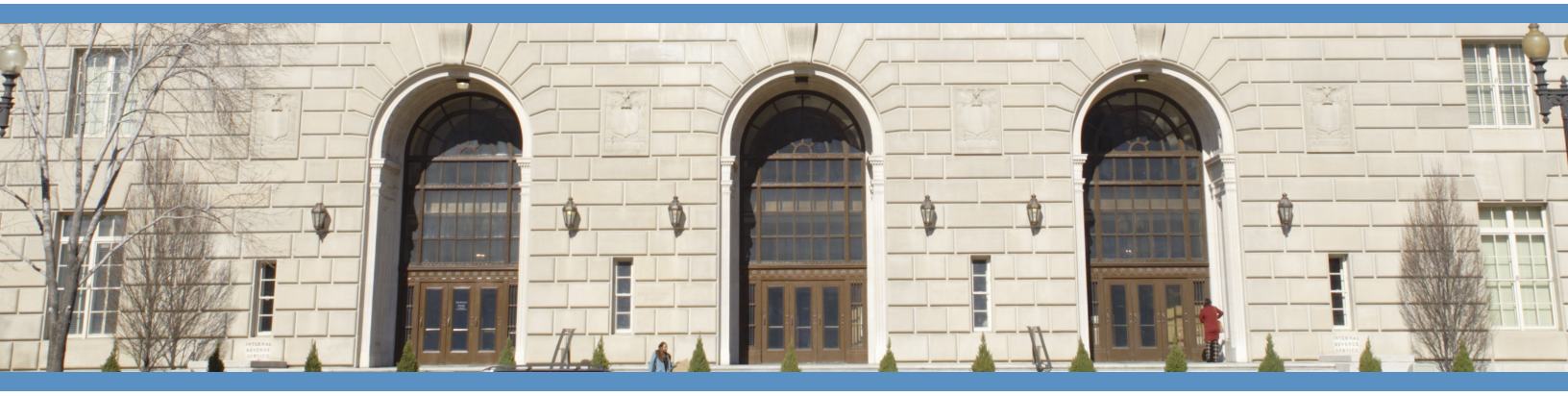

Internal Revenue Service Advisory Council

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IRSAC member biographies can be found in Appendix A

TABLE OF CONTENTS

General Report
of the
Internal Revenue Service Advisory Council

The predecessor to the Internal Revenue Service Advisory Council (IRSAC)—originally termed the Commissioner's Advisory Group—was established in 1953, a year prior to the enactment of the Internal Revenue Code of 1954 and the reorganization of the Bureau of Internal Revenue into the Internal Revenue Service. The IRSAC's operations are now governed by the Federal Advisory Committee Act (FACA), a "government in the sunshine" law enacted in 1972, which requires that advisory groups make their advice available to the public.

As a Federal Advisory Committee, the IRSAC's purpose is to serve as an advisory body to the Commissioner of Internal Revenue. According to its charter, the IRSAC provides an organized public forum between IRS officials and representatives of the public for discussing tax administration issues. Because a central purpose of the FACA is to ensure transparency in the work of government agencies to keep Congress and the public informed of the activities of various advisory bodies, the IRSAC is required to hold a public meeting each year and to memorialize its advice in at least one written public report during the year.

This General Report summarizes the IRSAC's work during 2018 and presents our recommendations to the Commissioner and other IRS leaders.

The IRSAC membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, academia and the payroll community. This year's IRSAC consisted of eighteen members with substantial experience and diverse backgrounds, many active in professional organizations but all selected in their individual capacities because of their expertise, interest in and commitment to improving federal tax administration. Specific subject matter and technical expertise in federal tax administration are generally required to help members advance the IRSAC's mission.

This year's IRSAC includes enrolled agents, certified public accountants and lawyers. These members come from firms and practices of varying sizes. They help

taxpayers prepare and file their tax returns and otherwise comply with the law, and they represent taxpayers in disputes with the IRS, both administratively and in court. The group also includes law and accounting professors, a corporate tax executive, a software developer, members of small, medium-sized, and large law and accounting firms and an industry liaison with a major tax preparation services firm. IRSAC members interact with all operating divisions of the IRS, including Appeals and the Office of Chief Counsel, and with taxpayers of all sizes and types—from low-income families, trust and estates, and small business to multinational corporations, pass-through entities and nonprofit organizations. Collectively, IRSAC members represent the agency's major stakeholders, customer segments and a broad cross-section of the taxpaying public.

The members of the IRSAC are volunteers, bound by a duty of confidentiality, and receive no compensation for their service. They eschew conflicts of interest and fully subscribe to the principle that the tax system will operate most effectively when the IRS, taxpayers, their representatives and other stakeholders work together collaboratively. As a group, the IRSAC adheres to a consensus model of decision-making.

Working with the IRS leadership, the IRSAC reviews existing practices and procedures, and makes recommendations on both existing and emerging tax administration issues. In addition, the IRSAC suggests operational improvements, conveys the public's views on 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 members appreciate the assistance and support provided by personnel from the IRS Office of National Public Liaison (NPL), Communications and Liaison, and the operating divisions. We single out for special thanks: Terry Lemons, Chief, Communications and Liaison; Melvin Hardy, Director, Office of NPL; John Lipold, Chief, Relationship Management, NPL; Anna Millikan, NPL Program Manager; Maria Jaramillo, NPL; Brian Ward, NPL; Johnnie Beale, Wage & Investment; Howard Zach, Online Services; and Shawn Hooks, Large Business & International.

The IRSAC is also grateful for the support provided by IRS executives and Operating Division personnel throughout the year. We thank them for their commitment

to the IRS's mission and for engaging in the meaningful discussions and dialogue that each subgroup held on numerous important issues. Given the unyielding demands on IRS executives and other IRS representatives, the IRSAC sincerely appreciates the time and effort devoted by them to the IRSAC's efforts this year.

Finally, the IRSAC wants to thank David Kautter for his nearly year-long service as Acting Commissioner of Internal Revenue. Acting Commissioner Kautter captained the IRS with a steady hand during the implementation of the most far-reaching tax reform effort in more than a generation while also serving as Assistant Treasury Secretary for Tax Policy. The IRSAC is particularly grateful for Acting Commissioner Kautter's observation when meeting with IRSAC leadership during the year that federal advisory bodies like the IRSAC fulfill their duties most effectively when they bring to the table a critical eye and maintain their independence from the governmental bodies and agencies to which they offer studied recommendations.

Subgroup Reports—Summary of Issues Discussed

The *Digital Services Subgroup*, chaired by Stephanie Salavejus, made recommendations on (i) developing a robust eA3 (electronic Authentication, Authorization and Access) policy to safeguard taxpayer information, (ii) leveraging Application Programming Interfaces (APIs) to implement frameworks supporting ACH payments and real-time authorization for and delivery of tax information and (iii) prioritizing the launch and implementation of a Tax Professional Account over continuing to fine-tune the program before releasing it.

The *Small Business/Self Employed and Wage & Investment (SBSE/W&I) Subgroup*, chaired by Phyllis Jo Kubey, made recommendations on (i) the efficiency of processing paper payments (i.e., Publication 3891/Lockbox addresses), (ii) improving systems for authenticating taxpayer representatives, (iii) increasing participation in digital communication in correspondence examinations and (iv) responding to the tax administration issues surrounding the emerging industry of alternative/virtual currencies.

The *Office of Professional Responsibility (OPR) Subgroup*, chaired by Shelly Kay, made recommendations on (i) updating Circular 230 for accuracy and reliability by excising old law and making other ministerial revisions, (ii) transitioning Circular 230 to a

principles-based rather than a rules-based standard of care, (iii) reinforcing the authority and relevance of Circular 230 by cross-referencing similar affirmative duties contained in the penalty provisions of the Code, (iv) publicizing the results of all OPR investigations and (v) creating an affirmative and disciplinary duty under Circular 230 for practitioners and their firms to meet a standard of competency related to technology.

The *Large Business & International (LB&I) Subgroup*, chaired by Shawn O'Brien, made recommendations on (i) educating taxpayers and their representatives on how documentation might be improved to increase earlier audit deselections and efficiencies and (ii) new procedures pertaining to transfer pricing risk assessment.

General Report

Issues addressed in the IRSAC's General Report typically represent topics identified by members as broad and Service-wide and that do not fall under the purview of any subgroup. This year, the IRSAC identified five such issues: (1) the continuing need for Congress to provide the IRS adequate and reliable funding so that the IRS can fulfill its core service, compliance and enforcement missions; (2) improving the Free File program by increasing IRS oversight and restructuring the Memorandum of Understanding; (3) the continuing need for Congress to provide the IRS express statutory authority to establish and enforce minimum standards of competence for all tax practitioners, including tax return preparers; (4) improving real-time IRS communications with tax practitioners and taxpayers during exigent circumstances and streamlining regular IRS communications with the tax practitioner community; and (5) considering the future of the IRSAC, an exploration focused on strengthening the role and effectiveness of the IRSAC in improving federal tax administration.

Finally, this year's report summarizes last year's achievements in a new section for the General Report entitled, "Progress on IRSAC's 2017 Recommendations." The IRSAC hopes that highlighting its achievements from the prior year will help publicize the IRSAC's valuable contributions to effective tax administration, and encourage various stakeholders—including professional organizations—to engage with the IRSAC in connection with their own efforts to improve tax administration.

ISSUE ONE: The Critical Need to Provide the Internal Revenue Service with Adequate and Reliable Funds

For the last eight years, the IRSAC has lent its voice to those urging Congress to fund the IRS adequately and reliably so that it can fulfill its core service, compliance and enforcement missions.[1] In 2011, under the leadership of then-Chair Charles Rettig, the IRSAC highlighted a single issue in its General Report: "The IRS must receive consistent, adequate and appropriate funding to achieve the proper administrative balance between service, compliance and tax enforcement."[2] That year's IRSAC was insistent that the IRS required "adequate funding commensurate with its ever-increasing responsibilities and workload to remain effective."[3] Both taxpayers and the tax system, the IRSAC warned, "will suffer without consistent and adequate levels of funding."[4]

Seven years later, as Mr. Rettig assumes the role of Commissioner of Internal Revenue, the IRS budget and resources are even more desperate than Mr. Rettig's IRSAC could have imagined. Far from "consistently, adequately and appropriately" funding the IRS to fulfill its core service, compliance and enforcement missions, Congress has slashed the IRS budget every year since 2011. The annual budget (adjusted for inflation) is $2.2 billion less (or 16 percent) than it was in 2011.[5] And while the IRSAC appreciates that appropriating the government's money requires Congress to create winners and losers when considering fiscal tradeoffs and policy imperatives, the protracted losses sustained by the IRS are indefensible. Worse, they hurt taxpayers and are counter-productive on both enforcement and revenue.

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[1] *See* Internal Revenue Service Advisory Council, 2017 Public Report, "The Essential Need to Provide the Internal Revenue Service with Adequate Funds to Fulfill Its Mission," at 12-14; Internal Revenue Service Advisory Council, 2015 Public Report, "The IRS Needs Sufficient Funding to Operate Efficiently and Effectively, Provide Timely and Useful Guidance and Assistance to Taxpayers, and Enforce Current Law So That the Integrity of, and Respect for, Our Voluntary Tax System is Maintained," at 8-27; Internal Revenue Service Advisory Council, 2014 Public Report, "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," at 9-16; Internal Revenue Service Advisory Council, 2013 Public Report, "The IRS Needs Sufficient Funding to Operate Efficiently, Provide Timely and Useful Guidance to Taxpayers and Enforce Current Law So That Respect for Our Voluntary Tax System is Maintained," at 7-12: Internal Revenue Service Advisory Council, 2011 Public Report, "The IRS Must Receive Consistent, Adequate, and Appropriate Funding to Achieve the Proper Administrative Balance Between Service, Compliance, and Tax Enforcement," at 9-12.

[2] Internal Revenue Service Advisory Council, 2011 Public Report, *supra* note 1, at 9.

[3] *Id.*

[4] *Id.*

[5] Emily Horton, *2018 Funding Bill Falls Short for the IRS*, Center on Budget and Policy Priorities (Mar. 23, 2018). The actual IRS budget in 2011 was $12.35 billion compared to $11.52 billion in 2017, or $830 million larger. *See* IRS, Data Book, 2011 (Mar. 2012), at 65; IRS, Data Book, 2017 (Mar. 2018), at 65.

The draconian cuts to the IRS budget have meant less of everything, from personnel to training to taxpayer assistance to enforcement activities to compliance to systems modernization and, ultimately, to tax revenue. Due to budget cuts, the IRS has almost 24,000 fewer full-time employees today than in 2010, reflecting a nearly 25 percent decline.[6] More than 17,000 of those employees worked in enforcement.[7] Not uncoincidentally, the audit rate has fallen by almost one-half. In 2010, the IRS audited 0.9 percent of all returns and 1.1 percent of individual returns from the prior calendar year, while in 2017 it audited 0.5 percent of all returns and 0.6 percent of individual returns.[8] Corporate audit rates also have fallen. In 2010, the IRS audited 1.4 percent of corporate returns (excluding S corporations) but just 1 percent of corporate returns in 2017 (even though there were 12 percent more corporate returns filed in 2010).[9] The IRS audited nearly 100 percent of "corporate giants" in 2010 (i.e., companies reflecting more than $20 billion in assets) compared to 58 percent in 2017.[10] Criminal investigations have also suffered due to the drastic budget cuts and staff reductions, resulting in fewer investigations initiated (4,706 vs. 3,019), fewer referrals for prosecutions (3,034 vs. 2,251) and fewer indictments and informations (2,645 vs. 2,294).[11]

At the same time, the IRS workload has increased substantially. Almost 12.5 million taxpayers have been added to the rolls since 2010,[12] and Congress tasked the IRS with implementing two major laws, the Patient Protection and Affordable Care Act[13] and the Foreign Account Tax Compliance Act,[14] as well as countless new tax provisions.

If that were not enough, the budget cuts and a hiring freeze have resulted in a distinctly aging IRS workforce. As of September 1, 2018, 25 percent of the Service's full-time workforce was eligible for retirement, while 40.5 percent will be eligible in 2021, 48.5 percent in 2023, and 64.5 percent in 2028.[15] The departing expertise and institutional

[6] The actual number is 23,734. Data provided by the IRS.
[7] IRS, Data Book, 2017, *supra* note 5, at 67 (35,038 at end of fiscal year 2017); IRS, Data Book, 2010 (Mar. 2011), at 67 (52,232 at end of fiscal year 2010).
[8] IRS, Data Book, 2010, id. at 22; IRS, Data Book, 2017, id. at 23.
[9] *Id.*; id.
[10] *Id.* (98 percent); id.
[11] IRS, Data Book, 2010, id. at 44; IRS, Data Book, 2017, id. at 44. Both indictments and informations are accusations of criminal conduct made by a federal prosecutor. Indictments also involve a federal grand jury "returning" an indictment with respect to the criminal conduct.
[12] IRS, Data Book, 2010, id. at 22 (187,124,450 total returns); IRS, Data Book, 2017, id. at 23 (195,614,161 total returns).
[13] Pub. L. 111-148 (Mar. 23, 2010).
[14] Pub. L. 111-147 (Mar. 18, 2010).
[15] Data provided by the IRS.

knowledge has been exacerbated since 2010 by the IRS's exception-only hiring freeze, resulting in an insufficient number of younger employees backfilling positions and developing into future leaders of the agency. In 2015, for instance, less than three percent of the total IRS workforce was under the age of 30, including both full-time and part-time employees.[16]

Defunding the IRS while increasing its workload has also yielded less tax revenue. For every dollar the IRS receives in funding, it returns $4 to the federal government.[17] And when those dollars are spent on enforcement activities, the IRS returns at least $6 for every dollar it receives.[18] The cumulative reduction to the IRS budget from 2010 to 2018—using the 2010 budget of $13.9 billion (adjusted for inflation) as the benchmark[19]—has resulted in the IRS receiving $14.5 billion less over those eight years. During the same period, 40 percent of the IRS budget went toward enforcement, while 60 percent went toward the combination of taxpayer services and operations support (the other two primary budget activities of the IRS).[20] Therefore, after accounting for the ratios of IRS dollars received to dollars returned (that is, 1-to-4 and 1-to-6) and the percentage of IRS dollars spent on enforcement, the cumulative $14.5 billion cut to the IRS budget over the last eight years has resulted in between $58 billion and $84 billion *less* tax revenue.[21]

Over the last year, both the Acting Commissioner of Internal Revenue and the Secretary of the Treasury have been outspoken over the need for a significant infusion of IRS funding. In early 2018, Acting Commissioner David Kautter and Treasury Secretary Steven Mnuchin urged Congress to allocate $397 million in additional funding to assist the IRS with the implementation of the Tax Cuts and Jobs Act (TCJA),[22] the most

[16] Prepared Remarks of John A. Koskinen, Commissioner, Internal Revenue Service, before the National Press Club (Mar. 31, 2015).
[17] Joe Davidson, *IRS Chief Says Trump's Budget Would Sharply Cut Taxpayer Service*, WASH. POST. (June 1, 2018).
[18] *Id.* For every dollar spent on enforcement, see Albert R. Hunt, *Look! Suddenly Republicans Don't Hate the IRS*, BLOOMBERG (Feb. 13, 2018) (reporting former Commissioner John Koskinen as saying that for every dollar spent on audits and enforcement, the IRS returns between $5 to $10).
[19] *See* Horton, *supra* note 5 (summing the real dollar cuts from 2010 to 2018).
[20] *See e.g.*, IRS, Data Book, 2010, *supra* note 7, at 65 (indicating 44.5 percent of total IRS budget spent on enforcement); IRS, Data Book, 2017, *supra* note 5, at 65 (indicating 40.7 percent of total IRS budget spent on enforcement).
[21] The $92.8 billion figure is the sum of $58 billion in tax revenue due to enforcement ($14.5 billion cumulative cuts to IRS budget x .40 [the percentage of IRS budget allocated to enforcement] = $5.8 billion x 10 [the return on investing one dollar to enforcement] = $58 billion) and $34.8 billion due to taxpayer services and operations support ($14.5 billion cumulative cuts to IRS budget x .60 [the percentage of IRS budget allocated to taxpayer services and operations support] = $8.7 billion x 4 [the return on investing one dollar in non-enforcement activities] = $34.8 billion).
[22] Pub. L. 115-97 (Dec. 22, 2017).

significant tax reform legislation in more than a generation.[23] Secretary Mnuchin reiterated this request, asking for $400 million for fiscal years 2018 and 2019 to adequately carry out the new tax law, both with respect to providing formal guidance to practitioners and taxpayers as well as increasing taxpayer services to assist taxpayers and their advisors in complying with the new law. "It is one of my top priorities," Mnuchin testified before the House Committee on Appropriations, "making sure we implement the tax plan, which impacts literally everything at the IRS, from customer service, to forms, to technology. That's why it is so important that we get the additional funding for it."[24] For its part, Congress agreed to only $320 million of additional funding and for one year rather than two.[25]

Secretary Mnuchin also has been cognizant of the correlation between the IRS budget and tax collections. During his confirmation hearings in 2017, Mr. Mnuchin testified that the IRS "is under-resourced to perform its duties," and that additional cuts to the IRS budget "will indeed hamper our ability to collect revenue."[26] He also acknowledged that "[t]o the extent we add resources, we can collect more money."[27] And he has further noted those resources must be focused on modernizing information technology at the IRS. "We have spent a lot of money on technology at IRS," Mnuchin stated earlier this year, "but have not spent enough."[28] To this end, the Secretary plans to unveil a five-year plan later this year "to bring IRS into the modern age of technology."[29]

The IRSAC was also heartened that during his confirmation testimony, newly installed Commissioner of Internal Revenue, Charles Rettig, indicated that he would press Congress to appropriate the kind of "consistent, adequate, and appropriate funding"[30] that the IRSAC called for under Mr. Rettig's tenure as Chair in 2011.[31]

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[23] *See* Written Testimony of David J. Kautter, Acting Commissioner, Internal Revenue Service, Before the Senate Finance Committee on IRS Budget and Current Operations (Feb. 14, 2018), at 5; Statement of Steven T. Mnuchin, Secretary, U.S. Department of the Treasury before the Committee on Appropriations, Subcommittee on Financial Services & General Government, House of Representatives (Mar. 6, 2018), at 2.
[24] *Id.*
[25] *See* Michael Rainey, *Spending Bill Includes $320 Million for IRS to Implement Tax Law*, THE FISCAL TIMES (Mar. 22, 2018).
[26] Hearing on the Nomination of Steve Mnuchin to be Secretary of the Treasury, Senate Finance Committee, Questions for the Record, January 2107, Tax Analysts Doc. 2017-1023, at 39 and 113.
[27] Doyle McManus, *If Trump Wants to Run the Country Like a Business, He Should Expand the IRS*, L.A. TIMES (Apr. 12, 2017).
[28] Charles S. Clark, *IRS Defends Budget That Would Cut More Than 2,200 Full-Time Jobs*, GOVERNMENT EXECUTIVE (May 22, 2018).
[29] *Id.*
[30] *Supra* note 2.
[31] *See e.g.*, Aaron Lorenzo, *Rettig Takes Over IRS Amid Budget Challenges, Regulatory Crunch*, POLITICO (Sept. 12, 2018) (reporting that at his confirmation hearing in June 2018, Rettig indicated "he wouldn't be shy about pushing to boost spending for the IRS").

Finally, the IRSAC understands that the IRS administers the tax laws and does not make them. Therefore, our recommendation highlighting “the critical need to provide the Internal Revenue Service with adequate and reliable funds to fulfill its mission” should not be interpreted as a recommendation for the IRS to draft legislation for new appropriations. Rather, we are recommending the IRS and the Treasury Department continue to advocate and push for adequate IRS funding from Congress and to connect clearly and directly the protracted budget cuts to the IRS’s inability to fulfill its core mission and basic regulatory functions. That is, to spotlight the connection between the budget cuts and customer service, timely guidance, systems infrastructure, retention, replacement and training of IRS personnel, enforcement of the nation’s tax laws, taxpayer compliance and federal revenues.

ISSUE TWO: Improving the Free File Program by Increasing IRS Oversight and Restructuring the MOU

This year, the IRS asked the IRSAC to provide feedback on the IRS Free File program, a public-private partnership between the IRS and private sector tax preparation software providers organized as Free File, Inc. (FFI),[32] though still widely known under its previous name, the Free File Alliance (FFA). Specifically, the IRS requested the IRSAC: (1) to evaluate the value of the existing Free File program and whether it has served its purpose and completed its mission; and (2) in the event the IRSAC determined that the Free File program remains viable and should continue, to recommend improvements to the program.[33]

After careful study, which included meeting with IRS leadership in W&I (the IRS Business Operating Division responsible for administering Free File) and with representatives from the FFA, the IRSAC has concluded that the IRS does not provide adequate oversight of the Free File program. The IRSAC has also concluded that the IRS should establish clearly delineated short- and long-term goals, objectives and performance metrics to evaluate the success or failure of the program going forward. The IRS's deficient oversight and performance standards for the Free File program put vulnerable taxpayers at risk, and make it difficult to ensure that FFA members are upholding their obligation to provide tax preparation and e-filing services "to economically disadvantaged and underserved populations at no cost to the individual or the government."[34] The current Free File program operates under the Seventh Memorandum of Understanding on Service Standards and Disputes (MOU) between the IRS and the FFA.[35] The current MOU expires on October 31, 2020. In negotiating a new MOU with the FFA, the IRSAC recommends that the IRS insist upon more robust protection and oversight components to ensure a fair and transparent program that meets its objectives, which we believe need to be clarified.

[32] The FFI was formerly known as the Free File Alliance (FFA), but changed its name in 2012. *See* 2014-2015 Free On-Line Electronic Tax Filing Agreement Amendment (Oct. 30, 2014), at 1.
[33] IRS Presentation, "Free File Past and Present" (Jan. 2018), Slide 18.
[34] *See* Seventh Memorandum of Understanding on Service and Disputes between the Internal Revenue Service and Free File, Inc., (Mar. 6, 2015), Art. 2, at 5 (2015 MOU).
[35] *See* id.

Finally, despite low participation rates among taxpayers in the Free File program—the program purports to cover 70 percent of taxpayers based on AGI[36] while less than 3 percent of taxpayers use the program[37]—the IRSAC believes that the program still warrants investment of IRS resources and sponsorship. With the negotiated changes to oversight recommended in this report, the program viability and relevance will improve, including by providing increased service to the program's target population of low- and middle-income taxpayers, and it will achieve the level of taxpayer assistance that the program was designed to achieve.

In 1998, Congress enacted the Internal Revenue Service Restructuring & Reform Act (RRA 98).[38] Among other directives, the law provided that the IRS reach an electronic filing rate of at least 80 percent, and that the IRS partner with private industry to accomplish that goal. In 2001, the Office of Management and Budget (OMB) announced 24 e-Government initiatives,[39] one of which instructed the IRS to provide free online tax return preparation and filing to taxpayers. The primary objective for this initiative aligned with the 80 percent e-file goal as set out in RRA 98, and aimed to increase electronic filing as a way to reduce return processing costs for the IRS, improve the accuracy of tax form data and calculations and reduce the need for customer support to resolve these kinds of errors. Other objectives contained in these initiatives included the availability of free basic tax preparation, quicker refunds and improved customer service.[40] Initially, the success or failure of these goals was measured against two primary performance metrics: (i) the percentage of the total tax-filing population covered (with a minimum target of 60 percent) and (ii) the number of taxpayers filing electronically (with a targeted 15-percent increase).[41]

[36] *See* id. Art. 1.5, at 3.
[37] *See* IRS Presentation, *supra* note 33, Slides 13-14; IRS, "Free File Tops 50 Million Users; Saves Taxpayers $1.5 Billion Since Its Inception," IR-017-68 (Mar. 28, 2017)
[38] Pub. L. 105-206 (July 22, 1998).
[39] *See* Office of Management and Budget (OMB), Executive Office of the President, E-Government Strategy, Implementing the President's Management Agenda for E-Government (2003). As described in the OMB report, "e-government" referred to the use of technology, particularly web-based internet applications, to make it easier for citizens and businesses to interact with the government, save taxpayer dollars, and streamline citizen-to-government transactions.
[40] *See* id.; Office of Information and Regulatory Affairs, Executive Office of the President, Managing Information Collection and Dissemination, Fiscal Year 2002, at 29-30 (2002).
[41] *See* OMB, *supra* note 39, at 24.

In October 2002, at the direction of Treasury[42] and in accordance with OMB instructions that the government should not provide services the private sector can provide more economically,[43] the IRS partnered with the FFA to offer taxpayers access to free, do-it-yourself, online tax preparation and e-filing services. The program was first available to taxpayers in 2003. In January 2009, the program expanded its offerings to include Free File Fillable Forms available for all taxpayers (not just a percentage of taxpayers based on AGI).[44] Currently, there are twelve tax preparation companies that belong to the FFA and that pay annual membership fees. For its part, the IRS hosts the Free File website on IRS.gov,[45] and devotes resources to the Free File program equivalent to three full-time IRS employees (FTEs).

Since its inception, an average of 3 million taxpayers have used Free File every year to file federal returns, equating to slightly less than 3 percent of eligible taxpayers. The number and percentage of Free File users has declined slightly over the years. The 2005 filing season represented the high point in usage with 5,142,125 taxpayers filing through Free File (which reflected 3.79 percent of all individual taxpayers), while the 2017 filing season represented the low point with only 2,231,261 taxpayers using Free File (reflecting 1.48 percent of all individual taxpayers).[46] There are several possible explanations for the decline in Free File usage, including (i) growth in the marketplace of free tax-filing alternatives (i.e., not just Free File), (ii) elimination of the IRS advertising budget for the Free File program due to budget constraints and (iii) FFA members directly marketing their non-Free File products to taxpayers who used their Free File product in prior years.[47]

Despite the drop in usage, the IRSAC believes that the Free File program remains viable. There is a positive return on investment with taxpayer participation currently averaging 3 million users a year, and with the IRS providing approximately 3 FTEs. At the same time, the program requires significant restructuring, both from the standpoint of

[42] U.S. Department of the Treasury, Treasury, IRS Announce New Efforts to Expand e-Filing (Jan. 30, 2002).
[43] Office of Management and Budget, Executive Office of the President, Circular A-76, § 5(c) (1983, revised 1999) (specifically, Circular A-76 states that "the Government shall not start or carry on any activity to provide a commercial product or service if the product or service can be procured more economically from a commercial source").
[44] IRS, Before Starting Free File Fillable Forms (last updated Apr. 19, 2018), available at https://www.irs.gov/e-file-providers/before-starting-free-file-fillable-forms; Free File, Free File Fillable Forms, available at https://www.freefilefillableforms.com/#/fd.
[45] *See* IRS, Free File: Do Your Federal Taxes for Free (last updated on May 22, 2018), available at https://www.irs.gov/filing/free-file-do-your-federal-taxes-for-free.
[46] *See* IRS Presentation, *supra* note 33, Slide 14; IRS, Data Book, 2007 (Mar. 2008), at 23; IRS, Data Book, 2017 (Mar. 2018).
[47] *Id.* at Slide 15

reworking the MOU and increasing IRS oversight of the program. The IRSAC further believes that implementing its recommendations (described below) will go a long way toward improving participation in the Free File program. As importantly, the IRSAC's recommendations have been designed to refocus the IRS and the FFA on providing free tax preparation and e-filing services "to economically disadvantaged and underserved populations."[48] Because taxpayers access Free File through the IRS website, and the IRS is a partner in this program, the IRSAC believes the IRS should assume a more direct role in ensuring that the Free File program provides taxpayers a way to file their taxes in a free and secure manner. The IRS should also have an expanded role in ensuring that the program does not unnecessarily expose Free File users to upselling of paid products by FFA members. These obligations can only be fulfilled through consistent and persistent oversight as well as by accountability of both the IRS and the FFA to the terms of a renegotiated MOU.

The IRSAC's following recommendations for the IRS Free File program are divided into two areas. The first area reflects recommendations for increased IRS oversight of the program, while the second area reflects recommendations pertaining to the renewal of the Free File MOU.

Recommendations for the IRS

- Reevaluate and develop short- and long-term goals, objectives and performance metrics for the Free File program specifying what the IRS wants to accomplish through the program and the renewal of the MOU.
- Develop more robust processes for reviewing best practices of the FFA and its members to ensure fairness, objectivity and transparency. One way to achieve this goal is through an annual independent audit of each member of the FFA.
- Develop standards for frequently and actively checking on FFA member websites during the filing season, including most importantly logging in as a taxpayer and going through the filing process on each FFA member's Free File website.
- Increase communication on the IRS website to clarify when a taxpayer is leaving the IRS website and being sent to the landing page of FFA members' Free File website.
- Increase visibility on the IRS website for Free File options, including after April 15. The increased visibility should include reference not just to the Free File program

[48] 2015 MOU, *supra* note 34.

and free fillable forms, but also to other free e-filing alternatives sponsored by the IRS, including the Volunteer Income Tax Assistance (VITA) program.

- Create additional questions on the IRS Free File landing page, "Software Lookup Tool," to more precisely ascertain taxpayers' eligibility for each FFA member's Free File offerings and to help avoid situations where taxpayers begin the tax filing process only to find out they do not qualify for the "free" filing.

Recommendation for the MOU

- Every year, provide all Free File users (including those who do not successfully complete a return) the option to complete customer satisfaction surveys pertaining to their experience using Free File.
- Share high-level statistical information between the IRS and each FFA member, particularly conversion rates, to assist in measuring taxpayer experience with the program as well as the overall success/failure of the program.
- Limit third-party advertising on FFA member Free File sites. Currently, some FFA members permit third-party vendors to advertise services on the FFA member's Free File website while taxpayers are going through the tax-filing process. Such activity is confusing and potentially misleading depending on the content of the advertising.
- Explore the benefits of mandating that FFA members offer free state returns for all users, either with the FFA member or a free state e-filing alternative. Also explore the potential impacts such a mandate might have on member participation.
- Require that Free File users returning directly to FFA members' websites the following year (and not through the IRS website) can be directed easily to (and in fact can reasonably reach) FFA members' Free File websites.
- Develop metrics for increased oversight of the Free File program and for FFA members' compliance with the MOU.
- Expand the annual audit requirements of FFA members with a process that is objective and transparent, including a third-party audit of each member. The IRSAC understands that the FFA currently engages a private sector auditor to review FFA members' compliance with the terms and conditions of the program. However, the IRSAC also understands that this auditor's review and findings are not shared with the IRS, Congress or the public.
- Require the FFA to spend a certain percentage of its membership dues for advertising and promotion of the program.

ISSUE THREE: Statutory Authority of the IRS to Establish and Enforce Minimum Standards of Competence for all Tax Practitioners, including Tax Return Preparers

As with the IRSAC's longstanding recommendation that Congress adequately and reliably fund the IRS (see "Issue One"), the IRSAC has urged Congress to provide the IRS express statutory authority to establish and enforce minimum standards of competence for all tax practitioners, including tax return preparers.[49] The IRSAC reiterates that recommendation this year, both because such statutory authority remains an urgent priority and because omitting the recommendation would give the false impression that the IRSAC believes the issue has receded in importance. Our summary of the issue from 2017 bears repeating:

> Taxpayers, tax practitioners, and the Internal Revenue Service all benefit from enforceable minimum standards of conduct for tax practitioners. First and foremost, it is in the public interest and the interest of taxpayers to safeguard the integrity of tax return preparation, tax advice and planning, tax representation generally, and the tax controversy process. The even-handed enforcement of minimum standards also benefits ethical practitioners who otherwise might find themselves disadvantaged by a seeming "race to the bottom" by unregulated practitioners. Recently, several courts have circumscribed the authority of the Treasury Department to establish, enforce, and require minimum standards of competence on tax return preparation and other pre-filing tax services, as well as on post-filing tax services prior to the audit stage.
>
> To ameliorate the threat posed by these court decisions to competent tax advice and return preparation, to tax administration, and to the integrity of the tax profession, the IRSAC believes that Congress should extend to the Treasury Department express authority to establish, enforce, and require minimum standards of competence for the full range of tax practice, from tax advice and planning all the way through tax litigation.[50]

The IRSAC has reason to believe that a bipartisan consensus has emerged over the last two years for providing the IRS express statutory authority to establish and enforce minimum standards of competence for all tax practitioners. President Trump, for

[49] Internal Revenue Service Advisory Council, 2017 Public Report, "The Need for Express Statutory Authority to Confirm the Treasury Department's Ability to Establish, Enforce, and Require Minimum Standards of Competence for All Tax Practitioners, Including Tax Return Preparers," at 104-10; Internal Revenue Service Advisory Council, 2016 Public Report, "Statutory Authority of the IRS to Establish and Enforce Professional Standards for Tax Practice," at 57-69; Internal Revenue Service Advisory Council, 2015, Public Report, "Statutory Authority of the IRS to Regulate Tax Practice," at 78-82; Internal Revenue Service Advisory Council, 2014 Public Report, "Statutory Authority of the IRS to Regulate Tax Return Preparers," at 20-24.

[50] Internal Revenue Service Advisory Council, 2017 Public Report, id., at 104.

example, called for "increase[ing] oversight of paid tax return preparers"[51] in his budget proposals for fiscal years 2018 and 2019. The Commissioner of Internal Revenue has reinforced the President's recommendations by calling on Congress to provide the IRS with "explicit authority to require minimum qualifications for return preparers."[52] In addition, Senators Rob Portman (R-OH) and Ben Cardin (D-MD) included a provision in their recently released "Protecting Taxpayers Act"[53] that would "reinstate[] IRS authority to regulate paid tax return preparers."[54] Moreover, the American Institute of Certified Public Accountants (AICPA), an important and influential stakeholder, has thrown its weight behind recent efforts to give the IRS explicit and stronger oversight of tax return preparers.[55] And finally, the high rates of participation in the IRS's voluntary Annual Filing Season Program indicate that otherwise non-credentialed or unlicensed tax practitioners want to be recognized and regulated in a manner that notifies taxpayers of their special expertise. In 2014, the IRS unveiled the Annual Filing Season Program to "recognize the efforts of non-credentialed return preparers who aspire to a higher level of professionalism."[56] During the 2018 filing season, over 61,000 preparers completed the program's Record of Completion[57] (which includes requirements in continuing education),

[51] OFFICE OF MANAGEMENT AND BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2019 114 (2018) ("This proposal would give the IRS the statutory authority to increase its oversight of paid tax return preparers…Increasing the quality of paid preparers lessens the need for after-the-fact enforcement of tax laws and increases the amount of revenue that the IRS can collect. This proposal saves $457 million over the 2019 through 2028 period."); OFFICE OF MANAGEMENT AND BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE U.S. GOVERNMENT, FISCAL YEAR 2018 118 (2017) ("Incompetent and dishonest tax return preparers increase collection costs, reduce revenues, disadvantage taxpayers by potentially subjecting them to penalties and interest as a result of incorrect returns, and undermine confidence in the tax system. To promote high quality services from paid tax return preparers, the proposal would explicitly provide that the Secretary of the Treasury has the authority to regulate all paid tax return preparers.").

[52] Written Testimony of David J. Kautter, Acting Commissioner, Internal Revenue Service, Before the Senate Finance Committee on IRS Budget and Current Operations (Feb. 14, 2018), at 6 ("Incompetent and dishonest tax return preparers," Acting Commissioner David Kautter told Congress, "harm taxpayers by subjecting them to potential audits and by potentially subjecting them to penalties and interest as a result of incorrect returns. Requiring all paid tax preparers to keep up with changes in the Code would help promote high-quality service from preparers, improve voluntary compliance and foster taxpayer confident in the fairness of the tax system.").

[53] *See* S. 3278, "Protecting Taxpayers Act," Sec. 202 ("Regulation of Tax Return Preparers"), 115th Congress, 2d Session (July 26, 2018).

[54] Sen. Rob Portman Press Release, "Portman, Cardin Introduce Protecting Taxpayers Act to Make IRS More Responsive and Accountable to Taxpayers" (July 26, 2018).

[55] *See* AICPA to Senator Rob Portman and Senator Ben Cardin, Re: Protecting Taxpayers Act (S. 3278) (Aug. 1, 2018) (stating that the AICPA "would like to express its support for Section 202, Regulation of Tax Return Preparers, which will help promote good tax administration and protect the interests of the American taxpayer by protecting taxpayers from incompetent and unscrupulous preparers…This authority will ensure minimum competency and ethical standards similar to what was required under the Registered Tax Return Preparer (RTRP) Program and all the agency to act swiftly and efficiently to stop preparers from continuing to file inaccurate and fraudulent tax returns."); AICPA to Honorable Lynn Jenkins and Honorable John Lewis, Re: "Taxpayer First Act" Discussion Draft (Apr. 6, 2018), 2018 TNT 68-26 (writing, "Requiring tax return preparers to follow the Circular 230 standards of conduct…is essential.").

[56] IRS, Annual Filing Season Program, https://www.irs.gov/tax-professionals/annual-filing-season-program. *See also* Rev. Proc. 2014-42; 2014-29 I.R.B. 192.

[57] Return Preparer Office, "Number of Individuals with Current Preparer Tax Identification Numbers (PTINs) for 2018," https://www.irs.gov/tax-professionals/return-preparer-office-federal-tax-return-preparer-statistics.

making these preparers the second largest category of tax professionals with PTINs (only behind Certified Public Accountants). A recent court decision affirmed the IRS's authority to offer the program and regulate its participants.[58]

To further facilitate this legislative, administrative and judicial momentum, the IRSAC strongly recommends that Congress provide the IRS statutory authority to establish and enforce minimum standards of competence for all tax practitioners, including paid return preparers.

[58] *See* AICPA v. IRS, No. 16-5256 (D.C. Cir. Aug. 14, 2018), reversed and remanded AICPA v. IRS, 199 F. Supp. 3d 55 (D.D.C. 2016).

ISSUE FOUR: Improving Real-Time IRS Communications During Exigent Circumstances and Streamlining Regular IRS Communications

This year the IRSAC tackled the issue of IRS communications to the tax professional community and to taxpayers as the IRS faced unprecedented communication challenges. In late December 2017, Congress passed and the President signed into law a sweeping tax reform bill, the Tax Cuts and Jobs Act (TCJA).[59] As last year's Chair of the IRSAC, Timothy McCormally, wrote in an excellent article describing the new tax law's challenges for the IRS,[60] "One important consequence of last year's truncated legislative schedule is that the final legislation contains myriad glitches, gaps, errors and ambiguities—as well as inconsistences between congressional intent (as set forth in the meager legislative history) and what the words of the statute mandate. Significantly," McCormally continued, "since the final bill introduces several brand-new concepts into the Internal Revenue Code…the not-always-clear legislative language virtually begs for exposition, line-drawing and interpretation. The net result of the *process* used and the *breadth* and *magnitude* of changes made," McCormally concluded, "is that the IRS's overall task in implementing the new law is far from ordinary or mundane."[61] So, too, with *communicating* with tax professionals and taxpayers how the IRS planned to implement the new law.

Two specific and "far from ordinary or mundane" communication challenges emerged early in the 2018 tax filing season. And while these challenges were unique, they also revealed systemic shortcomings in how the IRS communicates with tax professionals and taxpayers. The first challenge involved real-time communications on tax law and tax filing changes. The second issue involved coordinating and removing duplication of IRS email communications to the tax professional community.

Real-time communications with tax professionals and taxpayers on tax law and tax filing changes. Early in the 2018 filing season, the IRS faced two specific communications challenges that needed immediate attention and that had an equally immediate impact on accurate and timely tax filing.

[59] Pub. L. 115-97 (Dec. 22, 2017).
[60] Timothy J. McCormally, *Tax Reform and the IRS: Five Takeaways for Tax Practitioners*, THE TAX ADVISER (June 1, 2018).
[61] *Id.* (emphasis in the original).

First, on February 9, President Trump signed into law the Bipartisan Budget Act of 2018,[62] which contained dozens of extender provisions that had technically expired but were made retroactively effective through December 31, 2017.[63] Among the notable provisions affecting tens of millions of taxpayers included the:

- **Exclusion for discharge of indebtedness on a principal residence.** Extends the exclusion while also modifying the exclusion to apply to qualified principal residence indebtedness discharged pursuant to a binding written agreement entered into in 2017.
- **Deduction for premiums for mortgage insurance (PMI) deductible as mortgage interest.** Extends the treatment of qualified mortgage insurance premiums as interest for purposes of the mortgage interest deduction, while also phasing out the deduction for taxpayers with adjusted gross income (AGI) between $100,000 and $110,000.
- **Above-the-line deduction for qualified tuition and related expenses for higher education.** Extends the deduction, while also capping the deduction at $4,000 for individuals whose AGI does not exceed $65,000 ($130,000 for joint filers) and at $2,000 for individuals whose AGI exceeds the $65,000/$130,000 thresholds but does not exceed $80,000 ($160,000 for joint filers).

On February 9, the IRS communicated with the tax practitioner community regarding the retroactive extender provisions. In a short, three-sentence statement, the IRS indicated that it was "reviewing the legislation signed Feb. 9 that retroactively extended and modified numerous tax provisions covering 2017. We are assessing these significant changes in the tax law and beginning to determine next steps. The IRS will provide additional information as quickly as possible for affected taxpayers and the tax community."[64] The IRS failed to post or disseminate any additional notification of the retroactive extenders on IRS.gov. Nor did the IRS notify taxpayers visiting its Free File website. As a result of these communication failures, the IRSAC believes that large and untold numbers of taxpayers otherwise eligible to take advantage of the retroactive extenders filed returns without taking advantage of the tax savings because they were simply unaware of their eligibility.

The next time tax practitioners—but still not taxpayers—heard from the IRS about the retroactive extenders was two weeks later on February 22: "The Bipartisan Budget

[62] Pub. L. 115-123 (Feb. 9, 2018)
[63] *See* id. at §§ 40001-40501.
[64] IRS, IRS Statement on Retroactive Tax Extender Provisions, https://www.irs.gov/newsroom/irs-statement-on-retroactive-extender-provisions.

Act, enacted on February 9, renewed for tax year 2017 a wide range of individual and business tax benefits that had expired at the end of 2016. The IRS has now reprogrammed its processing systems to handle the three most likely to be claimed on returns filed early in the tax season."[65] In the interim, practitioners had to rely on the tax preparation software industry for updates. It took until April 5 for the IRS to update its own systems and forms so it could process returns claiming the full range of retroactive extender provisions and so taxpayers could file their returns "as they normally would."[66] The IRS's silence caused significant hardship to practitioners and taxpayers, the latter of whom may have unknowingly overpaid taxes. Taxpayers who somehow subsequently learned that they had overpaid taxes were further inconvenienced by having to amend previously filed returns.

The second specific communications challenge that the IRS faced—and for which it also failed to provide adequate updates and guidance—involved the unprecedented delay of the filing deadline due to a hardware failure. The system failure occurred in the wee hours of April 17, this year's Tax Day, and prevented taxpayers and their representatives from filing tax returns for more than eleven hours.[67] The tax practitioner community learned of the shutdown not from the IRS but from taxpayer-clients, the news media and tax software developers. The IRS failed to provide any meaningful, direct communication with the full tax practitioner community until late in the day on April 17 and then largely by stating that the filing deadline had been extended by a single day to April 18. Taxpayers were confused. Tax practitioners were angry. A single day of penalty relief was wholly insufficient under the circumstances.

The point in highlighting these instances of IRS communication failures is not to browbeat the IRS. The IRS faced a unique and monumentally challenging filing season this year. However, the IRSAC believes that the IRS contingency plans in emergency situations should be reevaluated in light of this year's experience. In such exigent

[65] IRS, Three Popular Tax Benefits Retroactively Renewed for 2017; IRS Ready to Accept returns Claiming these Benefits; e-file for Fastest Refunds, IR-2018-33 (Feb. 22, 2018) (the three "popular tax benefits" were the exclusion for discharge of indebtedness on a principal residence, deduction for PMI, and deduction for qualified tuition and related expenses for higher education).
[66] IRS, IRS Statement on Retroactive Tax Extender Provisions, *supra* note 64.
[67] It is worth emphasizing that the system failure was caused by a piece of hardware that was only a bit over a year old and that helped run the IRS's master file. Such a failure "had only occurred once before" according to the provider of the equipment, and never at the IRS. Charles S. Clark, *IRS Defends Budget That Would Cut More Than 2,200 Full-Time Jobs*, GOVERNMENT EXECUTIVE (May 22, 2018) (quoting Acting Commissioner David Kautter on the cause of the system failure). In other words, the failure was not related to the agency's 1960s-vintage legacy mainframe.

circumstances, the emphasis should be on communicating early and often with the tax practitioner community and with taxpayers. Both IRS.gov and the "Tax Professionals" landing page should immediately indicate the existence of a problem, and postings should be updated frequently and include time stamps. Even a communication stating, "Here's the situation and we're working on it," would have been more helpful than what tax professionals and taxpayers received this year regarding the retroactive extenders and Tax Day systems shutdown. The IRS should also consider holding more ad-hoc meetings with stakeholder groups during exigent circumstances to keep them apprised of developing situations.

Coordinating and removing duplication of IRS email communications to the tax professional community. The second IRS communications issue could be thought of as the inverse of the first issue. While the IRS provided inadequate communication on the retroactive extenders and Tax Day shutdown, it more generally inundates tax professionals with duplicative and uncoordinated email communications. The IRS offers tax professionals more than 30 e-News subscriptions, some of which are sent out daily, as well as an IRS2Go mobile app.[68] For tax professionals, these communications are an essential way to receive current information about tax and regulatory changes, security alerts, and the filing season.

Nonetheless, the communications can be repetitive and overwhelming to the point of being counterproductive. IRS news releases, tax law updates, and general tax information communications (including IRS Tax Tips, Tax Reform Tax Tips, IRS Newswire, Guidewire, Tax Statistics and Alerts from Office of Professional Responsibility) overlap in significant ways with IRS communications targeted specifically to tax professionals, IRS partners and software developers (including e-News for Tax Professionals, e-News for Payroll Professionals, Income Verification Express Service (IVES) Program e-News and Updates, Outreach Corner, e-News for IRS Continuing Education Providers, Modernized e-File News for Partnerships, General IRS e-File Service Center Messages, Quick Alerts, Alerts, Quick Alerts-Technical, Quick Alerts-Affordable Care Act Information Return and General Notifications).

[68] *See* "e-News Subscriptions," https://www.irs.gov/newsroom/e-news-subscriptions.

The IRSAC recommends that the IRS develop a process to coordinate its various electronic communications to tax professionals, reduce duplicative messaging and send out non-essential, non-emergency communications in a more consolidated fashion.

ISSUE FIVE: The Future of the IRSAC

In its 2017 annual report to the Commissioner, the IRSAC contemplated "the future of the IRSAC."[69] It explored—and invited the IRS to assist in that exploration—"how the IRSAC can operate most effectively" at a time the IRS and tax practitioner community were anticipating "the impending appointment of a new Commissioner of Internal Revenue" in addition to "the very real prospect of significant tax law changes as part of an ongoing tax reform effort."[70] The topic was both timely and prescient. John Koskinen's term as Commissioner was about to end, tax practitioners were taking bets on the identity of the next Commissioner, and Congress enacted in December the most sweeping and disruptive tax reform legislation in a generation.

The IRSAC embraced (and continues to embrace) its historical and essential duty to, as we put it last year, "provide the Commissioner of Internal Revenue with candid advice about how to improve tax administration."[71] In addition, we evaluated whether we could or should fulfill this traditional role by providing the Commissioner—and, more broadly, Congress and the public—with IRSAC's views on issues in tax administration that emerge throughout the year; specifically, whether there was a role for the IRSAC to deliver real-time advice on time-sensitive issues that might be moot by the time the IRSAC issued its yearly report in November. We queried whether the IRSAC should, among other items: (i) consider a mix of in-person and virtual meetings (rather than stick with the traditional four in-person working sessions and one public meeting) "to enable the IRSAC to better and more efficiently shape its agenda and do its work"[72]; (ii) intersperse virtual meetings for the full IRSAC membership between the four in-person working sessions; (iii) file interim reports throughout the year to the Commissioner; (iv) disseminate its views on real-time tax administration issues to Congress, the public and, for instance, the National Taxpayer Advocate; and (v) solicit feedback throughout the year from other stakeholders—particularly professional associations—on select topics in tax administration.

[69] *See* IRS Advisory Council, 2017 Public Report, *supra* note 1, at 20-22.
[70] *Id.* at 21.
[71] *Id.* at 20.
[72] *Id.* at 21.

What the IRSAC did not know before submitting its report to the Commissioner last year was that the Treasury Department had asked the IRS to undertake a similar reconsideration of the IRSAC, with an emphasis on streamlining the processes by which the Commissioner receives formal advice from the tax practitioner community on tax administration issues. Thus, beginning in December 2017, the IRS—with the active assistance of current and former members of both IRSAC and the Information Reporting Program Advisory Committee (IRPAC)—considered and then formulated a "consolidation" of the three Federal Advisory Committee Act (FACA) advisory groups that report to the Commissioner: the IRSAC, the IRPAC and the Advisory Committee on Tax Exempt and Government Entities (ACT).[73] The resulting effort culminated in merging the above three advisory groups into a single group under a larger and reconstituted IRSAC.

Beginning in 2019, the "new" IRSAC will include four subgroups reflecting the four business operating divisions (BODs) of the IRS: Large Business & International (LB&I), Small Business & Self-Employed (SB/SE) and Wage & Investment (W&I) and Tax Exempt and Government Entities (TE/GE). Aligning IRSAC's subgroups with the BODs will have several beneficial effects, including facilitating efficient flow of information between the IRSAC and the BODs; elevating more issues to the BODs; holding the BODs more accountable for assisting the IRSAC in developing IRSAC's issues and reporting back in a timely manner the implementation status of the issues[74]; and separating the current IRSAC subgroup, SB/SE and W&I, into two distinct subgroups.[75] The two other IRSAC subgroups, Digital Services and OPR, will no longer exist as independent subgroups. However, the IRSAC believes strongly that each of the four "new" subgroups should include at least one member with expertise in digital services. Those members should communicate regularly with each other throughout the year to consult each other on issues involving digital services, both to leverage their shared expertise and to avoid duplicative work in the subgroups. As to issues involving the Office of Professional

[73] For the FACA, see Pub. L. 92-463 (Oct. 6, 1972).
[74] This is not to say that the IRSAC believes the BODs have been unresponsive to IRSACs issues through the years, either in terms of development or implementation. However, the IRSAC expects that aligning its subgroups with the BODs will result in a smoother flow of information and structured accountability.
[75] Beginning in 2016, budgetary constraints and other factors compelled the IRS to combine the two subgroups. Over the last three years, it has become obvious to the IRSAC (as well as to the IRS) that the combined subgroup and the number of issues it develops is too unwieldy to justify its continued combination. In fact, in IRSAC's 2017 annual report, we recommended, "Given the importance of the work done and the constituencies served by SB/SE and W&I, augmented by our experience the last two years, the IRSAC believes that the IRS should reinstate SB/SE and W&I as separate subgroups." IRS Advisory Council, 2017 Public Report, *supra* note 1, at 22.

Responsibility and Circular 230, the IRSAC anticipates those issues will be handled either by the full IRSAC or specifically affected subgroups depending on the nature and extent of the issues. Finally, the IRSAC expects that the consolidated IRSAC will continue to advise groups ancillary to the BODs—particularly IRS Appeals, Chief Counsel and Criminal Investigations—with at least the same regularity it does now.

On membership, the IRSAC understands that beginning in 2019 there will be 36 members on the Council. These members will include those current members of the IRSAC, IRPAC and ACT not rolling off their respective groups in 2018 as well as a handful of new members. The 36 members will populate the subgroups as before; that is, based on skill sets and experience with an eye toward keeping subgroup sizes sufficiently large to develop anticipated issues for the upcoming year.

At its September 2018 working session, the IRSAC discussed "the future of the IRSAC," both in the context of the group's 2017 consideration of the topic and how the consolidated IRSAC will operate in 2019 and beyond. And while the group reached no consensus on the issues raised in the IRSAC's 2017 annual report (preferring instead to leave those decisions to next year's reconstituted group), members expressed general agreement for: (i) preserving the number of in-person working sessions at five; (ii) conducting general and or subgroup business as needed throughout the year by way of virtual meetings or conference calls; and (iii) soliciting feedback from external stakeholders through informal rather than formal processes. There was less agreement on whether the IRSAC should file interim reports to the Commissioner throughout the year, both because of concerns over member workload and reaching consensus on time-sensitive issues. There was support for an alternative suggestion to add an Appendix to the annual report highlighting important tax administration issues that emerged during the year and that remained relevant by year's end but that the IRSAC did not sufficiently develop. There was also less agreement on the need for the IRSAC to disseminate its views on timely tax administration issues beyond the IRS and to Congress or the public.

The one area the IRSAC agreed as a group involved the benefits of receiving timely notification from the IRS on the "implementation status" of issue recommendations made by the prior year's IRSAC. In years past, the IRSAC received these status reports informally, if at all, and then only late in the year. This year, the IRSAC received a status

report to consider before its September working session, but the report failed to include updates on several important issues, including attendance by Compliance and Counsel personnel at Appeals Division conferences.

Beginning in 2019, the IRSAC would like the IRS to deliver to the IRSAC the "implementation status" report from the immediately preceding year by, at the latest, July 1. In that way, the IRSAC will have sufficient time to digest the report and understand which issues from the prior year have been implemented fully or partially, which are under active implementation, and which have been rejected. In addition, receiving these reports in a timely manner will assist the IRSAC in determining, for instance, whether it should continue to recommend, fine-tune or abandon issues that span more than a single year. Timely receipt of these reports will also allow the IRSAC to highlight in its annual report to the Commissioner its achievements from the prior year, a form of publicity that will underscore the valuable contributions that the IRSAC makes to effective tax administration.[76] Such positive publicity might also encourage stakeholders—including professional organizations—to engage with the IRSAC in connection with their own efforts to improve tax administration.

[76] It is worth noting that the Electronic Tax Administration Advisory Committee (ETAAC) includes in its own annual reports (to Congress rather than to the Commissioner) a section detailing the "progress" made by the IRS in implementing and evaluating the ETAAC's preceding year's recommendations. *See* Electronic Tax Administration Advisory Committee, Annual Report to Congress, Publication 3415 (Rev. 6-2018), at 8-10.

PROGRESS ON IRSAC'S 2017 RECOMMENDATIONS

The IRSAC made seventeen primary recommendations and additional sub-recommendations in its 2017 annual report. As of August 15, 2018, the IRS had implemented, or was implementing, nearly all the IRSAC's recommendations from 2017. Included among the fully and partially implemented recommendations were:

- Suggestions on how the IRS can receive, process and learn from external feedback regarding its new examination system focusing on issue-specific compliance "campaigns" (as opposed to enterprise-based exams);
- Revising the Schedule UTP (Uncertain Tax Positions) to increase taxpayer compliance, yield more helpful information, enable better use of LB&I resources and reduce compliance burdens on taxpayers;
- Using W-2 verification codes to provide another level of security to authenticate claims of wages and withholding on e-filed returns, expanding outreach pertaining to the issue to tax practitioners and tax software vendors;
- Marketing and promoting the Practitioner Priority Service (PPS);
- Improving various aspects of the private debt collection program, including communicating the program to taxpayers, providing feedback on the public perception of the program and preventing scams and fraudulent schemes related to the program;
- Reviewing and suggesting revisions to IRS collection notices;
- Continuing to elevate the urgent need for legislation authorizing the Treasury Department to establish and enforce minimum standards of competence for tax return preparers;
- Adding short and accessible summaries of a tax practitioner's ethical obligations under Circular 230;
- Expanding the online and mobile functionality of the IRS's newly-developed Tax Professional Accounts;
- Expanding the use of Application Program Interfaces (APIs); and
- Learning from state tax agencies' online services for tax professionals, particularly those related to processing and managing a tax professional's various forms of authorization for representing a taxpayer.

Notwithstanding these achievements, the IRSAC wants to highlight once more an area that needs more explicit and public-facing IRS attention, namely the depleted IRS budget. As we explain in this year's General Report (see "Issue One"), the IRSAC appreciates that the IRS administers the tax laws and does not make them. Nonetheless, we continue to underscore "the critical need to provide the Internal Revenue Service with

adequate and reliable funds to fulfill its service, compliance and enforcement missions." In addition, the IRSAC recommends the IRS and the Treasury Department continue to push Congress for adequate funding and to connect clearly and directly the seemingly endless budget cuts to the agency's inability to fulfill its core duties. As the IRSAC stated in last year's annual report, the IRS is doing "less with less"[77] due to the drastic cuts to its budget over the last eight years. Congress must be reminded of that reality at every turn.

[77] Internal Revenue Service Advisory Council, 2017 Public Report, *supra* note 1, at 13.

Internal Revenue Service Advisory Council

Digital Services Subgroup Report

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INTRODUCTION/EXECUTIVE SUMMARY

The Digital Services Subgroup appreciates the cooperation of the IRS representatives who made themselves available for interviews and presentation updates on the IRS progress of online accounts and authentication processes as it relates to the current state of the IRS's digital initiatives. We enjoyed a close working relationship and applaud the Service's ability to adapt quickly to a constantly changing environment while remaining focused on the goal of providing all taxpayers a full modernized suite of customer service options.

We are encouraged by the Service's continued progress toward an enterprise-wide modernization even in the face of a long list of competing priorities related to the Tax Cuts and Jobs Act that passed in December of last year. The IRS has made significant strides in transitioning from traditional to agile software development methods in delivering online services while strengthening its focus on user experience and design to deliver the best possible customer experience for taxpayers.

The modernization of the IRS is an onerous undertaking involving a delicate balance between available resources, security and usability. Success is dependent on security being the number one priority but also investing in innovative technology, infrastructure and additional human resources to ensure the incorporation of a state-of-the-art online account processing system. The investment will expand customer service channels to include modernized conveniences for meeting the variety of taxpayer preferences. The immediate and substantial cost savings created by taxpayers using digital channels allows the IRS to leverage data-driven technologies to improve phone and in-person contact support channels.

The IRS continues to achieve success and growth in the taxpayer online account. Over 2 million taxpayers have successfully gained access to their online accounts through electronic authentication. The service continues to attract a growing base of online taxpayers, and they continue to expand features beneficial for taxpayers to monitor and ensure tax compliance with the IRS.

The IRSAC applauds the IRS's efforts to date, but strongly encourages the IRS to expand the online features and, in particular, implement a digital Tax Professional Account sooner rather than later, perhaps by expanding the IRS's e-Services platform

capabilities to provide tax professionals who have been vetted and approved by the IRS the ability to manage more within their e-file accounts. Tax professionals require a similar level of functionality so they can assist taxpayers in meeting their compliance obligations efficiently, securely and effectively. Maintaining momentum will move the IRS in the direction of providing taxpayers and tax professionals with the means to engage with the IRS virtually, the method of which many taxpayers now expect and demand. Delaying the availability of a Tax Professional Account would impair the IRS's ability to leverage tax professionals for customer service. Tax professionals routinely filter client questions, troubleshoot and resolve tax issues and intervene on behalf of taxpayers—all without requiring IRS contact. With a majority of taxpayers using a professional to prepare a return, leveraging the tax professional only makes sense. Tax professionals can also encourage the use of existing online accounts for individual taxpayers; the result is increased adoption of online services by taxpayers.

In this report, the Digital Services Subgroup makes recommendations on three different topics. First, the subgroup recommends the IRS develop a robust eA3 (electronic Authentication, Authorization and Access) policy to safeguard taxpayers' information. eA3 enables secure taxpayer interactions with IRS, including self- and third-party assistance.

Second, the subgroup makes a recommendation for leveraging Application Programming Interfaces (APIs) specifically to implement frameworks to support Automated Clearing House (ACH) payments as well as real-time authorization for and delivery of tax information. The IRS should leverage APIs for developing standards for digital taxpayer services through third-parties and benefit from the lessons learned from the "Refund Status API." The IRS should continue to work with key stakeholders to ensure only the information for facilitating the taxpayer's original need is accessed.

Third, the subgroup makes recommendations regarding the digital Tax Professional Account. These recommendations include staying on course and continuing moving forward with developing tools for empowering taxpayers to authorize tax professionals to assist with compliance. The IRS needs to continue communicating its strategies and working with their valued partners in the tax industry to make the tax professional online account a reality.

ISSUE ONE: eA3 Rule

Background

Digital services are a critical component for the IRS to enhance user experience and carry out its mission of providing *"America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."* To fully leverage the benefits of less expensive digital service channels, IRS must provide secure access to IRS Web-based applications and taxpayer data.

This access to IRS Web-based applications and taxpayer information will provide highly responsive customer service to taxpayers, their designated tax professionals and other stakeholders. However, access must be protected and limited to the taxpayer and their designated tax professionals and other stakeholders. Therefore, to effectively enable digital services for taxpayers and third parties while maintaining the security and integrity of taxpayer data, the IRS must utilize secure and robust authentication, authorization and access (eA3) procedures.[78] eA3 can provide a shared Enterprise Service or platform that can be used by new and existing, internal and external applications to provide authorization to users and services.

For purposes of this recommendation, "authentication" is any process by which an individual's identity is confirmed. "Authorization" is finding out if the individual, once identified, is permitted to have access to a resource or perform certain actions. "Access" is the determination if an individual should have access to a system.

eA3 is a linchpin capability to address the challenge of identity theft and refund fraud and to enable secure digital interactions for individuals, businesses, third parties, tax professionals and other IRS trusted network participants. eA3 presents several unique challenges that the IRS will have to resolve to achieve success. eA3 needs to be effective in a constantly changing environment and compliant with the new National Institute of Standards and Technology (NIST) guidelines.[79] These guidelines focus on the enrollment, verification of identity and authentication of subjects interacting with government systems over open networks.

[78] OMB Memo 04-04.
[79] NIST Special Publication (SP) 800-63-3.

NIST breaks out what was previously termed as authentication into two components: identity proofing and authentication. The objectives of identity proofing are to match a claimed identity to a single unique identity within the context of the population of users, validate all user-supplied information is correct, validate the claimed identity is authentic and validate the person providing the identity evidence. NIST alignment breaks out authentication into three identity proofing levels described as IAL1, IAL2 and IAL3.

NIST Special Publication 800-63A depicts the identity proofing process in the following graphic:

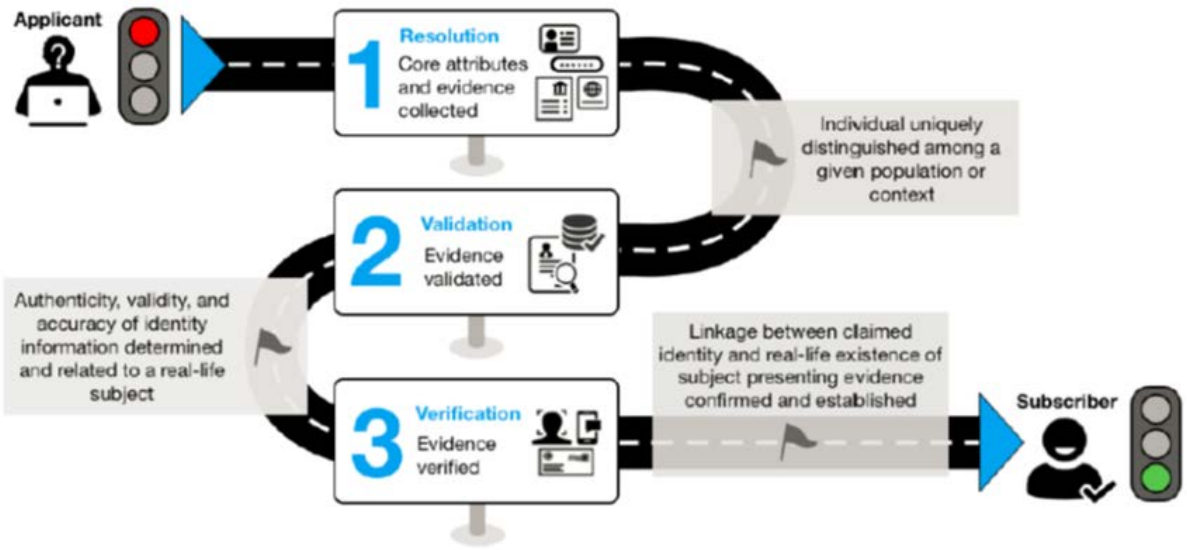

Figure 4-1 The Identity Proofing User Journey

The objective of authentication is to provide reasonable risk-based assurances that the subject accessing the service today is the same as the one who accessed the service previously. Authentication assurance levels are based on the level of risk and required strength for the system to recognize a subscriber. Each successive authentication assurance level requires a greater level of strength for subscriber access. Authentication assurance may be achieved through the use of third-party multiple credential service providers (CSPs) to accommodate various taxpayer demographics. In addition, NIST breaks out the authentication assurance levels into three categories described as AAL1, AAL2 and AAL3.

The IRS's current remote identity proofing and authentication solution is the Secure Access identity management platform. Generally, Secure Access requires the taxpayer to successfully complete a process of validating one's self using personal information, an email address, third party public information and a cell phone.[80] Upon returning to the service, the subscriber would be required to authenticate by entering shared secrets and a one-time passcode.

As discussed in the Digital Services Subgroup Report Issue Three: Tax Pro Account below, a taxpayer must authorize a third party before IRS can legally disclose taxpayer information to the third party or allow the third party to represent the taxpayer before the IRS. Authorization is granted through explicit consent from the taxpayer, either in writing or orally. Often times, the consent is made in writing using either Form 2848, *Power of Attorney and Declaration of Representative*, Form 8821, *Tax Information Authorization*, or the Third-Party Designee section on the tax return.

A Power of Attorney (POA) can authorize an individual to represent a taxpayer before the IRS, including advocating, negotiating and signing on the taxpayer's behalf. The authorized individual can argue facts and the application of law and receive copies of notices and transcripts of the taxpayer's account. POAs include attorneys, certified public accountants, enrolled agents, general partners, full-time employees, family members and others. POAs must be in writing.

A Tax Information Authorization (TIA) can authorize any individual, corporation, firm, organization or partnership designated by the taxpayer to inspect and/or receive confidential taxpayer information verbally or in writing for the specified type of tax and tax years or periods. TIAs can be submitted in writing, typically on Form 8821, or can be provided orally over the phone.

The Third-Party Designee section on certain tax returns can allow the IRS to discuss processing of the tax return, including the status of tax refunds, with the designated third party. A third-party designee authorization is limited to matters concerning the processing of the tax return containing the completed Third Party

[80] See 2018 ETAAC Annual Report to Congress for more information regarding risk level authentication: https://www.irs.gov/newsroom/electronic-tax-administration-advisory-committee-issues-2018-annual-report

Designee section. The third party designee authority expires one year from the due date of the return.

In summary, online engagement with the IRS is a method of communication which many taxpayers now expect and demand. Efficient and effective tax administration may be enhanced with greater access to taxpayer data. Online services could provide taxpayers and tax professionals with better and faster service and improve the user experience. However, access to taxpayer data must be guarded using appropriate identity proofing and authentication methods as described in the NIST guidance. Lastly, confirmation of authorization should be clearly communicated to both the taxpayer and the authorized third party.

Recommendations

1. The IRSAC recommends that the IRS continue to utilize a strategic risk-based approach to implementing eA3. For example, the IRS has several online services with different levels of assurance. Some services are associated with lower levels of risk because they provide access to less sensitive information, such as refund status, whereas others enable a taxpayer to pay a tax bill online. Some services require a higher level of assurance because the sensitivity of the information disclosed is associated with a higher level of risk, e.g., Get Transcript Online, Get an IP PIN, IRS e-Services and the taxpayer online tax account. Therefore, highly sensitive information services should require a higher level of assurance.
2. Continue progress towards implementing an enterprise-wide authorization strategy. It is a critical policy for IRS to move forward in its goal to safely share taxpayer information, and it is imperative for empowering and enabling all taxpayers to meet their tax obligations. This is an essential element to extend the availability of digital services beyond taxpayer-only tools and make them available to third parties such as tax professionals, financial institutions and tax software. Effective online access to taxpayer data by third parties allows the IRS to leverage tax ecosystem partners to achieve greater customer service. For example, tax professionals routinely filter client questions, troubleshoot, resolve tax issues and intervene on behalf of taxpayers—all without requiring IRS contact. The authorization strategy is particularly necessary and relevant for the implementation

of application program interfaces (APIs) as discussed in the Digital Services Subgroup Report Issue Two.

3. The IRSAC recommends that IRS implement closed loop authorization controls that require affirmative action by the taxpayer authorizing access to their information or action on their behalf as well as the tax professionals or third-party stakeholders to whom permission is granted. Confirmation of taxpayer or third-party access should be transparent and communicated through electronic or paper mechanisms, depending on user preference. Once the appropriate level of authentication assurance and identity proofing is complete, and the authorization is processed, taxpayers, designated tax professionals and other key stakeholders would ideally have access to taxpayer data in real time. Both taxpayers and authorized third parties should have an effective means to revoke the authorization and terminate access.

ISSUE TWO: Application Program Interface (API) Integration Strategy

Background

Application Programming Interfaces (APIs) are communication protocols used to safely and securely allow software platforms to share data, be they for private consumption (within IRS platforms) or public with trusted third parties. As identified in the 2017 IRSAC Public Report, Digital Services Subgroup Issue Two on Third-Party Application Programming Interfaces (APIs), it is imperative that the IRS begin work on developing a long-term API strategy that includes realistic goals.[81] Furthermore, as stated in Issue One, an authorization framework is absolutely imperative for IRS to implement and deploy APIs. As part of this year's recommendations, the Digital Services Subgroup builds upon last year's recommendation by identifying two APIs that can potentially become success stories and establish a standard for both internal/inter-department and third-party communication needs of the IRS.

1. Background on ACH Payments API

The IRS has multiple avenues for electronic payment, allowing for updated, secure and convenient options that are familiar to taxpayers accustomed to interfacing daily with banking and other online applications either via computers or mobile devices. The benefits of electronic payments to the IRS are many, including improvements in efficiency, timing and accuracy of payments as well as a significant decrease in the cost per payment as displayed in the table below:

[81] The Internal Revenue Service Advisory Council 2017 Public Report, Digital Services Subgroup Issue Two, available at https://www.irs.gov/pub/irs-utl/2017-irsac-public-report.pdf.

Table 1. IRS Processing Costs Per Taxpayer Payment Channel[82]

Channel	Period	Cost
Electronic Payment	FY17	$0.76
	FY18 (through June)	$0.79
Paper Payment Lockbox	FY17	$1.49
	FY18 (through June)	$1.48
Paper Payment Service Center	2011 (working on current costing)	$1.28

Although the majority of payments submitted by individual taxpayers are sent in the mail using paper forms, including 87.7% of estimated tax payments, the need for electronic platforms and an accelerated adoption rate are important goals of the IRS, Department of Treasury and the broader "All Electronic Treasury Initiative."[83]

The IRS offers electronic payment options that are in line with current taxpayer expectations, be they individual taxpayers or entities, such as Credit/Debit Card, Direct Pay, Electronic Funds Withdrawal using IRS e-file, Electronic Federal Tax Payment System® (EFTPS) filing, Online Payment Agreements or Same-Day Wire Federal Tax Payments. The November 2013 introduction of Direct Pay specifically is highlighted as a measurable success due to substantial year-over-year increases in adoption since 2013 and the percentage of successfully completed payments. Based on data collected via Google Analytics, in FY 2017 66.2% of users channeled through Direct Pay completed a payment. User dropout consistently trends towards the authentication steps of entering tax information or ID proofing.[84] User comments on the Direct Pay process, as gathered in a 2018 online survey, are generally very positive indicating that paying electronically provides a convenient, safe and secure option, which has the benefit of instant documentation for the taxpayer.[85] Complaints have centered on having to re-authenticate and re-enter information when progressing through the payment flow. This feedback

[82] IRS Office of Online Services. "Payments Data and Analysis." July 24, 2018, slide 4.
[83] IRS Office of Online Services. "Payments Data and Analysis." July 24, 2018, Slide 7.
[84] IRS Office of Online Services. "Payments Data and Analysis." July 24, 2018, Slide 10.
[85] IRS Office of Online Services. "Payments Data and Analysis." July 24, 2018, Slides 11-12.

coupled with the evidence in Google Analytics has created an opportunity for the development and implementation of an ACH Payments API.

Developing an ACH Payments API is not a new concept. In 2014 the IRS Office of Online Services (OLS) worked with the Bureau of the Fiscal Service (BFS) to define requirements for a payments API that would be built through the BFS financial agent and consumed initially by the IRS, with the vision that authorized and approved third parties could potentially have access in the future. As recent as the summer of 2018, the IRS and BFS have re-engaged in discussions to finalize the vision and requirements for an ACH Payments API. A successful implementation will require development by both the IRS (for an online account and supporting architecture) and BFS (payments API). Therefore, plans and timelines will have to be coordinated.[86] It is critical to encourage the continued joint effort from the IRS and BFS, both of which are engaged and see the benefits of a successful implementation of an ACH Payments API.

In searching for a controlled group for the initial implementation of the ACH Payments API, it was evident that finding a use that would not require any modification to the security requirements of the electronic Authentication, Authorization and Access (eA3) framework was a must. This led to the recommendation that the first planned use of the API will be to harness the current online account platform and its existing authentication protocols, offering an integrated payment feature that is seamless to the authenticated taxpayer interested in checking their balance and processing a payment in one session without having to jump from system to system. The three main functions suggested for the ACH Payments API are detailed in the table below, as identified when the OLS worked with the BFS in the Summer 2014 - March 2015 to outline initial requirements for an ACH Payments Application Program Interface (API).[87]

[86] IRS Office of Online Services. “Payments Data and Analysis.” July 24, 2018, Slide 18.
[87] IRS Office of Online Services. “Payments Data and Analysis.” July 24, 2018, Slide 15.

Payment Processing	Application would formulate a payment request for a specific taxpayer and send it to EFTPS for processing. A real-time response would provide the confirmation number that would be displayed to the user.
Payment Changes	For payments scheduled in advance, users will be able to modify or cancel the payment, which would also be sent to EFTPS for processing and the confirmation number would be displayed to the user.
Payment Status	A taxpayer would be able to view a listing of any scheduled payments submitted through electronic channels, including the status of any submitted or returned payments that have not yet posted.

Benefits abound to all stakeholders involved, from internal to external users, as this is the foundation for the future development of data communication between the IRS and other parties. Detailed below are the benefits by user group.[88]

- Taxpayers will have within their existing online account a centralized, improved user experience whereby they can complete payment processing without having to re-authenticate, schedule payment changes prior to processing and verify the status of their pending payments. Additionally, the taxpayer will have instant feedback on their historical actions and the ability to view future scheduled payments.
- The IRS and BFS benefit from an ACH Payments API as it creates a harmonious process that improves accuracy by suggesting where payments should be applied up front and decreases the opportunity for re-authentication related drop-off. The API has the added benefits of providing the IRS with a reusable payment channel to be leveraged by future applications such as IRS2Go mobile and other IRS applications, as well as the option to share with trusted third parties.
- SBSE/W&I Subgroup Issue One contained within this IRSAC annual report for the improved education, communication and decrease of incorrect lockbox addresses will also be positively affected by the implementation of an ACH Payments API, as more electronic payments applied correctly to taxpayer accounts equal fewer

[88] IRS Office of Online Services. "Payments Data and Analysis." July 24, 2018, Slide 17.

payments sent by paper that potentially could end up in incorrect lockbox addresses.

- Third Parties will see an effort by the IRS and BFS to improve communication and encourage innovation that would ultimately benefit the taxpayer.

2. Background on Tax Information Sharing API

Currently, the Income Verification Express Service (IVES) tool enables third parties such as those performing mortgage services, background or credit checks or other banking services to electronically receive, with the consent of the taxpayer, return transcripts, W-2 transcripts and 1099 transcript information for $2.00 per transcript. Third-party users must apply for IVES enrollment using Form 13803, *IVES Application Form*, at which point IRS performs suitability checks on the applicant and on all principal owners or controlling officers of the company listed on the application to determine the applicant's suitability to be an IVES participant. If an applicant passes the suitability check, IRS completes processing the application and notifies the applicant of acceptance to participate in the program.

Once enrolled, the IVES user submits a Form 4506-T, *Request for Transcript of Tax Return*, or Form 4506T-EZ, *Short Form Request for Individual Tax Return Transcript*, signed by the taxpayer to one of five designated IRS Return and Income Verification Services (RAIVS) units by fax. RAIVS personnel then manually process the form and upload taxpayer transcripts to the IVES user's secure electronic inbox located on the e-Services electronic platform. Though income verification through IVES includes user-friendly electronic processes such as providing the transcripts in electronic format and permitting the use of electronic signatures on the Form 4506-T, the process is still manually intensive and generally takes 2-3 business days from the time of request submission to transcript delivery.

Conversely, a tax information API could enable IRS to receive third-party authorization requests for tax information, process the authorization and provide the data back to the authorized third party, all in an automated, electronic manner and with monitoring and reporting capabilities to identify API misuse and fraud. A fully electronic and automated process could provide tax information in a matter of minutes, greatly improving the experience for users and taxpayers who are verifying their income or need

tax information to facilitate coming into compliance. Additionally, it would generate significant savings for the program by freeing up IRS resources which would otherwise be processing IVES requests. IRS could then leverage some of these resources to vet and audit the tax information API uses as well as to accommodate any residual requests requiring manual processing. The costs to develop and implement a new API could be offset through a temporary increase in user fees, but the eventual decrease in resources needed to administer the program after implementation of the API would allow IRS to reduce the $2.00 user fee to an amount that supports the costs of ongoing development and maintenance of the API as well as to cover the cost of audits of API users.

Furthermore, such an API would help IRS successfully develop standards for digital taxpayer services through third parties. External-facing APIs pose formidable risks and additional considerations beyond internal-only or inter-agency APIs. IRS previously piloted an external-facing API that allowed income tax software providers to proactively obtain from IRS and communicate to their software users the status of their tax refund. Though no longer active, learnings from this successful pilot should be leveraged and built upon to address the authentication, authorization and access requirements necessary for providing an external stakeholder with more sensitive taxpayer information. Once proven out in the form of a tax information API, these tools could then be leveraged to facilitate additional third-party APIs, such as sharing tax return information and refund status directly to tax software.

As mentioned in Digital Services Subgroup Issue One, IRS's use of its Authentication, Authorization and Access (eA3) frameworks are paramount to enabling digital services. An API that grants nearly instantaneous access to sensitive taxpayer information poses a significant risk and is certainly not exempt from the need for a robust eA3 policy. To mitigate the risk of improper disclosure of taxpayer data, IRS should require an adequate level of identity proofing, vetting and authentication of third-party users before granting access to the API or the ability to delegate access further. Appropriate authentication of all parties involved would, in turn, enable IRS to implement authorization standards that safeguard taxpayer information from unauthorized disclosure. Furthermore, ongoing, periodic audits of third-party users would ensure that

they have properly obtained a valid authorization from the taxpayer and are complying with applicable disclosure laws and procedural standards.

IRS has been working with key IVES stakeholders to determine better how they use tax transcript information in an admirable effort to ensure that IRS is not disclosing information beyond what is necessary to facilitate the taxpayer's original need. IRS should continue to consult with these key stakeholders and extend their engagement to include the tax professional and tax software communities to ensure that IRS efforts to minimize the risk of improper disclosure of taxpayer data is appropriately balanced against the API users' needs.

In summary, APIs are essential tools for IRS to enable digital services that taxpayers and third parties have come to expect as part of their interactions with financial institutions and other service providers. The use of APIs to connect IRS systems internally, with other government agencies and with third-party partners would improve the user experience for all stakeholders involved, save IRS resources and facilitate taxpayer compliance. IRS must take the necessary steps to establish standards for internal/inter-department as well as third-party facing APIs to enable digital services to serve taxpayers effectively through the communication channel of their choosing.

Recommendations

1. Implement an ACH Payments API. The implementation of the ACH Payments API is of tremendous benefit to taxpayers, the IRS, BFS and eventually third parties that require a payments API. By building this interface in collaboration with BFS, the savings are tangible in the form of reduced payment processing costs and IRS technology resources, as well as providing goodwill to the taxpayer by removing the re-authentication barrier, increasing the online account adoption rate and removing the doubts of payment application to the proper account and line item. The IRSAC recommends that the IRS moves forward with the development and implementation of the ACH Payments API.
2. IRS should develop and implement an API to automate requests for tax information disclosure. Such an API would improve taxpayer service, confer significant cost savings to the IRS as well as third-party users and mark a significant step in IRS's efforts to collaborate with external third parties to provide digital taxpayer services.

ISSUE THREE: Tax Pro Account

Background

As in the IRSAC's 2017 report, the IRSAC is recommending that the IRS launch a secure, online account for tax professionals (Tax Pro Account) as soon as possible. An online Tax Pro Account would provide a digital method for tax professionals to assist taxpayers efficiently and quickly with tax compliance and tax resolution.

In our opinion, a digital Tax Pro Account should be a high priority because of the substantial benefits it will provide to taxpayers and the IRS.

The recommendation and request for a secure, online account for tax professionals has been ongoing for several years by a variety of IRS advisory groups including the IRSAC[89] and ETAAC (Electronic Tax Administration Advisory Committee),[90] the Taxpayer Advocate,[91] tax professional organizations[92] and the IRS itself.[93] In addition, during the past two years, the IRS has conducted extensive research, surveys and interviews with tax professionals related to a Tax Pro Account, and in 2017 the IRS presented a prototype of a Tax Pro Account at the IRS Nationwide Tax Forums.

According to The Taxpayer Bill of Rights,[94] "taxpayers have the right to receive prompt, courteous and professional assistance in their dealings with the IRS." The IRS Mission is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness."[95] In our opinion, the current methods available to assist taxpayers with compliance and resolution issues do not include the tools necessary for tax professionals to help taxpayers receive prompt assistance or the IRS to provide top-quality service.

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[89] 2017 IRSAC Digital Services Subgroup Report, Issue 1, available at https://www.irs.gov/tax-professionals/2017-digital-services-report; 2016 IRSAC Small Business/Self-Employed and Wage and Investment Subgroup Report, Issue 2, available at https://www.irs.gov/tax-professionals/2016-irsac-sbse-wi-subgroup-report; 2015 IRSAC Small Business/Self-Employed and Wage and Investment Subgroup Report, Issue 4, available at https://www.irs.gov/tax-professionals/2015-irsac-sbse-wi-subgroup-report.

[90] 2018 ETAAC Report, Recommendations 16–18, available at https://www.irs.gov/pub/irs-pdf/p3415.pdf; 2016 ETAAC Report, Key Outcome 2, The Future State, available at https://www.irs.gov/pub/irs-prior/p3415--2016.pdf; 2015 ETAAC Report, Key Outcome 3, Recommendation 10, available at https://www.irs.gov/pub/irs-prior/p3415--2015.pdf; 2014 ETAAC Report, Key Outcome 4, Recommendation 8, available at https://www.irs.gov/pub/irs-prior/p3415--2014.pdf; 2013 ETAAC Report, Key Outcome 3, Recommendation 8, available at https://www.irs.gov/pub/irs-prior/p3415--2013.pdf

[91] National Taxpayer Advocate Objectives Report to Congress Fiscal Year 2019, MSP#3, available at https://taxpayeradvocate.irs.gov/Media/Default/Documents/2019-JRC/JRC19_Volume2.pdf; National Taxpayer Advocate Objectives Report to Congress Fiscal Year 2018, MSP#7, available at https://taxpayeradvocate.irs.gov/Media/Default/Documents/2018-JRC/JRC18_Volume2.pdf

[92] Ensuring a Modern-Functioning IRS for the 21st Century Report, available at https://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/IRS-Service-Improvement-Practitioner-Report.pdf

[93] IRS Strategic Plan FY 2018-2022, Strategic Goal 1, available at https://www.irs.gov/pub/irs-pdf/p3744.pdf; IRS Future State, available at https://www.irs.gov/newsroom/future-state-initiative

[94] https://www.irs.gov/taxpayer-bill-of-rights

[95] https://www.irs.gov/pub/irs-news/ir-98-59.pdf

Currently, the IRS offers an online application called e-Services that allows tax professionals, reporting agents, mortgage industry representatives, payers and others to complete transactions online with the IRS. The tools offered are limited and only include Registration Services, e-file Application, Transcript Delivery and TIN Matching. In addition to the tools currently offered by e-Services, there is a need for online Tax Pro Account that should at a minimum include a process for digital authorizations. If a taxpayer wants to authorize an individual to assist them with dealings with the IRS, an authorization needs to be processed before such individual may assist the taxpayer. Taxpayer authorizations are obtained through the manual processing of Forms 2848 and 8821 and processing can take up to five business days. For most taxpayers, contact by the IRS causes stress and anxiety, and responses required by the IRS are often time-sensitive. The lengthy processing times associated with the current manual processing of Form 2848 and Form 8821 prolongs this stress and anxiety, and it increases the possibility that taxpayers will not receive the benefit of representation in critical matters, such as levy actions. The current methods are inefficient and are not cost effective. According to the IRS Strategic Plan FY 2018-2022 (page 10), digital interactions in FY 2016 had a much lower per-transaction cost than traditional channels:

- Cost per Assistor Call (64M interactions) = $42 per interaction
- Cost per Correspondence (7.9M interactions) = $57 per interaction
- Cost per Taxpayer Assistance Center Contact (4.5M interactions) = $68 per interaction
- Cost per Digital Interaction (384M interactions) = $0.20 per interaction

Providing a method to quickly, efficiently and securely process authorizations through a digital method will not only provide peace of mind to taxpayers and allow timely assistance by representatives but will provide cost savings to the IRS and will permit better use of IRS resources.

In summary, the implementation of a Tax Pro Account will not only benefit taxpayers and improve a taxpayer's overall experience with the IRS, but will benefit the IRS by reducing traditional methods of corresponding with taxpayers and tax professionals which should reduce costs and allow for better uses of IRS resources. Finally, we refer to the comments of David J. Kautter, then Acting Commissioner of

Internal Revenue, per page 5 of the IRS Strategic Plan FY 2018-2022, “Providing service to taxpayers is a vital part of the IRS Mission... We’ll continue to provide, expand and improve service where, when and how taxpayers and tax professionals want and expect it. We’re modernizing our approach to make taxpayers’ experiences similar to the way they interact with private sector institutions. We’re working toward providing a wide array of electronic tax account options while improving service over the phone and face-to-face.”

Recommendations

1. Prioritize implementation of an online account for tax professionals. The implementation of a Tax Pro Account should be a high priority for the IRS and the delay in establishing a Tax Pro Account will impair the IRS’s ability to leverage tax professionals for taxpayer support. The IRS has experienced success with the launch of an online taxpayer account, and tax professionals can encourage the use of online taxpayer accounts which will free up IRS resources.
2. IRS should expand the online features of the www.irs.gov home page to include a link to a digital Tax Pro Account which will provide substantial benefits to taxpayers and the IRS.
3. The following three functions should be considered for inclusion in an initial version of a Tax Pro Account:
    - Digital notices/correspondence
    - Secure messaging
    - Document upload

    These features would substantially improve a tax professional’s ability to resolve tax issues for taxpayers. Such digital methods of resolving tax issues would also likely reduce calls to the IRS and free up IRS resources.
4. We recommend the following list of additional functions be considered for inclusion in future versions of an online Tax Pro Account:
    - Online chat
    - Electronic signatures
    - Withdrawal and revocation of taxpayer authorizations
    - Taxpayer search

- View of taxpayer records and payments
- User history
- Expansion on the Tax Pro Account to include business taxpayers

These additional features will only enhance a tax professional's ability to assist taxpayers and improve taxpayers' experiences.

Internal Revenue Service Advisory Council

Small Business/Self-Employed and Wage & Investment Subgroup Report

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Small Business/Self-Employed (SB/SE) and Wage & Investment (W&I) subgroup is a collaborative group of four members with practices including CPAs, enrolled agents, attorneys, academia, small business and payroll processing. The members' collective tax experience includes tax return preparation, tax planning and advice, payroll administration and representation of individual and business taxpayers from many segments of our society. SB/SE and W&I cover a large and diverse population of taxpayers with a wide range of income and tax return complexity. We consider service on the IRS Advisory Council a privilege, and we are pleased to present this report. We thank SB/SE Commissioner Mary Beth Murphy, W&I Commissioner Ken Corbin and the IRS personnel of their respective divisions for their cooperation and assistance in developing this report, and for their recognition of the Subgroup as an integral resource. We especially thank our liaisons for their guidance and facilitation of our service, providing information, advice and access to essential IRS personnel needed to develop our report. We also were privileged, in preparing our report, to work closely with our colleagues from the IRSAC Digital Services Subgroup, the ETAAC (Electronic Tax Administration Advisory Committee) and the IRPAC (Information Reporting Program Advisory Committee).

The SB/SE and W&I divisions requested our assistance with the four topics in this report. Our report addresses issues regarding the efficiency of processing paper payments (Publication 3891/Lockbox addresses), improving current systems for authenticating taxpayer representatives, digital communications in correspondence examinations and the IRS response to the emerging industry of alternative/virtual currencies. These topics share common themes of taxpayer protection and the integrity of the tax collection system, easing and enhancing effective communication to improve the delivery of IRS services, improving the taxpayer experience and the experience of the tax professionals who serve them and developing policies, methods and practices to improve the efficiency of IRS operations. Providing an exceptional taxpayer and tax professional experience while strengthening security and authentication measures factored heavily into our discussions, along with searching for current and future technology and digital solutions. In an era where identity thieves seek taxpayer and tax

professional data, the balance between security and taxpayer (and taxpayer's representatives) rights to conveniently access their tax information is paramount and challenging.

ISSUE ONE: Use of Lockbox

Executive Summary

The Fiscal Service's IRS Lockbox program helps the IRS collect taxes. The U.S. Treasury, via Financial Agent Agreements, agrees to allow outside financial institutions to process individual and business tax payments. The IRS publishes lockbox addresses in Publication 3891, *Lockbox Addresses*.[96] The IRS identified an issue where taxpayers are sending payments to Taxpayer Assistance Centers (TAC) instead of the published Lockbox addresses, particularly when using a Private Delivery Service (PDS) (e.g., Federal Express, DHL or United Parcel Service). The W&I Division requested the IRSAC's assistance in encouraging usage of updated Lockbox addresses, state alignments for individual and business tax forms and IRS street addresses for Private Delivery Services (PDS).

Background

The Lockbox Network's mission is collecting and accurately processing taxpayer remittances and accelerating deposits into the United States Treasury while maintaining the security and confidentiality of taxpayer information.[97]

The U.S. Treasury received approximately 243 million electronic and paper revenue receipts for 2017. Of these receipts, approximately 73 percent were electronic payments, 21 percent were payments made to the Lockbox Network and six percent were payments made to the Submission Processing Center. The total receipts received for 2017 were approximately $3.450 trillion, of which 13 percent (approximately $433 billion) were received through the Lockbox Network. The IRS updates Publication 3891 annually, including street addresses required for PDS delivery.

For 2017, 433 payments totaling $8 million were misdirected to the 600 Dr. Martin Luther King Jr Pl, Louisville, KY, 40202, IRS address. For April 2018, 401 payments totaling $15 million were misdirected to that address. Seventy-one were received from three CPAs using bulk mail, 77 were mailed directly to the TAC by individual taxpayers and 253 were mailed by individual taxpayers using UPS and FedEx. Because PDS cannot deliver to a U.S. Post Office box (P.O.), PDS providers were routing deliveries to that

[96] IRS Publication 3891 Lockbox Addresses Revised for 2019: https://www.irs.gov/pub/irs-pdf/p3891.pdf
[97] IRM 3.0.230.4, 3.0.230.5

address using the street addresses identified via a Google search, for the nearest IRS office. This data represents misdirected payments from just one IRS address. As of August 2018, there were 359 TAC offices.

The IRS conducted a Payment Routing Project for July 2018 to determine the number of total payments and unopened packages received by a sample of seven of the 359 TAC offices. USPS delivered 52 percent of the packages and several PDS providers delivered 48 percent. With IRS funding cuts and IRS workforce reduction, misdirected payments burden the IRS and potentially delay the processing of taxpayer payments. Misdirected payments are especially burdensome if the payments are sent to an understaffed IRS location not set up to handle the workload.

Both taxpayers and tax professionals may be reluctant to abandon traditional paper payment methods, especially those who have been making paper tax payments for many years. The IRS studied the demographic characteristics of taxpayers by payment channel. Taxpayers making tax payments have a median age of 56 and have a median income higher than the median income for the U.S. tax filing population. Of all paying taxpayers, 67 percent used tax professionals. At an income level of $128,928, 75 percent of the taxpayers used a tax professional and paid their taxes via paper check.

The 2019 Publication 3891 highlights electronic payment options as paperless, convenient, safe and secure. Electronic tax payments have increased significantly in the last five years as the IRS introduced Direct Pay and Online Accounts. The cost to process an electronic payment was $.76 for the FY 2017 compared to $1.49 to process a paper payment using the Lockbox Network.

Until more payments are made electronically, improving the use of the Lockbox Network by taxpayers, tax professionals and PDS providers is essential.

Recommendations

1. Encourage taxpayers to pay their taxes electronically. The IRS should use communications tools, including social media, to promote electronic payment of income taxes by both taxpayers and tax professionals. Highlight the benefits of electronic payments, including reduced costs to taxpayers and the IRS, time-saving, increased processing efficiency and immediate confirmation that IRS received payment. Allow taxpayer-authorized tax professionals to use Direct Pay on their clients' behalf. Tax professionals may be more familiar with making electronic payments and can assist taxpayers who have limited internet access. Update forms and other communications to highlight the electronic payment options. Raise the option of making electronic payments to the first page of the Form 1040 instructions.[98] Increase taxpayer awareness by including an insert with paper tax refund checks describing the benefits of direct deposit and electronic payment options. Reinforce the message encouraging electronic/online payments in the 1040-ES instructions by including electronic payment information on the 1040-ES payment voucher.[99] Consider additional ways of reassuring taxpayers and their preparers of the convenience and security of electronic payments. While many taxpayers are comfortable paying their bills electronically, when it comes to paying the IRS many taxpayers have expressed concerns about providing their bank account information to the IRS. The IRS should highlight that it is prevented from unauthorized access to taxpayers' bank accounts and that bank information is not retained by IRS Direct Pay.
2. Outreach to the Tax Professional Community: The IRS should enlist its stakeholder liaison network to educate tax professionals on the importance of using the Lockbox addresses. The IRS conducts practitioner liaison meetings across the country. IRS representatives frequently speak at professional organization meetings. Through these and similar channels, the IRS can optimize its outreach. The IRS or a trusted partner could write an article for the tax

[98] The 1040 instructions provide information for making payments electronically in two places. The first mention of making tax payments electronically refers the taxpayers to the IRS website. Later in the instructions, the complete list of electronic payment options are included.
[99] The IRSAC raised this issue in our working sessions with W&I. We understand our suggestions have been incorporated into the 2019 1040-ES to be released for the 2019 filing season.

professional trade magazines regarding the Lockbox Network and specifically address the issue with tax professionals sending the payments to the wrong address. Communicate directly with TAC-identified tax professionals to correct their mailing procedures. Use other outreach channels, such as social media and the IRS Nationwide Tax Forums, to inform tax professionals of the importance of using the Lockbox Network.

3. Engage software vendors and developers: Tax professionals and taxpayers use tax software to prepare and file tax returns. The software generates filing instructions, including mailing addresses. Many software providers provide diagnostics before the return is filed. These diagnostics offer valuable information to users to ensure the tax return is complete. The IRS should work with the software providers to ensure that they prompt for street addresses when the taxpayer or tax professional is using a PDS.
4. Expand the form instructions (Forms 1040, 1040-V, 1040-ES) to include all mailing addresses. The instructions to the forms include the mailing addresses if the taxpayer is making a payment or enclosing a check. The instructions do not include the IRS mailing address if the taxpayer is using a PDS. The instructions refer the taxpayer to the IRS website, an extra step that may be ignored. Consistent listing of PDS mailing addresses in the instructions will provide a quick and easy way to access the correct mailing addresses.
5. Work with the PDS providers: The IRS could prepare and distribute a brochure to each PDS location to inform the PDS provider of the proper street address for IRS mail addressed to a P.O. box. The National Taxpayer Advocate studied how education letters sent to EITC taxpayers influenced compliance. The research found that, for the cost of preparing and mailing a letter, the IRS could improve taxpayer compliance and reduce certain IRS associated costs. The same result may apply here. The cost of preparing the brochure may be less than the IRS burden of handling misdirected payments. To change PDS behavior of delivering to the closest IRS service center, the IRS could encourage the PDS to modify their software to review mail going to the IRS and automatically correct the address to the proper location if the sender used a P.O. box. Changing the software or

providing the employees with an approved/authorized IRS mailing street address list will prevent delivery to the wrong address. Instead of researching (using Google) to find the closest IRS Service Center, PDS employees will have a list with correct addresses or a reference to check for correct addresses on the IRS website. The IRS should also identify which Submission Processing Center locations have the most misdirected payments and visit the PDS locations to educate them on the proper mailing addresses.

6. Outreach to the taxpayer community: The IRS could use its communications tools (including social media) to inform taxpayers of the importance of using the Lockbox Network.
7. Encourage Certified Mail for taxpayers choosing not to pay electronically. Certified Mail will give taxpayers their proof of mailing and delivery without the PDS routing issues/misdirected payments.

ISSUE TWO: Third-Party Authentication

Executive Summary

IRM Section 21.1.3.3, *Third Party (POA/TIA/F706) Authentication*,[100] instructs IRS personnel on how to "complete the appropriate research" to verify the identity of a third party (i.e., anyone other than the taxpayer) asserting to represent a taxpayer.

In January 2018, the IRS instituted a new identity verification process to be used by IRS toll-free telephone and walk-in assisters. Under this new process, besides providing their name and representative's number, third parties must also verify their identity by providing "personal identifying information" (PII) to include their social security number (SSN) and date of birth (DOB). The IRS implemented this new verification process as an immediate remedy to address fraudulent activity in Centralized Authorization File (CAF) submissions and to protect taxpayer PII.[101] The new verification process was implemented without warning or input from the tax practitioner community and announced after the fact in an e-mail communication (1/9/2018). Since implementing the new verification process, practitioners have expressed deep concern about providing their PII.

The IRSAC has been asked for recommendations to strengthen the current process of verifying the validity of third-party authorizations while addressing practitioner concerns regarding providing PII.

[100] IRM 21.1.3.3 (10-01-2017)
Third Party (POA/TIA/F706) Authentication

1. When responding to a third party (anyone other than the taxpayer), who indicates he/she has a third party authorization on file, complete the appropriate research. For Power of Attorney (POA) Form 2848 and Tax Information Authorization (TIA) Form 8821 research the Centralized Authorization File (CAF) using CC CFINK or via the IAT Disclosure tool, if applicable, before providing any tax account information.
2. To verify that the caller is an authorized third party of the taxpayer, research the CAF. In order to research the CAF, you need the following information:
   - Taxpayer's Name
   - Taxpayer's TIN
   - Third Party's Name
   - Third Party's Number (also known as: Rep#, CAF#) see (8) below for exception
   - Tax Period(s) in question
   - Tax Form(s) in question

Note, IRM 21.1.3.3 was updated on 10/1/2018 to reflect the 2018 revisions implemented by the IRS in January 2018

[101] See IR-2018-61, How to Maintain, Monitor, and Protect Your EFIN, (Mar. 16, 2018).

Background

The Code sets forth privacy protections for taxpayers.[102] Under IRC section 6103, the IRS is generally prohibited from disclosing a tax return or return information. However, a taxpayer can designate a third party to receive such confidential taxpayer information from the IRS. Authorization to receive confidential taxpayer information is typically granted through filing third-party authorization forms with the IRS. The most common of these third-party authorization forms are the Form 2848, *Power of Attorney and Declaration of Representative*, and Form 8821, *Tax Information Authorization*.

Third-party authorization forms must have the taxpayer's information (name, address, phone number and tax identification number (TIN)), designate the type of tax, form(s) and period(s) for which authority is being granted and be signed and dated by the taxpayer. These forms must also specify the third party's information (name, address and phone), a Preparer Tax Identification Number (PTIN) or CAF number,[103] and must be signed and dated by the designated third party. Completed third-party authorization forms are filed with the IRS and, if completed correctly, processed. Tax practitioners may have hundreds of third-party authorization forms on file with the IRS.

Before the 2018 new identity verification process, third-party callers had to provide the IRS with the taxpayer's name and TIN, the tax period and forms in question and the representative's name and PTIN or CAF number.[104] However, the IRS discovered that cybercriminals obtained and posted stolen Electronic Filing Identification Numbers (EFIN)[105], PTIN and CAF numbers on the Dark Web as a crime kit for identity thieves who would then use the stolen information to access taxpayer transcript data and incorporate that data into fraudulent tax returns (or use for other illegal purposes).[106]

Realizing that the acceptance and processing of third-party authorizations have not kept pace with the current trends in fraud and identity theft, the IRS added the third party's SSN and DOB to the information requested by the IRS Customer Service

[102] I.R.C. Sec. 6103.
[103] Preparer Tax Identification Numbers are issued to those who, for a fee, prepare tax returns or claims for refund. CAF numbers are issued when tax practitioners or their firms file a request for third-party access to client files. Many tax professionals have both a PTIN and a CAF number, and include both on the Form 2848 or Form 8821.
[104] See IRM 21.1.3.3, *supra*.
[105] EFINs are necessary for tax professionals or their firms to file client returns electronically.
[106] See, IR-2018-61, *supra*

Representatives (CSR). The National Association of Enrolled Agents (NAEA) has had reports of other verifying information being requested.[107] The IRS's computer systems require the entire social security number (rather than just the last four digits) of a third-party representative to access the databases used to verify the PII, and therefore the identity, of the practitioner (not the taxpayer).

Practitioners, knowing the damage that can be done with someone's SSN and DOB, expressed concerns about providing their PII for any matter unrelated to their personal business and when privacy is frequently not feasible.[108] For those who do not wish to disclose their PII data, the IRS can send an access code by mail to the original CAF address. Discussions regarding the taxpayer between the IRS and the third party will be delayed until the practitioner receives the access code.[109]

The IRS is seeking to develop a process that would allow third parties to enter their SSN via a telephone keypad, eliminating the need to provide the information to the IRS verbally. This process would allow third parties to maintain the privacy of their SSN regardless of their work environment (e.g., cubicle, open office, etc.) and who may be present during the call to the IRS (e.g., client, co-worker, etc.). The IRS anticipates having this process in place in 2020.

Recommendations

The IRSAC acknowledges the great need for increased security and safeguarding taxpayer data. Attempting to balance security with the taxpayer's right to representation, often in situations demanding immediate access to taxpayer data, is a challenging and continually evolving project. The IRSAC proposes these recommendations:

1. Expedite the Digital Entry Process. Accelerating the digital entry process for third-party SSNs would be beneficial to the IRS, taxpayers and third-party representatives. It may also assist the CSR by eliminating the need to key in the SSN.

[107] See NAEA Letter to Acting Commissioner David Kautter dated 2/2/2018: https://www.naea.org/advocacy/comments-letters/NAEA-Comments-SSN-DOB-IRM-PPS-Line-Security-Questions

[108] The IRS acknowledged this latter concern in March 2018 Security Summit guidance:
"In instances where practitioners are reluctant to provide additional identity-proofing information, for example the client is present in the practitioner's office at the time they are filing the return, the tax practitioner should either ask the client to step outside or put them on the phone to make an oral authorization to the IRS assistor."

[109] The IRS has a digital third-party authentication system (Secure Access) in place for tax practitioners using e-Services where they receive a code via text message or via the IRS2GO application: https://www.irs.gov/individuals/important-update-about-your-eservices-account. Currently the CSRs do not have access to the Secure Access system.

2. Revamp the CAF Number Program. When practitioners file their third-party authorization forms, they are issued a CAF number without having to confirm their identities. If the CAF system is reworked so verification of identity is required before issuing CAF numbers – akin to the PTIN program – stronger security would be in place on a go-forward basis. In addition, layers of protection (e.g., "out-of-wallet"[110] security questions like the name of a third party's grade school, first pet, favorite sport, etc.) could be included in the CAF number setup procedure that would allow verification of the third party to the IRS CSR. In addition, the third party's responses to these "out-of-wallet" questions in front of clients or co-workers would be of little or no consequence. Example: If a third party's grade school was Madison, saying "Madison" out loud in response to a telephone question would not disclose PII. This verification system could replace the need to access the third party's PII.
3. Institute a Voluntary RSA (Rivest-Shamir-Adleman) Tokens Option. RSA SecurID authentication mechanism consists of a "token" – either hardware (e.g., a key fob) or software (a soft token) – assigned to a computer user that creates an authentication code at fixed intervals (usually 60 seconds) using a built-in clock and the token's factory-encoded random key (known as the "seed"). The seed is different for each token and is loaded into the corresponding RSA SecurID server as the tokens are purchased. On-demand tokens are also available, which provide a token code via email or Short Message Service (SMS) delivery, eliminating the need to give a physical token to the user. Using a multi-factor authorization like that used for the e-Services program, a token is given to or purchased by a third party wanting to file third-party authorization forms that would allow both online transcripts and conversations with call-in and walk-in IRS assistors by having a valid token on demand.
4. Incorporate an Authentication Option Tree. The IRS could incorporate a "tree" of other identifying information to authenticate a third party who has provided the CSR with his/her CAF number. The tree could include PTIN, client tax return data, payroll filing data and other data points accessible to the CSRs, with requests for

[110] Out-of-wallet (OOW) is a standard verification component used by financial institutions and others. Private data used for this verification is not found in a person's wallet. Typical out-of-wallet questions are "What was the color of your first car?" or "What was your favorite cartoon character?"

SSN and DOB toward the end of the tree. This tree would have to consider that not all third parties have PTINs or access to client return data, etc. Sometimes, a third party contacts the IRS on behalf of a client and may not have access to the client's tax return. For example, third parties dealing with penalties, innocent spouse situations and other matters outside of a specific tax return may not have ready access to tax return data.

5. Initiate an Automated Callback System through Online Services. The IRS could initiate an appointment setting procedure for callbacks from the IRS to the third party. The third party would go online to request a callback at a specific scheduled time. This is becoming more common in private businesses with high customer service call volumes. This would allow the two-step authentication already in existence with online services to be used for verification and allow better scheduling of IRS personnel to provide phone service to third parties. However, this system may not be ideal depending on the ability to get a call back in a prompt manner. In addition, this process would be difficult when a third party must speak with a specific IRS employee.
6. Leverage the Tax Pro Application. The IRS should use the multi-factor authentication process already in place on e-Services for third parties to retrieve online transcripts. This could be part of the Tax Pro Applications (See Digital Services Subgroup Issue Three).
7. CSR Access to SMS codes. Provide CSRs with a desktop version of IRS2GO, using the existing e-Services process to send multi-factor access codes to the third party.
8. Highlight the CAF77 Request to Third Parties. Publicize on the Tax Pro webpage and in the instructions to authorization forms the procedures for third parties to request every 18 months a CAF77 under FOIA. A CAF77 request response provides a third party with a list of all the taxpayers under the third party's CAF number. We believe if every CAF number holder did this every 18 months much of the fraudulent activity could be eliminated. The IRS should also put prominently on the Tax Pros website (and with the CAF77 response) instructions to third-party representatives on how to notify the IRS if their information has been

compromised. In such cases, the IRS would issue the third party a new CAF number, and valid client authorizations would be moved to the new number. The IRS should also inform third parties to check for duplicate CAF numbers, of which they may not be aware, when they make a CAF77 request. This can be accomplished via letter to the same fax number used for filing third-party forms.

9. Inform the practitioner community. The IRS should continue to communicate the risks of fraud through using stolen tax professional data, identify the problem of stolen third-party authorization numbers on the Tax Pros webpage and warn tax professionals of the ways to reduce the risks (See no. 8). An informed tax practitioner community will go a long way toward eliminating fraud.
10. Enhanced Partnership Strategy. Research what other organizations needing to authenticate telephone inquiries are doing to ensure the identity of the caller, and leverage the research and experience of other agencies and private businesses.

ISSUE THREE: Taxpayer Digital Correspondence (TDC) Pilot

Executive Summary

The IRS conducts examinations (exams) of tax returns to ensure information is reported correctly and to verify the reported information is correct. These exams may be conducted via in-person meetings with the taxpayer or his/her representative, or via correspondence. The IRS generally employs correspondence exams when questioning a specific item or a limited selection of items on a tax return. In December 2016, IRS began a pilot program for conducting correspondence exams via secure messaging, with the intent to have Taxpayer Digital Correspondence (TDC) replace conventional mail and phone interaction between the taxpayer and the IRS. TDC supports the IRS Future State and the IRS Strategic Plan 2018-2022. The IRS asked for the IRSAC's recommendations for increasing participation in the TDC by both taxpayers and tax professionals.

Background

TDC aims to ease the IRS exam process for both taxpayers and the IRS. Digital interaction, working optimally, should decrease the time between initiation and resolution of an exam. With TDC, uploading documents and correspondence securely, a taxpayer and examiner can rapidly share information, communicate quickly through secure and private means, save costs associated with copying documents and maintain an electronic record of all transactions. The ability to send and immediately receive confirmation that documents have been received would enhance taxpayers' experience.

The current pilot program operates solely out of the Philadelphia Service Center[111] and by invitation only. The IRS invites taxpayers to participate by way of a flyer or paragraph[112] included with the initial contact letter, Letter 566 (CG) informing the taxpayer of the correspondence exam. Then, the taxpayer must successfully pass IRS's identity proofing and authentication portal, Secure Access, to opt in and access the TDC interface. The taxpayer (if represented by a tax professional) must opt in before his/her representative can participate via TDC. Both the taxpayer and representative would be required to opt in, pass Secure Access and access the TDC interface in order to participate. If the taxpayer has appointed a representative (POA), the POA should be

[111] The campus exams are no longer assigned geographically, but by issues and workload.
[112] The flyer was used for Phase 1 only. Phase 2 incorporates the TDC invitation into Letter 566(CG).

notified of the initial exam contact and the TDC invitation. Prior to any exam, however, most taxpayers would not have a POA appointed. Thus, the tax professional will not know about the TDC invitation unless the taxpayer/client shares the initial exam correspondence, Letter 566 (CG).

The exams potentially conducted via TDC are campus exams (as opposed to office or field exams conducted out of local IRS offices). Once TDC is elected for an exam, the digital process follows the exam through the administrative procedures. However, by regulation, the 90-day Statutory Notice of Deficiency is sent via certified mail.

In the December 2016 TDC Phase 1 pilot (FY17), involving Schedule A deductions and education credits, the IRS sent out 9,150 invitations and 1,028 taxpayers signed up for TDC – an 11.23 percent participation rate. Ninety-eight percent of the TDC Phase 1 cases are closed. TDC Phase 2, initiated in March 2018, involves 18,500 letters and includes Child Tax Credit (CTC) exams. Statistically, there is not enough data to form a conclusion about changes in participation rates, but the initial data is promising.[113]

During the pilot program, the IRS observed three categories of taxpayers: 1) quick sign-up (Yes), 2) quick decline (No), and 3) taxpayers who start on paper but convert to TDC as the exam progresses. Some taxpayers who opted into the TDC pilot could not continue because of problems authenticating their identity using IRS e-authentication procedures, which may have affected the participation rate. There were only three POA sign-ups, which may be related to the need for taxpayers to opt in (and inform the POA of the TDC invitation) before the POA can participate.

The IRS noted the rate of taxpayer contacts increased dramatically with TDC exams; taxpayers were more engaged than typically seen in mail or phone interaction. The IRS also noted, however, that TDC exams required the same or more time and IRS personnel resources as the paper process. The IRS "cycle time" for TDC pilot opt-ins is improving gradually; the IRS time spent working the case may be longer due to the higher volume of back-and-forth correspondence.[114] The IRS attributes the added time factor to

[113] IRS provided taxpayers who participated in TDC with a Foresee survey. Out of 2,016 respondents the overall satisfaction rate = 82.2% (The survey company has a "top performer" baseline of 77%). 86.1% say they would use TDC again. Out of 29% who had experienced audit by mail, 89% thought TDC was much better than mail. Over 50% of users were very satisfied with the ease of signing up, communicating on the platform, and submitting documentation. Negative feedback was primarily about registration and login issues. IRS is modifying software based on taxpayer feedback.

[114] Phase 1 TDC data as of 8/2018: Cycle time 160 days for TDC/166 days for non-TDC, 4.1 average hours for TDC/2.6 hours non-TDC, 4.08 average number of taxpayer replies for TDC/1.29 for non-TDC, agreed rate 45.2% for TDC/50.3% for non-TDC, no-change rate 26.6% for TDC/24.2% non-TDC.

taxpayers sending information piecemeal rather than as a consolidated response. TDC exams initially move faster but slow down as the exam progresses. Agreed-upon and "no change" cases resolve more quickly, as in most exams, under the TDC pilot program.

The IRS is working toward expanding TDC to include Tax Compliance Officer (TCO) exams, Tax Exempt and Government Entities (TEGE), the Large Business & International operating division (LB&I) and Specialty Tax (estate & gift). The IRS is also looking to expand TDC to another campus (Ogden, Brookhaven or Memphis) for FY 2019.

A TCO pilot began in August 2018. TCOs will conduct the initial meeting in person at a local IRS office, but any needed follow-up can be done via TDC. The Taxpayer Advocate Service (TAS) is also testing TDC in four locations (Nashville, New Orleans, Dallas and Cleveland).[115]

Recommendations

The IRSAC strongly supports TDC. To improve and increase participation in TDC, the IRSAC recommends that:

1. The IRS engage the tax practitioner community and consider an option whereby taxpayer representatives could request to opt into TDC without a prior invitation. The IRS should use its social media channels, IRS Nationwide Tax Forums, local IRS stakeholder liaisons and its relationships with trusted partner organizations to spread the word about TDC and its benefits. Tax professionals, being familiar with IRS exam representation, should welcome the opportunity for working via TDC. A key element in TDC success is engaging the representatives that assist taxpayers in these examinations.
2. The IRS consider adopting a behavioral modification approach to the initial letter taxpayers receive, Letter 566 (CG), similar to the prototypes developed for Collection.[116] Use color, icons, highlights to emphasize the TDC option. Consider what the message is, how to best convey it and how to grab the reader's attention.

[115] Taxpayer Advocate Memo 4/13/2017, Control No: TAS-13-0417-001, Impacted IRM(s): IRM 13.1

[116] The IRSAC 2017 public report, SBSE/W&I Issue Five: One of IRS's Future State themes is to "[u]nderstand noncompliant taxpayer behavior, and develop approaches to deter and change it." Regarding the collection of delinquent taxes, the IRS initiated pilot programs to revise its collection notices. These collection notices are redesigned to understand taxpayer behavior (e.g., what motivates a taxpayer to respond, what draws the taxpayer's eye, what information gets the taxpayer's attention, etc.) and to develop approaches to encourage payment of outstanding liabilities. The IRS has requested the IRSAC review the prototypes for two collection notices, the LT16 and the CP14, and provide comments and suggestions regarding the effectiveness of the notices. https://www.irs.gov/tax-professionals/2017-irsac-sbse-wi-subgroup-report

3. The IRS consider adding a chat option for expediting immediate communication beyond what the current TDC offers. Many private businesses offer online chat functions, and the chat can often resolve simple issues more quickly than email/secure messaging.
4. The IRS collect and analyze data on taxpayers/representatives who begin the TDC process and abandon it. What are the reasons? Is there a common hurdle that discourages participation, and are there ways to enhance the program to encourage greater participation?
5. The IRS consider and publish tips, website content, checklists and step-by-step video presentations for taxpayers (and tax practitioners) responding to correspondence exam notices. Taxpayers may not realize that sending information intermittently is inefficient and delays resolution of their cases. The IRS should consider how an ideal response to an IRS inquiry should be submitted and provide written guidance for taxpayers to follow. This guidance could be displayed on the secure messaging landing page. See Appendix B SB/SE-W&I Subgroup Issue Three.
6. The IRS research what state taxing authorities that conduct exams via digital correspondence provide as guidance to taxpayers.[117]
7. The IRS should explore additional methods to balance security/authentication with taxpayer and tax professional convenience. Taxpayers want the ability to do business on their mobile devices.[118] The IRSAC appreciates that TDC includes IRS's highest level of authentication (Secure Access authentication). Two-factor authentication could be used with the IRS2GO app (similar to e-Services authentication for tax professionals). The IRS should also consider alternative methods for authenticating tax professionals whose cell phone accounts may be tied to their business and not to a personal cell phone account.
8. The IRS consider TDC for the Automated Underreporter Program (AUR) notices. Through AUR, the IRS contacts taxpayers about a mismatch between what was

[117] NYS Department of Taxation and Finance: https://www.tax.ny.gov/pit/letters/recordkeeping.htm ; California Franchise Tax Board; https://www.ftb.ca.gov/professionals/taxnews/tn_tps.shtml and https://www.ftb.ca.gov/Swift/Swift_Manual.shtml#S9
[118] Comprehensive Taxpayer Attitude Survey (CTAS) 2017, p. 7, IRS should prepare for greater demand for tax applications on mobile devices, available at https://www.irs.gov/pub/irs-soi/17ctas_report.pdf.

reported on the taxpayer's tax return and what third parties reported to the IRS. When taxpayers (or their representatives) send materials to the AUR unit via fax or mail, one of the problems is confirming whether IRS has received the information. With TDC, the ability to send and quickly receive confirmation that IRS has received your documents would greatly enhance user experience and should eliminate many of the calls inquiring whether materials had been received.

9. The IRS consider leveraging the TDC document upload platform to reduce submission of paper forms, e.g., Form 1040X, *Amended U.S. Individual Income Tax Return*, Form 13551, *Application to Participate in the IRS Acceptance Agent Program*, older tax returns no longer eligible for e-file, etc.

ISSUE FOUR: Comments on Virtual Currencies[119]

Executive Summary

In the last decade, innovations in virtual currencies have produced new concepts regarding what is a currency, property or security. Virtual currencies are one of those innovations. A "virtual currency" is generally defined as a digital representation of value that functions like a government-issued legal tender.[120] Virtual currency began in the late 2000s and continues to evolve in its concept, application and form.[121] Increased taxpayer use of virtual currencies has generated numerous tax issues and potential tax compliance challenges. The IRSAC was asked for suggestions on how to focus guidance to taxpayers that use or invest in virtual currencies and the practitioners who serve these taxpayers. The IRSAC was also asked for input on compliance and enforcement relating to collection actions on virtual currencies.

Background

Use of virtual currency as a payment method has grown in popularity and has emerged as an alternative to using fiat currencies (i.e., government-issued currency). Virtual currency allows taxpayers to pay for real goods and services as they would with fiat currencies, or to exchange virtual currency for fiat currency. Use of virtual currency, instead of fiat currency, may allow a taxpayer to pay lower transaction fees and achieve faster transfer of funds. Use of virtual currency may also allow taxpayers anonymity in transactions and the possibility of avoiding their tax reporting obligations.

Virtual currency poses tax compliance risks. These risks can arise from nonwillful conduct by a taxpayer (e.g., lack of understanding regarding the taxability of virtual currency transactions, how to calculate basis of gain/loss from virtual currency transactions, how to characterize income, third-party reporting responsibilities, etc.). Compliance risks can also arise from willful conduct by a taxpayer (e.g., using virtual currency to evade taxes).

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[119] The IRSAC has limited this report to the topic of virtual currencies. The IRSAC acknowledges that other virtual economy innovations generate a plethora of tax issues and potential tax compliance challenges.

[120] TIGTA Report, As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance, (Sept. 21, 2016) Ref. No. 2016-30-083, pg. 1, available at https://www.treasury.gov/tigta/auditreports/2016reports/201630083fr.pdf

[121] There are over 1,900 known virtual currencies that can be exchanged for real goods and services and held for investment. See https://coinmarketcap.com/

1. Background on Guidance

As the prevalence and use of virtual currencies have increased, taxpayers and tax professionals have sought guidance on how to correctly report virtual currency transactions. Published formal guidance from the IRS can reduce tax compliance risks arising from nonwillful taxpayer conduct and limit the risks from willful taxpayer conduct.

Multiple IRS divisions (e.g., LB&I, SB/SE and CI Divisions) are working on addressing guidance and policies on virtual currencies. In December 2013, the IRS established the Virtual Currency Issue Team (VCIT), whose members included LB&I, SB/SE, CI and the Office of Chief Counsel. The VCIT provided a forum to share knowledge within the IRS, and it developed training regarding virtual currency.[122] CI had formed a team to study the use of virtual currencies that led to the John Doe summons to Coinbase Inc., the largest U.S.-based virtual currency exchange, seeking the identities of its customers.[123] Recently, LB&I announced a compliance campaign, the Virtual Currency Compliance campaign, which "will address noncompliance related to the use of virtual currency through multiple treatment streams including outreach and examinations."[124]

The Treasury Inspector General for Tax Administration (TIGTA) proposed the IRS develop a coordinated virtual currency strategy that includes outcome goals, a description of how it intends to achieve these goals and an action plan with a timeline for implementation.[125] Such coordination should involve the LB&I, SB/SE and Criminal Investigation divisions. In its response to TIGTA's report, the IRS acknowledged that a comprehensive virtual currency strategy was important and that LB&I would be collaborating with other business operating divisions to identity potential noncompliance and strategies for dealing with such noncompliance, while CI would be coordinating with the divisions to promote fraud awareness and training.

In March 2014, the IRS published formal guidance, in the form of frequently asked questions (FAQs) on virtual currency in Notice 2014-21, *Virtual Currency Guidance*.[126]

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[122] See TIGTA Report, *supra*, (Sept. 21, 2016), at pg. 3.
[123] See Coinbase, Inc., 2017 U.S. Dist. LEXIS 196306, Case Number 3:17-cv-01431-JSC, November 28, 2017.
[124] *IRS announces the Identification and Selection of Five Large Business and International Campaigns* (Jul 2, 2018) available at https://www.irs.gov/businesses/irs-announces-the-identification-and-selection-of-five-large-business-and-international-compliance-campaigns
[125] See TIGTA Report, *supra*, (Sept. 21, 2016)
[126] Notice 2014-21, 2014-16 IRB 938 (3/25/14).

The FAQs presented in Notice 2014-21 provide basic information on the federal tax implications of virtual currency transactions. Notice 2014-21 clarified that, for U.S. federal tax purposes, virtual currency is treated as property and subject to the general tax principles that apply to property transactions (FAQs 1, 2).[127] The FAQs provide guidance on computing gross income, basis, fair market value and gain/loss and the character of any gain/loss (FAQs 3-8).[128] Additional FAQs provide guidance on employment tax and withholding issues (FAQs 9-11, 14), information reporting (FAQs 13, 15) and penalties (FAQ 16).[129] Public comments were solicited regarding the guidance in Notice 2014-21 and the IRS received comments that contained "examples of information requested by the public that would be helpful in understanding how to comply with the tax reporting requirements when using or receiving virtual currencies," per TIGTA.[130]

Notice 2014-21 also directs taxpayers to several IRS publications, notices and forms for additional guidance.[131] However, these publications and forms do not specifically reference virtual currency. Rather, the references in Notice 2014-21 to other forms and publications require a reader to apply traditional principles of tax law on "property" to virtual currency. In general, taxpayers have more "contact" with tax forms and their corresponding instructions (e.g., Schedule D, Form 433-A, etc.) than with IRS notices and rulings, and may not understand language in more formal guidance.

The IRS maintains a webpage, *Virtual Currencies*, wherein it states the IRS has issued guidance on the tax treatment of virtual currency transactions and provides a link to IRS Notice 2014-21.[132] This site further states the sale/exchange, use or holding virtual currencies "generally has tax consequences that could result in tax liability" and Notice 2014-21 applies to these taxpayers.[133]

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[127] Id.
[128] Id.
[129] Id.
[130] See TIGTA Report, *supra,* (Sept. 21, 2016) at pg. 10.
[131] Notice 2014-21 refers taxpayers to: Pub. 15, *(Circular E), Employer's Tax Guide*; Pub. 334, *Tax Guide for Small Businesses*; Pub. 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*; Pub. 525, *Taxable and Nontaxable Income*; Pub. 535, *Business Expenses*; Pub. 544, *Sales and Other Dispositions of Assets*; Pub. 551, *Basis of Assets*; Pub. 1281, *Backup Withholding for Missing and Incorrect Name/TINs*; Forms W-2 (*Wage and Tax Statement*), 1099-MISC (Miscellaneous Income) and 1099-K (*Payment Card and Third Party Network Transactions*); and FS-2007-18, *Business or Hobby? Answer Has Implications for Deductions*, (Apr. 2007).
[132] See https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies
[133] Id.

2. Background on Compliance

In response to a court-enforced John Doe summons to Coinbase, Inc., the IRS received information on approximately 13,000 account holders who used Coinbase's platform for exchanging bitcoin. The IRS is reviewing the information obtained by the Coinbase summons and, when applicable, incorporating the information provided in cases they have in process.

When applicable, transactions using virtual currency need to be reported by third parties using standard IRS forms (e.g., Forms W-2, 1099-MISC and 1099-K). These forms do not require that virtual currency transactions be separately identified. Not all sales of virtual currency require third-party reporting.

Taxpayer and tax professional behavior is often driven by software prompts and diagnostics. LB&I has proposed questions regarding virtual currency transactions to some software providers.

The IRS sought guidance on the ability to locate and seize virtual currency. The IRSAC believes such authority will be developed through state law regarding property rights. However, the IRSAC notes several states are considering accepting virtual currencies as payment for taxes[134] and the IRS could do the same. Section 6311(a) provides that the IRS may receive "any commercially acceptable means [of payment of tax] that the Secretary deems appropriate to the extent and under the conditions provided in regulations prescribed by the Secretary." The corresponding regulations provide for the payment of tax by cash, check, money orders and credit and debit cards. Taxpayers may also pay their taxes with foreign currency.[135]

Recommendations

1. Consider the Proposals and Comments Received. Notice 2014-21 was issued four years ago. Considering the increased prevalence of virtual currency, Notice 2014-21 does not adequately address many tax issues arising from such transactions. In addition to the public comments, several tax-related professional organizations

[134] See, e.g., Illinois Senate Bill 5335, Arizona Senate Bill 1091, Georgia Senate Bill 464. The proposed state legislation provides that, besides any other method of payment provided for by law, the state taxing authority shall accept payment by cryptocurrency for any tax imposed. Further, the state taxing authority will convert the cryptocurrency payments to United States dollars at the prevailing rate within 24 hours after receipt of the payment and credit the taxpayer's account with the converted dollar amount.
[135] See, I.R.C. §6316. Since virtual currency is not treated as a currency for tax purposes, section 6316 would not apply. Rather this section is referenced to show that various forms of payment a taxpayer can use.

proposed areas of guidance relating to virtual currency needed by taxpayers and tax professionals. The IRSAC has reviewed the recommendations for guidance submitted by the American Institute of CPAs (AICPA)[136] and the American Bar Association (ABA) Taxation Section[137] and strongly supports these recommendations. The IRSAC also recommends the IRS identify guidance relating to virtual currency on its upcoming 2018-2019 Priority Guidance Plan.

2. Coordinate Efforts. It is unclear if coordination efforts have developed or if there is a centralized group within the IRS coordinating the IRS's approach to the tax implications of virtual currency. The IRS has successfully implemented other coordinated strategies regarding listed transactions, tax identity theft and offshore reporting matters. Designating a Champion or group to head IRS's coordinated strategy on virtual currency would provide a contact person within the IRS for taxpayers, practitioners and IRS personnel.
3. Update Forms and Publications with Notice 2014-21 Guidance. Not one publication or form in Notice 2014-21 referring taxpayers for additional information references "virtual currency" or "cryptocurrency." The guidance provided in Notice 2014-21 is directed to sophisticated taxpayers and tax professionals requiring the application of traditional principles of tax law on "property" explained in these forms and publications to virtual currency. Such an application can be difficult even for tax professionals. The average taxpayer would probably not know of Notice 2014-21 unless advised by a tax professional or finding a link to it on the IRS's Virtual Currency webpage. Even upon finding Notice 2014-21, the average taxpayer may

[136] See AICPA Comment Letter to IRS dated June 10, 2016 (seeking guidance on acceptable valuation and documentation, expenses of obtaining virtual currency, computation of gains and losses, property transaction rules, character of virtual currency, charitable contributions, need for a de minimis election, holding virtual currency in a retirement account, virtual currency as a commodity, and foreign reporting requirements) available at https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/aicpa-comment-letter-on-notice-2014-21-virtual-currency-6-10-16.pdf; AICPA Comment Letter to IRS dated May 30, 2018 (re-requesting guidance on some of the issues raised in its 2016 letter, as well as guidance on virtual currency events, virtual currency held and used by a dealer, traders and dealers of virtual currency, treatment under sections 1031 and 453) available at https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20180530-aicpa-comment-letter-on-notice-2014-21-virtual-currency.pdf

[137] See ABA Section on Taxation, *Comments on Notice 2014-21,* (Mar. 24, 2015) (identifying issues raised in treating virtual currency as property and recommending additional guidance on character, reporting, compliance and enforceability to ensure the timing and characterization consequences of virtual currency transactions are consistent with cash and/or barter transactions) available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/032415comments.authcheckdam.pdf; and ABA Section on Taxation, *Tax Treatment of Cryptocurrency Hard Forks for Taxable Year 2017*, (Mar. 19, 2018) available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/031918comments2.authcheckdam.pdf

not understand the guidance or how to apply the guidance on a return, form or other tax reporting document. When taxpayers seek guidance on completing a tax form, they typically look to the form itself or the instructions accompanying that form or a publication referenced in the instructions. The guidance in Notice 2014-21 should be incorporated in these tax forms, instructions and publications.[138] Appendix C SB/SE-W&I Issue Four reflects the forms and publications that should be updated to include the guidance in Notice 2014-21.

4. Expand and Develop the Virtual Currencies webpage. The IRS Virtual Currencies webpage does not offer comprehensive resources on virtual currencies[139] and it is not easily found via the IRS search box.[140] Neither the IRS News Release reminding taxpayers that their virtual currency transactions may be reportable (Mar. 2018)[141] nor LB&I's announcement regarding its Virtual Currency campaign that includes the name of the IRS executive leading the campaign, is listed or referenced on the Virtual Currency webpage. The FAQs in Notice 2014-21 should be separately stated on the webpage so they can be easily located by taxpayers and expanded upon as further guidance is issued. Educational videos, brochures and other tools based on Notice 2014-21 should be included on the webpage.[142]
5. Leverage information obtained from Coinbase summons. Where appropriate, the IRS should issue "soft letters"[143] to taxpayers discovered through the Coinbase summons. The soft letter would offer, where appropriate, the taxpayer an opportunity to file amended returns and explain any substantial reporting failures. Further, like it did in its offshore disclosure programs and listed transaction settlement initiatives, where appropriate, the IRS should create Information

[138] Incorporating Notice 2014-21 guidance into IRS form and publications supports the IRS Strategic Plan (FY 2018-2022), *Empower and Enable All Taxpayers to Meet Their Tax Obligation*s, (available at https://www.irs.gov/about-irs/strategic-goals/empower-taxpayers) and will facilitate distribution of and increase the probability of taxpayers finding and understanding virtual currency guidance.
[139] The IRS' *Identity Protection*, *Recognized Abusive and Listed Transactions*, and *Offshore Voluntary Disclosure Program* are excellent examples of comprehensive webpages offered by the IRS.
[140] For example, at www.irs.gov a search of the word "cryptocurrency" results in a hit to the Joint Chiefs of Global Tax Enforcement webpage (relating to transnational tax crimes). Searching with "crypto currency" will bring up the Virtual Currency webpage, News Release IR-2018-71, and approximately 130 other hits that by title alone are unclear on whether they relate to virtual currencies. Last, a search for "Bitcoin" results in a hit to the Virtual Currency webpage and several hits to investigations regarding narcotics, money laundering and other criminal investigations.
[141] See IRS News Release, IRS reminds taxpayers to report virtual currency transactions, IR-2018-71 (3/23/18).
[142] Helpful general explanations, diagrams, and examples regarding virtual currency transactions are published in the U.S. Government Accountability Office's (GAO) report and could be incorporated on the Virtual Currency webpage.
[143] These "soft letters" would be akin to the Letter 6019 the IRS issued to taxpayers regarding foreign accounts. An example of a Letter 6019 is available at https://www.irs.gov/pub/irs-utl/6019.pdf

Document Requests and/or forms requiring these taxpayers to disclose information regarding their virtual currency (e.g., how it was issued, received, spent, bought, sold, traded, where it was held, etc.). If the information obtained from the Coinbase summons shows significant taxpayer noncompliance, the IRS should consider a voluntary disclosure program for taxpayers who may have failed to report taxable virtual currency transactions. The IRS had significant success with its listed transaction and foreign bank account disclosure programs, both of which generated a great deal of valuable information for the IRS, while allowing taxpayers to come back into compliance.

6. Revise Third-Party Information Reporting. Third-party methods of reporting taxable transactions to the IRS (e.g., Forms W-2, 1099-MISC, 1099-K and 1099-B) do not separately identify transactions conducted with virtual currency. One of the best ways to maximize taxpayer compliance with tax requirements is through third-party reporting. The IRS should revise third-party information forms to require identification of transactions conducted with virtual currency. Specific information reporting of virtual currency transactions will not only assist taxpayers in properly reporting their virtual currency transactions, but it would also provide the IRS with data to analyze the risk of taxpayer noncompliance regarding virtual currency. The IRS should also issue regulations on reporting virtual currency transactions akin to brokerage reporting (i.e., Form 1099-B).
7. Re-engage Software Providers. Despite receiving proposed questions regarding virtual currency transactions from the IRS, software providers have not incorporated these questions into their programs. Adding virtual currency to the list of items the software highlights will both educate users and encourage compliance. The IRS should re-engage software providers in incorporating questions regarding virtual currency in questionnaires, diagnostics and software prompts.
8. Accept payment of tax liabilities with virtual currency. The IRS should consider the feasibility of accepting payment of tax liabilities with virtual currency. If the regulations under section 6311 were amended to provide for the payment of tax through virtual currency, the IRS could leverage the information and experience

obtained from voluntary payments of virtual currency to strengthen enforced collections.

Internal Revenue Service Advisory Council

Office of Professional Responsibility Subgroup Report

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Office of Professional Responsibility (OPR) Subgroup consists of a diverse group of tax practitioners, including professionals with credentials as certified public accountants, lawyers and enrolled agents, who work in private practice (in firms of varying sizes) and as a law professor. This year the OPR Subgroup addressed three issues: (1) The Office of Professional Responsibility should publish information on actions taken as a result of its investigations, with no taxpayer or preparer information, (2) Updating Circular 230, with a first step to make ministerial revisions, and then to make the Circular more principles-based and import express references to affirmative duties contained in the Internal Revenue Code and regulations and (3) Creating an affirmative and disciplinary duty under Circular 230 for practitioners and their firms to meet a standard of competency related to technology.

Historically, the OPR Subgroup has enjoyed a solid working relationship with the Office of Professional Responsibility, and this year was no exception. Indeed, OPR personnel were helpful and cooperative in this subgroup's working sessions, contributing data and offering insight for the framework of this report.

The subgroup's recommendations on the following topics are set forth in this report:

1. **The Office of Professional Responsibility should publish Information on actions taken as a result of its Investigations, with no taxpayer or preparer information.**

The IRS Office of Professional Responsibility (OPR) administers all matters related to tax practitioner conduct, including the regulation of "practice" before the IRS and the oversight of all disciplinary proceedings pertaining to tax practitioners found to be in violation of Treasury Circular 230,[144] the regulations governing practice before the IRS.

Circular 230 § 10.51 lists a non-all-inclusive list of 18 types of conduct that could result in the imposition of sanctions for incompetence or disreputable conduct. These range from willfully failing to file one's own returns to conviction of any federal tax crimes or crimes involving dishonesty. It would be a great benefit for practitioners, as well as a

[144] *See* 31 C.F.R. § 10.1 (granting OPR "responsibility for matters related to authority to practice before the Internal Revenue Service" as well as "or matters related to practitioner conduct," including "exclusive responsibility for discipline…disciplinary proceedings, and sanctions"); id. at § 10.2(a)(4) (defining "practice before the IRS").

better deterrent of future conduct, if everyone knew what types of conduct would result in what kind of sanction.

However, many OPR matters are resolved without the institution of disciplinary proceedings. For these voluntarily agreed to matters, published information is limited to statistical information and practitioner information in cases that result in censure, suspension or disbarment. It would promote openness and trust, as well as provide useful guidance and publicity if the Office of Professional Responsibility would publish the resolutions of its investigations in a manner that is consistent with disclosure restrictions.

2. **Updating Circular 230**

Circular 230 contains the Treasury Department's "Regulations Governing Practice Before the Internal Revenue Service." Over the last 35 years, Circular 230 has emerged as *the* prevailing standard of care for federal tax practitioners. No other standard provides such detailed rules of behavior for tax practitioners nationwide, including lawyers, certified public accountants (CPAs), enrolled agents, enrolled actuaries and enrolled retirement plan agents. Moreover, no other standard garners as much respect from tax professionals or imposes such strictly enforced affirmative "duties and restrictions" on tax practitioners, violation of which can result in sanctions for "incompetence or disreputable conduct," including monetary penalties (on practitioners and firms), censure, suspension or disbarment from practice before the IRS.

Unfortunately, the high regard of Circular 230 among practitioners is in jeopardy. The IRS last updated Circular 230 in June 2014. So neglected, the Circular has become outdated, reflecting old law. In spots, it is also inaccessible to the average tax practitioner seeking guidance on her affirmative ethical obligations. As such, Circular 230 is inaccurate, unreliable and not user-friendly. It thus risks losing credibility as the prevailing standard of care for tax practitioners.

The OPR subgroup recommends strengthening the reliability and credibility of Circular 230 in two stages. We further recommend that the IRS implement the first recommendation immediately, with two latter recommendations being implemented over two years.

3. **Due Diligence – Cyber Technology**

As data security risks continue to grow, tax practitioners need to be vigilant with their client's data. We recommend the creation of an affirmative and disciplinary duty under Circular 230 for practitioners and their firms to meet a standard of competency related to technology.

ISSUE ONE: The Office of Professional Responsibility Should Publish Information on Actions Taken as a Result of its Investigations, with no Taxpayer or Preparer Information

Executive Summary

The IRS Office of Professional Responsibility (OPR) administers all matters related to tax practitioner conduct, including the regulation of "practice" before the IRS and the oversight of all disciplinary proceedings pertaining to tax practitioners found to be in violation of Treasury Circular 230,[145] the regulations governing practice before the IRS.

Circular 230 § 10.51 lists a non-all-inclusive list of 18 types of conduct that could result in the imposition of sanctions for incompetence or disreputable conduct. These range from willfully failing to file one's own returns to conviction of any federal tax crimes or crimes involving dishonesty. It would be a great benefit for practitioners, as well as a better deterrent of future conduct, if everyone knew what types of conduct would result in what kind of sanction.

However, many OPR matters are resolved without the institution of disciplinary proceedings. For these voluntarily agreed to matters, published information is limited to statistical information and practitioner identifying information in cases that result in censure, suspension or disbarment. It would promote openness and trust, as well as provide useful guidance and publicity if the Office of Professional Responsibility would publish the resolutions of disciplinary matters in a manner that is consistent with disclosure restrictions.

Background

31 U.S.C. § 330 authorizes the Secretary of the Treasury to "regulate the practice of representatives of persons before the department," including their character, reputation, qualifications and competency. For decades, under regulations promulgated under Title 31 and published as Treasury Circular 230, the IRS has overseen the professional behavior of attorneys, certified public accountants, enrolled agents and other credentialed professionals advising and representing taxpayers before the Internal

[145] *See* 31 C.F.R. § 10.1 (granting OPR "responsibility for matters related to authority to practice before the Internal Revenue Service" as well as "or matters related to practitioner conduct," including "exclusive responsibility for discipline…disciplinary proceedings, and sanctions"); id. at § 10.2(a)(4) (defining "practice before the IRS").

Revenue Service. At times this oversight has been intense, as with respect to tax shelter opinions in the 1980s (see former section 10.33 of Treasury Circular 230) and the written advice standards in the mid-2000s (see former section 10.35 of Treasury Circular 230), while at other times it has been more watchful than assertive. At all times, however, IRS oversight of tax professionals has been guided by the principle that a sound tax system relies on the integrity and competency of tax practitioners.

The IRS Office of Professional Responsibility (OPR) administers all matters related to tax practitioner conduct, including the regulation of "practice" before the IRS and the oversight of all disciplinary proceedings pertaining to tax practitioners found to be in violation of Treasury Circular 230,[146] the regulations governing practice before the IRS.[147]

After providing an opportunity for a hearing, OPR can sanction practitioners who are shown to be incompetent, disreputable, fail to comply with regulations or willingly or knowingly mislead or threaten a client or prospective client. [148] OPR has the authority to:

- Disbar
- Suspend
- Censure
- Reprimand
- Impose monetary fines [149]

Circular 230 § 10.51 lists a non-all-inclusive list of 18 types of conduct that could result in the imposition of sanctions for incompetence or disreputable conduct. These range from willfully failing to file one's own returns to conviction of any federal tax crimes or crimes involving dishonesty. It would be a great benefit for practitioners as well as a better deterrent of future conduct, if everyone knew what types of conduct would result in what kind of sanction.

OPR may issue a complaint, naming the practitioner, which would specify the sanction(s) sought for the violation(s) indicated.[150] While actions within such proceedings can be published in some cases, they are subject to redaction, etc. to protect taxpayer identity.

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[146] In January 2003, the Treasury Department established the Office of Professional Responsibility, before which time (and since 1954) the Director of Practice administered the regulations governing practice before the IRS. See 71 Fed. Reg. 6421, 6422 (2006).
[147] See 31 C.F.R. § 10.1-.93 (2014).
[148] Circular 230 § 10.50
[149] Circular 230 § 10.50;10.62.
[150] §10.62

However, many OPR investigations are resolved without the institution of disciplinary proceedings. For these voluntarily agreed to matters, published information is limited to statistical information and practitioner identifying information in cases that result in censure, suspension or disbarment.

A. Benefits of Publishing Disciplinary Actions

I. Promotes understanding of acceptable and unacceptable behaviors

Publishing the disciplinary actions would provide the IRS with the opportunity to highlight unacceptable behavior. It would let practitioners become aware of conduct that should be avoided or changed if needed. As technologies, issues, actions, etc. change, publicizing inappropriate behavior would give the IRS the opportunity to get "ahead of the curve."

II. Promotes openness and trust.

Identifying inappropriate behavior, and the penalties applicable as a result of this behavior, would promote trust in the system. Practitioners would know that they are being treated equivalently with other, similarly situated practitioners.

B. Discussion of Disclosure

IRC § 6103(a) provides that "return and return information shall be confidential…" IRC § 6103(b)(2) defines "return information" to include, among other items, the taxpayer's identity and information gathered, obtained, received or prepared by the IRS with respect to any tax, penalty, interest, fine, forfeiture, etc. In Chief Counsel Advice 2009-23038, Counsel opined that the determination that an appraiser had been subject to a penalty under IRC § 6701 was return information. The Supreme Court in *Church of Scientology v. Internal Revenue Service,* 484 U.S. 9 (1987) held that, in a Freedom of Information case, the IRS did not have a duty to redact tax return information. The Court held that the mere removal of taxpayer identifying information did not deprive the information of protection under IRC § 6103. The Court noted that the "Haskell Amendment" to IRC § 6103, which provides that tax return information does not include "data in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer" was added during a discussion of insuring that the IRS could continue to issue statistical studies or other compilations of data. A compilation is the grouping or a collection of separate things.

To qualify as tax return information, it must not "identify a particular taxpayer." *Church of Scientology*, 484 U.S. at 15. Further, to be return information, it must be "unique to a particular taxpayer" or be "taxpayer specific." *Tax Analysts v. Internal Revenue Service*, 117 F.3d 607, 614 (D.C. Cir. 1997).

Therefore, OPR could provide a statistical study of current actions, e.g. "OPR investigated 100 cases in which practitioner tax compliance was an issue, of which 50 resulted in actions stronger than a cautionary letter", or OPR could do a compilation of its data, as exemplified by the following examples.

The IRS, in Announcement 2018-11, announced recent disciplinary sanctions. This Announcement received widespread coverage. It was great for both the IRS and practitioners to see what sanctions resulted from the specified actions. The OPR subgroup feels that future actions could be publicized as exemplified below, and they would be equally newsworthy and helpful.

Therefore, the IRS could provide very useful information by identifying problem situations in a manner that is not taxpayer specific. A few examples are as follows:

Example 1

A practitioner failed to file their personal income tax returns for 3 consecutive years. Once contacted by the IRS, the practitioner provided an explanation for this delinquency, fully cooperated and promptly filed all delinquent returns and paid all taxes due. The Office of Professional Responsibility and practitioner agreed to _____ as the sanction.

Example 2

Same facts as in Example 1, except that the practitioner failed to cooperate with the IRS or pay the taxes due. The Office of Professional Responsibility recommended a sanction of _____.

Example 3

A practitioner failed to timely respond to reasonable information document requests from the IRS relating to an audit of one of practitioner's clients. After being

granted several extensions of time to respond, over a period of ___, the practitioner did not provide any responsive information, documents nor provide any explanation for the failure to do so. The Office of Professional Responsibility recommended a sanction of _____.

Recommendations

Publicize the results of all OPR investigations. This transparency will result in:

- Promoting trust. When taxpayers and practitioners know what type of conduct is actionable and what type of sanction is applicable, everyone's trust in the system is enhanced.
- Providing guidance and educational opportunities to practitioners. Providing detailed examples of actionable conduct, along with the range of sanctions and why the sanction was chosen, will provide an invaluable tool and guidance for practitioners and taxpayers alike.
- Uniformity. Practitioners will know what the results of various behaviors will be, and that they will be treated equivalently with other similarly situated practitioners.

ISSUE TWO: Updating Circular 230

Executive Summary

Circular 230 contains the Treasury Department's "Regulations Governing Practice Before the Internal Revenue Service."[151] Over the last 35 years, Circular 230 has emerged as *the* prevailing standard of care for federal tax practitioners. No other standard provides such detailed rules of behavior for tax practitioners nationwide, including lawyers, certified public accountants (CPAs), enrolled agents, enrolled actuaries and enrolled retirement plan agents.[152] Moreover, no other standard garners as much respect from tax professionals[153] or imposes such strictly enforced affirmative "duties and restrictions" on tax practitioners,[154] violation of which can result in sanctions for "incompetence or disreputable conduct,"[155] including monetary penalties (on practitioners and firms), censure, suspension or disbarment from practice before the IRS.[156]

Unfortunately, the high regard of Circular 230 among practitioners is in jeopardy. The IRS last updated Circular 230 in June 2014. So neglected, the Circular has become outdated, reflecting old law. In spots, it is also inaccessible to the average tax practitioner seeking guidance on her affirmative ethical obligations. As such, Circular 230 is inaccurate, unreliable and not user-friendly. It thus risks losing credibility as the prevailing standard of care for tax practitioners.

The OPR subgroup recommends strengthening the reliability and credibility of Circular 230 in two stages. We further recommend that the IRS implement the first recommendation immediately, with two latter recommendations being implemented over two years.

The first recommendation excises old law from Circular 230 and makes other ministerial revisions, including removing all references to the defunct Registered Tax

[151] *See* 31 C.F.R. pt. 10, §10.0 et seq.
[152] *See* id. at § 10.3. *See also* id. at Subpart A, Rules Governing Authority to Practice, §§ 10.1 to 10.9.
[153] *See* Michael B. Lang, *Thinking about Tax Malpractice*, 32 ABA SECTION OF TAXATION NEWS QUARTERLY 1 (Fall 2012) ("When tax practitioners think of who addresses substandard behavior to their colleagues they think of the IRS Office of Professional Responsibility [which enforces Circular 230 rules] and they are right to do so."). For the authority of OPR to administer and enforce the Treasury's practice regulations, see 31 C.F.R. §§ 10.1. *See also* id. at Subpart D, Rules Applicable to Disciplinary Proceedings, §§ 10.60 to 10.82.
[154] *See* id. Subpart B, §§ 10.20 to 10.38 (excluding § 10.33, which is aspirational rather than obligatory, and pertains to "Best practices").
[155] *Id.* at § 10.51.
[156] *Id.* at §§ 10.50(a)-(c). *See also* id. at Subpart C, Sanctions for Violation of the Regulations, §§ 10.50 to 10.53.

Return Preparer (RTRP) program, adding references to the new Annual Filing Season Program, and generally cleaning up the regulations for accuracy and readability.

The second recommendation expands OPR's long-running effort to reformulate Circular 230 towards a more principles-based rather than rules-based collection of practice standards in line with other professional codes of conduct. In 2014, such an effort eliminated the much-maligned covered opinion rules in former § 10.35, and replaced them with a new § 10.37 reflecting "principles to which all practitioners must adhere when rendering written advice."[157] It also included creating a new, principles-based § 10.35 pertaining to practitioner competence that borrowed heavily from the competency rule reflected in the American Bar Association (ABA) Rules of Professional Conduct.[158]

The third recommendation imports into Circular 230 express references to the affirmative duties of a practitioner contained in the Code and underlying regulations that reflect and reinforce the affirmative duties in Circular 230. Ideally, the educational feedback loop would work the other way as well, with the Code and regulations referencing related and relevant affirmative duties contained in Circular 230.[159] In this way, Circular 230 would feature more prominently in a tax practitioner's professional life, and reflect not just Treasury's regulatory authority but also Congress's statutory authority.

Finally, for the last two years, the IRS Advisory Council (by way of the OPR subgroup) has recommended that Congress provide the IRS statutory authority to establish, enforce and require minimum standards of competence for all tax practitioners, including tax return preparers.[160]

To date, those recommendations—which would significantly strengthen Circular 230—have gone unheeded. In this year's General Report, the IRSAC once again recommends that Congress provide the statutory authority recommended in previous

[157] 79 FED. REG. 33685, 33687 (2014). 31 U.S.C. § 10.37 (2014) (requirements for written advice).
[158] Indeed, the language in Circular 230 § 10.35 is nearly identical to the ABA Model Rule 1.1.
[159] To some extent, this educational feedback loop already exists, but only to a small degree. *See e.g.*, Treas. Reg. § 1.6664-4(c)(3) (cross-referencing "rules applicable to advisors" and flagging Circular 230 § 10.22 (regarding diligence as to accuracy) and § 10.34 (regarding standards pertaining to tax returns and documents, affidavits, and other papers); 31 C.F.R. § 10.34(a)(1)(i)(B) (2014) (discussing an "unreasonable position" as defined in "section 6694(a)(2) of the Internal Revenue Code"). Of course, we recognize that amending Code sections is not within the purview of the IRS. However, we also recognize—as highlighted immediately above—that Treasury is free to import pertinent references to Circular 230 in its regulations.
[160] *See* The Internal Revenue Service Advisory Council 2017 Public Report, Office of Professional Responsibility Subgroup Report, "Issue One: The Need for Express Statutory Authority to Confirm the Treasury Department's Ability to Establish, Enforce, and Require Minimum Standards of Competence for All Tax Practitioners, Including Tax Return Preparers" (2017), at 104-11; The Internal Revenue Service Advisory Council 2016 Public Report, Office of Professional Responsibility Subgroup Report, "Issue One: Statutory Authority of the IRS to Establish and Enforce Professional Standards for Tax Practice" (2016), at 57-69.

years. At the same time, to the extent the IRS has been waiting for Congress to facilitate the task of updating, reformulating and improving Circular 230, the OPR subgroup recommends that the IRS set the administrative wheels in motion for amending Circular 230. Indeed, for the sake of preserving the credibility and authority of Circular 230, the OPR subgroup urges the IRS to act now.

Background

Excising Old Law, Adding New Programs and Other Ministerial Changes

The OPR Subgroup recommends that the IRS excise old law from Circular 230, acknowledge a new category of federal tax practitioners and make various ministerial revisions pertaining to outmoded procedures, antiquated dates and deadlines, inconsistent use of terms and errors in grammar and spelling. In addition, the OPR Subgroup further recommends that the IRS seek specific authority to address these kinds of updates through Revenue Procedures or other administrative guidance so that going forward the IRS can keep the Circular updated and thereby preserve its credibility and reliability.

In 2013, the IRS suspended the short-lived Registered Tax Return Preparer ("RTRP") program after court decisions held that the IRS lacked the statutory authority under 31 U.S.C. §330 to regulate un-enrolled tax return preparers and subject them to the requirements of Circular 230.[161]

Today, the program is no longer in effect, yet Circular 230 still contains more than 70 references to registered tax return preparers and the RTRP program. These references are outdated, unenforceable and potentially misleading for practitioners seeking guidance and information on their prevailing standard of care, best practices, enrolled agent renewals, continuing education and other critical information relating to practice before the IRS. Even worse, the outdated and incorrect information currently contained in Circular 230 undermines the credibility, usefulness and authority of the Treasury regulations, and could adversely affect compliance.

[161] *See* Loving v. IRS, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g*, 920 F. Supp. 2d 108 (D.D.C. 2013). Subsequently, and relying on *Loving*, the D.C. District Court held in Ridgely v. Lew (55 F. Supp. 3d 89 (D.D.C. 2014) that the IRS did not have the statutory authority to prevent tax return preparers from charging contingent fees for "Ordinary Refund Claims" (that is, amended returns filed prior to an examination of the original return) on the basis that preparers of such returns were neither "representing" taxpayers nor "practicing" before the IRS as defined in 31 U.S.C. § 330. Through its Return Preparer Initiative, the IRS began the RTRP program in early 2013.

As part of the effort to keep Circular 230 relevant and reliable, the OPR Subgroup further recommends including information and references to the Annual Filing Season Program. In 2014, the IRS unveiled the Annual Filing Season Program to "recognize the efforts of non-credentialed return preparers who aspire to a higher level of professionalism."[162]

Participating preparers receive a "Record of Completion" after obtaining a preparer tax identification number (PTIN) from the IRS, and completing substantial requirements in continuing education (18 hours) and testing (6-hour course plus exam). Furthermore, participating preparers agree to be subject to Circular 230 Subpart B (Duties and restrictions relating to practice before the Internal Revenue Service) and § 10.51 (Incompetence and disreputable conduct). During the 2018 filing season, 61,413 preparers completed the program's Record of Completion,[163] representing the second largest category of tax professionals with PTINs (behind CPAs, but ahead of enrolled agents and attorneys). Moreover, a recent court decision held that the IRS had the authority to offer the program and to regulate its participants, thereby guaranteeing the continued efficacy of the program.[164]

No less important, the OPR Subgroup recommends cleaning up other areas of Circular 230, including:

- Updating the language in § 10.6(d)(2) pertaining to "Renewal" for enrolled agents. In particular, the rolling renewal schedule currently dates to July 2002, and should be replaced by a simple reference to where information on renewal cycles can be found on the IRS website or in published guidance.[165]
- Updating §§ 10.6(f)(1)-(2) pertaining to Continuing Education (CE). In particular, enrolled agents no longer determine the validity of their own CE. Rather, the IRS must issue a valid Course Approval Number.

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[162] Annual Filing Season Program, available at https://www.irs.gov/tax-professionals/annual-filing-season-program. *See also* Rev. Proc. 2014-42; 2014-29 I.R.B. 192.
[163] Return Preparer Office, "Number of Individuals with Current Preparer Tax Identification Numbers (PTINs) for 2018," available at https://www.irs.gov/tax-professionals/return-preparer-office-federal-tax-return-preparer-statistics. This figure is up 13 percent from 2017 when 54,484 preparers participated in the program.
[164] *See* AICPA v. IRS, No. 16-5256 (D.C. Cir. Aug. 14, 2018), reversed and remanded AICPA v. IRS, 199 F. Supp. 3d 55 (D.D.C. 2016).
[165] One such location includes the "Maintain Your Enrolled Agent Status" webpage on the IRS.gov website, which can be reached through the "Tax Pros" and "Enrolled Agent Program" links. *See* https://www.irs.gov/tax-professionals/enrolled-agents/maintain-your-enrolled-agent-status.

- Generally cleaning up inconsistencies and errors in word usage, language and spelling, including but not limited to:
    - "Treasury Department" in § 10.73(d), but "Department of the Treasury" throughout the rest of Circular 230;
    - "IRS" in §§ 10.3(a)-(b), but "Internal Revenue Service" throughout the rest of Circular 230;
    - "Code" in §§ 10.21, 10.34(a)(1)(i)(B)-(C), 10.34(a)(1)(ii)(B)-(C), but "Internal Revenue Code" throughout the rest of Circular 230;
    - Misspelling of "thereunder" as "there under" in § 10.63(a)(3)(i);
    - Awkward spelling of "time frame" as "timeframe" in § 10.71(a);
    - Incorrect citation in § 10.74—"31 U.S.C. § 483a" should be "31 U.S.C. § 9701" as revised by Pub. L. 97-258, 96 Stat. 1051 (Sept. 13, 1982);
    - Inconsistent use of language and possible grammatical error in § 10.76(b): "to be proved," "must be proven," and "must be proved"; and
    - Misplaced use of italics in §§ 10.72(a), 10.72(a)(3)(ii), 10.72(d)(3)(ii), 10.72(d)(3)(iv)(6).

Transitioning Circular 230 to a Principles-Based Code of Conduct

In 2014, under the leadership of then-Director of the Office of Professional Responsibility, Karen Hawkins, the IRS made a definitive move towards transitioning Circular 230 from a rules-based to a principles-based set of practice guidelines. This effort represented the first step in aligning Circular 230 with other professional codes of conduct, including those promulgated by the American Bar Association ("ABA"), American Institute of Certified Public Accountants ("AICPA") and National Association of Enrolled Agents ("NAEA"). In fact, by eliminating the much-maligned covered opinion rules in former § 10.35, and replacing them with a new principles-based § 10.37 pertaining to written advice as well as a new § 10.35 pertaining to practitioner competence that borrowed heavily from the ABA's Rule of Professional Conduct 1.1, the IRS signaled a commitment to a principles-based approach for Circular 230.[166]

[166] This was not the first time the IRS modeled its practice rules on those of tax practitioner organizations. In 2002, for example, the Treasury Department amended Circular's conflicting interests standard several months after the ABA finalized and adopted revisions to its own conflicts standard in ABA Rule 1.7. *See* 67 FED. REG. 48,760, 48,764 (2002) and ABA Center for Professional Responsibility, Evaluation of the Rules of Professional Conduct, Report No. 401 (Aug. 2001). The complementarity of the standards

The OPR Subgroup very much appreciates the IRS's initial efforts to transition Circular 230 from a rules-based to a principles-based document. Moreover, we strongly encourage the IRS to pick up from where it left off in 2014, and to develop over the next year specific and comprehensive plans to revise Circular 230 around a principles-based model. To this end, the OPR Subgroup offers some general suggestions.

First, the IRS should study the ethics codes and rules of professional conduct promulgated by the ABA, AICPA and NAEA as well as other practitioner organizations, including but not limited to the National Association of Tax Professionals, National Society of Accountants and National Society of Tax Professionals. Such organizations have long promulgated practice standards around general principles of conduct rather than particularized rules. For example, there is much to learn in the structure and content of the ABA's Rules of Professional Conduct, the AICPA's Code of Professional Conduct and Statements on Standards for Tax Services and the NAEA's Code of Ethics & Rules of Professional Conduct.

Second, the OPR Subgroup recommends that the IRS, after studying the practice standards of the above professional associations, pay particularly close attention to how it describes mandatory versus permissive behavior under a revised Circular 230. The current rendition of Circular 230 leaves much to be desired in this respect. For example, the current Circular 230 toggles back and forth between using must/must not,[167] shall/shall not,[168] will/will not[169] to depict mandatory practitioner behavior under the Circular. It even uses may/may not,[170] which raises additional confusion as to whether the converse of the permissive "may" is really "may not" or something more definitively prohibitive. Overall, it would be much less confusing to restrict the number of offsetting dyads depicting mandatory behavior to one, and using "may" only in the affirmative permissive sense.

Third, we recommend that a revised Circular 230 include a comprehensive "Definitions" section that covers the entire Circular. Currently, Circular 230 utilizes a

was purposeful, with the Treasury Department stating at the time that its rules had been "modified from the proposed regulations to conform more closely with the approach of the recently revised Model Rule 1.7 of the American Bar Association Rules of Professional Conduct." 67 FED. REG. at 48764.

[167] For "must," see §§ 10.22, 10.28, 10.34(c), 10.35, 10.36. For "must not," see § 10.30.

[168] For "shall," see §§ 10.50, 10.53, 10.71. For "shall not," see §§ 10.29(a), 10.50, 10.71.

[169] For "will," see §§ 10.36(b), 10.53(a). For "will not," see §§ 10.37(a)(2)(vi), 10.50(b)(2), 10.53(d).

[170] For "may," see §§ 10.25(b)(1)-(2) & (4), 10.30, 10.32, 10.34(d). For "may not," see §§ 10.23, 10.24, 10.25(b)(3), 10.26, 10.27, 10.30, 10.31, 10.34(a)-(b).

"Definitions" section in Subpart A § 10.2, but only for the limited purpose of explaining what it means to "practice before the Internal Revenue Service," and defining the specific terms "attorney," "certified public accountants," "Commissioner," "practitioner," "tax return," "Service" and "tax return preparer." A revised Circular 230 should rely on a comprehensive "Definitions" section covering words and phrases such as "knows,"[171] "reasonable"[172] and "reasonably,"[173] "reasonable practitioner standard,"[174] "willful,"[175] "reckless,"[176] gross incompetence"[177] and "informed consent, confirmed in writing."[178] In other instances, it would be helpful for the IRS to provide an example or examples of certain phrases, such as "nature of the relationship between the practitioner and the person"[179] (presumably referring to conflicts, but not specified), "ignore the implications of information furnished to, or actually known by, the practitioner"[180] and "assumptions as to future events"[181] (presumably referring to pre-tax profit potential of a tax-structured transaction or pre-arranged steps in a series of transactions between purportedly independent and arms-length actors, but not specified).

Fourth, as an integral part of transitioning Circular 230 to a principles-based document, the OPR subgroup recommends that the IRS move Subparts A and D out of Circular 230. These subparts contain minutely detailed rules governing, respectively, the authority to practice before the IRS and OPR's disciplinary proceedings for violating provisions of Circular 230. Practitioners certainly need ready access to the information contained in these two subparts, but including such detailed information in Circular 230 would conflict with any effort to make Circular 230 more principles-based and user-friendly.

[171] *See e.g.,* § 10.21.
[172] *See e.g.,* § 10.36.
[173] *See e.g.,* § 10.29.
[174] *See e.g.,* § 10.37(c)(1).
[175] *See e.g.,* §§ 10.34, 10.36(b)(3), 10.51(a)(13).
[176] *Id.*
[177] *Id.*
[178] *See e.g.,* § 10.29.
[179] *See e.g.,* § 10.22(b).
[180] *See e.g.,* § 10.34(d).
[181] *See e.g.,* § 10.37(a)(2)(i).

Cross-Referencing a Practitioner's Affirmative Duties in the Code's Penalty Provisions

The OPR Subgroup recommends importing into Circular 230 specific references to the affirmative duties of a tax practitioner contained in the Code and underlying regulations that reflect and reinforce the affirmative duties in Circular 230.

To a limited extent, Circular 230 already refers to Code sections when describing a practitioner's duties under both the Circular and the Code. For example, when discussing the prevailing standards for tax returns, documents, affidavits and other papers, the Circular states that a practitioner may not sign a return or advise a position that reflects an "unreasonable position as described in section 6694(a)(2)" of the Code.[182] Similarly, Treasury regulations promulgated under the Code refer to parts of Circular 230 when describing a practitioner's duties as to the reasonable cause and good faith exception to § 6662 accuracy-related penalties. Specifically, § 1.6664-4(c)(3) provides a "Cross-reference" to "rules applicable to advisors" contained in Circular 230 § 10.22 (regarding diligence as to accuracy) and § 10.34 (regarding standards pertaining to tax returns and documents, affidavits, and other papers).

The OPR Subgroup recommends that the IRS do more of this kind of cross-referencing in Circular 230. Not only would such cross-referencing explicitly root Circular 230's ethical obligations in substantive tax law, it would alert practitioners to the fact that substantive tax law reflects the ethical obligations described in Circular 230.

Consider some examples of how Circular 230 and the Code reflect and reinforce the same affirmative duties of tax practitioners.

Circular 230 states in several places that a practitioner "may not ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent, or incomplete."[183] For its part, the Code and underlying regulations impose the same duty to inquire on practitioners, requiring that they "may not ignore the implications of information furnished" to them "or actually known" by them, and that they "must make reasonable inquiries if the information as furnished appears to be incorrect or incomplete."[184]

[182] Section 10.34(a)(1)(i)(B)-(C) and § 10.34(a)(1)(ii)(B)-(C).
[183] *See* § 10.34(d) and §§ 10.37(a)(2)(iv), (a)(3), (b).
[184] Treas. Reg. § 1.6694-1(e).

Further, Circular 230 prohibits practitioners, when evaluating the merits of a tax position or transaction, from taking into account the "possibility that a position will not be challenged by the Service (e.g., because the taxpayer's return may not be audited or because the issue may not be raised on audit)."[185] For its part, when outlining the reasonable cause and good faith exception to penalties, the Code states that a taxpayer can only establish a reasonable belief in the tax treatment of an item if, among other things, the belief "relates solely to the taxpayer's chances of success on the merits of such treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit or such treatment will be resolved through settlement if raised."[186]

The OPR Subgroup believes that the IRS should do more to leverage this kind of explicit reinforcement of its ethical requirements contained in Circular 230 and the substantive tax law as enacted by Congress.

Recommendations

1. **Updating Circular 230 for Accuracy and Reliability**. The IRS should excise old law from Circular 230 and make other ministerial revisions, including removing all references to the defunct Registered Tax Return Preparer program, discussing the Annual Filing Season Program and generally cleaning up the regulations for consistency and readability.
2. **Transitioning Circular 230 from a Rules-Based to a Principles-Based Document**. The IRS should expand OPR's long-running effort to reformulate Circular 230 towards a more principles-based rather than rules-based collection of practice standards in line with other professional codes of conduct. This effort should build on the OPR's similar effort completed in 2014, which eliminated the detailed covered opinion rules contained in former § 10.35, created a principles-based competency standard in new § 10.35 and created a new § 10.37 reflecting a principles-based standard for rendering written advice. As part of the effort to transition Circular 230 to a principles-based document, the IRS should consider

[185] Section 10.37(a)(2)(vi).
[186] Section 6664(d)(4)(A)(ii). *See also* Treas. Reg. § 1.6664-4(f)(2)(B) (stating that a corporation may establish that it more likely than not believed that the claimed tax treatment of an item was correct only if the corporation's belief did not "tak[e] into account the possibility that a return will not be audited, that an issue will not be raised on audit, or that an issue will be settled").

moving Subparts A and D out of Circular 230 (which contain minutely detailed rules governing authority to practice and rules applicable to disciplinary proceedings).

3. **Reinforcing the Authority and Relevance of Circular 230 by Cross-Referencing Similar Affirmative Duties Contained in the Penalty Provisions of the Code**. The IRS should import into Circular 230 express references to the affirmative duties of a practitioner contained in the Code and underlying regulations that reflect and reinforce the affirmative duties in Circular 230. To the extent possible, the IRS also should import into its regulations promulgated under the Code's penalty provisions related affirmative duties contained in Circular 230. These recommendations would raise the profile of Circular 230, and remind practitioners of their affirmative and disciplinary duties under the Code and regulations.

ISSUE THREE: Due Diligence – Cyber Technology

Executive Summary

In recent years, hackers and participants in the Dark Web have targeted individuals, businesses (small and large, alike) and even, government agencies. In fact, there are now specific terms used to describe the different type of hackers. They include "Black Hats", "White Hats" and "Grey Hats". Why do they all wear different hats? "Black Hats" are the most malicious. They usually have extensive knowledge about breaking into computer networks and bypassing security protocols. They are also responsible for writing malware, which is a method used to gain access to these systems.

These cyber-attacks continue to increase at an alarming rate. As stated in the IRS Security Summit 101 outline called the "Security Six", even the tax professional community is at risk.[187]

According to a recent report, with tax fraud as a primary focus (i.e., fraudulent refunds), internet crimes resulted in $445 billion in losses. [188] If the cybercriminals can compromise a tax professional, they get access to two key things. One is the private information, often referred to as PII, of that tax professional's clients that can be used to file tax returns on their behalf. In addition to that, they can use the IP address and the computer of the tax professional to actually do the filing with the IRS.

Background

It all started in 1989 when the first computer worm was introduced to computers. A computer worm, simply put, is a malware program, which replicates itself on a computer and then can attach itself to other computers. These worms can do damage to the infected computer over and over again just with an innocent keystroke.

Fast forward to 2017 when Ransomware became the newest threat. Ransomware is a type of malicious software that threatens to publish the victim's data or perpetually block access to it unless a ransom is paid. While some simple ransomware may lock the system in a way which is not difficult for a knowledgeable person to reverse, more advanced malware uses a technique called crypto viral extortion, in which

[187] IR-2018-150, July 27th, 2018
[188] Report from the Center for Strategic and International Studies (CSIS)

it encrypts the victim's files, making them inaccessible, and demands a ransom payment to decrypt them. [189]

In recent years, these hackers have not only targeted the individuals and businesses, they are now focusing on the tax professional community. It does not seem so far-fetched, and it is logical that if hackers want personal data on individuals and business, who better to go after than Enrolled Agents, CPAs, attorneys and unenrolled preparers who handle taxpayer information. So, the Internal Revenue Service has made a concerted effort to educate and inform this profession as to the issues and threats when they kicked off a summertime awareness campaign.[190] They also updated Publication 4557, *Safeguarding Taxpayer Data*, which outlines basic steps the tax professional can take to counter these threats.

In fact, The Gramm–Leach–Bliley Act (GLBA), also known as the Financial Services Modernization Act of 1999[191] (repealing the Glass-Steagall Act), includes a Title V, Subtitle A[192] called the "Safeguards Rule", which governs the treatment of nonpublic personal information about consumers by financial institutions.

Established by the Title X of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[193], the Bureau of Consumer Financial Protection (aka the U.S. Consumer Financial Protection Bureau) regulates consumer financial products and services in compliance with federal law. The "Safeguards Rule" requires that financial institutions develop a written information security plan that describes how the company is prepared for and plans to continue to protect clients' nonpublic personal information. The "Safeguards Rule" applies to information related to any consumers, past or present, for which the financial institution rendered any products or services to. This plan[194] must include:

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[189] 1. *Young, A.; M. Yung (1996). Cryptovirology: extortion-based security threats and countermeasures. IEEE Symposium on Security and Privacy. pp. 129–140. doi:10.1109/SECPRI.1996.502676. ISBN 0-8186-7417-2*
2. *Jack Schofield (28 July 2016). "How can I remove a ransomware infection?". The Guardian. Retrieved 28 July 2016.*
3. *Michael Mimoso (28 March 2016). "Petya Ransomware Master File Table Encryption". threatpost.com. Retrieved 28 July 2016.*
4. *Justin Luna (21 September 2016). "Mamba ransomware encrypts your hard drive, manipulates the boot process". Neowin. Retrieved 5 November 2016.*

[190] IR-2018-147, July 10, 2018

[191] Pub.L. 106–102, 113 Stat. 1338, enacted on November 12, 1999

[192] Codified at 15 U.S.C. §§ 6801–6809

[193] Todd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, Title X, 124 Stat. 1983 (2010)

[194] https://complianceguidelines.com/glba-compliance.htm

- Denoting at least one employee to manage the safeguards,
- Constructing a thorough risk analysis on each department handling the nonpublic information,
- Develop, monitor and test a program to secure the information, and
- Change the safeguards as needed with the changes in how information is collected, stored and used.

The “Safeguards Rule” forces financial institutions to take a closer look at how they manage private data and to perform a risk analysis on their current processes. No process is perfect, so this has meant that every financial institution has had to make some effort to comply with the *GLBA.*

As reported in the 2018 Electronic Tax Administration Advisory Committee (ETAAC) Report released to Congress in June 2018, ETAAC emphasized the importance of requiring strong standards as it relates to cyber security, in general, and identity theft tax refund fraud (IDTTRF or fraud), specifically as it relates to the Internal Revenue Service’s Security Summit.[195]

It should also be noted that the American Bar Association and many states have instituted their own requirements for competency with regards to technology.

The ABA's Model Rules were modified in 2012 to confirm that a lawyer's duty of competence requires keeping "abreast of changes in the law and its practice," which includes knowing "the benefits and risks and associated with relevant technology.”[196] As stipulated in an earlier comment[197], the duty of competence includes the "use of methods and procedures meeting the standards of competent practitioners”.

At last count, 31 states[198] have enacted rules mandating that attorneys become and remain familiar with technologies that may impact their practices. ABA Model Rule 1.6(c) (also updated as part of the effort that added the technological competence language to Rule 1.1) mandates that lawyers make “reasonable efforts” to prevent inadvertent disclosure of or unauthorized access to confidential information. Though it may seem unclear as to what is considered “reasonable efforts”, Comment 18 of Model

[195] 2018 Electronic Tax Administration Advisory Committee (ETAAC) Report, page 30, recommendation #5
[196] Rule 1.1 comment 8 from the ABA Model Rules of Professional Conduct
[197] Rule 1.1 comment 5 from the ABA Model Rules of Professional Conduct
[198] https://www.lawsitesblog.com/2015/03/11-states-have-adopted-ethical-duty-of-technology-competence.html

Rule 1.6(c) states that factors that may be relevant to a determination of reasonableness in this context can include the sensitivity of the information at issue, the cost of additional safeguards and the extent to which such safeguards may impair a lawyer's ability to represent their clients.

Recommendations

We recommend the creation of an affirmative and disciplinary duty under Circular 230 for practitioners and their firms to meet a standard of competency related to technology.

Internal Revenue Service Advisory Council

Large Business & International Subgroup Report

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INTRODUCTION/EXECUTIVE SUMMARY

The LB&I subgroup strongly believes that the tax system operates most effectively, efficiently and equitably when the IRS, taxpayers, taxpayer representatives and other stakeholders work collaboratively. We therefore particularly appreciate the consistent cooperation and courtesy we received from LB&I Commissioner Doug O'Donnell and each member of his team, including, but not limited to, Nikole Flax, Holly Paz, DeLon Harris, Ted Setzer, Jennifer Best, John Hinman, Karen Kirwan, Inigo Zapater, Don Wilson, Robin Greenhouse, Barbara Franklin, Kathryn Patterson, Lisa Shuman, Shawn Hooks, Tina Briscoe and Anna Millikan. Their exceptional efforts to provide us with the information necessary for us to offer recommendations to improve tax administration for the benefit of all stakeholders exceeded all expectations and reflect their commitment to the IRS's mission to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."

In this report, the LB&I subgroup addresses and makes recommendations to facilitate more efficient transfer pricing risk assessments and examinations. Specifically, as discussed further below, we recommend (a) that the IRS further educate taxpayers and their representatives as to how documentation might be improved to increase the potential for earlier audit deselections and efficiencies and (b) that the IRS adopt the recommendations (to which it contributed) in the OECD Country-by-Country Reporting Handbook on Effective Tax Risk Assessment, published in September 2017 (the "OECD Handbook"), and monitor the information from Country-by-Country Reports to determine how the reports can best be used as a tool in transfer pricing risk assessment going forward.

ISSUE ONE: Transfer Pricing Documentation

Background

"Transfer Pricing Issues Make up a substantial portion of the LB&I inventory….LB&I recognizes that it needs to manage transfer pricing issues under examination and related resources in the most efficient and effective manner possible."[199] Taxpayers are required to maintain transfer pricing documentation supporting their return positions in order to avoid penalties in the event of adjustments.[200] With limited exceptions, these documents must be in existence at the time of the filing of the tax return and must be provided within 30 days of a request by the IRS in connection with an examination.[201] During recent years, the IRS and some external practitioners have observed that the quality of some transfer pricing documentation has declined to levels possibly falling short of the requirements of the statute and regulations, but the IRS has not consistently asserted the penalty. Moreover, despite the requirement that documentation exist at the time of filing of tax returns, taxpayers frequently submit more than one version of analysis in support of their transfer pricing.

In January 2018, LB&I issued five Directives to LB&I employees related to transfer pricing examinations and compliance. One of the objectives behind these Directives is to incentivize taxpayers to improve the quality of their transfer pricing documentation. The LB&I Subgroup believes direct guidance to taxpayers from the IRS would promote higher quality transfer pricing documentation not only to meet the existing legal requirements, but also to facilitate more efficient transfer pricing risk assessments and examinations, including potential deselections of taxpayers earlier in the examination process. While some taxpayers may choose to comply only with the requirements set forth in the Treasury Regulations, many are interested in understanding what the IRS views as best practices that could increase the chances of audit deselection or more efficient audits.

Below we summarize the existing transfer pricing documentation requirements (for taxpayers not participating in Advance Pricing Agreements (APAs)), three of the five Directives issued at the beginning of this year, and our recommendations relating to how additional guidance could benefit both the IRS and Taxpayers in satisfying the objectives behind the Directives.

[199] Memoranda for Large Business and International Division Employees, LB&I-04-0118-001 through 003 (January 2018).
[200] Treas. Reg. 1.6662-6(d)(2)(iii)
[201] *Id*.

Overview of Existing Transfer Pricing Documentation Requirements

U.S. Treasury Regulations

In general, Treas. Reg. § 1.6662-6(d)(2)(iii)(A) requires a taxpayer to maintain sufficient documentation "to establish that the taxpayer reasonably concluded that, given the available data and the applicable pricing methods, the method (and its application of that method) provided the most reliable measure of an arm's-length result under the principles of the best method rule in Treas. Reg. § 1.482-1(c)." In addition, the regulations require a taxpayer to provide the documentation to the IRS within 30 days of a request for it in connection with an examination of the taxable year to which the documentation relates. With certain exceptions, the transfer pricing documentation must be in existence when the return is filed.

Treas. Reg. § 1.6662-6(d)(2)(iii)(B) sets forth the principal documents that must be maintained by a taxpayer to satisfy the transfer pricing documentation requirement. The regulations specifically require that the taxpayer's transfer pricing documentation include the following:

i) Business Overview – An overview of the taxpayer's business, including an analysis of the economic and legal factors that affect the pricing of its property or services;

ii) Organizational Structure – A description of the taxpayer's organizational structure (including an organization chart) covering all related parties engaged in transactions potentially relevant under section 482, including foreign affiliates whose transactions directly or indirectly affect the pricing of property or services in the United States;

iii) Section 482 Documentation – Any documents explicitly required under section 482;

iv) Selected Method – A description of the method selected and an explanation of why that method was selected, including an evaluation of whether the regulatory conditions and requirements for application of that method, if any, were met;

v) Alternative Methods – A description of the alternative methods that were considered and an explanation of why they were not selected;

vi) Controlled Transactions – A description of the controlled transactions (including the terms of sale) and any internal data used to analyze those transactions;

vii) Comparables – A description of the comparables that were used, how comparability was evaluated and what (if any) adjustments were made;

viii) Economic Analysis – An explanation of the economic analysis and projections relied upon in developing the method;

ix) Relevant New Data – A description or summary of any relevant data that the taxpayer obtains after the end of the tax year and before filing a tax return, which would help determine if a taxpayer selected and applied a specified method in a reasonable manner; and

x) General Index and Record Keeping – An index of Principal and Background Documents and a description of the recordkeeping system used for cataloging and accessing those documents.

Treas. Reg. § 1.6662-6(d)(2)(iii)(C) sets forth the background documents that taxpayers are expected to maintain to support any assumptions, conclusions and positions contained in the principal documents. Treas. Reg. § 1.482-7(k)(2) sets forth the documentation to be maintained in connection with Cost Sharing Arrangements and also requires coordination with the section 6662 requirements.

BEPS Action Item 13 – Transfer Pricing Documentation (final Sept. 2017)

As a result of the OECD Base Erosion and Profit Shifting (BEPS) project, the IRS has adopted new country-by-country reporting requirements on Form 8975 (*Country-by-Country Report*), which is also referred to herein as the "CbC Report." Certain LB&I taxpayers are required to report their business activity, such as revenue, profits, tax, employees and other attributes, by tax jurisdiction. As noted in IRS Publication 5300, Transfer Pricing Examination Process (8-2018), the IRS views the CbC Report as "a tool intended to provide useful information to analyze high level transfer pricing risk, [BEPS] related risk, and where appropriate, conduct further economic and statistical analysis." In connection with BEPS Action Item 13, many countries are requiring certain Multinational Enterprises ("MNEs") to produce Master Files. The United States obtains some of the Master File information from § 6662 documentation and is not currently requiring production of Master Files for U.S. MNEs at the outset of a transfer pricing examination but might request such documentation during the course of an examination.

Information Required by Forms 5471, 5472, 8858 and 8975 (CbC Report)

Risk assessment for those taxpayers that have chosen not to participate in an APA involves an objective review of risk assessment indicators from information provided by Forms 5471, 5472, 8858 and 8975. Many of the risk factors to be analyzed are outlined in the Handbook On Effective Tax Risk Assessment (see OECD (2017), Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment, OECD, Paris).

Forms 5471, 5472 and 8858 and the attached schedules *Information Return of U.S. Persons With Respect to Certain Foreign Corporations* and *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*, respectively, are all helpful (via fill-in-the-blanks) in identifying the relationships between various U.S. and foreign business entities. Similarly, Form 8975 (CbC Report) requires the taxpayer to identify its business relationships within a single tax jurisdiction (country). Forms 5471, 5472 and 8858 are required to be filed annually with the appropriate tax returns; Form 8975 is required to be filed annually by those U.S. ultimate parent entity groups with gross revenues exceeding $850,000,000.

The transfer pricing documentation burden requirements are extensive, so taxpayers will reasonably require incentives and guidance in order to maintain more than the documentation required by Treas. Reg. § 1.6662-6(d)(2)(iii). We believe the primary incentives that can be offered are the potential for deselection earlier in the audit process or more efficient audits where documentation is more robust and reliable. We also recommend increased direct guidance about risk assessment considerations to taxpayers to increase the potential for audit deselection or to increase audit efficiencies.

Foreign Parents

The following is a comparison of the information reported on Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business) and Form 8975 (CbC Report):

Form 5472	Form 8975 (CbC Report)
Separate information for each corporation	Entities in a country are aggregated
Financial information is prepared using GAAP accounting rules	Information may reflect either book or tax information
Provides aggregated information on transactions with related entities other than the foreign shareholder	All related party transactions are aggregated
Provides breakdown of transactions with non-U.S. shareholder by category	No segregation by category
n/a	Provides country-aggregated financial and other information on related entities other than the non-U.S. shareholder (e.g., sister subsidiaries)
n/a	Includes number of employees by country

Form 5472 provides more specific information on transactions by the U.S. group with its parent and other related corporations. In contrast, the CbC Report aggregates both transactions and financial information. Where Form 5472 might provide additional information, the CbC Report is a view on the assets, income, taxes and employees of all related corporations. This information would not be directly applicable in risk assessing the reported tax liability of the U.S. subsidiary, but it does provide a broader view of the size and profitability of the taxpayer in other jurisdictions.

U.S. Parents

The following is a comparison of the information reported on Form 5471 (Information Return of U.S. Persons With Respect To Certain Foreign Corporations), including Schedule M, and Form 8975 (CbC Report):

Form 5471	Form 8975 (CbC Report)
Separate information for each foreign corporation	Entities in a country (including branches) are aggregated
Financial information is prepared using GAAP accounting rules	Information may reflect either book or tax information
n/a	Includes number of employees by country
Information (including taxes) provided based on GAAP accounting, generally using accrual method	In addition to taxes accrued, also provides taxes paid
Provides information on transactions with related persons by category	All related party transactions are aggregated

The following is a comparison of the information reported on Form 8858 (Information Return of U.S. Persons With Respect To Foreign Disregarded Entities), including Schedule M, and Form 8975 (CbC Report):

Form 8858	Form 8975 (CbC Report)
Separate information for each foreign corporation	Entities in a country (including branches) are aggregated
Financial information is prepared using GAAP accounting rules	Information may reflect either book or tax information
n/a	Includes number of employees by country
Information provided based on GAAP accounting, generally using accrual method	In addition to taxes accrued, also provides taxes paid
Provides information on transactions with related persons by category	All related party transactions are aggregated

In the case of U.S. parent companies, Forms 5471 and 8858 (with Schedule M) provide information based on legal entities rather than a taxpayer's activities grouped by country. Because transfer pricing is applied on a legal entity basis, it is not possible, using the CbC Report, to determine the activity, profitability or assets of any entity if there are multiple entities in a jurisdiction. By contrast, the information on Forms 5471 and 8858 is filed for each controlled foreign corporation and disregarded entity. The additional information provided in the CbC Report, such as the number of employees and taxes paid

(as opposed to accrued), might be of some use in assessing risk, but that information could lead to misleading results if not utilized effectively.

January 2018 Transfer Pricing Directives

In January 2018, LB&I Commissioner Douglas W. O'Donnell issued five Directives, each a "Memorandum for LB&I Division Employees." Three of the five Directives are generally applicable to transfer pricing examinations. Those three Directives are identified as "Interim Instructions on Issuance of Mandatory Transfer Pricing Information Document Request (IDR) in LB&I Examinations," LB&I-04-0118-001; "Instructions for LB&I on Transfer Pricing Selection and Scope of Analysis – Best Method Selection," LB&I-04-0018-002; and "Instructions for Examiner on Transfer Pricing Issue Examination Scope-Appropriate Application of IRS Section 6662(e) Penalties," LB&I-04-0118-003. The remaining two Directives are not directly relevant to the issue of improving examinations through improved documentation, so they are not addressed in this report.

Elimination of Mandatory Transfer Pricing IDR

In 2003, LB&I's predecessor organization issued a directive requiring examiners to issue an Information Document Request (IDR) for the transfer pricing documentation at the beginning of any examination involving cross-border transactions (the "Mandatory IDR").[202] The reasoning behind the Mandatory IDR directive was twofold – (1) to encourage taxpayers to prepare detailed transfer pricing documentation and (2) to allow examiners immediate access to data upon which to evaluate the arm's-length nature of the taxpayer's pricing.

The new Directive revisits the requirements under the 2003 directive and eliminates the Mandatory IDR except in cases where (a) an LB&I campaign contains guidance that includes issuing a Mandatory Transfer Pricing IDR or (b) there are "initial indications of transfer pricing compliance risk" in an examination and in which the exam has been staffed with employees from the IRS's Transfer Pricing Practice (TPP) or Cross Border Activities (CBA) Practice.

[202] Memorandum for LMSB Executives, Managers and Agents from: Larry R. Langdon, Commissioner LMSB Division, "Transfer Pricing Compliance Directive" (January 22, 2003).

Limiting issuance of the Mandatory IDR to these circumstances is consistent with the need for the IRS to manage transfer pricing issues under examination and related resources in the most efficient and effective manner possible and also provides an opportunity for taxpayers with transactions that may be perceived as risky without detailed information to use that documentation to the taxpayer's advantage to limit the scope and duration of the IRS examination process.

Formal Review for IRS Change of Taxpayer Best Method Selection

The new Directive titled "Instructions for LB&I on Transfer Pricing Selection and Scope of Analysis – Best Method Selection" also benefits taxpayers that maintain and provide documentation that facilitates the IRS review process. This Directive, which prevents an examiner from departing from a taxpayer's determined best method unless the change is approved through a formal approval process, applies only to cases where a taxpayer has provided, as part of its section 6662(e) documentation, "a report that both clearly states the method the taxpayer has selected as the best method and the analysis to support that conclusion."

In the context of an examination (as opposed to consideration of an APA application, to which this Directive also applies), the Directive recognizes that, where such documentation is provided, "[to] ignore that analysis and conclusion and start the best method selection analysis from scratch protracts the examination timeline and diverts resources." Although the formal review process relates only to selection of the best method, not application of the best method, the review process set forth in the Directive is an effective incentive for taxpayers to provide a "robust analysis and conclusion to support their selection of the best method."

Reminder To Impose 6662(e) Penalties in Appropriate Cases

The "Instructions for Examiner on Transfer Pricing Issue Examination Scope-Appropriate Application of IRS Section 6662(e) Penalties" Directive provides the following guidance: "IRC §6662(e) penalties should be applied if appropriate." Unlike many penalties, sections 6662(e) and (h) penalties may apply automatically when transfer pricing adjustments eclipse a certain dollar threshold unless the taxpayer maintains

adequate contemporaneous transfer pricing documentation and provides it to the IRS within 30 days of a request.

This Directive specifically references the legislative history to the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-67), which strengthened the penalty rules. In so doing, the Directive states that the "the penalty rules serve the dual purposes of holding taxpayers accountable for the reasonableness of their return positions and helping to motivate taxpayers and their advisors to not only take reasonable return positions but also to adequately document them." The Directive further states that, "[u]nless a taxpayer's IRS §6662(e) documentation is adequate and timely, the regulations require the net adjustment penalty to be assessed in every case where the penalty thresholds are met."

The new Directive reminds examiners that merely maintaining and providing transfer pricing documentation is insufficient. Rather, the documentation must meet the requirements of section 6662(d) and the regulations thereunder. Although statistics are not yet available, it is fair to anticipate that this Directive may increase the incidence of imposition of penalties and that it indirectly put taxpayers on notice that failure to satisfy the documentation requirements set forth in Treas. Reg. § 1.6662-6(d)(2)(iii) would result in penalties.

Recommendations

Our primary recommendation is that the IRS provide more direct guidance to taxpayers with regard to best practices and common flaws in transfer pricing documentation. While some taxpayers may choose to comply only with the requirements set forth in Treas. Reg. § 1.6662-6(d)(2)(iii), many would benefit from additional information on what information and documentation could be included to increase the chance of audit deselection or more efficient audits. In recent years, the IRS has used Frequently Asked Questions (FAQs) to extremely positive effect (i.e., with regard to the offshore voluntary disclosure programs).

In IRS Publication 5300, Transfer Pricing Examination Process (8-2018), the IRS provides as Exhibits B and C examples of timelines for two hypothetical examinations, one of 24 months and one of 36 months. We believe that the potential for deselection of issues earlier in the examination process would be a powerful incentive for many

taxpayers to improve their transfer pricing documentation and that published guidance discussing how taxpayers can achieve robust documentation that may result in early issue deselections and more efficient examinations would be welcome by taxpayers and tax practitioners. We recommend that the IRS issue non-binding FAQs and then hold periodic public meetings with taxpayers and tax practitioners to further expand upon the FAQs. These discussions could include when and how deselections would generally occur, the benefits of improved documentation for taxpayers, and current observations of what the IRS believes are best practices in preparing transfer pricing documentation.

The following is an example of how the FAQs might be drafted:

PROPOSED FAQs

1Q. What benefit(s) might there be for taxpayers who invest in transfer pricing documentation that is more detailed than that required to avoid penalties pursuant to IRC section 6662(e)?

1A. As has often been said, the best defense is a good offense. Typically, the IRS's high-level data analytics process flags a potential transfer pricing issue from tax return information and an examination ensues—UNLESS the review of a robust high-quality documentation report shows mitigation of the initial perceived compliance risk, in which case the issue would be "deselected." Transfer pricing reports exceeding the threshold documentation requirements of section 6662(e) that demonstrate low levels of compliance risk will generally result in deselection of the transfer pricing issue from further examination, because the report will better enable the examining agent to rely on the taxpayer's analysis of functions, risks, intangibles, value drivers, etc. This will save both the taxpayer and the IRS time examining low-risk transfer pricing issues. High-quality transfer pricing documentation facilitates more efficient transfer pricing risk assessments and examinations for both taxpayers and examiners. As an example of the benefit of good documentation, consider the case of a U.S. distributor of heavy machinery that it purchases from its foreign parent. A review of the tax return of the U.S. distributor shows that it had significant losses in 2017, the year under audit. These losses are an indicator that the intercompany prices paid by the U.S. distributor might have been too high. Further analysis is needed to determine whether the losses were due to business circumstances or incorrect pricing. Based on prior history, prices are set so that the U.S. distributor would expect to earn a return of 8% of sales. During 2017 and the two preceding years, the demand for heavy machinery drops dramatically, and the U.S. distributor can sell only a handful of machines. This reduction in sales volume forces the U.S. distributor into a loss. Ideally, the goal of the documentation in this case would be to explain how business circumstances caused the observed financial results and that the losses were not caused by intercompany prices. However, the taxpayer might instead develop a documentation report based on an analysis that reduces the degree of comparability in the selection of comparable companies until the results of the

distributor fall within the interquartile range. This approach would result in additional rounds of IDRs and an unnecessary and lengthy analysis of the reliability of the comparable companies selected by the taxpayer and would stretch out the audit period considerably.

As another example, a foreign subsidiary of a U.S. company licenses technology from its U.S. parent to manufacture widgets for sale in Europe. The foreign subsidiary earns an operating margin of 15%, which might not necessarily indicate high transfer pricing risk; however, the audit team reviews the foreign subsidiary's form 5471, calculates a 60% return on assets (ROA) and concludes that the royalty rate might be too low. Consequently, the audit team would request the taxpayer's documentation. The taxpayer's documentation concludes the royalty rate was reasonable, but there is no analysis to support the selection of the operating margin as the most reliable profit level indicator (PLI) or an explanation of why the ROA is unexpectedly high. As a result, the audit would proceed. Perhaps there is a good explanation of why the ROA is unexpectedly high, such as the European demand for widgets exploded during the year under audit, triggering a sharp reduction in inventories of the foreign subsidiary and the addition of an extra production shift with the same fixed assets. The assets employed per unit of sales went down, thus generating a very high ROA. In preparing the documentation report, the taxpayer should understand there is a possible perception of high risk that needs to be preemptively explained and that there are potential benefits for the taxpayer in doing so. The taxpayer should include in the documentation a description of the market changes that resulted in the very high ROA during the year under audit. This additional explanation would completely change the audit process and help the examiner deselect the issue quickly.

Inefficient exams involve an investment of resources by both taxpayers and the IRS that could be better utilized elsewhere. Even if an issue is not immediately deselected, additional information provided at the outset of an examination could also permit the IRS to raise more focused questions (in the nature of clarifications) more quickly so that, rather than an examination possibly taking years, issues might be raised and addressed within a much shorter time frame.

The only safe harbor against penalties is compliance with the Regulations promulgated pursuant to Internal Revenue Code section 6662(e). However, improved documentation may result in the potential deselection of certain audit issues and/or a more efficient audit. The more complex the transaction, the greater the potential benefit of detailed analysis and documentation.

2Q. What is the IRS's guiding principal in establishing the right prices to be charged in intercompany transactions?

2A. The IRS's guiding principle to establish the right prices to be charged in intercompany transactions is the arm's-length standard. Under the arm's-length standard, the *right* price is the price unrelated parties would have charged under the same or comparable circumstances. The IRS looks for *actual* transactions conducted

between unrelated parties that share the same circumstances as the controlled transaction under review and whatever the unrelated party charged is what the controlled party should charge.

In this paradigm, taxpayers determine the best method for comparing related and unrelated transactions and use that method to check that the controlled prices applied during the year were consistent with those used by uncontrolled parties. If the taxpayer's actual results are not consistent with the comparable uncontrolled results, the taxpayer adjusts its intercompany prices before filing the tax return, explaining that adjustment in its report.

It follows that compliance with the transfer pricing regulations should be *self-enforcing*. The taxpayer and the tax authority should reach the same conclusion, because they have the same information and access to the same comparables data. Thus, a transfer pricing report prepared in good faith by the taxpayer should, in most cases, be sufficient to prove compliance. Once the documentation report is reviewed by the tax authority and after a small number of clarifying questions, the transfer pricing audit should be over.

3Q. What if close comparables cannot be identified?

3A. In reality, the world is not as perfect as described above. For example, it might be very difficult to find direct and close comparables, or they might not exist. Once we leave the world of direct and close comparability, we need to make adjustments to compensate for the imperfect comparability. These adjustments should be applied rationally and follow basic economic principles.

In the field of transfer pricing, there is no established outside organization (such as FASB or the American Appraisal Association) to tell taxpayers *what is right and what is wrong*, or what kind of measurements or adjustments are reasonable or which ones are not, or what are best practices. In addition, the transfer pricing regulations do not discuss every conceivable adjustment. In this context in particular, the IRS has observed that, in some cases where the application of a specified method is not direct and requires comparability adjustments, the quality of transfer pricing documentation has declined and become less useful as a starting point for risk assessment or examination of the arm's-length nature of intercompany pricing. Inclusion of a thorough analysis of how and why adjustments were selected and applied is required by regulation, and that analysis facilitates risk assessment and examination.

4Q. What are some areas the IRS has identified in transfer pricing documentation reports that could benefit from improvement?

4A. Below are some, but by no means all, of the areas the IRS has identified that could benefit from improvement. Strengthening the sections identified below will not provide a safe harbor as against either a continued examination or imposition of penalties but may

result in the deselection of certain audit issues and/or a more efficient audit. The more complex the transaction, the greater the need for detailed analysis and documentation.

4A.1 ***The industry and company analysis sections of the report could be enhanced for clarity.*** These sections should ideally educate the IRS about the industry in which the taxpayer operates and the way in which different related parties operate. The purpose of these sections is to provide information relevant to the transfer pricing analysis. It is, in effect, a place (along with the functional analysis narrative) for a taxpayer to "tell its story." This analysis of the context in which the intercompany transactions take place should give a sense of the total value the multinational enterprise has created.

The comparable profits method ("CPM") analysis may be very different depending on whether the total value is very large or negative. The number of years of analysis used in the application of the CPM could be very different. In this part of the report, it may be helpful to provide information as to expectations versus reality. For example, is the industry experiencing a downturn? If so, either distributor or manufacturer/supplier may experience losses that are difficult to support in a CPM analysis with imperfect comparables. Adjustments may be needed to separate the effects of bad risk realization from the effects of intercompany pricing. The IRS's ability to efficiently and effectively conduct and rapidly conclude transfer pricing risk assessments and examinations should be better in situations where the taxpayer includes a robust analysis of:

- Special business circumstances that might have affected results,
- Effects of discrepancy, if any, between pricing policy and method analysis (e.g., cost plus policy but test is CPM on distributor returns) and any year-end adjustments, and
- Any adjustments made to the CPM (e.g., excess capacity).

4A.2 ***Functional analysis narratives should be robust and link facts to analysis.*** Sometimes a list of facts is provided with no real analysis to connect the business description to the method selection. This type of functional analysis is a checklist of who does what with very little attention to the "analysis." Not linking the business operational structure to the subject transactions and intercompany pricing policy or explaining how and where the value is created that supports the allocation of profits among the parties does not substantially advance an examination toward a conclusion. Analysis should be well-supported factually and should not rely on broad assumptions about the business. Strengthening this analysis can benefit a taxpayer by answering questions before they are asked by the IRS.

4A.3 ***Risk analysis should be based on intercompany agreements.*** Every business faces risks. From a transfer pricing perspective, risks must be identified and then allocated between the controlled parties. Intercompany policies generally establish how risks are allocated. The intended allocation of certain risks can be done directly. For example, the distributor can return all unsold inventory to the related supplier. Other

risks can be determined indirectly by looking at the pricing policy. For example, a "resale price minus" places all market risk on the controlled supplier.
Trying to establish risk allocation without considering intercompany agreements is likely to lead to erroneous conclusions. For example, the statement that "Since USCO's functional currency is the U.S. dollar and it buys in Euros, USCO faces foreign exchange risk" does not establish risk. If you are billed in Euros, you go to the bank, get some Euros and pay. Risk stems from the intercompany agreement and pricing policy and not from the form of currency. For example, if a U.S. company pays its French parent manufacturing cost plus 5%, since manufacturing costs are measured in Euros, the U.S. company bears foreign exchange risk. The U.S. company could pay in USD, but it would still have foreign exchange risk. If the Euro goes up, the U.S. company would have to pay more dollars for the same French widget. That is foreign exchange risk.

4A.4 *Support for best method selection should be provided, as should the reason for rejecting specified methods.* The IRS's recent directives reflect a reaction to a perception by the IRS that the best method analysis and conclusions often could be more robust and more specific to a taxpayer's circumstances. For example, a sentence or two that reads "there are no Comparable Uncontrolled Prices ('CUPs') so we didn't apply the CUP method" is not as helpful as a description of why such comparables do not exist and/or how such determination was made.

To be more specific, when eliminating methods, particularly a Comparable Uncontrolled Transaction ("CUT"), the IRS values documentation that discusses what internal and/or external data was sought. Frequently, a phrase in the taxpayer documentation indicates "We were unable to locate any internal agreements…." Multinationals often maintain internal databases of legal agreements. Documentation of a thorough method selection process should state as clearly as possible the internal and external data that was requested and reviewed in the process of selecting a method. Preparing this documentation contemporaneously should facilitate preparation of the transfer pricing report and could be helpful to taxpayers in the future, as well as in interactions with the IRS.

As a hypothetical example, a company determined a royalty using a Residual Profit Split Method ("RPSM") type model. Through the IDR process, the IRS obtained a list of hundreds of internal uncontrolled agreements where royalties were paid. This list was generated by the legal department, but the tax department and outside advisors had not requested it as part of their documentation analysis. Taxpayer's documentation merely stated that a "prior review" (i.e., very old initial section 6662 analysis) of internal agreements was conducted and that a new search was conducted using an external royalty database. There was no discussion of what search process the taxpayer undertook to locate the data or what was reviewed.

In addition, use of an unspecified method requires a reasoned basis for rejection of specified methods pursuant to the penalty regulations. However, it is not uncommon for taxpayers not to provide a reasoned basis for rejection of the specified methods when an

unspecified method is selected. There may be very good reasons to reject specified methods. Those reasons should be provided.

4A.5 ***Analysis should be provided to support the Profit Level Indicator ("PLI") conclusion.*** The IRS sees reports that say things like "We selected the Operating Margin as the PLI in the application of the CPM, because distributors typically measure their profits as a function of sales." The examiner's conclusion about the arm's-length nature of the taxpayer's results may very well depend on the choice of PLI, which should therefore be substantively supported as thoroughly as possible.

4A.6 ***Complete comparability analysis should be provided.*** The IRS often sees failure to thoroughly address the comparability criteria enumerated in the regulations. In cases where taxpayers use a method like the CUT, they often do not thoroughly address the comparability criteria, such as profit potential. While profit potential is a difficult criterion to analyze, it should not be ignored. A numeric analysis of profit potential may not be possible, but strong indications that the profit potential of controlled and uncontrolled transactions is similar (e.g., the controlled brand and those of the comparable company brands are middle of the road brands) would improve the usefulness of the analysis. In the worst cases, the comparables used in the transfer pricing documentation analysis are not even remotely similar to the tested party or transaction. If CPM comparables are just barely comparable, the documentation should provide additional support for the reliability of the results. For example, if an operating margin of 0.5% falls within the benchmark range but the comparable companies distribute different products from a different industry, explanation should be provided to support the appropriateness of the comparability conclusion.

4A.7 ***The impact of differences in risks or functions between the tested party and the comparable should be provided.*** In an application of the CPM, one of the purposes of performing a risk analysis is to ensure the risks borne by the tested party are comparable to those borne by comparable companies. For example, if the risk analysis establishes that the tested party does not bear inventory risk and the selected comparable companies do bear that risk, the report should either demonstrate that the effect of the difference in risk is inconsequential or perform an adjustment that would increase the reliability of the CPM analysis, if possible. The same logic applies to differences in functions.

4A.8 ***Detailed well-reasoned support for proposed adjustments to the application of a specified method should be provided.*** Adjustments should be made for differences in *comparability factors*, characteristics that would likely have an impact on prices in arm's- length transactions. Those adjustments, including the reasons for the adjustments, should be explained in the report. For example, the tested party's operating expenses to sales ratio is higher than that of the comparable, so an adjustment may be made for the differences in operating expenses and the portion that corresponds to the return on the excess expenses remove from the tested party's returns. In this case, a taxpayer could show first that the larger expenses of the tested

party would be remunerated in the marketplace. What are these excess expenses? Additional services provided to customers or inefficiencies? Is it just an expense classification issue (cost of goods sold of the comparable versus operating expenses in the tested party financials)?

5Q. ***What are some features of the most useful transfer pricing documentation reports?***

5A. Below are some, but by no means all, of the most useful features the IRS has identified. Including these features will not provide a safe harbor against either a continued examination or imposition of penalties but may result the deselection of certain audit issues and/or a more efficient audit.

5A.1 ***Full explanation of the data used in the analysis.*** If segmented data is used, include a description of how the data was constructed, tie data used in the analysis to financial data, and provide complete income statements and balance sheets of the tested party (not just sales, total costs, and profits).

5A.2 ***Descriptions of the general business risks of the transaction and then more detailed descriptions of how these risks are allocated among the controlled participants to the transaction based on the intercompany policies/agreements.*** For example, if manufacturing volume is a risk to the profitable operations, a policy that "ensures" that the distributor makes a 5% margin allocates volume risk to the manufacturer/supplier. As another example, a cost-plus policy allocates foreign exchange risk to the distributor, regardless of denomination of the transaction.

5A.3 ***Reports with more than one CPM that provide a functional and risk analysis for each transaction.***

5A.4 ***Complete comparability analysis of the tested party and comparable companies.*** Identify differences, and explain any resulting adjustments.

5A.5 ***Analysis of special business circumstances that may have affected the profitability of the tested party.***

5A.6 ***Description of challenges of the analysis (e.g., the joint profits were negative, and the challenge is to allocate losses among the controlled participants).***

6Q: Can you provide an example of a helpful Intercompany Transaction Summary?

6A. The below sample summary presentation is very useful for risk assessment to deselect transactions from audit or establish the scope of the transfer pricing audit, which can save a significant amount of examiner time at the beginning of an audit.

Sample Intercompany Transaction Summary

thousands USD

Country	Transaction	TP Doc Location Reference	APA	Amt Reported Local Tax Form	Transfer Pricing Policy	Transfer Pricing Method	Tested Party	Benchmark Range			Actual Results
CA	XYZ America license of trademarks, know-how and tech information from FP	A1	Y	$12,345	Royalty rate = 2% of net sales	CUT	N/A	Royalty Rate	LQ	2.0%	2.10%
									M	3.4%	
									UQ	4.3%	
IT	XYZ America purchase of product from FSub1 for distribution into U.S. market	B2	N	$23,456	Cost plus 10% markup	CPM (3-yr)	XYZ America	OM	LQ	1.6%	OM = 2.9%
									M	3.4%	
									UQ	3.8%	
AS	XYZ America manufactured product sales to FSubA	C3	N	$555	Cost plus 10% markup	CPM (3-yr)	XYZ America	MUTC	LQ	6.1%	Markup = 12.3%
									M	9.4%	
									UQ	17.8%	
CA	FP Provision of IT Services to XYZ America	D4	N	$1,212	Cost plus NO markup	Services Cost Method (SCM)	N/A	N/A	-	-	Cost
									-	-	
									-	-	
CA	FP Provision of IT Services to XYZ America	E5	Y	$7,474	Cost plus 5% markup	CPM (3-yr)	XYZ America	MUTC	LQ	2.4%	Markup = 3.3%
									M	2.5%	
									UQ	6.1%	
AS	XYZ America provision of services to FSubA	F6	N	$2,222	Cost plus 5% markup	CPM (3-yr)	XYZ America	MUTC	LQ	2.9%	Markup = 4.3%
									M	5.8%	
									UQ	12.2%	
CA	FP Provision of IT Services to XYZ America	E5	Y	$7,474	Cost plus 5% markup	CPM (3-yr)	XYZ America	MUTC	LQ	2.4%	Markup = 3.3%
									M	2.5%	
									UQ	6.1%	
AS	XYZ America loan to FSubA	G7	N	$2,000	1.3% Interest	Credit Rating + Bond Interest Rate	N/A	Range	LQ	0.5%	1.31% Interest
									M	1.5%	
									UQ	2.3%	

ISSUE TWO: Use of New Country-by-Country (CbC) Reports for Transfer Pricing Risk Assessment

As noted above, as a result of the OECD Base Erosion and Profit Shifting project, the IRS has adopted new country-by-country reporting requirements. The CbC Reports are being filed with corporate tax returns for the first time on Form 8975. Certain LB&I taxpayers are required to report their business activity, such as revenue, profits, tax, employees and other attributes, by tax jurisdiction. LB&I asked the LB&I subgroup to review the utility of the CbC Reports for Outbound Risk Assessment.

Recommendations

Overall, we believe that the OECD Country-by-Country Reporting Handbook on Effective Tax Risk Assessment, published in September 2017 (the "OECD Handbook"), to which the IRS contributed through active participation, provides excellent discussions relating to (a) incorporating the CbC Reports into a Tax Risk Assessment Framework (Chapter 4), (b) challenges to the effective use of the CbC Reports for Tax Risk Assessment (Chapter 5), and (c) using CbC Reports with data from other sources (Chapter 6). Indeed, Annex 2 (pages 64 to 65) provides an outstanding guide to potential tax risk indicators, what such indicators could mean and how else such risk indicators might be explained. We do not think we can improve on that guidance and offer no further specific recommendations to supplement those included in the OECD Handbook.

We do, however, recommend monitoring the information from the CbC Reports to determine how the reports can best be used as a tool in transfer pricing risk assessment going forward. In addition, it may be of particular value to track the changes in the CbC Reports over the course of the next few years to determine whether there are patterns that demonstrate increased or decreased risk resulting from the Tax Cuts and Jobs Act of 2017.

Appendix A

IRSAC Member Biographies

Brenda M. Bianculli - Ms. Bianculli has worked in the tax field for more than 25 years and is the owner of Brenda M. Bianculli, CPA, LLC, in Charlton, MA. Her firm handles complex tax and business issues for a variety of clients and specializes in the real estate and service industries. Several of her clients are owners of small to mid-size businesses and she works closely with them on various tax preparation and planning issues. She has experience with issues relating to multi-state tax reporting, business sales and acquisitions, stock redemptions, incentive stock options, and estate, gift and trust taxes. Her firm also prepares financial statements and represents clients to resolve income and sales tax matters with the IRS and various state agencies. Ms. Bianculli is currently on the Board of Advisors for Nichols College. She previously served as treasurer of Woman in Business, Inc. She is a member of the American Institute of Certified Public Accountants and the Massachusetts Society of Certified Public Accountants. Ms. Bianculli holds a B.S. in Business Administration (Accounting) from Nichols College in Dudley, MA, and a Master of Science in Taxation from Bentley College in Waltham, MA. **(Digital Services Subgroup)**

Ben Deneka - Mr. Deneka is an industry operations liaison with H&R Block in Pittsburgh, Pa. He manages H&R Block's relationship with the IRS and represents H&R Block in various industry working groups, including CERCA. Additionally, he served as H&R Block's business owner for the IRS Online Service's Where's My Refund API pilot. His IRS strategic partnerships include: ensuring filing-season readiness by coordinating meetings between H&R Block and IRS Submission Processing; partnering with IRS Accounts Management and W&I Communications to reduce costly taxpayer contacts through aligned messaging; and coordinating outreach meetings between IRS Criminal Investigations and H&R Block local field office leaders to partner in the fight against tax-related fraud. Mr. Deneka earned his B.A. degrees in Art and Biology from the University of Mississippi and J.D. from the University of Mississippi School of Law. **(Digital Services Subgroup)**

Diana L. Erbsen - Ms. Erbsen is a tax partner at DLA Piper in New York, New York. She has worked at DLA Piper since 2000, except for a period (between November 2014 and January 2017) when she served as the Deputy Assistant Attorney General for Appellate and Review in the Tax Division at the U.S. Department of Justice. At DLA Piper, she represents business entities, individuals, and trusts and estates in complex federal, state, local, civil, and criminal tax controversies. Federal matters include IRS audits, IRS appeals, and tax litigation in the U.S. Tax Court, U.S. District Courts, and U.S. Court of Federal Claims. At DOJ, she oversaw the Appellate Section, which was responsible for all federal appellate litigation, including to the Supreme Court, as well as the Office of Review and the Financial Litigation Unit, which was tasked with collecting judgments secured by the Trial Sections of the Tax Division. She represented the DOJ on the Advisory Committee on Rules and Bankruptcy Procedure. Ms. Erbsen earned her B.A. degree from Amherst College (cum laude), J.D. from Northeastern University School of Law, and LL.M. (Taxation) from NYU School of Law. **(LB&I Subgroup)**

Sharyn Fisk - Ms. Fisk is Assistant Professor of Accounting at California State Polytechnic University – Pomona, where she specializes in taxation. She is actively engaged in the campus' VITA program. She has participated in the American Bar Association's Adopt-A-Base program, wherein she provided training to military VITA volunteers at a naval base in San Diego. She has researched and drafted several in-depth articles on taxation subjects, including tax identity theft, the Tax Court's standing, and the deductibility of medical expenses. In 2009 on behalf of the California Bar Section of Taxation, she drafted a detailed paper to the IRS regarding the implementation and proposed regulations for IRC section 6676. In 2004 on behalf of the ABA Section of Taxation, she was involved in drafting comments to Treasury and IRS on the National Taxpayer Advocate's Preparer Licensing Proposal. She has been a Certified Specialist in Taxation Law by the State Bar of California Board of Legal Specialization since 2004. Prior to her academic career, she clerked for the Honorable Maurice B. Foley, Judge, U.S. Tax Court in Washington, D.C., followed by both associate and principal positions at Hochman, Salkin, Rettig, Toscher & Perez, PC in Beverly Hills, CA. Ms. Fisk is a member of the State Bar of California, where she served as chair of the Tax Policy & Legislation Committee, and as a vice chair of the Executive Committee – Taxation Section. She is also a member the ABA's Standards of Tax Practice Committee – Taxation Section, and she is the immediate past Chair of the Los Angeles County Bar Association's Executive Committee – Taxation Section. Ms. Fisk holds a B.A. (Journalism) from San Diego State University, a J.D. from Rutgers University and an LL.M. from New York University School of Law. **(SBSE/W&I Subgroup)**

Antonio Gonzalez - Mr. Gonzalez is a CPA and the Founder and Co-Owner of Sydel Corporation in Coral Gables, Florida. It is both an accounting and information technology consulting firm specializing in the financial services industry. In his current role, he designs and develops multilingual applications to assist financial institutions manage both operations and compliance functions. Sydel's flagship product CompliXpert includes a taxation module for FATCA, CRS and 1042-S reporting in addition to proactive, alert-based activity monitoring and watch list name checking technologies leveraged by both domestic and international financial institutions. Mr. Gonzalez is currently an appointed board member of the City of Coral Gables Property Advisory Board and has earned a B.B.A. degree in Accounting from the University of Wisconsin-Madison and a M.S. in Accounting (specialization in Accounting Information Systems) from Florida International University. **(Digital Services Subgroup)**

Kathy R. Hettick - Ms. Hettick, EA, ABA, ATP is the owner of Hettick Accounting & Tax, LLC in Enumclaw, WA, where she has provided accounting and tax services to small businesses and individuals for almost 30 years. She has first-hand experience in addressing the tax needs of clients, working with the IRS to resolve issues, and constantly adapting her practice to account for tax changes. She has held numerous leadership roles at the local, state and national levels of organizations, including the National Society of Accountants (NSA), the National Association of Enrolled Agents, the Washington Association of Accountants and the Washington Association of Enrolled Agents. With NSA, she has served as president, 1st and 2nd Vice President, Administrative Chair and State Director for Washington. Ms. Hettick was President of the Washington Association of Accountants. Since 2004, she has routinely instructed in-person and online courses on

ethics and Circular 230. For the past seven years, Ms. Hettick has presented seminars at the IRS Nationwide Tax Forums on behalf of NSA. For several years, she was a panel member on the OPR ethics panels at the tax forums. She served as Chair of the IRS Working Together Symposium in Washington State, where she coordinated with several other tax and accounting organizations, including the local IRS liaison team, to produce annual events. **(IRSAC Vice Chair and OPR Subgroup)**

Stuart M. Hurwitz - Mr. Hurwitz, J.D., LL.M, is owner of CPA & Law Offices, in San Diego, CA. He has over 45 years of experience in business and taxation. His legal and tax practice serves a wide breadth of U.S. citizens and persons and entities of various nationalities from those with a high net worth to many of more modest means who are involved in or want to enter the United States business environment or who have foreign bank accounts, foreign business investments, real estate, estate and gift, employment and income-related issues. Mr. Hurwitz's diverse and disparate work experience includes that of a U.S. Army prosecutor and contracting officer, land developer and home builder, and president of a non-profit. He has served on numerous occasions as an expert witness for tax and accounting issues in both Federal and State courts. Mr. Hurwitz is certified by the State Bar of California as a Tax Specialist and is a Chair Emeritus of the 3,200-plus member Taxation Section of the State Bar of California. He has been repeatedly honored as a *Super Lawyer*, one of *San Diego's Best Attorneys* (by the Union Tribune), and a *5 Star Wealth Manager*. His education includes a B.S. in (Accounting) from the Ohio State University, a J.D. from the University of Nebraska School of Law, and an LL.M. in Taxation from the University of San Diego School of Law. **(LB&I Subgroup)**

Sheldon M. Kay - Mr. Kay has over 40 years of experience as a CPA and an attorney. He is currently Partner for Crowe, LLP, CPA, in Atlanta, GA, where he represents clients before all divisions of the IRS and coordinates the Washington National Tax Office. Between 2011 and 2013, he served IRS as the Chief and Deputy Chief, Appeals. He was personally involved with multiple Appeals initiatives, including Appeals Judicial Approach and Culture, Ex Parte Rev. Proc. 2012-18 and coordination of the review of the alternative dispute resolution procedures by Harvard University's Negotiation and Mediation Clinical Program. Mr. Kay has taught the following tax courses at the university level: Tax Practice and Procedure, Basic Income Taxes, Corporate Income Taxes and Tax Accounting Methods. He is also a frequent speaker before the Tax Executives Institute, various bar associations and state CPA societies. He is a member of the Georgia, Missouri, Illinois, Wisconsin and DC Bar Associations. He is a CPA in the state of Georgia and is a fellow of the American College of Tax Counsel. Mr. Kay received his undergraduate degree (Accounting) from Northern Illinois University and holds a J.D. from John Marshall Law School. **(OPR Subgroup Chair)**

Phyllis Jo Kubey - Ms. Kubey has over 30 years of experience in taxation. She is the owner of Phyllis Jo Kubey, EA CFP ATA ATP Tax Preparation & Consultation in New York, NY – offering tax preparation, planning, and representation services to a diverse population of clients. She is actively involved with professional associations at the local, state and national levels. She is a member of the National Association of Enrolled Agents (NAEA) and the New York State Society of Enrolled Agents (NYSSEA). She served as moderator for NYSSEA's Tax Questions Google Group, an online tax-related discussion

forum. She is the Chair of NAEA PAC Steering Committee and regularly attends NAEA's national conferences and board meetings. She is an officer of NYSSEA, and currently serves on its Membership, Government Relations and IRS Continuing Education Reporting Committees. She is also NYSSEA's liaison to the New York State Department of Taxation. As the liaison, she actively builds relationships with and further opens lines of communication between the tax professional community and the State of NY. Ms. Kubey is a member of the National Association of Tax Professionals, the National Society of Accountants, the National Society of Tax Professionals, the Financial Planning Association, and is a non-attorney member of the American Bar Association. Ms. Kubey is a professionally-trained vocalist and is a certified teacher of the Alexander Technique. Ms. Kubey holds a Bachelor of Fine Arts from Carnegie-Mellon University and a Master of Music (Voice) from The Juilliard School. **(SBSE/W&I Subgroup Chair)**

Charles (Sandy) Macfarlane - Mr. Macfarlane has 36 years of experience in corporate tax. He is Vice President and General Tax Counsel for Chevron Corporation in San Ramon, CA, where he is responsible for Chevron and its subsidiaries' worldwide tax affairs. He manages the Corporate Tax Department of 140 professionals and serves as functional tax leader for tax professionals in Chevron's foreign subsidiaries. Employed with Chevron for the past 30 years, his previous positions included Assistant General Tax Counsel and Tax Compliance Manager. He led the team that designed and implemented transfer pricing documentation. When FIN 48 was issued, he led the group that established Chevron's process to ensure accurate financial reporting for uncertain tax positions. He managed Chevron's Tax Compliance group through a major overhaul of its U.S. income tax compliance process, adopting new software, streamlining processes and moving from the September 15 return filing to early July filing. He is a member of Chevron's Management Committee and the Finance Leadership Committee. Mr. Macfarlane served as Chair of the Tax Legislative Committee for the American Petroleum Institute for 11 years, and he represented Chevron on the tax committees of National Foreign Trade Council, U.S. Council for International Business, American Chemistry Council and Business Round Table. Mr. Macfarlane is past international president of the Tax Executives Institute, where he has been a member for 20 years. He is a member of the American Bar Association Section of Taxation. Mr. Macfarlane holds an A.B. (History) from Brown University, a J.D. from Boston College Law School and an LL.M. (Taxation) from the Boston University School of Law. **(LB&I Subgroup)**

Shawn R. O'Brien - Mr. O'Brien is a tax partner with Mayer Brown, LLP, in Houston, Texas. His tax practice includes representing clients in all types of tax disputes with taxing authorities on international, federal and state levels. Mr. O'Brien routinely advises clients on various tax issues during tax examinations, in administrative appeals and as an advocate in trial and appellate litigation before the U.S. Tax Court, U.S. District Courts and U.S. Court of Federal Claims. Mr. O'Brien's tax controversy and litigation experience spans a broad range of areas, including transfer pricing controversies, debt v. equity issues, international withholdings, advance pricing agreements, "tax shelter" disallowances, research and development tax credits, excise taxes, and changes in accounting methods. Mr. O'Brien also advises foreign and domestic corporations, partnerships, MLPs, and LLCs seeking corporate and tax advice regarding various types of foreign and domestic transactions, including 1031 exchanges, mergers and

acquisitions, restructurings, divestitures, leveraged buyouts, structured financings, and oil and gas transactions. He is a CPA licensed in Louisiana. In addition, he is particularly focused on a variety of tax issues facing the energy industry including tax controversy, joint ventures, restructuring acquisitions and disposition of energy assets. Mr. O'Brien has written numerous tax articles and regularly presents to tax groups around the country. Mr. O'Brien is a member of the Tax Section of American Bar Association, Houston Bar Association Tax Section, International Tax Roundtable, and Federal Tax Procedure Group. Mr. O'Brien holds a B.B.A. in Accounting from Millsaps College in Jackson, Mississippi, a J.D. from Loyola University School of Law in New Orleans, LA, and an LL.M, Taxation, from New York University School of Law. **(LB&I Subgroup Chair)**

Charles Read - Mr. Read is a CPA and the Founder and CEO of Custom Payroll Associates Inc. in Lewisville, Texas, where he has provided full service payroll and payroll tax services since 1991. He is also Founder and CEO of Payroll on a Budget, GetPayroll, and the Simon Payroll App. His extensive background stretches across accounting, tax, manufacturing, construction, IT, marketing, transportation, logistics, human resources, wholesale distribution, and insurance. As the head of Custom Payroll Associates Inc., he leads business development, strategy, and operations for a full-service B2B payroll and payroll tax processing company that helps small to medium-sized businesses across the U.S. with direct deposits, debit card loads, printed checks, payroll deposits, reports and tax filings, year-end Forms W-2, and employer-employee website portals. He is the author of three E-books: Starting a New Business: Accounting, Finance, Payroll, and Tax Considerations, Small Business Short Course (Employees Book 1), and The Little Black Book of the Beauty Biz, Volume 1 The secrets of business critical to a salons success. He passed the U.S. Tax Court Non-Attorney Practitioner's Examination, which enables him to represent clients in the U.S. Tax Court without being an attorney. Mr. Read earned his B.B.A. (cum laude) and M.B.A. from the University of North Texas. **(SBSE/W&I Subgroup)**

Martin Rule - Mr. Rule is a CPA and Senior Manager with Deloitte Tax LLP in Chicago, Illinois. He has over 20 years of experience as a tax and accounting professional. He is a subject matter expert in both tax management and payroll processing with a range of knowledge stemming from employment with academic institutions, private tax practitioner businesses, and healthcare institutions. Prior to his work at Deloitte, he was the Director of Payroll and Tax at Northwestern University and at Lurie Children's Hospital. Throughout his career, he has engaged in improving and developing electronic systems and tools for managing federal, state, and local employment tax and information reporting. Key to his success is his passion for training others. He currently coaches staff at Deloitte Tax to exceed client expectations. He was also a part-time lead tax instructor at DePaul University, where he developed and presented lectures for the individual income tax module of the school's Certificate of Financial Planning Program. Mr. Rule earned his B.S. in Accounting from Northeastern Illinois University and his M.S. in Taxation from Northern Illinois University. **(Digital Services Subgroup)**

Stephanie Salavejus - Ms. Salavejus is vice president with Peninsula Software (PenSoft) in Newport News, VA. She is responsible for software solutions and product requirements for clients. She has 28 years of experience in electronic filing of tax reports and software

development. She is a member of the American Payroll Association, obtaining her CPP designation in 2000 and, also a member of the National Association of Computerized Tax Processors. She regularly speaks on tax administration topics related to payroll. Ms. Salavejus earned a B.S. in Accounting from Christopher Newport University in Newport News, Virginia. (**Digital Services Subgroup Chair**)

Jeffrey Schneider - Mr. Schneider has 35 years of experience as an Enrolled Agent and currently is Vice President of SFS Tax & Accounting Services in Stuart, Florida. His company handles all areas of tax for multiple types of taxpayers, including bookkeeping, payroll, and other related services. Prior to joining SFS in 1999, he worked in private practice for 20 years. He is a Fellow of the NAEA National Tax Practice Institute and a Certified Tax Resolution Specialist. He currently serves on NAEA's Board of Directors. Most recently, he was involved in creating NAEA's strategic plan and hiring the new Executive Vice President. He previously served as Chair of NAEA's National Government Relations Committee. He is a national speaker on all things tax, including Circular 230 and ethics. Mr. Schneider earned his B.S. in Finance from College of Staten Island and his Master of Science in Tax from Long Island University. **(OPR Subgroup)**

Dave Thompson, Jr. - Dr. Thompson has 40 years of experience in taxation. He currently serves as the Director/Master of Accounting and Chair of the Accounting and Finance Department for Alabama State University in Montgomery, Alabama, where he prepares students for professional careers in public accounting and management and government. This program helps students to achieve professional certifications in accounting, such as Certified Public Accountant (CPA), Certified Internal Auditor (CIA), and Certified Management Accountant (CMA); and to pursue terminal or Ph.D. degrees. He is also serving as an AICPA Academic Champion. Dr. Thompson has helped to coordinate partnership efforts for many colleges as one of the leaders who formed the "Path To Financial Independence" group. This group provided partnerships between 20 different "Historical Black Colleges" and corporations to bring financial literacy education to thousands all over the United States. In addition, he helped put together partnerships with banks, financial institutions and philanthropic organizations to provide tax services and financial education. He has been chosen as an Albert Nelson Marquis Who's Who Lifetime Achievement inductee. Dr. Thompson holds a B.S. (Accounting) from Birmingham-Southern College, an M.B.A. (with M.A. concentration in Management/Accounting) from Samford University in Birmingham, AL, a J.D. from Birmingham School of Law and a Ph.D., from Jackson State University in Jackson, MS. **(LB&I Subgroup)**

Patricia Thompson - Ms. Thompson is a CPA and Tax Partner with Piccerelli, Gilstein & Company, LLP in Providence, Rhode Island. She has extensive experience in complex tax transactions including multi-state tax returns, real estate transactions and like-kind exchanges. She focuses on assisting clients with the intricacies of sale transactions to minimize income tax consequences, business and financial consulting, and audits with governmental agencies. In addition to directing the firm's tax department, she has distinguished herself in the accounting profession both at the state and national levels. She is a member of the Rhode Island Society of CPAs, where she previously served on the Board of Directors and held the positions of Secretary, Treasurer, Vice President, and

President. At the national level, she served as Chair of the AICPA Tax Executive Committee, which is AICPA's final authority on policy recommendations relating to national tax legislation, tax administration, and ethical standards. She is currently the Chair of the AICPA Relations with The Bar Committee, which maintains cooperative professional relations with the American Bar Association to identify areas of mutual concern to the professions and seeks to have them addressed through mutual discussion and concurrence. Ms. Thompson earned her B.S. in Accounting from the University of Rhode Island and her Master of Science in Taxation from Bryant College, and she received the Personal Financial Specialist (PFS) designation from AICPA. **(SBSE/W&I Subgroup)**

Dennis J. Ventry, Jr. - Dr. Ventry has worked in the tax field for over 20 years and is a Professor of Law at UC Davis School of Law in Davis, CA. Dr. Ventry's areas of specialization include Standards of Tax Practice, Tax Administration and Compliance, Tax Expenditure Analysis, Tax Policy, Legal & Professional Ethics, Whistleblower Law, Family Taxation, and U.S. Economic, Legal, and Tax History. He has published dozens of articles, contributed chapters to books, authored edited volumes, and is co-author of a federal income tax casebook whose original author was legendary Harvard law professor Stanley Surrey. Dr. Ventry participates in federal and state tax debates over tax reform, administration, and policy through public testimony and amici curiae briefs, face-to-face meetings with tax officials, legislators, and legislative staff, and as a member of tax commissions, workgroups, and committees. In addition, Dr. Ventry serves as an expert consulting/testifying witness in matters involving the standard of care for tax practitioners, and he also teaches CLE/CPE classes on standards of tax practice. Dr. Ventry is a member of the American Bar Association, the Association of American Law Schools, the Law and Society Association, and the National Tax Association. Dr. Ventry holds a J.D. from New York University School of Law, a Ph.D. in History (U.S. Economic & Legal) from the University of California, Santa Barbara, an M.A. in History from the University of California, Santa Barbara, and a B.A. in History with a specialization in Business Administration from the University of California, Los Angeles. **(IRSAC Chair and OPR Subgroup**)

Appendix B

SB/SE-W&I Subgroup Issue Three - Taxpayer Digital Correspondence (TDC)

GENERAL TIPS

- Don’t panic! You may be nervous when you receive a letter from the IRS, but remember that we’re all working toward the same goal – ensuring that you pay the correct tax, no more/no less.
- Think like an investigative reporter. Show the examiner the “who, what, where, when, and how” of each item. Remember, it’s obvious to you what you did and why you did it. The examiner needs your help so he/she can understand too.
- Complete and include any questionnaires the examiner sends you.
- Communication is critical. If you need additional time to submit the required information and documentation, please let the examiner know.

AFTER YOU’VE COLLECTED YOUR DOCUMENTS, HERE ARE SOME TIPS FOR ORGANIZING THEM

- Try to submit all of your documentation simultaneously.
- If submitting information for more than one examination issue, organize the documents by issue. Organizing your documents will help the examiner quickly consider them and understand what you the IRS to consider.
- Number your pages, so you and the examiner can find things quickly and easily.
- Include a summary page of the documentation you are submitting and the page numbers of where to find each document.
- When sending receipts or statements, include the page with the name of the company or institution issuing the statement and the identity of the owner. Sometimes this information is only included on the first page of the statement.
- Dates are critical in an exam. Make sure your receipts and documents are for the correct tax year. Be sure the dates are visible on the documents, including the date an expense was incurred or paid.

Appendix C

SB/SE-W&I Subgroup Issue Four - Comments on Virtual Currencies

Form, Schedule, Publication	Title
Form W-2 & Instructions	*Wage and Tax Statement*
Form 433-A	*Collection Information Statement for Wage Earners and Self-Employed Individuals*
Form 1042 & Instructions	*Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*
Form 1099-B	*Proceeds from Broker and Barter Exchange Transactions*
Form 1099-MISC	*Miscellaneous Income*
Form 1099-K	*Payment Card and Third Party Network Transactions*
Form 8938 & Instructions	*Statement of Specified Foreign Financial Assets*
Form 8949 & Instructions	*Sales and Other Dispositions of Capital Assets*
Publication 15	*(Circular E), Employer's Tax Guide*; Pub. 334, *Tax Guide for Small Businesses*
Publication 515	*Withholding of Tax on Nonresident Aliens and Foreign Entities*
Publication 525	*Taxable and Nontaxable Income*; Pub. 535, *Business Expenses*
Publication 544	*Sales and Other Dispositions of Assets*
Publication 550	*Investment Income and Expenses*
Publication 551	*Basis of Assets*
Publication 1281	*Backup Withholding for Missing and Incorrect Name/TINs*
Publication 1854	*How to prepare a Collection Information Statement (Form 433-A)*
Schedule A & Instructions	*Itemized Deductions*
Schedules C or C-EZ & Instructions	*Profit or Loss From Business*
Schedule D & Instructions	*Capital Gains and Losses*
Schedule E & Instructions	*Supplemental Income and Loss*
Form 4797 & Instructions	*Sales of Business Property*