

Internal Revenue Service Advisory Council

# PUBLIC REPORT

November 2019



# INTERNAL REVENUE SERVICE ADVISORY COUNCIL

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*IRSAC member biographies can be found in Appendix A*



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**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 the Internal Revenue Service. 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.

In 2019, with the active assistance of current and former members of IRSAC and the Information Reporting Program Advisory Committee (IRPAC), and the Advisory Committee on Tax Exempt and Government Entities (ACT), there was a consolidation of the three FACA advisory groups that report to the Commissioner: the IRSAC, the IRPAC, and the ACT into a single group under a larger and reconstituted IRSAC. The new IRSAC includes four subgroups reflecting the four business operating divisions (BODs) of the IRS: Large Business and International (LB&I), Small Business/Self-Employed (SB/SE), Wage & Investment (W&I) and Tax Exempt & Government Entities (TE/GE). Aligning IRSAC’s subgroups with the BODs had several beneficial effects, including facilitating efficient flow of information between the IRSAC and the BODs which provided real-time advising;

elevating more issues to the BODs; holding the BODs more accountable for assisting the IRSAC in developing IRSAC's issues and reporting back on the implementation status of the issues.

The IRSAC membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, academia, the non-profit community and the payroll community. This year's IRSAC consisted of 35 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 necessary to help members advance the IRSAC's mission.

Collectively, IRSAC members represent the agency's major stakeholders, customer segments and a broad cross-section of the taxpaying public. 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.

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 Brown, NPL Program Manager; Maria Jaramillo, W&I Subgroup Liaison; Brian Ward, TE/GE Subgroup Liaison; Carolyn Sanders-Walsh, SB/SE Subgroup Liaison; and Rose Smith, LB&I Subgroup Liaison.

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. 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 thanks Commissioner Charles Rettig for his support and leadership. We appreciate his understanding of the value of the IRSAC, having served as a prior member and chair. We take to heart his passion for civility, diversity and inclusion; the challenge to serve, and make the IRS a better functioning tax administration. Commissioner Rettig's respect for the value of IRSAC's independence and constructive criticism encouraged its public members to offer multiple perspectives and recommendations and also encouraged IRS subject matter experts to fully collaborate with the public members. In the words of the Commissioner, "if it is out there, take a swing at it!"

This General Report summarizes the IRSAC's work during 2019 and presents our recommendations to the Commissioner and other IRS leaders. The year brought challenges for the IRSAC, not only with the complete re-organization and expanded committee structure, but starting the year with a 35-day government shutdown. This caused the January orientation to be cancelled and as a result, the IRSAC members got a late start on issue development, working harder under a shorter timeframe to develop and research relevant tax administration issues. Every member of the IRSAC team went above and beyond in their efforts to bring



forward these recommendations and meaningful discussion for the success of the IRS and tax administration.

### **Subgroup Reports—Summary of Issues Discussed**

The *Small Business/Self-Employed (SB/SE) Subgroup*, chaired by James Paille, made recommendations on (i) the Form W-4 2020 version, (ii) the effectiveness of guidance and outreach for 199A, Qualified Business Income, (iii) the sharing economy and impact on the tax gap, (iv) updating “Small Business Taxes: The Virtual Workshop”, (v) the reporting issues faced by issuers and Applicable Large Employers (ALE) under the Affordable Care Act (ACA), (vi) the Form 1099-NEC, (vii) the need for guidance for “On-Demand Payroll” and (viii) increasing compliance through the alignment of the Form 945 to amounts reported on Forms 1099.

The *Wage & Investment (W&I) Subgroup*, chaired by Phyllis Jo Kubey, made recommendations on (i) improving customer experience and service delivery, (ii) providing feedback on the IRS initiatives for earlier intervention with 1040 taxpayers who have underreported wage income on their tax returns, (iii) prioritizing the electronic filing of the 1040X, (iv) improving the marketing, promotion and participation of VITA/TCE programs and other services and (v) improving specific forms and filings particularly Form 1040NR and Form 1040NR-EZ.

The *Tax Exempt & Government Entities (TE/GE) Subgroup*, chaired by Jean Swift, made recommendations on (i) broadening and improving a self-correction program for tax exempt bonds (TEB), (ii) improving the accuracy of Form 990 filings (EO) and (iii) changing the IRS advisory opinion process to improve transparency and compliance for employee plans (EP).

The *Large Business and International (LB&I) Subgroup*, chaired by Diana Erbsen, made recommendations on (i) the IRS offering an issue by issue opportunity to qualifying taxpayers to address specified issues in a given tax year by extending elements of the Compliance Assurance Process (CAP) program, (ii) establish safe harbors by relying on certain conclusions of independent parties and

(iii) adopt and implement specific information reporting guidance, including relating to the TCJA.

### **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 six 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) accelerating the use of e-signatures in federal tax administration; (3) the need to proceed with an efficient and educational approach to the penalty program; (4) the continued dedication of the IRS to issue guidance as a result of the Tax Cuts and Jobs Act; (5) maintaining the hiring of attorneys in the Office of Professional Responsibility (OPR); and (6) improving the Free File program by increasing IRS oversight and restructuring the Memorandum of Understanding.

Finally, this year's report includes a summary of last year's achievements entitled, "Progress on IRSAC / IRPAC / ACT 2018 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.

## **PROGRESS ON IRSAC'S 2018 RECOMMENDATIONS**

The IRSAC made 16 primary recommendations and additional sub-recommendations in its 2018 annual report. As of July 2019, the IRS had implemented, or was implementing, several of the IRSAC's recommendations from 2018. Included among the fully and partially implemented recommendations were:

- Coordinating and improving real-time IRS communications and various electronic communications to tax professionals;
- Improving the Free File Program by increasing IRS oversight and restructuring the MOU – see Issue Six of this 2019 report for a status of 2018 recommendations;
- Continuing to elevate the urgent need for legislation authorizing the Treasury Department to establish and enforce minimum standards of competence for tax return preparers;
- Providing IRSAC a timelier implementation status of prior year's issues;
- Continuing focus on implementing and streamlining eA3 Rule;
- Expanding the use of Application Program Interfaces (APIs);
- Prioritizing the implementation of the online Tax Pro Account;
- Encourage taxpayers to pay their taxes electronically and provide additional education and outreach on the importance of using Lockbox addresses;
- Informing the practitioner community about the risks of fraud and ways to reduce their risk of stolen tax pro data;
- Educating taxpayers and tax practitioners, as well as collecting and analyzing data on the Taxpayer Digital Correspondence Pilot program;
- Providing more direct guidance with regard to best practices and common flaws in transfer pricing documentation; and
- Using the Country-by-Country (CbC) reports and monitoring the information from these reports for transfer pricing risk assessment.

## **PROGRESS ON IRPAC'S 2018 RECOMMENDATIONS**

The IRPAC made five general recommendations and 41 recommendations from subgroups in its 2018 annual report. As of July 2019, the IRS had implemented, or was implementing, several of the IRPAC's outstanding recommendations from the 2018 report. Included among the fully and partially implemented recommendations were:

- Providing effective guidance as timely as possible so that all industry-wide information reporting issues can be addressed as a result of the Tax Cuts and Jobs Act;
- Updated the instructions to IRS Form 1099-MISC to make it clear that scholarship and fellowship grants may have to be reported on IRS Form 1098-T;
- Implementing good faith penalty relief for reporting of incorrect or incomplete Forms 1095-B and 1095-C and a 30-day delay in filing the 2018 forms;
- Improvements to the FIRE system for electronic filers of certain information returns;
- Updated Forms W-9 and Notices CP-2100/2100A to reflect the current backup withholding rate; and
- Reinstatement of IRS Form 1099-NEC for tax year 2020.

## **PROGRESS ON ACT'S 2018 RECOMMENDATIONS**

The ACT made five primary recommendations in its 2018 annual report. As of July 2019, the IRS had implemented, or was implementing, several of the ACT's recommendations from 2018. Included among the fully and partially implemented recommendations were:

- Recommendations regarding re-opening the determination letter program in certain;
- Recommendations regarding missing participants;
- Recommendations regarding incentivizing universal e-filing for Form 990; and

- Recommendation to encourage self-compliance by issuers to tax-advantaged obligations.

## **ISSUE ONE: Continued Underfunding of the IRS is Undermining the Integrity of, and Respect for, Our Voluntary Tax System – Which if Continued will Likely Lead to Substantial Lost Federal Revenue and Substantial Future Investments to Restore the Balance**

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### **Executive Summary**

Including the effects of across-the-board rescissions and reductions required by sequestration and other adjustments, overall funding for the IRS has decreased about 20 percent on an inflation-adjusted basis from FY 2010 to FY 2018,<sup>1</sup> and is now below FY 2009 levels.<sup>2</sup> These reductions largely do not include the effects of the unfunded mandates of significant program costs, like administration of the Patient Protection and Affordable Care Act (the ACA), implementation of the significant tax reforms of 2017 (commonly known as the “TCJA”) and other requirements that have been imposed on the IRS.

Over the past several years, the IRS’s workload and responsibilities increased even as staffing levels declined. For example, since FY 2010, the total number of returns filed increased by nine percent. The number of IRS employees is down by more than one-third from past staffing levels,<sup>3</sup> primarily in compliance and enforcement, which as discussed below, is in some part attributable to investments in modernization and automation of tax systems, but in large part is attributable to fewer positions and unfilled positions due to loss of funding.

In FY 2018, the IRS audited 0.6 percent of all individual returns filed, compared to 1.1 percent in FY 2010, a drop of approximately 50 percent. In FY 2018, the IRS audited 2.5 percent of all business returns (assets greater than \$10 million) filed, compared to 5.7 percent in FY 2010, a drop of more than 50 percent. Meanwhile, cybersecurity and identity theft refund fraud prevention programs consume a larger share of the budget.<sup>4</sup>

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<sup>1</sup> In nominal terms the \$11,431M enacted for FY 2018 is lower than the \$11,522 enacted in FY 2009. (IRS CFO/Corporate Budget Records). See also National Taxpayer Advocate 2014 Annual Report to Congress 13 (Most Serious Problem: TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers).

<sup>2</sup> *Id.*

<sup>3</sup> IRS has positions realized in 2019 of 75,519, which is a 37% reduction from peak staffing in 1992 of 116,673. IRS Data Book 2018, table 29.

<sup>4</sup> Fiscal Year 2020, Department of the Treasury, Internal Revenue Service, Congressional Budget Justification and Annual Performance Report and Plan (CJ), at IRS-3.

The IRS has managed these massive downward adjustments in its funding by scaling back activities, freezing hiring, limiting training and using limited budget flexibility<sup>5</sup> to reallocate resources among its four appropriations accounts and the programs they respectively control.

These cuts have had a significant and negative effect on both the taxpayer service and enforcement functions of the IRS, inhibiting its ability to fulfill the IRS mission. In our view and in the views of others who have looked at and commented on this situation, the adjustments forced by recent budget reductions have had substantial and widespread negative effects on the agency, all of its approximately 73,519 current personnel,<sup>6</sup> federal taxpayers, state taxpayers whose state tax-related obligations are affected by interaction between their state tax system and the IRS and taxpayer representatives (the attorneys, certified public accountants, enrolled agents, software providers and others who assist taxpayers in filing their tax returns and dealing with the resulting obligations that flow from them). Thus, the reductions affect all the issues with which the IRSAC and taxpayers generally are concerned.

The degraded service and enforcement functions may adversely affect the voluntary compliance of many taxpayers. Our tax system is one of self-assessment. The cost of collecting the taxes imposed by the government to enable funding of government programs is orders of magnitude less than it would have to be if taxpayers did not themselves voluntarily assess and collect those taxes. We are on a slippery slope in that once taxpayers lose confidence in the present system, that voluntary compliance may significantly erode.

The funding deficiencies compromise the IRS's ability to deal with the challenges now before us and those yet to come and may have even more dramatic and costly future effects on our system of voluntary compliance and self-assessment. An efficient, well-functioning IRS is critical to every aspect and

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<sup>5</sup> See discussion below for additional discussion of these constraints.

<sup>6</sup> As noted above, IRS Data Book 2018 reported 73,519 Full Time Equivalents ("FTE") for FY 2018. Since FY 2010, IRS's overall staffing has declined by about 21,000 FTEs (22.4 percent). FTEs units are the computed number of equivalent employees working full-time, or the ratio of the total number of paid hours during a period (part time, full time, contracted) by the number of working hours in that period. FTEs are calculated by dividing the total hours worked (excluding things like overtime and terminal pay) by the number of work hours in that year (typically 2088).

program of our federal government. State governments are also adversely affected, as most state tax systems “piggyback” off aspects of the federal tax system.

Recent deficiencies in funding are eroding the significant investments and substantial progress made in the last two-and-a-half decades in modernizing and streamlining the IRS and making it more efficient. The IRS made these investments at the behest and with the support of House and Senate Congressional leaders in both parties, the Treasury Department and private individuals, all of whom care deeply about both particular issues and the core integrity and effectiveness of our tax system.

The IRSAC believes that current levels of funding are inadequate to achieve these goals so necessary to each and every one of us as American citizens. We say this as professionals who deal with the tax law, tax system and tax agency daily. We say this because, candidly, it needs to be said. Our tax system, which depends on voluntary compliance, is increasingly at risk.

### **Description of the Problem**

The Internal Revenue Service is a bureau of the Department of the Treasury, one of the world’s most efficient tax administrators,<sup>7</sup> and by some measures the largest financial services organization in the world. The financing of the federal government depends largely upon the Internal Revenue Service, which collected 95 percent of federal receipts in FY 2018.<sup>8</sup> During Fiscal Year (FY) 2018, approximately 73,519 IRS employees collected more than \$3.5 trillion in gross tax revenue and issued more than \$464 billion in tax refunds.<sup>9</sup> In FY 2018, the IRS

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<sup>7</sup> The IRS spent just 34 cents for each \$100 it collected in FY 2018. (Table 29, IRS 2018 Data Book.) This is the lowest cost IRS has ever achieved, and technology is driving that improvement. The US spends roughly half what the average OECD country spends to collect \$1,000. See Organization for Economic Cooperation and Development, “Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies,” at <http://www.oecd.org/ctp/administration/tax-administration-23077727.htm>. According to IRS Budget Division, in 2013 IRS spent less than \$5 to collect every \$1,000 in net revenue. Later statistics show that amount to be even lower, below \$4, and that it is likely that only Switzerland now spends less. IRS also spends under one tenth of one percent — currently about 0.06%— of U.S. GDP on tax administration, far lower than most developed countries, again with only Switzerland lower. Note that most OECD countries generate a substantial portion of their revenue from indirect/consumption taxes with self-enforcing features, including electronic invoicing, that require less service/compliance work, making the comparison even more significant.

<sup>8</sup> Senate FSSG language 2020 report to accompany HR3351, September 16, 2019, at 24.

<sup>9</sup> Total IRS staffing as of April 13, 2019. Testimony of The Honorable J. Russell George, Treasury Inspector General for Tax Administration, May 9, 2019, “Understanding The Tax Gap And Taxpayer Noncompliance,” before the Committee on Ways and Means, U.S. House of Representatives, at 1. Included in the total are approximately 15,740 seasonal and part-time employees. The seasonal employees push up the total employee headcount for part of the year, but when condensed into FTE the number is less. IRS Data Book shows average positions realized of 73,519 for FY 2019,



collected \$3.0002 trillion in net revenue<sup>10</sup> - processing more than 250 million tax returns and more than 2.763 billion information returns.<sup>11</sup>

Because of the accumulated expertise of its large workforce, its massive systems and the huge data depository they hold, the IRS has been mandated additional duties outside its traditional mission and responsibilities, such as administration of significant portions of the Affordable Care Act (ACA), the Foreign Account Tax Compliance Act (FATCA), the Achieving a Better Life Experience (ABLE) Act, the Health Coverage Tax Credit, the 2017 tax reform legislation and the Taxpayer First Act.

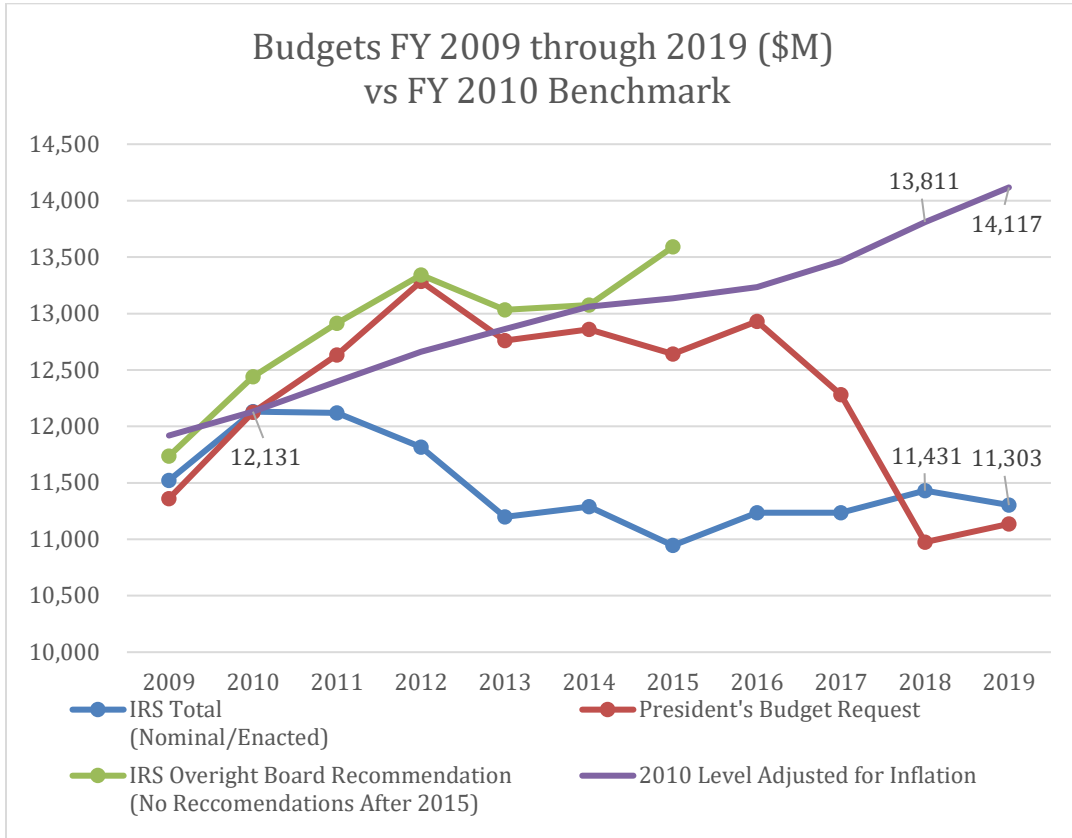
Adjusting for inflation, the IRS budget in FY 2010 would be \$14.1B in FY 2019, \$2.8B higher than the enacted budget of \$11.3B.

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<sup>10</sup> IRS Data Book 2018 and Pub 6961 (2019 Update). Note that net collections subtracts refunds. The gross collections do not subtract refunds, so it overstates the true benefit to the taxpayer.

<sup>11</sup>There were 2,763,024,112 information returns of various types filed in 2018. See Publication 6961 (Rev. 8-2019).

**The IRS's Recommended, Requested and Appropriated Budgets  
From FY 2009 to FY 2019<sup>12</sup>**



Source: IRS Budget Division

Including the effects of across-the-board rescissions and reductions required by sequestration and other adjustments, overall funding for the IRS has decreased about 20 percent on an inflation-adjusted basis since FY 2010,<sup>13</sup> and is still below FY 2009 levels.<sup>14</sup> Further, the timing and uncertainties created by the appropriations process has also affected the management and operation of the Agency.<sup>15</sup>

<sup>12</sup> This chart and the one that follows are slightly different takes – one inflating the FY 2010 funding level up to current, and the other deflating the annual budgets to FY 2010 real dollars. This first chart for the most part presents budgets in “nominal” terms (not inflation adjusted). To provide a benchmark we are showing the nominal budgets against what IRS budget would be if IRS just got what it got in FY 2010 but adjusted up for inflation each year. This shows in real terms IRS is getting \$2.8B less than it got in 2010.

The chart below shows an inflation adjusted “Real” view of what was enacted each year. Because inflation makes more recent dollars less valuable than older dollars, what you see is that IRS budgets now, when adjusted for inflation to compare to FY 2010 in “real” terms, are quite a bit lower.

<sup>13</sup> See n. 6.

<sup>14</sup> *Id.*

<sup>15</sup> It has been many years since yearly funding for the government has resulted from the annual passage of all 13 appropriations bills, which themselves were normally based on a process of budget resolutions, committee hearings and annual appropriations bills, and then passage by the Congress. As noted in Treasury Inspector General for Tax

This startling statistic does not include the substantial burdens of unfunded mandates such as the ACA. From FY 2010 to FY 2018 the IRS spent nearly \$2.7B on the ACA and continues to spend scarce resources to administer it.<sup>16</sup> Likewise, new Treasury Department initiatives on taxpayer information exchanges or participation in those of other government organizations, such as the FATCA passed by the Congress, and the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) initiative, have also magnified the need for resources without corresponding increases in funding. And while the Congress provided some additional funding<sup>17</sup> that was intended to offset the costs of implementation of the significant tax reform (the Tax Cuts and Jobs Act) in 2017, those amounts only partially offset the costs<sup>18</sup> attributable to the most significant changes in the tax laws since 1986.

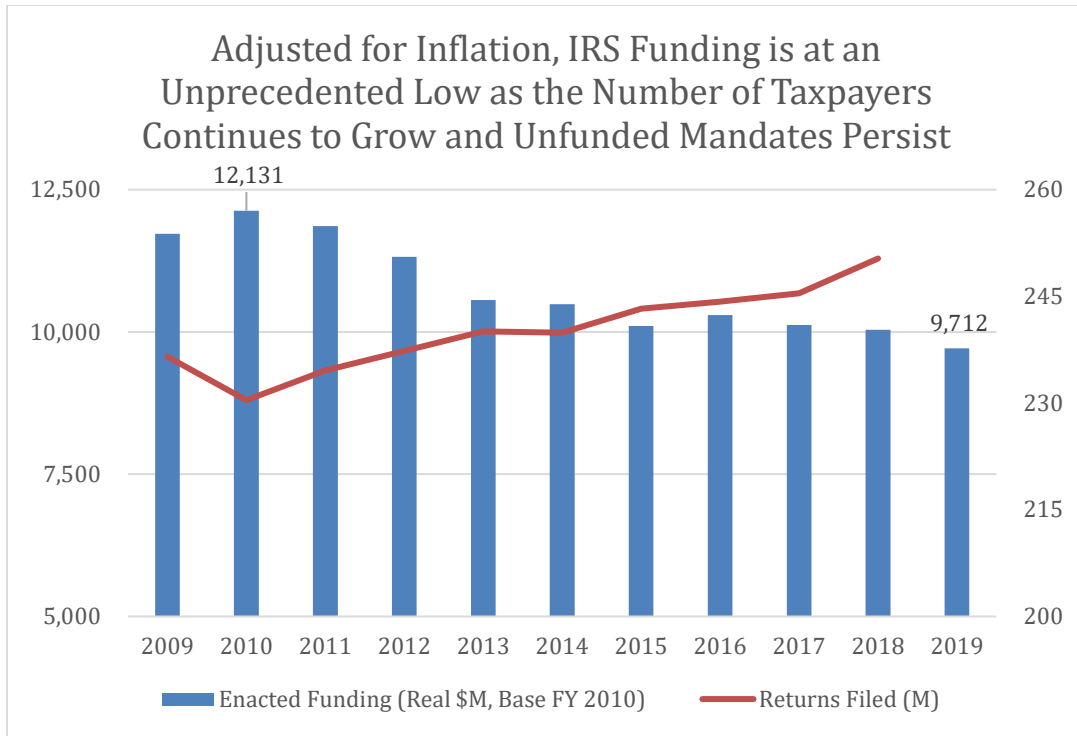
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Administration, "Reduced Budgets and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected," Report 2015-30-035, May 8, 2015, at 1: "Due to delays in enacting Federal budgets for the past several years, Continuing Resolutions have been passed to keep the Government operating. As such, the full-year operating budget has not been known until well into the fiscal year. Additionally, the impact of the sequestration provisions in the Balanced Budget and Emergency Deficit Control Act, as amended by the Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 240 (2011), significantly affected the IRS. During Fiscal Year (FY) 2013, the IRS operated under a Continuing Resolution, in addition to sequestration rules, that funded the agency at just less than \$11.2 billion. That amount was significantly lower than both the President's and the IRS Oversight Board's FY 2013 recommendations, approximately \$948 million less than the FY 2010 budget. The IRS's FY 2015 enacted budget of \$10.9 billion was more than \$1.2 billion (10 percent) less than the FY 2010 enacted budget."

<sup>16</sup> \$500M was provided to the IRS for ACA implementation, but the rest of this has been funded internally.

<sup>17</sup> \$320M in FY 2018 and \$77M in FY 2019 for a total of \$397M. Note these are two-year funds so any unobligated balance of the \$77M would still be available for new obligations in FY 2020.

<sup>18</sup> As of September 13, 2019, IRS has spent a total of \$601M of which \$220M was funded from non-TCJA funds.



Notes to figure: The taxpayer population has grown about 9 percent since FY 2010 while the IRS budget, in real terms, has decreased 20 percent. In addition, unfunded mandates from activities related such enacted legislation such as ACA and FATCA and the ABLE Act, the Health Coverage Tax Credit, and the 2017 tax reform legislation, have required activity and investments of hundreds of millions of dollars not provided for in the annual appropriations (with the exception of certain sums that were specifically added for the 2017 tax legislation. Inflationary costs such as increased contributions to employee health plans and pay raises also costs IRS about \$200 million a year. Source: IRS Budget Division.

The IRS has responded by scaling back activities, freezing hiring, limiting training and using limited budget flexibility to reallocate resources among its four appropriations accounts.<sup>19</sup>

Over the past several years, the IRS’s workload and responsibilities increased even as staffing levels declined. For example, since FY 2010, the total number of returns filed increased by nine percent, and staffing decreased by about 22 percent, primarily in compliance and enforcement. In FY 2018, the IRS audited 0.5 percent of all individual returns filed, compared to 0.9 percent in FY 2010.

<sup>19</sup> See discussion below. A GAO investigation reported that IRS is utilizing its limited budgeting flexibility and taking steps to improve agency-wide coordination of budgeting decisions. GAO-15-624, at 4-5.

Meanwhile, cybersecurity and identity theft refund fraud prevention programs consume a larger share of the budget.<sup>20</sup>

### **The Permitted Uses of the Appropriated Funds are as Important as the Aggregate Level of Funding**

Federal appropriations laws constrain and limit agencies from cross-funding or transferring resources between appropriations. This restriction is important to note because of recent criticism the IRS should be nimbler and adjust by moving money to higher priority needs and defunding others.

The appropriations provided by Congress for the IRS currently fall into four bucketed amounts or accounts: Enforcement, Operations Support, Taxpayer Services and Business Systems Modernization.

Congressionally-approved appropriations are intended to provide a mandated framework that supports the activities of an agency. Generally, the IRS cannot transfer resources from one appropriations account to another without specific statutory authority, which often requires Congressional approval. The IRS may only reprogram funds among budget activities within certain limits. Reprogramming shifts funds within an appropriations account and, within those specified limits, agencies may reprogram them without additional approvals. The IRS is further restricted from reprogramming funds within appropriation accounts without Congressional committee approval if the reprogramming will, among other things, augment existing programs, projects or activities (which the IRS refers to as budget activities) in excess of \$5 million or 10 percent, whichever is less.

For example, in at least one instance the appropriations for enforcement has been used, with the limited authority given in the appropriation language for inter-appropriation transfers, to fund other operations.<sup>21</sup>

Enforcement (EF) funds activities such as determining and collecting owed taxes, providing legal and litigation support and conducting criminal investigations.

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<sup>20</sup> Fiscal Year 2020, Department of the Treasury, Internal Revenue Service, Congressional Budget Justification and Annual Performance Report and Plan (CJ), at IRS-3.

<sup>21</sup> FY 2019 IRS Operating Plan includes a \$194.4 million inter-appropriation transfer from Enforcement to Operations Support to cover operations and maintenance requirements in FY 2019.

Operations Support (OS) funds activities including facilities rent and facilities expenses, IRS-wide administration activities and Information Technology (IT) maintenance and security. Taxpayer Services (TS) funds taxpayer service activities and programs, including pre-filing assistance and education, filing and account services and taxpayer advocacy services. Business Systems Modernization (BSM) funds the planning and capital asset acquisition of IT to modernize IRS business systems. In addition to the amount appropriated to these four accounts, the IRS supplements its budgetary resources through specific collections, such as user fees and certain reimbursables, which are not appropriated annually, but which do require submission to Congress of a plan for expenditure<sup>22</sup>.

Budget activities further divide appropriations accounts into additional functions. For example, EF appropriation is broken into three budget activities: Investigations, Exam and Collections, and Regulatory. Each budget activity, in turn, has multiple program activities. For example, Exam and Collections has 20 program activities, such as Tax Reporting Compliance – Field Exam; Earned Income Tax Credit Management and Administration; and Whistleblower Office. Besides program activities, the lower levels of the budget formulation and budget execution structures include business units and other areas of interest, which are not discrete categories. For example, Wage and Investment is one division within the IRS and can be called a business unit, while identity theft would be considered an area of interest that crosses divisions within the IRS.

There are interrelationships between the effects of funding the four appropriations accounts. Funding one account may necessarily positively or negatively affect adequate funding of the others. It is important to note that IRS appropriation language specifies OS and BSM are the only appropriations that IRS can use for purchasing IT and several other shared services utilized in OS, so if IRS expands its footprint in TS and EF, it almost has to increase the support they get from OS.

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<sup>22</sup>S. Rpt. 115-281, accompanying S. 3107 at 26, as incorporated by Rpt. 116-9, accompanying PL 116-6, at 661.

For example, in the 2020 CJ, page 103, Table 4.5 – Summary of IRS FY 2020 Request, in the Program Integrity Cap section (which is an additional request focused squarely on enforcement), one can see that even “Increase Audit Coverage” and similar initiatives require a dollar of OS funding for every 2-3 dollars of EF. That required complementary increase is because shared services must be funded from OS, so an examiner funded from EF sits in a building funded from OS, and uses a computer funded from OS, etc. The Data Analytics and Prevent Identity Theft initiatives have sizable direct enforcement elements. Beyond direct enforcement spending, taxpayers expect the IRS to provide services in a modern way with agile technology.

Part of the President’s management agenda focuses on agencies that interact with the American public and requires a plan for how they improve the customer experience. The IRS uses the limited funds it has available for IT development to deliver the new services that taxpayers expect, modernize its technology infrastructure, protect taxpayer information and enable effective enforcement of the tax laws. The President’s request for additional funding for the IRS for FY 2020 includes additional amounts for the appropriation account for business systems modernization and automation. The FY 2020 Budget Request includes an increase of \$344 million for four high-priority areas: modernization (the IRS Integrated Modernization Business Plan), cybersecurity and identity theft, infrastructure and data analytics. Although these amounts are critically needed and would be very beneficial in their direct effects, as well as their effects in support of the enforcement function, we do not believe that they otherwise sufficiently improve and support the enforcement process (and its decline), a particular focus of the IRSAC’s concerns.

As in most modern organizations, IT is more and more necessary to its operations as other functions rely more and more on IT to deliver services previously provided through other means, so it needs to be funded proportionally. IT investment, however, does not compensate fully for lost employees. Technology can help examiners be more efficient, but the only way the IRS can get back to historical audit rates is to hire more people.

Indeed, the IRSAC commends the IRS for continuing to seek ways to improve taxpayer service and ensure compliance, while reducing taxpayer burden by, among other measures, deploying new and improved technology. But there are significant implications to these changes, both in the short and longer term. Even those changes that may at first seem to be improvements may have long-term negative consequences — for example, the shift to more automation and less contact with live persons may disadvantage and disappoint taxpayers who often have complex problems that are not easily addressed by those automated systems.

The IRS needs a balanced and carefully considered budget in all four appropriations accounts.

### **Importance of Voluntary Compliance**

A degraded enforcement presence may adversely affect the voluntary compliance of many taxpayers. Our tax system is one of self-assessment. The Voluntary Compliance Rate (VCR) is the amount of tax for a given tax year that is paid voluntarily and timely, expressed as a percentage of the corresponding amount of tax that the IRS estimates should have been paid. It reflects taxpayers' compliance with their filing, reporting and payment obligations. For example, a 2007 report issued in conjunction with Congressional reviews of the then approximately \$345 billion Tax Gap (the aggregate amount of taxes of each type that should be paid each year and are not) provided an estimate of the VCR of 83.7 percent for all taxes and all taxpayers for FY 2001.<sup>23</sup> Similarly, the amount was estimated at \$450 billion for FY 2006, and the overall VCR, or the gross Tax Gap as a percentage of total true tax liability, at 83.1 percent.<sup>24</sup> That VCR has remained remarkably stable at around 83 percent for some years.<sup>25</sup> The IRS made

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<sup>23</sup> Internal Revenue Service, U.S. Department of the Treasury, "Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance," August 2, 2007.

<sup>24</sup> Theodore Black, Kim Bloomquist, Edward Emblom, Andrew Johns, Alan Plumley, and Esmeralda Stuk, "Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation," IRS Research, Analysis, and Statistics Working Paper, March 2012.

<sup>25</sup> It should be noted, however, that IRS must make its estimates on the basis of data collected. Data collections as part of the National Research Program (NRP) were curtailed in the mid-1990's because of Congressional concerns about the burden of those collections on taxpayers. TIGTA has continued to monitor the results. See, for example, National Research Program Audits of Individuals Are Closely Monitored, but the Quality of Tests for Unreported Income Is a Concern, Rpt. 2011-30-102, September 15, 2011.



an announcement on September 26, 2019,<sup>26</sup> in which the gross Tax Gap was estimated at \$441 Billion, and the VCR of taxes paid voluntarily and on time was 83.6 percent. Including taxes paid in response to enforcement actions, the net compliance rate was 85.8 percent.

The continued noncompliance of some taxpayers presents a fairness issue. If 86 percent (after enforcement actions) of taxes are paid and 14 percent are not paid, then the 6 of 7 Americans who dutifully pay their taxes are subsidizing the 1 of 7 who don't pay (or underpay) but still benefit from all the services and privileges the United States government provides. That imbalance is unfair, and taxpayers who dutifully pay their taxes should welcome scrutiny for those who don't, since ultimately, the compliant taxpayer has to pay more to compensate for the non-compliant taxpayer.



## The Threat to Voluntary Compliance

| Individual Income Tax Underreporting Gap and Net Misreporting Percentage by "Visibility" Category |                                       |   |  |  |
|---|---------------------------------------|---|--|--|
|   | Substantial Reporting and Withholding | Substantial Reporting                                   | Some Information Reporting                               | Little or No Information Reporting               |
| Voluntary Compliance Rate   | 99%                                   | 92%   | 89%  | <50%   |
| Associated Revenue Loss (Tax Gap)   | \$11B                                 | \$12B   | \$64B  | \$120B   |
| Examples  | Wages and Salaries                    | Pensions, Dividend/ Interest Income, SS and UI Benefits | Deductions, Credits, Partnerships/S-Corps, Capital Gains | Proprietor Income, Rents, Royalties, Farm Income |

**Overall voluntary compliance rate of about 83 percent.**

**For every 1 percent increase in voluntary compliance the IRS collects an additional \$30 billion in revenue.**

Source: IRS.

A significant concern is the extent to which the VCR will remain at present levels in an era of significantly less enforcement activity. The most cost-effective systems of imposing and collecting taxes are those that encourage and permit the

<sup>26</sup> IR-2019-159, September 26, 2019.

vast majority of taxpayers to meet their tax obligations voluntarily, allowing for tax administrations to concentrate their efforts and limited resources on those taxpayers who do not comply. The VCR has remained remarkably constant over the decades since statistics began to be kept in 1974, but that may change if and when major changes are made in the system or taxpayers no longer fear that if they don't comply there will be significant and negative consequences. Even a small percentage of degradation of the VCR would necessitate considerable additional resources to be committed to maintain the new lower level of compliance and would likely result in significant revenue losses.

### **Impacts of Insufficient Funding**

Recent funding levels at the IRS impair the ability of the Agency to adequately perform its critical mission of providing needed services and support to taxpayers who strive to meet their tax obligations, and to identify and address the non-compliance of those who are not so inclined.

The Tax Inspector General for Tax Administration made his concerns clear in testimony to the Congress:

#### ***Diminished Resources Have Impacted Tax Compliance***

Given the importance of audits to tax compliance, both because of the extent to which underreporting is the most significant component of the Tax Gap and because of the significant positive multiplier compliance effect from audits, it is important that the IRS has the resources to maintain or increase its audit coverage. However, due to diminished resources, IRS Examination personnel have decreased 38 percent from 13,138 examiners in FY 2010 to 8,205 examiners in FY 2017. The number of audits has also decreased by 32 percent from 1.6 million in FY 2013 to 1.1 million in FY 2017. Proposed assessments have steadily declined over the last 10 years, from \$44 billion in FY 2007 to \$29 billion in FY 2017.

Nonpayment of taxes owed is a smaller portion of the Tax Gap, estimated to be \$39 billion annually. However, similar reductions in resources have impacted payment compliance. From FY 2010 to FY 2017, field revenue officers have decreased by 42 percent from 4,016 to 2,364 (*i.e.*, 1,652 fewer Collection personnel). On average, revenue officers typically collect close to \$2 million each annually. With 1,652 fewer revenue officers, the Treasury collects approximately \$3.3 billion less each year.

The nonfiler component of the Tax Gap is estimated to be \$32 billion. In 2002, the IRS determined that of all the compliance programs, the nonfiler program is the most cost-effective. At the time, however, the IRS believed that it was following up on most of the nonfiler leads. In several recent audits, TIGTA has determined that the IRS's nonfiler program has been significantly diminished. [Footnote 7: 7 TIGTA Ref. No. 2017-30-078, *A Significantly Reduced Automated Substitute for Return Program Negatively Affected Collection and Filing Compliance* (Sept. 2017); TIGTA Ref. No. 2016-30-085, *Improvements to the Nonfiler Program Could More Effectively Help the IRS Address Additional Nonfilers Owing Billions of Dollars in Taxes*, (Sept. 2016).] From FY 2011 to FY 2014, the IRS collected \$11 billion from the Automated Substitute for Return Program (ASFR) (a component of the IRS's overall nonfiler strategy); however, during TIGTA's 2017 audit, it was determined the program had been suspended due to resource issues. In an audit of the IRS's overall nonfiler strategy, TIGTA learned that, due to resource issues, the IRS decided not to pursue high-income taxpayers who had submitted applications for extension of time to file tax returns for Tax Year (TY) 2012 but did not file a tax return, and that the IRS had not pursued any taxpayers in TY 2013 who had submitted applications for extension of time to file but had never filed tax returns. TIGTA recommended that the IRS resume the ASFR program, and the IRS agreed and is in the process of revising its nonfiler strategy.

The Criminal Investigation (CI) division contributes to increased tax compliance by pursuing tax and tax related crimes. However, resource constraints have caused CI to reduce its investigations by 45 percent. The number of investigations started by CI diminished by 2,428 per year, down from 5,234 in FY 2013 to 2,886 in FY 2018. In FY 2018, CI had 720 fewer special agents than it had in FY 2012, a reduction of 26 percent.

The IRS's FY 2020 budget requests additional funding for compliance positions; however, the request does not fully address the attrition that has occurred over the last five years. For Examination personnel, the FY 2020 budget would add 943 Full Time Equivalent (FTE) for a total of 9,148 Examination personnel. This would return Examination function staffing to 2015 levels when there were 9,189 Examination personnel. The attrition of Examination personnel in FY 2015 (342) and FY 2016 (642) alone was 984. The IRS's proposed FY 2020 budget adds 173 FTEs for Field Collection revenue officers for a total of 2,537, which would not even make up for the attrition of 264 revenue officers from 2015. The 144 proposed special agents for CI in the FY 2020 budget only covers a single

year's (FY 2018) attrition of 140 agents, but CI will still have a net loss of 576 agents from FY 2012.<sup>27</sup>

The IRSAC recognizes the immense challenges that the Congress faces in trying to address federal spending on government programs to balance the federal budget. These challenges and issues, however, make it more, not less, important for the IRS to have the resources and support it needs to appropriately manage and perform its central function of administering the tax laws fairly and collecting the taxes properly due under those laws.

Reducing funding to the IRS costs taxpayers money; it is “penny-wise and pound-foolish” to underfund its operations. Enforcement efforts generate and protect revenue, and they also encourage voluntary compliance for taxpayers who would otherwise seek to avoid meeting their tax obligations under the law. The IRS calculates a return on investment for both revenue-generating and revenue-protecting investments. Revenue generated is from compliance efforts that yield direct, measurable results through enforcement activities, such as examination and collection returns. Protected revenue is revenue the IRS protects from being refunded erroneously. Protected revenue is associated with activities that occur before the IRS issues a taxpayer's refund, including the identification of fraud and questionable returns. For example, the FY 2020 Budget submission includes \$311.3 million in investments for traditional enforcement and strategic revenue programs, which the IRS projects to generate more than \$2 billion in revenue once the investments reach full potential in FY 2022, with an expected total ROI of \$5.7 to \$1.

#### *Direct Program Impacts*

The IRS initially absorbed the recent budget cuts through savings and efficiencies, but the reductions eventually compelled the IRS to reduce, delay or

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<sup>27</sup> From Treasury Inspector General for Tax Administration, “Reduced Budgets and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected,” *supra*, at 3.

eliminate services. The IRS also scrutinized contract spending to ensure it fully funds only the most critical and mandatory requirements.<sup>28</sup>

A GAO investigative report looked at the IRS's responses to the funding decreases since FY 2010, and it concluded that the examined business units (several larger and key units) scaled back activities, potentially reducing program effectiveness or increasing risk to the IRS and the federal government.<sup>29</sup> Each business unit examined — Human Capital Office, Office of Chief Counsel and SB/SE Division — took actions to absorb budget reductions:

One common element among each of the business units examined is that they spend 80 percent or more of their funds on labor.... From fiscal year 2010 to fiscal year 2014, FTEs declined through attrition in each of the business units examined [from 20 to as much as 29.6 percent of unit FTEs]. Because labor comprises the majority of these business units' expenses, unit managers are limited in how they implement budget cuts. According to business unit officials, budget reductions were often implemented by decreasing the amount or type of activity performed. One key factor that influenced business units' decisions about how to prioritize activities was whether the activity was statutorily mandated. According to IRS officials, statutorily mandated activities—such as tax litigation in the Office of Chief Counsel—remained a priority. [tabular data summarized]<sup>30</sup>

Some examples of reduced or eliminated activities that the GAO cited include non-filer investigations, private letter rulings, bankruptcy program, acquisition of e-discovery and document management software for tax litigation and background reinvestigations of employees. These are important activities.

### *Lack of Necessary IRS Personnel at Required Experience Levels*

Besides the reductions just mentioned, the IRS also made significant reductions in internal staff costs, such as hiring, training<sup>31</sup> and travel.<sup>32</sup>

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<sup>28</sup>GAO-13-541R, "IRS's 2013 Filing Season and 2014 Budget Request," April 15, 2013, at 20.

<sup>29</sup> GAO-15-624.

<sup>30</sup> *Id.*, at 10.

<sup>31</sup> Reductions in training budgets, some of which continue, in particular functions ranged from 74 to 96 percent in the four operating divisions. GAO-14-534R, "Internal Revenue Service: Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performance," April 10, 2014 (Updated April 18, 2014), at 22. See also, Written Statement of Nina E. Olson, National Taxpayer Advocate, Hearing on Internal Revenue Service FY 2015 Budget Request Before the Comm. on Appropriations, Subcomm. on Financial Services and General Government, U.S. Senate, 113th Cong., 2d Sess. (Apr. 30, 2014), at 11.

<sup>32</sup> Reductions in travel costs were cut by 87 percent. GAO-14-534R, at 22.

Another example of how the IRS has had to respond to the budget realities are the severe constraints placed on hiring, either new hires or the filling of vacated positions. The report explains that:

IRS plans to replace few employees who leave the agency. In an agency with over 80,000 FTEs, all requests for external hiring in fiscal year 2015 must be approved by a direct report to the Commissioner. Specifically, requests for new hires are reviewed by the Deputy Commissioner for Operations Support, Deputy Commissioner for Services and Enforcement, and in certain cases, the Chief of Staff.<sup>33</sup>

Despite recent increases in hiring activity, many critical positions remain unfilled.

These reductions are not “cost free” to the tax system. Taxpayers and practitioners are experiencing adverse effects due to required cutbacks attributable to recent and projected funding reductions. Although the IRS recently restored some training allowances and even hiring, the effects of earlier cuts on program effectiveness, not to mention staff retention, cannot be overstated.

Further, cutbacks and sequestration meant that most IRS personnel saw limited or no compensation raises in recent years, even without considering the effect of the furloughs in FY 2013. This environment likely hastened the departure of senior IRS personnel already eligible for retirement. The IRSAC is concerned that, coupled with other personnel policy changes that constrain the IRS’s inability to fill vacancies, the budget reductions contribute to a significant erosion of experienced leadership at a critical time, adversely affecting taxpayer service and tax law enforcement.

The longer-term effects of those adjustments may be more dramatic than the cuts themselves. The IRS must recruit and properly train sufficient staff to perform the critical functions (that Congress has assigned it) in the face of complex and constantly changing tax laws. Since its most recent major reorganization pursuant to the RRA 1998, IRS personnel and their activities have been centered on two major functions: taxpayer services and enforcement of the tax laws. The IRS has made major strides to automate its systems and operations in both areas and to reduce costs of operations through such means. The IRSAC believes there

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<sup>33</sup> *Id.* at 14.

have been many positive advances in essential IRS programs throughout the IRS. But as the above-cited GAO study indicates, many necessary IRS programs are still people-intensive and therefore highly dependent on qualified and experienced personnel, supported by appropriate levels of funding for compensation, training, travel and other items.

With many senior IRS personnel opting for retirement, and funding limits preventing many vacancies from being filled, the IRSAC is concerned that the IRS will not have sufficient experienced and trained personnel to adequately address taxpayer needs and protect taxpayer rights - resulting in a decline in taxpayer service.

#### *Decreases in Quality of Taxpayer Service*

The taxpayer, their representatives and Agency personnel feel the effects of reduced funding in various negative ways. There are many areas in which the metrics of taxpayer service at the IRS have been measured and scrutinized over the years.<sup>34</sup> Of particular note are the observations with respect to telephone calls and taxpayer correspondence, affecting the ability of taxpayers to interact with the IRS in matters of great importance to them, and while these services have shown improvement in the last year or so, they continue to be a source of taxpayer and practitioner frustration:

During the filing season, the IRS was only able to answer about 37 percent of the calls routed to telephone assistors, and those callers who managed to get through had to wait on hold an average about 23 minutes....

The percentage of calls answered by telephone assistors (known as the "Customer Service Representative Level of Service" or "LOS") and the average hold times this filing season constituted by far their worst levels since the IRS adopted its current performance measures in 2001. For comparison, the IRS

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<sup>34</sup> Taxpayer Advocate Service, Fiscal Year 2016 Objectives Report to Congress, June 30, 2015. To understand the IRS's telephone statistics, a few concepts are important to review. First, the IRS tracks the total number of calls it receives, which is known as the "Enterprise Total." The Enterprise Total includes calls to the "Accounts Management" (AM) telephone lines (which typically account for around 85-90 percent of all "Enterprise Total" calls), calls to the compliance telephone lines, and calls to a few additional low-volume telephone lines. Second, answered calls are split between "Assistor Answered Calls" and calls handled by the IRS's automated processes. Whether a call is routed to automation or to a customer service representative (CSR) depends on the telephone number the taxpayer calls and how the caller responds to the prompts he or she encounters. Third, the official "Level of Service" statistics reflect only calls routed to CSRs on the AM telephone lines.

reached its high-water mark in providing taxpayer service in 2004 when it answered 85 percent of taxpayer calls directed to telephone assistors and hold times averaged three minutes during the filing season. Even during last year's filing season, the IRS answered 71 percent of its calls and hold times averaged about 14 minutes.

Between January 1 and April 18, the IRS Accounts Management (AM) telephone lines received about 50 million taxpayer telephone calls. Of those, about 30 million were routed to automated processes, and about 20 million were routed to telephone assistors. One might assume that calls routed to automation would be answered at a much higher rate than calls routed to telephone assistors, but that is not the case. Of the 49.9 million calls the IRS received on its AM lines, including calls routed to automation, 24.1 million were deemed to be answered. That is less than 50 percent.

One basic system limitation results in what in IRS parlance is known as a "courtesy disconnect." When the IRS switchboard is overloaded and cannot handle additional calls, the IRS essentially hangs up on callers. The number of courtesy disconnects skyrocketed this filing season as compared with prior years, rising by more than 1,500 percent from about 544,000 in 2014 to about 8.8 million this year.

The Practitioner Priority Service (PPS) phone line is used by tax professionals who are trying to reach the IRS to assist their clients. Over the course of the filing season, the IRS answered only 45 percent of practitioner calls on this line, and the hold time averaged 45 minutes. Thus, the use of the term "priority" has understandably evoked a combination of frustration and amusement from tax attorneys, CPAs and Enrolled Agents, who must decide whether and how much to charge their clients for the time they spend waiting on hold. Of course, the 45-minute hold time represents merely an average. One practitioner told the National Taxpayer Advocate of waiting six hours to reach a telephone assistor....

Since 2008, the IRS has received more than 100 million telephone calls from taxpayers in every year, and it has received an average of more than ten million letters from taxpayers responding to proposed adjustments and other notices (e.g., requesting penalty abatements, responding to math error notices, and making payment arrangements).

There is a large pool of AM employees that the IRS shifts back and forth between answering the phones and responding to taxpayer correspondence. However, the IRS faces a difficult choice in deciding which service to prioritize, and with relatively poor levels of service on both and limited resources, it is not an easy choice....



At the end of the 2014 filing season, 22.7 percent of taxpayer correspondence had not been processed within normal timeframes and was considered “overage.” At the end of the 2015 filing season, the overage percentage was 25.1 percent.

While the decline in processing taxpayer correspondence was much more modest than the decline in telephone performance, the consequences of a failure to process taxpayer responses to proposed increases in tax liability can be more significant. Therefore, the IRS made a decision to minimize increasing correspondence delays. [Portions of text, graphics, and internal footnotes were omitted.]<sup>35</sup>

The GAO and IRS Oversight Board reports indicate percentages of overaged taxpayer correspondence at even higher levels, as high as fifty percent as measured in those studies.<sup>36</sup>

These statistics have real-world consequences for taxpayers and their representatives. The only good news in them is that the call volumes are down from the levels in the early to mid-1990s, and that is likely owing to the positive effects of increased automated assistors and other technology, such as the IRS’s website IRS.gov, and fewer tax law changes.

Much work has been done to make necessary information and services available on the IRS website, and the progress there is remarkable and positive. However, many of the unanswered calls and correspondence are from taxpayers seeking additional information to prepare and file their tax returns and reports. Many calls and correspondence are taxpayers and/or their representatives trying to respond to IRS inquiries and notices, including impending levies and other collection matters. Because some of these processes are automated, the inability to engage with the IRS can mean serious problems for the affected taxpayers and significantly higher costs for their representatives. And many taxpayers are trying to deal with problems related to identity theft.<sup>37</sup> Resolution of these types of issues

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<sup>35</sup> *Id.* at 9-19.

<sup>36</sup> Report GAO-15-420R, “Internal Revenue Service: Observations on IRS’s Operations, Planning, and Resources,” April 10, 2014 (Updated March 3, 2015), at 18. GAO-15-163, “Tax Filing Season,” at 18-19. IRS Oversight Board FY 2015 Budget Recommendation Special Report, at 13.

<sup>37</sup> In 2013, the Service had approximately 690,000 open cases of identity theft. Written Statement of Nina E. Olson, National Taxpayer Advocate, at 4, *Hearing on Identity Theft-Related Tax Fraud Before the Comm. on Oversight and Government Reform Subcomm. on Government Operations, U.S. House of Representatives*, 113th Cong., 1<sup>st</sup> Sess. (Aug. 2, 2013).

cannot and should not be fully automated because they require engagement with IRS personnel to resolve complex matters.

The IRSAC is concerned that because most of the IRS's budget is devoted to personnel costs, years of funding reductions have necessarily reduced the staff available to deal with these issues.

### *Negative Effects on the IRS's Ability to Administer and Enforce the Law Fairly*

The decline in budget resources has hurt enforcement programs. When the IRS is struggling to meet taxpayer needs in its service functions, it has also been struggling in its enforcement efforts — its work to close the “Tax Gap.” These problems have real-world effects.

In addition to the direct effects on taxpayer compliance, the IRS lack of adequate funding to do its job effectively means the government will have fewer dollars available to fund all federal programs, including national defense, Social Security, Medicare, Veterans' benefits, medical research and disaster relief — or simply to reduce the deficit. In FY 2018, the IRS brought in net federal revenue of about \$3.0 trillion on a budget of \$11.4 billion, a return-on-investment (ROI) of \$263 for every dollar spent.<sup>38</sup> Virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. Historically, for every dollar invested in IRS tax enforcement, the United States received at least \$4 in return.<sup>39</sup>

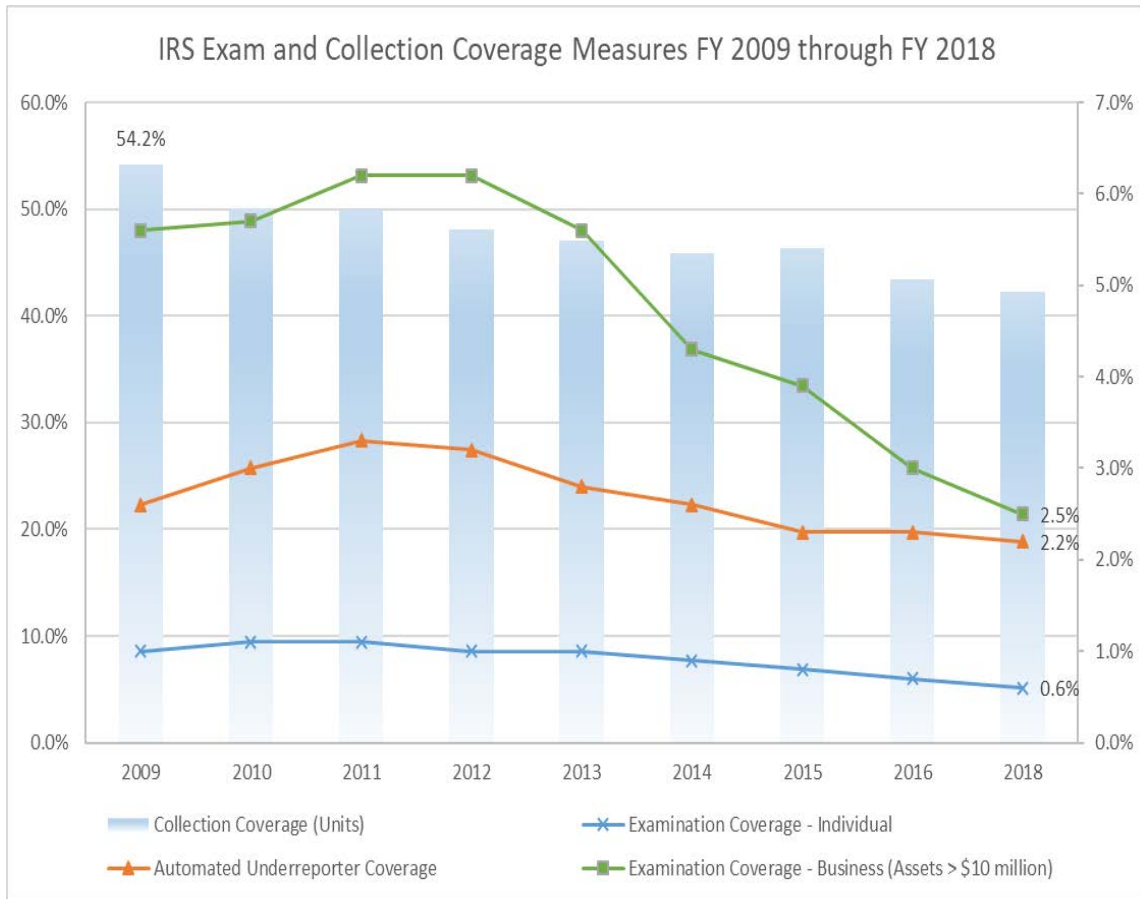
In addition, while much of the lower collections will be attributable to the relatively small percentage of taxpayers who have traditionally ignored their responsibilities, a growing amount may be attributable to the effects of increasing cynicism of taxpayers about the fairness and integrity of the tax system. Thus, previously honest and diligent taxpayers who would otherwise end up paying more to subsidize noncompliance by others could themselves be tempted toward noncompliance.

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<sup>38</sup> In addition, IRS Research has estimated that for every \$1 of enforcement revenue, there is an \$11.70 increase in collections due to indirect effects. See Plumley, “The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results,” at 8.

<sup>39</sup> See, e.g., Letter of seven former Commissioners of Internal Revenue (who served under three Democratic Presidents and three Republican Presidents) to Congressional Appropriations Committees, November 9, 2015. See also Letter of Commissioner Koskinen to the House Appropriations Committee, June 20, 2014.

Any reduction in voluntary compliance and the VCR will increase the cost of enforcing the tax law. Whatever the costs of running the current system, those costs are orders of magnitude less than what would be necessary if taxes were forcibly exacted rather than paid by honest citizens striving to voluntarily comply with their obligations. Who would want to live in such a system?



|                                  |      |                    |  |
|----------------------------------|------|--------------------|--|
| Examination Coverage, Individual |      |                    |  |
| 2010                             | 1.1% | $\leq \frac{1}{2}$ |  |
| Examination Coverage, Individual |      |                    |  |
| 2018                             | 0.6% |                    |  |

Source: IRS FY 2020 CJ and FY 2016 CJ

IRS Enforcement Coverage Measures Fiscal Years 2009 through 2018

|   | 2009  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2018  |
|---|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Selected Examination Measures</b>                    |       |       |       |       |       |       |       |       |       |
| Examination Coverage - Individual                       | 1.0%  | 1.1%  | 1.1%  | 1.0%  | 1.0%  | 0.9%  | 0.8%  | 0.7%  | 0.6%  |
| Examination Efficiency - Individual                     | 138   | 140   | 139   | 142   | 142   | 138   | 148   | 143   | 121   |
| Examination Coverage - Business (Assets > \$10 million) | 5.6%  | 5.7%  | 6.2%  | 6.2%  | 5.6%  | 4.3%  | 3.9%  | 3.0%  | 2.5%  |
| Automated Underreporter Coverage                        | 2.6%  | 3.0%  | 3.3%  | 3.2%  | 2.8%  | 2.6%  | 2.3%  | 2.3%  | 2.2%  |
| Automated Underreporter Efficiency <sup>2</sup>         | 1,905 | 1,924 | 2,007 | 2,041 | 2,025 | 1,935 | 2,209 | 2,196 | 2,188 |
| <b>Selected Collections Measures</b>                    |       |       |       |       |       |       |       |       |       |
| Collection Coverage (Units)                             | 54.2% | 50.1% | 50.0% | 48.1% | 47.0% | 45.9% | 46.3% | 43.4% | 42.2% |
| Collection Efficiency (Units) <sup>2</sup>              | 1,854 | 1,822 | 1,952 | 1,997 | 2,057 | 2,051 | 2,448 | 2,266 | 2,135 |
| Automated Collection System Accuracy <sup>2</sup>       | 94.3% | 95.9% | 94.9% | 94.7% | 94.4% | 95.2% | 95.3% | 95.4% | 94.7% |

Source: IRS FY 2020 CJ and FY 2016 CJ

**Recommendation**

Fund the IRS at least at a level no lower than the FY 2010 aggregate budget benchmark, as adjusted for inflation, or \$14.117 Billion. Funding levels continue to be significantly below levels that the IRSAC members, in our role as concerned citizens, believe necessary for the IRS to successfully achieve its traditional mission, and the new ones it is given as we move forward. These roles include both assisting taxpayers in complying with their legal obligations and enforcing those legal obligations when necessary. The effects of recent reductions in IRS programs are already being felt by all American taxpayers. These issues must be addressed now.

Recent deficiencies in funding are eroding the significant investments and substantial progress made in the last two-and-a-half decades in modernizing and streamlining the IRS and making it more efficient. Insufficient funding may have even more dramatic and costly future effects on our system of voluntary compliance and self-assessment, particularly if the rate of that voluntary compliance starts to slip down a “slippery slope” of taxpayer respect for our system of taxation.

We have experienced the fact that taxpayers often blame the IRS for their unhappiness with their obligation to pay taxes, or in some cases its enforcement. The IRS does not make the tax laws, and unless and until the laws are changed, the IRS must enforce those laws enacted by the Congress and signed by the President. Lawmakers in both political parties often criticize the IRS, usually

because of genuine concerns with specific aspects of tax administration and enforcement. When criticism is due to poorly executed enforcement, those problems should be specifically and surgically addressed, either by realignment of programs and resources, by additional funding or by personnel actions specific to the individuals involved. An efficient, well-functioning IRS is necessary to the functioning of our federal government, and, as their performance indicators show, since FY 2010 the IRS has had difficulties maintaining that position.<sup>40</sup> The same is true for our state governments, as most state tax systems “piggyback” off aspects of the federal tax system. We do not believe that current levels of funding are adequate and express our concern that, if they continue, they may lead to serious consequences to all of us.

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<sup>40</sup> IRS often benchmarks to FY 2010 largely because its performance then was considered adequate and the measures reflect that.

## **ISSUE TWO: Accelerating the Use of Electronic Signatures**

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### **Executive Summary**

The use of electronic signatures (“e-signatures”) in federal tax administration is limited despite the IRS having requisite statutory authority and a long-standing legislative mandate to accept digital and electronic signatures.<sup>41</sup> Recent legislation directs the IRS to (1) develop a plan to accelerate the use of e-signatures and (2) publish guidance for the use of e-signatures for disclosure authorization and power of attorney to practitioners.<sup>42</sup>

The IRSAC assessed the IRS’s current e-signature roadmap and recommends the IRS leverage private sector expertise and resources to accelerate e-signature use in furtherance of its tax administration goals.

### **Background**

Electronic signatures present an opportunity for the IRS to improve customer service, facilitate tax compliance, safeguard taxpayer data and collaborate with external partners. E-signatures reduce taxpayer burden and promote tax compliance by facilitating convenient, digital interactions. Standards for attribution (verifying the signature is associated to a specific person) and integrity (preventing changes or errors in the electronic record) protect taxpayers and the IRS from forged and fraudulent documents. As further discussed below, the IRS can better realize e-signature benefits through a comprehensive policy with an established timeline.

The IRS has the legislative authority to accept e-signatures for returns, statements and other documents and a long-standing congressional mandate to develop procedures for the acceptance of signatures in digital and electronic form. Under more recent legislation, the IRS is required to (1) provide to Congress by June 18, 2019, a plan to accelerate the use of e-signatures and (2) publish e-signature standards for “any request for disclosure of a taxpayer’s return or return

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<sup>41</sup> Electronic Signature in National & Global Commerce Act (E-SIGN), 15 U.S.C. 7001 et seq. (2000); IRS Restructuring & Reform Act of 1998 (RRA 98), I.R.C. 6061.

<sup>42</sup> 21st Century Integrated Digital Experience Act (IDEA), § 5 (2018); Taxpayer First Act, § 2302, I.R.C. 6061(b)(3) (2019).

information under section 6103(c) to a practitioner or any power of attorney granted by a taxpayer to a practitioner.”<sup>43</sup>

The IRS accepts e-signatures only when the Service has expressly authorized their use through published guidance or the Internal Revenue Manual (IRM) and issues these authorizations on an ad hoc, form-by-form basis.<sup>44</sup> Without an enterprise-wide e-signature policy, use of e-signatures in federal tax administration is limited to most tax returns and extensions, some electronic filing authorization forms, the Form W-8 family for withholding agents, requests for transcripts of tax returns, reporting agent authorizations and employment tax returns. Notably, e-signatures are not authorized for use on Form W-9, *Request for Taxpayer Identification Number and Certification*, Form 8821, *Tax Information Authorization*, Form 2848, *Power of Attorney and Declaration of Representative*, or Forms 8879-C, 8879-S, 8879-PE or 8879-F, *IRS e-file Signature Authorization* for corporation, S-corporation, partnership and estate or trust returns, respectively.

The IRS plans to accelerate the use of e-signatures through a two-pronged approach: publish an e-signature policy and develop technical solutions that comply with the policy. For policy, the IRS has drafted IRM copy that is, at the time of writing this report, in the document clearance process. The publishing process for IRM guidance does not incorporate comment periods, the applicable section of IRM, 10.10.1, is not available to the public, and the IRS indicated there are currently no plans to solicit feedback from external stakeholders before publishing the e-signature IRM policy. Regarding a technical solution, the IRS is building an in-house product to serve as the signature mechanism across various applications. The IRS’s initial use case, electronic authorization via online tax professional accounts, is dependent on the development of this e-signature solution.

The IRS could better align with its strategic goal to collaborate with external partners by proactively working with the e-signature industry and Identity-as-a-Service Providers (hereinafter referred to as “external partners”) as well as tax

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<sup>43</sup> At the time of writing this report, the IRS’s plan to accelerate the use of e-signatures was under review with Treasury and unable to be shared with the IRSAC.

<sup>44</sup> See Chief Counsel Advice 2016- 50019 (Dec. 9, 2016), IRS Chief Counsel advised IRS auditors that an electronic signature should only be accepted by the IRS when there is published guidance or Internal Revenue Manual (IRM) provisions that specifically authorize use of an electronic signature for the specific form involved.

preparers and tax software developers (hereinafter referred to as “mission and business partners”) to design and issue a policy that enables the development of technical e-signature solutions beyond an internally developed product. Engaging external partners and mission and business partners would improve speed to market for technical solutions, enhance the IRS’s ability to comply with evolving digital identity standards and accelerate use by expanding the number of customer service delivery channels through which to garner adoption.

First, issuing a policy that authorizes the use of standards-based, externally developed e-signatures would immediately provide the e-signature industry with a business case on which to build compliant solutions. The private sector is unlikely to proactively build solutions that the IRS does not view as legally valid, so the business case does not exist without express authorization. Thus, without published standards deployment of technical solutions will depend entirely on the IRS’s internal development timeline, whereas by publishing relevant standards, the IRS could increase speed to market and drive adoption beyond individual and tax professional accounts.

Second, the IRS could leverage the expertise and agility of private sector providers to better comply with evolving digital identity standards. The biggest challenge in implementing an e-signature technical solution is attributing a real-life identity to the digital transaction. The identity verification event must be rigorous enough to mitigate the risk that the signer can disavow the signature but frictionless enough that users will adopt it. The IRS’s technical solution must also comply with standards set forth by the National Institute of Standards and Technology (NIST) in Special Publication 800-63, *Digital Identity Guidelines*, currently in its third iteration.<sup>45</sup> To further complicate efforts, these standards are periodically updated to combat evolving identity theft threats, and government services must be able to keep pace.

As NIST standards continue to evolve, e-signature guidance can be updated and published more efficiently than technical solutions can be enhanced and deployed. Therefore, the IRS would be well served to issue a policy that

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<sup>45</sup> Natl. Inst. Stand. Technol. Spec. Publ. 800-63-3 (June 2017).



enables third parties that specialize in developing solutions for components of the e-signature framework, such as the e-signature industry and Identity-as-a-Service Providers, to do so.

Last, by enabling private sector technical solutions, the IRS could focus information technology resources on integrating solutions across multiple service delivery methods and channels to boost adoption and accelerate use. The IRS could integrate e-signature delivery through traditional, forms-based authorization methods and modern, electronic authorization mechanisms such as Web Applications (“WebApps”). Additionally, the IRS could expand e-signature use to a broader array of service delivery channels—channels ranging from those that are well known and widely used by taxpayers (like electronic tax return filing) to new and emerging channels (like a WebApp for automated tax information disclosure and IRS online taxpayer and tax professional accounts).<sup>46</sup> Integration of e-signatures into more service delivery channels and through more delivery methods will help boost adoption and accelerate e-signature use which will in turn improve customer service and facilitate tax compliance by reducing burden.

### **Recommendations**

1. Collaborate with external partners and mission and business partners, such as members of the e-signature industry, tax practitioner groups, tax software industry associations and key internal stakeholders, to develop and publish an enterprise-wide e-signature policy.
2. Publish an e-signature policy that enables the development of e-signature technical solutions by external partners in addition to solutions developed by the IRS. The policy should encompass various customer service methods including forms-based solutions and modern, electronic authorization flows and enable multichannel delivery through standalone

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<sup>46</sup> See *infra* Wage & Investment Subgroup Issue One: Customer Experience/Service Delivery Plan, (recommending that the IRS optimize the tax return filing process by incorporating electronic authorization of third parties such as tax preparers and tax software providers to enable customer service delivery); The Internal Revenue Service Advisory Council 2018 Public Report, Digital Services Subgroup Issue Two, available at <https://www.irs.gov/pub/irs-pdf/p5316.pdf> (recommending the IRS develop an automated, electronic API for securely disclosing tax information to authorized third parties).

authorizations, filing of tax returns, income verification online tools and IRS online taxpayer and tax pro accounts.

3. Enable e-signatures on key forms such as Form 8821, *Tax Information Authorization*, Form 2848, *Power of Attorney and Declaration of Representative*, Form W-9, *Request for Taxpayer Identification Number and Certification*, and Forms 8879-C, 8879-S, 8879-PE and 8879-F, *IRS e-file Signature Authorization* for corporation, S-corporation, partnership and estate or trust returns, respectively.

## **ISSUE THREE: IRS Penalty Process**

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### **Executive Summary**

The IRSAC recommends the IRS proceed with an efficient and educational approach to the First Time Abate Policy. By doing so, taxpayers will have increased knowledge as to their ability to have proposed penalties relieved.

### **Background**

The IRSAC and previous advisory committees have worked with the IRS for years to assist with taxpayer education and application of penalty relief. The goal of these discussions was to achieve a process that gained efficiencies for both taxpayers and the IRS while at the same time offering education to taxpayers on their options as to how to respond to penalty notices. Throughout these discussions the IRS has been a tremendous partner in achieving our mutual goals.

Taxpayers seeking penalty relief draft reasonable cause abatement requests for the IRS to review and determine if the facts and circumstances were present in order to grant penalty relief. This process requires a tremendous amount of time, effort and resources from both the taxpayer and the IRS. The results were inconsistent on reasonable cause relief and most taxpayers were unaware of their ability to utilize a First Time Abate (FTA) waiver for failure to file, pay or deposit tax penalties under §6651, 6698, 6699 and 6656, if the taxpayer qualified for it.

### **Recommendations**

The IRS is considering a process where prior to notifying a taxpayer about proposed penalties, they will identify if a taxpayer qualifies for a FTA waiver and grant the taxpayer penalty relief automatically. If the taxpayer does qualify for the FTA, the IRS will notify the taxpayer through an official mailing. The IRSAC applauds the IRS for considering this efficient process for handling penalty waivers. The IRSAC recommends the notification to the taxpayer of the FTA application also include information that if a taxpayer chooses to utilize a reasonable cause abatement, they may do so within a thirty-to-sixty-day timeframe. The IRSAC believes taxpayers should retain the right to choose whether or not to pursue penalty abatement through a reasonable cause defense, even if a FTA is available to them. The IRSAC recommends the Office of Servicewide Penalties retroactively

apply the reasonable cause abatement to the taxpayer's account, thus preserving a possible future FTA waiver.

## **ISSUE FOUR: Guidance Relating to the Tax Cuts and Jobs Act**

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### **Executive Summary**

The IRSAC recommends the IRS continue to place an emphasis on needed guidance as a result of the Tax Cuts and Jobs Act (TCJA). The IRSAC commends the IRS for their efforts in developing a central location on IRS.gov to place guidance that has been released (IRS.gov/tax-reform). To date, approximately 30 regulations, 11 treasury decisions, 29 revenue procedures, five revenue rulings and 34 notices have been issued relating to the TCJA. This guidance includes critical issues ranging from the Global Intangible Low-Tax Income to the qualified business income deduction under §199A. The IRS should not falter in the effort to release needed guidance. For example, employers are seeking guidance, particularly in the tax-exempt sector on how to comply with the calculation for Unrelated Business Income from providing parking to employees and how to properly identify a separate trade or business for the Unrelated Business Income Tax (UBIT).

### **Background**

The Tax Cuts and Jobs Act, H.R. 1, (TCJA) was signed into law on December 22, 2017, with many provisions becoming effective on January 1, 2018. The act was an overhaul of the U.S. tax code, which impacted nearly every individual, business and tax exempt entity. Tax rates changed, deductions and credits were introduced or expanded, and some were suspended or eliminated. Many provisions were included affecting the tax exempt & government entities division that are unprecedented and left many taxpayers concerned with meeting their tax compliance obligations.

### **Recommendations**

The IRSAC recommends the IRS continue to dedicate the resources necessary for areas of guidance needed that are identified by industry. While not intended to be an exhaustive list of needed guidance, requests have been made on the following topics; §512(a)(6) UBIT “Basketing”, §512(a)(7) Increase in UBIT due to disallowed fringe benefits and §199A Qualified Business Income deduction. The IRSAC further recommends the IRS grant penalty relief to those taxpayers

who can demonstrate a good-faith effort in complying with unclear provisions of the TCJA.

## **ISSUE FIVE: Attorney Positions Should Be Retained in the Office of Professional Responsibility**

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### **Executive Summary**

The IRS intends to phase out attorney positions (GS-905 series) in the Office of Professional Responsibility (OPR) and replace them with non-attorney positions.<sup>47</sup> While open OPR positions *could* be filled with personnel with legal degrees, such staff could not act as attorneys. The IRSAC recognizes that this decision has been made by the Treasury Department General Counsel, but believes it is appropriate for the IRS Commissioner to recommend in favor of maintaining attorney positions (GS-905 series) in OPR in light of OPR’s singular role within the IRS.

### **Background**

OPR has “exclusive responsibility for discipline, including disciplinary proceedings and sanctions”<sup>48</sup> related to all practitioner conduct in practice before the IRS. This role requires independence and nuanced legal judgment. The American Bar Association Section of Taxation (ABA Tax Section) wrote to the IRS Commissioner on August 7, 2019, stating “OPR’s independence is vital to carrying out its mission. OPR requires independent attorneys who can provide conflict-free services in setting and enforcing ethical and disciplinary standards for practice before the Service. In addition, the Section believes attorneys are uniquely trained and qualified to carry out this essential role.”<sup>49</sup> The IRSAC has reviewed the comments submitted by the ABA Tax Section and strongly supports these comments.

The IRSAC views the role of attorneys as vital to preserving the independence of OPR (as distinct from the IRS enforcement functions) and views as critical to the effectiveness and fairness of OPR the specialized legal training of attorneys in addressing issues such as privilege and conflicts of interest—sensitive issues that often arise in OPR cases. Further, in the experience of IRSAC’s

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<sup>47</sup> Kristen A Parillo, *IRS to Gradually Eliminate Attorneys From OPR*, Tax Notes Today (Apr. 1, 2019), <https://www.taxnotes.com/tax-notes-today/professional-responsibility/irs-gradually-eliminate-attorneys-opr/2019/04/01/299tz>.

<sup>48</sup> 31 C.F.R. §10.1(1).

<sup>49</sup> <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/080719comments.pdf>

members, it is often challenging to hire attorneys for non-attorney positions because such positions may be career-limiting for attorneys.

**Recommendation**

The IRSAC recommends the Commissioner advocate for continuing to employ attorneys acting as attorneys in the GS-905 series in OPR as such attorneys are essential to the independence, effectiveness and fairness of OPR. As OPR is tasked with oversight of professionals practicing before the IRS, the public perception of the IRS's oversight of these practitioners is critical to IRS operations. In the alternative, the IRSAC urges the Commissioner to be sensitive and responsive to any diminution in the independence, effectiveness and fairness of OPR as a consequence of phasing out the attorney positions in that office.



## **ISSUE SIX: Continued Support to Improving the Free File Program by Increasing IRS Oversight and Re-evaluating the MOU**

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### **Executive Summary**

The IRS provides opportunities for individual taxpayers to access free tax filing options from the IRS website; one of those options for qualified individuals is the Free File program. The IRSAC believes that with increased oversight and accountability, the Free File program provides a valuable resource and tax administration tool, particularly for the targeted population of low to middle income taxpayers. The IRSAC continues to advocate for recommendations made in the 2018 Public Report<sup>50</sup>, and included at the end of this report.

### **Background**

Last 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), though widely known as the Free File Alliance (FFA).<sup>51</sup> 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.

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 concluded that the Free File program remains viable and developed a list of recommendations for the MOU and for the IRS to improve oversight and usage. The IRSAC continues to advocate for full implementation of these recommendations.

The Free File program currently operates under the Eighth Memorandum of Understanding<sup>52</sup> (MOU) between the IRS and the FFA which was signed on October 31, 2018, and will expire on October 31, 2021. This MOU was signed prior

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<sup>50</sup> See 2018 IRSAC Public Report 14-18, <https://www.irs.gov/pub/irs-pdf/p5316.pdf>

<sup>51</sup> 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.

<sup>52</sup> See Eighth Memorandum of Understanding on Service and Disputes between the Internal Revenue Service and Free File, Inc., (November 2, 2018).

to the release of the IRSAC's 2018 Public Report but incorporated several recommendations made by the IRSAC. We are encouraged that the IRS also communicated in November of 2018<sup>53</sup> that they were implementing a few recommended changes, the results of which are unknown.

While there was an estimated 5.7 percent increase in the 2019 filing season, continued low participation rates among taxpayers in the Free File program is concerning.<sup>54</sup> However, the IRSAC still believes that the program is viable and warrants investment of IRS resources and sponsorship. With more robust protection, oversight and promotion, we believe there can be increased participation in the Free File program that will ensure a fair and transparent free tax filing option for taxpayers, particularly those “economically disadvantaged and underserved populations.”<sup>55</sup>

### **Recommendations**

The IRSAC strongly recommends that the IRS re-evaluate the current MOU, as well as internal practices, taking into consideration the IRSAC's recommendations, the results of the 2019 internal review<sup>56</sup> as well as the Treasury Inspector General for Tax Administration (TIGTA) audit which has not yet been released.

The IRSAC's following 2018 recommendations, updated in red for 2019, for the IRS Free File program are divided into two areas of focus. 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.

#### *2018 Recommendations for the IRS (red indicates current status July 2019)*

- 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. **Active, IRS is studying the issue.**
- Develop more robust processes for reviewing best practices of the FFA and its members to ensure fairness, objectivity and transparency. One way to

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<sup>53</sup> IR-2018-213(Nov 2, 2018)

<sup>54</sup> See IR-2019-40 indicating 1.4 million taxpayers used Free File to file their 2018 return as of March 8, 2019, a 5 percent increase over the same time in the prior year (March 13, 2019).

<sup>55</sup> 2018 MOU, Article 2.

<sup>56</sup> IRS statement May 3, 2019

achieve this goal is through an annual independent audit of each member of the FFA. **Implemented partially.**

- 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. **Active, per IRS "The additional in-season reviews of the members were performed in the Spring by IRS and FFI's auditor: there were no findings of violations of the MOU."**
- 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. **Closed as this would be inconsistent with IRS.gov's policy. As an alternative, we recommend a disclaimer be placed on the IRS website page (that lists the vendors) stating the individual will be leaving the IRS site. IRS update: The company list page is being considered for updates based on review by web experts. IRS will consider the disclaimer subsequently recommended by IRSAC along with the web expert's advice.**
- 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 and free fillable forms, but also to other free e-filing alternatives sponsored by the IRS, including the Volunteer Income Tax Assistance (VITA) program. **Implemented partially.**
- 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. **Closed, no action taken. The IRSAC believes that there can be valuable additions to the look up tool that effectively screen for the primary causes of ineligibility without adding substantial burden for taxpayers.**

*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. **Active, but no additional information is provided at this time as the IRS has indicated that this item may be considered for the 2021 MOU expiration.**
- Share with the IRS each FFA member's high-level statistical information, particularly conversion rates, to assist in measuring taxpayer experience with the program as well as the overall success/failure of the program. **Active, but no additional information or feedback was provided to the IRSAC.**
- 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 both confusing and potentially misleading depending on the content of the advertising. **Active, but no additional information or feedback was provided to the IRSAC.**

- 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. **Closed, no action taken.**
- Require that Free File users returning directly to FFA members' websites the following year (and not through the IRS website) can easily be directed to and reach FFA members' Free File websites. **Implemented fully.**
- Develop metrics for increased oversight of the Free File program and for FFA members' compliance with the MOU. **Implemented partially, but no additional information or feedback was provided to the IRSAC.**
- 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. **Closed, no action taken. The IRSAC believes this is still a viable recommendation that will enhance the accountability of the program.**
- Require the FFA to spend a certain percentage of its membership dues for advertising and promotion of the program. **Active.**



**Internal Revenue Service Advisory Council**

**Small Business/Self-Employed Subgroup Report**

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## **INTRODUCTION / EXECUTIVE SUMMARY**

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The Small Business/Self-Employed (SB/SE) division of the IRS aims to help small businesses and self-employed taxpayers understand and comply with their tax obligations. The SB/SE division is strategically focused on addressing the tax gap, improving customer service, enhancing business processes and systems, reducing burden and increasing stakeholder engagement. The IRSAC's SB/SE subgroup represents a diverse group of tax practitioners, including professionals from accounting and law firms, software providers, payroll processors, academia and gig economy platforms. The subgroup appreciated the opportunity to discuss issues impacting the SB/SE's mission and enjoyed sharing its varied experience with SB/SE leadership and staff.

In support of the SB/SE's mission and strategic objectives, the subgroup addressed issues concerning the Tax Cuts and Jobs Act (TCJA), taxpayer burden related to the Affordable Care Act (ACA) and various issues stemming from the gig economy and tax gap. Specifically, this report sets forth observations and recommendations on the following issues:

- The new Form W-4, which addresses the new wage withholding requirements under the TCJA;
- The availability of a qualified business deduction (Sec. 199A) for owners of domestic pass-through business entities;
- Tax reporting and compliance related to the gig economy and its impact on the tax gap;
- Taxpayer training thru updates to the "Small Business Taxes: The Virtual Workshop";
- Taxpayer burden and relief related to ACA compliance;
- Commentary on the new Form 1099-NEC, which reports non-employee compensation and other items that might result from participation in the gig economy;
- The growing trend toward "on-demand" pay and the need for additional guidance; and

- Increasing compliance through the alignment of the Form 945 to amounts reported on Forms 1099.

The subgroup looks forward to its continued partnership with the SB/SE division as it reviews and implements the recommendations in this report.



## **ISSUE ONE: Form W-4 2020 Version**

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### **Executive Summary**

In 2020 the Internal Revenue Service will be introducing a new W-4 and W-4P. These forms eventually will be used by all taxpayers that receive Forms W-2 and W-2P. The new form is necessitated by changes in the Tax Cuts and Jobs Act (TCJA) and more accurately calculates withholdings. While this form is more accurate, it is a major change from the W-4 and W-4P that taxpayers have used for the past 30 years. Employers and taxpayers will need to understand the new form and must use the new form for any new employment or changes after December 31, 2019.

### **Background**

Public Law No. 115-97, often referred to as the Tax Cuts and Jobs Act (TCJA), was enacted on December 22, 2017, with the bulk of the law taking effect for the 2018 tax year. Employees received the benefit of the law's reduced tax rates soon after the 2018 withholding tables were issued on January 11, 2018. The second early release draft of the 2020 Form W-4, *Employee's Withholding Certificate*, was released on August 8, 2019. The form eliminates allowances for the employee's spouse and dependents because of the TCJA's reduction of the personal exemption amount to zero but allows employees to claim the increased child tax credit and new non-child dependent tax credit to reduce the amount of tax withheld.

Current employees are not required to submit a 2020 Form W-4 to their employers unless they wish to make a change to the form that they have on file but are encouraged to do a "Paycheck Checkup" by using the IRS's revised withholding estimator. Because the TCJA nearly doubled the standard deduction, many people are now filing their Form 1040 returns taking the standard deduction when in the past they itemized their deductions. This change is heightened by the limitation of state and local tax (SALT) deductions to \$10,000, the limit on interest deductions for mortgages exceeding \$750,000, and the elimination of most miscellaneous deductions including non-reimbursed employee business expenses.

Allowing two significantly different versions of Forms W-4 or W-4P for an extended period is confusing to both employers and employees/retirees. The IRS is constantly trying to educate the public to check their withholding. The IRS has stated they will accommodate both 2020 and prior year versions of Forms W-4 and W-4P when the 2020 income tax withholding tables are released. While there are no “exemptions” or “allowances” per se on the draft 2020 Form W-4 (other than the two or three allowances assigned to the employee based on filing status), allowing the continued use of pre-2020 version Forms W-4 and W-4P implies that they still exist. Under the new system, an employee indicating “single or married filing separately” or “head of household” will receive two allowances and an employee indicating “married filing jointly” will receive three allowances.

Employer payroll systems will need to identify at the employee level which Form W-4 or W-4P method is being used – 2020 or pre-2020. Having the employer maintain dual withholding calculation systems/processes causes unnecessary administrative burden and costs to employers and payroll service providers (in addition to being confusing to employees and payors). This burden will go on for years until an employee with a Form W-4 issued prior to the new 2020 W-4 either files a changed W-4 or quits working for the employer. Additionally, in 2020 if the employee finds they are under-withheld due to having income tax withheld based on a pre-2020 Form W-4 or W-4P, he or she will need to file a 2020 W-4 / W-4P.

To avoid the potential of under-withholding it is believed many employees will not update their Form W-4 or W-4P status and to simplify reporting requirements, the IRSAC recommends that the IRS review the decision to allow pre-2020 Forms W-4 or W-4P to be used indefinitely and require employees to file a 2020 Form W-4 by a certain date (e.g., Oct. 1, 2020). This would be consistent with the timing for requiring new Forms W-4 and W-4P after enactment of the Tax Reform Act of 1986. This would also encourage employees/retirees to file a 2020 Form W-4 or W-4P sooner rather than later. The IRSAC understands that the IRS believes that this recommendation might require Congressional action, but believes it is in the best interest of taxpayers to use a Form W-4 and

W-4P that is consistent with current law and is designed to reach a correct amount of income tax withholding.

The 2020 Form W-4 has a check box to withhold at a higher rate in Step 2. The line instructions state “Consider checking the box on line 2 if there are only two jobs in the household. The standard deduction and tax brackets will be divided equally between the two jobs.” Nowhere do the instructions explain what this language means. Only in Publication 15-T is this explained. The IRSAC believes this will increase confusion for taxpayers and employers and recommends more detailed explanation and examples of increased withholding if the Step 2 box is checked. At the least, the instructions should reference Publication 15-T for more information on this point.

Prior to January 1, 2020, employers that do not receive a Form W-4 or W-4P for new employees or receive an invalid Form W-4 or W-4P from an employee (and have no valid Form W-4 or W-4P on file for that employee) are instructed to withhold as if the employee claimed to be a single filer with zero withholding allowances (married with three allowances for retirees who do not submit Form W-4P or submit an invalid form). For 2020 this does not seem to be the correct result. It is the IRSAC’s belief that the proper withholding for the above situations would be based on a filing status of single with two allowances. IRS Frequently Asked Questions (FAQs) regarding Form W-4 do provide some clarification by stating that any new employees who do not submit a 2020 Form W-4 “will be treated as a single filer with no other adjustments.” The IRSAC recommends that the IRS provide further clarification through written guidance for these two specific situations.

Taxpayers remain confused about their federal income tax withholding. The new withholding estimator that appears on the IRS website is using the old marital status and allowance routine (for all but spousal and dependent allowances) because it applies for 2019. It also requires taxpayers to come prepared with their prior year tax return and a current paystub to properly use the estimator. In 2020 the estimator will have to be replaced by one based on the new Form W-4 and W-4P method of withholding, which is very different than

what has been used for the last three decades. The IRSAC believes that many employees will not complete and submit a new Form W-4 or W-4P to their employers due to the changes and the confusion the employees will have in completing the new form and using the estimator. In the past, employers and payroll professionals have been instructed not to assist employees with Form W-4 submission to avoid being put in the role of tax advisor. The complexities of the new Form W-4 will add additional pressure on employers to take a more active part in the taxpayer education process.

The new estimator is an improvement and quite user-friendly. It still requires the user to have computer access and a recent pay stub and does provide a nice summary at the end to help the employee complete a Form W-4.

### **Recommendations**

1. The IRSAC recommends the IRS update the withholding estimator to account for the 2020 Form W-4 and W-4P changes as soon as possible.
2. The IRSAC recommends the IRS further clarify the rules and procedures for federal income tax withholding in 2020 and require employees to submit a new 2020 W-4 by October 1, 2020.
3. The IRSAC recommends the IRS further clarify the “withhold at a higher rate” check box in step 2 and provide examples of the higher amounts of withholding. The IRSAC further recommends the IRS state that the employee could check Single status even when married to have additional withholding (as in prior years).
4. The IRSAC recommends the IRS provide guidance to employers that do not receive a 2020 Form W-4 for new employees hired after January 1, 2020, or that receive an invalid Form W-4 or W-4P. Further, the IRSAC recommends the IRS provide consistent guidelines for employers to follow for invalid Form W-4 or W-4P for years prior to 2020 (was S-0).
5. The IRSAC recommends the estimator should produce a prefilled Form W-4 the taxpayer could print, sign and submit to their employer. Further, the estimator should have a disclaimer at the end that says if the taxpayer is using the estimator during a year, the taxpayer is encouraged to redo the

estimator at the beginning of the next year to accurately compute withholdings.

6. The IRSAC further recommends that the IRS encourage employers to distribute the 2020 Instructions for Form W-4 to all employees or provide the link to the document's location on the IRS website to the employees.

## **ISSUE TWO: Section 199A Qualified Business Income**

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### **Executive Summary**

The Tax Cuts and Jobs Act of 2017 (TCJA) reduced the corporate tax rate to 21 percent and included a provision for a qualified business income tax deduction (IRC Sec. 199A) for owners of domestic pass-through business entities to allow the owners' taxation of qualified business income to be more in line with the taxes paid by C corporations. With the deduction, qualified business income would be taxed at an effective tax rate of 29.6 percent for an owner in the highest income tax bracket. Sec. 199A is effective for taxable years beginning after December 31, 2017, through taxable years beginning before January 1, 2026.

The Small Business/Self-Employed Division requested the IRSAC's feedback on the effectiveness of its guidance and outreach to help taxpayers file timely and accurately when claiming the 199A deduction for Tax Year 2018 and suggested additional guidance and outreach for future tax years.

This deduction has no historical precedent and is a key part of tax reform.

### **Background**

The IRS estimates that almost 23.7 million taxpayers may be eligible to claim the deduction.<sup>57</sup> The Joint Committee on Taxation estimated a tax reduction of \$27.7 billion in Fiscal Year 2018 and \$47.1 billion in Fiscal Year 2019 and totaling \$414.5 billion over Fiscal Years 2018 through 2027.<sup>58</sup>

On March 23, 2018, the Consolidated Appropriations Act, 2018 made technical corrections to 199A to remove a provision that gave farmers a new tax incentive to sell crops to certain buyers.

The IRS released proposed regulations for 199A on August 16, 2018. On January 18, 2019, the IRS released (published on February 8, 2019) final regulations that adopted and modified the proposed regulations. The proposed regulations issued in August 2018 included a reliance clause allowing taxpayers to use the proposed regulations in preparing 2018 tax returns. The final regulations also provided that taxpayers could choose to rely on either the proposed

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<sup>57</sup> TIGTA Report dated March 18, 2019 Reference Number 2019-44-022 (TIGTA 199A Report)

<sup>58</sup> Ibid

regulations, in their entirety, or the final regulations, in their entirety, in preparing 2018 tax returns.

IRS also posted Frequently Asked Questions (FAQs) to the IRS website on August 8, 2018, after releasing the proposed regulations. On April 11, 2019, additional FAQs were added. More FAQs were added on June 28, 2019, after additional guidance was issued on Patrons and Cooperatives.

Simultaneous with the release of the final regulations, the IRS released new proposed regulations covering the following issues not previously addressed specifically: (1) the treatment under 199A of previously suspended losses, (2) 199A dividends paid by a RIC and (3) the treatment of amounts received from split interest trusts and charitable remainder trusts. Revenue Procedure 2019-11 provides methods for calculating W-2 wages for 199A and Notice 2019-07 contains a proposed revenue procedure that provides a safe harbor for rental real estate enterprises to be treated as a trade or business solely for 199A. The final rental real estate safe harbor was released on September 24, 2019, and was published as Revenue Procedure 2019-38 on October 15, 2019.

IRS provided "soft guidance" in web content, webinars, practitioner education at the 2018 IRS Nationwide Tax Forums, computational worksheets in publications and instructions and directed communications with software developers through Council for Electronic Revenue Communication Advancement (CERCA).

IRS is working on additional guidance to be issued in various forms to assist with compliance with 199A. Issuing this guidance is a priority within the IRS.

The TIGTA 199A Report highlighted the proactive steps IRS initiated regarding implementing 199A. The proactive steps included:

- The IRS established an implementation team with representatives from both the Small Business/Self-Employed and the Large Business and International Divisions.
- The Tax Reform Implementation Office has centralized responsibility for leading and coordinating IRS implementation efforts. The Tax Reform Implementation Office worked with the business units to identify impacted areas, *i.e.*, tax

products, employee training, etc., and to track the progress of the implementation efforts.

- The IRS also created an action plan outlining necessary actions to update existing forms, instructions, and publications; determine necessary computer programming updates; communicate changes externally; provide training to employees, etc.
- The IRS developed a communication strategy to provide taxpayers information about the Qualified Business Income Deduction. The IRS plans to provide information through various outreach platforms including IRS.gov, videos, webinars, social media and events. Outreach began in July 2018 with the start of the Tax Forums, and communication will continue throughout Calendar Years 2018 and 2019.<sup>59</sup>

For the 2018 tax year, taxpayers were uncertain on how the 199A provisions would apply to many types of businesses. For example, before the proposed regulations were issued, taxpayers were uncertain on how broadly the provision would be applied to disallow the deduction in the case of personal service income from a trade or business where the principal asset was the reputation or skill of one or more owners or employees. Another provision that created uncertainty was whether a rental real estate activity would be treated as a trade or business for purposes of Section 199A. Taxpayers spent considerable time and money trying to understand the complex and highly technical provision by engaging tax professionals. Some FAQs were issued in April 2019 after many 2018 business and personal tax returns had been filed, potentially causing amended returns to be required. Tax professionals were required to notify clients impacted by the late guidance increasing their workload during an already busy time.

Tax software companies rely on IRS guidance when updating their software to comply with tax legislation. Having guidance issued after the software has been updated increases the cost to the software company by having to update their software more than once. In addition, taxpayers have used the software and filed tax returns before the software was updated for the most recent guidance.

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<sup>59</sup> Ibid



Taxpayers may not be aware of any change and may not know that their tax returns have not been filed properly or that amended tax returns may be required. The software companies had to create an outreach program to inform its customers of the impact of the additional guidance. Also, the tax software may not be adequately developed to automatically calculate the deduction leaving calculations to be performed by the taxpayer or the tax professional. This situation can lead to errors in calculation, taxpayers not taking the deduction and inconsistencies among taxpayers in applying the provision. Although the Tax Reform Implementation Office (TRIO) was in regular communication with CERCA throughout the implementation process, software providers had to scramble to update their programs given the late date that this guidance was provided.

The definition of Code Section 162 is important when evaluating if a business is eligible for the Sec. 199A deduction. It is most important when evaluating a rental real estate business. The IRS has indicated the definition of Code Section 162 is beyond the scope of 199A, but the number of Code provisions that now refer to Sec. 162 has grown significantly. The draft Instructions for Form 8995, *Qualified Business Income Deduction Simplified Computation*, state: "In general, to be engaged in a trade or business under section 162, the activity must be conducted with continuity and regularity, and the primary purpose for engaging in the activity must be for income or profit." Referring to case law and legislative history may not provide consistent tax treatment under the same or similar fact patterns. Not having more discussion about or providing a framework of factors to complete the analysis of Code Section 162 causes a great deal of uncertainty for taxpayers evaluating the ability to take advantage of the Sec. 199A deduction.

Taxpayers were uncertain on where to report rental income that is deemed to be a trade or business either because it met the definition of a trade or business, the taxpayer elected to use the rental real estate safe harbor or was treated as a trade or business due to the self-rental rules. The draft Instructions for Recipient to Form 1099-MISC box 1 were also confusing. It provided for the recipient to report rents from real estate on Schedule E of Form 1040 or 1040-SR, but it also provided to report rents on Schedule C of Form 1040 or 1040-SR if one provided

significant services to the tenant.

### **Recommendations**

The IRS should be commended for delivering final tax regulations, a proposed regulation, a Revenue Procedure and a Notice regarding 199A during the shutdown and while working with reduced staff.

The IRSAC appreciates the 199A guidance issued to date and understands that the IRS had to provide significant guidance on many provisions of the TCJA in a short amount of time. The IRSAC also recognizes the lengthy process of providing guidance. The IRSAC proposes these recommendations:

1. Provide guidance early enough for taxpayers and tax practitioners to have sufficient time to evaluate the guidance, given each taxpayer's situation, and to determine whether the provisions will apply. Provide additional guidance on these issues:
  - a. Application of the provision to rental real estate enterprises when a taxpayer has triple net leases on multiple properties.
  - b. Information reporting requirements on Form 1099 for trade or business activities especially those related to rental real estate enterprises. Such guidance should address when the rental activity is treated as a trade or business because it is combined with a commonly controlled related trade or business for 199A.
  - c. Clarification that the self-employment tax doesn't apply to a rental real estate enterprise which rises to the level of a trade or business or one treated as a trade or business under 199A.
  - d. Clarification on whether Schedule C or E is used for the rental real estate enterprise activity which rises to the level of a trade or business or one treated as a trade or business under 199A.
  - e. Clarification on whether all businesses located in U.S. Possessions are eligible for 199A. The final regulations define the term United States to include only the Commonwealth of Puerto Rico.

2. Expand the education and information outreach communication plan to include the use of social media, podcasts, more webinars and YouTube videos. The IRS had two webinars, one YouTube video and sessions at each of the 2018 and 2019 IRS Nationwide Tax Forums on the 199A deduction. The 2019 IRS Nationwide Tax Forums video will be posted to IRS.gov in the fall of 2019. Additional webinars and YouTube videos can cover different aspects to the 199A deduction to assist taxpayers and tax practitioners with understanding the nuances of the deduction. The nuances could include the application of the provision to rental real estate enterprises, the calculation of unadjusted basis immediately after acquisition (UBIA) especially when there has been a transfer of a partnership interest by sale or exchange or on the death of a partner, instances when there can be multiple activities within one entity and the impact of the taxpayer's taxable income once it exceeds the threshold.
3. Have a dedicated webpage on the IRS website for 199A. Currently, the 199A information is in various locations on the website. Having a dedicated webpage would provide a central location for taxpayers and tax practitioners to view in order to find information on 199A. Since everything would be in one place, it will also be easier for the IRS to make changes and have a consistent message.
4. Include a high-level discussion of 199A in the 2019 version of Publication 535, *Business Expenses*. Refer to Forms 8995 and 8995-A to allow for fewer products to be changed if necessary and to provide a consistent message. The 2018 version of Publication 535 didn't include the simplified worksheet for calculating the 199A deduction. The worksheet was included only in the 1040 instructions.
5. Create tools to assist taxpayers and tax practitioners in applying the provision. Tools could include:
  - a. A worksheet to calculate UBIA when there has been a transfer of a partnership interest by sale or exchange or on the death of a partner.
  - b. A worksheet or form to track 199A losses from year to year.

- c. A flowchart to determine if an activity is a specified service business and if it is eligible for the deduction.
  - d. A flowchart or a worksheet to determine how suspended losses impact the 199A deduction.
- 6. Train the telephone assistors regarding 199A. The telephone assistors were not answering 199A questions for preparing 2018 tax returns. The assistors staffing the tax practitioner hotline telephone were also not answering questions regarding 199A, but they were referring callers to the tax return instructions and to Publication 535. Since 199A is a complex area, the IRS should train a select group of individuals to answer questions for taxpayers, and callers should be referred or transferred to that select group by other telephone assistors.

## **ISSUE THREE: Sharing Economy and Impact on the Tax Gap**

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### **Executive Summary**

The sharing economy (also called the gig economy or the on-demand economy) has become an important segment of our economy, and it is evolving and growing at a very high rate.

Recent studies have been conducted that estimate that there are millions of workers participating in the sharing economy and that hundreds of billions of dollars earned in the sharing economy may be under-reported or non-reported. This has a significant impact on the tax gap.

### **Background**

The IRS has developed a comprehensive IRS Sharing Economy Communication Plan. The IRSAC commends the IRS for these efforts and encourages a commitment to continuing progress on the plan with respect to development and implementation of a variety of targeted communications and efforts (e.g., news releases and social media messages, stakeholder outreach, podcasts, webinars, YouTube videos and use of third-party communications, such as drop-in articles and tax tips).

The IRSAC also commends the IRS for developing a very comprehensive website aimed at education of participants in the sharing economy and for seeking stakeholder feedback, conducting thoughtful analyses on the site and for taking steps to redesign the site to increase usability and the site's effectiveness for payors, service providers and tax professionals.

Under Internal Revenue Code (I.R.C.) Section 6050W, as enacted by the Housing Tax Assistance Tax Act of 2008, payment settlement entities are required to file an information return for each calendar year to report payments made in settlement of reportable payment transactions. I.R.C. Section 6050W covers reportable payment transactions which are payment card transactions or third party network transactions. Third party network transactions are reported by a third party settlement organization (TPSO). Under I.R.C. 6050W, a TPSO must report the gross amount of third party network transactions for a participating payee (e.g.,

Service Provider) if the amount to be reported exceeds \$20,000 and the total number of transactions with that Service Provider exceeds 200.

Treas. Reg Section 1.6050W-1(a)(6) defines the gross amount to be reported as the total aggregate reportable payment without regard to any adjustments (e.g., credits, discounts, fees, refunded amounts). The TPSO reports the gross amount of all reportable payment transactions (i.e., amounts over \$20,000 and 200 transactions) to the Service Provider on Form 1099-K, *Payment Card and Third Party Network Transactions*. The reporting thresholds for Form 1099-K are much higher than under Form 1099-MISC (amounts reported over \$600 in a calendar year) or under Form W-2 (no threshold for reportable amounts).

Use of Form 1099-K for reporting by TPSOs to sharing economy service providers contributes to the tax gap in a significant way because no information return is required if payments to one provider are less than \$20,000 and the provider had fewer than 200 transactions during the year. The IRSAC recommends that the IRS focus on this important area of tax reporting and take steps to modernize Form 1099-K (instructions thereto and related guidance) so that it better reflects the types of transactions that are being reported and to help improve under-reporting and non-reporting of income by Service Providers. The IRSAC recommends also that the IRS issue guidance and take steps to educate the public and industry on how payments made in the sharing economy should be taxed and reported.

### **Recommendations**

The IRSAC recommends that the IRS:

1. Take steps to clarify the income reporting and filing responsibilities of those participating in the sharing economy. These steps would be aimed at educating the public, improving tax compliance related to under/non-reporting and non-filing by sharing economy workers and helping to reduce the tax gap. The IRSAC suggests use of a variety of outreach avenues to better connect with the widest audience in order to educate the public. For example, the IRS should consider use of social media, podcasts, webinars, YouTube videos, as well as print media.

2. Continue its work to redesign and keep refreshed the newly created IRS.gov Sharing Economy Tax Center.
3. Publish a definition of “gross amount” for purposes of transaction thresholds for reporting on Form 1099-K that excludes from the reportable amount items that are not part of the economic transaction between the parties. Specifically, the IRSAC recommends that the IRS provide a way to exclude from the reportable amount items that are not part of the economic transaction between the parties (e.g., discounts, returns, allowances and taxes collected on the transaction). The current full gross amount is not meaningful as a business transaction amount and is not easy to use from a reconciliation point of view. The IRSAC recommends that the IRS consider alternative ways of addressing this issue and might want to consider adding a box to Form 1099-K to allow voluntary reporting of an adjustment amount (e.g., for returns, allowances, discounts, etc.). The IRSAC recommends that the IRS work with businesses to understand better alternative definitions of “gross amount” that would be more useful for reporting purposes.
4. Consider reviewing the definition of “third party settlement organization” (TPSO) for purposes of tax reporting and filing to reduce the type of participants in the sharing economy whose income is reportable on Form 1099-K and thus, would be then reportable on other information returns such as Form 1099-MISC. The IRSAC suggests that the IRS focus this review on how the “tie breaker rule” is employed when determining when the regulations under section 6041 or 6041A apply, rather than when section 6050W should be applied.
5. Consider providing additional guidance on how to determine if payments made to service providers participating in the sharing economy are subject to reporting under section 6041 or 6041A, rather than 6050W with the aim at reducing under/non-reporting by sharing economy workers. Any guidance changes would necessitate a variety of communications as well as changes to the instructions for Form 1099-K.

6. Consider what regulatory or administrative steps the IRS can take to reduce the current high level of under/non-reporting by sharing economy workers. The IRSAC recognizes that the monetary amount (\$20,000) and transaction level (200 transactions) requiring Form 1099-K reporting are legislated by statute. The IRSAC recommends that the IRS consider the “tie-breaker rule” related to reporting under section 6041 or 6041A, rather than 6050W in order to reduce the level of under/non-reporting by sharing economy workers.



## **ISSUE FOUR: Tax Gap: Updating Small Business Taxes: The Virtual Workshop**

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### **Executive Summary**

The IRS requested the IRSAC's feedback on its approach and recommendations on topics to include in the Small Business Taxes: The Virtual Workshop.

The IRSAC commends the IRS for its work on educating small businesses and providing this material despite the lack of budget. The IRSAC continues to recommend that these video training programs be revised and updated. The IRSAC agrees that the new approach to keep the videos evergreen as well as not using paid actors/actresses to keep the cost down is a good approach.

The IRSAC recommends that segments such Reporting Cash Income, Bartering, and 199A be added as components to the repertoire of online videos. We believe that stressing the need to report all income as well as the benefits associated with reporting of income such as the 199A pass-through deduction, increase Social Security benefits, Earned Income Tax Credit and increased access to credit will help to encourage small businesses to report income and help close the tax gap.

### **Recommendations**

1. The IRSAC recommends that the IRS look at some of the low cost tools that are available on the market for producing educational videos such as MOHO Debut 12, Muvizu Play+, Vyond, etc. Videos can be made using avatars or with voice over as screen shots of forms or drawings are shown. The IRS should seek to find employees within the Service that have a video or broadcasting background or consider hiring one such individual.
2. The IRS should consider different alternatives for keeping the videos evergreen such as blurring of the year on any forms that are shown, using short YouTube videos which are easy to maintain and update should the need arise and continue to provide the videos in a modular format. In addition, YouTube is the second most used site, after Google. The IRSAC recommends that the videos be kept to two minutes or shorter as the

attention span and engagement drops off significantly after two minutes. This will also allow watchers to easily share on point videos. Having the text for the video available is also a good practice that the IRS should continue as some people are visual learners while others are auditory learners. The IRSAC recommends that the text is done in a more readable format perhaps along with slides that were used to create the videos. The text should be kept as short as possible as studies have shown that only 20 percent of people actually read articles from start to finish therefore by having text with each slide, will promote reading to the end of each slide. The IRSAC also recommends providing reference material links in a written form that is not at the bottom of the text but above the line. The reference material could also be provided in the video itself, as a link to a document that can be downloaded by a viewer.

3. The ability to add new content as new topics arise should also be top of mind. This year for example, a video on the new 1099-NEC and changes to the 1099-MISC would be pertinent. As guidance on cryptocurrency is available, that could be another topic to consider. 199A is also a topic that many small businesses find confusing.
4. There are tools available that the IRS may already have in house such as Camtasia and Audacity as well as the Adobe Suite. LinkedIn Learning offers free classes on both tools.

## **ISSUE FIVE: Issues Faced by Issuers and Applicable Large Employers under IRC §§ 4980H, 6055 and 6056**

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### **Executive Summary**

Issuers and applicable large employers (ALE's) still face burdens with respect to reporting under the Affordable Care Act (ACA). With the TCJA's reduction of the penalty for the individual shared responsibility payments under IRC §36B to \$0 beginning for tax year 2019, the IRSAC recommends that the IRS relieve issuers from penalties related to the furnishing of forms to their responsible individuals. Also, with almost two years of interacting with the IRS on the evaluation and assessment of employer shared responsibility payments, the IRSAC has recommendations for improvements to that process.

### **Background**

#### *Filing and furnishing of ACA information reporting forms*

The IRS announced in Notice 2018-94 in December 2018 that it was providing an automatic extension of the due dates to comply with the ACA's reporting requirements. The due date to furnish individuals the 2018 Form 1095-B, *Health Coverage*, and the 2018 Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, was extended from January 31, 2019, to March 4, 2019. In addition, this notice provided that penalties would not be imposed on health insurers and employers that make a good faith effort to comply with the reporting requirements, provided statements were furnished to individuals and filings were made with the IRS on a timely basis. Because the individual shared responsibility payment was reduced to zero for months after December 31, 2018, this Notice announced that the IRS and Treasury would be studying whether and how the reporting requirements under IRC Section 6056 would change going forward.

To date, the IRS and Treasury have not announced any changes to the reporting requirements. The IRSAC recommends that issuers be relieved of any penalties related to the furnishing of Forms 1095-B and 1095-C to recipients as the information on that form is no longer necessary for taxpayers with the

elimination of the individual shared responsibility payments in 2019.<sup>60</sup> Moreover, there would be little value in filing the Form 1095-B (or 1094-B) with the IRS. The IRSAC recognizes that, to administer the assessment and collection of the employer shared responsibility payments, much of the information required on Forms 1094-C and 1095-C would be necessary to be filed with the IRS.

However, in the absence of relief from penalties related to the furnishing of these forms to taxpayers, the IRSAC would recommend that the IRS continues to delay the furnishing date for 30 days from the January 31 deadline. The nature of the health insurance information required to be provided for everyone cannot always be collected in a manner to timely publish the forms by January 31. There are often situations where the offer and coverage of individuals in late December cannot be determined until late January or February. For example, some COBRA elections can be made in February which would implicate coverage in the preceding December. The human resource and benefits administration systems have frequent retroactive entries meaning that in the absence of the extension, the IRS may be inundated with numerous requests for extensions or issuers will be unduly burdened by the need to issue revised or corrected forms.

The IRSAC also recommends the continuation of the good faith accuracy penalty waiver. This waiver is required for the same reasons as it has been instituted in the past. Based on our anecdotal experience, the preponderance of errors being identified on these ACA forms continue to be around name/TIN mismatches, especially for dependents. Some employers have experienced these errors for employees whose name/SSN combination are not being flagged for the same combination when submitted on Forms W-2 for the same calendar year.

Proposed regulations were published on August 2, 2016, which explain a newly designed process by which solicitations must be done to allow filers to demonstrate reasonable cause for missing or incorrect TINs. Due to the burdens on the IRS to issue guidance under the Tax Cut and Jobs Act, it appears highly unlikely that these regulations will be finalized by the end of 2019.

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<sup>60</sup> The IRSAC recognizes that several jurisdictions have adopted their own individual mandates with the absence of payments being due at the federal level. Issuers will still need to issue these forms to residents of those jurisdictions under the statutes of those jurisdictions.

Especially in light of the number of these name/TIN errors as well as the problems highlighted in the Treasury Inspector General for Tax Administration report issued March 21, 2018<sup>61</sup>, filers are understandably nervous about the potential imposition of penalties for these purported errors. It is especially difficult to address these errors without TIN matching capability. While most of these errors might be abatable for reasonable cause, the mere act of assessing such penalties based on an imperfect system of matching names to TINs will put an undue burden on both the IRS and filers. It would be especially ironic to have penalties apply with respect to name/TIN errors on information concerning the enrollment of individuals on Forms 1095-B or 1095-C while that information will not be used in any way for federal tax administration.

For these reasons, we recommend that the good faith standard be extended until ACA-reporting specific TIN solicitation rules are finalized and the IRS's TIN name matching processes are significantly improved. We would recommend that such relief be extended to these specific TIN/name matching errors if broader relief is not forthcoming.

*Improvements to the employer shared responsibility payment assessment processes*

In late 2017 and throughout 2018 and 2019, large employers have received notices of potential assessments of liability for employer shared responsibility payments (Letters 226-J). These notices are being sent to the address that the IRS has for the legal entity in its business master file. This is an address that is generally established for tax administration, but it is not necessarily the address that the employer entered on its Form 1094-C. For many applicable large employers, the address and the person to contact on Form 1094-C references the employer's benefits department and a professional in that department. In some large organizations that means the Notices are being sent to an entity's tax department, which may or may not be aware of what these notices are and who in

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<sup>61</sup> Treasury Inspector General for Tax Administration, Affordable Care Act: Processes to Identify Employers Subject to the Employer Shared Responsibility Payment Need Improvement, March 21, 2018, highlighting needs to streamline TIN validations, p. 15-19.

their organization should craft a response. In extreme cases, the addresses may have been inadvertently changed on the IRS's business master file through an erroneous or inadvertent tax filing. When there has been a change in personnel, locations or ownership, these notices have gotten lost in large organizations which precludes a timely response. We recommend that the IRS leverage the employer address and contact person and telephone to contact employers who do not respond to a Letter 226-J within the first 30 days and alert that person of the existence of such a notice.

In addition, some applicable large employers are receiving Letters 226-J with a large list of assessable employees on the included Employee Premium Tax Credit (PTC) Listing, Form 14765. Currently, corrections must be entered directly on those forms (or PDF versions) of those forms. The IRS recommends that employers fax their responses to the Letter 226-J, including the Form 14765 with the corrections entered on that form. The loss in quality of faxed and refaxed forms has made legibility an issue. It would be extremely useful if the IRS could provide this form information electronically. Having this data electronically would greatly aid employers in reviewing the information concerning their employees on the list and preparing a response including corrections of inaccurate codes, if any. It would also alleviate delays due to the loss of legibility when the forms are faxed and refaxed several times.

### **Recommendations**

1. The IRSAC recommends that the IRS waive the penalties relating to the requirement to furnish Forms 1095-B and 1095-C considering the reduction of the individual shared responsibility payment to zero in 2019.
2. In the absence of a complete suspension of the furnishing requirement, the IRSAC recommends extending the furnishing deadline by 30 days as it has done for each calendar year's forms since 2019.
3. The IRSAC recommends that the IRS waive the penalties relating to the requirement of filing the Forms 1094-B and 1095-B.

4. The IRSAC recommends that “good faith efforts” penalty relief for reporting of incorrect or incomplete information reported on returns be extended to 2019 Forms 1095-B and Forms 1095-C filed in 2020.
5. The IRSAC recommends that, in enforcing the employer shared responsibility payment provisions: (a) the IRS utilize the contact information provided on Form 1094-C, and (b) make the Form 14765 available in an electronic format for review and response to the IRS.

## **ISSUE SIX: Form 1099-NEC**

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### **Executive Summary**

The Protecting Americans from Tax Hikes (PATH) Act of 2015 required nonemployee compensation to be reported to the IRS by January 31<sup>st</sup>. All other payment amounts reported on the Form 1099-MISC were not due until February 28<sup>th</sup>, if filing on paper, or March 31<sup>st</sup> if filing electronically. Having different due dates for the same form has been challenging for employers, third party reporting entities and the IRS. The Internal Revenue Service released a draft version of a new tax form called 1099-NEC to alleviate confusion with different filing dates created by the PATH Act of 2015.

### **Background**

In Tax Year 1983, the IRS eliminated Form 1099-NEC and expanded the Form 1099-MISC to include reporting nonemployee compensation. Since that time, nonemployee compensation has been reported in Box 7 of Form 1099-MISC.

The Internal Revenue Service has taken careful steps to develop a new draft Form 1099-NEC, *Nonemployee Compensation*, to be used starting with the 2020 reporting period. Box 1 reports nonemployee compensation. Boxes 4 and 5 are used to report applicable backup and state withholding respectively. A draft of the form is available on the IRS website: <https://www.irs.gov/pub/irs-dft/f1099nec-dft.pdf>

Box 2 of the draft form is a checkbox that has been reserved for 'Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale'. The instructions for this box state that 'If checked, \$5,000 or more of sales of consumer products was sold to you on a buy-sell, deposit-commission, or other basis. A dollar amount does not have to be shown. Generally, report any income from your sale of these products on Schedule C (Form 1040 or 1040-SR).' This box for sales of consumer products is also present on the 2020 draft Form 1099-MISC (Box 7). Having this checkbox on both forms causes confusion as to when a filer should report the Form 1099-NEC and when the 1099-MISC should be used. Through discussion with the IRS, the IRSAC learned that the decision to include this checkbox on the 1099-NEC was prompted by the option for filers to



report an amount in box 1 for non-employee compensation. This was the reporting behavior that the IRS experienced from filers when non-employee compensation and sales of consumer products were reported on the 1099-MISC. However, with the 1099-NEC being developed for the sole purpose of reporting non-employee compensation adding an amount of sales from consumer products to a form and box specifically labeled 'non-employee compensation' is being viewed as inaccurate.

Specific to the instructions, the draft Form 1099-NEC instructions for Payer refer to the 2020 General Instructions for Certain Information return. Additionally, the instructions for box 1 state: 'If you are in the trade or business of catching fish, box 1 may show cash you received for the sale of fish. This has caused confusion as to how impacted filers should reconcile transactions previously reported in box 5 of Form 1099-MISC for 'Fishing Boat Proceeds.'

### **Recommendations**

The IRSAC recommends the IRS either remove the box regarding consumer product sales from one of the forms or issue guidance as to when a seller should report sales on Form 1099-NEC vs Form 1099-MISC. It is the recommendation of the IRSAC that this transaction better aligns with Form 1099-MISC as the payments have nothing to do with nonemployee compensation. The IRSAC understands that previously filers have used the legacy 1099-MISC box for nonemployee compensation to report this amount. The IRSAC recommends that the IRS remove box 2 from the 1099-NEC and repurpose the open box (box 11) on the 2020 1099-MISC draft to provide filers the option of reporting the amount of sales from consumer products if the filer so chooses.

Given that backup withholding may be reported on Form 1099-NEC, the IRSAC recommends adding Form 1099-NEC to Publication 2108A making recipients of the form eligible for TIN Matching. Additionally, the IRSAC recommends the IRS make updates to include the 1099-NEC on Form 1096, Form 945 instructions, Publication 6961 and Publication 1220 record layouts for both the 1099-NEC & 1099-MISC.

The IRSAC recommends the IRS expand the instructions for Box 1 to

provide an explanation on when to use and how it is connected to the NEC. The Form 1099-MISC Box 7 instructions gave more detail and showed how it was connected to the nonemployee compensation. Additionally, the IRSAC recommends that the instruction specifically pertaining to cash received from the sale of fish be removed as this transaction type better aligns with box 5 of Form 1099-MISC for Fishing Boat Proceeds. Lastly, the IRSAC recommends that complete instructions should be included with the 1099-NEC rather than having the Payer refer to the 2020 General Instructions for Certain Information returns.

## **ISSUE SEVEN: On-Demand Payroll**

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### **Executive Summary**

There is a growing trend and clamor for “On-Demand Pay” or “Payroll On - Demand”, particularly in the gig economy. Some of this is driven by employees and independent contractors, some is driven by software companies wanting to sell more expansive and expensive software and subscriptions and some by lenders trying to increase revenue through additional service offerings.

There is no one model for on-demand pay. Essentially, it’s an umbrella definition. It’s not necessarily a loan, though it might be; it’s not necessarily an advance against already earned payroll, though it could be; it is not necessarily payroll, though it could be. Basically on-demand pay allows employees to access some or all of their earned wages on a shorter pay cycle than the normal pay period for their employer. There may or may not be costs and fees which may be paid by the employee, though not necessarily.

There is a need for guidance for employers, workers and payroll processors on the proper treatment and administration of the various forms of On-Demand Pay.

### **Background**

There are several questions that need to be addressed in regulating on-demand payroll. Some approaches currently being utilized may be arbitrary because there are numerous competing points of view in the absence of guidance from the regulatory agencies, including the IRS.

Various states are working on their own regulations which may or may not be compatible with what the IRS determines to be appropriate. Software companies and financial companies are also moving forward in the absence of guidance to put forth their ideas of what is the appropriate way to have on-demand payroll structured. Once such practices become embedded, it may be difficult for the IRS to effectively regulate the practices in a manner consistent with effective and consistent tax policy. The longer the wait for guidance from the IRS and other stakeholders, the more difficulty there will be in modifying existing practices to bring them into compliance with any such guidance.

After discussions with the IRS, the IRSAC was asked to prepare questions that need to be considered in the creation of a regulatory environment for on-demand payroll. Besides the IRS, the IRSAC had conversations with several software company representatives, discussions with employees and independent contractors, reviewed American Payroll Association documents and searched current literature.

Accordingly, the following is a list of issues, in no particular order, that the IRSAC feels need to be included in the discussion of guidance for on-demand payroll. Some of the issues clearly fall outside of IRS jurisdiction but need to be considered in the drafting of a regulatory framework.

*Issues for guidance concerning on-demand pay*

1. When is on-demand pay considered a payroll payment for tax purposes?
  - Must it be paid by the employer?
  - If a third party pays, can it be payroll?
2. When is on-demand pay considered a loan for tax purposes?
3. When is on-demand pay considered an advance for tax purposes?
4. When on-demand pay is considered a payroll payment, how are taxes calculated?
  - Tables based on daily payment?
  - Calculation based on percentages of a nominal period payroll's time?
  - Calculation of percentage of a payroll period average total?
  - Flat percentage?
  - Something else?
  - Or a combination of any of the above?
5. When on-demand pay is considered a payroll payment when is it includible in the taxable income of the employee?
6. Is it includible on the day of receipt or when the rest of the payroll for that period is paid? Note that how this is answered could involve treating the payment as made in different calendar quarters and years.

7. How do the concepts of “actual and constructive receipt” impact on-demand pay?
8. How will on-demand payments impact reporting on Forms W-2, 941 and 940?
9. Does the option to receive payroll through on-demand pay constitute constructive receipt even for employees who decline that option?
10. When is an on-demand payment deductible for a cash basis employer (*i.e.*, when paid to the employee or on the nominal payday of the pay period)? Note that how this is answered could involve treating the payment as being made in different calendar quarters and years.
11. If the employer sets up a true on-demand only payroll system and the employee let earnings accumulate past what would be the normal payday (*e.g.*, to provide a savings mechanism, or to create a fund for larger ticket items, or for some other reason), what are the tax implications for the employee and the employer? Might this constitute deferred compensation?
12. If an employee ends up in with a negative payroll balance (having taken out more demand pay disbursements than earned) at the end of the pay period, was some of what the employee received really payroll or does it have to be reclassified as a loan or even a gift from the employer? How would this impact the taxability of both parties to the transaction? Could there be a need for the employer to issue a Form 1099 for unearned income if this condition occurred at the end of a calendar year?
13. If paid by a third party and the payment is guaranteed back to the third party out of the employees’ paycheck; is it a loan or is it an advance payroll subject to tax withholding, depositing and reporting? If it is payroll, who reports it (*i.e.*, the employer or the third party)? Who is required to make the deposit of employment taxes?
14. How will daily “tip out” payments, paid to tipped employees, be affected by any new guidance?
15. What are the minimum wage considerations of fees that may be charged to the employee, whether related to payroll, an advance or a loan?

16. Are the fees charged by third parties to be considered fees or interest subject to usury laws? Note that the State of California is proposing (S.B. 472) exempting on-demand payroll from credit transaction rules, limits on fees, and more.
17. How should on-demand payments be represented on the earning statement? How should the payments be reflected in the year-to-date aggregations?
18. How should payroll deductions be calculated?
  - For child support payments; does it all come out of the initial on-demand payroll payment in a nominal pay-period or is it spread over the pay period in some way? If the employee receives out all available pay without paying full child support and quits, who is responsible for the unpaid child support?
  - What about tax levies?
  - If there is a flat dollar local tax, is it prorated over the pay period or should it be taken out of the first on-demand payroll payment?
  - How should ordering rules for the various types of deductions be applied to the on-demand payroll payments?

### **Recommendations**

The IRSAC recommends that the IRS pursue the creation of guidance for on-demand payroll, working with other stakeholders such as the Social Security Administration, Department of Labor, Consumer Financial Protection Bureau and possibly the various states, as quickly as possible that addresses the issues and questions outlined above.

## **ISSUE EIGHT: Employer Reporting, Form 945, Annual Return of Withheld Federal Income Tax**

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### **Executive Summary**

There is frequently a lack of consistency of employer identification number (EIN) on Forms 945/945-A and the related information returns. This inconsistency in EINs makes reconciliation of payee-level data to the annual return difficult and complicates the IRS's compliance efforts. The IRSAC understands that the topic of backup withholding also appears to be a misunderstood and confusing area for many taxpayers.

The Small Business/Self-Employed Division of the IRS requested the IRSAC's feedback on this issue and any suggestions on the IRS's current and planned efforts to improve compliance in this area.

### **Background**

Form 945, *Annual Return of Withheld Federal Income Tax*, is used to report withheld federal income tax from nonpayroll payments which are reported on Forms 1099 for various nonpayroll payment, and Form W-2G, *Certain Gambling Winnings*. Semiweekly depositors (and monthly depositors that accumulate \$100,000 or more monthly in nonpayroll withheld tax liability) must also use Form 945-A, *Annual Record of Federal Tax Liability*.

Nonpayroll payments include a wide variety of payment types, including items such as:

- Pensions, Annuities, IRAs and Military retirement
- Gambling winnings
- Payments subject to backup withholdings

Recipients of these types of payments receive a variety of information returns reporting the individual's income and any federal income tax withheld, including Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc.*, Form 1099-MISC, *Miscellaneous Income* and Form W-2G, *Certain Gambling Winnings*.

Form 945 reports nonpayroll withheld federal income tax from Pensions, Annuities, IRAs, and Military retirement, Gambling winnings, etc. on one line; and

Backup withholding on a separate line. All nonpayroll (Form 945) withheld federal income tax, including backup withholding, are combined for purposes of depositing withheld taxes.

Income tax reported on non-wage information returns is not always being reported consistently under the same employer identification number (EIN) as the tax on annual Form 945. This severely restricts the IRS's ability to reconcile the tax between these two sets of returns and hampers the IRS's backup withholding compliance program. The IRS recently issued Program Manager Technical Advice 2019-010. In this PMTA, the IRS said that it has the authority to require taxpayers that file Forms 945, *Annual Return of Withheld Federal Income Tax*, to use the same EIN when filing related information returns. The forms, publications, and instructions to Forms 945/945A and the related information returns do not make clear that there must be EIN consistency among these filings.

Several recent government reports have highlighted this significant compliance issue. A TIGTA Report dated May 20, 2019, (Reference Number 2019-40-028) provided information that this issue impacts billions of dollars of non-payroll payments. Similarly, an earlier TIGTA reports (Reference Number 2017-40-022) and a 2016 Back-up Withholding Audit report (Reference Number 2016-40-078) provide recommendations that the EIN inconsistency problem should be corrected to improve compliance.

The IRSAC understands the difficulty faced by the IRS when attempting to reconcile data reported on Form 945 and Form 945-A, to the information returns (namely, Forms 1099-R, 1099-MISC and W-2G). The IRSAC supports the IRS making needed changes to require that both information returns issued by the payor to the recipients, and data reported on Forms 945 (and 945-A) use the same EIN. This change should enable the IRS to improve the efficiency and effectiveness of its compliance efforts in the area of withheld taxes and reporting of nonpayroll payments. This is especially important as there appears to be an increase in amounts reported on Form 1099 and required backup withholding. EIN reporting consistency would enable the IRS to identify underreporting of backup withholding, specifically on Forms 1099-K, 1099-MISC, and W-2G. Consistency of



EIN would help improve the tax compliance gap. The IRSAC understands that the IRS has planned to make the needed changes to forms, instructions and publications to require consistent EIN reporting for Tax Year 2021. The IRSAC applauds this aggressive plan.

The IRSAC notes that many taxpayers lack awareness of compliance requirements in this area. In addition, the IRSAC cautions that taxpayer systems and processes may need to be modified to ensure that payors have the data needed to report tax information on information returns and on Forms 945/945-A consistently under the same EIN. The IRS has developed a comprehensive “Payor Awareness” communication plan aimed at providing education to taxpayers on EIN consistency with Forms 1099 and 945/945-A and education on the topic of backup withholding compliance rules. The backup withholding and reporting rules seem difficult for some taxpayers to understand and the IRSAC commends the IRS for also addressing this issue in its communication plan. The IRS has shared its communication plan with the IRSAC, and the IRSAC considers it to be well thought out. The IRS has established a team of 13-15 staff operating out of Cincinnati to focus on backup withholding and TIN compliance matters. The IRSAC commends these efforts as they will help ensure understanding of the issues from both the IRS and taxpayer points-of-view.

### **Recommendations**

The IRSAC recommends that the IRS:

1. Make needed changes to forms, publications and instructions, to require employer identification number (EIN) consistency in information return reporting and on Forms 945/945-A by tax year 2021 or sooner.
2. Fully implement the IRS’s communication plan to achieve payor awareness of the compliance requirements and to articulate a requirement for consistent EIN reporting. A timely IRS communication effort would be informative on tax compliance rules and would help enable payors to make any needed system and process changes to help ensure that information returns, and Forms 945/945-A are reported under the same EIN.

3. Continue focusing on training and education on backup withholding requirements for both taxpayers and IRS compliance and audit staff.
4. Continue to explore adding a Schedule R for Form 945/945-A to enable reporting of organizational structures as determined by the IRS to serve as an aid in compliance efforts.
5. Develop and issue a letter to the taxpayer when an EIN inconsistency is identified between information return reporting and Forms 945/945-A. This letter would be used to inform and educate the taxpayer for one or two years prior to issuance of any penalty for non-compliance.



**Internal Revenue Service Advisory Council**

**Wage & Investment Subgroup Report**

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## **INTRODUCTION / EXECUTIVE SUMMARY**

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The IRSAC Wage & Investment (W&I) subgroup is a collaborative group of eight members with practices including CPAs, enrolled agents, attorneys, academia, small business and volunteer income tax assistance. The members' collective tax experience includes accounting and tax return preparation (ranging from solo practitioners to large, commercial tax preparation firms), tax industry operations liaison, tax planning and advice, information technology consulting and software development, payroll processing, litigation support, valuation and forensics and representation of individual and business taxpayers from many segments of our society. The W&I spectrum covers a large and diverse population of taxpayers with a wide range of income and tax return complexity. W&I encompasses forms publication, electronic products and services, preventive and corrective identity theft programs, and the overall administration for delivering timely, accurate and excellent service while reducing taxpayer burden. We consider service on the IRS Advisory Council a privilege, and we are pleased to present this report. We thank W&I Commissioner Ken Corbin, and the many IRS personnel with whom we've worked closely this year 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 full IRSAC, with its increased numbers and diversity.

Our collaborative discussions with our W&I colleagues enriched and informed our work on five issues. Our report addresses improving customer experience and service delivery, new IRS initiatives for earlier intervention with 1040 taxpayers who have underreported wage income on their tax returns, recommendations on specific forms and filing (Form 1040NR and Form 1040X), and enhancing the visibility of W&I's education and outreach programs and delivery of services in the IRS Stakeholder Partnerships, Education &

Communication (SPEC) programs. These topics share common themes of enhancing taxpayer service and reducing taxpayer burden, leveraging potential one-to-many benefits from engaging with critical external stakeholders, improving communication and providing excellent digital options across multiple service delivery channels. Delivering an exceptional customer experience while strengthening security and authentication measures factored heavily into our discussions, along with searching for current and future technology and digital solutions.

The IRSAC W&I Subgroup thanks our IRS colleagues for their careful consideration of the issues presented in our 2018 report – Use of Lockbox for tax payments and Third-Party Authentication. We see progress in driving taxpayers toward electronic payment methods, eliminating the need for paper check processing and the risk of routing to incorrect mailing addresses. The IRS could not, with current resources, implement our recommendations to explore alternative methods of authenticating third-party representatives without asking for their personal identity information (Social Security Number and Date of Birth), an issue noted by both the IRSAC and the IRPAC – and the practice continues.

## **ISSUE ONE: Customer Experience/Service Delivery Plan**

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### **Executive Summary**

Beginning in 2015, the IRS developed a future-state vision for the individual taxpayer customer experience. Building off this strategy, the Wage and Investment (W&I) Division developed the Customer Experience/Service Delivery (CXSD) plan, the combination of a detailed view of the customer experience vision and a service delivery plan to implement that vision. The IRS envisions seamless service delivery across proactive, self-service, digitally-aided and assistor-aided channels that would provide taxpayers (and their representatives) with secure access to necessary tax information and empower them with integrated capabilities that deliver the services they need. Achieving this will require adapting to the growing demand for IRS services and customer expectations for a digital experience while continually improving the taxpayer experience within and across all channels. In alignment with this vision, W&I developed the CXSD plan to increase awareness of channel options and communicate with customers in a manner customized for their unique individualized needs while leveraging tax preparers, tax software vendors, financial institutions, and payroll providers (hereinafter referred to as “mission and business partners”) to educate and inform customer segments.

The IRSAC has been asked to review and provide recommendations for the Customer Experience Vision and Strategic Service Delivery Plan. The IRSAC identified opportunities to (1) envision a holistic customer journey; (2) enable mission and business partners as service delivery channels; and (3) embrace collaboration and agile development methods earlier in the planning phase.

### **Background**

Under and in alignment to Office of Management and Budget guidance and Presidential Management Agenda, the IRS developed a Customer Experience/Service Delivery (CXSD) plan.<sup>62</sup> The CXSD plan aligns to the IRS Strategic Plan 2018-2022, W&I Operating Plan and the IRS Integrated Modernization Business Plan. The purpose of the CXSD plan is to define a future-

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<sup>62</sup> Office of Management and Budget, Circular No. A-11, Sec. 280 (June 2019); President's Management Agenda, Cross Agency Priority Goal 4: Improving Customer Experience with Federal Services.

based vision and strategy for delivering top quality service to all of America's taxpayers. The IRS envisions a seamless service strategy that provides taxpayers (and their representatives) with secure access to necessary tax information and empowers them with integrated capabilities that deliver the services they need.

The CXSD plan goals are to expand access to services, increase customer awareness of the service channels that are the most convenient, efficient and effective for resolving their tax issues, and improve the customer experience within and across all channels. To develop the plan, the IRS evaluated existing interactions with its customers, classified into four service delivery channels: proactive, self-service, digitally-aided and assistor-aided. Then the IRS identified 90 technical capabilities to augment existing processes, optimize traditional channels and increase digital options. The IRSAC identified 15 of these for top priority (see Exhibit A immediately following the issue report).

While the CXSD plan superbly incorporates many of its goals, there are opportunities to address additional aspects of the taxpayer journey to better provide a seamless experience and align with the IRS Strategic Goals and Integrated Modernized Business Plan. Specifically, the IRS can improve its CXSD plan in three areas: (1) envision a holistic customer journey; (2) enable mission and business partners as service delivery channels; and (3) embrace collaboration and agile development methods earlier in the planning phase.

First, the CXSD plan can better envision customer service holistically across the entire customer journey by incorporating all of the IRS's customers and by considering taxpayer experience beyond direct interactions with the IRS. The initial CXSD plan includes customer visions for individual taxpayers, third-party preparers and IRS assistors; however, the IRS's deliberate use of the term "customer" is intended to encompass other taxpaying entities. A holistic plan should include visions for all of the IRS's customers including businesses, tax-exempt entities, government entities and payroll providers. Business taxpayers interact more frequently with the IRS compared to individual taxpayers, so improving service delivery efficiency for businesses can generate increased



adoption and a higher rate of return. If the IRS strives for a complete customer experience vision, it should encompass all customers.

Additionally, the IRS should address aspects of the customer experience beyond existing or direct interactions with customers. Under the CXSD plan, the IRS intends to incorporate into Online Accounts (OLAs) refund status, digital notices and the ability to make simple return amendments. OLA is seeing moderate usage (in August 2019, over 570,000 unique users accessed their account in more than 950,000 sessions), but the IRS has not achieved high adoption due in part to the fact that only 41 percent of average taxpayers can successfully register and authenticate through the IRS's rigorous identity verification and multifactor authentication protocol, titled Secure Access.<sup>63</sup> While deploying capabilities in the online account would enable the IRS to control the experience closely, there are opportunities for indirect service delivery through mission and business partners, as discussed further below, that would improve usability and result in a more holistic customer experience vision.

Furthermore, incorporating indirect service delivery would better account for customer preferences. Rather than beginning their search with the IRS, taxpayers with questions about tax law may start their journey on search engines, and taxpayers seeking refund status information may expect it to be delivered proactively similar to SMS text message updates for package deliveries. In a similar vein, taxpayers and their preparers are accustomed to using tax preparation software to prepare returns. A holistic customer experience vision should incorporate realistic customer preferences, even those that reside outside of the IRS's control.

Second, the CXSD plan could better align to the IRS's strategic goal to collaborate with external partners proactively to improve tax administration by incorporating opportunities to leverage and enable as customer service delivery channels trusted members of the tax community. Tax practitioners, tax software vendors, financial institutions and payroll providers are aligned with the IRS's

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<sup>63</sup> IRS officials indicated as of July 2019, over 4 million online accounts have been created reflecting a 41 percent success rate.

mission to provide quality taxpayer service by helping taxpayers understand and meet their tax obligations. Each mission and business partner can serve dozens, hundreds, thousands or millions of taxpayers. Thus, the CXSD plan should consider the exponential delivery of service that third parties can provide.

As the CXSD plan indicates, most taxpayers' only interaction with the IRS each year is filing a tax return and addressing the associated refund or balance due. Over 143 million filers (or 96 percent of individual income tax return filers) used tax software to prepare their Tax Year 2017 individual tax return,<sup>64</sup> compared to four million OLAs created, suggesting the IRS could improve its CXSD plan by contemplating optimization of the tax return filing process.

One opportunity to optimize electronic return filing is to incorporate the ability to e-file amended tax returns through commercial tax software, as recommended in Issue Three of this Wage & Investment Subgroup report.<sup>65</sup> Another opportunity is to incorporate the ability to electronically authorize third-party tax professionals and business entities to receive and relay information related to the return.<sup>66</sup> Specifically, these trusted partners could proactively provide information that traditionally drives high volumes of customer contacts such as the status of the return and any associated refund, refund offsets, balance due and collection notices and math error discrepancies.

Providing return-specific information to the party that originated the return entails less risk than granting access to a third party with Power of Attorney (POA). Therefore, electronic authorization could be granted without requiring the taxpayer to prove their identity as stringently as is necessary for higher-risk authorizations such as POA. Incorporation into a widely used service delivery channel (electronic tax return filing) with less user friction increases likelihood of adoption and provides an efficient method of electronic authorization for individuals unable to pass Secure Access.

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<sup>64</sup> Tax Year 2017 IRTF Table via CDW by Wage and Investment Strategies & Solutions extracted on February 29, 2019. TY 2017 reflects volumes received through cycle 52. Of 148,652,888 total TY 2017 individual returns, 133,655,763 were prepared in software and filed electronically, 9,439,645 were prepared in software and filed by paper, and 5,557,480 were prepared by hand and filed on paper.

<sup>65</sup> See *infra* Wage & Investment Subgroup Issue 3: Form 1040X Electronic Filing.

<sup>66</sup> Though the IRS enables a Third Party Designee to receive and provide information for purposes of processing the return, it is not clear that this enables a third-party tax professional or business entity to receive information such as refund status or notices related to the return.

The CXSD plan thoughtfully incorporates mission and business partner enablement through the creation of web-based Application Program Interfaces (“APIs” or “WebApps”) in alignment with Strategic Goals and the IRS Integrated Modernized Business Plan. As the IRSAC identified in 2017 and expounded upon in its 2018 report, development and execution of a long-term strategy for APIs, including web-based APIs for third parties, is a critical step in modernizing customer service for the IRS.<sup>67</sup> Tax software and financial industry associations such as the Council for Electronic Revenue Communication Advancement (CERCA) and the Financial Data Exchange can offer expertise and resources to develop secure and scalable WebApps. Leveraging tax software and tax preparation firms will also enable the IRS to perform limited outreach while maximizing potential adoption channels.

Entity level authorizations are essential to effectively utilize WebApps because software developers are better suited to build the architecture necessary to obtain resources from IRS servers compared to individual end users. The IRS requires authorization to disclose taxpayer information to third parties; thus, taxpayers need the ability to authorize disclosure to the business entities that develop WebApps.

An example in the context of using WebApps and traditional service channels to enable mission and business partners would be to provide tax software vendors with electronic notices for balance due, collections and refund offsets. During the return preparation process, the taxpayer could authorize the tax software and, for those using assistance, the tax preparer or tax preparation firm. Authorizing the tax software and preparer firm would allow the IRS to disclose the information via WebApp in bulk to these entities who could then provision the information to the authorized accounts, resolve the issue proactively if possible or provide it to the taxpayer augmented with clear next steps, providing a truly seamless experience for the customer.

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<sup>67</sup> 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>; The Internal Revenue Service Advisory Council 2018 Public Report, Digital Services Subgroup Issue Two, available at <https://www.irs.gov/pub/irs-pdf/p5316.pdf>.

In calendar year 2018, the IRS issued more than 9 million refund offset notices, 8.7 million non-collection balance due notices, 23.1 million balance due collection notices, and 3.2 million requests for verification of unreported income, payments or credits, at a total cost for paper, postage and inserts of \$57.1 million.<sup>68</sup> Even a 20 percent adoption of electronic notices provided through tax software accounts in a single year could yield cost savings to pay for initial WebApp and back end development. Furthermore, the IRS could reduce balance due, collection and wage discrepancy related notice volume by working collaboratively with mission and business partners to communicate early warning, informational notices in line with the W&I Subgroup Report Issue Two: Test to Expand Systemic Verification To Improve Voluntary Compliance For Income Reporting.

Last, the CXSD plan development process reflects a traditional waterfall development mentality where the plan is developed by business owners and then socialized with key stakeholders within and outside of W&I or the IRS. Industry best practices are shifting towards incorporating into business units the agile development methods employed by their information technology counterparts. Involving key stakeholders earlier and more often in the CXSD plan development process can help ensure those key stakeholders are not overlooked and reduce redundant and non-productive work. And it better positions the organization to adapt more quickly to the ever-evolving technology landscape, better aligns their behavior with their IT counterparts employing agile development methods, and better aligns the organization to the enterprise goal to collaborate with external partners proactively.

### **Recommendations**

1. Prioritize the implementation of the capabilities in Exhibit A: Customer Experience/Service Delivery Plan Year 1 Capability Prioritization.
2. Enable mission and business partners as customer service delivery methods. Include mission and business partners as service delivery

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<sup>68</sup> The IRS sent 9.0 million CP49 notices costing \$3.9 million, 8.7 million CP14 notices costing \$3.9 million, 7.8 million CP504 notices costing \$29.3 million, 6.4 million CP503 notices costing \$3.2 million, 5.3 million CP501 notices costing \$2.4 million, 3.6 million CP504B notices costing \$12.8 million, and 3.2 million CP2000 notices costing \$1.6 million.

methods in the Customer Experience Vision and Strategic and Tactical Service Delivery Plans.

3. Optimize the tax return filing process to enable customer service delivery through third parties. Incorporate authorization of third parties during tax return filing to proactively communicate information related to the tax return, specifically information that drives high volumes of contact such as refund status, return errors and balance due notifications.
4. Include Web Applications (WebApps) with third parties in the Customer Experience vision. Specifically, incorporate WebApp pilots into the Tactical Plan and capability prioritization and anticipate impacts when establishing objectives-based metrics. Work closely with subject matter experts from pertinent stakeholders, including CERCA and the Financial Data Exchange, to develop protocols that are secure and scalable. Prioritize pilot services that are low risk and have aligned interest across the tax ecosystem, such as refund status or electronic delivery of high-volume tax notices such as balance due, collection and refund offset notices.
5. Incorporate entity-level authorizations for tax software and tax preparation firms into the IRS's authorization framework and digital service delivery capabilities.
6. Incorporate agile development best practices into CXSD plan development, specifically including key IRS and external stakeholders in iterative development discussions.
7. Fast-track the development of Customer Experience Visions detailing the experience for additional customers—including business taxpayers, tax-exempt entities and government entities.

**Exhibit A**

**Customer Experience/Service Delivery Plan Year 1 Capability Prioritization**

| <b>Priority</b> | <b>Capability</b>                            | <b>Delivery Channel</b> |
|-----------------|--|-------------------------|
| 1.              | Authentication                               | Foundational Capability |
| 2.              | Wait Time Transparency                       | Proactive               |
| 3.              | Customer Call Back                           | Digitally Aided         |
| 4.              | Refund WebApp & Integrated Refund Tracker    | Proactive               |
| 5.              | Simple Mobile Experience                     | Self-Service            |
| 6.              | E-File Enabled Authorization                 | Third Party             |
| 7.              | Third Party Online Account                   | Third Party             |
| 8.              | AI-Powered Transactional Chat                | Self-Service            |
| 9.              | Document Upload                              | Digitally Aided         |
| 10.             | AI-Powered Informational Chat                | Digitally Aided         |
| 11.             | Form 1040X, Amended Return Electronic Filing | Third Party             |
| 12.             | Employee-Powered Chat                        | Assistor Aided          |
| 13.             | Knowledge Base                               | Assistor Aided          |
| 14.             | Digital Notice WebApp                        | Third Party             |
| 15.             | Search-driven Website                        | Self-Service            |

## **ISSUE TWO: Test to Expand Systemic Verification to Improve Voluntary Compliance for Income Reporting**

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### **Executive Summary**

Starting in 2019, the IRS W&I Return Integrity Compliance Services' Business Performance Lab (RICS BPL) initiated a controlled test notifying a sampling of taxpayers via an informational notice (Letter 6115C) that they have underreported their W-2 income on a recent tax return. The focus of the test was to change taxpayer behavior through voluntary compliance and quality customer service rather than through other compliance activities that are both more costly and resource-intensive.

### **Background**

In its August 2014 recommendations to the IRS related to identity theft refund fraud, the United States Government Accountability Office (GAO) emphasized the importance of accelerating the deadline for receipt of W-2 data from employers to January 31. This deadline acceleration was not determined to be burdensome, would make W-2 data available sooner for the IRS to perform pre-refund matching of W-2s and identify potential differences before issuing refunds.<sup>69</sup>

Once feasibility was determined, Congress and the President enacted the Protecting Americans from Tax Hikes Act of 2015, which included provisions requiring employers submit W-2s to the Social Security Administration (SSA) by January 31 (as contrasted with previously required deadlines of last day of February for manual forms and March 31 for electronically filed forms). This gave the IRS wage data one to two months earlier than in prior years.<sup>70</sup> The SSA would, in turn, send W-2 data to the IRS sooner to verify employee wage and withholding data on tax returns. Earlier W-2 matching to tax returns would reduce billions of dollars in potentially fraudulent, underreported or non-compliant refunds.

With the Consolidated Appropriations Act of 2016, the IRS tax code was amended to accelerate the W-2 filing deadline to January 31 starting with W-2

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<sup>69</sup> GAO, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud*, GAO-14-633 (Washington, D.C.: August 2014)

<sup>70</sup> Pub. L. No. 114-113, div. Q, Title II, § 201, 129 Stat. 2242, 3076 (codified at 26 U.S.C. §§ 6071 and 6402).

payments made in 2016 and filed in 2017.<sup>71</sup> This early reporting requirement, coupled with adding W-2 data into the Return Review Program (RRP) created the opportunity for better customer service via voluntary compliance the IRS had been seeking.

The Honorable J. Russell George, Treasury Inspector General for Tax Administration, in his May 9, 2019, testimony before the Committee on Ways and Means, U.S. House of Representatives titled “Understanding The Tax Gap And Tax Noncompliance,” highlighted reducing the Tax Gap as a potential opportunity to improve tax compliance. The Tax Gap is defined as the difference between what taxpayers owe and what they pay on time. The Gross Tax Gap is the total amount owed by taxpayers and is estimated at \$458 billion annually.<sup>72</sup> The testimony highlights that if the IRS can increase the rate of voluntary compliance, it will reduce the Tax Gap at a substantially lower cost than via other enforcement actions such as examinations.

Voluntary compliance, as identified by the Department of the Treasury, GAO reports and reinforced in the testimony of The Honorable J. Russell George, is necessary to improve tax compliance. The recommendation to expand systemic verification to improve voluntary compliance based on W-2 data availability early in the tax season is a low-cost, positive step in the right direction.

#### *Objectives*

Based on the complexities of enforcement actions, the recommendation to create an informational letter encouraging voluntary compliance was approved to be performed by the RICS BPL group in 2019, to gauge taxpayer response. The informational letter provides taxpayers with options and states they have been identified as underreporting income on their tax return. The objectives the IRS is hoping to accomplish are predicated on a customer service effort to create an “early warning system.” The main goal was to collect revenue due by offering proactive customer service to taxpayers.

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<sup>71</sup> Pub. L. No. 114-113, div. Q, § 201, 129 Stat. 2242 (Dec. 18, 2015).

<sup>72</sup> TIGTA, *Testimony of The Honorable J. Russell George Treasury Inspector General for Tax Administration “Understanding The Tax Gap And Taxpayer Noncompliance”*, (Washington, D.C.: May 9, 2019)



The taxpayer is offered three definitive resolutions to remedy the omission: 1) review their tax documents and voluntarily amend their return with corrected information before enforcement actions are taken, 2) proactively complete an Identity Theft Affidavit (IRS Form 14039) and contact the Federal Trade Commission for more information if they feel they are a victim of identity theft, and 3) contact the payer(s) listed to verify what was reported for the taxpayer. Payer name, address and the amount reported all appear on the letter.

#### *Test Approach*

RRP is a web-based automated system designed to detect, resolve and prevent criminal and civil non-compliance via a review of individual tax returns through a set of business rules and algorithmic models. The main goal was to have a singular system of record to identify potentially fraudulent returns while lowering false positives.<sup>73</sup> Systemic verification is a critical element of the IRS's RRP where information reported by taxpayers is compared against W-2 data provided by employers to identify discrepancies in both wage and withholding information.<sup>74</sup>

In 2018, the total number of taxpayer returns with missing W-2 data identified by RRP's systemic verification was 1.6 million, representing \$18.6 billion in unreported W-2 wages. The initial test consisted of a random sample of 1,000 tax returns based on these criteria:

- All year 2018 tax returns with missing W-2 data of \$2,000 or more as identified by systemic verification.
- Tax returns currently going through Taxpayer Protection Program (TPP) or other non-compliance treatments were excluded.
- Tax returns where the taxpayer account's conditions prevented refund or offset were excluded.
- Tax returns where the tax account showed an amendment or superseding return for 2018 at the time of selection were excluded.

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<sup>73</sup> TIGTA, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed*, Reference Number 2017-20-080 (Washington, D.C.: August 2014)

<sup>74</sup> GAO, *IRS Managed Processing Challenges and Enhanced Its Management of Tax Law Changes*, GAO-18-471 (Washington, D.C.: September 2018)

The 1,000 taxpayers were selected in three iterations: taxpayers with returns filed from 1/1/2019-2/24/2019, taxpayers with returns filed from 2/25/2019-3/14/2019, and taxpayers with returns filed from 3/15/2019-6/15/2019. Letter 6115C was sent out in early April for the first two iterations and early August for the third iteration. The IRS additionally added a detailed description of Letter 6115C, including useful FAQs, to the IRS website (<https://www.irs.gov/individuals/understanding-your-letter-6115c>). It is estimated the postage and production cost of each letter was approximately \$0.8636.

As of August 2019, RICS BPL has provided preliminary numbers that suggest the test succeeded in improving voluntary compliance via a customer service effort with minimal cost to the IRS and taxpayers in general. These are the results:

- Eight taxpayer amendments filed after selection was made but before letters were sent.
- Twenty-six taxpayer amendments were filed after letters were sent.
- No (zero) taxpayer fraud was reported via an Identity Theft Affidavit (IRS Form 14039).
- Thirty letters were returned by the postal service as returned mail.

### **Recommendations**

The IRSAC acknowledges the importance of voluntary compliance and applauds the RICS BPL efforts to develop a controlled test notifying a sampling of taxpayers via an informational notice that they underreported their W-2 income. While encouraging the expansion of the test in 2020, the recommendations below are made in an effort to align this voluntary compliance concept within the vision of the Customer Experience/Service Delivery Plan (CXSD), and the recommendations made in the 2019 IRSAC report on that topic.<sup>75</sup>

1. Provide access and visibility to the informational notice via the taxpayer online account. This platform already functions within the electronic Authentication, Authorization and Access (eA3) framework and is an essential electronic taxpayer resource. This will improve communication

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<sup>75</sup> See *infra* Wage & Investment Subgroup Issue 1: Customer Experience/Service Delivery Plan

- with the taxpayer and potentially increase the response rate as the online account adoption rate grows. The IRSAC suggests the taxpayer receive a notification that the letter has been sent to their online account.
2. Include in the initial version of the Tax Pro Account the informational notice (Letter 6115C) as part of the digital notices/correspondence to encourage communication between the taxpayer and his/her authorized representative(s). This will expedite the response to the IRS regarding the potential information error request by allowing representatives to participate as valuable service delivery channels.
  3. Add an informational box to Form 1040X, *Amended U.S. Individual Income Tax Return*, Part III – Explanation of Changes section indicating the source of the amendment being made. By adding this data point to the Form 1040X, the IRS could gain valuable metrics on response rates for different communications channels, including this informational notice.
  4. Upon selection of taxpayers that qualify for the informational notice (Letter 6115C), send a copy to the third-party designee indicated on the originally filed tax return. This will result in the IRS receiving a faster response.
  5. Modernize the informational notice so it has a more contemporary look that incorporates the collection notice revision pilot previously reported by the IRSAC's Small Business/Self-Employed and Wage & Investment Subgroup.<sup>76</sup> A modern informational notice will capture the taxpayer's attention and encourage voluntary compliance via simple concepts such as:
    - Increasing font sizes where needed.
    - Highlighting important amounts or due dates.
    - Adding graphical indicators such as icons for each of the major sections.
    - Clearly identifying the objectives of the notice to either amend the tax return or report fraud.

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<sup>76</sup> The Internal Revenue Service Advisory Council 2017 Public Report, Small Business/Self-Employed and Wage & Investment Subgroup Issue Five, available at <https://www.irs.gov/pub/irs-utl/2017-irsac-public-report.pdf>.

## **ISSUE THREE: IRS Form 1040X – Electronic Filing**

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### **Executive Summary**

To err is human, and taxpayers often find themselves in need of correcting a tax return they already filed with the IRS. Individual taxpayers use Form 1040X, *Amended U.S. Individual Income Tax Return*, to change a previously-filed tax return. In Publication 6292, *Fiscal Year Projections for the United States: 2017-2024*, the IRS projects a slight decrease on amended return filing (Form 1040X). However, with changing tax law, new compliance initiatives about cryptocurrency, earlier and more accurate electronic data matching, taxpayers may file more amended returns than ever before – and the projections for tax years 2017-2024 project over three million amended returns per year.<sup>77</sup> Although over 90 percent of 1040 series tax returns are e-filed,<sup>78</sup> Form 1040X must be submitted on paper – presenting inefficiencies for taxpayers, tax professionals and the IRS. As the IRS moves ahead with other initiatives to enhance the customer experience and improve taxpayer services, the inability to e-file individual amended returns leaves a large gap. The IRSAC, recognizing that the IRS has limited resources and many demands for information technology (IT) development, advocates strongly for fast-tracking Form 1040X into the Modern E-file (MeF) so taxpayers and the IRS can benefit from the ease, efficiency, security and accuracy of e-filing amended returns. We propose that the IRS leverage existing MeF intake and processing capabilities, quickly, to offer the benefits of e-filing. Funding has been requested through the IRS Development, Modernization and Enhancement (DME) process and is awaiting a budget decision. Assuming budget approval, the IRS is looking at a Processing Year 2021 implementation. The IRSAC strongly urges the IRS to give implementation its highest priority and to explore whatever means possible to provide this critical aspect of customer experience and service delivery.

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<sup>77</sup> See page 4, Publication 6292: <https://www.irs.gov/pub/irs-soi/p6292.pdf>.

<sup>78</sup> <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-may-10-2019>

## **Background**

Taxpayers amend their tax returns for many reasons – some simple and some complicated. Amended and superseding corporate returns have been eligible for MeF for many years<sup>79</sup>, as are partnership returns<sup>80</sup>, and trust and estate returns,<sup>81</sup> but individual returns are not<sup>82</sup>. Individual amended returns involve the IRS’s Submission Processing (SP) and Accounts Management (AM) employees – more straightforward issues stay with SP (53-59 percent) and more complex involve AM review (41-47 percent). Recent IRS statistics show that taxpayers filed 3.9 million 1040X returns in FY2016, 3.4 million in FY2017, and 3.5 million in FY2018. The IRS does not separately track the cost of processing a paper 1040X; it is considered part of the paper/correspondence inventory. The cost of working paper/correspondence inventory, historically (per piece and including both SP and AM costs), is \$56.56 for FY2016, \$64.71 for FY2017, and \$63.85 for FY2018. The cost (per thousand) of working Form 1040X through SP is \$5100 for FY2016 (\$5.10 per return), \$5400 for FY2017 (\$5.40 per return), and \$4700 for FY2018 (\$4.70 per return). The IRS does not track statistics on how many 1040X returns are self-prepared vs. prepared by a paid or volunteer tax preparer. Processing time for paper-filed 1040X returns is optimally 10-12 weeks, but anecdotal reports often reflect much longer processing times, especially with complex issues such as amending from Married Filing Separately to Married Filing Jointly. For refund returns, delays can mean increased refund interest costs for the Treasury. For balance due returns, increased interest charges for the taxpayer.

The IRS has made tracking the status of amended returns easier with their Where’s My Amended Return application, which is an excellent tool and should ease call volume. However, the landing page for the application warns that “Your amended return will take **up to 3 weeks** after you mailed it to show up on our system” and “Processing it can take **up to 16 weeks.**”<sup>83</sup>

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<sup>79</sup> <https://www.irs.gov/businesses/corporations/amended-and-superseding-corporate-returns> last reviewed or updated 29-Nov-2018

<sup>80</sup> <https://www.irs.gov/e-file-providers/guidance-for-amended-partnership-returns> last reviewed or updated 05-Feb-2019

<sup>81</sup> <https://www.irs.gov/e-file-providers/estates-and-trusts> last reviewed or updated 26-Sep-2019

<sup>82</sup> <https://www.irs.gov/newsroom/what-taxpayers-should-know-about-amending-a-tax-return> 18-Jul-2019

<sup>83</sup> <https://www.irs.gov/filing/wheres-my-amended-return> last reviewed or updated 10-Sep-2019

With a paper-filed Form 1040X, there is no way to indicate electronic funds transfer for a balance due. While it is possible to pay online using EFTPS or IRS Direct Pay, it is not intuitive to do so when one is mailing in a paper return. The Form 1040X instructions outline online payment options, but how many taxpayers (or tax professionals) reach page 16 of the instructions? If one is using software, for a paper-filed return, the default instructions are to mail a check. The IRS costs for processing paper checks are higher than processing electronic payments; e-filing amended returns will enable more significant cost savings via EFT payments. For taxpayers with overpayments and claimable refunds on their amended returns, no direct deposit is available with a paper-filed 1040X. The IRS mails a paper check, which involves not only higher costs for the IRS but greater risk of loss or theft of the check in the mail.

To summarize, the current state of 1040X filing involves 1) the inability to e-file, 2) a large volume of paper 1040X returns, 3) a wide range of issues that prompt tax return amendments and 4) potential increases in amended return volume with tax law changes and uncertain tax positions. The IRS is testing an early systemic verification initiative to help taxpayers identify unreported income and urging them to amend their returns.<sup>84</sup> Also, the IRS is sending letters to cryptocurrency investors advising them of reporting requirements and encouraging them to amend their returns.<sup>85</sup> We predict, therefore, even higher volumes of individual amended returns. If the IRS can cost-effectively expand “early warning” wage letters to a higher percentage of filers with discrepancies, one would expect a corresponding increase in amended returns filed.

The time for integrating individual amended return filing into MeF is now – and could be implemented by using the Form 1040 e-file schema with an amended return checkbox. Electronic filing is the method of choice for most taxpayers and almost all tax professionals. Amended returns, particularly those involving more complex issues, may always require human review. The efficiencies of e-filing,

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<sup>84</sup> See *infra* Wage & Investment Subgroup Issue Two – Test to Expand Systemic Verification to Improve Voluntary Compliance for Income Reporting.

<sup>85</sup> IR-2019-132, July 26, 2019: <https://www.irs.gov/newsroom/irs-has-begun-sending-letters-to-virtual-currency-owners-advising-them-to-pay-back-taxes-file-amended-returns-part-of-agencys-larger-efforts>

however, should yield a less labor-intensive process. E-filing should 1) reduce costs, 2) improve accuracy (both from taxpayers and the IRS, 3) reduce time from submission to resolution, 4) allow for enhanced security screening, 5) enable immediate validation for taxpayers and tax professionals that their amended returns safely reached their destination and 6) reduce phone and written inquiries about amended return processing progress. E-filing will improve the customer experience immensely while leveraging and channeling IRS resources. It will yield consistency by aligning with state taxing authorities that allow, encourage or mandate e-filing of amended returns, and enable taxpayers (and tax professionals) to stay in their preferred filing method (e-file) throughout the filing process. It will also ensure more accurate transfer of carryover amounts from year to year.

The IRS has been working on integrating individual amended return filing into the MeF for many years. Unfortunately, there have been other urgent projects that superseded implementation. The IRSAC is not the first to advocate emphatically for e-filing individual amended returns. The Treasury Inspection General for Tax Administration (TIGTA) has reported on erroneous and fraudulent refunds with amended returns – most recently in July 2019<sup>86</sup> but also four times since 2011<sup>87</sup>. The proverbial elephant in the room, also referenced by TIGTA, is whether it is time to retire Form 1040X and move to using the 1040 schema for individual amended returns. Taxpayers and tax professionals use Form 1040 and associated schedules to recalculate their tax returns – and then transfer the numbers to Form 1040X. We use the 1040 as a “worksheet” for Form 1040X.<sup>88</sup> Why not incorporate a checkbox on Form 1040 and in the schema to indicate that it is an amended return, similar to how taxpayers amend partnership, trust and estate returns?

E-filing Form 1040X fulfills the goals of the IRS Strategic Plan<sup>89</sup>, the IRS Integrated Business Modernization Plan<sup>90</sup>, the IRS W&I Customer Experience

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<sup>86</sup> TIGTA Office of Audit Reference Number 2019-40-042 July 31, 2019: Actions Have Not been Taken to Improve Amended Return Review Procedures to Reduce Erroneous and Fraudulent Refunds: Highlights with link to the full report: [https://www.treasury.gov/tigta/auditreports/2019reports/201940042\\_oa\\_highlights.html](https://www.treasury.gov/tigta/auditreports/2019reports/201940042_oa_highlights.html)

<sup>87</sup> TIGTA Reference Number 2011-41-057 (June 2011), 2012-40-065 (June 2012), 2012-40-103 (Aug 2012), 2014-40-028 (Apr 2014)

<sup>88</sup> Ibid, p.9

<sup>89</sup> <https://www.irs.gov/about-irs/irs-strategic-plan> last reviewed or updated 08-Aug-2019

<sup>90</sup> [https://www.irs.gov/pub/irs-utl/irs\\_2019\\_integrated\\_modernization\\_business\\_plan.pdf](https://www.irs.gov/pub/irs-utl/irs_2019_integrated_modernization_business_plan.pdf)

Service Delivery (CXSD) initiative, the 21<sup>st</sup> Century IDEA Act<sup>91</sup> and the Taxpayer First Act<sup>92</sup>. It will help make the IRS a world-class organization providing helpful and efficient taxpayer services.

### **Recommendations**

1. Modify Form 1040 to allow individual amended return e-filing.
2. Approve and implement e-filing of individual amended returns as quickly as feasible – according it the highest priority as a measure to enhance cost savings, accuracy, security, efficiency and to decrease identity theft-related and other fraud.
3. Allow taxpayers to use an Identity Protection PIN (IP PIN) on an e-filed individual amended return.
4. Implement interim measures such as allowing tax professionals to upload Form 1040X digitally via Taxpayer Digital Correspondence (TDC) or their Secure Object Repository (SOR)/secure E-Services mailbox.
5. Consider interim measures to further encourage electronic balance due payments and direct deposit of refunds for amended individual returns.

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<sup>91</sup> <https://www.energy.gov/eere/communicationstandards/21st-century-integrated-digital-experience-act>

<sup>92</sup> <https://www.congress.gov/bill/116th-congress/house-bill/3151/text?q=%7B%22search%22%3A%5B%22latestMajorActionCode%3A28000%22%5D%7D&r=1&s=2#toc-HCEBCCBDBF1F04CAE8F9177E055E62BBF>



## **ISSUE FOUR: Improve Marketing/Promotion and Participation of VITA/TCE Programs and Other Services**

### **Executive Summary**

Stakeholder Partnerships, Education and Communication (SPEC)<sup>93</sup> is the outreach and education function of the IRS's Wage and Investment (W&I) Division. SPEC uses a three-pronged approach to serve the W&I taxpayer: free tax preparation, tax education (outreach) and financial education and asset building. SPEC's prominent volunteer tax preparation program, Volunteer Income Tax Assistance (VITA), serves its free tax preparation goal. Despite the vital service the VITA program provides, SPEC has found this program is not well-known to the public nor widely associated as a free tax preparation program.

The IRSAC has been asked for recommendations to 1) promote SPEC, 2) promote the VITA program to the public and other community service agencies and strengthen the association between the VITA name and its free tax preparation services for eligible taxpayers and 3) grow the VITA program.

### **Background**

#### *SPEC*

SPEC is the IRS's community outreach program. Although it is best known for its VITA and Tax Counseling for the Elderly (TCE) programs, SPEC'S community involvement involves much more than assisting in providing free tax return preparation. Through offering the VITA and TCE programs, SPEC draws in involvement from community leaders with common goals and customers. Working with these community leaders and other interested third parties allows SPEC to provide tax education to those taxpayers most likely to be unfamiliar with the complexities of return filing and unable to afford professional tax assistance. This tax education includes information on the Earned Income Tax Credit (EITC), filing responsibilities and locations of VITA and TCE tax assistance locations, among others. Also, through its VITA and TCE programs, SPEC and its community partners educate low-income taxpayers about asset-building opportunities by collaborating to provide taxpayers with the information, knowledge and skills

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<sup>93</sup> SPEC's directives are set forth in IRM 22.30.1.

needed to evaluate their financial options and make informed financial decisions.<sup>94</sup> With partner organizations, SPEC programs reach the W&I taxpayer from the high school level to retirement age with information and tax return assistance. Thus, SPEC provides life-long support for taxpayers.

Although the vehicle for community involvement in the IRS, SPEC is not well-known to the public regarding the services the IRS provides, nor is it well-known within the IRS. Unlike other divisions in the IRS, SPEC does not have a dedicated webpage on the IRS's website identifying its mission, purpose, services or personnel organization or contact information.

### VITA

In 1969, the IRS started the VITA program.<sup>95</sup> In its first filing season, the VITA program had 7,500 IRS-certified volunteers who assisted 100,000 taxpayers in filing their returns.<sup>96</sup> During the 2018 filing season (preparing 2017 returns), more than 84,000 IRS-certified volunteers at over 11,000 sites assisted over 3.4 million taxpayers.<sup>97</sup> During the 2019 filing season (preparing 2018 returns), more than 82,000 volunteers at over 10,900 sites filed 3.4 million returns.<sup>98</sup> The accuracy rates for the VITA filed returns for the 2018 and 2019 filing seasons were 93.3 percent and 98.0 percent, respectively.<sup>99</sup>

The VITA program notably differs from the IRS's Free File program. The VITA program offers eligible taxpayers free income tax return preparation by trained and certified volunteers, whereas the Free File program allows eligible taxpayers to prepare and file their own federal income tax returns for free using commercial do-it-yourself (DIY) tax software or fillable forms.

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<sup>94</sup> See IRM 22.30.1.8.10.5, Financial Education and Asset Building (FEAB)

<sup>95</sup> Presentation, *IRS SPEC VITA/TCE 2019, VITA –One Tax Season at a Time Since 1969*, (May 6, 2019) located at <https://www.webcaster4.com/Player/Index?webcastId=29863&q=3681bf16-6b22-494d-98e0-d0d43788dd13&uid=4010366&sid=>

<sup>96</sup> *IRS Historical Fact Book: a chronology, 1646-1992*, United States. Dept. of the Treasury, Internal Revenue Service (1993).

<sup>97</sup> Pub. 1084, *2019 Volunteer Site Coordinator Handbook*, Stakeholder Partnerships, Education and Communication (SPEC) (Rev.10-2018).

<sup>98</sup> 2018 IRS Databook, Table 19.

<sup>99</sup> IRS Publication 5299 <https://www.irs.gov/pub/irs-pdf/p5299.pdf#targetText=Overall%2C%20the%20return%20accuracy%20rate.Filing%20Season%202018%20was%2093.30%25>.

IRS Publication 5347: <https://www.irs.gov/pub/irs-pdf/p5347.pdf>

The VITA program trains and certifies volunteers to prepare tax returns for eligible taxpayers. VITA volunteers serve those taxpayers who may need assistance in meeting their tax-filing responsibilities: individuals with low-to-moderate income (defined by the EITC threshold), persons with disabilities, elderly and Limited English Proficiency (LEP) taxpayers. VITA clients are generally low-to moderate-income taxpayers who file Form 1040, *U.S. Individual Income Tax Return*. Community organizations partner with the IRS and host VITA sites at local places such as libraries, senior centers, colleges and universities (hereinafter referred to as “community partners”). These sites are staffed with IRS certified volunteers from the community. Community partners are often colleges and universities, churches, military, senior centers, unions and other special interest groups. Recently, SPEC has partnered with high schools to train students to prepare returns and open VITA sites.

Since the VITA sites are run by each community partner, there is little, if any, consistency on marketing each VITA site. Further, locations, days and hours, and services vary at each VITA location. Typically, community partners operate their sites during the tax filing season (January – April). However, some community partners keep their VITA sites open year-round.

Although the VITA program is an IRS program, the IRS’s involvement is limited to training the volunteers and providing computer equipment and access to the tax preparation software. It is the community volunteers who run the VITA sites, and these volunteers do not work for the IRS. However, many taxpayers have the misconception that VITA sites are staffed by IRS personnel. Thus, some taxpayers who may be eligible for assistance at a VITA site forego the opportunity based on the unwarranted fear that the information they give in having their return prepared is being directly provided to IRS personnel. Many taxpayers have a perverse impression the IRS is “out to get” taxpayers.

The IRS has a “VITA” webpage<sup>100</sup>; however, this site does not use “VITA” as its heading. Rather, this webpage is titled “Free Income Tax Return Preparation for You by Volunteers.” For example, if you Google “free tax file tax preparation

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<sup>100</sup> <https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers>

and IRS," you get a link with lots of information and resources but not one directly mentions VITA. There is minimal information on the "VITA" webpage directed to taxpayers who may be seeking information about VITA services—just one paragraph explains what VITA does.<sup>101</sup> The remaining portion of the webpage directs taxpayers to publications regarding what to bring to a VITA site, provides a VITA/TCE site locator tool or information for volunteers or provides information directed to VITA volunteers and site coordinators.

Several recent changes have created a ripe atmosphere for the IRS to refocus efforts on promoting SPEC and growing the VITA program. Specifically, the Taxpayer First Act of 2019 (the "Act") codified the VITA program, allowing the Secretary of Treasury to allocate up to \$30 million per year in matching grant funding to qualified partner organizations to expand the VITA program in local communities. Additionally, the Act allows the IRS to promote the benefits of VITA using mass communications. Next, the IRS recently announced a new organizational structure for SPEC that will make it more efficient for SPEC to research, develop and establish new partnership opportunities. The IRSAC believes there are several opportunities for the IRS to take advantage of these new provisions and policies to help promote both SPEC and the VITA program.

## **Recommendations**

### *SPEC Promotion*

1. Create a dedicated webpage for SPEC on the IRS website providing information regarding its purpose, goals, services and contact information for key personnel. By having this information easily locatable, existing and new community partners can more easily contact SPEC regarding opportunities furthering SPEC's goals. On this webpage, SPEC should

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<sup>101</sup> This one paragraph states:

"The Volunteer Income Tax Assistance (VITA) program offers free tax help to people who generally make \$55,000 or less, persons with disabilities and limited English speaking taxpayers who need assistance in preparing their own tax returns. IRS-certified volunteers provide free basic income tax return preparation with electronic filing to qualified individuals.

In addition to VITA, the Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older, specializing in questions about pensions and retirement-related issues unique to seniors. The IRS-certified volunteers who provide tax counseling are often retired individuals associated with non-profit organizations that receive grants from the IRS." Located at <https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers>.

- include highlights of the beneficial services it provides to assist taxpayers (e.g., VITA, TCE, etc.). Such information would promote SPEC and its goals and promote the IRS as “doing good.”
2. Contact other federal agencies that follow SPEC’s anti-poverty goals (e.g., U.S. Department of Agriculture’s Supplemental Nutrition Assistance Program, U.S. Department of Housing and Urban Development, etc.) to promote SPEC’s programs. In addition, other federal agencies such as the Social Security Administration and Veteran Affairs would also have clients in common with SPEC’s goals. By introducing SPEC’s programs to these other federal agencies, SPEC could receive referrals from these organizations.
  3. Communicate SPEC’s goals to other divisions of the IRS itself. Because other divisions of the IRS also work with outside agencies and even taxpayers themselves, IRS employees should be encouraged to help spread SPEC’s message and refer taxpayers who may benefit from its beneficial services.

*VITA Promotion, Branding, & Marketing*

4. Work with an advertising firm to brand, promote and market the VITA program with consistent, well-researched materials. SPEC could work with a couple of pilot programs to test out branding and materials before expanding nationwide.<sup>102</sup>
5. Change the name of the program as it applies to taxpayers. Although the VITA name has been used for the past 50 years, there is not a large-scale brand recognition of the program as free tax preparation assistance. “VITA” does not convey free return preparation services. In seeking help with preparing their income tax return, a taxpayer likely would not search “volunteer income tax assistance” on the internet. Most likely, such a search would use the term “free tax return preparation.” A new name and brand directed to taxpayers would help with awareness of the services the

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<sup>102</sup> Article, *Special study on Taxpayer First Act of 2019*, Thomson Reuters Tax & Accounting (June 17, 2019)

- program offers. “VITA” can still be used for the volunteer side of the program (i.e., the volunteers are providing “volunteer income tax assistance”).
6. Create general marketing materials and shared marketing files that can be downloaded by community partners for use at their VITA sites. There is little branding consistency across VITA sites. Providing general marketing materials that could be downloaded from a VITA website would promote that the program is nationwide and serviced by the IRS. The marketing materials could be written in several languages.
  7. Create a webpage for community partners separate from the VITA webpage, which is primarily directed to volunteers. The partner page should include information about the VITA grant and provide a link to the grant application and instructions. The site should also provide the marketing materials that local VITA sites can download and use to promote their local programs. A simple scheduling program or app that VITA sites could download for scheduling appointments to ensure sufficient volunteer coverage would also be helpful. The partner page should also promote opportunities and ideas that community partners could use to expand their programs (e.g., promoting the use of coalition grants, successful marketing strategies, etc.). These resources would be especially beneficial to smaller VITA sites that may have limited funds for developing their materials and marketing strategies. Last, the site should include testimonials from existing partners touting their programs and discussing how VITA benefits local communities.
  8. Promote VITA as a trusted and reliable program. Many taxpayers feel that if it is a free service it must not be reliable or good quality. However, the 3.4 million tax returns prepared through VITA sites during the 2019 filing season had a 98 percent accuracy rate.<sup>103</sup> By emphasizing the reliability of the VITA program, the IRS can develop trust among taxpayers about the benefits of having their tax returns prepared and filed through the VITA program.

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<sup>103</sup> Pub. 1084, *2020 Volunteer Site Coordinator Handbook*, Stakeholder Partnerships, Education and Communication (SPEC) (Rev.10-2019) <https://www.irs.gov/pub/irs-pdf/p1084.pdf>

9. Create a “Taxpayer Assistance” webpage highlighting the programs the IRS has to assist taxpayers in meeting their filing obligations<sup>104</sup> (e.g., VITA, Free File<sup>105</sup>). This webpage could also include information for taxpayers seeking assistance with tax disputes (e.g., Low Income Tax Clinic [LITC] programs), penalty abatements (e.g., First Time Abate), and assistance with collection matters (e.g., installment plans, offer-in-compromise, etc.). In essence, a one-stop site for taxpayers needing assistance.
10. Revise the “Free Tax Return Preparation for Qualifying Taxpayers” page on the IRS website to be more informative and more prominent, so it is more easily discovered by taxpayers going to the IRS page for information about available resources. This can be done in several ways:
  - a. Emphasize on the VITA webpage that while the VITA program is serviced by the IRS, the individual VITA sites are not staffed with IRS personnel nor are the VITA volunteers sharing information with the IRS directly. However, the website should also be clear that the VITA program is supported/structured by the IRS, so the IRS gets recognition for helping taxpayers (i.e., IRS doing good).
  - b. Emphasize the longevity and past success of the program explicitly highlighting the number of taxpayers served, the accuracy rate of VITA-filed returns and savings to taxpayers.
  - c. Explain the mission of the VITA program, the taxpayers helped through this program (i.e., low-income, elderly, military/veterans, etc.), and how taxpayers benefit from the program. Also, emphasize the training VITA volunteers must complete becoming certified.
  - d. Clarify that the VITA/TCE tool operates on a real-time basis. Therefore, to see what local options are available, taxpayers should search close to the time when they are ready to have their tax returns prepared. Currently, there is a message stating to check back regularly. If the taxpayer is frequently checking during the off-season

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<sup>104</sup> To date the IRS has a webpage with these resources grouped under e-file options <https://www.irs.gov/filing/e-file-options>

<sup>105</sup> This webpage should clarify the differences between the VITA program and the Free File program.

and continually sees no option, he or she may be discouraged from checking during the season when more sites are open.

- e. Add a link to this information on the main page of the IRS site to make it more visible to taxpayers (as is done for the Free File program). This can be done in one of two ways: 1) Add a stand-alone “Free Tax Return Preparation” button on the main page, or 2) Update the existing “File Your Taxes for Free” button to something that encompasses both the Free Preparation and Free File program (i.e., Free Tax Return Preparation/Filing) and allow taxpayers to navigate to the preferred service from there.
- f. Launch a social media ad directed towards potential VITA-eligible taxpayers. Social media is one of the cheapest sources of advertising and is a fantastic way to build brand recognition inexpensively.
- g. Leverage the use of technology to provide for virtual VITA sites in urban settings to provide a free alternative to qualified taxpayers who may be physically unable to get to a VITA site or to shift taxpayers from VITA sites where there are fewer volunteers to VITA sites with an abundance of volunteers. SPEC is already doing this in rural areas where it is difficult to build a traditional VITA site.
- h. Engage payroll providers in providing information regarding the VITA program on Forms W-2 and 1099 when such income reported on these forms reflect that a taxpayer may be eligible for the VITA program. Such information could merely consist of a brief statement advising the taxpayer they may seek the benefit of free tax preparation services through VITA and a reference to the IRS’s VITA website for further information.

#### *VITA Growth*

11. Focus on continuing to develop partnerships, coalitions and the number of volunteers to help grow the VITA program through increased availability of sites and services. This can be done in several ways:



- a. Modify the annual survey completed by the VITA sites to include questions on successes and failures in the current tax filing season and provide an opportunity to make recommendations. Such feedback and recommendations can assist SPEC in continuing to improve its VITA program, which can help with partner and volunteer retention rates. Maintaining existing sites and volunteers is as essential to growing the program as recruiting new partners.
- b. Coordinate between the IRS's LITC program and SPEC's VITA program to encourage site coordinators to refer clients to each other. Often, a LITC taxpayer will need to have past, or current returns prepared to address a tax matter (e.g., a collection issue) and should be referred to a local VITA site. VITA site coordinators can build into their questioning whether the taxpayers they are serving have any ongoing problems with the IRS so a referral to the LITC can be made if such problems exist.
- c. Mine existing data to determine where to best target community partner recruiting efforts. For example, if it is determined that 90 percent of universities are already partnering with the IRS to offer VITA, then recruitment efforts can be diverted to other sectors that are underutilized. Additionally, if successful partnerships are identified in underutilized sectors, the IRS could solicit the assistance of existing partners in their efforts to increase participation in these areas.
- d. Create a digital badge that volunteers could display on professional sites such as LinkedIn. The badge could indicate the level of VITA certification achieved and the number of years the individual has volunteered. Creating a digital badge would provide the opportunity for volunteers publicly to showcase their educational development and community involvement.

- e. Produce a model tax curriculum as a resource for high school and college educators seeking to teach students about the tax reporting and to develop a VITA program.

## **ISSUE FIVE: IRS Form 1040NR and 1040NR-EZ**

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### **Executive Summary**

Nonresidents working in the United States (U.S.) have U.S. tax filing obligations. For tax purposes, an “alien” is an individual who is not a U.S. citizen. Nonresidents fall into two categories – Resident Aliens (RA) and Nonresident Aliens (NRA).<sup>106</sup> RAs file Form 1040 as U.S. tax residents and are generally subject to the same tax rules as U.S. citizens. Taxpayers qualify as RAs if they meet the Green Card Test or Substantial Presence Test. NRAs file Form 1040NR (or Form 1040NR-EZ) and generally pay tax only on U.S. source income. NRAs meet neither the Green Card nor Substantial Presence test (or qualify as NRAs based on tax treaty provisions). Form 1040NR is also filed by nonresident estates and trusts. The IRS requested the IRSAC’s assistance in revising and aligning Form 1040NR (and Form 1040NR-EZ) with 2018 and 2019 Form 1040 changes.

### **Background**

When the IRS redesigned Form 1040, for 2018 tax returns filed in 2019, the service eliminated Form 1040-A and Form 1040-EZ – aiming to “streamline the Form 1040 into a shorter, simpler form for the 2019 filing season.”<sup>107</sup> Form 1040NR and 1040NR-EZ retained the old design, more closely aligning with the 2017 and prior-year Form 1040. Over the years, for electronic tax return filing, the IRS migrated from an older legacy system to the Modernized e-File (MeF) platform. The IRS integrated Form 1040 and 1040-related forms into MeF in 2010. The IRS added Form 1040NR and related forms to MeF in 2016 (excluding Form 1040NR-EZ, Dual-Status, Fiscal Year, and Estate or Trust returns).<sup>108</sup> Both taxpayers and tax professionals, perhaps because they could not e-file for so many years, seem to favor paper-filing. Also, first-time Form 1040NR filers often submit their initial Form 1040NR along with an individual taxpayer identification number (ITIN) application (Form W-7) which, to date, requires paper filing (23,951 in 2017, 25,159 in 2018 and 12,125 in 2019 through 7/31/2019). The IRS also reports that 6-7

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<sup>106</sup> For additional details on RA and NRA status see IRS Publication 519, U.S. Tax Guide for Aliens: <https://www.irs.gov/forms-pubs/about-publication-519> and Form 1040NR Instructions: <https://www.irs.gov/forms-pubs/about-form-1040-nr>

<sup>107</sup> IR-2018-146 June 29, 2018: <https://www.irs.gov/newsroom/irs-working-on-a-new-form-1040-for-2019-tax-season>

<sup>108</sup> Modernized e-file (MeF) overview: <https://www.irs.gov/e-file-providers/modernized-e-file-overview>

percent of 1040NR e-file attempts are rejected.<sup>109</sup> While we see a slight increase in e-filing since MeF embraced Form 1040NR, the fact that Form 1040NR-EZ is not eligible for e-file, along with some of the aforementioned issues, yields striking statistics – 23 percent e-file rate for TY2016, 31 percent e-file rate for TY2017 and 34 percent e-file rate for TY2018 (as of 7/31/2019).

Statistically, overall, we do not see large filing volume for Forms 1040NR and 1040NR-EZ. Overall tax return volume for the 1040NR series, including Form 1040NR-EZ, was 757,000 (2016 returns filed in 2017), 758,000 (2017 returns filed in 2018) and 522,000 (2018 returns filed in 2019 through 7/31/2019). Although filing season 2019 statistics for 2018 returns are not complete, we have valid statistics as of July 31, 2019:

#### Total Returns

| FORM TYPE      | TY2016         | TY2017         | TY2018         |
|----------------|----------------|----------------|----------------|
| Form 1040NR    | 547,000        | 548,000        | 326,000        |
| Form 1040NR-EZ | 210,000        | 210,000        | 196,000        |
| <b>Total</b>   | <b>757,000</b> | <b>758,000</b> | <b>522,000</b> |

#### Paper Returns

| FORM TYPE      | TY2016         | TY2017         | TY2018         |
|----------------|----------------|----------------|----------------|
| Form 1040NR    | 370,000        | 312,000        | 150,000        |
| Form 1040NR-EZ | 210,000        | 210,000        | 196,000        |
| <b>Total</b>   | <b>580,000</b> | <b>522,000</b> | <b>346,000</b> |

#### E-filed Returns

| FORM TYPE   | TY2016  | TY2017  | TY2018  |
|-------------|---------|---------|---------|
| Form 1040NR | 177,000 | 235,000 | 176,000 |

<sup>109</sup> The most common e-file rejections are: 'Primary SSN' and 'Primary Name Control Txt' must match the e-File database and 'Primary Prior Year PIN' or 'Primary Prior Year AGI Amt' in the Return Header must match the e-File database.

Others have researched and reported on possible reasons for the low 1040NR volume. The Government Accounting Office (GAO) released a report, GAO-10-429, on May 14, 2010,<sup>110</sup> looking at NRA compliance issues. While beyond the scope of our W & I subgroup focus, we found the report to be of great interest and hope that, as the IRS moves forward with its overall efforts to improve customer service, customer experience, technology, and compliance it consider another look at how to better serve the NRA community while enhancing taxpayer compliance. A May 2018 Tax Policy Center blog post by one of their NRA employees states, “Most Americans are proud to pay taxes; about nine in ten see taxpaying as a civic duty. So do most immigrants and nonresidents, regardless of their lawful status. But the U.S. government does not make it easy, and prevailing myths about immigrants’ compliance with taxes certainly do not help.”<sup>111</sup> NRAs may have limited English proficiency and face other obstacles in complying with their U.S. tax obligations.

W&I, at the submission processing (SP) level, rarely investigates whether a taxpayer’s use of Form 1040 or Form 1040NR is appropriate, based on their circumstances. That investigation would fall to other units (i.e., Underreporter, Exam or Compliance). One circumstance under which SP would question a taxpayer’s U.S. RA/NRA status is described in The Internal Revenue Manual (IRM) when a taxpayer files a Form 1040 refund claim with all income reported on Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding (IRM 3.21.3.15.5.1 and IRM 3.22.3.257.3.4).

NRA taxpayers must also determine whether their income is effectively connected with a U.S. Trade or Business or whether it’s not effectively connected with a U.S. Trade or Business, as well as deciding whether to file as residents or nonresidents. Effectively connected income may be taxed at different rates from non-effectively connected income. They must also familiarize themselves with Tax Treaty provisions that apply to their situation. Both Form 1040NR and 1040NR-EZ

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<sup>110</sup> Tax Compliance: IRS May Be Able to Improve Compliance for Nonresident Aliens and Updating Requirements Could Reduce Their Compliance Burden: <https://www.gao.gov/products/GAO-10-429>

<sup>111</sup> Filing Taxes: A Nonresident’s Experiences: <https://www.taxpolicycenter.org/taxvox/filing-taxes-nonresidents-experiences>

include additional schedules speaking to these provisions particular to NRA taxpayers – Schedule NEC (Tax on Income Not Effectively Connected With a U.S. Trade or Business) and Schedule OI (Other Information) with additional questions particular to NRA taxpayers. NRAs filing Form 1040NR cannot use the standard deduction (with a limited exception for residents of India who were students or business apprentices eligible under Article 21(2) of the United States-India Income Tax Treaty). They are eligible, however, for the qualified business income deduction (assuming they meet the other tests to claim it). Form 1040NR has other line items that are unique.

Looking at the complexities associated with an NRA's U.S. tax filing, not surprisingly, many turn to tax preparers for assistance. Over the past three years over 60 percent of Forms 1040NR and 1040NR-EZ were prepared by tax preparers – with a much higher ratio for Form 1040NR returns than for 1040NR-EZ returns. Tax preparer usage of e-file for 1040NR returns has improved (36 percent for TY2016, 49 percent for TY2017 and 65 percent for TY2018 to date).

Form 1040NR also has different labels for many fields in the taxpayer information area – Identifying number instead of Social Security Number for taxpayers and dependents, checkboxes for individual and estate or trust, different filing status options (Single nonresident alien, Married nonresident alien) and dedicated lines for scholarships and fellowship grants, income exempt by treaty, exemptions for estates and trusts, tax on income not effectively connected with a U.S. trade or business, transportation tax, withholding from Forms 8805, 8288-A, and 1042-S and credit for amounts paid with Form 1040-C. The IRSAC, noting these differences, considered whether the IRS could effectively redesign Form 1040NR to conform to the redesigned Form 1040 and eliminate Form 1040NR-EZ. As we developed the issue, we recognized that aligning Forms 1040NR with Form 1040 benefits taxpayers, tax software vendors, other tax industry stakeholders and the IRS. The IRSAC believes there is ample correlation between Form 1040 and Form 1040NR. We understand that, as we were developing our recommendations, IRS Information Technology (IT) requested a redesign of Form 1040NR to align with Form 1040. We reviewed the most recent draft form of both Form 1040 and

Form 1040NR. The 2019 Form 1040, incorporating both the experience of the 2019 filing season and stakeholder input, is redesigned with a two-page 1040 (including more line numbers) and three numbered Schedules (reduced from six numbered Schedules with the 2018 Form 1040). We support aligning Form 1040NR with the Form 1040 redesign and are pleased to offer our recommendations.

### **Recommendations**

1. Encourage higher utilization of e-file through taxpayer and practitioner outreach. Leverage the one-to-many ratio of tax preparers to improve e-filing numbers.
2. Engage the software industry to offer 1040NR e-file in tax professional products and Do It Yourself (DIY) software packages. Many DIY software products, including Free File offerings, do not support Form 1040NR and related schedules.
3. Explore incorporating Form 1040NR into the base 1040, perhaps through the inclusion of a checkbox to indicate non-resident status, which would decrease the burden of supporting electronic filing for the IRS and software providers. Closely correlating Form 1040NR with Form 1040, using Form 1040 with a checkbox and additional schedules pertaining to NRAs, should encourage more tax software vendors to embrace 1040NR e-filing.
4. Eliminate Form 1040NR-EZ. Since Form 1040NR-EZ filers could not use MeF, transitioning them to Form 1040NR should also help drive more 1040NR filers to e-file.
5. Align Form 1040NR line items that match Form 1040 so that, when 1040 changes occur, the 1040NR specifications match.
6. Coordinate VITA programs with communities and institutions that serve NRAs.
7. Develop an interactive tax assistant (ITA) application for NRAs that will help guide them to the correct forms and schedules for filing their U.S. tax returns.

8. Promote the availability of Form 1040NR filing through the VITA programs and, where available, through Free File.





**Internal Revenue Service Advisory Council**

**Tax Exempt & Government Entities Subgroup Report**

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## **INTRODUCTION / EXECUTIVE SUMMARY**

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The IRSAC Tax Exempt & Government Entities (TE/GE) subgroup is a diverse group of eight members working collaboratively with representatives of TE/GE regarding a broad range of issues, including employee plans, exempt organizations, Indian tribal governments, state and local government entities and tax-advantaged bonds. The subgroup members include attorneys, certified public accountants and financial and benefit advisors. The TE/GE subgroup is grateful for the cooperation we received from members of the Tax Exempt and Government Entities Division of the IRS in producing this report, including Louis Leslie, Technical Advisor, Employee Plans, Richard Crom, Analyst, Program Management Office, Exempt Organizations, and Bob Griffo, Technical Advisor, Indian Tribal Governments/Tax Exempt Bonds. Our report addresses three topics, at the request of TE/GE: (1) suggestions for changing the IRS advisory opinion process to increase transparency and improve operational compliance for pre-approved retirement plans, (2) suggestions to assist in improving the accuracy of information on Form 990 series filings and (3) suggestions for mechanisms for self-remediation with respect to tax-advantaged bonds that would make correction more cost effective, less complex and promote voluntary compliance. Consistent with the intent of the Taxpayer First Act of 2019, H.R. 1957 (2019), our suggestions in this report address a common goal: relief of burden of taxpayers and the IRS while facilitating effective tax administration.

## **ISSUE ONE: Changing the IRS Advisory Opinion Process to Increase Transparency and Improve Operational Compliance for Pre-Approved Retirement Plans**

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### **Executive Summary**

The IRSAC is recommending modification to the pre-approved plan advisory opinion process by adding disclosures from pre-approved plan sponsors regarding the level of internal controls and assumption of responsibility on operational compliance issues. This recommendation is intended to increase transparency and improve operational compliance for adopting employers.

The vast majority of retirement plans sponsored in the U.S. are pre-approved plans, and the thousands of sponsoring employers using pre-approved plans have varying levels of sophistication and resources. These employers rely heavily on external vendors and third parties in the drafting, operation and administration of their retirement plans. Employers using a pre-approved plan document may not fully understand the operational control issues that effect compliance. For example, the employer may not understand the division of plan compliance responsibilities between the employer, pre-approved plan sponsor, third-party administrator and other external vendors. In addition, the division of such responsibilities may not be fully or clearly delineated in contracts or other material provided to the employer. This can result in the employer not knowing what operational compliance issues are its responsibility, which ones the vendor or administrator is intending to assume or the depth of their internal compliance controls. By requiring that the pre-approved plan provider disclose its roles and responsibilities, and its control environment with respect to various operational compliance requirements, the IRS will make information available to employers of pre-approved plans so they can be more compliant, select a vendor that best meets its needs and facilitate more open discussion amongst the marketplace participants that will lead to less operational failures.

We are also recommending that the IRS collect and share information regarding known or suspected plan operational compliance issues with pre-approved plans with pre-approved plan providers so they are aware of the

compliance issues employers are encountering and they can work to eliminate them. This information sharing between the IRS and the pre-approved plan providers should help the pre-approved plan provider community become aware of compliance issues and help them minimize the future occurrence of those issues with other adopting employers.

Our recommendations strive to achieve the goals of the Taxpayer First Act of 2019 (H.R. 1957), of relieving burdens on both taxpayers and the IRS. See Revenue Procedure 2019-19, 2019-19 I.R.B. 1086.

### **Background**

According to the IRS, for 2017 72 percent of all qualified retirement plans are pre-approved plans. Pre-approved plans are flexible documents that can be tailored within certain specified parameters to meet the needs of a variety of employers. The pre-approved plans often have adoption agreements (or selection menus) that let employers choose from a limited number of options. They are prepared by a financial institution or benefits practitioner that has met the IRS's requirements ("pre-approved plan provider") and are sold to employers by that pre-approved plan provider.

Although pre-approved plans cover 72 percent of all qualified plans, they only cover approximately 20.7 percent of all plan participants.<sup>112</sup> This is reflective of the fact that smaller employers adopt pre-approved plans more often than larger employers. These smaller employers typically have fewer resources to focus on retirement plan compliance. It is common for smaller employers with fewer compliance resources to rely more heavily (than larger employers) on the entity hired to handle the plan administration.

Qualified retirement plans need to be compliant with IRC requirements<sup>113</sup> in both form and in operation.<sup>114</sup> Pre-approved plans are submitted to the IRS by the pre-approved plan provider for an advisory opinion that the plans meet the

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<sup>112</sup> Data provided by staff in the Employee Plans division of the IRS based on Form 5500 and other data.

<sup>113</sup> See IRC Section 401(a) and 403(a).

<sup>114</sup> Other qualification categories used by the IRS are demographic failures and employer eligibility failures. Rev. Proc. 2019-19, Part III Section 5.01(2). These types of qualification failures are included in the scope of these recommendations. It is not intended, however, that these recommendations change the availability of any of the correction programs under Rev. Proc. 2019-19 for these types of defects.

compliance requirements in form, effectively eliminating the risk of noncompliance in form.

The current advisory opinion process only considers the form of the plan when opining on whether the plan meets IRS qualification requirements.<sup>115</sup> The employer does not, however, generally have any information about whether the plan it adopts will be compliant in operation, whether there are controls in place to help maintain operational compliance,<sup>116</sup> or what are its responsibilities in relation to operating the plan.

### **Recommendations**

Based on this background, the IRSAC has two primary recommendations:

1. Improve operational compliance for employers adopting pre-approved plans with minimal additional resources from the IRS by providing the employers with increased transparency related to: (1) the control environment related to plan compliance and (2) the employer's and administrator's roles and responsibilities relating to compliance.
2. Improve operational compliance for employers adopting pre-approved plans by: (1) documenting known or suspected operational compliance problems with pre-approved plans and (2) sharing knowledge of those problems with the pre-approved plan providers so they can address administrative issues within their scope of responsibility and help educate adopting employers about common compliance problems arising within the employer's responsibilities.

#### ***Recommendation 1: Increasing Transparency Related to Controls, and Roles and Responsibilities***

The IRSAC recommends that the advisory opinion process be modified so that pre-approved plan providers are required to disclose a self-assessment of the control environment maintained by the administrator related to plan compliance areas, and provide a summary of the roles and responsibilities of the employer and

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<sup>115</sup> Rev. Proc. 2017-41 (2017-29 I.R.B. 92).

<sup>116</sup> Some plan administrators have periodic audit reviews performed and reports issued that examine the control environment of certain aspects of their administrative system and processes (sometime referred to as a SSAE 16). These reports are often very long, confusing, and typically not presented in a consistent format that allows for a comparison between vendors. Generally, they are neither read nor relied upon by smaller employers.

the administrator related to plan compliance.<sup>117</sup> By providing this information, employers (who are generally smaller employers with fewer resources), will be able to ascertain what additional oversight should be provided, internal controls that should be added with the employer or its vendors, or testing that might be warranted in more targeted areas to insure that the plan is compliant in operation.

### ***Proposed Process to Implement Disclosure Recommendation***

When a pre-approved plan provider submits a plan document to the IRS for an advisory opinion<sup>118</sup> it will provide the IRS with a copy of the disclosure information that it will provide to each employer that adopts the pre-approved plan. The disclosure will contain:

- a summary of the roles and responsibilities of the employer and the administrator related to plan compliance and
- the pre-approved plan provider's determination of the level of controls maintained by the administrator in the areas where it is responsible.

It is possible to summarize the roles and responsibilities of the employer and the administrator in a variety of ways. However, the IRSAC believes that summarizing the information in a clear, simple and consistent table will provide employers with the best opportunity to compare different administrative options and address the range of compliance challenges. For example, 10 areas<sup>119</sup> where the employer, administrator or another entity might have responsibility related to plan compliance are:

#### **1. Eligibility data collection**

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<sup>117</sup> We recommend that the disclosure be partially waived in two situations. First, to help facilitate the transition of providing the new disclosures we recommend that pre-approved plan providers be given the option for two years of not disclosing the information recommended by the IRSAC. (See the table below which illustrates the disclosure and includes an option for pre-approved plan providers to indicate that they are not disclosing the information.)

Second, the IRSAC recognizes that not all pre-approved plans are administered by the pre-approved plan provider or an entity related to the pre-approved plan provider. For example, the pre-approved plan provider may provide the plan document and investment options, but not handle the plan administration. Accordingly, the recommended disclosures (and the table that serves as an example), do contemplate the situations where the pre-approved plan provider and the administrator are not the same entity or otherwise coordinated.

<sup>118</sup> Rev. Proc. 2017-41.

<sup>119</sup> These ten areas typically have clear ownership by either the employer or the plan administrator, and are the most common sources of operational compliance issues. We expect that what is encompassed by each of these areas would be defined.

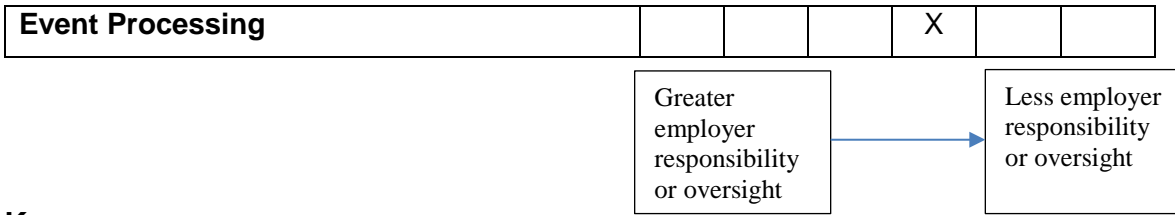
2. Eligibility determination
3. Contribution or benefit eligibility
4. Contribution or benefit limit monitoring
5. Distribution form election processing
6. Distribution calculation and payments
7. Benefit payment cessation
8. Discrimination data collecting
9. Discrimination testing
10. Event processing<sup>120</sup>

The responsibility and controls disclosure will include who is responsible for each of the above areas and the control environment for each of the areas where the administrator is responsible. The following table is an example of how this information can be simply, clearly and consistently disclosed to employers. This illustration assumes that the employer is responsible for gathering the data regarding plan eligibility and discrimination testing and is also responsible for benefit cessation. The administrator is responsible for all other areas which have varying levels of controls. The key to the abbreviations used in the table follows the table.

| Responsible Area                                | Responsible Party and Control Environment |   |    |    |    |     |
|---|---|---|----|----|----|-----|
|   | E   | U | AU | AL | AC | ACT |
| <b>Eligibility Data</b>                         | X   |   |    |    |    |     |
| <b>Eligibility Determination</b>                |   |   |    | X  |    |     |
| <b>Contribution/Benefit Election Processing</b> |   |   |    |    | X  |     |
| <b>Contribution/Benefit Limit Monitoring</b>    |   |   | X  |    |    |     |
| <b>Benefit Election Processing</b>              |   |   |    |    |    | X   |
| <b>Benefit Payments</b>                         |   |   |    |    | X  |     |
| <b>Benefit Cessation</b>                        | X   |   |    |    |    |     |
| <b>Discrimination Data Gathering</b>            | X   |   |    |    |    |     |
| <b>Discrimination Testing</b>                   |   |   |    |    |    | X   |

<sup>120</sup> This includes events such as changes in employee status, rehires, plan mergers, etc.





**Key**

E = Employer responsibility

U = Unknown or undisclosed responsibility<sup>121</sup>

AU = Administrator responsibility; not controlled, controls unknown, or controls are not documented<sup>122</sup>

AL = Administrator responsibility; limited controls<sup>123</sup>

AC = Administrator responsibility; controlled but not tested<sup>124</sup>

ACT = Administrator responsibility; controlled and tested<sup>125</sup>

The summary disclosure (such as the table above), would be accompanied by an explanation of the table, a description of what is covered by each of the “responsible areas,” and a description of the items under “responsible party and control environment.”<sup>126</sup> The summary, explanation and descriptions should be provided to the employer by the pre-approved plan provider (or administrator), and be written in a way so a typical smaller employer can understand the rating and the responsibilities it is assuming. Where a pre-approved plan provider has some exceptions to what is being disclosed, we would envision that they would be allowed to describe those exceptions. For example, a pre-approved plan provider may have documented controls in place but only a portion of the controls are tested. In such a case, if the above described format was used, the pre-approved plan provider could use AC or ACT for that area and describe the exceptions to the employer.

<sup>121</sup> “U” is used if the pre-approved plan provider is not responsible for the administration, or if they decide they do not want to disclose who is responsible or their controls.

<sup>122</sup> It is always assumed that all controls are documented so they can be reviewed, if needed, by the employer, plan fiduciary, or IRS. If there are controls but they are not documented, the administrator would use “AU.”

<sup>123</sup> Limited controls spans the gap between situations where there are essentially no controls and where the area is substantially controlled.

<sup>124</sup> If a control had been tested in the past it should no longer be considered tested if there have been changes made to the administrative system that could affect the effectiveness of the control.

<sup>125</sup> The controls can be tested by the administrator or a third-party.

<sup>126</sup> For consistency, simplicity, and to minimize costs for pre-approved plan providers, we recommend that the IRS and the pre-approved plan provider community develop sample explanations and descriptions.

## ***Disclosures and Descriptions***

The IRSAC believes that the disclosure can be accomplished either by the IRS providing the disclosure in the advisory opinion (which is later given by the pre-approved plan provider to the employer during the contracting process), or in a separate document<sup>127</sup> that is given by the pre-approved plan provider to the employer with the advisory opinion, adoption agreement, or plan document. The objective is to provide the disclosure early in the employer's decision-making process so the division of responsibilities and the control environment are known by the employer before they make a final decision selecting or retaining the pre-approved plan provider.

The disclosure should be accompanied with an explanation of the table and its significance, and a description of any exceptions. For example, it could state:<sup>128</sup>

The pre-approved plan provider has summarized on the above table the operational compliance areas that you, as the employer, have responsibility. There may also be other areas for which you have responsibility regarding the plan's operational compliance and it is important that you identify, understand, and oversee these areas. In addition, the pre-approved plan provider has summarized the areas where it is responsible, and the level of controls that exist in those areas. Where the administrator has indicated that there are no controls, limited controls, or the controls are not tested, you should monitor and manage these areas to ensure that the plan remains in compliance. Clearly understanding one's responsibility and having effective compliance controls is critical to maintaining the plan's tax-favored status and avoiding the potential imposition of significant taxes and penalties.

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<sup>127</sup> The separate document can be required under the current Rev. Proc.'s document retention requirement.

<sup>128</sup> Where the pre-approved plan provider does not provide the administrative service (and most of the designation are "U"), the following language could be used:

The pre-approved plan provider of the document you are adopting has indicated that it does not currently provide the noted administrative services or have a relationship with the entity providing the administrative services, or does not know the controls used by the administrator. As the adopting employer of this plan, it is your responsibility to ensure that the plan remains in compliance with the IRC, and the pre-approved plan provider is not assisting you with the plan's compliance. Knowing the pre-approved plan provider's, plan administrator's, and adopting employer's roles and responsibilities is important in maintaining compliance. Similarly, knowing the controls that exist to maintaining compliance help to manage compliance risk. These are areas that you should address with your plan administrator to ensure that all compliance requirements are being met.

## ***Recommendation 2: Improve Tracking and Sharing of Pre-approved Plans Compliance Issues***

Our second recommendation is made up of two parts. First, that the IRS collect and aggregate self-reported data of recurring or systemic known or suspected operational compliance issues that are disclosed or identified under the Employee Plans Compliance Resolution System (EPCRS)<sup>129</sup> or plan audits of pre-approved plans. Second, provide notice to the pre-approved plan provider of known or suspected operational compliance issues identified from the collected and aggregated data.

## ***Plan Audit Data Aggregation and Sharing of Pre-approved Plans Operational Defects***

### **Recommendation One**

The IRS possesses extremely valuable compliance data from the various programs within the EPCRS and the plan audits that it conducts.<sup>130</sup> Within this data possible compliance problems related to a particular pre-approved plan provider or plan administrator may be able to be identified. For example, an administrator may not check or review reported participant compensation which may result in plan deferral amounts or benefit limits being exceeded. This responsibility may be left to the employer under the administrative agreement. If employers using this pre-approved plan sponsor or administrator are having frequent problems exceeding these limits and are encountering compliance problems, that may be indicative of a broader-based compliance trend with other employers using that administrator. Collecting, aggregating and analyzing data related to pre-approved plan providers will help the IRS address potentially recurring or systemic

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<sup>129</sup> The EPCRS provides three ways to correct mistakes to qualified plans and avoid the tax consequences of plan disqualification. The three correction mechanism under EPCRS are (1) self-correction by the plan sponsor with no communication with the IRS, (2) voluntary correction where the plan sponsor submits a request to correct to the IRS and pays a fee, and (3) the audit closing agreement program which permits the sponsor of a plan under IRS audit to correct the failure and pay a sanction. See Rev. Proc. 2019-19, (2019-19 I.R.B. 1086).

<sup>130</sup> It is the IRSAC's understanding that the IRS already collects much of this data, through a combination of voluntary disclosures made by pre-approved plan providers, news stories regarding suspected breaches of data, EPCRS, and audits of adopting pre-approved plans.

The IRS may also want to consider obtaining and integrating the audit and other compliance data obtained by the Department of Labor and Pension Benefit Guaranty Corporation.

compliance issues with providers and potentially help proactively predict compliance issues with such plans.

In recommending that the data be aggregated, we appreciate the fact that developing such a system or process will require the use of IRS resources and could be burdensome. We believe that the data aggregation challenge can be appropriately managed by limiting the breadth and volume of data analyzed as follows:

- Phase-in the collection and analysis of data from pre-approved plan providers to those that are requesting new advisory opinions rather than attempting to collect and analyze data for all pre-approved plan providers at once.
- Initially limit the range of operational and administrative compliance issues that will be collected, aggregated and analyzed. For example, the IRS can initially focus on the 20 most common compliance issues for pre-approved plans.

We believe that the data aggregation will have additional benefits to the employer plans community:

- The collection, aggregation and analysis of data will not only highlight the plans of pre-approved plan providers with employers who have been audited or had issues submitted under EPCRS, it will also identify those pre-approved plan providers who have not had employer plans audited or submitted under EPCRS. The pre-approved plan providers with employers that are not audited by the IRS will be able to be identified which could expose a potential gap in enforcement. The collection, aggregation and analysis of data will give the IRS actionable compliance data that will allow the IRS to better focus its resources.
- Pre-approved plan providers that have recurring or significant issues will be able to be identified and can be more closely scrutinized to protect the plans and participants.

As pre-approved plan providers obtain new advisory opinions, the amount of data collected can be aggregated and become more statistically significant. This may encourage pre-approved plan providers to offer more robust internal controls to differentiate themselves from, or compete against, other pre-approved providers. It is expected that market forces would drive demand for pre-approved plan providers who either accept or manage more responsibility on behalf of the adopting employer and implement more internal controls to manage those responsibilities. The approach does, however, allow pre-approved plan providers to not adopt, improve or increase controls to manage risks (perhaps with a lower overall administrative cost), leaving the adopting employer responsible for managing the risk. These proposed disclosures will allow adopting employers to better understand what internal controls and processes are in place and what risks are allocated to them or to the pre-approved plan sponsor. These disclosures will also permit the adopting employer to analyze and allocate those risks in their contractual agreements with the pre-approved plan sponsor.

#### *Recommendation Two*

As available data of pre-approved plan provider potential compliance issues increases, the IRS should be communicating these identified issues to the pre-approved plan provider so it can act to resolve those issues. Accordingly, it is recommended that the IRS establish a liaison for the pre-approved plan providers who can facilitate the compliance process in three ways. First, the liaison can coordinate notifying the pre-approved plan provider of identified compliance issues, audit issues and potential “mass” corrections that have been identified with employers that have adopted the provider’s pre-approved plan (or used the administrator’s services). This accomplishes the critical step of taking the compliance issues that have been identified through the IRS’s data collection process and getting it to the pre-approved plan provider so corrections can begin.

Second, the liaison can initiate and drive the discussion with the pre-approved plan provider concerning changes to the control environment that the administrator may want to consider to help remediate recurring systemic compliance issues. Part of this dialogue would include having the pre-approved

plan provider report back to the liaison on any action they have taken in response to the identified recurring or systemic operational issues. If no action is taken to address an operational compliance issue by the pre-approved plan provider, the IRS can notify adopting employers, conduct a survey of adopting employers that are using the pre-approved plan provider about that issue, or initiate audits. On the far end of the spectrum where there is a significant impact to the employer plans community as a result of systemic errors, the IRS could require that the pre-approved plan sponsor's disclosures accurately reflect the issues or control weaknesses contributing to the compliance issues. Having a proactive communication process can warn current and future adopting employers regarding of the potential risks, the potential need to adopt additional controls or increase oversight, or other steps the employer may want to take to address the issues with the pre-approved plan provider.

Third, the liaison can also serve as a source for ideas on how to improve compliance with employers through communication with the employers about their controls and responsibilities.

### ***Potential IRS Resources Needed***

We have attempted to develop recommendations that would require minimal IRS resources. However, to implement the above recommendations we believe that the IRS would need to dedicate financial and personnel resources to the following tasks:

- Amending Rev. Proc. 2017-41 to add the disclosure requirement,
- Creating a database to capture and track pre-approved plan provider compliance issues and
- Creating a dedicated liaison position to help communicate compliance problems with pre-approved plan providers. This position could be a new full-time equivalent employee, or the tasks could be added to, or split between, one or more existing Service employee's duties.

Finally, because of the potential impact the above recommendations may have on the pre-approved plan provider community, we believe that the

mechanism to implement the above recommendations should be opened-up for comment to the pre-approved plan provider community, including both pre-approved plan sponsors and vendors, as well as participants and the public at large. We hope that they would be able to collectively develop and agree-upon a simplified, clear, and consistent way to communicate the roles and responsibilities of all the parties, and level of controls established for compliance areas and that this increased transparency would improve operational compliance amongst preapproved plans.

## **ISSUE TWO: Improving Accuracy of Form 990 Returns**

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### **Executive Summary**

The Tax Exempt and Government Entities Division has requested that the IRSAC make suggestions to assist in improving the accuracy of information on Form 990 series filings (the “Form 990 Series”). Under the Internal Revenue Code of 1986, as amended (the “Code”), organizations exempt under Section 501(a) of the Code must file an annual return; although, certain exceptions are provided.<sup>131</sup> Forms 990, 990-EZ and 990-PF are all available to be filed electronically. Form 990-T (which is part of the Form 990 Series) is not an information return and is not presently available to be electronically submitted. Only some of all Form 990 Series returns have been filed electronically, as previously no electronic filing mandate existed.

If an organization fails to file a required return by the due date, or if the filing is not made in the manner prescribed or involves a failure to include required information, a penalty may be imposed.<sup>132</sup> The IRS sends back Form 990 Series returns filed on paper – and rejects electronically filed returns – when they are materially incomplete or the wrong return.<sup>133</sup> Organizations excepted from filing an annual information return due to its gross receipts levels resulting in it being referred to in Section 6033(a)(3)(A)(ii) (gross receipts generally \$5,000 or less) or (a)(3)(B) (IRS discretionary relief provision) must file the electronic notice, Form 990-N.<sup>134</sup> An exempt organization that is required to file annual information returns will have its exempt status revoked if it fails to file an information return for three consecutive years.<sup>135</sup> Automatic revocation of exempt status applies to failure to file a required return or notice.<sup>136</sup>

The percentage of errors, over the past five years, resulting in rejected filings of Form 990 Series returns, has ranged as follows: paper (19 percent to 33 percent) and electronic (5 percent to 24 percent), depending upon the return and

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<sup>131</sup> Code §6033.

<sup>132</sup> Code §6652.

<sup>133</sup> See <https://www.irs.gov/charities-non-profits/annual-filing-and-forms>.

<sup>134</sup> Code §6033(i).

<sup>135</sup> Code §6033(j).

<sup>136</sup> Code §6033(j).



year filed. Thus, the percentage of errors of those filing electronically, resulting in rejection, is generally substantially lower than those filing with paper.

The Taxpayer First Act of 2019 (the “2019 Act”), H.R. 1957, 116<sup>th</sup> Cong. (2019), amended Section 6033 of the Code to impose mandatory electronic filing of tax-exempt organization returns. Additionally, Section 6104 of the Code was amended by the 2019 Act to require electronically filed returns to be provided to the public as soon as practicable in machine readable format.<sup>137</sup> The 2019 Act applies to taxable years beginning after the date of enactment (July 1, 2019). Under the 2019 Act, the IRS can defer the e-filing mandate for two years (i.e., until July 1, 2021).<sup>138</sup>

Because tax-exempt organizations, particularly small ones, should be given adequate time to obtain software and be informed about the electronic filing mandate, the transition to mandatory electronic filing should be transitioned with adequate information and assistance provided to tax-exempt organizations to ease their filing burden and ensure the provision of accurate information available to the public in tax-exempt organization returns.

### **Background**

Tax-exempt organizations, generally exempt from income tax under Section 501(a) of the Code, serve vital functions, performing a wide variety of activities, including relieving poverty, providing education, healthcare and religious activities, or other services for the public interest as provided under the Code.<sup>139</sup> The contributions to certain tax-exempt organizations are deductible.<sup>140</sup> A large percentage of tax-exempt organizations are small, with limited resources and staff. Some tax-exempt organizations are run by volunteers with limited accounting, computer or legal assistance.

Section 6033 of the Code provides that every organization exempt from tax under Section 501(a) must file an annual return. Under the Code, the annual return is to specifically state items of gross income, receipts, disbursements and such

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<sup>137</sup> 2019 Act §3101.

<sup>138</sup> 2019 Act §3101(d)(2).

<sup>139</sup> See Code §501(a).

<sup>140</sup> Code §170.

other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe.<sup>141</sup> Churches, religious orders and any organization (other than a private foundation) with gross receipts in each taxable year normally not more than \$5,000 are excepted from the annual filing.<sup>142</sup> The Secretary of the Treasury has discretion to relieve any organization (other than those described in Section 509(a)(3)) of annual filing if it is determined not necessary to the efficient administration of the internal revenue laws.<sup>143</sup>

The accuracy of tax-exempt organization returns is vitally important because they are to be made available to the public for inspection<sup>144</sup>, to assist the public in determining whether to make a contribution. Additionally, receiving accurate information is crucial for the IRS to effectively perform its oversight function, ensuring that tax-exempt organizations are complying with Code restrictions supporting their exemption. The IRS maintains two public databases (TEOS and EO BMF Extract) that provide information about certain tax-exempt organizations.<sup>145</sup> Neither database, however, contains information regarding all tax-exempt organizations. TEOS contains information of organizations eligible to receive tax-deductible charitable contributions (Pub. 78 data), automatically revoked organizations, IRS determination letters issued on or after January 1, 2014, Form 990 Series returns for 501(c)(3) organizations filed in 2018 or later and information on organizations that have filed a Form 990-N (e-postcard). The EO BMF Extract contains information including name, EIN, type of organizations and other data for organizations recognized as exempt by the IRS.<sup>146</sup>

The IRS has provided forms, the Form 990 Series, to assist tax-exempt organizations in complying with their filing requirements. The forms range from the relatively simple Form 990-N (e-Postcard) (technically a notice under Section 6033(i)), for organizations with gross receipts equal to or less than \$5,000, to the more complicated and lengthy Form 990. While certain of the Form 990 Series are

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<sup>141</sup> Code §6033(a)(1).

<sup>142</sup> Code §6033.

<sup>143</sup> Code §6033(a)(3)(B).

<sup>144</sup> Code §6104.

<sup>145</sup> See [www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-EO-BMF](http://www.irs.gov/charities-non-profits/exempt-organizations-business-master-file-extract-EO-BMF); <https://apps.irs.gov/app/eos/>.

<sup>146</sup> <https://www.irs.gov/charities-non-profits/tax-exempt-organization-search>.

available to be filed electronically, such as Form 990, 990-EZ, and 990-PF, the Form 990-T, for exempt organization business income tax, is not available to be filed electronically.

Prior to the 2019 Act, only certain exempt organizations, generally those with total assets of \$10 million or more, who file at least 250 (information) returns annually, and private foundations and charitable trusts that file at least 250 (information) returns annually, were required to file electronically.<sup>147</sup> The IRS has been receiving both electronic and paper filed returns, although those filed electronically have been recently increasing, as described below.

Given the need for transparency and provision of accurate information, the IRS requested that the IRSAC make recommendations to facilitate the provision of accurate information on the Form 990 Series.

#### *Data Regarding Common Form 990 Series Errors*

The IRSAC requested data from the IRS for the last five years regarding the most common five errors made by tax-exempt organizations resulting in rejected returns. The information provided to IRSAC is included in Appendix B. The IRS provided the most common errors separately for paper and electronic filers, and with respect to specific Form 990 Series forms. Generally, the error rate resulting in rejected returns during the five-year period was substantial, although significantly higher for paper filers than electronic filers, ranging from approximately five percent for electronic filers of Form 990, in certain years, to thirty-three percent, in certain years, for paper filers of Form 990-EZ. The most common errors for filers appear to be mismatching of names, type of organization, and EIN and filings without proper schedules completed. Generally, the data provided demonstrates that over the last five years, more tax-exempt organizations are filing electronically, although a substantial portion of returns are still filed on paper. Additionally, the data evidences that electronically filed returns experience a lower rejection rate than paper filed returns.<sup>148</sup>

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<sup>147</sup> Treas. Reg. §301.6033-4.

<sup>148</sup> See Appendix B.

## 2019 Act

The 2019 Act was signed into law on July 1, 2019, and revises provisions relating to the IRS, including customer service, enforcement procedures, cybersecurity, identity protection, management of information technology and use of electronic systems.

Section 3101 of the 2019 Act amends Section 6033 of the Code to require mandatory electronic filing of annual returns for tax-exempt organizations, and the return for reporting unrelated business income.<sup>149</sup>

The electronic mandate applies for tax-exempt organizations for taxable years beginning after the date of the enactment of the 2019 Act (July 1, 2019). However, the 2019 Act permits the Secretary of the Treasury to provide transitional relief for (1) “small organizations” having less than \$200,000 per year of gross receipts and aggregate gross assets of less than \$500,000 (or any other organization the Secretary of the Treasury determines the amendment would cause undue burden without a delay), and (2) any organization required to file Form 990-T (the “Exempt Organization Business Income Tax Return) (basically applicable to organizations described in Section 511(a)(2) which are subject to the tax imposed by Section 511(a)(1) on unrelated business taxable income). Under the 2019 Act transitional relief, the Secretary may delay the application of the amendments made for two years after enactment (July 1, 2021).<sup>150</sup>

In previous years, the Advisory Committee on Tax Exempt and Government Entities (“ACT”) recommended required electronic filing for the Form 990 Series returns. E-filing for tax-exempt organizations is now no longer a goal – it is a mandate under the 2019 Act. The IRS cannot fulfill this mandate without help. Ensuring a smooth transition to e-filing requires that the IRS rely on strong partnerships with tax-exempt organizations, tax practitioners and software providers to implement successful e-filing. The electronic mandate of the 2019 Act will assist effective tax administration as the software for electronic form submission can potentially be designed to guide the user, check for internal form

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<sup>149</sup> 2019 Act §3101.

<sup>150</sup> 2019 Act §3101(d)(2).

inconsistencies and minimize return rejections. Unlike the Form 990-N (ePostcard), the IRS has not directly provided a platform for tax-exempt organizations to electronically file Form 990 Series (990, 990-EZ, 990-PF) returns. Rather, tax-exempt organizations may purchase or use online software from private vendors to prepare and file Form 990 Series returns electronically via the IRS's Modernized eFile (MeF) system. The IRS issues guidance to vendors to facilitate electronic filings and meets with them regularly, discussing current issues and other matters.<sup>151</sup> Such vendors generally charge their customers for the purchase or usage of the electronic form software. Certain tax-exempt organizations have, in the past, made available electronic filing software for other tax-exempt organizations, either for free or for a fee based on the organization's size.

### **Recommendations**

To facilitate the accurate filing of Form 990 Series returns and the smooth transition to electronic filing mandated by the 2019 Act, the IRSAC recommends the following:

1. To provide time for tax-exempt organizations to obtain adequate software for electronic filing and to obtain other appropriate resources to comply with the mandate, such as technical assistance, we recommend that the IRS delay the effective date of mandatory electronic filing for all tax-exempt organizations for two years (for tax years beginning July 1, 2021).
2. To assist tax-exempt organizations adjusting to the new requirement, and to avoid burdening the IRS with the consequences of late or rejected filings, we recommend that the IRS waive penalties for late filing of electronic Form 990 Series forms for at least two taxable years after the mandate becomes effective (tax years beginning prior to July 1, 2023 - this would be two years beyond the effective date that would apply if the transition relief in 2019 Act §6033(d)(2) were utilized) for those who establish that the late filing was due to difficulties complying with the new mandate. We also recommend that any improper filings or failures to file because of the new

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<sup>151</sup> <https://www.irs.gov/e-file-providers/how-tax-preparation-software-is-approved-for-electronic-filing>.

- electronic mandate (e.g., mistakenly filed paper returns) for at least the first two taxable years from the effective date (tax years beginning prior to July 1, 2023) not be considered failure to file for purposes of revocation of exemption of the organization under Section 6033 for failure to file for three consecutive years.
3. The most common e-filing errors over the last five years relate to basic issues: wrong EIN, type of organization, name mismatches and incorrect or missing schedules. We recommend the IRS focus on these particular common errors, highlighting them in the Form 990 Series instructions as areas to “double check”, and request that software developers implement diagnostics and strategies to address these areas, such as the electronic checking of publicly available information on IRS.gov against taxpayer provided information.
  4. The Form 990 return is lengthy and complicated. To facilitate accuracy, we recommend that software providers be strongly encouraged by the IRS to provide built-in “logic” assisting the user in completing the return accurately, such as explanation text boxes, “blinking” of inapplicable lines or sections, and checks for internal inconsistencies. To the extent electronic forms (with adequate built-in user assistance) are not provided by the marketplace within the next two years, given the importance of accurate information, we recommend that the IRS consider directly providing such electronic forms. In particular, given the Form 990-T cannot yet be filed electronically with the IRS, we recommend the IRS directly provide such form to be filed electronically. The Department of the Treasury’s pay.gov. is an existing resource that might lend itself to such use. Contractors should also be encouraged to provide the electronic form software at a reasonable or discounted cost, given the use is for tax-exempt organizations. Increasing compliance checks and/or audits might also raise awareness, minimize future mistakes and increase clear and accurate reporting.
  5. To achieve maximum compliance and ensure the successful implementation of the electronic mandate, the change from permissive to mandatory e-filing

must be widely publicized. Besides those avenues where the change will likely be advertised (such as the IRS website, Form 990 Series instructions and the Form 990 Series forms themselves), we recommend the IRS utilize paper notices to either the entire universe of prior Form 990 Series filers, or at a minimum, to previous paper filers. It is anticipated that the mailing of a paper notice would greatly increase the chances of informing affected taxpayers of the new mandate, especially for those taxpayers who do not currently elect to file electronically based on technological challenges. The IRS sending a hard copy notice is a proactive step to encourage compliance, and the cost may not be greater than the reactive step of the IRS sending notices to filers who fail to file or file a paper return. In addition, we recommend that the Form 990 Series forms clearly state at the top that they must be filed electronically to avoid mistaken paper filings.

6. While the new electronic mandate of the 2019 Act should improve the provision of accurate information and assist timely filing of Form 990 Series returns, which will benefit the public by promoting transparency of information relating to tax-exempt organizations, the IRS needs adequate resources to effectuate the required IRS responsibilities under the 2019 Act. We therefore recommend that the IRS allocate existing resources to provide adequate funding and staff to fully implement its responsibilities under the 2019 Act which should include mailings, and tax-exempt organizations education regarding the new requirement. We also recommend the provision of resources for continued expansion and improvements to IRS.gov to provide easy access by tax-exempt organizations and the public to basic information about tax-exempt organizations and their status, as well as all Form 990 Series e-forms. These recommendations are consistent with the IRS Integrated Modernization Business Plan goals which should be adequately funded for effective tax administration.<sup>152</sup>

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<sup>152</sup> See [https://www.irs.gov/pub/irs-utl/irs\\_2019\\_integrated\\_modernization\\_business\\_plan.pdf](https://www.irs.gov/pub/irs-utl/irs_2019_integrated_modernization_business_plan.pdf)

## **ISSUE THREE: Self Correction for Tax-Advantaged Bonds**

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### **Executive Summary**

The Tax Exempt and Government Entities Division has requested that the IRSAC suggest “mechanisms for self-remediation with respect to tax-advantaged bonds that would make correction more cost-effective and less complex and potentially promote and increase voluntary compliance.” Tax-advantaged bonds, a crucial tool for state, local and Indian tribal governments to fund vital infrastructure and other needs, are generally subject to certain Internal Revenue Code (the “Code”) restrictions relating to the usage and investment of proceeds (and financed facilities) for the term to maturity of the bonds, necessitating careful post-issuance compliance to maintain the tax-advantaged status. The burden of managing post-issuance compliance may be significant for small local governmental entities. During the last five years over 80 percent of all tax-exempt governmental bond issues had a principal amount of \$10,000,000 or less and were generally issued by small local governmental issuers.<sup>153</sup> Despite good intentions, such local entities, with small staff and limited resources, might inadvertently violate Code restrictions. Because of many factors, including staff turnover and the possibility of violating due to complexity, mistakes occur.

Given the substantial liability associated with violating Code restrictions applicable to tax-advantaged bonds and the limited resources of both state and local governments and the IRS, it is important to provide mechanisms that facilitate timely self-correction of certain violations which minimize the burdens on state and local governments and the IRS. The existing self-correction program for tax-advantaged bonds, which requires issuers to submit a request for a negotiated voluntary closing agreement (“VCAP”), while helpful and appropriate for certain situations, imposes substantial burdens on the resources of state, local and Indian tribal governments and the IRS. Consistent with the goals of the Taxpayer First Act of 2019 (the “2019 Act”), H.R. 1957 (2019), which relieves burdens on both

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<sup>153</sup> Based upon IRS data requested by and provided to the IRSAC.



taxpayers and the IRS, taxpayers need a flexible, timely and simple self-correction program that will facilitate self-correction.

### **Background**

Tax-advantaged bonds, many of which are issued by small issuers, are subject to complex Code restrictions that must be monitored for the bond issue term to maturity. The financial consequence of a Code violation is generally large. If a Code violation exists, tax-exempt bondholders do not hold bonds with earnings excludable from gross income for federal income tax purposes, and the tax on the interest generally represents a substantial potential liability given the large principal amount of such issues.<sup>154</sup> Because of different factors, including the potential of violating due to complexity, the passage of time, and staff turnover, violations occur.

To facilitate compliance and ease the burdens on both issuers and the IRS related to compliance, the IRS has provided procedures that focus on issuers to resolve violations. The Advisory Committee on Tax Exempt and Government Entities (“ACT”) has issued reports making suggestions relating to the structure of IRS guidance for voluntary correction; these recommendations build upon such suggestions.<sup>155</sup>

Different forms of guidance exist that permit issuers to voluntarily take certain actions to remediate and resolve tax compliance issues regarding tax-advantaged bonds. The “change in use” provisions of Treasury Regulation §1.141-12 and Revenue Procedure 2018-26, 2018-18 I.R.B. 546, permit issuers to remediate contemporaneously or before certain deliberate actions so a violation of Code restrictions will not be considered to exist.<sup>156</sup> VCAP, addressed in I.R.M 7.2.3 and Notice 2008-31, 2008-11 I.R.B. 592 and other corrective measures, contains procedures for issuers to resolve existing Code violations. The existing VCAP program is frequently costly and time consuming for issuers. It involves an issuer submitting an often lengthy written VCAP request to the IRS to be resolved in a

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<sup>154</sup> Tax-advantaged bonds are generally not subject to a Code provision requiring the mandatory filing of an annual tax return to provide the IRS with information regarding post-issuance compliance. See Code §103; 149.

<sup>155</sup> See, e.g., ACT reports dated June 11, 2008, June 9, 2010, and June 7, 2018.

<sup>156</sup> See also I.R.M. 7.2.3.1.4 for a list of “change in use” remedial action provisions (called “change in use” procedures).

negotiated closing agreement.<sup>157</sup> The written VCAP process can necessitate an issuer spending from \$20,000 to \$60,000 or more on attorney's fees. While the VCAP resolution process is helpful and appropriate in certain situations, a more straightforward less burdensome approach would be more efficient to resolve certain common violations that are not intentional. Building upon the VCAP program, with a structure that minimizes or eliminates the expensive submission and resolution process (to the extent appropriate) will not only save issuers and the IRS expenses but also encourage usage and voluntary self-correction.

Besides cost, resolution time is an important factor that issuers consider when confronted with a compliance violation issue. Because of the present necessity of submitting a lengthy VCAP request to the IRS for a determination resulting in a negotiated closing agreement, resolution of an issue frequently takes several months, a period of time that might be difficult for issuers, particularly small ones, needing quick resolution. Over 49 percent of VCAP cases over the last five years took longer than 180 days to resolve and over 75 percent of cases took 90 days or more for resolution.<sup>158</sup> Issuers have disclosure responsibilities and may need quick resolution of issues to protect bondholders and the public.<sup>159</sup> Issuers also may need to access the market during the resolution process to lower borrowing costs to benefit the public and the United States Treasury (by reducing tax-exempt interest). Procedures that permit self-correction without a lengthy closing agreement process alleviate issuer and IRS burdens while facilitating self-correction.

The existing VCAP program often involves uncertainty for issuers. The IRS has endeavored to provide certainty on the resolution amount regarding certain identified violations in I.R.M. 7.2.3.4.3 and 7.2.3.4.4. The existing program generally requires payment of tax exposure on the applicable "nonqualified bonds" (often, only a portion of the issue) regarding the violation if the issuer submits the request within six months of the violation and 110 percent of such exposure if

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<sup>157</sup> Notice 2008-31, 2008-11 I.R.B. 592, and I.R.M. 7.2.3.

<sup>158</sup> Information requested by and provided to the IRSAC by the IRS.

<sup>159</sup> We note that 17 C.F.R. 240.15c2-12 generally requires disclosure by issuers of material events affecting the tax status of publicly offered tax-advantaged bonds, which can include material events affecting the tax status of the security depending on the facts and circumstances.

submitted within one year. However, if the discovery of the violation and submission of the request is outside of one year from the date of the violation, an issuer generally will not have upfront assurance on the resolution amount, which might be full taxpayer exposure.<sup>160</sup> This uncertainty may hinder usage of the procedure, as tax exposure, even on a portion of a bond issue, is often a substantial amount, and frequently discovery of errors does not occur within one year. Issuers might be hesitant to file when the existence of a violation is not clear under the Code because of limited precedent.

Correction through the VCAP program typically requires a substantial upfront cash payment and redemption of bonds.<sup>161</sup> Under the existing program, depending upon the facts and circumstances, the required remediation might be more than tax exposure on the “nonqualified bonds” plus redemption.<sup>162</sup> If remediation is viewed as unreasonably large, the program will not be as effective at encouraging issuer post-issuance compliance, and may result in increased need for IRS oversight through exams, burdening the IRS and issuers.

While a large cash payment and redemption is appropriate in certain instances, this remediation might not be appropriate for others. The remediation of a violation might not address issuer needs for flexibility, given state law, documentation, financial and political considerations. For example, under state or local law, bonds might need an election before issuance. Issuers, in such instance, might be greatly assisted by remediation remedies that do not involve redemption. More flexibility to issuers might be provided by allowing investment in tax-exempt obligations, as an alternative to redemption, or the expenditure of other amounts on alternative project costs, depending on the violation to be addressed.<sup>163</sup>

The existing VCAP procedures involve complex calculations to determine the resolution amount payable.<sup>164</sup> Simpler methods for remediation would reduce burdens.

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<sup>160</sup> See I.R.M. 7.2.3.3.2.1; I.R.M. 7.2.3.4. Taxpayer exposure generally means tax otherwise owed by the bondholder.

<sup>161</sup> I.R.M. 7.2.3.3.2.1.

<sup>162</sup> “Nonqualified bonds” are defined in the I.R.M. and are frequently only a portion of the issue. The IRS generally does not request payment of more than tax exposure on the entire issue of bonds.

<sup>163</sup> The “change in use” provisions permit remediation in different ways (e.g., spending funds on an alternative project) and consequently provide more flexibility for issuers, encouraging voluntary compliance. See Treas. Reg. §1.141-12; Rev. Proc. 2018-26, 2018-18, I.R.B. 546.

<sup>164</sup> See I.R.M. 7.2.3.3.2.1.

Existing procedures provide that VCAP is available only if the “IRS has a reasonable basis to believe there has been a federal tax law violation.”<sup>165</sup> Often issuers might not be certain that a tax law violation exists. Seeking a private letter ruling is expensive, involving substantial user fees, and time-consuming. Further, issuers in certain circumstances, might not need guidance regarding an issue and may only need to ensure resolution of a potential issue to decrease risk. Given that voluntary self-correction should be encouraged to use IRS resources effectively, utilization of the self-correction program for tax-advantaged bonds should include merely a possibility of a violation for usage.

When a VCAP closing agreement is initiated the issuer must execute a Consent to Disclose Tax Information form, which, under Section 6103(c) of the Code, allows the IRS to disclose the existence and subject matter of the VCAP arrangement (to the extent the IRS deems necessary) to correct any material misstatement in response to a public statement by the issuer or agent. We suggest that such a consent requirement be retained with respect to the self-correction program.

### **Recommendations**

To alleviate burdens on issuers of tax-advantaged bonds, we recommend the following:

1. The IRS should establish a consolidated, to the extent practicable, flexible multi-level self-correction program, in a revenue procedure that is periodically updated, that encourages compliance by incentivizing issuers to self-correct.<sup>166</sup> We suggest that the self-correction program be established with flexibility for the IRS to refine the program, describing additional applicability, additional remedial actions and moving particular violations to different levels for remediation.
2. Similar to what has been done with respect to employee plans, we suggest that for existing violations there be three levels of voluntary correction.

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<sup>165</sup> I.R.M. 7.2.3.1.4.

<sup>166</sup> To increase efficiency we suggest that with respect to all filings in this area, including notices, issuers be permitted to file electronically. A possible mechanism to utilize for such electronic submissions is an interface with the Department of the Treasury’s pay.gov, which is being utilized for submissions in other areas, such as employee plans.

- We recommend that Level 1 self-correction be without approval of the IRS for certain insubstantial and unintentional violations provided a written notice is provided. The notice should be simple, briefly identifying the applicable bond issue, the error type, the remediation taken, and existence of issuer corrective actions to monitor and prevent reoccurrence of the error. We strongly suggest that the IRS provide the form to be filed for the notice.<sup>167</sup>
- We recommend that Level 2 self-correction be under a streamlined program with a normally automatic IRS confirmation letter, without necessarily an IRS review, that the violation is considered corrected if the issuer has satisfied specified criteria. We recommend that the submission for Level 2 be simple, utilizing a form that is, although streamlined, more lengthy than the Level 1 postcard-type notice suggested (with perhaps one or two pages that briefly describe the issuer, bond issue, violation, and remediation). To efficiently utilize resources, provide a timely remedy, and save issuers expenses, we recommend that the confirmation letter be promptly provided to the issuer and sent automatically, normally without a review process (immediate confirmation after submission).<sup>168</sup> To the extent it is appropriate, given the facts and circumstances of a particular type of violation, to have an IRS review, we recommend that the Level 2 review be by a TEB tax law specialist, normally without further layers of review, such that receipt of the confirmation letter is within two weeks of submission, as Level 2 is not intended to result in a binding closing agreement.
- We recommend that Level 3 self-correction be through the negotiated VCAP to address less common fact patterns or more egregious situations. Because an issuer might want or require a

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<sup>167</sup> The absence of an IRS-provided form for notice in the "change in use" area, under Treasury Regulation §1.141-12, has resulted in confusion and less efficiency. To further administrability for issuers, we recommend the form provided contain boxes to be "checked" to the extent appropriate.

<sup>168</sup> If the IRS were to utilize pay.gov, the confirmation would be normally sent by pay.gov.

binding closing agreement, we suggest that issuers have the option to utilize Level 3 despite potential applicability of Levels 1 or 2.

3. With respect to the overall program, we recommend that the required remediation be refined to encourage issuers to identify and voluntarily correct violations early. Cash payment remediation that is significantly less than the liability as a result of an audit and that is scaled to encourage early correction will facilitate self-correction in an efficient manner.
4. We recommend a simplified reasonable formula be provided for cash payments and not necessarily attempt to calculate tax exposure. To lessen complexity, we suggest that the new revenue procedure build upon and potentially cross reference concepts in existing “change in use” procedures of Treasury Regulation §1.141-12 and Revenue Procedure 2018-26.
5. We recommend that issuers be provided more flexible methods of remediation, building upon concepts in the “change in use” procedures of Treasury Regulation §1.141-12 and Revenue Procedure 2018-26 such as permitting remediation by investment in tax-exempt obligations and/or expenditures on qualified project costs.
6. Consistent with the deference given to issuers in the tax-advantaged bond program, we suggest that the self-correction program be accessible by issuers and not borrowers of the proceeds of tax-exempt obligations. Issuers are normally the entities that receive notice from the IRS and must respond to audits of tax-advantaged bonds and consequently should be entitled to retain control over violation correction decisions.

Some examples of types of violations that might be appropriate for each level are in Exhibit A (immediately following this issue report). Additionally, the existing “change in use” procedures are complex and have generally been in existence for many years. If resources permit and the IRS wishes to undertake a more comprehensive review of self-correction procedures, we suggest that the existing “change in use” procedures be simplified, consolidated and made more flexible to address more issues and provide for less burdensome remediation.

## Exhibit A

### *Level 1 – Example*

An example of a violation appropriate for Level 1 resolution might be failure to invest in a zero-interest United States Treasury Time Deposit Security, State and Local Government Series (“SLG”) to reduce the yield on an escrow investment to the legally permissible yield. Certain amounts, such as those held in an escrow to retire obligations, must in certain situations be invested at a yield not over the yield on tax-exempt obligations under Section 148 of the Code. Amounts might not be invested at a legally permissible yield because of an escrow bank error or the lack of availability of SLGs on a reinvestment date.<sup>169</sup> The remediation might be the appropriate yield reduction payment. Filing a notice regarding Level 1 would be an efficient and effective process to address this violation.

Another example that might be appropriate for Level 1 might be to resolve issuer concerns regarding whether “hedge bond restrictions” of Section 149(g) of the Code would be considered violated, given facts and circumstances that involve failure to meet hedge bond expenditure requirements by ten percent or less. The “hedge bond restrictions” were imposed by Congress to generally limit an issuer’s ability to issue tax-advantaged bonds earlier than necessary, burdening the Federal government. The “hedge bond restrictions” involve certain specified percentage expenditure requirements over certain periods. Code §149(g). Remedial action to resolve violations in this area might include calculating a “nonqualified amount,” perhaps equal to the sale and investment proceeds not timely spent under the spending restrictions, and investing the “nonqualified amount” in “non-AMT” tax-exempt obligations until either spent on a qualified cost or used to redeem bonds. As an alternative to investing in tax-exempt obligations, a relatively small penalty might be paid based on a simple formula.

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<sup>169</sup> While the Treasury Regulations do permit “yield reduction payments” in certain circumstances (amounts that issuers are permitted under the Treasury Regulations to pay to the Federal government to reduce yield on an investment), “yield reduction payments” are not permitted in certain circumstances (such as with respect to a defeasance escrow funded with revenues). See Treas. Reg. §1.148-5.

We note that Treasury Regulation §1.150-1 provides that a tax-exempt obligation includes interest in a regulated investment company for which at least 95 percent of the income of the holder is excludable income under Section 103. It is frequently difficult for issuers to ascertain whether a particular investment meets such requirement. Because issuers typically will need liquidity and may endeavor to invest in a fund that holds tax-exempt obligations, for administrability, it would be helpful if the IRS provided clarification that a tax-exempt fund will be considered a tax-exempt obligation for purposes of the self-correction program if the fund offering document provides that substantially all assets of the fund are normally tax-exempt obligations.

*Level 2 - Example*

An example of usage for Level 2 might be “excessive nonqualified use” type violations, described in I.R.M. 7.2.3.4.3.





**Internal Revenue Service Advisory Council**

**Large Business and International Subgroup Report**

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## **INTRODUCTION / EXECUTIVE SUMMARY**

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The IRSAC 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 appreciate the consistent cooperation and courtesy we received from everyone with whom we have interacted at the IRS over the last year, including but not limited to LB&I Commissioner Doug O'Donnell, Deputy Commissioner Nikole Flax, Executive Lead Holly Paz and the LB&I team, Division Counsel Robin Greenhouse, Deputy Division Counsel Kathryn Patterson, Senior Level Division Counsel Lisa Shuman, Associate Chief Counsel John Sweeney and other members of the Office of Chief Counsel, our LB&I liaison Shawn Hooks and our NPL liaison Rose Smith.

Particularly during a year when substantial new legislation was implemented, we appreciate that the IRS engaged with us in a continuing and productive conversation regarding ways in which the IRS might provide more certainty to taxpayers while focusing its resources as efficiently as possible and also regarding ways that information reporting could be modified to address taxpayer concerns while accommodating IRS needs.

Consistent with those discussions and as further set forth below, we recommend that the IRS (1) offer an issue by issue opportunity to qualifying taxpayers to address specified issues in a given tax year by extending elements of the Compliance Assurance Process (CAP) program, (2) establish safe harbors by relying on certain conclusions of independent parties and (3) adopt and implement specific information reporting guidance, including relating to the Tax Cuts and Jobs Act (TCJA).

## **ISSUE ONE: Issue by Issue Extension of Elements of the CAP Program**

### **Executive Summary**

LB&I should consider adding a program that would allow certain qualifying taxpayers the option of filing a form that would request a prompt decision by the IRS as to whether the IRS agrees, disagrees, wants to further examine or does not want to examine specific issue(s) for the particular year. This program would complement the current CAP program and expand its possible use to more taxpayers, while allowing the IRS greater flexibility in allocating its limited resources.

### **Background**

The CAP program was created to help in identifying and resolving tax issues for selected taxpayers utilizing open, cooperative and transparent interaction between LB&I and the taxpayers.<sup>170</sup> The CAP program began as a pilot program in 2005<sup>171</sup> and was made permanent in 2011<sup>172</sup>.

The goals of the CAP program include:

- Ensuring compliance through enhanced issue identification;
- Increasing transparency and collaboration between LB&I and the taxpayer;
- Reducing the burden on tax administration and compliance;
- Shortening the examination cycle times;
- Providing earlier identification of emerging issues;
- Utilizing current corporate governance and accountability;
- Achieving increased currency in LB&I examinations; and
- Allowing taxpayers the ability to achieve financial statement certainty earlier and with less administrative burden<sup>173</sup>

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<sup>170</sup>IRM 4.51.8.2.2

<sup>171</sup>Announcement 2005-87, 2005-50 IRB 1144

<sup>172</sup>News Release IR 2011-32 (March 31, 2011)

<sup>173</sup>IRM 4.51.8.2 and .3; Announcement 2005-87, 2005-50 IRB 1144

During the CAP review, the parties should expect to enter into an Issue Resolution Agreement or a Closing Agreement.<sup>174</sup> This is expected to occur prior to the filing of the taxpayer's income tax return.

In practice, however, these goals have not always been met. LB&I has not achieved its sought after benefit of reduced burden on its resources. In fact, according to LB&I, hours charged and months spent by the IRS on CAP examinations have been greater than expected. The result has been that CAP examinations are "more resource intensive than normal post-filing examinations."<sup>175</sup> This is, in part, due to the all-encompassing nature of the review needed to arrive at an agreement for the entire return. Rather than permitting it to focus its limited resources, LB&I has found that the CAP program has been counterproductive in this aspect. We commend LB&I for looking for ways to expand and utilize the positive aspects of the CAP program.

LB&I has also noted other examples of significant or material failures of taxpayer behavior in the program, including:

- Not adhering to IDR response times or providing incomplete responses;
- Not fully engaging in resolution discussions;
- Failing to fully and timely disclose material matters;
- Failing to disclose limits on access to information;
- Not disclosing tax shelters or listed items; and
- Not adhering to other elements of the MOU<sup>176</sup>.

For taxpayers, access to the CAP program has been very limited. Initially, there were only 17 taxpayers in the CAP program. Today this number has only increased to 161. Taxpayers have also had to devote substantial resources to complying with requests from LB&I, often at times when their resources are needed elsewhere.

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<sup>174</sup>IRM 4.51.8.4.25

<sup>175</sup>Compliance Assurance Process (CAP) Recalibration Discussion Document, Slide 2), September 28, 2018

<sup>176</sup>Id at Slide 6

## **Recommendations**

For LB&I taxpayers, with assets over \$XX million that have certified audited financial statements<sup>177</sup>, we recommend that the IRS allow them to file a form requesting a decision for specific issue(s) for a specific year. This form should allow the taxpayer to identify such an issue(s) and provide relevant documents, opinions or other evidence to support its position(s).

In response, assuming the information provided is accurate and sufficient in all material respects, LB&I would respond within 90 days with its decision. Such a decision could be that:

- The IRS will accept the position for this particular year and will not examine it, but reserves the right to examine it in future years;
- The IRS needs additional information and may request further information to assist in its review;
- The IRS accepts the taxpayer's position on the issue;
- The IRS does not agree with the position; and
- The IRS may not currently agree with the position and might want to examine it.

This will allow the IRS the opportunity to make decisions on how to allocate its resources to achieve the maximum positive utilization without necessarily requiring it to commit to conducting an examination that would result in a Closing Agreement or an Issue Resolution Agreement. For taxpayers, it could provide certainty for its financial statement tax reserves for that issue(s) for a particular period.

This approach could be used for many issues, even some non-complex transfer pricing issues. For example, the taxpayer could provide its transfer pricing study, Material Intercompany Transactions Template (MITT), etc. and the IRS, considering its resources, could decide that it will not examine the issue(s) for this particular year, without having to acquiesce to the taxpayer's methodology.

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<sup>177</sup>Outside independent auditors must exercise due professional skepticism and professional care. This requires that auditors objectively evaluate the competency and sufficiency of the evidence. AU sec. 230, American Institute of Certified Public Accountants Statements of Auditing Standards

Taxpayers could still have the option to request a Private Letter Ruling (PLR) on an issue. PLRs require the IRS to opine on an issue, with in depth legal analysis. The Issue by Issue CAP approach allows the IRS to make resource determinations without necessarily having to agree or disagree on particular issue(s) for a particular year.

## **ISSUE TWO: Establishing Safe Harbors by Accepting “Book” Treatment or Otherwise Relying on Independent Third Parties**

### **Executive Summary**

Taxpayer examinations by the IRS can consume significant IRS and taxpayer resources. However, where factual determinations and adequacy of documentation have already been reviewed by other independent parties, such as other governmental entities or independent financial auditors, a second review by the IRS may be unnecessary. Acceptance of the earlier third parties’ review, either directly or with minimal modifications, can save time for the IRS and taxpayers without compromising the IRS’s mandate to ensure compliance with the applicable tax laws.

### **Background**

An example of this approach is the IRS directive on R&D expenses qualifying for the section 41 credit.<sup>178</sup> This directive provides an administrative solution to accept as sufficient evidence of qualified research expenses the Adjusted ASC 730 Financial Statement R&D for the credit year. This saves time and effort on the part of taxpayers and the IRS, but still provides assurance that credits claimed by taxpayers are in accordance with the statute. Another example is the IRS directive on reserves used for the calculation of cost depletion.<sup>179</sup>

### **Recommendations**

The IRSAC recommends that the IRS embrace this approach where possible and proposes several areas where this approach may prove helpful.

#### 1. De Minimis Expenditures

Treas. Reg. § 1.263(a)-1(f) establishes a de minimis safe harbor capitalization threshold which allows taxpayers that have an applicable financial statement to deduct amounts paid for tangible property up to \$5,000 per item if certain requirements are met. It should be noted that the de minimis election is meant to be a safe harbor rather than an absolute

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<sup>178</sup> See <https://www.irs.gov/businesses/corporations/guidance-for-allowance-of-the-credit-for-increasing-research-activities-under-irc-ss41-for-taxpayers-that-expense-research-and-development-costs-on-their-financial-statements-pursuant-to-asc-730>.

<sup>179</sup> <https://www.irs.gov/businesses/field-directive-on-cost-depletion-determination-of-recoverable-reserves>



maximum limit. The final repair regulations allow the IRS and the taxpayer to determine a minimum threshold that is relative to the taxpayer, which could be higher than the \$5,000 safe harbor, as long as such threshold clearly reflects the taxpayer's income. The Preamble to the final repair regulations, TD 9636, Sep. 13, 2013, states that "[i]f examining agents and a taxpayer agree that certain amounts in excess of the de minimis safe harbor limitations are not material or otherwise should not be subject to review, that agreement should be respected." Also see Rev Proc 2015-20, Sec. 3.02, 2015-9 IRB 694 which states:

*Consistent with longstanding law, a taxpayer may continue to deduct all otherwise deductible repair or maintenance costs, regardless of amount. In addition, the existence of the de minimis safe harbor does not mean that a taxpayer cannot establish a de minimis deduction threshold in excess of the safe harbor amount, provided the taxpayer can demonstrate that a higher threshold clearly reflects the taxpayer's income.*

There is no effective procedure to establish a higher threshold applicable on a prospective basis.

The IRSAC recommends that the IRS issue a directive allowing taxpayers that have an applicable financial statement to follow the de minimis threshold used for book accounting purposes.

A de minimis rule is not a principled determination of whether an item is properly capitalized or expensed under accounting principles. Instead it is a rule of convenience to minimize the accounting, documentation and resources necessary for items which have no material effect on the accuracy of the financial statements. Without a de minimis rule, the taxpayer would need to make a capital/expense determination for each expenditure and if the item is capitalized, a fixed asset would need to be established on the financial books until the cost is fully amortized or depreciated or until the item is sold or retired. The \$5,000 per item rule in

the regulations for taxpayers that have an applicable financial statement recognizes the value of avoiding such challenges and unnecessary use of IRS's and taxpayers' resources, especially for amounts that are small.

"Small" is a relative term. For large taxpayers, amounts in excess of \$5,000 may not be material. Under the GAAP (ASC 105-10-05-6) and IFRS (IAS 8.8, IFRS Practice Statement 2) accounting rules a reporting group may expense otherwise capitalizable costs if the practice does not have a material effect on the financial results. Materiality will vary depending on the size of the group, but it should not lead to material distortion of the financial results. The IRS should rely on the determination of independent financial auditors and allow taxpayers to use the same de minimis threshold for tax as that used for financial accounting.

It should also be noted that, in addition to the professional responsibility of the financial auditors to ensure that the accounts are materially in accordance with GAAP or IFRS, there is another natural brake to ensure that taxpayers do not adopt inappropriate de minimis thresholds. Expensed items reduce reported income, while capitalized items only do so over time. Taxpayers generally prefer to maximize current period reported profits. An overly generous de minimis rule would do the opposite.

While the current provision is not permanent, it should be noted that the general rule at this time is immediate expensing of the costs for most depreciable property.

## 2. Foreign Tax Credit Receipts

Taxpayers claiming a deduction or credit for foreign taxes paid or accrued are typically required to provide receipts for the taxes paid during an examination. However, the same taxes are recorded for financial accounting purposes under GAAP. The independent auditors who attest that the financial statements are prepared in accordance with GAAP must

take steps to ensure that the taxes recorded have been properly paid or accrued. This may include a review of such taxes, particularly large items, and/or a review of procedures used to record the taxes, including reconciliations of the relevant income statement and balance sheet accounts.

If the IRS issued a directive stating that agents may accept book accruals without further examination (absent unusual circumstances) this would save taxpayers considerable time compiling the receipts and the IRS examination team would not need to review these items.

3. Solar Investment Tax Credits (ITC) – Section 25D (Residential Energy Efficient Property) and Section 48 (Energy Credit).

The solar ITC is currently 30 percent of the eligible costs for both residential and commercial solar panels. The credit is reduced in 2020 to 26 percent and in 2021 to 22 percent for both residential and commercial solar property. Beginning in 2022, the Section 25D credit is phased out and the Section 48 credit is reduced to a permanent 10 percent.

IRS examinations of these ITCs have traditionally been lengthy and resource heavy because the credit is determined by the eligible cost of the solar panels (residential and commercial) or commercial solar farms. The IRS has historically conducted a detailed review of the input costs associated with the production of the solar panels, factoring in a markup for profit, as well as utilizing income-based valuation methodologies. Due to the large number of solar panels in production, the IRS generally uses a time-consuming sampling approach, which can include the review of hundreds of solar panels. These examinations extend over years and many times involve review by the IRS Office of Appeals and the Federal courts.

To short-cut the examination process, the use of Department of Energy (DOE) supported installed cost data has been utilized by some IRS

examination teams, but not consistently, to create a “safe harbor” for taxpayers. This data is produced by the Lawrence Berkeley lab at the University of California and is funded by the DOE. The Lab’s “Tracking the Sun” Report provides detailed average cost data by state with respect to the construction of residential and commercial solar panels that may be utilized to create a safe harbor production cost for taxpayers who claim solar ITCs. This approach eliminates the need for separate valuation studies subject to review by the IRS and would provide certainty to taxpayers claiming solar ITCs on tax returns.<sup>180</sup> The IRS could issue a directive allowing this approach.

#### 4. Cross-Border Intercompany Transactions – Regulation W

Regulation W interprets and applies the provisions of Sections 23A and 23B of the Federal Reserve Act to all member banks.<sup>181</sup> A member bank is defined in the statute and regulations as any National bank, State bank, Trust company or other institution that is a member of the Federal Reserve System. Affiliate banks include banks (and their subsidiaries) under control of a common parent. For regulated banks and their international affiliates, cross-border transactions are scrutinized under an arm’s length transaction doctrine by the bank’s Federal regulators (Federal Reserve, OCC, FDIC, etc.). This standard is virtually identical to the requirements of section 482 of the Internal Revenue Code and should preclude the need for any further review of these transactions by the IRS on examination. These transactions include intercompany financial transactions (i.e., loans, equity transactions) and services. The standard is applied by the bank’s attest auditors reviewing its financial statements during the course of regular bank examinations by the various Federal regulators. To the extent that similar Federal arm’s length transaction standards exist in other industries that are

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<sup>180</sup> The most recent study and data from 2018 can be found at <https://emp.lbl.gov/tracking-the-sun>.

<sup>181</sup> Reg. W (12 U.S.C. § 223.2(a)(2)).

scrutinized by Federal regulators, no further review of these transactions by the IRS should be necessary and a directive may be appropriate.

## **ISSUE THREE, Topic 1: TCJA Repeal of IRC Section 958(b)(4) Reporting**

### **Executive Summary**

IRC Section 958(b)(4) was repealed in full as part of the TCJA tax reform legislation, passed in December 2017.<sup>182</sup> While the Senate colloquies indicate the legislative proposal was intended to be targeted at potentially abusive transactions which resulted in technical de-control of foreign subsidiaries under then-law, the enacted law appears much broader in scope.<sup>183</sup> This resulted in numerous apparently unintended consequences, including information reporting requirements for foreign corporations subsequently deemed to be Controlled Foreign Corporations (CFCs), following its repeal. While the IRSAC recognizes that a Technical Corrections bill has been proposed that would address some of these concerns<sup>184</sup>, we recommend guidance to taxpayers and withholding agents on how reporting related to the consequences of Section 958(b)(4) repeal should be handled.<sup>185</sup>

### **Background**

Section 958(b) provides the stock attribution rules specific to foreign entities. Section 958(a) provides that “stock owned” includes both direct and indirect ownership through foreign entities. Section 958(b) provides, in general, that the stock attribution rules of Section 318 apply with respect to foreign entities, with certain modifications. More specifically, Section 958(b)(1) provides that stock owned by non-resident aliens is not attributed to U.S. citizens and U.S. residents, regardless of familial ties. Section 958(b)(2) provides that entities which own more than 50 percent of the voting stock of an entity are deemed to own 100 percent of such entity, while subsection 958(b)(3) provides that when attributing shares owned by a corporation to its shareholders under Section 318(a)(2)(C), one is to substitute 50 percent in each instance where 10 percent otherwise appears.

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<sup>182</sup> Tax Cuts and Jobs Act, P.L. 115-97.

<sup>183</sup> See 163 Cong. Rec. S8110 (daily ed. December 19, 2017).

<sup>184</sup> See the Tax Technical and Clerical Corrections Act (submitted on January 2, 2019).

<sup>185</sup> The IRSAC appreciates the October 1, 2019, guidance released after this report was drafted. Specifically we appreciate the guidance in Rev. Proc. 2019-40, which “provides a safe harbor for determining whether a foreign corporation is a [CFC] within the meaning of Section 957” and in proposed regulation 1.6049-5(c)(5)(i)(C), which provides that a US payor includes only a CFC that is a CFC without regard to downward attribution from a foreign person. <https://federalregister.gov/d/2019-20567> [Reg -104223-18].

Prior to its repeal, Section 958(b)(4) provided that subparagraphs (A), (B), and (C) of Section 318(a)(3) were not to be applied to consider a U.S. person as owning stock which is owned by a person who is not a U.S. person. Accordingly, after such repeal, stock owned directly, indirectly, or constructively by a foreign person is subject to downward attribution to a U.S. person. This has the result of characterizing many more foreign corporations as CFCs, which in turn results in substantially greater information reporting requirements. Many taxpayers and withholding agents are now unclear as to their requirement to abide by such reporting requirements, as it is widely understood that the repeal of Section 958(b)(4) in full was not intended by Congress.

### **Recommendation**

There are numerous facets to this issue, although the IRSAC's focus herein is limited to Form 1099 reporting requirements of newly-characterized CFCs. Due to the removal of the limitations regarding downward attribution of shareholdings to U.S. subsidiaries under current law, entities which were previously not considered to be CFCs are now classified as such, resulting in a much greater application of Form 1099 reporting requirements by foreign corporations, especially in brother-sister and other non-linear structures.

Under Chapter 61 of the IRC, a payor of income is required to impose backup withholding, at a 24 percent rate, on certain payments to U.S. nonexempt payees to the extent a payee has not been documented with a U.S. taxpayer identification number. Notwithstanding, foreign payors generally have historically been exempt from such reporting and backup withholding requirements with respect to payment of non-U.S. source income. However, CFCs are not eligible to apply this exemption as they are deemed to be U.S. payors under the IRC and therefore have been subject to Form 1099 reporting and backup withholding requirements for many years. The inapplicability of the foreign payor exception is good tax policy as it eliminates the ability of a U.S. parent entity from forming a CFC to make such payments and easily avoid the imposition of the Form 1099 reporting and backup withholding regime.

Nonetheless, the expansion of the CFC characterization in the wake of Section 958(b)(4) repeal is preventing CFCs which have ultimate foreign parents from being able to apply the historically available exception. Given the widespread reliance on the general foreign payor exception in this area, especially by foreign banks and other multinational corporations which have U.S. subsidiaries in their organizational structures, the apparent expansion of the CFC definition has resulted in a substantially uncertain environment in this area, at best, and potentially monumental lack of compliance, from otherwise compliant taxpayers and withholding agents, at worst. Accordingly, the IRSAC recommends retroactive relief and/or additional guidance in order to restore compliance by such otherwise compliant foreign payors, particularly since the removal of the foreign payor exception was not part of the Foreign Account Tax Compliance Act (FATCA), when it was enacted by Congress in 2010, nor has it been scheduled as a future expansion of FATCA, of which there have been several in the intervening years since its enactment.



## **ISSUE THREE, Topic 2: Permit Filing Form 1042 Electronically**

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### **Executive Summary**

The IRS recommends that the IRS permit withholding agents to file Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, electronically rather than requiring such agents to file the form on paper.

### **Background**

Withholding agents submitting Forms 1042 to the IRS are currently required to file these forms by mailing them to the IRS. Conversely, the corresponding form (i.e. Forms 1042-S) can be, and in some instances is required to be, filed electronically.

Financial institutions are required to file Forms 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, electronically, and while other withholding agents are permitted to file up to 249 Forms 1042-S on paper, they are encouraged by the IRS to submit these forms electronically. As withholding agents are required to file Forms 1042 on paper, this adds an extra step operationally as withholding agents are required to deviate from their normal processes where they file electronically. Additionally, as the Form 1042 is not filed electronically, there may be an added risk of error when the data is being inputted into IRS systems manually.

### **Recommendation**

Due to the operational burden and to promote accuracy and efficiency for both withholding agents and the IRS, the IRSAC recommends the IRS permit withholding agents to submit Forms 1042 electronically.

## **ISSUE THREE, Topic 3(a): Assistance for FATCA and QI Portal Users**

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### **Executive Summary**

Users of the IRS FATCA (Foreign Account Tax Compliance Act) Foreign Financial Institution (FFI) Registration System and Qualified Intermediary (QI) Application and Account Management System are having difficulty obtaining timely and appropriate assistance from the Help Support feature available for both systems.

### **Background**

Examples of problems encountered include the following:

- An email from a user locked out of the FATCA FFI Registration System to Help Support did not receive a response.
- An email from a user to Help Support inquiring about how to properly reflect a final certification of compliance after termination within the QI Application and Account Management System received a response that did not actually answer the question but rather pointed to a generic, inappropriate answer from the user guide for such system.
- An email from a QI to Help Support indicating that the QI Application and Account Management System was not reflecting properly the QI's selected third year of the certification period for periodic review purposes was not responded to by Help Support. Instead of December 31, 2019, being reflected as the correct date, the system was reflecting July 1, 2019.

### **Recommendation**

The IRSAC recommends that the IRS redesign or enhance the Help Support feature of both the IRS FATCA FFI Registration System and QI Application and Account Management System to ensure that inquiries are properly addressed and appropriately escalated.

## **ISSUE THREE, Topic 3(b): Communications with Non-U.S. Users of FATCA and QI Systems**

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### **Executive Summary**

Outside the U.S., non-U.S. users of the IRS FATCA FFI Registration System and QI Application and Account Management System have limited means to interact with the IRS and ask questions about the systems. While the Help Support feature for both systems is an option, it is a limited option. In addition, the non-U.S. users do not always have the financial means to travel to the U.S. for industry conferences where the IRS often addresses questions and provides relevant information. Likewise, non-U.S. users do not always have the financial means to hire outside consultants or attorneys that can act as a conduit to the IRS to ask questions.

### **Background**

In July 2018, the IRS provided in-person presentations in London and Germany regarding the QI (Qualified Intermediary)/WT (Withholding Foreign Trust)/WP certification (Withholding Foreign Partnership) and periodic review process. Likewise, in May 2019, the IRS provided in-person presentations in Hong Kong and Seoul regarding the QI/WT/WP certification and periodic review process. These presentations were well-received by non-U.S. participants. The IRSAC commends the IRS for these efforts to engage with non-U.S. participants.

### **Recommendation**

In light of the in-person QI/WT/WP certification and periodic review presentations mentioned above, the IRSAC recommends that the IRS coordinate an online or in-person presentation for non-U.S. users regarding the IRS FATCA FFI Registration System and QI Application and Account Management System. Presentations regarding the IRS FATCA FFI Registration System and QI Application and Account Management System would allow non-U.S. users to have the opportunity to ask questions and understand the capabilities and limitations of such systems. Also, such an online or in-person presentation by the IRS would be beneficial to opening communication channels between the IRS and non-U.S. users. Some non-U.S. users hesitate to ask questions or feel intimidated asking

questions to a tax authority that is not their local tax authority. An online forum or in-person presentation that allows for discussion between the IRS and a large group of non-U.S. industry participants would foster a more comfortable communication forum by showing that the IRS was open to questions and discussion.

## **ISSUE THREE, Topic 3(c): Form 1042-S, Audit Campaign Concerns**

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### **Executive Summary/ Background**

As announced by the IRS, the Audit Campaign will target withholding agents (including QIs) and focus on inconsistent and incorrectly filed Forms 1042, including reconciliation of the Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, with filed Forms 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*.<sup>186</sup> As part of the Audit Campaign, withholding agents will be advised of errors via letter from the IRS. Letters, especially sent overseas, may be re-routed to the incorrect contact in a large institution or simply take a prolonged period of time to be processed through the mail system of the overseas withholding agent receiving the letter.

### **Recommendation**

Due to such delays, the IRSAC recommends that the IRS consider formally providing overseas withholding agents additional time to respond to such audit campaign letters or that the IRS otherwise recognize and address the concerns described above.

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<sup>186</sup> <https://www.irs.gov/businesses/irs-announces-the-identification-and-selection-of-six-large-business-and-international-compliance-campaigns>

## **ISSUE THREE, Topic 4(a): QI Agreements and Proposed Regulations Under Section 1446(f)**

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### **Executive Summary**

The proposed regulations (REG-105476-18) addressing “Withholding of Tax and Information Reporting with Respect to Interests in Partnerships Engaged in the Conduct of a U.S. Trade or Business” (the Proposed Regulations), as currently drafted, will require QIs involved in Publicly Traded Partnership (PTP) disposition transactions to assume primary withholding responsibility. The IRSAC believes this requirement will be detrimental to non-primary withholding QIs who would have to segregate and build the necessary systems, procedures and controls (not currently in place) to accommodate such withholding as a primary QI specifically for PTP disposition transactions while remaining a non-primary QI for other types of U.S. source income. The IRSAC requests that the IRS consider allowing both primary and non-primary QIs for purposes of addressing withholding responsibility for PTP disposition transactions. Additionally, since the IRS has indicated it will be amending the QI agreement in coordination with implementing the Proposed Regulations, the IRSAC believes the IRS should take this opportunity to specifically categorize both Section 1446(a) and Section 1446(f) income in the QI agreement under the definition of Chapter 3 for purposes of both primary and non-primary QIs.

### **Background**

In May of 2019, the IRS issued the Proposed Regulations, which addressed the withholding and reporting of partnership interests engaged in a U.S. business as required under section 1446(f) of the Code. These regulations are a product of the TCJA introduction of new Code Section 1446(f) - Special Rules for Withholding on Dispositions of Partnership Interests. In general, the TCJA designates the transferee as the responsible party to withhold on a transfer of an interest. The Conference Report for the TCJA acknowledged that transfers involving PTP interests required withholding rules that may differ from transfers involving non-PTP interests as transferees may not know the transferors. As such, proposed §1.1446(f)-4(a)(1) provides that if a transfer of a PTP interest is effected through a

broker, the transferee generally is relieved of the requirement to withhold, and that obligation is imposed on a broker involved with the transfer.

The preamble to the Proposed Regulations noted that multiple brokers may be involved with dispositions, including, at times, QIs. In particular, the preamble indicates that:

*If a transfer of a PTP interest is effected through multiple brokers, proposed §1.1446(f)-4(a)(2) provides rules that specify which broker or brokers have a withholding obligation. Under proposed §1.1446(f)-4(a)(2)(i), a broker that pays the amount realized to a foreign broker is required to withhold unless the foreign broker is either a U.S branch treated as a U.S. person or a QI that assumes primary withholding responsibility for the payment. Consistent with this rule, the Treasury Department and the IRS intend to modify the QI agreement provided in Revenue Procedure 2017-15, 2017-3 I.R.B. 437, to allow QIs to assume primary withholding responsibility on the amount realized.<sup>187</sup>*

While §1.1446(f)-4(a)(2)(i), appears to limit the withholding to a QI that assumes primary withholding responsibility, the section immediately thereafter, §1.1446(f)-4(a)(2)(ii), states that “Brokers with customer relationship with transferor” and places a possible obligation to withhold on any broker, which would include a QI, that effects the transfer for a transferor who is a customer of the broker/QI. The IRSAC believes this obligation would impact non-primary withholding QIs such that it requires a non-withholding QI to institute primary withholding procedures for the limited purpose of PTP withholding. This would require an operational restructuring of non-primary withholding QIs or elimination of the PTP transactions as an investment option for clients of non-primary withholding QIs who cannot restructure their operations. Either restructuring or elimination would have a significant impact on the non-primary QI. Restructuring would require new operational systems to be built, new compliance controls and resource training for a non-primary QI which may not understand what the obligations are of a primary QI as it has always functioned as a non-primary QI for

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<sup>187</sup> Federal Register/Volume 84, No. 92 Monday May 13, 2019, page 21207.

all U.S. source income streams. Also, the non-primary QI would have to coordinate with business, legal, tax and compliance functions to assess whether such a restructuring was acceptable to the organization as a whole and possible to implement. The elimination of PTP as an investment option for clients of the non-primary QI would directly impact the business and profit of the non-primary QI which may be in a local market in which competitors can offer PTP transactions as an investment option.

In addition, requiring a QI to assume primary withholding responsibility on a transactional basis could conflict with Section 3.03 of the current 2017 QI agreement (IRS Revenue Procedure 2017-15) which requires the QI to assume all withholding on an account for which it has assumed primary withholding responsibility. Thus, if a non-primary QI has a single, omnibus account with an upstream party it would be systemically difficult for it to segregate the PTP transactions within the account itself. It would have to change the entire account to primary withholding responsibility to be in-line with Section 3.03 or create a brand new account just for PTP transactions which may not be a viable option or permitted by the upstream party due to resource and monetary restraints.

The proposed Regulations also indicate that the IRS intends to modify the QI Agreement for purposes of allowing QIs to assume primary withholding responsibility for purposes of Section 1446(a) which addresses distributions by publicly traded partnerships. The issues stated above would apply to such Section 1446(a) income as well.

Overall, the IRSAC applauds the IRS for the manner in which it has incorporated the complexities of Section 13501 of the TCJA into the broker reporting and withholding regimes.

### **Recommendation**

In order to facilitate withholding and reporting on PTP dispositions, the IRSAC recommends Section 1446(a) and Section 1446(f) income be treated similarly to other U.S. source income under the QI Agreement for which a QI may choose to assume withholding responsibility as a primary QI or choose not to assume such withholding responsibility as a non-primary QI.



## **ISSUE THREE, Topic 4(b): QI Agreements and Pooled Reporting for Sections 1446(a) and 1446(f)**

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### **Executive Summary**

The IRSAC believes the IRS should permit pooled reporting of a QI's direct account holders under the QI Agreement for foreign partners' share of effectively connected taxable income generated under Section 1446(a) and Section 1446(f). The ability to create reporting pools of varying withholding percentages, and review disposition transactions, will facilitate compliance by the primary and non-primary QI community with both IRS regulations and local data privacy laws.

### **Background**

In May of 2019, when the IRS issued Proposed Regulations addressing withholding and reporting on partnership interests engaged in a U.S. business, as required under section 1446(f) of the Code, the IRS indicated its intention was to change the QI Agreement for purposes of incorporating both Section 1446(a) and Section 1446(f). Section 1446(a) would be incorporated to allow QIs to assume primary withholding responsibility for distributions by publicly traded partnerships. Section 1446(f) would be incorporated to allow QIs to assume primary withholding responsibility for dispositions by publicly traded partnerships. These Proposed Regulations also refer to Form 1042-S reporting of amounts paid to a foreign partner or payee. However, these Proposed Regulations do not specifically allow for pooled reporting by QIs (regardless of whether primary or non-primary) of their direct account holders but appear to imply that recipient specific Form 1042-S would be applicable when such amounts are paid to a foreign partner or payee.

The IRSAC believes the use of pooled reporting of Section 1446(a) and Section 1446(f) income is vital to both primary and non-primary QIs who may not be able to accommodate specific recipient reporting due to local data privacy laws that prohibit the disclosure of such information to the IRS. For example, Germany is a jurisdiction in which strict local data privacy laws prohibit such disclosure. In addition, while there is a growing transparency of tax information being disclosed between and amongst various jurisdictions through such tax regimes as FATCA and the Automatic Exchange of Information, these regimes cannot be used as

appropriate approval to supersede local data privacy laws for purposes of reporting Section 1446(a) and Section 1446(f) income.

**Recommendation**

The IRSAC recommends that the amended QI Agreement allow for pooled reporting of Section 1446(a) and Section 1446(f) income by primary and non-primary QIs for direct account holders of these QIs. This would ensure compliance with both the IRS reporting obligations that QIs must fulfill and local data privacy laws that these same QIs are subject to in their jurisdictions.

## **ISSUE THREE, Topic 5: Limits on Requesting Payee-Specific Forms 1042-S**

### **Executive Summary**

The IRSAC encourages the IRS to consider instituting a deadline by which an account holder must request a payee specific Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, from a Qualified Intermediary (QI). Currently, account holders are able to request separate payee specific Forms 1042-S from a QI at any time, potentially causing operational burdens for QIs.

### **Background**

Under Section 8.01 of the QI Agreement, a QI is generally permitted, with certain exceptions, to file Forms 1042-S in Chapter 3 and Chapter 4 reporting pools. However, the QI Agreement permits an account holder to request a payee specific Form 1042-S from a QI. If a QI has already filed its Forms 1042-S in a reporting pool, it must not only file the payee specific Form 1042-S, but it must also amend a previously filed Form 1042-S and reduce the amount of the payment reported in order to reflect the amount allocated to the account holder.

As a practical matter, this can be operationally cumbersome for a QI if, to accommodate account holder requests, it must continually recalculate reporting pools and amend Forms 1042-S which have been filed. In some instances, this requires the QI to perform this task manually, as the systems are already set for the current tax year. Also, as there is no current time limit on an account holder to request a payee specific Form 1042-S, an amended return may reopen a closed tax year or prevent a tax year from closing indefinitely.

### **Recommendation**

The IRSAC recommends that a deadline be set for account holders to make the request for a payee specific Form 1042-S. Specifically, it recommends that August 1st of the following calendar year for Forms 1042-S filed by March 15th (e.g. August 1st, 2020 for TY2018 Forms 1042-S filed by March 15th) be set as a deadline. If a QI does not file a Form 1042-S by March 15th, the IRSAC recommends that the account holder have a period of 18 months after the QI files the pooled Form 1042-S by which to make the request.

## Appendix A

### IRSAC Member Biographies

**Lisa Allen** – Ms. Allen, CAPPP, CHRS, CAS, CFC is the VP of Regulatory Affairs, Relph Benefit Advisors an Alera Group Company, in Fairport, NY. Ms. Allen has over 25 years of employee benefit experience and is also a Certified Healthcare Reform Specialist. Ms. Allen manages regulatory updates and provides clients with counsel regarding ACA, ERISA and Sections 125 & 105(h) as well as assisting employers on 226J responses. Ms. Allen is the 2019 Chairman of The Benefit Advisors Network Compliance Committee and a member of the International Foundation of Employee Benefit Plans, Employer Council on Flexible Compensation, SHRM, NAHU and National Association of Professional Women. Ms. Allen is a frequent guest speaker at symposiums and conferences across the nation. **(Tax Exempt & Government Entities Subgroup)**

**Martin Bentsen** – Mr. Bentsen is an attorney and director of product development, FIS Wall Street Concepts (WSC), in New York, NY. He interacts with hundreds of financial firm clients on tax reporting matters. WSC's client base is comprised of self-clearing brokerage firms, hundreds of trust companies, large online brokers and international banking institutions and firms in the asset management advisory business. Mr. Bentsen is the lead for WSC's "Tax Community" outreach to clients, which provides a forum for clients to express their views and positions on tax-reporting matters. He is a member of the New York State Bar Association and a certified regulatory and compliance professional. **(Large Business and International Subgroup)**

**Tenesha Carter** – Ms. Carter is the Senior Vice President of Tax Preparation Services for the State Employees Credit Union in Raleigh, NC. Ms. Carter supervises and coordinates the tax preparation program for the credit union's 264 branches. She previously supervised daily operations of IRA services to ensure proper handling and reporting for the credit union. Ms. Carter is an enrolled agent and holds a B.A. from the University of North Carolina - Chapel Hill. **(Wage & Investment Subgroup)**

**Randall Cathell** – Mr. Cathell is a Tax Director for Cherry Bekaert LLP and heads the firm's international section in the State of Florida. He has more than 25 years of experience in federal, international and state tax matters. Mr. Cathell focuses on subchapter C corporations and partnerships in both the private and public sectors, in addition to foreign nationals with U.S. investments. He specializes in companies with international operations, from both a planning and compliance perspective, focused on tax efficiency and the associated reporting requirements. Mr. Cathell is a member of both the American Institute of Certified Public Accountants and the Florida Institute of Certified Public Accountants. Mr. Cathell earned his Bachelor's degrees in Accounting and General Business &

Management from the University of Maryland and his Master's degree in Taxation from Texas Tech University. **(Large Business and International Subgroup)**

**Alexandra Cruz** – Ms. Cruz is a Senior Manager in the Information, Reporting & Withholding practice of Ernst & Young's Financial Services Office in New York. Ms. Cruz works with large asset management and banking organizations with both domestic and nonresident alien reporting and withholding issues. For the past six years, she has been primarily focused on FATCA and its impact on the asset management industry. Ms. Cruz was a member of the Information Reporting Program Advisory Council in 2018. She is an attorney and is a member of the bar in the state of New York. **(Large Business and International Subgroup)**

**Ben Deneka** – Mr. Deneka serves as industry operations liaison with The Tax Institute at H&R Block. In addition to managing H&R Block's relationship with the IRS, Mr. Deneka represents H&R Block in the Security Summit and various industry working groups, including CERCA. He has over 7 years of experience providing expertise on IRS administration and informing his business partners on how to effectively implement standards and practices into H&R Block's scaled tax preparation operation, which includes over 10,000 U.S. tax offices and a robust suite of do-it-yourself tax products. Mr. Deneka earned his B.A. from the University of Mississippi and J.D. from the University of Mississippi School of Law. He currently resides in Pittsburgh, PA. **(Wage & Investment Subgroup)**

**Alan Ellenby** – Mr. Ellenby is an executive director and an attorney serving as national tax technical advisory leader for Ernst & Young's practice providing ACA compliance and reporting services to large employers. Additionally, he has worked with qualified and non-qualified retirement plans, other types of compensation and employee benefit issues, assisted multinational corporations with the U.S. taxation of employees participating in foreign pensions. He is a member of the American Bar Association. He has served as a member of the AICPA Tax Division's Employee Benefit Technical Resource Panel. Mr. Ellenby holds a degree in actuarial science from the University of Illinois and a J.D. from the University of Chicago. **(Small Business/Self-Employed Subgroup)**

**Michael Engle** – Mr. Engle is a partner with BKD, LLP in Kansas City, MO. He has extensive experience working with exempt organizations and governmental entities on various tax issues including employment tax. He has direct experience working with non-profit hospitals and colleges and universities. He has written a number of technical articles and has been a presenter for conferences and webinars. He is a CPA and actively involved with the AICPA. He serves on the BKD, LLP non-profit committee and is the leader of its healthcare committee. He is involved with the AICPA and the Missouri Society of CPAs. **(IRSAC Co-Chair and Tax Exempt & Government Entities Subgroup)**

**Diana Erbsen** – Ms. Erbsen is a New York based tax partner at DLA Piper, where she has worked since 2000, except during her service as the Deputy Assistant

Attorney General for Appellate and Review for the Tax Division of the U.S. Department of Justice, which position she held from November, 2014 until January, 2017. During her tenure at the DOJ Tax Division, Ms. Erbsen oversaw the Appellate Section, the Office of Review (responsible for civil settlements), and the Financial Litigation Unit (tasked with collecting judgments secured by the Trial Sections of the Tax Division). She was also actively involved in the management and operations of the Civil and Criminal sections of the Tax Division and served in an ex officio capacity on the Bankruptcy Rules Advisory Committee. Since returning to DLA Piper, Diana has resumed representing clients (public and privately held corporations, as well as partnerships estates and individuals) in all aspects of sophisticated, challenging tax disputes. She concentrates her practice on federal, state and local tax controversies, including criminal tax matters. Informed by her experience at the DOJ, she regularly counsels clients on issues relating to judicial deference to IRS guidance as well as on the appeal process and the intersection of criminal and civil tax enforcement. In 2018, Ms. Erbsen was selected as a member of the IRSAC and during 2019 she chaired the LB&I Subgroup. She also serves on the Council of the ABA Tax Section, in which capacity she oversees the operations of the Civil & Criminal Tax Penalties Committee, the Tax Policy & Simplification Committee and the Standards of Tax Practice Committee. Ms. Erbsen earned her B.A. degree from Amherst College (cum laude), J.D. from Northeastern University School of Law, and LL.M. from NY School of Law. She has been recognized by the American College of Tax Counsel as a Fellow. **(Large Business and International Subgroup Chair)**

**Sharyn M. Fisk** – Professor Fisk is CBA Professor of Tax at California State Polytechnic University – Pomona, where she specializes in taxation. She is also the Director of the University's VITA Program. She participated in the American Bar Association's Adopt-A-Base program, where she provided training to military VITA volunteers at a naval base in San Diego. She has researched and drafted 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 a 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. **(Wage & Investment Subgroup)**

**Dana Flynn** – Ms. Flynn is an Executive Director at Morgan Stanley and senior advisor within Wealth Management Operations Tax Compliance. Previously, she was a Director in the Corporate Tax Department at BNP Paribas and the Global Head of U.S. Information Reporting & Withholding, FATCA, and QI Advisory. As U.S. tax advisory, she worked with various local and global divisions of BNP Paribas relating to their policy planning and development, as well as, strategic compliance and control implementation pertaining to various areas of U.S. domestic and non-resident withholding and information reporting, including the Foreign Account Tax Compliance Act (FATCA), Qualified Intermediary (QI) Agreement and Section 871(m) of the Internal Revenue Code. Prior to BNP Paribas, she was a Director within Group Tax at UBS where she was the Americas regional expert for FATCA. Ms. Flynn has been a guest speaker and chairperson at various tax information reporting and withholding conferences within the industry and was the 2018 Chair of IRPAC (Information Reporting Program Advisory Committee). Currently, she is the 2019 Vice-Chair of the Securities Industry and Financial Markets Association (SIFMA) Tax Compliance Committee. Dana received her BA from Boston College and JD from Suffolk University Law School. **(Large Business and International Subgroup)**

**Deborah Fox** – Ms. Fox is a Certified Scrum Product Owner (CSPO) in Boca Raton, FL, with experience in a broad spectrum of verticals. As the Director of Marketing she is responsible for developing future strategy for tax solutions portfolio. She has a broad background in all aspects of product management, including business case development, project management, partner management, development, operations, client services, systems analysis, sales and quality assurance. Ms. Fox is a self-starter with team building and leadership skills, as well as a strategic thinker with market analysis skills. She is currently pursuing her EA designation. **(Small Business/Self-Employed Subgroup)**

**April Goff** – Ms. Goff a Partner with the law firm Perkins Coie LLP in Dallas, TX. Prior to joining Perkins Coie LLP, she acted as the sole in-house ERISA counsel for J. C. Penney Corporation, Inc. and was in private practice since 2003 with Holland & Knight LLP, Sonnenschein Nath & Rosenthal LLP (now Dentons LLP), Seyfarth Shaw LLP, and Warner Norcross & Judd LLP where she assisted clients ranging from small employers to Fortune 50 companies on complex employee benefit plans and strategic labor and employment issues. Ms. Goff holds multiple leadership roles within the American Bar Association, currently serving as the Vice-Chair of the Employee Plans and Executive Compensation Group under the Real Property Trusts & Estates Division and acting as a publications editor and columnist. She held multiple leadership positions at the local and national level with the Association of Corporate Counsel while in-house, including acting as the national Vice Chair of the national Employment and Labor Law Network. She also serves on the TEGE Council – Gulf Coast Area. Ms. Goff is CIPP/US certified and

a frequent speaker and author on a variety of ERISA, Labor & Employment, and Cybersecurity and Data Privacy topics. She completed her B.B.A. in Financial Institution Management and a minor in Economics from Tarleton State University at age 18, and Ms. Goff went on to obtain an M.B.A. with an emphasis in Global Finance from Baylor University and a J.D. from St. Thomas University School of Law. **(Tax Exempt & Government Entities Subgroup)**

**Antonio Gonzalez** – Mr. Gonzalez is a CPA and Founder and Co-Owner of Sydel Corporation in Coral Gables, FL, an accounting and information technology consulting firm specializing in the financial services industry. 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. He 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. **(Wage & Investment Subgroup)**

**Kathy R. Hettick** – Ms. Hettick, EA, ABA, ATP, has worked in the tax field for over 30 years and is the owner of Hettick Accounting & Tax, LLC in Enumclaw, WA. Her firm provides accounting and tax services to a variety of clients, and focuses on small businesses and individuals. She has first-hand experience in addressing the tax needs of clients, working with the IRS to resolve issues, and she is continually adapting her practice to account for tax changes. She has held numerous leadership roles at the local, state and national levels of various organizations, including President of the National Society of Accountants (NSA) and the Washington Association of Accountants and Tax Professionals (WAATP). She has enjoyed long time membership in other professional organizations including the National Society of Enrolled Agents (NAEA) and the Washington State Society of Enrolled Agents (WSSEA). She previously 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. Since 2004, she has provided in-person and online courses and education on a multitude of tax topics, including S-Corporations, Partnerships, Individuals, and Ethics. Ms. Hettick presents seminars at the IRS Nationwide Tax Forums on behalf of NSA and was recipient of Speaker of the Year from NSA in 2017. **(IRSAC Co-Chair)**

**Sheldon M. Kay** – Mr. Kay has over 40 years of experience as a CPA and attorney. He currently volunteers with the Georgia State University Law School's Low Income Tax Clinic. He is a former Partner for Crowe, LLP, CPA, in Atlanta, GA, where he represented clients before all divisions of the IRS and coordinated 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 frequently spoke 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 Washington, DC, and is a fellow of the American College of Tax Counsel. Mr. Kay earned his undergraduate degree (Accounting) from Northern Illinois University and holds a J.D. from John Marshall Law School. **(Large Business and International Subgroup)**

**Sanford Kelsey** – Mr. Kelsey works with ecommerce tax issues at Expedia Group. He is a CPA and attorney with experience in government and private law practice. He worked on administrative and legislative initiatives while in government. In addition, his tax experience includes structuring transactions and providing representation during tax contests. He is a member of the ABA Tax Lawyer Editorial Board. Mr. Kelsey earned both J.D. and LL.M. degrees. **(Large Business and International Subgroup)**

**Phyllis Jo Kubey** – Ms. Kubey has over 30 years of experience in taxation. She is the owner of Phyllis Jo Kubey, EA CFP NTPI Fellow 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 (2<sup>nd</sup> Vice President) of NYSSEA and 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 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, the American Payroll 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. She is a director of Voices of Ascension, a professional choral ensemble in NYC. Ms. Kubey holds a Bachelor of Fine Arts from Carnegie-Mellon University and a Master of Music (Voice) from The Juilliard School. **(Wage & Investment Subgroup Chair)**

**Mas Kuwana** – Mr. Kuwana is a member of Uber’s corporate tax department in San Francisco, CA, where he supports Uber’s tax operations and advises the business on items related to information reporting/withholding. Prior to joining Uber, Mr. Kuwana was a member of Amazon.com’s tax operations team and worked as an executive director at JPMorgan Chase & Co, where he managed U.S. tax operations supporting multiple lines of business. **(Small Business/Self-Employed Subgroup)**

**Joel Levenson** – Mr. Levenson, as assistant vice president for tax, payables and procurement at the University of Central Florida, considers the partnership between IRSAC and the IRS to be critically important for gaining tax compliance efficiencies for the tax community. His role at UCF includes advising on the unrelated business income tax, tax-exempt debt, payroll, excise and charitable issues. As a member of the Tax Council of the National Association of College & University Business Officers (NACUBO), the Inter-Institutional Committee on Finance & Accounting Officers (ICOFA), Tax Sub-Committee; and the University Tax Peer Group; he assists universities in the state of Florida and across the country with tax compliance needs. He earned his Bachelor of Science and Master of Science (Taxation) from the University of Central Florida. **(IRSAC Co-Chair and Tax Exempt & Government Entities Subgroup)**

**Carol Lew** – Carol Lew is a shareholder of Stradling, Yocca, Carlson & Rauth in Newport Beach, CA. She has over 32 years as a tax lawyer with substantial experience with TEB audits and TEB VCAP cases. She served as president of the National Association of Bond Lawyers from 2006-2007, and she served as chair of the ABA Tax-Exempt Financing Committee from 2001-2003. She has experience as bond counsel, underwriter’s counsel, special tax counsel and borrower’s counsel for various kinds of bond issues for state and local government and non-profits for the provision of public infrastructure, housing, charter schools, performing arts facilities, hospitals, museums and other types of facilities. She served as editor-in-chief of the Federal Taxation of Municipal Bonds from 2000-2001. **(Tax Exempt & Government Entities Subgroup)**

**Emily Lindsay** – Ms. Lindsay is a former executive of Marriott International, Inc., serving as Vice President, Corporate Accounting Services. She directed a large and diverse team of accounting, tax, systems and business services experts responsible for a wide variety of payroll, business support services, business systems analyses and development, payroll tax services, payroll accounting, and related banking services functions. Ms. Lindsay is a CPA and Chartered Global Management Accountant (CGMA). She serves on the Board of Directors of the American Payroll Association and was on the Board of the Greater Washington Society of CPAs (GWSCPA) and received the 2018 GWSCPA Outstanding Member in Business & Industry award. She has been a past member of three IRS advisory committees (IRSAC, IRPAC, and ETAAC). She currently teaches accounting and MBA courses at American University in Washington, DC, where

she has received several outstanding teaching and service awards. **(Small Business/Self-Employed Subgroup)**

**Ryan Lovin** – Mr. Lovin serves as tax counsel at Vanguard—the largest provider of mutual funds and the second-largest provider of exchange-traded funds in the world—where he focuses his practice on the firm’s products and portfolio investments. He has over 10 years of experience in the tax industry and previously worked in Washington for the Investment Company Institute and the international law firm Fried Frank. Mr. Lovin has a Masters in Accounting from the University of North Carolina, Chapel Hill and a Juris Doctorate from Georgetown University. **(Large Business and International Subgroup)**

**Charles “Sandy” Macfarlane** – Mr. Macfarlane has 40 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 35 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. **(Large Business and International Subgroup)**

**Fred Murray** – Mr. Murray is an attorney and certified public accountant and professor. He has served the Director of the Graduate Tax Program and Professor of Taxation Practice at the University of Florida Levin College of Law, and has also taught at Georgetown University, the University of Texas at Austin, the University of Houston, and Rice University, and lectured extensively elsewhere. In addition to public law and accounting practice, his experience includes government service as Deputy Assistant Attorney General in the Tax Division at the Department of Justice and as a Special Counsel to the Chief Counsel for the Internal Revenue Service. He is a past chair of the IRSAC, former advisor to the International Tax

Working Group of the United States Senate Finance Committee and a former member of the Commissioner's Advisory Council to the Department of Taxation and Finance, State of New York. He is vice chair for CLE and a former council director of the Governing Council of the American Bar Association Section of Taxation, as well as former chair of several of its committees. He has twice served as chair of the Federal Bar Association Section of Taxation. He is a fellow of the American College of Tax Counsel, a Life Elected Member of the American Law Institute and a member of the International Bar Association, International Fiscal Association and Bloomberg BNA International and Transfer Pricing Tax Advisory Board. **(Large Business and International Subgroup)**

**James Paille** – Chief Compliance Officer / Corporate Secretary (myPay Solutions). Mr. Paille has been an executive manager in the payroll service industry for over 30 years, specializing in managing multi-location offices. He has extensive experience in operations, customer service, mergers and acquisitions, payroll system conversions, operational startups and turnarounds, product development, call center design and implementation and financial and large IS installations and conversions. He has designed and implemented standard branch management practices that resulted in dramatic customer service and client retention improvements and has also designed a comprehensive due diligence checklist that is used in acquisitions. In his current position at Thomson Reuters, he is responsible for compliance, regulatory licensing with the federal government and many states, periodic examinations, FINCIN reporting and AML programs. Previously, Mr. Paille was responsible for payroll delivery and tax operations as well as assisting with product development, third-party integration, strategic growth and acquisitions. He writes *The Payroll Report*, a monthly blog on current payroll issues. Mr. Paille served as Senior Vice President of PaySystems, Vice President of Time Plus Payroll Services, Inc. and Vice President of Operations for SmallBizPros, Inc. He has also served as Vice President of Branch Operations for Advantage Business Services, Vice President and General Manager of Employee Solutions, Inc. and Director of Operations and Regional Controller for ADP. Mr. Paille is a member of the American Payroll Association's Board of Directors and past president, sits on the Executive Committee and Finance Committee and National Speakers Bureau and chairs the CPP Certification Review Panel. He has authored numerous publications on the subject of payroll and payroll taxation. Mr. Paille is also a member and past president of the Detroit Chapter of the American Payroll Association. He was a past Michigan Payroll Professional of the Year. He is a member of the IRS Reporting Agent Forum, IPPA, NACHA, NACTP, Citizens Bank Treasury Advisory Board and serves on a number of APA committees. Mr. Paille holds a B.S. in Accounting from St. John Fisher College in Rochester, NY, and is a Certified Payroll Professional. **(Small Business/Self-Employed Subgroup Chair)**

**Charles Read** – Mr. Read is a CPA and the Founder and CEO of Get Payroll in Lewisville, TX, where he has provided full-service payroll and payroll tax services since 1991. Get Payroll 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. Mr. Read is an accomplished senior executive and entrepreneur with more than 50 years of financial leadership experience in a broad range of industries, as well as a licensed CPA. In addition, he is also a U.S. Tax Court Non-Attorney Practitioner which enables him to represent clients in the U.S. Tax Court without being an attorney. 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*. Mr. Read is an accomplished speaker and has been featured on Fox Business News, Biz TV Texas, New York City Wired, Dallas Innovates and many more. In addition to his executive career, Mr. Read is a decorated United States Marine Corps sergeant, and a combat veteran of the Vietnam War. **(Small Business/Self-Employed Subgroup)**

**Martin Rule** – Mr. Rule is a CPA with over 25 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 public accounting firms, academic institutions, and healthcare institutions. He previously was a Senior Manager with Deloitte, and he also served as 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 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. **(Wage & Investment Subgroup)**

**Jeffrey Schneider** – Mr. Schneider has over 35 years of experience as an enrolled agent and currently is Vice President of SFS Tax & Accounting Services in Stuart, FL. His company handles all areas of tax including taxpayer representation and tax preparation bookkeeping and payroll for multiple types of taxpayers. Prior to joining SFS in 1999, he worked in various corporate taxpayers for 20 years, culminating as a Director of Tax for a major jewelry concern. He is a Fellow of the NAEA National Tax Practice Institute and a Certified Tax Resolution Specialist. He served 4 years as a director for the National Association of Enrolled Agents, two years as a member of NAEA's National Government Relations Committee. He served two terms as chair of NAEA's Awards Committee, and one year as chair of the NAEA's Membership Committee. Mr. Schneider was a founding member of the NAEA Educating America's Task Force. He was also President of the Florida Society of Enrolled Agents. 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. **(Wage & Investment Subgroup)**

**Clark Sells** – Mr. Sells leads the Payroll, Tax, and Mobile product teams at Ascentis. In this role, Sells is responsible for leading the product development life cycle that drives the payroll tax calculation within Ascentis platforms. Mr. Sells has experience in building, implementing and maintaining payroll and tax software for employers and payers of all volumes. In addition to payroll, Mr. Sells has product strategy experience in a multiple of tax regimes including: 1099, FATCA, CRS and ACA. He is a subject matter expert in the area of taxpayer identification number matching, non-wage and state reporting. Mr. Sells has over 10 years of experience serving as liaison to various public and private industry groups that aim to reduce the burdens of tax information reporting. Previously in his career, he held product management roles at Ceridian, where he focused on the creation of the on-demand payment platforms, an industry principal role at Sovos Compliance, and has worked in various global treasury services roles within Bank of America and Ameriprise Financial. **(Small Business/Self-Employed Subgroup)**

**Jean Swift** – Ms. Swift is a tribal leader in Mashantucket, CT, with diverse experience in business and financial management, administration, and establishing strategic partnerships. She is a Certified Public Accountant in the State of Connecticut and a certified financial counselor. She recently served as Tribal Council Treasurer of the Mashantucket Pequot Tribe, and currently works for the Tribe as a Financial Advisor. **(Tax Exempt & Government Entities Subgroup Chair)**

**Patricia Thompson** – Ms. Thompson is a CPA and Tax Partner with Piccerelli, Gilstein & Company, LLP in Providence, RI. 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, Master of Science in Taxation from Bryant College and received the Personal Financial Specialist (PFS) designation from AICPA. **(Small Business/Self-Employed Subgroup)**

**Daniel Welytok** – Mr. Welytok has over 30 years of experience as an attorney. He is currently a shareholder in Von Briesen & Roper, S.C., in Milwaukee, WI, where he serves as chair of the Opinion Review Committee reviewing and analyzing numerous opinions on taxable and tax-exempt bond issues, many involving the State of Wisconsin Public Finance Authority. He practices primarily in the areas of taxation, exempt organizations, employee benefits and business law. He also provides a broad range of representation, advising clients on various aspects of nonprofit organization and planning, 501(c) operational issues and compensation practices, income reporting and recognition issues. He represents clients before the DOL, the IRS and state departments of revenue in obtaining and maintaining tax-exempt and nonprofit status, as well as audits and tax controversies. **(Tax Exempt & Government Entities Subgroup)**

**Mary Jo Werner, CPA, CFF, JD** – Ms. Werner is a partner in Wipfli's tax services and valuation, forensics and litigation services groups. She specializes in litigation support for law firms and assists in fraud and forensic investigations. She is certified in financial forensics by the AICPA. She prides herself on establishing long-term, solid relationships with her clients and works very hard to help them achieve their goals. Ms. Werner's professional memberships and activities include AICPA, American Bar Association, WICPA and Wisconsin Bar Association. She currently serves on the Wisconsin State Bar Tax Board of Directors and is a past member of the IRS Taxpayer Advocacy Panel. **(Wage & Investment Subgroup)**

**Charles Yovino** – Mr. Yovino is currently President of Global HR GRC in Atlanta, GA and provides litigation support on retirement plan cases and also writes about HR governance, risk management and compliance. Prior to that he spent 28 years at PricewaterhouseCoopers and was head of the Atlanta HR consulting practice and a national leader of the HR tax, accounting and regulatory practice. He spent the first six years of his career working at a Washington, DC law firm and then for the IRS in Employee Plans Technical. He has worked in all aspects of benefits, including plan design, plan compliance, determination letter requests, VCP applications and working with clients on IRS audits. **(Tax Exempt & Government Entities Subgroup)**

## Appendix B

### TE/GE Subgroup Issue Two - Improving Accuracy of Form 990 Returns

| Form 990 Paper: January - December 2016 |                |  |       | Form 990 Electronic: January - December 2016 |                          |               |                | % Paper                                       | % Electronic      |                      |
|---|----------------|--|-------|--|--------------------------|---------------|----------------|---|-------------------|----------------------|
| Total filings                           |                | # with errors  |       | Total filings                                |                          | # with errors |                | 57%   | 63%               |                      |
| 135,331                                 |                | 35,491   |       | 229,678                                      |                          | N/A           |                |   |                   |                      |
| Causes                                  |                | Causes   |       | Causes                                       |                          | Causes        |                |   |                   |                      |
| Error                                   | rejection? Y/N | Description  | Error | rejection? Y/N                               | Description              | Error         | rejection? Y/N | Description                                   | # by practitioner | # by self-filing org |
| 1                                       | N              | No reply to correspondence                                 | 1     | Y  |                          | 1             | Y              |   |                   |                      |
| 2                                       | N              | Total excess year calculation                              | 2     | Y  |                          | 2             | Y              |   |                   |                      |
| 3                                       | N              | Total Net assets or fund calculation                       | 3     | Y  |                          | 3             | Y              |   |                   |                      |
| 4                                       | N              | Name control mismatch                                      | 4     | Y  |                          | 4             | Y              |   |                   |                      |
| 5                                       | N              | Missing or incomplete Schedule A                           | 5     | Y  |                          | 5             | Y              |   |                   |                      |
|   |                |  |       |  |                          |               |                |   |                   |                      |
| Form 990 Paper: January - December 2017 |                |  |       | Form 990 Electronic: January - December 2017 |                          |               |                | % Paper                                       | % Electronic      |                      |
| 113,716                                 |                | 29,495   |       | 239,588                                      |                          | 12,188        |                | 32%   | 68%               |                      |
| Causes                                  |                | Causes   |       | Causes                                       |                          | Causes        |                |   |                   |                      |
| Error                                   | rejection? Y/N | Description  | Error | rejection? Y/N                               | Description              | Error         | rejection? Y/N | Description                                   | # by practitioner | # by self-filing org |
| 1                                       | N              | Missing schedule O   | 1     | Y  | Subsection code mismatch | 1             | Y              | EIN not established as an exempt organization |                   |                      |
| 2                                       | N              | Total net assets end of year calculation                   | 2     | Y  |                          | 2             | Y              | Return type must match IRS database           |                   |                      |
| 3                                       | N              | Total net assets beginning of year calculation             | 3     | Y  |                          | 3             | Y              | Name control mismatch                         |                   |                      |
| 4                                       | N              | Total functional expenses calculation                      | 4     | Y  |                          | 4             | Y              | Fiscal year mismatch                          |                   |                      |
| 5                                       | N              | Total revenue calculations                                 | 5     | Y  |                          | 5             | Y              |   |                   |                      |
|   |                |  |       |  |                          |               |                |   |                   |                      |
| Form 990 Paper: January - December 2018 |                |  |       | Form 990 Electronic: January - December 2018 |                          |               |                | % Paper                                       | % Electronic      |                      |
| 105,785                                 |                | 26,339   |       | 252,601                                      |                          | 34,902        |                | 30%   | 70%               |                      |
| Causes                                  |                | Causes   |       | Causes                                       |                          | Causes        |                |   |                   |                      |
| Error                                   | rejection? Y/N | Description  | Error | rejection? Y/N                               | Description              | Error         | rejection? Y/N | Description                                   | # by practitioner | # by self-filing org |
| 1                                       | N              | Return with missing or incorrect EIN                       | 1     | Y  | Subsection code mismatch | 1             | Y              | EIN not established as an exempt organization |                   |                      |
| 2                                       | N              | Name control mismatch                                      | 2     | Y  |                          | 2             | Y              | Return type must match IRS database           |                   |                      |
| 3                                       | N              | Tax period on return different from what is on the account | 3     | Y  |                          | 3             | Y              | Name control mismatch                         |                   |                      |
| 4                                       | Y              | Missing Schedule O   | 4     | Y  |                          | 4             | Y              | Software ID must have passed testing          |                   |                      |
| 5                                       | Y              | Missing Schedule A or B                                    | 5     | Y  |                          | 5             | Y              |   |                   |                      |

Efile returns reject upfront and must be corrected before they can be Accepted electronically.  
 Number of errors represent the total number of times the rule was triggered. This can include the same return rejecting more than once.  
 # of errors as of May 22, 2019.



| Form 990-EZ Paper: January - December 2016 |                |  |                   | Form 990-EZ Electronic: January - December 2016 |                |   |                      |
|--|----------------|--|-------------------|---|----------------|---|----------------------|
| Total Filings                              | # with errors  | Causes   |                   | Total Filings                                   | # with errors  | Causes  |                      |
| Error                                      | rejection? Y/N | Description  |                   | Error   | rejection? Y/N | Description                                   |                      |
| 1  | N              | Net fund balance calculation                               | # by practitioner | 1   | N/A            | Efile rejects are purged after 2 years.       | # by self-filing org |
| 2  | N              | No reply to correspondence                                 | # by practitioner | 2   |                |   | # by self-filing org |
| 3  | N              | Total excess year amount calculation                       |                   | 3   |                |   |                      |
| 4  | N              | Missing or Incomplete Schedule A                           |                   | 4   |                |   |                      |
| 5  | N              | Missing or incomplete Schedule B                           |                   | 5   |                |   |                      |
| Form 990-EZ Paper: January - December 2017 |                |  |                   | Form 990-EZ Electronic: January - December 2017 |                |   |                      |
| Total Filings                              | # with errors  | Causes   |                   | Total Filings                                   | # with errors  | Causes  |                      |
| 1  | N              | No reply to correspondence                                 | # by practitioner | 1   | Y              | Subsection code mismatch                      | # by self-filing org |
| 2  | N              | Total excess year amount calculation                       |                   | 2   | Y              | EIN not established as an exempt organization |                      |
| 3  | N              | Missing or Incomplete Schedule A                           |                   | 3   | Y              | Return type must match IRS database           |                      |
| 4  | N              | Total revenue calculation                                  |                   | 4   | Y              | Fiscal year mismatch                          |                      |
| 5  | N              | Tax period on return different from what is on the account |                   | 5   | Y              | Name control mismatch                         |                      |
| Form 990-EZ Paper: January - December 2018 |                |  |                   | Form 990-EZ Electronic: January - December 2018 |                |   |                      |
| Total Filings                              | # with errors  | Causes   |                   | Total Filings                                   | # with errors  | Causes  |                      |
| 1  | N              | Return with missing or incorrect EIN                       | # by practitioner | 1   | Y              | Subsection code mismatch                      | # by self-filing org |
| 2  | N              | Name control mismatch                                      |                   | 2   | Y              | EIN not established as an exempt organization |                      |
| 3  | N              | Tax period on return different from what is on the account |                   | 3   | Y              | Return type must match IRS database           |                      |
| 4  | N              | Checking final box in error                                |                   | 4   | Y              | Fiscal year mismatch                          |                      |
| 5  | Y              | Missing Schedule A   |                   | 5   | Y              | Name control mismatch                         |                      |

Efile returns reject upfront and must be corrected before they can be Accepted electronically.  
 Number of errors represent the total number of times the rule was triggered. This can include the same return rejecting more than once.  
 # of errors as of May 22, 2019.

Form 990-PF Paper: January - December 2016

|               |        |               |        |
|---------------|--------|---------------|--------|
| Total filings | 72,242 | # with errors | 16,153 |
|---------------|--------|---------------|--------|

| Error | Causes | Description                         | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|-------------------------------------|----------------|-------------------|----------------------|
| 1     | N      | Name control mismatch               |                |                   |                      |
| 2     | N      | Total assets book value calculation |                |                   |                      |
| 3     | N      | No reply to correspondence          |                |                   |                      |
| 4     | N      | Missing or blank Schedule B         |                |                   |                      |
| 5     | N      | Excise tax calculation              |                |                   |                      |

Form 990-PF Electronic: January - December 2016

|               |        |               |     |
|---------------|--------|---------------|-----|
| Total filings | 58,363 | # with errors | N/A |
|---------------|--------|---------------|-----|

| Error | Causes | Description | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|-------------|----------------|-------------------|----------------------|
| 1     |        |             |                |                   |                      |
| 2     |        |             |                |                   |                      |
| 3     |        |             |                |                   |                      |
| 4     |        |             |                |                   |                      |
| 5     |        |             |                |                   |                      |

% Paper 55%  
% Electronic 45%

Form 990-PF Paper: January - December 2017

|               |        |               |        |
|---------------|--------|---------------|--------|
| Total filings | 65,079 | # with errors | 13,577 |
|---------------|--------|---------------|--------|

| Error | Causes | Description                         | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|-------------------------------------|----------------|-------------------|----------------------|
| 1     | N      | Total assets book value calculation |                |                   |                      |
| 2     | N      | Missing or blank Schedule B         |                |                   |                      |
| 3     | N      | No reply to correspondence          |                |                   |                      |
| 4     | N      | Excess of revenue calculations      |                |                   |                      |
| 5     | N      | Total revenue per books             |                |                   |                      |

Form 990-PF Electronic: January - December 2017

|               |        |               |       |
|---------------|--------|---------------|-------|
| Total filings | 61,824 | # with errors | 6,488 |
|---------------|--------|---------------|-------|

| Error | Causes | Description  | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|--|----------------|-------------------|----------------------|
| 1     | Y      | Subsection code mismatch   |                |                   |                      |
| 2     | Y      | EIN not established as a private foundation  |                |                   |                      |
| 3     | Y      | Return type must match IRS database  |                |                   |                      |
| 4     | Y      | Fiscal year mismatch   |                |                   |                      |
| 5     | Y      | Part XV, Line 3a, address, purpose and amount must be present; if name is present. |                |                   |                      |

% Paper 51%  
% Electronic 49%

Form 990-PF Paper: January - December 2018

|               |        |               |        |
|---------------|--------|---------------|--------|
| Total filings | 61,406 | # with errors | 11,982 |
|---------------|--------|---------------|--------|

| Error | Causes | Description                 | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|-----------------------------|----------------|-------------------|----------------------|
| 1     | N      | Name control mismatch       |                |                   |                      |
| 2     | Y      | Missing or blank Schedule B |                |                   |                      |
| 3     | Y      | Signature                   |                |                   |                      |
| 4     | N      | Total revenue per books     |                |                   |                      |
| 5     |        | Excise tax calculation      |                |                   |                      |

Form 990-PF Electronic: January - December 2018

|               |        |               |        |
|---------------|--------|---------------|--------|
| Total filings | 68,147 | # with errors | 13,074 |
|---------------|--------|---------------|--------|

| Error | Causes | Description  | rejection? Y/N | # by practitioner | # by self-filing org |
|-------|--------|--|----------------|-------------------|----------------------|
| 1     | Y      | Subsection code mismatch   |                |                   |                      |
| 2     | Y      | EIN not established as a private foundation  |                |                   |                      |
| 3     | Y      | Return type must match IRS database  |                |                   |                      |
| 4     | Y      | Fiscal year mismatch   |                |                   |                      |
| 5     | Y      | Part XV, Line 3a, address, purpose and amount must be present; if name is present. |                |                   |                      |

% Paper 47%  
% Electronic 53%

File returns reject upfront and must be corrected before they can be Accepted electronically.  
Number of errors represent the total number of times the rule was triggered. This can include the same return rejecting more than once.  
# of errors as of May 22, 2019.

| Form 990-T Paper: January - December 2016 |                |  |                   | Form 990-T Electronic: January - December 2016 (N/A)* |                |             |                      | % Paper % Electronic |    |
|---|----------------|--|-------------------|---|----------------|-------------|----------------------|----------------------|----|
| Total filings                             | # with errors  | Causes                                 |                   | Total filings   | # with errors  | Causes      |                      | 100%                 | 0% |
| Error                                     | rejection? Y/N | Description                            |                   | Error   | rejection? Y/N | Description |                      |                      |    |
| 168,935                                   | 31,694         |  |                   |   |                |             |                      |                      |    |
| 1   | N              | Name control mismatch                  | # by practitioner | 1   |                |             | # by self-filing org |                      |    |
| 2   | N              | Total filer computations doesn't match |                   | 2   |                |             |                      |                      |    |
| 3   | N              | computer computation                   |                   | 3   |                |             |                      |                      |    |
| 4   | N              | Tax before credit computation          |                   | 4   |                |             |                      |                      |    |
| 5   | N              | Corporation tax calculation            |                   | 5   |                |             |                      |                      |    |
|   |                | Failure to include Form 8941           |                   |   |                |             |                      |                      |    |
| Form 990-T Paper: January - December 2017 |                |  |                   | Form 990-T Electronic: January - December 2017 (N/A)* |                |             |                      | % Paper % Electronic |    |
| Total filings                             | # with errors  | Causes                                 |                   | Total filings   | # with errors  | Causes      |                      | 100%                 | 0% |
| 128,360                                   | 30,788         |  |                   |   |                |             |                      |                      |    |
| 1   | N              | Name control mismatch                  | # by practitioner | 1   |                |             | # by self-filing org |                      |    |
| 2   | N              | Penalty and interest code error        |                   | 2   |                |             |                      |                      |    |
| 3   | N              | Total filer computations doesn't match |                   | 3   |                |             |                      |                      |    |
| 4   | N              | computer computation                   |                   | 4   |                |             |                      |                      |    |
| 5   | N              | Tax before credit computation          |                   | 5   |                |             |                      |                      |    |
|   |                | Unrelated taxable income calculation   |                   |   |                |             |                      |                      |    |
| Form 990-T Paper: January - December 2018 |                |  |                   | Form 990-T Electronic: January - December 2018 (N/A)* |                |             |                      | % Paper % Electronic |    |
| Total filings                             | # with errors  | Causes                                 |                   | Total filings   | # with errors  | Causes      |                      | 100%                 | 0% |
| 189,827                                   | 39,820         |  |                   |   |                |             |                      |                      |    |
| 1   | N              | Name control mismatch                  | # by practitioner | 1   |                |             | # by self-filing org |                      |    |
| 2   | N              | Total filer computations doesn't match |                   | 2   |                |             |                      |                      |    |
| 3   | N              | computer computation                   |                   | 3   |                |             |                      |                      |    |
| 4   | Y              | Tax before credit computation          |                   | 4   |                |             |                      |                      |    |
| 5   | N              | Failure to include Form 8941           |                   | 5   |                |             |                      |                      |    |
|   |                | Trust income tax calculation           |                   |   |                |             |                      |                      |    |

\*Form 990-T is paper filed only.