Internal Revenue Service Advisory Council

Annual Report

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NOVEMBER 19, 2014

GENERAL REPORT

OF THE

INTERNAL REVENUE SERVICE ADVISORY COUNCIL

The Internal Revenue Service Advisory Council (the “IRSAC”), the successor to the Commissioner’s Advisory Group established in 1953, serves as an advisory body to the Commissioner of Internal Revenue.

Chartered to convey the public’s perception of the Internal Revenue Service and its activities to the Commissioner, the IRSAC membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, state tax administration, and the payroll community. The IRSAC currently consists of 19 members, all volunteers, with substantial, disparate experience and diverse backgrounds. Many provide tax advice to clients, others guide their large employer’s tax affairs, and many are active in the volunteer income tax community. In addition to representing different-sized organizations, industries, and geographic regions of the United States, members also represent several occupations that interact with the IRS and the tax community. Each member has a unique perspective on tax administration and is committed to providing meaningful feedback to the IRS.

The purpose of the IRSAC is to provide an organized public forum for IRS officials and representatives of the public to discuss relevant tax administration issues. Working with IRS leadership, the IRSAC reviews existing practice and procedures and makes recommendations on both existing and emerging tax administration issues. In addition, the IRSAC suggests operational improvements, conveys the public's perception of professional standards and best practices for tax professionals and IRS activities, offers constructive observations regarding current or proposed IRS policies, programs, and procedures, and advises the Commissioner and senior IRS executives on substantive tax administration issues.

The IRSAC is organized into four subgroups — the Wage and Investment (W&I) Subgroup, the Small Business/Self-Employed (SB/SE) Subgroup, the Large Business and International (LB&I) Subgroup, and the Office of Professional Responsibility (OPR) Subgroup. The members appreciate the invaluable assistance, dedication, and support provided by personnel from the IRS Office of National Public Liaison (NPL) and the operating divisions — Candice Cromling, Director, NPL; Carl Medley, Chief, Liaison Advisory Groups, NPL; Lorenza Wilds, IRSAC Program Manager, NPL; Rose J. Smith, NPL; Anna Millikan, NPL; Maria Jaramillo, NPL; Brian Ward, NPL; Johnnie Beale, W&I; Tonjua Menefee, SB/SE; and Kate Gregg, LB&I. They also appreciate the assistance provided by IRS executives and other personnel throughout the year. We thank them for their commitment to the IRS's (and IRSAC's) mission and for engaging in meaningful discussions on important tax policy and procedural issues. The IRSAC members were honored for the opportunity to work with these dedicated, qualified individuals. Their service to the IRSAC, the IRS, and the public should be recognized as truly exemplary.

Issues selected for inclusion in this annual report were identified, researched, and discussed with the subgroups during four working sessions and numerous conference calls throughout the year.

The 2014 W&I Subgroup, chaired by André L. Re, prepared the attached report which provides recommendations for changing taxpayer behavior in their filing of tax returns (where a taxpayer uses a computer to prepare their tax return and then files a paper return) along with customer service improvements in both collections and in the automated underreporting function.

The 2014 LB&I Subgroup, chaired by Mark S. Mesler, Sr., prepared the attached report which provides recommendations for risk assessing large employers to assist in the audit process, clarifying the rules of engagement between the IRS and an LB&I taxpayer under exam, and addressing an apparent disconnect between the goals of the Compliance Assurance Process program and the Advance Pricing Agreement process surrounding the timing of issue resolution.

The 2014 SB/SE Subgroup, chaired by Sherrill L. Trovato, prepared the attached report which provides recommendations surrounding the simplified home office deduction, the IRS Fresh Start initiative, and business identity theft awareness, a topic of emerging concern to tax administration.

The 2014 OPR Subgroup, chaired by John G. Ams, prepared the attached report which provides recommendations concerning the regulation of tax return preparers, tax professionals giving tax assistance to a (legal under state law) marijuana business, and general guidance to tax professionals regarding professional obligations.

In addition to the reports and recommendations of the four IRSAC subgroups, the Council as a whole identified a transcendent issue — securing adequate funding for the IRS — that merits attention because of its importance to enabling the United States to have a system of tax administration worthy of its people.

GENERAL REPORT ISSUE: THE IRS NEEDS SUFFICIENT FUNDING TO OPERATE EFFICIENTLY AND EFFECTIVELY, PROVIDE TIMELY AND USEFUL GUIDANCE TO TAXPAYERS, AND ENFORCE CURRENT LAW, SO THAT RESPECT FOR OUR VOLUNTARY TAX SYSTEM IS MAINTAINED

Executive Summary

The IRSAC commends the IRS for seeking to improve taxpayer service, reduce taxpayer burden, and ensure compliance by both deploying new and improved technologies and implementing creative program initiatives. These unassailable goals cannot be achieved with inadequate funding. Without adequate funding, both taxpayers and the tax system will continue to suffer. IRS personnel must receive the tools, training, and technology required to perform effectively. Advances in private sector technology are outpacing a resource-challenged IRS at a time when it is called upon to do more and when improved technology and a larger workforce are essential to its efficient operation. Without adequate funding, the IRS will be unable to balance the competing demands of its compliance, enforcement, and taxpayer service functions — a balance that is absolutely necessary to the proper functioning of our voluntary tax system. IRSAC is concerned that the long-term degradation of the IRS's service and enforcement capabilities that inevitably flows from persistent underfunding will undermine this core of our tax system.

Background

In IRSAC's view, the IRS is in the midst of an existential funding crisis. Recent funding levels at the IRS impair the ability of the agency to perform its critical mission of providing much needed services and support to taxpayers who strive to meet their tax obligations and to identify and address the non-compliance of those who are not so inclined. We say this as professionals who deal with the tax law, tax system, and tax agency on an almost daily basis. We say it because, candidly, it needs to be said: Our tax system, which is dependent on voluntary compliance, is increasingly at risk.

Since FY 2010, the IRS budget declined each year, even though the agency was required to assume greater responsibilities (such as those mandated by Congress's enactment of the Foreign Account Tax Compliance Act and the Affordable Care Act), and absent congressional action, it will be further reduced. The Internal Revenue Service Oversight Board, an independent body chartered by Congress to provide advice on, among other things, the IRS's budget, confirmed the problem; in an October 20, 2011, letter to the Senate Committee on Appropriations, the Oversight Board commented that the gap between the budget it recommended and the budget approved by the House and Senate Appropriations Committees was "disturbingly large."[1]

Senior IRS leadership reiterated this appraisal in many appearances before Congress along with the Government Accountability Office, which is often characterized as a congressional "watchdog." Regrettably, the IRS's fiscal situation has not recently improved, and has in fact deteriorated. Full Time Equivalents ("FTEs," a measure of the number of full-time personnel) were reduced by about 8,000 FTEs since fiscal year 2009. The IRS absorbed prior budget cuts through savings and efficiencies, but was compelled to reduce, delay, or eliminate services.

[1] Letter of the IRS Oversight Board to Senator Daniel K. Inouye, Chairman, and Senator Thad Cochran, Ranking Member, of the Committee on Appropriations of the United States Senate dated October 20, 2011.

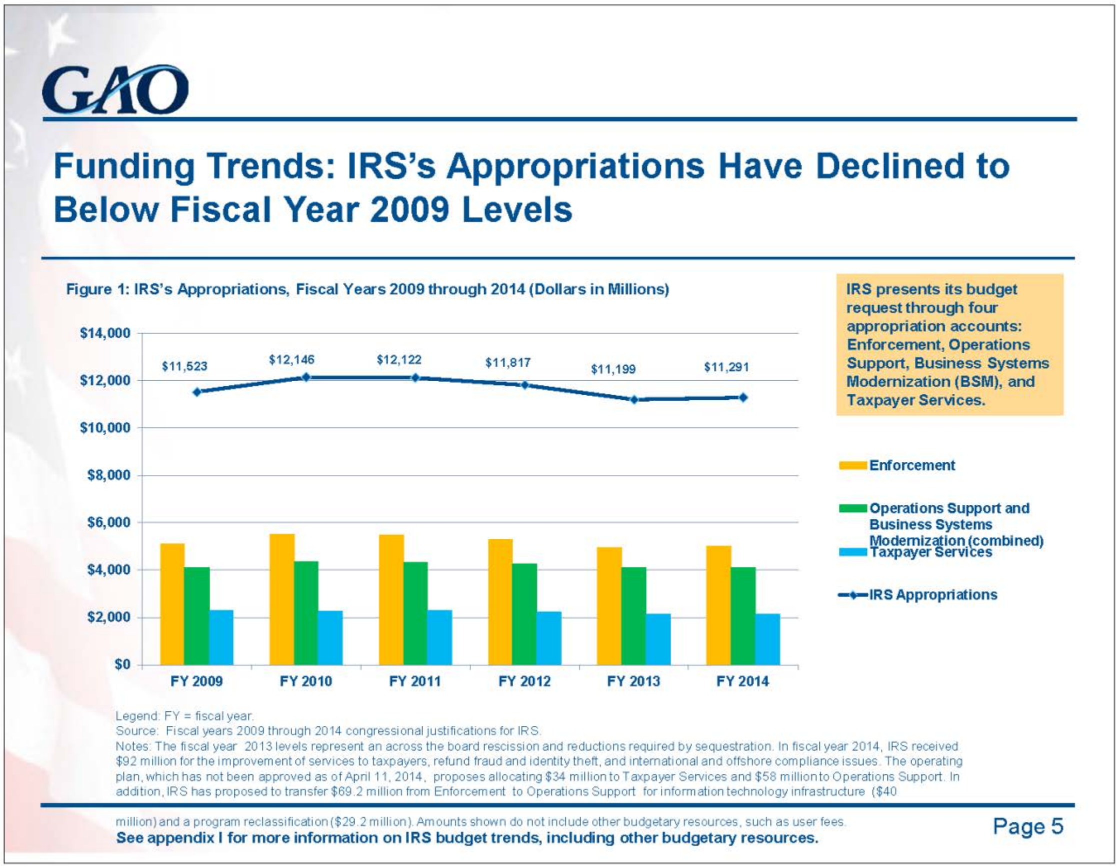

Figure 1 — Report GAO-14-534R, "Internal Revenue Service: Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performance," U.S. Government Accountability Office, April 10, 2014 (Updated April 18, 2014) (hereinafter "GAO Report"), at 5.

The IRS requested a significant budget increase for 2015. Not including other budgetary resources such as user fees, the fiscal year 2015 budget request for IRS is $12.5 billion, which represents an increase of 10.5 percent ($1.2 billion) in funding and 8.3 percent in staffing (6,998 FTEs) over fiscal year 2014.[2] Nevertheless, earlier this year, the U.S. House of Representatives passed H.R. 5016, The Financial Services and General Government Appropriations Act, which would fund the IRS at significantly reduced levels compared with fiscal year 2014.

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[2] GAO Report, at 4.

Although IRSAC recognizes the challenges that Congress faces regarding the federal budget, we respectfully disagree with its treatment of the IRS's budget, which we submit is both short-sighted and counterproductive. Providing the IRS with sufficient resources is essential to its providing adequate taxpayer service, collecting taxes properly due, and ensuring compliance. The proposed funding reduction in H.R. 5016 would reduce the IRS's funding to its lowest level in ten years. While the IRS made great strides in reducing costs, such as increasingly automating its systems, IRSAC believes that continued reduced funding will negatively affect the IRS's ability to serve taxpayers and enforce the tax laws that Congress enacts. In particular, we are concerned that by not adequately funding the IRS, the following consequences might occur.

Declining Federal Revenues

Every dollar devoted to tax enforcement yields a substantial increase in tax collections, and reducing funding in the IRS's tax enforcement efforts results in significantly lower tax collections.[3]

Lack of Necessary Service Personnel at Required Experience Levels

The IRS must recruit and properly train a sufficient staff to perform the critical functions that Congress has assigned it in the face of complex and constantly changing tax laws. With many senior IRS personnel opting for retirement, and funding limits preventing many vacancies from being filled, IRSAC is concerned that the IRS will not have sufficient personnel to address taxpayer needs. Since the IRS's training budget has

[3] National Taxpayer Advocate, 2013 Annual Report to Congress — Executive Summary, at 21 (Dec. 31, 2013).

already been reduced by 85 percent since fiscal year 2009[4] we are concerned about the adverse effects this reduction may have on tax administration and taxpayer rights.

Although the IRS made major strides to automate its systems and operations in its taxpayer service and enforcement functions, many essential IRS programs remain people-intensive and highly dependent on qualified personnel, supported by appropriate levels of funding for compensation, training, travel, and other items. The IRS responded to current cuts through hiring freezes, reduced funding for grants and other expenditures, and cuts in travel, training, facilities, supplies and other costs. The IRS also scrutinized contract spending to ensure only the most critical and mandatory requirements are fully funded.

These adjustments are not "cost free" to the tax system. Taxpayers and practitioners are already experiencing adverse effects due to cutbacks attributable to recent and projected funding reductions. Although recently some training allowances were restored, the effects of the earlier cuts on program effectiveness, not to mention staff retention, cannot be overestimated.

A further comment about staffing is appropriate. Recent cutbacks and sequestration meant that most IRS personnel saw limited or no compensation raises in recent years, even without considering the effect of the furloughs in FY 2013. This fiscal environment likely hastened the departure of senior IRS personnel who were already eligible for retirement. Coupled with other personnel policy changes that constrained the IRS's inability to fill vacancies, we are concerned there will be a significant erosion of

[4] Written Statement of Nina E. Olson, National Taxpayer Advocate, at 11, Hearing on Internal Revenue Service FY 2015 Budget Request Before the Comm. on Appropriations, Subcommittee on Financial Services and General Government, U.S. Senate, 113th Cong. (Apr. 30, 2014).

experienced leadership at a critical time, which cannot help but adversely affect taxpayer service and tax law enforcement.

Negative Effects on the Service's Ability to Administer the Law Fairly

The decline in budget resources unavoidably adversely impacted enforcement programs. Further, the IRS is required by law to implement congressionally enacted laws, such as FATCA and the ACA, and a number of other complex statutes.[5] The IRSAC commends the IRS's efforts to blunt the effects of a reduced budget, but reluctantly concluded that the agency's ability to carry out these duties runs the risk of being significantly compromised because the necessary resources are simply not available.

Decreases in the Quality of Taxpayer Service

The effects of the reduced funding are being felt in negative ways, not only by agency personnel but also by taxpayers and their representatives. In FY 2012, the IRS received around 125 million telephone calls. The IRS answered only about two out of three calls from taxpayers trying to reach a live person, and those taxpayers had to wait, on average, about 17 minutes. Meanwhile, at fiscal year end, the IRS had a backlog of more than 1 million pieces of correspondence (up 188 percent from FY 2004), and almost half of that backlog was overage (up 316 percent from FY 2004). While the percentage of calls answered increased, wait times also increased.

These are not mere abstract statistics; they have real-world consequences for taxpayers and their representatives. The only good news in them is that the call volumes

[5] IRS's workload is dedicated to legislative mandates and priority programs. GAO Report at 4, 18.

are actually down from the levels in the early to mid-1990s, and that is likely owing to the salutary effects of increased automated assistors and other technology, such as the IRS's website, as well as fewer tax law changes. Many of the calls and correspondence are from taxpayers and their representatives trying to respond to IRS inquiries and notices, including levies, other collection matters and identity theft (in 2013 the IRS had approximately 690,000 open cases of identity theft).[6] Resolution of these types of issues cannot be automated because they require engagement with IRS personnel. Similarly, the ability of taxpayers to meet with the Office of Appeals to resolve cases administratively has also been negatively affected by decreased funding.

Effects on a System Based on Voluntary Compliance

The IRS's enforcement efforts — its work to close the "tax gap" (which has been estimated at nearly $400 billion a year) — are also affected by the funding question. In FY 2012, the IRS brought in federal revenue of about $2.52 trillion on a budget of $11.8 billion, a return-on-investment (ROI) of 214:1. As the IRS recently estimated in a letter to Congress, reductions in the enforcement budget will inevitably and negatively affect the level of tax collections by as much as seven times the amount of the budget cuts.

In addition, while much of the lower collections will be attributable to the relatively small percentage of taxpayers who have traditionally ignored their responsibilities, a growing amount may be attributable to the effects of increasing cynicism of taxpayers about the fairness and integrity of the tax system. Thus, previously

[6] Written Statement of Nina E. Olson, National Taxpayer Advocate, at 4, *Hearing on Identity Theft-Related Tax Fraud Before the Comm. on Oversight and Government Reform Subcomm. On Government Operations, U.S. House of Representatives*, 113th Cong. (Aug. 2, 2013).

honest and diligent taxpayers who would otherwise end up paying more to subsidize noncompliance by others could themselves be tempted into noncompliance.

More broadly, any reduction in voluntary compliance will increase the cost of enforcing the tax law. Whatever the costs of running the current system, those costs are orders of magnitude less than what would be necessary if taxes were, in fact, routinely forcibly exacted rather than paid by honest citizens trying to voluntarily comply with their obligations.

Recommendations

Funding levels are now significantly below levels that IRSAC members, in our other role as concerned citizens, believe necessary for the IRS to fully and successfully achieve its mission of assisting taxpayers in complying with their legal obligations and enforcing those legal obligations when necessary. Recent reductions in funding endanger the significant investments and substantial progress made in the last two decades in modernizing the IRS, and compromises the IRS's ability to deal with the challenges now before us and those to come. We recommend that the IRS be funded at a level no lower than the level requested by the Administration.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

OFFICE OF PROFESSIONAL RESPONSIBILITY
SUBGROUP REPORT

JOHN G. AMS, SUBGROUP CHAIR
RONALD D. AUCUTT
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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC OPR Subgroup (hereafter "Subgroup") is comprised of a diverse group of tax professionals, including lawyers, enrolled agents and a certified public accountant. This year the OPR Subgroup addressed the regulation of tax professionals, the application of return preparer standards and ethics obligations to marijuana businesses, and continued participating in the promulgation of new and expanded guidance for practitioners.

The Subgroup has always enjoyed a very good working relationship with the Director of the Office of Professional Responsibility and this year was no exception as all the personnel from the Office of Professional Responsibility were extremely cooperative and forthcoming, even in a difficult budget environment and as they addressed various court challenges.

IRSAC was asked to provide feedback and recommendations on the following three topics included in this report.

1. **Statutory authority of the IRS to regulate tax return preparers**

In 2010, the IRS instituted a program requiring all individuals who prepare tax returns for compensation to meet certain minimum standards including testing and annual continuing education. Earlier this year, the U.S. Court of Appeals for the D.C. Circuit invalidated this program because the IRS does not have the statutory authority to make this program mandatory. The Court's decision also raised questions about the extent to which the IRS can regulate any tax return preparer who is not acting as a taxpayer's representative. We believe all tax return preparers should be required to demonstrate competency by successfully passing an appropriate test, taking annual continuing education, and being subject to the competency and ethical standards in Treasury Circular 230. We therefore recommend the IRS be granted the explicit statutory authority to regulate tax return preparers.

2. **Tax assistance to marijuana businesses**

Marijuana businesses that are now legal in some states but still illegal under federal law need ethical and competent professional tax advice. Tax professionals who give that advice need assurance that they will not be adversely affected by the fact that the business is illegal under federal law.

3. **Guidance to practitioners regarding professional obligations**

Following up on the recommendations in the 2012 and 2013 OPR Subgroup reports concerning guidance regarding the obligations of practitioners under Treasury Circular 230, we recommend that the IRS address additional guidance as part of a multi-phase project. We also offer suggested "Frequently Asked Questions" for this guidance at Appendix A.

ISSUE ONE: STATUTORY AUTHORITY OF THE IRS TO REGULATE TAX RETURN PREPARERS

Executive Summary

In 2010 the IRS instituted a program requiring all individuals who prepare tax returns for compensation to meet certain minimum standards including testing and annual continuing education. Earlier this year the U.S. Court of Appeals for the D.C. Circuit invalidated this program because the IRS does not have the statutory authority to make this program mandatory. The Court's decision also raised questions about the extent to which the IRS can regulate any tax return preparer who is not acting as a taxpayer's representative. We believe all tax return preparers should be required to demonstrate competency by successfully passing an appropriate test, taking annual continuing education, and being subject to the competency and ethical standards in Treasury Circular 230. We therefore recommend the IRS be granted the explicit statutory authority to regulate tax return preparers.

Background

In order to help them deal with the complexities of federal income tax rules, regulations and filing requirements, approximately 80 million taxpayers pay someone else to prepare their federal returns for them. Whether the taxpayer has received his or her money's worth is open to question.

The Government Accountability Office (GAO) addressed tax preparer competency in a recent report, GAO-14-467T, to the Senate Finance Committee. In its report, the GAO noted that 45 percent of preparers were subject to regulation by the IRS because they were attorneys, certified public accountants or enrolled agents, while 55 percent were subject to no regulation. It conducted site visits to 19 preparers and found that only two calculated the correct tax refund for its sample return. Although this is a small sample, GAO also found that some preparers did not even prepare the correct *type* of return.

The GAO concluded that its findings in this study are consistent with the results of GAO's analysis of IRS' National Research Program (NRP) database from tax years 2006 through 2009, which showed that both individuals and preparers make errors on tax returns. Most surprising, even startling, is that tax returns prepared by preparers had a <u>higher</u> estimated percent of errors—60 percent—than self-prepared returns—50 percent. Perhaps as a result of the GAO report and others like it, including the 2008 report of IRSAC, the IRS launched a Tax Return Preparer Review in June 2009. As part of this effort, the IRS received input from a large and diverse community, including tax return preparers, tax professional organizations, members of associated industries, federal and state government officials, consumer groups and the public. The review focused on individuals meeting the definition of "tax return preparer" contained in 26 USC 7701(a)(36), which includes individuals who prepare for compensation, or who employ one or more persons who prepare for compensation, any tax return or claim for refund of tax imposed by Title 26 of the US Code. The definition of tax return preparer includes individuals who prepare a substantial portion of a return or claim for refund.

The report issued following the review, IRS Publication 4832, noted that, "although some tax return preparers (*e.g.*, attorneys and certified public accountants) are licensed by their states and others are enrolled to practice by the IRS, many tax return preparers do not pass any competency requirements before they prepare a federal tax return. This last category of tax return preparer is not required to have any minimum education, knowledge, training or skill before they prepare a tax return for a fee." The report concluded that, due to the concerns outlined in the preceding paragraphs, the IRS should increase its oversight of unenrolled preparers by, among other things, requiring such preparers to take and pass an IRS-administered test and to take at least 15 hours of annual continuing education. Accordingly, the IRS incorporated such requirements in the Registered Tax Return Preparer Program it began to implement in the fall of 2010. The regulations requiring unenrolled preparers to take the test and annual continuing education were issued in June 2011.

In *Loving v. Commissioner*, 920 F. Supp. 2d 108 (D.D.C. 2013), three individual paid tax return preparers (Plaintiffs) filed suit against the IRS, arguing that tax return preparers cannot be regulated by the IRS because the preparers are not acting as "representatives of persons before the Department of the Treasury" under 31 USC §330, the statute underlying Treasury Circular 230. The District Court agreed with the Plaintiffs, as did the U.S. Court of Appeals for the D.C. Circuit, which decided that the term "representative" generally is understood to refer to an agent with authority to bind others. "Put simply, tax-return preparers are not agents. They do not possess legal authority to act on the taxpayer's behalf." Furthermore, the preparation of a tax return does not constitute "practice . . . before the Department of the Treasury."

The rationale in the *Loving* case was followed by the District Court in *Ridgely v. Lew*, Civ. No. 1:12-cv-00565 (CRC), which involved a CPA who entered into a contingent fee arrangement with a client to prepare ordinary refund claims. Such contingent fees are prohibited by §10.27 of Treasury Circular 230. The plaintiff argued that, even though he is a CPA, while preparing the claims he was not acting as a "representative" and was therefore not subject to IRS regulation. The Court agreed that §10.27 does not apply in this situation and enjoined the IRS from enforcing this section of Treasury Circular 230.

In the absence of statutory authority to regulate all tax return preparers, IRSAC is concerned that:

- We will return to a tax preparation environment where, as GAO discovered, tax returns prepared by preparers have a higher estimated percent of errors than self-prepared returns;
- The IRS will be severely limited in its ability to prevent unethical and incompetent tax preparers from taking advantage of taxpayers;
- The outcomes of *Loving* and *Ridgely* will spawn additional cases challenging other sections of Treasury Circular 230 and possibly, or perhaps probably, limiting some of the ethical rules of practice applicable even to attorneys, CPAs and enrolled agents; and
- The IRS will be restricted or prevented altogether from offering even a voluntary program of testing and education for preparers.

Recommendation

We believe it imperative that appropriate tax return preparer testing and education be required before an individual can prepare an income tax return or claim for refund and that all such preparers, whether or not they are considered "representatives," should be subject to Treasury Circular 230.

Accordingly, we strongly believe the IRS should be granted the explicit statutory authority to regulate tax return preparers.

ISSUE TWO: TAX ASSISTANCE TO MARIJUANA BUSINESSES

Executive Summary

Marijuana businesses that are now legal in some states but still illegal under federal law need ethical and competent professional tax advice. Tax professionals who give that advice need assurance that they will not be adversely affected by the fact that the business is illegal under federal law.

Background

In January 2014, Colorado legalized recreational marijuana businesses. Prior to this, Colorado had approved medical marijuana businesses. Both involve the federally illegal sale of a controlled substance. As of the end of March 2014, there were 190 recreational marijuana businesses in Colorado which are expected to gross one billion dollars in sales this year. Washington state legalized recreational marijuana businesses in July 2014.

Marijuana businesses are required to file federal income tax returns, but are not allowed to deduct all their expenses under IRC §280E, which states:

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by federal law or the law of any state in which such trade or business is conducted.

The application of section 280E is not simple. For example, section 280E is not intended to disallow the adjustment to gross receipts with respect to costs of goods sold. S. Rep. No. 97-494 (vol. I), 97th Cong., 2d Sess. 309 (1982). Furthermore, if a taxpayer is engaged in trades or businesses in addition to the trade or business of the sale of controlled substances, section 280E does not disallow the deduction of the expenses of those other trades or businesses. *Californians Helping to Alleviate Medical Problems v. Commissioner*, 128 T.C. 173 (2007).

To complicate matters further, the new marijuana businesses, legal under state law, are cash businesses because banks will not do business with them for fear of violating federal trafficking and federal money laundering regulations. Federal money laundering convictions can mean decades in prison. Rep. Ed Perlmutter (D-CO-7th) was quoted on July 18, 2014, as saying "You cannot track the money. There is skimming and tax evasion. So the guidance by the Justice Department and the guidance by the Treasury Department is to bring this out into the open."

With over 20 states allowing medical marijuana and now states beginning to legalize Recreational Marijuana, this industry needs qualified, ethical professionals to help them fulfill their income tax obligations. But IRSAC members have heard concerns from tax professionals in Colorado as to whether their federal licenses are at risk or their ethics are in question if they serve the marijuana industry.

IRSAC members believe that as a matter of substantive tax law either section 280E or the controlled substance schedules incorporated by reference into section 280E (or both) need clarification in light of these state law developments. Regardless of any such substantive changes, however, tax professionals need reassurance regarding their own roles in giving tax advice to and preparing tax returns for such businesses.

Recommendation

Published guidance should promptly clarify that a tax professional will not be considered unethical, will not be targeted for audit, and will not be in violation of

Treasury Circular 230 solely for representing or preparing a return for a business that is illegal under federal law but legal at the state level under state law.

ISSUE THREE: GUIDANCE TO PRACTITIONERS REGARDING PROFESSIONAL OBLIGATIONS

Executive Summary

Following up on the recommendations in the 2012 and 2013 OPR Subgroup reports concerning guidance regarding the obligations of practitioners under Treasury Circular 230, we recommend that the IRS address additional guidance as part of a multi-phase project. We also offer suggested "Frequently Asked Questions" for this guidance at Appendix A.

Background

In our 2012 and 2013 reports, the OPR Subgroup recommended that the IRS develop a publication that enumerates in reasonable detail the obligations of practitioners under Treasury Circular 230. The purpose of this publication would be to assist the majority of practitioners who attempt to fulfill their professional obligations in good faith. We acknowledged that the development of this proposed publication would constitute a significant undertaking for the IRS.

In light of the scope of this project and the resources that will be required to develop a publication meeting our 2012 recommendation, we believe that the IRS should not attempt to develop guidance in the form of a comprehensive publication as a single project. Rather, we believe that approaching this guidance as a multi-phase project will permit the IRS to provide a basic framework for practitioners and to issue additional guidance on a topic-by-topic basis in the order of their importance to practitioners. Our 2014 recommendation includes "Frequently Asked Questions" at Appendix A, providing further guidance to practitioners concerning a variety of Treasury Circular 230

Recommendation

In furtherance of our 2012 and 2013 recommendation that the IRS develop a multi-phased project enumerating the obligations of practitioners under Treasury Circular 230, we recommend that the IRS continue with the current multi-phased plan to expand this guidance.

In advancement of this endeavor, we offer suggested “Frequently Asked Questions” for consideration at Appendix A.

APPENDIX A: SUGGESTED GUIDANCE

TREASURY CIRCULAR 230 FREQUENTLY ASKED QUESTIONS

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(1) Q: While reviewing a new client's prior year returns, I realized her last preparer had claimed numerous expenses that were not deductible. I informed the client of the errors and advised her to correct the noncompliance. Do I need to make sure she files an amended return, or is it enough to notify the client of her obligation?

A: You must advise the client of the consequences of the noncompliance and must inform her of any penalties that are reasonably may apply. You will also want to verify the accuracy of any amounts carrying forward to the current year if you prepare her return. *Treasury Circular 230 §10.21, §10.22*

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(2) Q: I discovered a large error on a client's return that I prepared last year. If I inform him of it, he may fire me. It was an honest mistake and the IRS will probably never notice. Can I just ignore it and not tell him about it?

A: No. You must promptly advise a client when you find an error or omission in any return or document previously submitted to the IRS, even if it was your mistake. You must also advise the client of the consequences of the client's noncompliance, including potential penalties and the opportunity to avoid such penalties. *Treasury Circular 230 §10.21*

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(3) Q: I have heard I can rely on information furnished by my client without verifying it, so if my client completes an organizer, can I take it at face value?

A: No. Due diligence requires that you determine the correctness of representations made on tax returns or other documents relating to Internal Revenue Service matters. To the best of your ability, you must gather sufficient information, consider all facts, know the applicable laws, and accurately apply the laws to these facts. You cannot ignore facts that you know, or should have known, were inaccurate, and must make reasonable inquiries if the information appears to be incorrect, incomplete, or inconsistent with other facts. *Treasury Circular 230 §10.22, §10.34(d)*

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(4) Q: Am I in violation of the due diligence requirements if my client lies to me?

A: Only if you knew, or should have known from other evidence, that your client has lied to you. You cannot ignore implications of information furnished by the client or facts that are known by you, and must make reasonable inquiries to determine the accuracy of the information. *Treasury Circular 230 §10.22, §10.34(d)*

(5) Q: Can I rely on work that was done by someone else in my office?

A: Yes, as long as you have used reasonable care in selecting the person performing the work and that person is competent. For example, you may rely on a competent colleague, but would likely take more care if relying on a first year staff person who may not be competent. *Treasury Circular 230 §10.22*, *§10.37(b)*

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(6) Q: Following a disagreement between us, my client called and demanded his records back and is refusing to pay me for my time. What are my obligations?

A: Generally, upon demand, you must return all documents necessary for the client to fulfill his tax obligations. In the case of a dispute over fees for services rendered, state law controls whether you may be entitled to withhold some records, but otherwise, all documents obtained from the client or a third party must be returned. *Treasury Circular 230 §10.28*

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(7) Q: I inherited a number of clients from a preparer who used questionable judgment on a few issues in multiple clients' returns, but otherwise he seems competent. Can I rely on his work papers, calculations, and schedules if they appear to be reasonable and are unrelated to the questionable items?

A: Maybe. The standard for reliance requires evaluation of all facts and circumstances to make a determination of the reasonableness and correctness of information supplied. You cannot rely on another who you know or should know is incompetent, lacks the necessary qualifications to perform the work, or has a conflict of interest in violation of Treasury Circular 230. You also cannot rely on another's work if you know or should know it is based on faulty data or assumptions. *Treasury Circular 230 §10.37*

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(8) Q: I think my business partner is advising his clients to take credits for which they do not qualify. We have never had policies involving supervision or training since we are both licensed and neither of us "manages" the other. Can I be sanctioned for his negligent or reckless actions?

A: Yes. The IRS may designate one or more individuals to be responsible for the firm's compliance with Treasury Circular 230. If you know or should have known of others within your firm who are engaged in a pattern or practice in violation of Circular 230, you could be held accountable for failure to correct the noncompliance, even if it involves individuals who you do not supervise. *Treasury Circular 230 §10.36*

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(9) Q: A new client owes the IRS for multiple years of tax, penalties, and interest. When I called the IRS to inquire about the status of her account, they told me a

levy had been issued to my client's bank the previous day. Can I advise the client to move the money to a different bank?

A: No. You may tell the client a levy has been issued and can reveal the details furnished by the IRS, but you cannot advise the client to move her money to avoid the levy. Treasury Circular 230 prohibits counseling or suggesting a client evade taxes or payment of taxes. *Treasury Circular 230 §10.51(a)(7)*

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(10) Q: Can I advise a client to submit a request for a Collections Due Process (CDP) hearing to stop collection activity if the client is not compliant and does not intend to become compliant?

A: No. This is an example of making a submission to delay or impede tax administration. As a tax practitioner you know, or should know, that the IRS will not consider resolution of a collection action when a taxpayer is not in compliance. *Treasury Circular 230 §10.34(a), 10.34(b)(2)*

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(11) Q: A returning client started a new business in an industry with numerous specialized tax regulations and incentives. As I began working on his tax return, I found I did not understand most of the elections and credits. Can I prepare and sign this tax return?

A: No. You cannot prepare or sign a tax return if you lack sufficient competence. Competence requires the appropriate level of knowledge, skill, thoroughness and preparation. You can become competent through consulting with experts in the relevant area or studying the relevant law applicable to this client's new venture. *Treasury Circular 230 §10.35*

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(12) Q: Can I represent both spouses in the audit of a Married Filing Joint return if they are now divorced?

A: Treasury Circular 230 prohibits representation of parties in conflict, but provides an exception under certain circumstances. You can represent parties when a conflict exists if you believe you will be able to provide competent and diligent representation to each affected client and the representation is not otherwise prohibited by law. This engagement involves the representation of persons whose interests may be adverse to one another. Under these circumstances, both spouses must be fully informed of the potential issues and both must consent, in writing, to waive the conflict. *Treasury Circular 230 §10.29*

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(13) Q: I joined a tax resolution marketing service that refers representation clients to me for a fee. Is this type of solicitation allowed?

A: Yes, but you must be cautious about the referral service's solicitation practices and advertising claims. You may not assist or accept assistance from any person or entity who obtains clients using false, fraudulent, or coercive claims or otherwise uses misleading or deceptive advertising. *Treasury Circular 230 §10.30(d)*

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(14) Q: Can a tax preparer use Form 8888, Allocation of Refund, to pay their tax preparation fee?

A: No. The federal government prohibits a tax practitioner from directly or indirectly negotiating a taxpayer check into an account owned or controlled by the practitioner or an associated entity. This includes depositing a taxpayer's check or electronically directing all or a part of a refund to a tax preparer. *Treasury Circular 230 §10.31*

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(15) Q: How are certain tax preparation businesses able to receive their fees from a client's refund?

A: Certain vendors have third-party affiliated or contracted relationships with service providers (financial institutions) who are separately regulated by the federal government. In these arrangements, the refund is deposited into a temporary bank account in the taxpayer's name and the taxpayer directs the bank to pay the tax return preparer fee.

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(16) Q: If I advised a client to take a position on a tax return for which penalties may be incurred, what are my duties?

A: You must advise the client of the penalties which are reasonably likely to apply regarding a position on a tax return if you advised the client regarding the position or if you prepared the tax return. You must also advise the client of how to avoid these penalties. *Treasury Circular 230 §10.34(c)*

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(17) Q: If a client tells me she used her automobile 100% for business and tells me the business mileage, may I rely on her statement without further information?

A: No. This is a case in which you must make reasonable inquiries including, for example, does the client have another automobile for personal use? Did the client commute to work? Did the client keep records of the business mileage? *Treasury Circular 230 §10.34(d), §10.22*

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(18) Q: I am the tax partner in charge of our tax department although I do not supervise all of our tax preparers. Can I be subject to discipline if one of my preparers violates Circular 230?

A: Yes. The person who has principal authority for overseeing the firm's tax practice must take reasonable steps to ensure that adequate procedures are in place and are followed to comply with Treasury Circular 230. You can be subject to discipline if the violation is a result of willfulness, recklessness, or gross incompetence and is part of a practice or pattern of failure to comply. *Treasury Circular 230 §10.36*

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(19) Q: I work in the tax division of a large firm with a management team that does not include tax professionals. What if there is no individual who has responsibility for the firm's procedures to ensure compliance with Treasury Circular 230?

A: If no person is designated as having principal authority over a tax practice, the Internal Revenue Service may identify one or more individuals in the practice as having principal authority for the firm's compliance with this section. *Treasury Circular 230 §10.36*

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(20) Q: How do I demonstrate compliance with the oversight requirements of §10.36?

A: Some of the steps may include:

- Treasury Circular 230 training for all members of the department
- Requirements that other's work is reviewed
- Periodic monitoring of compliance
- Written quality control procedures

Treasury Circular 230 §10.36

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(21) Q: Can I rely on another practitioner's work product without question?

A: Generally, yes, but only if the advice is reasonable and in good faith. You cannot rely on advice if you know or reasonably should know:

- That the advice is not reliable. For instance, if you have not provided all of the relevant facts to the other practitioner who is rendering the advice.
- That the person rendering the advice is not competent or qualified. For instance, if the person rendering the advice has limited knowledge of the tax law.
- If the person rendering the advice has a conflict of interest that violates Treasury Circular 230.

Treasury Circular 230 §10.37(b), §10.22

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(22) Q: If my State Board of Accountancy suspends my CPA license, may I still represent clients before the IRS?

A: No. Treasury Circular 230 allows a certified public accountant who is not under suspension or disbarment from the IRS to practice only after filing a written declaration that the CPA is currently qualified to practice as a CPA and is authorized to represent the party. *Treasury Circular 230, §10.3(b)*

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

LARGE BUSINESS AND INTERNATIONAL
SUBGROUP REPORT

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC LB&I Subgroup (hereinafter "Subgroup") consists of five tax professionals with a variety of experience in large corporate tax departments, large public accounting firms, government, and academia. We have been honored to serve on the Council and appreciate the opportunity to submit this report.

The Subgroup has had the opportunity to discuss several topics throughout the year with LB&I management. This report is a summary of those discussions and the Subgroup's recommendations with respect to each topic. We would like to thank LB&I Commissioner Heather Maloy and the professionals on her staff for their time spent discussing these topics with the Subgroup and for their valuable input and feedback.

The Subgroup is reporting on the following three issues:

1. **<u>Risk Assessing Large Taxpayers</u>**

At the request of LB&I management, this report builds upon the recommendations contained in last year's report concerning efforts to better risk assess taxpayers. The subgroup reviewed a comprehensive report prepared by the Organisation for Economic Co-operation and Development (OECD) and analyzed in particular the tax risk assessment programs in Australia, Canada, and New Zealand. The subgroup then developed a series of recommendations, including the revision of Schedule UTP "Uncertain Tax Positions" (as well as the expansion of the class of taxpayers required to complete it) and the expansion of LB&I's Compliance Management Operations (CMO) program.

2. **<u>Rules of Engagement and Escalation of Issues</u>**

LB&I asked for the Subgroup's assistance in identifying ways to increase efficiency in the resolution of issues at the examination level. The exam team will often seek the assistance of expertise within the IRS, including functional experts, technical experts, and issue experts. It is important that there be an understanding as to who "owns" an exam issue when these varied parties all have input. In this report, the Subgroup focuses on opportunities for better educating taxpayers and IRS employees on resolution of issues when these various experts are involved in the analysis of an issue.

3. **CAP Taxpayers with Pending APAs**

Taxpayers participating in the real-time review program known as the Compliance Assurance Process seek to achieve financial certainty sooner than business taxpayers that undergo typical post-filing examinations. Although the same goal of early certainty may prompt taxpayers with significant international transactions to enter the Advance Pricing Agreement program to resolve transfer pricing matters, these agreements can take several years to negotiate. As a result, the taxpayer's goal of achieving financial certainty sooner is thwarted. This report explores several options to facilitate financial certainty under the Compliance Assurance Process while the Advance Pricing Agreement process is still underway.

ISSUE ONE: RISK ASSESSING LARGE TAXPAYERS

Executive Summary

At the request of LB&I management, this report builds upon the recommendations contained in last year's report concerning efforts to better risk assess taxpayers. The subgroup reviewed a comprehensive report prepared by the Organisation for Economic Co-operation and Development (OECD) and analyzed in particular the tax risk assessment programs in Australia, Canada, and New Zealand. The subgroup then developed a series of recommendations, including the revision of Schedule UTP "Uncertain Tax Positions" (as well as the expansion of the class of taxpayers required to complete it) and the expansion of LB&I's Compliance Management Operations (CMO) program.

Background

1. 2013 Recommendations

For half a century, the returns of the largest business enterprises have been scrutinized as part of the so-called Coordinated Industry Case (CIC) Program. In 2012, to both conserve resources and improve IRS case development and resolution, the IRS set out to modernize its risk assessment capabilities. As described by the then acting Commissioner, the IRS wanted "to spend less time with compliant taxpayers" and "to reduce the time spent looking for issues and increase the time spent understanding and resolving them."

As part of its efforts, in 2013 the IRS asked IRSAC's Large Business & International subgroup "to recommend risk assessment techniques that may be employed as part of the audit selection process." In its report last year, IRSAC reviewed risk assessment efforts of tax authorities in the United Kingdom and Australia and then turned to the challenges of implementing a risk assessment protocol in the United States, starting with the need to train IRS agents in risk assessment methodologies. It recommended that any proposed risk assessment methodology be developed using a select group of taxpayers in the Compliance Assurance Process (CAP) program.

Second the IRSAC recommended that the initial request for risk assessment information should be in the form of a "yes or no" list of indicators that is part of the filed tax return, suggesting that the checklist could be a section of Schedule UTP that would be required for all taxpayers. Based on the responses to the initial questions, the IRS could make further inquiries. The subgroup suggested 17 risk assessment factors — many of which speak to the oversight of companies' tax function by their board of directors — including (a) the amount of guidance and oversight provided by the board of directors; (b) the board's providing guidance to management on the level of tax risk to be taken by the company; (c) whether appropriate review and sign-off procedures are in place for material transactions; (d) whether the company has reported a material weakness or financial restatement relating to the tax function; and (e) whether the taxpayer has been involved with major tax planning initiatives during the year.

2. 2014 Request

LB&I Commissioner Maloy has asked the LB&I Subgroup to review best practices of other countries such as Australia, New Zealand, and Canada and consider whether they hold promise for LB&I. In particular, the subgroup was asked to develop recommendations to enhance LB&I's risk assessment protocols, such as refining the recommendations contained in last year's IRSAC report.

Discussion

1. 2013 OECD Report

In 2013, the Organisation for Economic Co-operation and Development (OECD) published *Co-operative Compliance: A Framework*, which is based on a survey of 21 members of the OECD's Forum on Tax Administration (FTA) as well as consultations with the Business and Industry Advisory Committee. The framework provides a status report — five years after the issuance of FTA's *Study into the Role of Tax Intermediaries* on efforts of revenue bodies to establish a so-called enhanced relationship with large business taxpayers based on trust and cooperation and details the practical experiences of countries that developed cooperative compliance programs.

Advancing the term "co-operative compliance" to replace "enhanced relationship,"[7] the OECD report confirms that collaborative and trust-based relationships have been widely established between large corporate taxpayers and revenue bodies, listing 24 countries that have such programs. It also concludes that concepts of cooperative compliance have been fully integrated into the coherent compliance risk management strategies that revenue bodies have adopted, which reflects an increasing focus on understanding and influencing taxpayer compliance behavior.

The 2013 OECD report also reflects the business community's experiences of the cooperative compliance approach, highlighting the importance of transparency and disclosure on the part of both parties in a framework of cooperative compliance to reduce uncertainties over companies' tax positions more effectively and efficiently. The importance of good corporate governance systems that support transparency and disclosure has emerged much more clearly over the past five years as an integral part of

[7] This IRSAC report adopts the standard American usage of not hyphenating the word "cooperative."

cooperative compliance. The report thus confirms that tax is increasingly (and appropriately) more important in the boardroom, devoting an entire chapter to the importance of a solid tax control framework. The report highlights the central importance of a tax control framework in bringing rigor to the cooperative compliance concept, demonstrating that the relationship between taxpayers and revenue bodies is based on objective criteria and justified trust. The report concludes with some thoughts about the future direction of the cooperative compliance concept. It suggests that the concept of the tax control framework could be developed further and that further work on measures of effectiveness may be needed.

2. Canada

Under the Canada Revenue Agency's (CRA) *Approach to Large Business Compliance* program which is to be phased in over five years beginning in 2010, large corporations are assigned one of three overall levels of risk (high, medium, and low) with a taxpayer's rating depending on numerous factors. In general, the level of audit coverage is adjusted based on the rating, with quick reviews for low-risk taxpayers and full audits for high-risk ones.

Risk assessments are based on the taxpayer's tax filing history, relationship with CRA, and industry considerations. The quality of the taxpayer's tax governance is given priority in CRA's approach to assessing risk. An integral part of the Canadian initiative is a meeting between Canada Revenue Agency representatives and senior representatives of the taxpayer, who may include chief financial officers (CFOs) and other executives with oversight responsibilities. In advance of the meeting, taxpayers are provided with interview questions that are relevant to the taxpayer's risk rating. Although the process can vary from case to case, some or all of the questions may be directly addressed during the meeting. There will also be a discussion of CRA's redefined risk-based approach to large business compliance and CRA's findings and observations noted during the taxpayer's risk assessment. CRA will also seek to understand how the taxpayer manages tax risk at its highest governance levels. And there will be a discussion of the risk of non-compliance associated with the company's business activities, governance regime, internal controls, and inherent and behavioral risk factors affecting the risk segmentation. For example, the CFO may be asked detailed questions about the quality of the company's tax oversight, controls, and involvement in aggressive tax planning or unusual or complex transactions. While taxpayers are informed that they should not view the meeting as an opportunity to "negotiate" its ranking, for medium and high risk taxpayers there will be a discussion of what can be done to reduce the rating in the future.

The taxpayer's risk rating, however, is not the end of the story: Each audit program is individually tailored to the particular taxpayer — that is to say, not every high-risk taxpayer will be treated in the same manner. Thus, one might be subjected to an intense *international* tax audit, whereas another could be subject to an aggressive tax *planning* audit.

The objective of Canada's new approach is to reduce the number of large corporations audited by changing CRA's assumption that all are high risk to a more focused risk-based approach. CRA has released information indicating that after the initial risk reviews, 37 percent of large corporations were high risk, 38 percent are medium risk, and 25 percent are low risk. Anecdotal reports suggest the split may currently be one-third, one-third, and one-third. Although some taxpayers have seen their audit coverage reduced or eliminated, concerns have been raised that the process remains subjective, taxpayers are provided with only limited input into the process, and the "carrot" of a low or medium risk taxpayer being able to obtain real-time audit assistance has not materialize in many cases, presumably due to resource constraints. Cultural attitudes and distrust on both sides of the relationship remain issues.

Indeed, some tax directors, CRA representatives and outside advisers regard the interviews as little more than "window dressing" that may even be counterproductive. This reaction, justified or not, highlights a challenge tax authorities must address as they strive to transform targeted programs, such as CAP, where taxpayers "self-select" themselves into the program, into more broad-based, universal ones.

3. Australia

The Australian Tax Office (ATO) has developed a comprehensive risk-differentiation framework (RDF) to assess large corporations' tax compliance risk and determine the manner in which of it engages with those taxpayers. The RDF is based on the premise that tax risk assessment should take into account the tax authority's perception of two things:

- Estimated likelihood of the taxpayer's having a tax position that ATO disagrees with, or the taxpayer's having misreported — through error or omission — its tax obligations, as evidenced by its behavior, approach to business activities, governance, and compliance with the tax law; and

- Consequences (in terms of dollars, relative influence, effect on community confidence) of the potential noncompliance.

The framework is generally applied on an economic group basis, with the economic group being placed into one of four broad risk categories — higher risk, medium risk, key taxpayer, and lower risk — for each relevant tax type. Each year, the large business is notified of its RDF categorization, which determines and "the formality and intensity" of ATO's approach to the taxpayer. For example, higher risk taxpayers will be subject to continuous review. For key taxpayers, ATO will carefully review the company's risk management and governance frameworks to evaluate how efficaciously they mitigate tax compliance risks. Significantly, ATO expects key taxpayers "to fully disclose potentially contestable matters to us as they arise," and it encourages them to enter into annual compliance arrangements (which provide real-time, practical certainty and reduced compliance costs). For medium-risk taxpayers, in contrast, ATO will undertake only targeted activities to deal with tax compliance concerns. And lower-risk taxpayers will face the lightest "touch."

That said, ATO applies a level of risk analysis to *all* large businesses, closely examining significant transactions and business results that show inconsistencies between tax and economic income. ATO also assesses the effectiveness and accuracy of a large taxpayer's business systems, including its tax risk management and governance systems (*i.e.*, its tax control framework), and has released a checklist of matters that may constitute, such as cross-border or tax-haven dealings, tax benefits from financial or other arrangements that are disproportionately high compared with its financial exposure, and lack of capacity or capability in tax governance processes and personnel.

In 2013, the Australian Tax Office (ATO) began exploring an external compliance assurance process (ECAP) for taxpayers in the large market. After several months of consultation and design — which focused on issues relating to auditor independence, materiality, and assurance — in June 2014, ATO announced a pilot ECAP pilot, whose goal is to test the efficacy of using taxpayers' registered company auditors to conduct assurance on factual matters.

ECAP will only be offered to public groups that have an ATO risk rating of medium or lower (*i.e.*, not high-risk or key taxpayers), and will be limited to factual matters.[8] The ECAP engagement will be initiated by ATO by a letter to the taxpayer identifying the matters to be assured. The taxpayer will then consider their choice and may engage the assurance practitioner.[9] The first phase of the ATO pilot will be limited to 32 taxpayers (16 ATO cases and 16 ECAP cases). Depending on results, the second phase would involve a much broader pilot or integration into ATO's ongoing compliance work.

4. New Zealand

In 2013, New Zealand Inland Revenue (NZIR) launched its Significant Enterprises Initiative, which marked a change in how NZIR approached the risk assessment of multinational corporations. Specifically, most groups of companies with annual turnover in excess of $30 million are now required to provide copies of their financial statements, tax reconciliations, and group structures at the time they file their returns. Moreover, in its October 2013 publication entitled "Multinational Enterprises: Compliance Focus," NZIR has set forth ten "familiar red flags" that may prompt questions from the tax authorities. None of these, however, formally focuses on tax governance or other common indicia of tax risk.

[8] As part of ATO's efforts, its Large Business & International Line became the Public Groups and International Line and is responsible for all public groups, all foreign-owned entities, and international strategies. (The Medium Business Line was renamed Private Groups and High Wealth Individuals, with realigned responsibility for private groups with turnover of more than $2 million as well as High Wealth Individuals; and all other groups are part of the Small Business and Individual Taxpayers Business Line.) The change was made to better reflect the external community where legal structure, reporting requirements, and governance arrangements shape and define how business operates.

[9] Additional information about ECAP — including detailed guidelines for auditors and information on the mandatory integrity-checking approach —https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/External-compliance-assurance-process/.

More generally, NZIR has embraced the increasingly global view that tax management must be a part of good corporate governance, and has released four key questions that taxpayers should consider in respect of their tax risk:

- Are appropriate resources (including local capability) being applied to tax matters?
- Are sufficient internal controls, checks and balances in place and actually carried out?
- Is there good tax awareness in critical business areas beyond the central tax or finance team?
- Are you aware of legislation changes affecting your business?

Equally important, as part of New Zealand's involvement in the OECD's Base-Erosion and Profit Shifting project, NZIR has identified a need for significantly more (and more timely data) about large corporations and their international operations. This has prompted NZIR to propose consideration of the following proposals:

- Developing a voluntary code of practice for large corporations (potentially modelled on codes in the United Kingdom, South Africa, and Spain).
- Requiring enhanced information disclosure (in electronic form) from large corporations.
- Requiring large corporations to file their tax returns earlier.

5. LB&I's Compliance Management Operations Program

In February 2010, LB&I initiated a multiyear pilot, the Compliance Management Operations (CMO) program, to test whether a more comprehensive approach for identifying and selecting for audit the returns of taxpayers smaller than Coordinated Industry Case (CIC) taxpayers, *i.e.*, those classified as Industry Cases (IC). Under the CMO approach, tax returns and specific issues are selected for audit centrally and then assigned to an examiner.

The benefits of CMO to LB&I include an increased ability to recognizing emerging areas of noncompliance by reviewing returns at a global scale that would not be evident at the individual-return level; greater capacity to respond in a timely manner to areas of compliance risk by identifying and building cases with specific issues; and delivery of higher risk cases to the field as determined by application of rules and filters and upfront risk assessments. Moreover, by centralizing the risk assessment process, improved efficiencies and specialization are allowed (compared with field level assessments), especially when coupled with collaboration with Issue Practice Groups (IPGs) and International Practice Networks (IPNs).

The CMO pilot has garnered very positive feedback and good results. There has been improvement in examination results per staff hour, reduction in months in process, reduction in total examination time, and reduction in pre-opening conference examination time. In addition, the enhanced feedback process between CMO and the field enables the field to improve its own issue selection process.

Recommendations

Risk assessment is critical to selecting taxpayers and the issues to be audited in a manner that conserves resources, reduces burden, and enhances certainty. The IRSAC commends LB&I for its previous efforts to enhance its approach to auditing large corporations — namely, moving away from a taxpayer-based approach (*i.e.*, CIC versus IC) to an issue-based approach. Risk analysis can be done more efficiently, for example, by reviewing publicly available data regarding the taxpayer, using transparency tools such as (revised) Schedule UTP, Uncertain Tax Positions, and expanding its centralized approach to analyzing the compliance risk associated with large corporations.

Although even the most comprehensive, successful risk assessment program will never supplant the need for hands-on, thorough examinations, the subgroup is convinced that LB&I can benefit significantly from further refining its risk assessment efforts. Indeed, improved risk assessment techniques will not only allow LB&I to be smarter and more selective in identifying taxpayers and issues to be examined. Properly designed, these efforts can have a prophylactic effect, positively influencing taxpayer behavior. Thus, the IRSAC endorses one of the principles underlying many of the requirements of the Sarbanes-Oxley Act: The very act of asking questions has the potential for changing the landscape.

1. The review of the OECD's 2013 report and developments in Australia, Canada, and New Zealand confirms two things: First, there is no one-size-fits-all approach to risk assessing taxpayers. Practices vary from country to country. The differences can be explained by a multitude of factors, ranging from the size and sophistication of the business community, to the technological wherewithal of the tax authorities, to cultural norms, to resource constraints. Second, the growing global consensus is that governance — the presence and testing of a tax control framework — should be an integral part of tax authorities' risk assessment protocols.

Apropos the first point, two observations about Australia's efforts bear mention. First, the IRSAC endorses the decision of ATO to recognize formally the fundamental differences — especially in respect of the effectiveness of a company's Tax Control Framework — between publicly held and other taxpayers. Although a change in nomenclature similar to that in Australia (from "Large Business" to "Public Groups") may not be necessary, the tax authority's effective leveraging of the enhanced scrutiny paid to publicly held companies by their independent authorities as well as other governmental bodies (such as the Securities and Exchange Commission) is critical. In addition, as intriguing as ATO's External Compliance Assurance Process is (and as much as the IRSAC agrees that the United States could better rely on the work done by independent auditors), we do not recommend that LB&I currently devote resources to a similar process. Stated candidly, the potential merits of ECAP notwithstanding, we do not believe sufficient political or public support for such as initiative exists (or could be generated) to justify the effort. Indeed, even in Australia, the announcement of the ECAP pilot prompted "fox guarding the henhouse" headlines.

Secondly, given the increasingly important role that governance plays in the board room, the IRSAC endorses LB&I's taking more into account a large company's commitment to good tax governance in its refining its risk assessment protocol. In line with the recommendations in last year's IRSAC report, we recommend that the IRS revise Schedule UTP to collect additional information from large corporations on their tax governance practices and, indeed, that it consider expanding the class of taxpayers required to file the schedule.

Specifically, to the extent possible, the revisions to the schedule should focus on the existence and support for the company's tax control framework, and should be framed as yes-or-no questions, such as the following:

- Does the Chief Tax Officer make periodic presentations to the board of directors or one of its designated committees?
- Has the board provided guidance to management and the tax department as to the level of tax risk that should be taken by the company?
- Is there in place appropriate review and sign-off procedures for material transactions, thereby ensuring that significant tax risks are elevated to the board?
- Has the company reported a material weakness or financial restatement related to tax matters in the last two years?
- Is the company's internal audit function involved in reviewing the tax function?

- Has the taxpayer been a party to a recent merger or acquisition or other development that has or may cause a significant change in tax department personnel or availability of tax reporting data?

In addition, the IRSAC believes that questions that are subjective in nature (*e.g.,* are the company's internal control adequate?) or particularly freighted (*e.g.*, is the company's tax strategy consistent with its overall business strategy? does the company have a history of overaggressive tax planning?) should generally be avoided in revising Schedule UTP, especially in light of our recommendation (below) that risk assessment occur on a centralized (CMO-focused) basis. This recommendation is consistent with the OECD's conclusion that the cooperative compliance concept depends on an *objective* assessment of the relationship between taxpayers and tax authorities. Moreover, a decision not to include such questions on the revised Schedule UTP does *not* mean that that risk assessment personnel should ignore information otherwise available (*e.g.,* from public available documents or prior examinations) that touch on the same concepts or behaviors.

The existence of a strong tax control framework within a company, of course, does not mean that a taxpayer, perhaps especially a very large company, should necessarily be given a "pass" by LB&I. However, it does suggest that the amount of time given to testing, for example, the integrity of the taxpayer's systems can prudently be limited. In this way, LB&I can effectively leverage the efforts of internal and external auditors, as well as in some cases the SEC and the Public Company Accounting Oversight Board, and devote its personnel and resources to examining tax issues of greater significance.

More fundamentally, the *absence* of a strong tax control framework should properly send a strong signal to LB&I that a taxpayer may merit a closer look. Indeed, one reason the IRSAC believes that Schedule UTP should be revised is that the form can provide the IRS with information about groups of taxpayers that, primarily because of limited resources, may previously have escaped scrutiny.

With respect to revised Schedule UTP, we reiterate the recommendation in our 2013 report that LB&I work with a large group of taxpayers currently participating in the CAP program. As explained in last year's IRSAC report, "The taxpayers who participate in the CAP program have a demonstrated level of transparency and desire to improve the examination program, and importantly, a working relationship with the IRS." We acknowledge that the information we have had access to — publicly released reports from other tax authorities and anecdotal reports from companies and practitioners in other countries — may not be as complete (or candid) as that the IRS may able to secure through its country-to-country exchanges. Accordingly, we recommend that LB&I work through the OECD and other intergovernmental bodies, as well as with their counterparts in other countries, whose experiences and insights may support design changes not yet announced or forecast publicly. To the extent confidentiality concerns allow, the information should be shared with the CAP taxpayers involved in the project.

2. The IRSAC recommends that LB&I's risk assessment protocol should be implemented on a centralized basis, as an expansion of its CMO program. The CMO pilot has demonstrated the promise of developing a cadre of specialists that would could build up their expertise (not only in tax matters but in financial analysis), develop rapport with

subject matter experts in the IPGs and IPNs, and professionally analyze the data collected.

In terms of what information the CMO should avail itself of, there is an enormous amount of information available in the public domain or that can be derived from filed returns, including revised Schedule UTP and from asking pre-audit questions as well as from reviews of audit history (*e.g*., adjustments, litigation, and transactions). Among the issues are:

- Relationship with IRS generally
- Staff capability based on audit history
- Amount of tax consulting and counsel fees
- Uncertain Tax Positions
- Tax haven investments or transactions
- Significant related party international transactions
- SEC filings if applicable
- Audited financial statements
- Acquisition merger and disposition activity
- Industry posture and experience
- Tax rate continuity analysis including competitor comparisons
- Timing versus permanent taxable income adjustments
- Incentive claims and audit history, competitor comparisons
- Press reports and investment community analyses

3. Although the IRSAC believes the IRS, as part of its risk assessment process, should collect additional information about a company's tax control framework as well as other aspects of its tax posture, we have significant reservations about making interviews with the company's tax director or other representatives (as is currently done in Canada) an integral part of the risk assessment process. First, we question whether the IRS has the resources required to conduct the in-person interviews and appropriately analyze the information for the broader range of LB&I workload. It is better, we submit, to collect the

information centrally and to have it analyzed by trained screeners, as envisioned by our CMO-focused recommendation. Of course, as CMO expands, the training and, ultimately, perhaps the grade of its personnel may have to be enhanced.[10]

Focusing its risk assessment efforts on the CMO will permit LB&I to leverage its expertise. The insights and intuition of someone who reviews, say, ten or twenty times as many cases as another person will undeniably be more sophisticated and insightful. This approach will also avoid possibly impairing the IRS's relationship with the taxpayer's representatives who may become defensive or guarded during the interview; something that is especially important given the role that intermediaries, particularly, in-house advisers, play in ensuring compliance. In this latter regard, we suggest that risk assessing a limited number of CAP taxpayers is fundamentally different from risk assessing the entire LB&I population or only CIC taxpayers. Indeed, whereas CAP taxpayers accept enhanced transparency as a requirement of self-selecting their way into the volunteer program, a significant percentage of LB&I taxpayers are not in this program for legitimate reasons originating with LB&I or the taxpayer, including the respective parties "resource bandwidth."

[10] An element of the risk-assessment programs in several countries whose practices are catalogued in the OECD Report are discussions with the taxpayer of how it can improve its risk rating. We suggest that LB&I would be better served by focusing its risk assessment efforts on "diagnosing" which taxpayers are high risk rather than concerning itself with, as part of the process, "treating" or "remediating" high-risk behavior. In our mind's eye, the IRS's enforcement efforts are the proper place to stress that latter goal.

ISSUE TWO: RULES OF ENGAGEMENT AND ESCALATION OF ISSUES

Executive Summary

LB&I asked for the Subgroup's assistance in identifying ways to increase efficiency in the resolution of issues at the examination level. The exam team will often seek the assistance of expertise within the IRS, including functional experts, technical experts, and issue experts. It is important that there be an understanding as to who "owns" the IRS position on an examination issue when these varied parties all have input. In this report, the Subgroup focuses on opportunities for better educating taxpayers and IRS employees on resolution of issues when these various experts are involved in the analysis of an issue.

Background

LB&I has a knowledge management network that includes Issue Practice Groups ("IPGs") for domestic issues. IPGs are designed to provide examination teams the technical information and advice they need to manage their cases efficiently, consistently, and with a high degree of technical proficiency. IPGs are designed to foster effective collaboration and the sharing of knowledge and expertise across LB&I and Chief Counsel. LB&I views the IPGs as balancing the need for consistency while recognizing that there is no "one size fits all" approach to examining and resolving issues.

The IPGs reflect LB&I's premise that consistent treatment and proper tax administration is best served in a collaborative environment. IPGs are a resource for examiners, managers, and executives to use during audits and in managing compliance priorities. Agents are encouraged to consult IPGs, especially when they encounter issues with which they are not familiar or when dealing with complex technical issues.

In addition, the IRS has developed significant expertise in such areas as international compliance, engineering, and economics, among others. The advice of these experts will often be sought during the course of an examination. Often, these experts will be integral members of the exam team, working on site.

The IRSAC supports the IRS's leveraging of existing technical expertise across the agency in developing the IRS position on examination issues. The IRSAC believes the effectiveness of the IPG network and other experts can be enhanced by appropriate communication and interaction between the IRS and taxpayers. Providing pathways for communication between taxpayers and the IRS can avoid misunderstandings (especially about the underlying facts), enhance the knowledge and understanding of both the IRS and taxpayers, and thereby facilitate agreement (or, at a minimum, crystallize what is not agreed) on complex issues.

It behooves both the IRS and taxpayers to have the proper parties discussing the IRS' position on the issues.

Recommendations

1. As a part of the opening conference, there should be an open discussion of the use of experts, including those in the IPG program. As part of this discussion, taxpayers should be informed that, as appropriate, experts may be consulted by the exam team on specific issues.
2. When the exam team contacts an expert to discuss the application of the law to the facts, the taxpayer should be informed that such contact has been made and what specific issue is being addressed.
3. It should be made clear to both the IRS and the taxpayer that, notwithstanding

the involvement of the expert, the team manager remains responsible for the management of the case and the issue. Thus, despite the involvement of the IPG and or other experts, the manager needs to be able to clearly state and support the IRS position.

4 If the team manager is unable to support the IRS position to the taxpayer, then the taxpayer needs to follow the rules of engagement to escalate the issue to the appropriate level in order to receive a clear understanding of the IRS position. The taxpayer should first work with the team manager to accomplish the escalation.

5. If the team manager cannot or will not facilitate the escalation of the issue, the taxpayer must know whom to contact to get the desired explanation or clarification.

ISSUE THREE: CAP TAXPAYERS WITH PENDING APAs

Executive Summary

Taxpayers participating in the real-time review program known as the Compliance Assurance Process (CAP) seek to achieve financial certainty sooner than business taxpayers that undergo typical post-filing examinations. Although the same goal of early certainty may prompt taxpayers with significant international transactions to enter the Advance Pricing Agreement (APA) program to resolve transfer pricing matters, these agreements can take several years to negotiate. As a result, the taxpayer's goal of achieving financial certainty sooner is thwarted. This report explores several options to facilitate financial certainty under the Compliance Assurance Process while the Advance Pricing Agreement process is still underway.

Background

The Compliance Assurance Process is a program for large corporate taxpayers in which they work collaboratively with an IRS team to identify and resolve potential tax issues before the tax return is filed each year. With major potential tax issues largely settled before Form 1120 is filed, taxpayers are generally subject to shorter and narrower post-filing examinations.

If, at the conclusion of the pre-filing stage of the CAP, all identified items and issues have been resolved, the IRS will provide the taxpayer with a Full Acceptance Letter, confirming that the IRS will accept the taxpayer's return if it is filed consistent with those resolutions. In other words, if a post-filing review indicates that all material items and issues were disclosed and resolved, the IRS will issue a No Change Letter concluding the examination of the taxpayer's books of account for purposes of IRC section 7605(b). In full acceptance situations, the post-filing review is generally completed within 90 days of the taxpayer's filing its return.

If the taxpayer and the IRS cannot resolve all identified issues before the filing of the tax return, the IRS will issue a Partial Acceptance Letter. In this situation the post-filing review of the unresolved issues will resemble a typical examination. The examination will formally remain open while the taxpayer and the IRS work to resolve the remaining issues.

Taxpayers typically choose to participate in CAP because they can receive financial statement certainty relating to federal tax matters sooner than they would in a normal post-filing examination. The completion of an agreed examination is the most common way for a taxpayer subject to U.S. Generally Accepted Accounting Principles (U.S. GAAP) to attain certainty for "uncertain" tax positions for the examined year.

U.S. GAAP (ASC 740) provides that, for financial reporting purposes, whether a company may recognize a benefit for any tax position is to be evaluated under a two-step approach. Step 1: Recognition occurs when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Step 2: Measurement is only addressed if Step 1 has been satisfied (i.e., the position is more likely than not to be sustained). Under Step 2, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, that is more likely than not to be realized upon ultimate settlement. When a tax position does not satisfy Step 1 and Step 2, a reserve for an uncertain tax position is established and remains on the entity's books until a future event allows recognition of the benefit of the tax position.

Those tax positions failing to qualify for initial recognition are recognized in the first subsequent interim period that they (1) meet the more-likely-than-not standard, (2) are resolved through negotiation or litigation with the taxing authority, or (3) are precluded from being challenged because of the expiration of the statute of limitations.

Resolution with the taxing authority is referred to as “effectively settled,” and effectively settled through examination is deemed to have occurred when the following has occurred:

1. The taxing authority has completed all its required or expected examination procedures;

2. The entity does not intent to appeal or litigate any aspect of the tax position; and

3. It is considered “remote” that the taxing authority will reexamine the tax position assuming full knowledge of all relevant information related to the tax position (i.e., the chance of the event occurring is slight).

Applying these principles to a CAP taxpayer with a Full Acceptance Letter, effective settlement would occur upon the successful completion of the post-filing examination and receipt of the No Change Letter because, assuming the taxpayer fully disclosed all material positions, the likelihood of reopening the examination under current IRS policy would be remote.

Many CAP taxpayers are multinational enterprises whose uncertain tax positions will commonly include transfer pricing, i.e., the setting of the price for goods and services sold between controlled (or related) legal entities within an enterprise. For example, if a foreign subsidiary company sells goods to a U.S. parent company, the cost of those goods is the transfer price. Intercompany transactions, including transfer pricing, are eliminated for financial reporting purposes. Thus, any profit or loss from the intercompany transactions will not be recognized because the transactions are within a single financial reporting enterprise. In contrast, the foreign subsidiary and the U.S. parent are not consolidated for tax purposes and will typically file separate returns with their respective countries. Thus, the transfer price can affect the allocation of profit or loss between the countries and, consequently, the amount of tax reported and paid in each country. This allocation is often the subject of controversy with the taxing authorities. Thus, multinational taxpayers commonly have uncertain tax positions related to transfer pricing.

Taxpayers can reduce or eliminate controversy with transfer pricing though the Advance Pricing Agreement (APA) program. An APA allows the taxpayer and the tax authority to avoid future transfer pricing disputes by entering into a prospective agreement, generally covering at least five tax years, regarding the taxpayer's transfer prices. APAs can be unilateral, involving a single country; bilateral, involving two countries; or multilateral, involving more than two countries. While not a requirement of the CAP program, CAP taxpayers are encouraged to seek APAs to cover recurring intercompany transactions because they will advance the goal of achieving early certainty. APAs, however, may take considerable time (between three and four years) to negotiate.

If a CAP taxpayer has a pending APA, the examination team will conduct the post-filing examination, but will hold the examination in suspense to allow for incorporation of any adjustments arising from the APA. Thus, the examination will remain open and the IRS will not issue the No Change Letter. Thus, by the time an APA is completed, there may be five years open for examination. This means that the taxpayer will be unable to achieve the purpose for agreeing to enter CAP in the first place, that is, to obtain financial certainty sooner.

<u>Recommendations</u>

The LB&I Subgroup recommends the IRS make one of the following changes to the CAP program that will permit an examination involving an APA to be closed and a No Change Letter to be issued. These alternatives all assume that a CAP taxpayer with a fully accepted return (or a partially accepted return with the APA as the only unresolved issue) that has satisfactorily completed the post-filing review.

1. Modify the CAP Memorandum of Understanding to include a provision that the implementation of a final APA will not constitute a reopening of the examination under section 7605(b) and, further, that the IRS will not reexamine any other position in the closed year unless one of the reopening circumstances in Rev. Proc. 2005-32 is present.
2. Modify the CAP Memorandum of Understanding to allow the taxpayer to elect to implement the APA by making a cumulative adjustment in the current CAP year. The adjustment will incorporate the net effect of the APA on past years to the present. If the time value of money is a concern, then Rev. Proc. 2002-18, Sec. 6.02(4), which concerns accounting method changes, provides a model to take into account the time value of money over a multi-year adjustment period.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

SMALL BUSINESS/SELF EMPLOYED
SUBGROUP REPORT

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Small Business/Self-Employed Subgroup (hereafter "Subgroup") consists of four tax professionals from wide-ranging backgrounds. Its members include an attorney, a certified public accountant, a certified payroll professional, a U.S. Tax Court practitioner, and an enrolled agent, serving the tax system in public practice, education and in private industry. The Subgroup's membership reflects the broad range of taxpayers served by the Small Business/Self-Employed Division of the Internal Revenue Service (hereafter "SBSE").

The Subgroup enjoys a close working relationship with the professionals within SBSE. This relationship has granted this subgroup an opportunity to consult with SBSE leadership on many issues over the past year; the Subgroup and SBSE consulted both formally and informally on all issues contained in this report.

The Subgroup respectfully recommends the following three actions relating to the three issues raised in this report:

1. **Business Identity Theft Awareness**

More needs to be done to protect employer identification numbers (EINs) so they cannot be easily used without the EIN owner's knowledge or permission to obtain a fraudulent refund or to promote individual identity theft schemes.

2. **The Fresh Start Initiative**

The IRS made many changes to the Fresh Start Initiative program to assist financially-distressed taxpayers, but more can be done to help taxpayers who are struggling to meet their tax obligations.

3. **<u>Simplified Home Office Deduction</u>**

The IRS now provides a simplified home office deduction for taxpayers who use their home as a business location, but it is limited to 300 square feet and $5 per square foot, which may not adequately represent the costs of maintaining a home office.

ISSUE ONE: BUSINESS IDENTITY THEFT AWARENESS

Executive Summary

Business identity theft can be a more complex issue than individual identity theft. While individual identity theft with the Internal Revenue Service is accomplished by filing one fraudulent tax return at a time, business identify theft can occur in many ways. A fraudulent business entity tax return can be filed that generates a larger refund than would be obtained on an individual income tax return due to available refundable business tax credits, or fraudulent W-2 forms with fictitious withholding may be filed and the information subsequently used to file multiple fraudulent individual income tax returns claiming refunds. Similar to individual identity theft, business identity theft also impacts the banking and business communities. Because of the potentially larger payoffs available, business identity theft is on the rise.

The members of IRSAC were asked to provide information on 1) how businesses can reduce their organization's employer identification number (EIN) exposure, 2) how the IRS can reduce the number of fictitious EINs being established, and 3) what kind of business identity theft outreach is needed from the IRS.

Background

Business identity theft is defined in the Internal Revenue Manual (section 10.5.3.3.1) as "creating, using, or attempting to use business' identifying information without authority to obtain tax benefits." Business identity theft can occur with corporations, partnerships, government entities, trusts, estates, and exempt organizations. The theft can be accomplished by using the EIN of an active or inactive business without the EIN owner's permission or knowledge to file fraudulent tax returns (e.g. Forms 941, W-2s, Form 1120, Form 1041, etc.) to obtain a fraudulent refund or to further perpetuate individual identity theft and refund fraud.

Business identity theft cases can be located in any IRS function and it is likely that a single case will cross functional lines. While in the past identity theft was generally viewed as a crime against individuals, it appears criminals now discovered that stealing business identities may not only be much easier than individual identity theft, it can also result in much larger payoffs.

Business identity theft is not the same as a computer security breach, which can occur at large retailers or medical facilities when private personal information and credit card numbers are hacked or compromised, and can lead to identity theft at the individual level. Business identity theft occurs when a thief actually impersonates the business itself by using the business' employer identification number and other business credentials, such as name, address, contact information, etc. to create false business filings of various types in an effort to steal from the United States Treasury, financial institutions, creditors, suppliers and others. The focus on this report is the impact that business identity theft has on the IRS and the U.S. Treasury, but as with individual identity theft, the issue extends far beyond tax fraud. Once an identity thief obtains access to a business EIN, the potential for much larger payoffs exists because businesses generally maintain larger bank account balances that could be stolen and they have availability to more funds from loan accounts with higher credit limits. Business creditors may be less likely to question large purchases on credit cards, and smaller businesses and non-profit organizations may not have the layers of internal control, security and oversight necessary to prevent issues.

Greater fraudulent refunds than those claimed on an average individual tax return could be paid by the IRS, since businesses are more likely to claim larger refundable tax credits on the returns they file.

Business identity theft can be readily accomplished because employer identification numbers are easily obtained. While social security numbers receive some level of protection, there is no protection for business identification numbers. Employer identification numbers (EIN) by law are publicly available to every employee to whom the employer issues a W-2 and to every vendor or investor or other individual or business to whom the entity issues a Form1099 *U.S. Information Return* reporting form. By submitting a Form W-9, *Request for Taxpayer Identification Number and Certification*, which requests the business EIN or a sole proprietor's social security number, and carries a penalty for noncompliance, or by making a simple request for this same information by telephone, the requestor can easily obtain the EIN. Non-profit organizations and many for-profit entities are required to make their tax filing information public, including their EIN.

A taxpayer who is a victim of individual identity theft often learns of the theft when an anticipated refund is delayed, but a taxpayer who is a victim of business identity theft may be unaware of the theft for a long time. For example, if false Form W-2s are filed and subsequently used to file multiple fraudulent individual tax returns it can take a significant amount of time for the IRS to match the fraudulent W-2s with the missing Form 941s. This is partially because the Social Security Administration, rather than the IRS, receives the employer's Forms W-2 and W-3, which adds time to the matching process. Due to the myriad of interrelated filings, business identity theft case resolution is generally more complicated and difficult to rectify and takes longer to resolve than individual identity theft. Because of the various types of business entities that can be involved in business identity theft, the numerous types of possible tax filings involved, and the significant amount of time it takes to reach resolution, highly-skilled and trained IRS personnel are required to work these cases. Sufficient personnel must be devoted to business identity theft to allow one person to handle the case from identification to resolution.

A report issued by the Treasury Inspector General for Tax Administration (TIGTA)[11] estimates the IRS could issue nearly $2.3 billion in potentially fraudulent tax refunds based on stolen or falsely obtained EINs each year. For tax year 2011, TIGTA identified 767,071 electronically-filed individual tax returns with fraudulent refunds based on falsely reported income and withholding. There were 285,670 EINs used on these tax returns. Of these, more than 8,000 were falsely obtained EINs used to report false income and withholding on over 14,000 tax returns, with potentially fraudulent refunds issued totaling more than $50 million. In addition, stolen EINs were used to report false income and withholding on over 700,000 tax returns, with potentially fraudulent refunds issued totaling more than $2.2 billion.

The members of the IRSAC commend the many steps taken by the Internal Revenue Service to address the issue of individual identity theft, including, but not limited to:

- developing and using Form 14039 – *Identity Theft Affidavit*;

[11] Source: Treasury Inspector General for Tax Administration Report, "Stolen and Falsely Obtained Employer Identification Numbers Are Used To Report False Income and Withholding", September 23, 2013, Reference Number: 2013-40-120

- specific Web pages at irs.gov providing pertinent information for individuals who are victimized by identity theft;
- dedicated points of contact for affected taxpayers; and
- REG-148873-09, IRS truncated taxpayer identification numbers (TTINs) where the IRS issued final rules that allow filers of information returns to truncate a taxpayer's identification number on payee statements and other documents, including social security numbers and employer identification numbers of payees. These new rules are generally effective for payee statements due after December 31, 2014.

Recommendations

1. Because employer identification numbers (EINs) are readily accessible to the public, more needs to be done to protect them. We recommend expansion of REG-148873-09 *truncation guidance* to include truncated employer identification numbers (TEIN) of issuers on any copies of IRS filings that are provided to outside parties or made public, or to any forms not submitted to the IRS. For example Form 8879, *E-file Signature Authorization,* which is subject to exposure due to the fact that many times it is either posted in the U.S. mail or emailed between taxpayers and their tax professionals, authorizes the tax professional to electronically file the tax return and is retained in the tax professional's office for inspection at the IRS request. Full EINs should only be provided on documents actually filed with the IRS.
2. Develop and implement procedures where a taxpayer must surrender an EIN that is no longer in use because the business is closed or no longer in service. When

the IRS receives notification that an EIN is inactive as of a particular date, any subsequent use of the EIN should trigger an alert that the IRS can respond to in less time than it now takes to learn a business identity theft occurred.

3. Include a specific Web page at irs.gov that describes what to do if a taxpayer has been a victim of business identity theft (see http://www.irs.gov/uac/Taxpayer-Guide-to-Identity-Theft). This page should provide guidance to business entities and include tips to avoid business identity theft and links to education on proper business transition procedures, proper business closure steps and a link to Form 14039-B, *Business Identity Theft Affidavit*. References on this page can be updated to also include what to do if a taxpayer believes their EIN has been used improperly.
4. Increase awareness of Form 14039-B, *Business Identity Theft Affidavit*, and make it more readily available to taxpayers who are victims. This can be accomplished through outreach to stakeholders groups and the Web page link previously noted.
5. Provide a dedicated point of contact for victims of business identity theft. Because of the complexity of business identity theft issues, these cases cannot be handled by the same IRS personnel who handle individual identity theft without additional training that allows the IRS to effectively develop business identity theft specialists to work with victims.
6. Many of the current business identity theft cases at the IRS result from the invalid issuance of a new EIN. The IRS has already taken steps to reduce the number of EINs that can be obtained to one per day. Unfortunately, this can hamper tax professionals who are trying to legitimately obtain EINS for their trust and estate

clients, but may not stop thieves from obtaining fraudulent EINS. The IRSAC recommends the IRS use the e-authentication system Out-of-Wallet questions to verify that the request is valid. This would require that anyone wishing to obtain an EIN verify his or her identity through a series of personal questions that only that individual would know. This may add a few more minutes to the process but the additional security could prove worthwhile.

ISSUE TWO: THE FRESH START INITIATIVE

Executive Summary

The Fresh Start Initiative is a series of changes to IRS Collection policies and

The members of the IRSAC were asked to provide feedback on the effectiveness of current Fresh Start Initiatives, including ways that the Internal Revenue Service can improve these initiatives, ideas for future Fresh Start initiatives that the IRS can implement without legislative changes, and suggestions for marketing current and future Fresh Start initiatives.

Background

The Fresh Start Initiative makes it easier for individuals and small business taxpayers to pay back taxes and avoid tax liens that can harm their credit and impede their ability to borrow funds. The recent economic downturn left many taxpayers struggling to pay their income tax obligation in full. The IRS has many voluntary programs available for taxpayers, but statistics provided by the IRS indicate declines in voluntary program use, possibly due to the government shutdown, reduced potential direct case time, and decreased staffing in both field and campus locations:

- Offer in Compromise receipts are down by 8.7 percent from June 2013 to June 2014.
- Currently not collectible cases decreased 14 percent compared with June 2013.

- The number of liens prepared, withdrawn and released declined 13.1 percent, 4.3 percent and 6.2 percent respectively during the same time period.
- Installment agreements established are up by 1 percent for the third quarter of FY 14 compared with FY 13, potentially due to staffing declines.
- Online Payments Agreements (OPAs) are down by 18.1 percent, FY 14 compared with FY 13, potentially the result of system or authentication challenges.

When taxpayers owe the IRS they can make voluntary payments either by paying the full amount due or by making arrangements with the IRS to make payments over a specified time period. The IRS offers installment agreements that will either partially or full pay the balance.

There are fees for entering into installment agreements, depending on whether the payment is directly debited from the taxpayer's bank account or made by a check sent to the IRS, and the appropriate interest and penalties continue to accrue until the balance is paid in full. The IRS' successful marketing of the Direct Debit Installment Agreements (DDIA) contributed to an increase in DDIAs of 24.2 percent from June 2013 to June 2014. DDIAs reduce taxpayer burden by directly debiting the taxpayer's bank account and offers a lower user fee; the benefit to the IRS is a lower default rate.

Taxpayers can submit an offer in compromise (OIC) to settle the tax debt for less than the full amount due. Acceptance of an OIC requires that the amount offered be based on the reasonable collection potential of the taxpayer's assets and future income over a 12 or 24 month period of time, depending upon whether the offer is considered a cash payment or a periodic payment. It can take the IRS up to two years to investigate an OIC, and there is an initial $186 non-refundable application fee that must accompany the application. The fee and all payments received are applied to the account. A waiver of the fee and payment is granted to taxpayers meeting low income guidelines; the low income waiver and guidelines are included on the OIC application form. The paperwork is complex and the OIC may be returned as unprocessable if all the requested paperwork is not submitted.

When taxpayers either do not pay the amount they owe or are unable to honor payment arrangements previously made, the IRS has many collection options available to them. The IRS can levy bank accounts or wages or record a Notice of Federal Tax Lien (NFTL) that notifies others that the IRS has an outstanding claim against the taxpayer.

A NFTL documents the government's legal claim against a taxpayer's property, and it protects the government's interest in all of the taxpayer's property, including personal property and financial assets. The NFTL is a public document that alerts creditors that the government has a legal right to the taxpayer's property; having a lien filed can impair a taxpayer's ability to secure credit, rent property, find employment or make a purchase or any other activity that requires a credit check.

Although a lien will be released within 30 days of the payment in full of all outstanding taxes, interest and penalties, it continues to appear on the taxpayer's credit report as a satisfied debt. A lien can also be discharged or removed from specific property. If the lien is subordinated, which allows other creditors to move ahead of the IRS, it may be easier for the taxpayer to obtain a loan. When the lien is withdrawn, it removes the public NFTL, which assures other creditors that the IRS is not competing for the taxpayer's property, but the taxpayer remains liable for the liability due to the IRS.

Fresh Start Initiatives

In the face of the economic downturn, the IRS has made a number of changes to assist financially distressed taxpayers. In late 2008, the IRS announced an expedited process to make it easier for financially-distressed homeowners to avoid having a NFTL block refinancing of mortgages or the sale of a home. By reducing the processing time to request a discharge or subordination of a tax lien, taxpayers were able to access their home equity by sale or refinance to pay their IRS debt.

On January 16, 2009, the IRS announced additional steps to assist financially-distressed taxpayers, giving IRS employees more flexibility to work with taxpayers. Collection employees were given greater authority to suspend collections actions, without financial documentation, in some hardship cases where the taxpayers were unable to pay. The IRS employees were also given the ability to allow either a skipped or a reduced monthly payment when taxpayers lost their job or suffered another financial hardship, without automatically terminating an installment agreement. The IRS allowed a second review of home equity information to determine if it was appropriate to accept an OIC to satisfy the debt. Other options were made available to taxpayers who were unable to meet their obligations to help them avoid default. For instance, expedited levy releases eased requirements on taxpayers who requested expedited handling for hardship reasons that would allow them to sell or refinance their residence.

The Fresh Start Initiative increased the NFTL filing threshold from $5,000 to $10,000, although NFTLs can still be filed on amounts less than $10,000 when circumstances warrant. The criteria for accepting an OIC were also eased, basing the reasonable collection potential (RCP) calculation on only 12 or 24 months of future income.

On March 7, 2012, the IRS announced a major expansion of its Fresh Start Initiative by providing penalty relief to the unemployed and making streamlined installment agreements available to more people. Certain taxpayers who have been unemployed for 30 days or longer were able to avoid failure-to-pay penalties by providing a six-month grace period if a wage earner was unemployed at least 30 consecutive days during 2011 or in 2012 up to the April 17, 2012 deadline for the 2011 return, or if a self-employed individual experienced a 25 percent or greater reduction in business income in 2011 due to the economy. This penalty relief was available for balances under $50,000 and was subject to income limits. It was not available if a taxpayer's income exceeded $200,000 if he or she filed as married filing jointly or $100,000 if he or she filed as single or head of household.

At the same time, to help more people qualify for the program, the IRS raised the threshold for using an installment agreement without having to supply the IRS with a financial statement from $25,000 to $50,000. The Online Payment Agreement (OPA) allows qualifying taxpayers to set up an installment agreement without even speaking with an IRS assistor. Penalties were reduced, although interest continues to accrue on the outstanding balance. Payments must be made by direct debit for taxpayers to qualify for the new streamlined installment agreement.

The members of the IRSAC understand from other practitioners that Fresh Start is accomplishing its goal and is providing a positive experience for practitioners and taxpayers by reducing the time and effort required to prepare an offer in compromise and enter into installment agreements. The members of the IRSAC commends the IRS for its efforts to bring the Fresh Start Initiative forward to remove obstacles and assist struggling taxpayers and to broaden the number and type of taxpayers who can benefit from these initiatives. The Fresh Start Initiative not only reduces taxpayer burden, but also enhances taxpayer voluntary compliance for those taxpayers who are able to use the program.

Taxpayers Not Served by the Fresh Start Initiative

There are taxpayers who are not yet served by the Fresh Start Initiative. When a taxpayer requests an installment agreement for larger tax liabilities (generally those exceeding $50,000) or proposes an OIC, the IRS applies collection financial standards to determine the amount of payment the IRS expects a taxpayer can make. Those standards include expenses that meet the "necessary expense" test, which is defined as reasonable expenses that are necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income. The total necessary expenses threshold establishes the minimum a taxpayer and family need to live and serves as the basis for granting installment agreements and offers in compromise when financial information must first be collected by the IRS.

Collection Financial Standards

In October 2007, the IRS revised its Collection Financial Standards. Although the IRS issue revised standards annually, most recently in March 2014, they have not varied significantly from the revised 2007 standards, which essentially employ a "one size fits all" rule. As a result, the lowest income family receiving food stamps is allowed the same amount for food and clothing as a middle class family that does not receive any subsidy.

The current standards do not recognize the varying cost of living in different regions and communities because, beginning in 2007, the IRS eliminated differentials for Hawaii and Alaska, our two most expensive states. Many of the country's major metropolitan areas also have very high costs of living including New York, Los Angeles, San Francisco and Washington, D.C.

National Standards: These standards establish reasonable amounts for five categories of necessary expenses food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. These standards are derived from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey. Taxpayers are allowed the total monthly National Standards amount for their family size, without consideration of the amounts they actually spend. Generally, the total number of persons allowed for National Standard expenses should be the same as those allowed as exemptions on the taxpayer's current year income tax return, although reasonable exceptions are permitted if they are fully documented, e.g., to accommodate for foster children or children for whom adoption is pending.

Out of Pocket Health Care: These standards establish reasonable amounts for out-of-pocket health care costs including medical services, prescription drugs, and medical supplies including eyeglasses and contact lenses. The table for health care allowances is based on Medical Expenditure Panel Survey data. Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts they actually spend.

Local Standards: These establish standards for two necessary expenses: housing (including utilities) and transportation. Taxpayers will normally be allowed the lesser of the local standard or the amount they actually pay. Deviations from the local standard are not allowed merely because it is inconvenient for the taxpayer to dispose of valued assets or reduce excessive necessary expenses. For housing and utilities, the standards are established for each county within a state and are derived from Census and BLS data. The standard for a particular county and family size includes both housing and utilities allowed for a taxpayer's primary place of residence. Housing and utilities standards include mortgage (including interest) or rent, property taxes, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, telephone and cell phone.

The standards are not differentiated further and there can be wide variations in housing costs within a county. For example, Orange County, California, includes the relatively poor neighborhoods found in central Orange County cities like Santa Ana, where rents for a one or two bedroom apartment can range from $858 to more than $2,000 per month to more affluent neighborhoods in south Orange County like Lake Forest, where rents for a one or two bedroom apartment can range from $1,325 to more than $3,000 per month. The current local standards for Orange County allow a maximum housing and utility cost for 1 person of $2,486 and a family of 5 or more of $3,486.

The transportation standards consist of nationwide figures for loan or auto lease payments (referred to as ownership costs) and additional amounts for automobile operating costs broken down by Census region and Metropolitan Statistical Area (MSA). Operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls. If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has a car, but no car payment, only the operating cost portion of the transportation standard is generally used to figure the allowable transportation expense. There is a single nationwide allowance for public transportation for taxpayers without a vehicle. If the taxpayer owns a vehicle and uses public transportation, actual expenses incurred may be allowed if necessary for the health and welfare of the individual or family, or for the production of income.[12]

Other Expenses: These expenses may be allowed if they meet the necessary expense test. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances.

Conditional Expenses: Conditional expenses do not meet the necessary expense test, but may be allowable if the tax liability, including projected accruals, can be fully paid within six years. The amount allowed for necessary or conditional expenses depends on the taxpayer's ability to pay the liability in full within that time. If the liability can be paid within six years, it may be appropriate to allow the taxpayer the excessive necessary and conditional expenses; even if payment cannot be made within six years, it may be appropriate to allow the taxpayer the excessive necessary and conditional expenses for up to one year in order to modify or eliminate the expense. [IRM 5.14.1.4.1]

Taxpayers who owe higher balances require IRS assistance to obtain a payment plan or to compromise the IRS debt. After completing the financial information on Form 433-A (OIC) *Collection information Statement for Wage Earners and Self-Employed Individuals* and Form 433-B (OIC) *Collection Information Statement for Businesses*, the

[12] **Note:** Vehicle Operating standards are based on actual consumer expenditure data obtained from the BLS, adjusted using Consumer Price Indexes (CPI) to allow for projected increases throughout the year (These CPI are used to adjust all allowable living expenses (ALE) standards.). Vehicle operating standards are not based on average commuting distances. Fuel costs, which are part of Vehicle Operating Costs, have a separate fuel price adjustment which is based on Energy Information Administration (EIA) data which allows for projected fuel price increases.

taxpayer and the IRS representative discuss the taxpayer's assets, income and monthly expenses, and Automated Collection Service (ACS) representatives or a revenue officer compare the taxpayer-reported amounts with the National Standard tables in order to arrive at the greatest monthly amount the taxpayer can afford to pay.

Discretion

The Internal Revenue Manual (IRM) specifically notes that national and local expense standards are guidelines and that deviations are allowed if it is determined that the standard amount is inadequate to provide for a specific taxpayer's basic living expenses. Taxpayers must provide reasonable support for the requested deviations, which must be documented in the case file.

With respect to offers in compromise, section 7122 of the Internal Revenue Code provides: "(A) In General – in prescribing guidelines under paragraph (1), the secretary shall develop and publish schedules of national and local allowances designed to provide for basic living expenses. (B) Use of schedules. The guidelines shall provide that officers and employees of the Internal Revenue Service shall determine, on the basis of the facts and circumstances of each taxpayer, whether the use of the schedules published under subparagraph (A) is appropriate and shall not use the schedules to the extent such use would result in the taxpayer not having adequate means to provide for basic living expenses."

With respect to installment agreements, the IRM 5.15.1.1.6 91 provides that "Guidelines are designed to account for basic living expenses. In some cases, based on a taxpayer's individual facts and circumstances, it may be appropriate to deviate from the standard amount when failure to do so will cause the taxpayer economic hardship."

Many IRS collection employees do not exercise discretion when applying the standards. There may be different reasons for this: employees may not be thoroughly trained in procedures, or may not feel empowered or possess the confidence to vary from them. Employees in ACS seem even less likely to be flexible than revenue officers when applying the standards initially, although an Appeals employee is more likely to vary from the standards when handling a collection appeal. The failure to exercise discretion results in more defaulted installment agreements, reduces the number of accepted offers in compromise, and effectively encourages taxpayers to seek bankruptcy relief from tax obligations. The IRS can increase total tax collections by empowering its employees to exercise greater flexibility in applying the standards.

The determination of allowable expenses can be particularly problematic with respect to taxpayers in high cost areas, since the IRS is applying a more stringent standard to taxpayers than it uses with respect to federal government employees. Federal employees in high cost Metropolitan Statistical Areas (MSAs) are granted Cost of Living Allowances (COLAs) to account for those higher costs. A similar application of COLA allowances overlaid on the adjustments to the standards would be fairer to taxpayers in high cost metropolitan areas like New York, or states such as Alaska and Hawaii.

More fundamentally, expense standards inherently fail to account for the substantial variance in living expenses in various communities and discriminate against urban dwellers compared with more rural dwellers. Unquestionably, the cost of living is higher in Washington, D.C. than in Abilene, Kansas, and yet there are no adjustments made for these differences. The IRS should revise its standards to allow cost of living adjustments for taxpayers in high cost communities that are equivalent to those provided to federal employees residing there. The collection standards also fail to adequately acknowledge that some taxpayers may need to maintain higher professional standards in their dress, personal appearance, and vehicle, so that for production of income, a realtor, corporate executive, or physician may have different "necessary expenses" than an employee who is able to wear a work-provided uniform or drive a company-provided vehicle.

Recommendations

1. Make the Fresh Start NTFL withdrawal feature available equally to all business entities served by SBSE. That brings parity to sole proprietors and other small business entities by expanding the availability of lien withdrawals to encompass all small businesses. Under the current program, individuals who file Schedule C with Form 1040 are eligible for lien withdrawals under the Fresh State Initiatives, but similarly situated small corporations or partnerships are not entitled to this same relief.
2. Consider increasing the NFTL filing from the current $10,000 threshold to $20,000 or $25,000 for individuals and businesses. NFTLs can still be filed on lower amounts when circumstances warrant, but this can reduce the burden on taxpayers who owe the IRS and will see their credit costs rise due to the negative effect a federal tax lien creates.
3. The IRSAC recommends that the IRS increase its marketing efforts to reach the taxpaying public and tax professionals. The IRS should highlight its efforts by:
    a. Prominently displaying the Fresh Start Initiatives on the landing page of irs.gov, especially during March and April when taxpayers are working to

meet their tax filing obligations, but may not be able to meet their tax paying obligations.

   b. Prominently displaying the Fresh Start Initiative with notices or bills sent to qualified individual or small business taxpayers as a reminder of the relief available.

4. The IRS should provide information about the Fresh Start Initiative to the various tax professional and industry groups and ask their assistance in reminding their members that this valuable option is available to assist their struggling taxpayer clients.
5. The IRS can increase marketing efforts during the January through April filing season using electronic media and newsletters that are geared toward the Wage and Investment and Small Business Self-Employed taxpayers who are most likely to need this option.
6. The IRS can create a YouTube video highlighting the Fresh Start Initiative and how they can help a taxpayer who owes the IRS. This outreach may be especially effective for younger taxpayers who are more likely to use YouTube as a source of information.
7. The IRS should implement the following changes to enhance the fairness and effectiveness of its Collection Financial Standards:
   a. Implement a system to apply COLAs to the National Standards for each MSA.
   b. Publish the COLA adjustment standards on the IRS website with the standards. Train each IRS collection employee on the application of

COLAs to the standards. Clearly note on the website that IRS employees have discretion to vary from the standards so taxpayers know they can request deviations.

c. Implement a system that encourages employees to use the discretion allowed them under the program terms to evaluate the individual facts and circumstances of each taxpayer. The current system discourages employees' use of discretion in reviewing the complex circumstances of individual taxpayers, thereby creating cases of undue hardship.

d. Create a range of expenses within which individual ACS employees can deviate from the standards without managerial approval. This would empower employees to make decisions on allowable expenses based upon the individual facts and circumstances of the taxpayer.

e. Revise Publication 594 *The Collection Process* to reflect the changes noted above and to emphasize those IRS employees may exercise discretion when applying the Collection Financial Standards.

f. Implement an extensive training system to inform collection employees of their duty to review the individual facts and circumstances of a taxpayer before routinely applying the Collection Financial Standards. Each employee should be empowered to vary from the standards in appropriate circumstances. Frontline collection managers must encourage their subordinates to apply the Collection Financial Standards fairly and to vary from those standards in appropriate cases.

8. Train ACS representatives to use discretion when resolving a collection matter. While the name ACS connotes a computer-driven system, its effective operation requires both human and automated elements. Using ACS is efficient to track deadlines, account for tax balances due (including interest and penalties), process powers of attorney, track correspondence, and issue notices from a simple installment plan payment reminder to notices of levy. But the computers are only as efficient as the people who provide them with input. This is where the breakdown in efficiency at ACS occurs as ACS representatives vary widely in their approach to the taxpayer or his agent, and this should not be the case. It appears that some ACS employees are less unwilling than others to work with the taxpayer's unique issues and work out a "best possible" solution for future tax compliance. The differences can sometimes be traced to the location of the call center since calls made at different times during the day are handled differently. It benefits both the IRS and the taxpayer for IRS management to remind ACS representatives that they have flexibility to exercise discretion when deciding whether to place liens, delay levy notices, or adjust installment payments to maintain taxpayer compliance and reduce the chance of default.

ISSUE THREE: SIMPLIFIED HOME OFFICE DEDUCTION

Executive Summary

The members of the IRSAC were requested to provide feedback about, and recommendations for, additional outreach on the simplified home office deduction.

Background

If taxpayers use a portion of their home exclusively and regularly for business, or storage of inventory or product samples, or for daycare facilities, they can deduct an amount allocated for their home office. The deduction is also available to employees if the home office is maintained for the convenience of the employers. Prior to 2013, if the qualifying use tests were met, the home office deduction required that taxpayers report the ratio of their business square footage to the total available square footage and apply that ratio to their indirect and direct home office costs.

In 2013, the IRS issued Revenue Procedure 2013-13, which provides an optional safe harbor method for small business/self-employed taxpayers to determine the amount of deductible expenses a taxpayer may claim for the use of a home office. The IRS provided this method to reduce the administrative, recordkeeping and compliance burdens on taxpayers who qualify for the home office deduction. The option became effective for taxable years beginning on or after January 1, 2013. Earlier in 2014, the members of the IRSAC were asked to provide feedback of how the IRS could increase awareness of this new method during filing season; now IRSAC has been asked to provide additional feedback and recommendations on the method.

The simplified home office option allows a deduction of $5 per square foot of home used for business up to a maximum of 300 square feet, or a total of $1,500 per year.

Under this method, there is no reduction in the allowable home-related itemized deductions claimed on Schedule A, including mortgage interest and real estate taxes. No separate deduction can be claimed for depreciation and there is no later recapture of depreciation for the years the simplified home office option is used. Taxpayers may choose either the simplified method or actual expenses for any taxable year and may alternate between the two methods. Based on statistics for 2010 and 2011 tax return filings, approximately 4,000,000 taxpayers claimed the home office deduction each year by filing Form 8829 *Expenses for Business Use of Your Home*, which represents approximately 3 percent of all returns filed.

The IRSAC commends the IRS' efforts to reduce the burdensome recordkeeping requirements on taxpayers who claim the home office deduction and suggests that when evaluating the effectiveness of the simplified method the following situations should also be considered:

1) Most taxpayers desire to maximize their allowable deductions. Because of this, taxpayers may still need to calculate the actual home office deduction and the simplified home office deduction, in order to determine which method will provide greater tax savings. In this case the estimated time savings in calculating the home office deduction using the simplified method will not be experienced.

2) Some taxpayers use more than 300 square feet of their home for business, so the actual expense method (as calculated on Form 8829) may be more advantageous.

3) Because of differences in the prevailing real estate costs and the varying occupancy costs of home mortgage interest, real estate taxes, insurance and utilities, the actual costs of a home office vary greatly within the United States. As a result, the $5 per

square foot value may not fairly represent the cost of the home office in every location.

4) While the simplified method will be useful to many taxpayers, some taxpayers will find it more advantageous to use the actual expense method, as discussed below:
   a) Some states, such as Pennsylvania, do not follow the federal guidelines for home office deductions. Taxpayers in these states must still calculate the actual expense deduction for their state income tax deduction and are likely to have limited use for the simplified method on their federal tax return.
   b) Taxpayers who experience a loss on their business may carryover their home office deduction if they use an actual expense, which allows a tax benefit in subsequent years when they have income. This benefit is not available for users of the simplified method since there is no carryover allowed.

Recommendations

In an effort to make the simplified home office deduction more attractive and possibly more widely used:

1. Create a home office deduction "How To" video which can be used in multiple ways such as posting a link on the IRS website, marketing it in newsletters, highlighting it in seminars and forums, reaching out to stakeholder groups to solicit their assistance to publicize it, and issue a press release to highlight it. The IRSAC recommends it would be advisable to work with the IRS communications team in conjunction with stakeholder public relations teams to utilize main stream media where possible. The IRSAC feels that high profile spots on television and

radio would be most effective and could be achieved by working with the Ad Council and other outside groups, including professional organizations.

2. Update Publication 587 *Business use of Your Home* to include the website link for the “How To” video and other relevant information.
3. Institute more outreach and education using YouTube, Facebook, Twitter, electronic newsletters and distribution to professional and industry organizations to increase taxpayer awareness of this simplified method.
4. Reach out to stakeholders and state and local governments for assistance in highlighting the deduction through publication in their newsletters and on their websites, development of small business workshops and inclusion in seminars and educational opportunities.
5. Increasing use of the Simplified Home Office deduction can reduce IRS burden when verifying the home office deductions claimed using the actual expense method (Form 8829). Streamlining the examination process can occur if more taxpayers are encouraged to utilize the simplified home office deduction. To achieve this, the IRSAC offers the following recommendations:
    a. Recalculate the per square foot allowance by location based on Bureau of Labor statistics.
    b. Consider allowing the application of the per square foot allowance to all square footage used for business purposes instead of limiting it to 300 square feet.

c. Allow for the carryover of disallowed deductions due to business losses based on the carryover guidelines that currently exist for the actual cost method.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

WAGE AND INVESTMENT SUBGROUP REPORT

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Wage & Investment Subgroup (hereafter "subgroup") is composed of a diverse group of tax professionals including, attorneys, enrolled agents, educators, general tax practitioners, and persons with financial backgrounds. The members of this group have a wide range of experience in taxation, including both preparation of tax returns and representation of taxpayers. We are honored to serve on the IRS Advisory Council and appreciate the opportunity to submit this report.

The Subgroup would like to thank W&I Commissioner Debra Holland for her recognition of the value of the Subgroup as an integral part of her leadership team. The Subgroup has had the privilege of working with the professionals within the W&I operating divisions of the IRS and found them to be helpful in providing the information, resources, guidance, and IRS personnel necessary to develop our report. We also appreciate the support provided by our designated liaisons who did a masterful job at navigating the IRS and ensuring that we generally had access to the necessary information to develop our analysis and issue our report.

The Subgroup has researched and is reporting on the following three issues:

1. **<u>Changing Behavior of Taxpayers who electronically Prepare Their Tax Returns but Paper File</u>**

The Subgroup was requested to provide input on how to reduce the number of individuals who file paper returns which they have prepared electronically. Recommendations include developing a 5-year media campaign that continues to increase electronic filing; encouraging employers to offer tax preparation software to employees which will aid in promoting e-file; encouraging software providers to include e-file as a Federal/State package so that users can e-file Federal & State Returns together; expanding the number of self-preparation kiosks in the Taxpayer Assistance Centers throughout tax season, including the extension period (the availability is pivotal for those taxpayers who have a limited or no computer access); producing and mailing postcards to paper filers only to emphasize the benefits of Free File and e-file; highlighting the expanded amount of allowable Adjusted Gross Income for no-cost federal filing in advance of the upcoming tax filing season; and alerting those outside the allowable income amounts of the option of Free File Fillable Forms that may be sent directly to the IRS for faster processing. Additional recommendations are listed in the body of this report. Furthermore, it is recommended that funding and support be increased for the VITA (Volunteer Income Tax Assistance) Program to increase the number of sites, which will also increase electronic filing.

The Subgroup would like to recognize the progress and accomplishments the IRS has made in the individual identity theft prevention program. The Service has initiated additional filters and other analyses to prevent erroneous refunds, while simultaneously protecting legitimate taxpayers.

2. **Improving Compliance Services Collections Operations (CSCO) Customer Satisfaction**

The Subgroup was asked to look at ways the IRS could improve the CSCO customer satisfaction. The most recent survey results indicate a statistically significant drop in customer satisfaction this past tax season. Major recommendations include developing an online status web tool on the IRS website. This would relieve some anticipation taxpayers face waiting for an IRS response and possibly reduce the amount of phone calls as well. The online status web tool could be integrated with "Where's My Refund" and other online status web tools to enable taxpayers to review their entire status at one time. The IRS should improve notices within and outside CSCO by simplifying the language and adding an amortization table or similar information (see report for an example). IRS should explain to taxpayers that the $43 (Low Income), $52 (Direct Debit Installment Agreement), and $120 (All others) Installment Agreement Origination User Fees charged to them for setting up an installment agreement cover a portion of the roughly $300 in costs that at the IRS incurs to process their Installment Agreement. An informed Taxpayer will appreciate the manner in which installment agreements are managed.

3. **Improving Automated Underreporter (AUR) Customer Satisfaction**

The Subgroup was asked to identify ways the IRS can improve the AUR customer satisfaction rate. Although the AUR program has no control over the document matching timeline, the taxpayer's goal is to resolve the case as timely as possible. It is recommended that the AUR program apply process analysis management principles by flowcharting the entire AUR workflow to identify relevant measurement points that would lead to revealing areas of improvement to implement. The Service should also consider developing an online status web tool for taxpayers, similar to "Where's My Refund". Other recommendations support additional funding, correspondence review for clarity, and practitioner and employee group focus interviews.

ISSUE ONE: CHANGING BEHAVIOR OF TAXPAYERS WHO ELECTRONICALLY PREPARE THEIR TAX RETURNS BUT PAPER FILE

Executive Summary

The Subgroup was asked to provide assistance by developing guidance for changing the behavior of taxpayers who electronically prepare their tax returns but paper file. Although there has been a slight increase in electronic submissions through e-filing, there remains diminished access to computers or smartphone devices preventing a greater number of taxpayers to prepare and file their returns electronically. Other factors that impede the growth in e-filed returns include cost factors, personal tax data safety concerns, and security. The use of tax preparation software while efficient to those of us who are practitioners, can often impede electronic preparation where a lay person is concerned.

Background

Taxpayer concern has revolved around data security as the primary issue because it does not avoid electronic submissions via an intermediary rather than directly to the IRS. For this reason, at minimum, it is essential to this entire process to present and require a consistent message indicative of the stringent standards and safeguards placed on external stakeholders covering federal tax data.

E-filing offers taxpayers a cost effective, faster, and more direct mechanism by which to transmit their return to the IRS and receive refunds promptly. E-file is more secure than mailing a tax return, as a paper return is cumbersome and susceptible to intrusion, lost pages, and technician misinterpretation. Electronically filed returns submitted through highly secured and encrypted transmission systems that prevent data breaches are inputted directly into processing systems without any human intervention**.** The IRS system employs multiple firewalls, state-of-the-art virus, and worm detection, and its system is constantly monitored for weaknesses by penetration testing, which bolsters taxpayers' confidence.

Although a paper option remains available, customer conversion to e-file is possible. In order to begin the process of accomplishing the IRS objectives, we suggest the incorporation of the following recommendations.

Recommendations

1. Develop a 5-year media campaign that continues to increase electronic filing. This campaign should include using multiple media outlets that showcase the benefits of e-filing in all aspects by engaging taxpayers in using the IRS website. That means, marketing the website so that taxpayers get accustomed to using it as a resource for information that will serve their needs.
2. Promote and expand the explanation of the safety of personal data transmission and accuracy of e-file, via on-air Public Service Announcements with Public Access Television, Print, Radio, and social media outlets.
3. Encourage Tax Preparers to offer free electronic filing in their individual offices.
4. Encourage employers to offer tax preparation software to employees which will aid in promoting e-file and/or Free File. Additionally, employers could be encouraged to put a Free File link on employee pay stubs.
5. Encourage software providers to include e-filing as a Federal/State package so that users can electronically file Federal & State returns together for one cost.
6. Expand the number of self-preparation kiosks in the Taxpayer Assistance Centers

throughout tax season including the extension period. The availability is pivotal for those taxpayers who have limited or no computer access.

7. Produce and mail postcards to paper filers only, which will emphasize the benefits of Free File and e-file, highlighting the expanded amount of allowable Adjusted Gross Income for no-cost federal filing in place for the upcoming tax filing season. For those outside the allowable income amounts, indicate the option of Free File Fillable Forms which may be sent directly to the IRS for faster processing.
8. Reiterate through on-line resources that balance due returns submitted through electronic means do not require immediate payment, but allow a grace period until the last day of the tax season.
9. Increase funding and support for the VITA (Volunteer Income Tax Assistance) Program to increase the number of sites and returns that are filed.

ISSUE TWO: IMPROVING COMPLIANCE SERVICES COLLECTIONS OPERATIONS (CSCO) CUSTOMER SATISFACTION

Executive Summary

The W&I Subgroup was requested to provide input on ways the Service can improve the CSCO customer satisfaction. The issues that appeared to frustrate the taxpayers most were: (1) Difficulty understanding notices; (2) The amount of time it takes CSCO to initially contact taxpayers about delinquent accounts; (3) The amount of time it takes CSCO to respond to communications and installment agreement requests from taxpayers; and (4) The wait time it takes to reach the IRS by phone after receiving a notice.

Background

To operate successfully and build customer satisfaction, it is imperative that CSCO coordinate directionally and work with other divisions of the IRS. Many of these issues are outside of the CSCO's direct control and automated processes.

While phone contact with taxpayers is generally not within the control of CSCO, taxpayers' phone relationship can significantly impact their impression of CSCO. While working with the IRS on these issues, delays cause taxpayers concern about their status and can be exacerbated if the taxpayer receives notices from other divisions of the IRS.

Taxpayers noted they had difficulty understanding CSCO's notices, but it is unclear if the taxpayers are basing their responses on CSCO's notices or other notices sent by the IRS. For example, a CP 2000 notice, not issued by CSCO, may alert a taxpayer of a deficiency in their return. Based on that letter, the same taxpayer may request an installment agreement with CSCO. The taxpayer's impression of the IRS and CSCO will be partially determined by the CP 2000 letter that was not sent by CSCO.

Delays in responding to Taxpayers are also another area with low customer satisfaction. Much of this is out of CSCO's control as it does not have much control over flow of its casework. The Installment Agreement Account Listing (IAAL) refers cases to CSCO, so it does not have control over the timing of the receipt of most cases and suffers from a backlog of cases during certain times of the year. Increasing the number of staff during those periods (generally May through July) would help with the backlog, increase customer satisfaction with more timely responses, and increase the revenue generated.

CSCO's CP 14, 501, 503 and 504 are some of the more easily understood notices, but improvements could be made that include information that explains the process to taxpayers. Notices that originate outside CSCO but may then lead the taxpayer to CSCO could also be improved. The CP 2000 used to inform taxpayers of changes made to their return is an example and is discussed further in Issue Three.

The W&I Subgroup also looked at ways to help taxpayers better manage an Installment Agreement by educating them on methods for early payoff. CSCO's installment agreements and other notices do not include language explaining the number of months or years it will take to pay off the debt at the agreed monthly payment. To be more effective, all Installment Agreement statements sent monthly to the taxpayer should also include the amount of principal, interest and penalty paid with each payment along with a plausible offer for early payoff, i.e., a discount for early payoff. In addition, a complete Installment Agreement statement should also provide the taxpayer with a sample amortization of actual savings if payment is made in less than the agreed upon payment period.

How can the IRS help ensure taxpayers understand how their payment arrangements with the IRS can work to the taxpayer's benefit? CSCO's installment agreements and other notices do not include language explaining the number of months or years it will take to pay off the debt at the agreed monthly payment. The W&I subgroup recommends that they should state the amount of principal paid with each payment, not just penalty and interest. That information may encourage taxpayers to pay off their delinquencies earlier. The following is an example:

TP Owes	**Monthly Payment**	**Years to Pay**	**TP Grand Total**	**TP Saves**
5,000	416	1	5,168.80	1,055.52
5,000	208	3	5,339.68	884.64
5,000	139	3	5,525.37	698.95
5,000	104	4	5,733.06	491.26
5,000	83	5	5,963.93	260.39
5,000	69	6	6,224.32	($1,224.39)

The W&I subgroup also looked at the cost for engaging in an Installment Agreement which is approximately $300. The Taxpayer is assessed a portion of this cost. Taxpayers who are already frustrated with penalties and interest are often frustrated with this fee. It may help taxpayer satisfaction if the taxpayer knew that the user fee covers only a portion of the cost of processing the installment agreement request.

Customer satisfaction surveys of taxpayers show a low level of satisfaction with the length of time it takes the IRS to handle their return. This includes the amount of time it takes the IRS to notify the taxpayer of a change to their return, as well as the amount of time it may take CSCO to process a taxpayer communication such as an installment agreement request.

Recommendations

1. Develop an online status web tool on the IRS website. This would relieve some frustration or anxiety taxpayers experience waiting for an IRS response and possibly also reduce the amount of phone calls. The online status web tool could be integrated with other "Where's My Refund" and other online status web tool so a taxpayer can review their entire status at one time.
2. Improve notices within and outside CSCO:
    a. Make CSCO's CP 14, 501, 503, and 504 include information that explains the process to taxpayers.
    b. Simplify the language and instructions in CP 2000 notices.
    c. Ensure notices regarding the Affordable Care Act, such as 14H and 15H, are easily understandable.
    d. Add an amortization table or similar information that explains installment agreements payments and payoffs to taxpayers.
    e. IRS/CSCO should explain to taxpayers that the $43 (Low Income), $52 (Direct Debit Installment Agreement), and $120 (All others) Installment Agreement Origination User Fees charged to them for setting up an

installment agreement only cover a portion of the roughly $300 in costs at the IRS to process their installment agreement.

3. Add staff to handle existing cases and anticipated increase in Affordable Care Act Advanced Premium Tax Credit cases.
4. Ensure taxpayers receive notices required by Internal Revenue Manual section 21.3.3.1.2 explaining length of time it takes to process correspondence and further notices if delay in response is expected.

ISSUE THREE: IMPROVING AUTOMATED UNDERREPORTER (AUR) CUSTOMER SATISFACTION

Executive Summary

The Subgroup was asked to identify ways the IRS can improve the AUR customer satisfaction rate. Although the AUR program has no control over the document matching timeline, the taxpayer's goal is to resolve the case as timely as possible. Recommendations include analyzing the relationship of overage data to customer satisfaction because length of processing time is the major issue contributing to customer dissatisfaction, and applying process analysis management tools to help identify areas of improvement. The Service should also consider developing an online status web tool for taxpayers, similar to "where's my refund". Other recommendations support additional funding, correspondence review for clarity, and practitioner group focus interviews.

Background

An analysis of the last several years of survey data shows no statistically significant variation in customer satisfaction levels. The most recent data, 2012, reflects a 70% level of overall satisfaction for the way IRS handled an AUR case; however, customer satisfaction did drop to 67% in September of 2013, with 17% being dissatisfied. The recent drop was attributed to changes in survey methodology and questionnaire revisions. The primary reason for dissatisfaction appears to be length of time it takes to hear from the IRS regarding proposed adjustments. Currently the IRS is in the process of developing publications and notices to help manage taxpayer expectations and to provide clearer information on the AUR process. This group performed a Kincaid test to determine the comprehension reading level required to understand the introductory paragraph in the CP 2000 Notice. That test placed that paragraph at the 15th grade reading level which is commensurate to a junior in college. The average reading level of US citizens is at the 8th grade level, making it difficult for most Americans to understand. (REF:http://www.hsph.harvard.edu/healthliteracy/files/2012/09/doakchap1-4.pdf)

The AUR program is one of IRS most efficient and productive enforcement tools, yet further improvements could be made by analyzing the workload selection process to improve on the historical averages of 15% no change rate and the 15% screen out rate. Clearly much of the effort is nonproductive; in addition there is a 33% default rate where the taxpayer does not respond. Some of the defaults are late responses by taxpayers and need to be reworked later. It should be noted that the no change rate has shown moderate improvement in recent years; however, additional analysis of workload selection filters, application of process analysis management principles, and more detailed overage monitoring could make a good system even better. There is a question of whether or not there is a relationship to overage inventory and length of time to process a case and correspondingly to customer dissatisfaction. The subgroup was not able to visit the AUR, Atlanta Campus, site as planned to observe inventory levels and processes. Uncontrolled inventory may also be contributing to the default rate because taxpayer responses may not be associated with a case in a timely manner.

Recommendations

1. Reduce uncontrolled correspondence to a minimum and adjust the default timeline periodically to consider the uncontrolled mail receipt delay.

2. Apply process analysis management principles by flowcharting the entire AUR workflow to help identify areas of improvement.
3. Develop an online status web tool for taxpayers, similar to “Where’s my Refund,” as proposed in the 2012 survey results.
4. Conduct focus group interviews with practitioner groups and employee groups to receive their input for improvements.
5. Revise taxpayer correspondence, such as the CP 2000, to provide clarity regarding processing times and “truth-in-lending” information.

Internal Revenue Service Advisory Council

2014 Member Biographies

Michele J. Alexander

Ms. Alexander has over 30 years' experience in taxation, and is the owner of Jackson, Jackson & Jackson, in Pittsburgh, PA. She specialize in tax preparation for individuals, businesses and organizations, including the preparation and filing of all federal, state and local tax returns as well as business, corporate, partnerships and Pennsylvania inheritance tax returns. As tax professionals, her company handles all aspects of taxation. In addition, she represents clients before the IRS at the Examination and Appeals level. Prior to owning and operating Jackson, Jackson, & Jackson, her professional work experience included teaching, grant writing, negotiating federal contracts, preparation of individual and business taxes and preparing clients for tax audits. Ms. Alexander is a member of the Allegheny County Bar Association, NATP and is a Court Appointed Special Advocate (CASA). She is also a member of the National Society of Accountants (NSA). Ms. Alexander holds a B.A. from Shaw University, Raleigh, NC. **(W&I Subgroup)**

John G. Ams

Mr. Ams, J.D., is the Executive Vice President and Chief Operating Officer for the National Society of Accountants ("NSA") in Alexandria, VA. He has over 30 years in the federal tax arena with expertise providing legislative and regulatory representation in accounting and federal tax matters to a variety of constituencies including individuals, non-profit organizations, and corporations. At NSA, a professional society whose members are professionals in the areas of accounting and taxation, he is responsible for all operations and provides information, education and guidance to his membership regarding IRS regulations and administrative concerns including the new IRS tax return preparer requirements. He has presented testimony to IRS on numerous occasions and most recently testified in support of Circular 230 proposed regulations, where he raised a number of implementation concerns. Mr. Ams holds a J.D. from Georgetown University Law Center and a BA from Michigan State University, East Lansing, MI. **(OPR Subgroup Chair)**

Tara S. Anthony

Ms. Anthony is a Manager/Tax Practitioner with Popular Ventures, in Detroit, MI. Her responsibilities include working with audits, offers in-compromise, installment agreements and penalty abatements and payroll taxes. She is a chartered tax professional and has completed courses in individual and small business income tax preparation. She works with seniors and low income taxpayers in a large urban metropolitan area, and assist students with their tax filing requirements and tax counseling. Ms. Anthony holds a BA in Finance from Trinity College, Metatarie, Louisiana and a BA in Management Organizational Development from Spring Arbor University, Spring Arbor, MI. **(W&I Subgroup)**

Ronald D. Aucutt

Mr. Aucutt, J.D., has 38 years' experience in taxation and is a partner with McGuireWoods, LLP in Tysons Corner, VA. Mr. Aucutt's past experience includes corporate reorganizations, the investment tax credit, tax-exempt financing, TEFRA partnership audits and tax treatment of inventories, as well as tax-exempt organizations, estate and gift taxes and the income taxation of estate and trusts, which in time became his areas of concentration. Prior to joining McGuireWoods LLP a partner with Miller & Chevalier, where he handled tax planning matters and tax audits and appeals throughout the country. He compiled the factual background and analysis that was adopted by the Senate Finance Committee in changing the effective date of the first generation-skipping transfer (GST) tax in the Tax Reform Act of 1976 to June 12, 1976. Mr. Aucutt is a member and past President (2003-2004) of the American College of Trust and Estate Counsel (ACTEC) and the past Chair of its Washington Affairs Committee (2009-2013). He is also a member of the American Bar Association. He holds a J.D. and a BA from the University of Minnesota. **(OPR Subgroup)**

F. Robert Bader

Mr. Bader, J.D., EA, is the Director of Tax Operations for the Baltimore CASH Campaign in Baltimore, Maryland. Mr. Bader was introduced to free tax preparation services while managing a partner program of the Baltimore CASH Campaign. In 2008, he became Director of its tax programs and now coordinates organizations throughout the Baltimore area that prepare returns for 8,000-10,000 low-income working families. Mr. Bader is an active member of the National

Community Tax Coalition (NCTC), an organization that represents Volunteer Income Tax Assistance (VITA) programs and Low Income Tax Clinics (LITCs). Mr. Bader is the Vice Chair of the Maryland Board of Individual Tax Preparers and a member of the Maryland Society of Accounting and Tax Professionals. He is a member of the Maryland bar and previously represented low-income individuals as a legal aid attorney in Massachusetts and Pennsylvania. He served in the United States Peace Corps in the countries of Côte d'Ivoire and Ghana. He holds a J.D. from the University of Toledo School of Law and a B.A. in Political Science with a certificate in Peace Studies from Siena College. **(W&I Subgroup)**

Cheri H. Freeh

Ms. Freeh, CPA, CGMA, is the principal owner of Hutchinson, Gillahan & Freeh, P.C. in Quakertown, PA. Ms. Freeh has over 30 years' experience in the field of accounting for privately held businesses, non-profit organization, local governments, estates, trusts and individuals. Her firm specializes in small businesses (most gross receipts under $1 million), mostly middle class individuals, small estates and trusts, non-profits and overall the CPA practitioner community. She is the immediate Past President of the Pennsylvania Institute of CPAs (PICPA) and currently serves on the governing council of the AICPA. She also serves as a member of the Pennsylvania State Department of Community and Economic Development's Act 32 advisory committee and the advisory committee on the local earned income tax register for the Governor's Center for local Government. In addition, she has served as an expert witness in small business and non-profit fraud cases and has also served as an adjunct instructor for DeSales University. Ms. Freeh holds a BS in Business Administration with an accounting specialization from Thomas A. Edison State College. **(SBSE Subgroup)**

Linda S. Harding

Ms. Harding, CPA is the Director of Tax for CPAmerica International, a national association of independent CPA firms in Gainesville, FL. She has 30 years in the field of taxation. Her responsibilities include overseeing the members' tax needs including technical resources, tax practice management, best practices, publications, continuing education and information disbursement. She has a strong technical background in federal and state taxation, including tax minimization strategies, tax compliance, FAS 109/FIN 48 requirements and disclosures and is proficient in tax issues regarding C Corporations, S Corporations, Partnerships, LLCs, individuals and estate and gift tax planning and GAAP. In addition, she is charged with keeping members informed of the requirements of Circular 230 standards as well as other practice issues (such as IRC Section 7216). In addition, she is a member of the American Institute of Certified Public Accountants (AICPA), a member of the AICPA Legislation and Policy Committee and the Florida Institute. **(OPR Subgroup)**

Jennifer MacMillan

Ms. MacMillan, EA, is the owner of Jennifer MacMillan EA in Santa Barbara, CA. Ms. MacMillan has over 25 years' experience in taxation. She specializes in representation services, which includes audit, collections, appeals, compliance issues and individual income tax preparation and planning, and is licensed to represent taxpayers before the Internal Revenue Service. She has been an instructor at the National Association of Enrolled Agents (NAEA) National Tax Practice Institute for many years (teaching advanced representation skills to EAs, CPAs, and Attorneys). In addition, she teaches two-hour Ethics courses for many of the California Society of Enrolled Agents (CSEAs) local chapters, giving hundreds of Enrolled Agents in-depth interpretations of Circular 230 and real-world applications that relate to the daily challenges that arise in their practices. Ms. MacMillan has written numerous articles, such as Avoiding the Perils of Fee Predicaments. She is a member of the National Association of Enrolled Agents and the Chair, of the California Society of Enrolled Agents, Government Relations Committee**. (OPR Subgroup)**

Timothy J. McCormally

Mr. McCormally is the Director in the Washington National Tax practice of KPMG, LLP, in Washington, DC. He has nearly 40 years' experience as a tax attorney. Before joining KPMG, he spent 30 years on the staff of Tax Executive Institute, first as General Counsel and then as Executive Director. At TEI, his responsibilities included the overall administration of the professional association of 7,000 in-house tax professionals from around the world. He also participated in the Institute's extensive advocacy program, contributing to comments submitted to the IRS, Treasury Department, Canada Revenue Agency, the Canadian Department of Finance, and the Organisation for

Economic Co-operation and Development. Mr. McCormally is a contributor to numerous publications and recently co-wrote an article with Michael Dolan, a former IRS Deputy Commissioner, entitled "Knowing Which Way the Wind Blows: Best Practices for Mitigating the Risk of Tax Whistleblowing." He is a member of ABA, Section of Taxation (Administrative Practice and Employment Tax Committees) and the American College of Tax Counsel. Mr. McCormally holds a J.D. from Georgetown University Law Center, and a B.A. from the University of Iowa. **(LB&I Subgroup)**

Mark S. Mesler (Sr.)	Mr. Mesler, J.D., has over 25 years' experience in taxation, and is a Principal with Ernst and Young LLP, in Atlanta, Georgia. He leads E&Y's Southeast Tax Controversy and Risk Management Service group and represent taxpayers before the IRS at all levels of tax controversies. His responsibilities include both large global companies and middle market. He has assisted them on a variety of dispute resolution tools and processes ranging from the Quality Examination Process, Fast Track Settlement, preparing for litigation, Pre-Filing Agreements, Private Letter Rulings, etc. In addition, he served on teams tasked with implementing major IRS policy initiatives, such as the disclosure of reportable transactions by taxpayers and material advisors, implementation of Schedule M-3, Schedule UTP, and changes to Circular 230. He is the author and presenter of various legal and accounting education seminars. Previously, he was a trial attorney for the IRS' Office of Chief Counsel, where he specialized in complex litigation and bankruptcy matters. Mr. Mesler holds a J.D. from Georgia State University College of Law and a B.S. from Baptist University of America. **(LB&I Subgroup Chair)**
Fred F. Murray	Mr. Murray, JD, CPA, is a Managing Director, Grant Thornton, LLP, U.S. member of Grant Thornton International, in Washington, DC. His responsibilities include managing policy, procedures, and risk in relation to United States Tax Services practice for a major international accounting firm with more than 500 offices in 113 countries – including evaluation of tax return positions and penalty concerns; risk analysis; reportable transactions and material advisor concerns; disputes and controversies with tax authorities, Sarbanes-Oxley, SEC, GAO and PCAOB matters; and SFAS 109/FIN 48 (ASC 740)

financial accounting matters. He is a recipient of the 2010 Grant Thornton Tax Outstanding Performance Award. His experience includes public law and accounting practice and previous government service as Special Counsel to the Chief Counsel for the Internal Revenue Service and as Deputy Assistant Attorney General in the Tax Division at the Department of Justice. He is an Adjunct Professor of Law at Georgetown University Law Center. He is a member of the American Bar Association (ABA) Section of Taxation, (Council Director (2012-2015), and Chair (2009-2011), Committee on Administrative Practice). In addition, he is a Fellow of the American Law Institute, and a member of the American College of Tax Counsel, AICPA and the Federal Bar Association (Last Retiring Chair, Section of Taxation). Mr. Murray holds a J.D. from the University of Texas at Austin Law School and a B.A. from Rice University. **(SBSE Subgroup and Vice Chairman)**

Paul O'Connor

Mr. O'Connor, LLM, JD, CPA, is the Vice President, Head of U.S. Tax for EMD Millipore Corporation, in Billerica, MA. He has 32 years in taxation in the technology, software, and bioscience fields. For more than two decades, he has been chief tax officer for Millipore Corporation (now EMD Millipore, a wholly-owned subsidiary of Merck KGaA, Darmstadt, Germany), a company engaged in bioscience research, chemical and pharmaceutical production. He manages a department of 11 members; overseeing all tax matters for Merck's North American subsidiaries, which include corporate tax, risk management, transfer pricing, and dispute resolution. He is a member of Tax Executive Institute (TEI) and served as the International President from 2010-2011. Mr. O'Connor holds a LL.M in Taxation from Boston University Law School, a J.D from Suffolk University Law School and a B.S from Boston College, School of Management. **(Chairman IRSAC)**

Luis R. Parra, EA

Mr. Parra, EA, is the owner of Key Accounting of New York, in Bronx, NY. He has over 25 years of professional experience in accounting, auditing and taxation. He prepares tax returns for individual tax clients, small business and non-profit organizations. He previously served as a VITA instructor and he is the founder and President of the Latino Association of Tax Preparers, Inc (LATAX). The LATAX is a non-profit organization providing education and support to Latino Tax Preparers in the United States. It has over 200 members in ten states that provide tax preparation services. In addition, he is the founder of the first tax school in the Bronx, NY (English and Spanish classes) and over 1,200 have participated in classes. Mr. Parra is a member of NATP and NAEA. He holds a BA degree in accounting from Inter-American University in San Juan, PR. **(W&I Subgroup)**

David M. Penney

Mr. Penney, CPA, CA (Canada) was the General Director, Taxes and Customs and Assistant Secretary, General Motors of Canada Limited, Oshawa Ontario, Canada. He recently retired. He has 36 years of tax experience in government and industry. He served as the Head of Tax for General Motors of Canada, leading a team responsible for income, property and commodity tax matters. His experience includes a wide range of cross border issues and in particular transfer pricing controversies involving Canada and the United States. Mr. Penney served as TEI's International President for the 2011-2012 term. A member for more than two decades, he previously held several important positions in TEI's senior leadership cadre, including Senior Vice President and as a member of TEI's Executive Committee. In addition, he has served on the Large Business Advisory Committee, of the Canada Revenue Agency. Mr. Penney holds a Bachelor of Commerce degree from Carleton University School of Business and a Chartered Accountant designation from the Institute of Chartered Accountants of Ontario, Canada. **(LB&I Subgroup)**

Andre' L. Re

Mr. Re has worked in the field of taxation for over 41 years and is the owner of Andre' L. Re, in McDonough, GA. He is a tax consultant and has represented large and medium size corporations before the IRS regarding complex issues at the group and Appeals level. His responsibilities include research and development, travel and entertainment, insurance, tax exempt status, large partnership, and many other issues. Prior to owning his own business he worked for Ernst & Young where his responsibilities included IRS income tax examinations, Service Center processes, employee plans and exempt organizations, tax controversy, and collection matters. He has had numerous opportunities to work with IRS Service Center Campuses to resolve issues with account records, sub S elections, collection procedures, entity elections, and AUR notices. In addition, he worked as a VITA volunteer and has assisted taxpayers with offers in-compromise, installment agreements and other individual and small business tax issues. Mr. Re holds a BS in accounting from Ferris State University, Big Rapids, MI, and an MA in Public Administration from Syracuse University. **(W&I Subgroup Chair)**

Janeen Ryan	Ms. Ryan, EA has 29 years' experience in the field of taxation and is the owner of Janeen Ryan, EA, in Silverthorne, CO. As a self-employed tax accountant she does tax preparation and tax planning for individuals and small businesses. Her expertise is predominantly small businesses and residential rental properties. She is the Past President of the Colorado Society of Enrolled Agents (COSEA) 2009 and 2010. In addition, she is a member of the National Association of Enrolled Agents (NAEA). Ms. Ryan holds a BS in Accounting from the University of Illinois, Champaign, IL. **(OPR Subgroup)**
Karen Salemi	Ms. Salemi, CPP, FLMI, is Learning Consultant with Zero Chaos, which provides high-quality contingent workforce solutions. Previously, she was a Global Training Leader at International Business Machines (IBM) Corporation, in Pepperell, MA, where she created and delivered payroll related courses including COBRA, 401k, Stock options, accounting, balancing and reconciling, year-end W-2c, multistate issues and local tax classes. Prior to working at IBM, Ms. Salemi, was a Solutions Consultant and Training Manager at Kronos, Inc., a management software and services company, where she helped define their work requirements and building the technical specifications document that is used to configure the HR and payroll systems. She also worked as a Practice Leader of the Employment Tax Consulting group in Ernst & Young's Dallas office, assisting small business and other clients with various process and tax compliance issues, as well as systems implementations. Ms. Salemi is a member of the American Payroll Association (APA) and currently serves as its treasurer. She also serves on APA board of contributing writers, where she publishes and reviews articles dealing with payroll tax and compliance issues, and the Government Affairs Task Force (GATF) for Paycards subcommittee. Ms. Salemi holds a MBA from Seton Hall University, South Orange, NJ and a BA in Accounting from William Paterson University, Wayne, NJ. **(SBSE Subgroup)**

Neil D. Traubenberg

Mr. Traubenberg, JD, recently worked as Vice President-Corporate Tax for Sun Microsystems, in Broomfield, Colorado. He has over 35 years' experience in taxation that included an international restructuring strategy that integrated subsidiaries attained through acquisition with existing Sun subsidiaries. In addition, he managed a valuation allowance in excess of $1.8 billion and was responsible for all federal, state and foreign tax matters of the corporation and multiple subsidiaries located in the United States, Europe, and Asia. He regularly attended audit committee meetings to advise on tax matters of the company and oversaw the implementation of the Sarbanes-Oxley tax process review that resulted in no material weaknesses or significant deficiencies. Mr. Traubenberg is a lecturer on various topics to professional organizations, most recently focusing on matters related to FIN 48, International Financial Reporting Standards (IFRS), and new IRS Schedule UTP. He is a member of the ABA-Tax Section, MAPI and was Tax Executive Institute (TEI), International President from 2009-2010. Mr. Traubenberg was recently awarded Honorary Membership by TEI. Mr. Traubenberg holds a JD and a BS from Case Western Reserve University. **(LB&I Subgroup)**

Sherrill L. Trovato

Ms. Trovato, EA, is the Principal/Owner of Sherrill Trovato, MBA, MST, EA, USTCP, in Fountain Valley, CA. Ms. Trovato has more than 20 years of compliance expertise in tax preparation and consultation, and specializes in tax controversy representation before the IRS and in the Tax Court. She provides other services for her predominantly small business clients including financial statement compilation. She has authored articles and developed a program that teaches tax professionals about practice before the US Tax Court. Since 2002 she's been a regular speaker at the National Association of Enrolled Agents' National Tax Practice Institute and instructs for other professional groups across the nation. Ms. Trovato is a past president of the National Association of Enrolled Agents (NAEA). Ms. Trovato holds a Master of Science Degree in Taxation, a Master of Business Administration and a BA in Accounting from California State University, Fullerton. **(SBSE Subgroup Chair)**