as a source of continued
6 funding.

7 FURTHER RESOLVED, that the LITC program should only fund organizations
8 that either engage in controversy representation on behalf of low income taxpayers or that
9 provide taxpayer rights and responsibilities outreach to individuals who speak English as
10 a Second Language (“ESL”); provided that this outreach does not generally include tax
11 return preparation for the current year.

REPORT

I. Background on LITCs

In part attributable to the efforts of many lawyers affiliated with the American Bar Association Tax Section, Internal Revenue Code Section 7526 was enacted by RRA 98.¹ It authorizes the Secretary of the Treasury to allocate up to \$6 million of IRS funding per year for matching grants to LITCs. Under Section 7526(c), grants may not exceed \$100,000 per clinic per year and are subject to the availability of appropriated funds. Clinics must match IRS funding on a dollar-for-dollar basis, although in-kind contributions can be counted as part of the match. The IRS may award multi-year grants for a period up to three years.²

In its first year of operation, Congress appropriated \$2 million for this program. In June, 1999, Stefan Tucker, on behalf of the Tax Section, wrote to key Congressional members requesting that the appropriations be significantly increased:

the [Tax] Section . . . believes that tax clinics play a vital role in the tax controversy process, by insuring the fair resolution of tax cases across all income classes. In the last several years, controversies involving low income taxpayer issues have come to represent a significant part of the overall number of cases in dispute, both administratively within the IRS, and in litigation before the U.S. Tax Court. Taxpayers involved in these cases are not financially able to obtain private counsel to help them, and the clinics have been important players in helping shepherd these taxpayers through the system and settle their cases. Moreover, these programs have made a significant contribution to the tax system as a whole, by giving their taxpayer-clients a better understanding of the process in which they are involved, as well as a sense of confidence that their cases have been resolved fairly.³

In 2000 and in 2001, Congress has appropriated \$6 million a year to LITCs, with \$7 million

¹P.L. 105-206. For a discussion of the strong support the Tax Section has provided to tax clinics, see Leslie Book, *Tax Clinics: Past the Tipping Point and to the Turning Point*, 92 Tax Notes 1089, 1090 (Aug. 20, 2001).

²Under section 7526(c)(4), the criteria relevant for the awards are the following: the number of taxpayers who will be served by the clinic, including the number of English-as-a-Second- Language (ESL) taxpayers in the clinic's geographic area; the existence of other LITCs serving the same population; the quality of the LITC program, including staff and volunteer qualifications and the LITC's record, if any, of serving low income taxpayers; and the clinic's alternative funding sources, including grants and contributions as well as the sponsoring institution's endowment and other resources.

³Letter from Stefan Tucker to the Honorable C.W. Young and Honorable David R. Obey (June 25, 1999), reprinted in Tax Notes Today, 1999 TNT 140-37 (July 22, 1999).

appropriated for 2002.⁴

II. The Need for Adequate Funding to Ensure that LITCs Can Serve Their Important Role In The Tax System

Prior to RRA 98, approximately 15 tax clinics existed nationwide; of those clinics, 14 were at accredited law or accounting schools. Because of the funds available to LITCs under RRA 98, the number of tax clinics grew to 39 in the year following the legislation. The FY 2000 and FY 2001 grant cycles witnessed a significant growth in LITC creation, particularly among nonprofit organizations:

	FY 1999	FY 2000	FY 2001
Grant Applications Received	43	88	141
Grants Approved	34	81	102
Grants Rejected	9	7	39
Grants to Start-Up Clinics	10	54	30
Grants to Existing Clinics	24	34	72
Grants re: LITP Representation	22	18	27
Grants re: ESL Education	4	14	10
Grants re: LITP Rep & ESL Educ	8	56	65
Grants to Law Schools	16	24	24
Grants to 501(c)(3) Organizations	13	58	67
Grants to Business/Accntg Schools	5	14	11
Total Grant \$ Authorized	\$2 million	\$6 million	\$6 million
Total Grant \$ Awarded	\$1.459 million	approx. \$5 million	\$6 million

⁴In fiscal year 2000 and 2001, Congress approved 100 percent of the Administration's budget request for the IRS. Because the IRS requested the full \$6 million authorized by Section 7526 in its budget requests for those years, that amount was available for making grants. In FY 2002, the Statement of Managers accompanying H.R. 2590 indicated that \$7 million should be appropriated to LITCs, and the IRS awarded \$7 million in grants consistent with that appropriation request. Statement of Managers, H.R. 2590 (2001).

The figures reflect an incredible growth in both LITCs and the demand for funds under the program. In FY 2001, the 141 organizations applied for funding and submitted applications for LTC grants totaling over \$9.8 million, more than \$3.8 million authorized to be allocated under Section 7526 and a significant increase from just the previous year. In FY 2002, Congress specifically appropriated \$7 million for the LTC program. In that year, 149 organizations submitted applications for grants totaling over \$10.6 million, more than \$3.6 million over the amount appropriated to the LTC program, and 127 organizations received funding.

Because in large part of funding limitations, otherwise qualified organizations were unable to get funded, and still other qualifying organizations were unable to receive the full amount of funds requested in the application. In fact, according to the IRS itself, of those LITCs awarded funding for the 2001, almost 50% would have received additional funding consistent with their grant applications had the amount appropriated been higher.⁵ Moreover, according to the IRS, the \$6 million limitation in 2001 prevented eight otherwise qualifying organizations from receiving any funding at all.⁶

The situation described above has resulted in serious adverse consequences for many organizations and thus low income taxpayers. There are still seven states without LITCs, and even within states with LITCs, there is demand for increased capacity to represent and educate low income and ESL taxpayers. In sum, the net effect of the current funding limitation for LITCs is that many low income taxpayers are not able to receive representation at all, and organizations that received some funding are not able to serve their communities.

The negative effects of inadequate funding for LITCs are exacerbated by continuing Congressional concern about over-claiming of the earned income credit (EIC).⁷ LITCs are uniquely situated to represent low income taxpayers who have compliance issues centering around EIC, and thus can provide a valuable service for those not familiar with these incredibly

⁵This information was conveyed via an April 10, 2001 e-mail from Beverly Smith, LTC Grant Program Analyst, to LITP Chair Leslie Book and is on file with Book. A request for a similar breakdown of information for FY 2002 was made to the Grant's Office, but the IRS has declined to make this information available absent a Freedom of Information Act Request.

⁶Id.

⁷See e.g., GAO/GGD-99-48, "IRS AUDITS: Weaknesses in Selecting and Conducting Correspondence Audits." (Mar. 31, 1999)("GAO Correspondence Audit Report"). The GAO Correspondence Audit Report noted that there were significant increases in the use of correspondence audits to reflect Congressional concerns about EIC noncompliance. The GAO Correspondence Audit Report highlighted some significant problems with the IRS's use of the correspondence audit technique, namely that the auditors did not always have adequate levels of documentation to support adjustments, that there was different levels of justification among IRS Service Centers for accepting EIC Claims, there was inadequate review to ensure audit quality and that there was an excessively high rate of nonresponsive taxpayers.

complex provisions and the procedural challenges of the tax system.⁸ In addition, in their role of educating ESL taxpayers about their rights and responsibilities as taxpayers, LITCS are also well situated to increase tax compliance by a low income population that is otherwise difficult to access.

To address these limitations, Congress should amend Section 7526(c) to increase or eliminate the limitation in Section 7526(c) that prevents the Treasury, absent specific Congressional appropriation, from allocating more than \$6 million to the LITC program. Moreover, during the appropriation process, Congress should specifically appropriate adequate funding to the LITC program to ensure that the IRS is not forced to make the unilateral and difficult decisions about priorities in order to actually provide the funds to LITCs.

III. Funding For LITCs Should Not Be Considered Only Seed Funding

One possible objection to increasing the amount authorized for appropriation under Section 7526 would be that Congress might not wish to fund LITCs indefinitely. In fact, the current IRS grant administration has stated its belief that the funding under Section 7526 should be properly viewed as seed money, with funding likely to decrease over the next few years.⁹

There are significant problems with this view. The continued existence of federal funding has allowed organizations to leverage the federal dollars and compete in the fund-raising marketplace to supply the match necessary to receive federal funding. But for federal support, which is by far the most important outside source of support for almost all LITCs, it is highly unlikely that LITCs will be successful in this competitive market for public interest grants,

⁸For a discussion of the significant efficiency benefits the LITCs provide to the IRS and the courts, see, e.g., Testimony of Timothy Heavner Before the Committee on House Ways & Means Subcommittee on Oversight, SR No. 107-32, 50 -51 (stating that LITCs save time of IRS Counsel attorneys and the Tax Court, and often are able to explain to taxpayers why certain positions claimed on tax returns may not be meritorious) (July 12, 2001); Janet Spragens and Nina Olson, *Tax Clinics: The New Face of Legal Services*, 88 Tax Notes 1525 (Sept. 18, 2000) (discussing that in addition to the important assistance LITCs provide to individual clients, LITCs produce significant systemwide benefits, including increasing the overall confidence in the tax system and ensuring that the tax system is more responsive to low income taxpayer needs).

⁹Statement of Keith Restaino, Chief, LITC Grants Administration, Before the 2002 Annual LITC Conference (Jan. 8, 2002). It should be noted that in the Report of the National Commission on Restructuring the Internal Revenue Service recommended the creation of federally supported tax clinics, and supported the notion that funding for tax clinics should be considered as seed money for tax clinics. This concept of funding as seed money was not adopted in either the statutory language of Section 7526 or found in the legislative history. In fact, Section 7526(a) specifically provides that grants are to be made for the “development, expansion, or *continuation*” of qualified LITCs. (emphasis added).

contributions and allocations. The requirement for matching dollars ensures that no organization can remain complacent and completely dependent upon federal largesse. We note that without Congressional funding, it is unlikely that any but the few hard-funded committed LITCs that existed prior to RRA 98 would continue to exist. Moreover, as the program becomes more competitive, even if there were additional funds authorized and appropriated, the IRS, in administering the grant program, would likely reward those LITCs that show strong quality or improvement.

The clinics' track record in successfully helping taxpayers resolve their tax disputes shows unquestionably that these programs work. The increased demand for federal funding in the last two years, especially among nonacademic non profit (NANP) legal service organizations, reflects a growing understanding among those who work with the low income population that representation and education centering around tax issues is vitally important to our nation's working poor, particularly in light of the enormous complexity of the tax system.

IV. The Interpretation of Section 7526 to Allow Funding Under the LTC Program to be Given to Organizations Providing ESL Tax Return Preparation Services¹⁰

In addition to requiring that LITCs may charge no more than a nominal fee for their services, Section 7526(b)(1)(A) provides that qualified low income taxpayer clinics may either represent low income taxpayers in controversies or operate programs to inform ESL taxpayers about their rights and responsibilities as taxpayers. It is under the second prong of the statute that the IRS apparently believes LITCs have authority to operate programs to prepare tax returns for all ESL (not just low income) taxpayers.

When this program was statutorily created under RRA 98, the intent of Congress was to give monetary grants to organizations that would provide tax *controversy* assistance to low income taxpayers and who might also engage in ancillary educational outreach sessions about taxpayer rights and responsibilities to ESL taxpayers.¹¹ Both currently and at the time, low

¹⁰This section is largely based on the written statement Professor Janet Spragens presented to the IRS Oversight Board on January 29, 2002.

¹¹See Section 7526(b)(2)(A) and (B) further provides that the term "clinic" includes clinical programs at accredited business or law schools that provide representation to low income taxpayers in controversies or other nonprofit organizations that either represent low income taxpayers or refer such taxpayers to qualified representatives. This again suggests that outreach, while a permitted activity under the LTC program, is properly viewed as an ancillary activity that organizations can undertake in addition to the primary task of representation of low income taxpayers in controversy matters. In fact, many LITCs do perform valuable outreach to the ESL community about the importance of substantive and procedural issues that have particular affect among that community. For example, the Community Tax Law Project in Richmond, Virginia, in addition to its representation and referral activities, has conducted targeted outreach to ESL taxpayers on the many issues relevant for ESL taxpayers and produced training materials for other LITCs to do this as well. See Anita Soucy, *Immigration and Tax Consequences for the Low-Income U.S. Newcomer*, ABA Section of Taxation Newsletter, Vol. 19, No. 4 (2000) (noting how status for immigration purposes may be affected by compliance with federal tax laws).

income taxpayers who needed filing assistance had several possible sources of help, including the free VITA and TCE programs operated around the country through the IRS; other nonprofit preparers around the country, such as Community Tax Aid, Inc. in New York City and Washington DC and the Center for Law and Human Services in Chicago, Illinois; and large institutional paid preparers such as H&R Block and Jackson/Hewitt, which charged moderate fees.

By contrast, taxpayers who were being audited and needed legal assistance to resolve their tax matters had few options in the legal community. To retain an attorney was normally out of the question for economic reasons. Moreover, even if a low income taxpayer could afford to retain a legal representative, because of the (relatively) small amounts in dispute, say \$500 to \$5000, it usually made no economic sense to do so, because the legal costs would usually equal or exceed the deficiency in question. Public Defenders and Legal Services offices across the country, who might be available to assist with, say, a criminal indigency defense, a landlord tenant problem, a domestic violence issue, a consumer fraud problem, or other similar civil issue, did not handle tax disputes. These organizations routinely considered tax to be “rich people’s law,” and as a result tax controversy assistance was not a service area offered by the non-profit legal community.

There is a significant need for controversy assistance for these taxpayers.¹² The FY 2001 National Taxpayer Advocate’s Report lists several low income issues among the top ten issues most frequently litigated by taxpayers.¹³ Recent newspaper stories in the New York Times, moreover, have made clear what IRS statistics already had shown: that the number of low income audits now exceeds the number of high income individual and businesses being audited.¹⁴

¹²The number of audit issues faced by low income taxpayers is practically endless. The list includes, among many others, the earned income tax credit, dependency exemptions, filing status, innocent spouse claims, gambling losses, tip income, self employment income, employee/independent contractor issues, charitable deductions, automobile expense deductions, substantiation, cancellation of debt income (often from predatory lenders); and Schedule C income and expense. Notwithstanding the strong need for controversy assistance, the Section recognizes that lower-income taxpayers may need additional federal assistance with respect to return preparation for all low-income filers, but does not at this time take a position as to the means for such assistance.

¹³The Report lists Dependency Exemptions as #3; Collection Due Process as #6; and the Earned Income Tax Credit as #7.

¹⁴*E.g.*, David Cay Johnston, “IRS Audits of Working Poor Increase,” New York Times, March 1, 2002, p. C-2

When these audits occurred, they were extremely stressful for taxpayers who found themselves under attack and totally lost and alone in a complex administrative and judicial world. On the other side, these cases were taking up significant enforcement resources of the Internal Revenue Service as taxpayers (many of them non-English speakers) were failing to show up for meetings, not responding to audit letters, and generally not being able to organize their cases and present the appropriate information necessary to defend their return positions and resolve their cases.

The legislative history of Section 7526. The animating idea behind Internal Revenue Code Section 7526 (the authorizing statute for the LITC funding program), *i.e.*, to promote organizations which provided free tax controversy assistance to low income taxpayers through matching grants, originated in the final report of the Restructuring Commission. The Report was introduced as legislation in the House of Representatives, a bill which later became RRA 98. .

When this bill, H.R. 2676 was passed by the House in late 1997, reached the Senate, the Senate Finance Committee voted it out with the tax clinic funding provision intact. As passed by the House and the Senate Finance Committee, the Bill defined a qualified LITC as including a law school program or section 501(c)(3) organization that either (A) represented low income taxpayer clients in controversies with the Internal Revenue Service; or (B) referred such taxpayers with controversies to qualified representatives.

Subsequently the Restructuring Bill was considered on the Senate floor, and at that time the Senate adopted a floor amendment sponsored by New Mexico Senator Jeff Bingaman (Floor Amendment 2385) which amended the Senate Bill to add a third category of LITC, as follows:

“(C) a volunteer income tax assistance program which is described in section 501(c) and exempt from tax under section 501(a) and which provides tax preparation assistance and tax counseling assistance to low income taxpayers.”

The Senate passed the Restructuring Bill with the Bingaman amendment. In conference, however, this amendment was defeated and the statute was passed without it.

Because this issue is so critical, the relevant language in the Conference Report to HR 2676, released on June 24, 1998, is repeated in full:

G. Low Income Taxpayers Clinics (sec. 361 of the House bill and sec. 3601 of the Senate amendment)

Present Law

There are no provisions in present law providing for assistance to clinics that assist low-income taxpayers.

House Bill

The House bill provides that the Secretary is authorized to provide up to \$3,000,000 per year in matching grants to certain low-income taxpayer clinics. No clinic could receive more than \$100,000 per year. Eligible clinics would be those that charge no more than a nominal fee to either represent low-income taxpayers in controversies with the IRS or provide tax information to individuals for whom English is a second language.

A “clinic” includes (1) a clinical program at an accredited law school, in which students represent low income taxpayers, or (2) an organization exempt from tax under Code section 501(c) which either represents low-income taxpayers or provides referral 981 to qualified representatives.

Effective Date.--Date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Secretary is authorized to provide up to \$6,000,000 per year in matching grants. A clinic also includes an accredited business school or an accredited accounting school. Grants can also be made to volunteer income tax assistance programs. Grants can also be made to training and technical assistance programs, up to 7.5 percent of total amount available for grants, and without regard to the \$100,000 per clinic limitation.

Effective Date. — Same as the House bill.

Conference Agreement

The conference agreement follows the House bill, except that the overall limit is \$6,000,000 and clinical programs of accredited business schools or accounting schools would be eligible for grants.

Misinterpretation of the Statute. The statutory language, in light of the legislative history, suggest that Congress considered and specifically rejected organizations which provide tax preparation assistance as being eligible for LITC grants as part of this program. Nonetheless, the IRS has interpreted the statute to include tax preparation assistance to ESL taxpayers as an eligible activity for funding,¹⁵ and has

¹⁵*E.g.*, Low-Income Taxpayer Clinics 2001 Grant Application Package and Guidelines, p.4 (a program to inform ESL taxpayers includes a program that targets “taxpayers in the preparation of federal tax returns or other required tax forms.”)

made multiple grants to such tax preparation organizations, even those that provide no direct tax controversy assistance. Ironically, this year because of the limited funds available to the program, many of the tax controversy programs were cut back in their funding in order to fund tax preparation organizations.

On July 12, 2001, the Oversight Subcommittee of the House Ways and Means Committee held IRS oversight hearings on the administration of the LITC program. In that hearing, Congressman Rob Portman, a member of the Restructuring Commission and a principal sponsor of section 7526, specifically questioned the IRS' continuing award of LITC grants to tax preparation organizations. After expressing strong support for the LITC program, he stated:

“But I have to make the point, that when we put this together it was about controversies with the IRS. It was not about tax preparation. You remember, Ms. Spragens, when we came up with this idea was a new idea building on an old system [pro bono tax preparation assistance] that has been out there for years...

But it was to focus not on the broader issue of how to prepare your taxes but when people with low income got involved with the controversy with the IRS where they could go. And some of the testimony, Mr. Book and others, have said, several of you have said we should perhaps set up a separate program for tax preparation or put more money in here for tax preparation. That is something we need to think about and talk about as a Subcommittee. Because that may be a different mission that what we at least had anticipated...

It is under the ESL part of the statute that the IRS has expanded into tax preparation which isn't really — I don't think was the intent of the Congress.

To effectuate the result consistent with the legislative history, Section 7526 should be revised to clarify that preparing tax returns for ESL taxpayers is not a permissible program by which to inform taxpayers about their rights and responsibilities.

Respectfully Submitted,



Richard M. Lipton
Chair, Section of Taxation

August, 2002

EXECUTIVE SUMMARY

1. Summary of the Recommendation

To amend the Internal Revenue Code to allow the Treasury Department to provide adequate funding to the LITC program, clarify that the funding under the program should not be viewed solely as seed money, and clarify that the current interpretation of Section 7526 authorizing the expenditure of LITC funds on ESL return preparation is incorrect.

2. Summary of the Issue That the Recommendation Addresses

The resolution proposes amendments to the Internal Revenue Code to (i) ensure adequate funding to the LITC program (ii) clarify that funding under the LITC program is not to be considered only seed money, and (iii) clarify that the current IRS interpretation of Section 7526 authorizing the expenditure of LITC funds on ESL return preparation is incorrect.

3. Please Explain How the Proposed Policy Position will Address the Issue

RRA 98 gave taxpayers important rights to assist them in resolving tax disputes with the IRS and to assist them in satisfying their tax liabilities. These taxpayer rights provisions particularly benefit low income taxpayers. The LITC program is one of the hallmarks of RRA 98 and one of RRA 98's most important provisions. The benefits of the LITC program inure to the system as a whole. LITCs can play an important role in bridging low income taxpayers' knowledge gap and in assisting those taxpayers to exercise responsibly the rights granted them. Amending Section 7526 to allow Treasury to allocate adequate money to the LITC program under Section 7526, will help ensure that these rights remain meaningful by allowing existing LITCs access to needed resources and provide the means for the creation of new LITCs. In addition, amending Section 7526 to ensure that LITCs are engaged in controversy representation and outreach to the ESL population, rather than ESL tax return preparation, will help ensure that LITCs remain true to their central mission of direct representation.

4. Summary of Minority Views

There were no minority views expressed on this proposal

GENERAL INFORMATION FORM

Submitting Entity: Section of Taxation

Submitted By: Richard M. Lipton, Chair

1. Summary of Recommendation(s).

To amend the Internal Revenue Code to allow the Treasury Department to provide adequate funding to the LITC program, clarify that the funding under the program should not be viewed solely as seed money, and clarify that the current interpretation of Section 7526 authorizing the expenditure of LITC funds on ESL return preparation is incorrect.

2. Approval by Submitting Entity.

Approved by the Section of Taxation at its May, 2002 Meeting

3. Has this or a similar recommendation been submitted to the House or Board previously?

No

4. What existing Association policies are relevant to this recommendation and how would they be affected by its adoption?

None

5. What urgency exists which requires action at this meeting of the House?

Limited funds allocated and appropriated to LITCs have resulted in qualified organizations not receiving any funds and some organizations receiving less funds than needed to adequately represent low income taxpayers in controversies with the IRS.

6. Status of Legislation.

There is proposed legislation in the House of Representatives, H.R. 3991, the Taxpayer Protection and IRS Accountability Act of 2002, that, if enacted, would allow Congress to appropriate additional funding to LITCs and clarify that LITCs are not permitted to engage in return preparation activities.

7. Cost to the Association. (Both direct and indirect costs.)

None

8. Disclosure of Interest. (If applicable.)

Members of the Section of Taxation are affiliated with organizations that receive funding under the LITC Program. Adoption of the proposed resolution contained herein may benefit these organizations.

9. Referrals.

All sections and Divisions

10. Contact Person. (Prior to the meeting.)

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11. Contact Person. (Who will present the report to the House.)

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