

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
STATEMENT PRESENTED TO**

**DEPARTMENT OF THE TREASURY
AND THE INTERNAL REVENUE SERVICE**

ROUNDTABLE DISCUSSION ON THE TAX GAP

March 9, 2007

The American Institute of Certified Public Accountants thanks the Department of Treasury and the Internal Revenue Service for the opportunity to appear before you today. I am Jeffrey R. Hoops, Chair of the AICPA's Tax Executive Committee; and a tax partner with Ernst & Young, LLP, New York, New York.

The AICPA is the national, professional organization of certified public accountants comprised of approximately 350,000 members. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses. It is from this broad perspective that we offer our comments today on the tax gap and improving compliance with the nation's tax laws.

GENERAL COMMENTS

The AICPA commends Treasury for the September 2006 release of its report entitled, *A Comprehensive Strategy for Reducing the Tax Gap*. We strongly support Treasury's comprehensive multi-year strategy to reduce the tax gap which consists of seven integrated components: (1) reducing opportunities for evasion; (2) making a multi-year commitment to research; (3) continuing improvements in information technology; (4) improving compliance activities; (5) enhancing taxpayer service; (6) reforming and simplifying the tax law; and (7) coordinating with partners and stakeholders. We have organized our written statement around these seven strategies, including reiteration of our long-standing support for a fully funded IRS budget.

Closing the tax gap is consistent with the AICPA Tax Division's Mission Statement which places a major emphasis on promoting the interests of the public.¹ Similarly, our current strategic plan states that:

As representatives of CPAs in tax practice, the Tax Section best serves the public interest by assisting members to hone their professional skills, regulating unacceptable

¹ The Tax Section serves the public interest by assisting AICPA members to be the preeminent professional providers of tax services, and by advocating sound tax policy and effective tax administration.

professional conduct, and – simultaneously – demonstrating our commitment to promoting and developing an efficient and effective system of taxation.

The AICPA is committed to this common effort of mitigating the tax gap and fostering fair and efficient tax administration. In this context, the AICPA plans to survey our Tax Section members at the close of the 2007 filing season to assess the perspective of CPAs on ways to address the tax gap.

CLOSING THE TAX GAP CALLS FOR A FULLY FUNDED IRS BUDGET

A central component of any tax gap strategy is ensuring a fully funded IRS budget. For this reason, we strongly support full funding of the Internal Revenue Service’s fiscal year 2008 budget. We have long advocated funding levels which would allow the IRS to efficiently and effectively administer the tax laws and collect taxes. Giving the IRS the resources necessary to properly process tax returns and enforce the tax laws is vital to maintaining our voluntary compliance system.

We agree with the IRS Oversight Board that “just applying additional resources to do more of what is being done today” is not sufficient, and any plan to address the tax gap must be more comprehensive.² Treasury’s September 2006 report aptly adopts a comprehensive view by including an IRS commitment to customer service, a greater emphasis on research to spot major areas of non-compliance, and a major focus on IRS enforcement activities. However, none of these objectives can be seriously accomplished without addressing a realistically funded IRS budget for fiscal year 2008.

Commissioner Everson recognizes that “[a] critical element in [the Service’s] ability to make a serious dent in the tax gap is to have the necessary resources available to fund [the IRS’s] service, enforcement, and information technology programs.”³ We agree. The AICPA encourages this type of balanced approach and stands ready to work with the Treasury and the Service to ensure that the tax gap dilemma is properly addressed and the needs of America’s taxpayers are fulfilled. As we have stated in the past, all taxpayers must have access to resources that enable them to fulfill their responsibilities, and budgetary funding must be provided to ensure this access.

A balanced approach to customer service and enforcement is critical. At the same time, reductions in IRS funding requests that focus too much on cuts in customer service only serve to undercut tax compliance over the longer term, with the nation’s taxpayers suffering as a direct result.

² IRS Oversight Board 2006 Annual Report, January 2007, page 36.

³ IRS Commissioner Mark Everson, Statement on “Deconstructing the Tax Code: Uncollected Taxes and the Issue of Transparency,” before the Senate Homeland Security and Governmental Affairs Committee, Subcommittee on Federal Financial Management, Government Information and International Security, September 26, 2006.

1. REDUCE OPPORTUNITIES FOR EVASION

The AICPA supports Treasury and IRS's efforts to develop constructive legislative and administrative policies designed to reduce opportunities for evasion. We commend Treasury for recognizing that the issuance of regulations and administrative guidance is a critical component of responding to the tax gap problem.⁴ In this context, we appreciate Treasury and IRS's periodic publication and updating of the "Priority Guidance Plan," providing a comprehensive list of guidance the government has scheduled for completion during the fiscal year. The AICPA annually provides comments to the Administration regarding our suggestions for new guidance projects; and we look forward to providing our updated guidance recommendations in the next few months.

The Administration's proposed fiscal year 2008 budget includes a number of tax administration proposals that target the tax gap. These proposals include (among others) expansion of information reporting, basis reporting on securities sales, expanded electronic filing for certain large organizations, and increases in the scope of tax penalties. We are currently reviewing the broad range of tax administration proposals contained in the 2008 budget, and we hope to provide comments on a number of these proposals in the coming weeks. At this time, we offer some important observations on tax penalties and basis reporting on securities sales.

Tax Penalties and the Tax Gap

A number of legislative proposals involving tax penalties have been raised under the guise of closing the tax gap. As a general principle, the AICPA supports carefully crafted penalties that promote tax compliance and result in a meaningful reduction in the tax gap. However, we are concerned that many of these civil penalty proposals are being raised by Congress and the Administration in a narrow, rifle-shot perspective. Instead, we believe greater levels of tax compliance could be achieved among the public if Congress established a legislative oversight process similar to that which was used in the drafting of the *Improved Penalty Administration and Compliance Tax Act*, which ultimately became law as part of the *Omnibus Budget and Reconciliation Act of 1989*.

In our opinion, establishing a broad legislative oversight (penalty) review process would not only achieve higher levels of tax compliance, but should also result in greater numbers of taxpayers believing that tax fairness has been achieved. This is consistent with a 2006 statement by J. Russell George, Treasury Inspector General for Tax Administration (TIGTA), that "...it is often difficult to ascertain whether a taxpayer has intentionally evaded taxes, or whether there was an honest misunderstanding. Therefore, the IRS use of punitive penalties must be tempered to ensure taxpayers are not penalized for honest misunderstandings."⁵

⁴ Treasury Report entitled, *A Strategy for Reducing the Tax Gap*, September 2006. See report section III; subsection 1, Reduce Opportunities for Evasion.

⁵ Statement of the Honorable J. Russell George, Treasury Inspector General for Tax Administration, on "A Closer Look at the Size and Sources of the Tax Gap," before the Senate Finance Committee, Subcommittee on Taxation and IRS Oversight, July 26, 2006; see document section entitled "Reduce the Complexity of the Code."

Prior to the 1989 reforms, taxpayers and tax professionals saw penalties as: (1) an IRS tool for punishing taxpayers and a bargaining chip in audit examinations; and (2) a means of raising revenues for the U.S. Treasury. Before 1989, penalties were viewed as being applied unevenly in differing regions of the country, as well as lacking in coordination and overlapping in application.⁶ Representative J.J. Pickle, one of the main proponents of penalty reform at the time, viewed the 1989 reform measures as more fair and less complex than the prior penalty regime, and an inherent extension of tax reform and simplification.⁷ The fundamental purpose of the 1989 penalty reform was to overcome the piecemeal approach to legislative penalty changes.

Basis Reporting on Securities Sales

The AICPA conceptually supports the Administration's proposal requiring brokers to report to the IRS a customer's adjusted basis in publicly-traded securities sold during the preceding taxable year. While we believe that this proposal could significantly increase tax compliance with respect to the reporting of capital gains and loss transactions over the longer term, we stress that the technical problems associated with implementation of this proposal in the short-term should not be underestimated.

We believe that the technical problems involved with the proposal can be addressed and overcome, but the pace with respect to implementation of a capital gains basis reporting initiative should not get ahead of the ability of the IRS to utilize such basis information for examination purposes. Otherwise, taxpayers would be subjected to additional reporting burdens without a commensurate ability within the Service to utilize the basis information for enforcement purposes. In particular, we take note of the June 2006 Government Accountability Office (GAO) report⁸ acknowledging the challenges relating to: (1) the Service's computer system capacity to store and use additional data and (2) the potential that the Service will be unable to process and match capital gains and loss transaction data reported on Form 1040, Schedule D.

The proposal would presumably require brokers to furnish customers with information statements showing the same basis information that the brokers provide the IRS. Assuming the information is provided by brokers to taxpayers in an understandable form, we believe this is a positive requirement. We would encourage brokers to provide this basis information involving capital gains and loss transactions to taxpayers in a format that would enable taxpayers and tax preparers to download the basis information directly into their tax return preparation software. This would enable a taxpayer to provide the IRS with details of each capital gain and loss transaction on a separate line on Form 1040, Schedule D and D-1. Absent the availability of such software, we urge the IRS to maintain its current policy of permitting individual taxpayers to provide summary totals for security transactions on Schedule D and D-1, coupled with the attachment of brokerage statements to the Form 1040.

⁶ "Tax Politics and a New Substantial Understatement Penalty," by Dennis J. Ventry, Jr., Tax Notes Today, October 3, 2006.

⁷ Ibid.

⁸ General Accountability Office Report on *Capital Gains Tax Gap, Requiring Brokers to Report Securities Cost Basis Would Improve Compliance if Related Challenges Are Addressed*, June 2006, page 28.

The proposal includes rules for reporting basis when the reporting broker executed the sale, but not the original purchase. We support the requirement that, when securities are transferred from one broker to another, the transferring broker must furnish the transferee broker with sufficient detail relating to the basis of the securities being transferred. However, we are concerned about the compliance burdens placed on taxpayers who receive securities by gift, inheritance, or through a direct purchase from the issuing company, and who later transfer the securities into a brokerage account. In these cases, the proposal contemplates the promulgation of regulations requiring taxpayers to furnish the basis information to the transferee broker. We urge caution in providing for the routine assessment of a civil penalty against taxpayers for a failure to furnish correct basis information due to the rigorous recordkeeping burdens that may be associated with retaining such information.

Taxpayers will have difficulty in tracking the basis of securities involved with corporate spin-offs, recapitalizations, and mergers. Moreover, there will be circumstances when brokerage houses may inaccurately report basis amounts to customers, such as when: (1) a taxpayer sells securities involving a wash sale under Internal Revenue Code section 1091 and (2) a corporation or regulated investment company (RIC) makes a distribution determined to be a return of capital. Reporting basis information to customers may also prove problematic in cases in which taxpayers have chosen the specific identification method of calculating the basis and holding period of a stock sale. As part of any reporting requirements in this area, brokers should be required to provide straightforward mechanisms by which taxpayers can electronically notify the broker of a specific lot that should be sold. These situations need to be carefully reviewed before implementing a broad capital gains and loss basis reporting rule.

2. MAKE A MULTI-YEAR COMMITMENT TO RESEARCH

The AICPA supports Treasury's call for a multi-year commitment to research as part of its comprehensive strategy for mitigating the tax gap. In this context, we support the IRS's development and implementation of the National Research Program (NRP), the Service's primary research program involving compliance data. We believe the NRP is a positive foundation for meeting the IRS's needs for data and analysis of the tax gap. When the Service rolled out NRP a few years ago with a focus on individual tax returns, the taxpayer and practitioner communities were deeply concerned that the program would prove extremely burdensome to the public, much like the NRP's unpopular predecessor – the Taxpayer Compliance Measurement Program (TCMP).

The Service's outreach and discussions with stakeholders about the NRP's objectives, prior to the program's actual rollout, did much to lessen the public's concerns about the NRP's initial focus on 46,000 individual tax returns from tax year 2001. The Service has now turned the focus of the NRP to business returns, and it is starting the planning process for further individual return research. With this in mind, we reiterate our call for the IRS to maintain a high level of outreach and dialogue with the stakeholder community to ensure positive implementation and minimal taxpayer burdens, both critical ingredients for the program's success.

As the IRS increasingly relies on the NRP to better target its examination and compliance activities, we stress the ongoing need to continuously refine the tax gap data, including the level of the overall tax gap and identification of the types of industries and taxpayers contributing to the growth in the tax gap “numbers.” This recommendation involves further analysis of the components of the tax gap.

3. CONTINUE IMPROVEMENTS IN INFORMATION TECHNOLOGY

The fiscal year 2008 budget submission recommends a \$282.1 million direct appropriation for Business Systems Modernization (BSM). Although we are not in a position to evaluate what constitutes an appropriate funding level, we are pleased that the Administration is requesting a significant increase in BSM appropriation funds over the prior fiscal year.⁹

The AICPA appreciates Treasury’s view that “[s]uccessful BSM program delivery during the past two years demonstrates that the IRS has established a foundation of disciplined project delivery and accomplishment.”¹⁰ We support IRS’s intent to continue to focus on four key tax administration systems: (1) Customer Account Data Engine (CADE), (2) Account Management Services (AMS), (3) Modernized e-File (MeF), and (4) Filing and Payment Compliance (F&PC). BSM must remain a central feature of the Service’s strategic plan; and we believe systems like CADE (designed to replace the Service’s ancient Master File System) should ultimately yield benefits to both taxpayers and IRS employees through reduced burden and faster account resolution.

4. IMPROVE COMPLIANCE ACTIVITIES

We support Treasury’s tax gap strategy involving improving compliance activities. This strategy is generally consistent with the AICPA’s September 2005 study entitled, *Understanding Tax Reform: A Guide to 21st Century Alternatives*. The report highlights increases in IRS examinations, information reporting, and withholding as approaches to reducing the tax gap.¹¹

While not endorsing any specific recommendations for closing the tax gap, the AICPA report does emphasize that using any of these approaches would impose additional burdens on taxpayers, and “the cost of these new burdens should not overwhelm the benefit of more effective tax administration.”¹²

IRS and Treasury acknowledge that any proposal to close the tax gap must be balanced against imposing unacceptable burdens on enforcement resources and on the vast majority of America’s

⁹ Department of Treasury-Budget in Brief Fiscal Year 2008, February 2006, page 63.

¹⁰ Ibid, pages 66-67.

¹¹ AICPA Report entitled, *Understanding Tax Reform: A Guide to 21st Century Alternative*, Chapter 4, subsection D entitled, *Closing the ‘Tax Gap*, September 2005.

¹² Ibid.

taxpaying public who are otherwise compliant with the tax laws. We believe that this is the right approach and appreciate IRS and Treasury's quest to balance the need for closing the tax gap with imposing unacceptable burdens on compliant taxpayers.

Modernized E-File

The AICPA appreciates the benefits electronic filing offers to both tax administration and taxpayers, particularly as it may help to mitigate the tax gap. Therefore, we support the Service's continued development of electronic filing, as well as further improvements in the modernized e-file (MeF) platform. CPAs recognize the administrative efficiencies and budgetary savings electronic tax administration achieves for the IRS, and the customer service benefits that accrue to taxpayers from an effective electronic filing (e-file) program. The administrative benefits of e-filing include faster tax processing, reduced cycle time, quicker identification of emerging audit trends, and the potential for more current resolution of taxpayer uncertainties.

We applaud the success the IRS had with the e-filing program during the 2006 filing season. In part, we believe the e-file program was successful because of the unprecedented effort the IRS made to gain the input and involvement of affected parties. The AICPA is proud of the proactive role it played in surfacing issues and solutions that ultimately contributed to the success of e-file; and we will continue to work closely with the Service to meet its expectations for the e-file program for the 2007 filing season. In this context, the AICPA is closely consulting with the Service on implementing the mandatory e-file programs for large corporations, exempt organizations and partnerships during the current filing season.

We support the IRS's web-based "e-services" for tax professionals and taxpayers. Through e-services, practitioners and taxpayers have access to a suite of online products, including the Preparer Tax Identification Number (PTIN) Application; the Online e-file Application; Electronic Account Resolution (EAR); submission of Form 2848, Power of Attorney and Declaration of Representative; and the Service's Transcript Delivery System (TDS).

When the program was launched in 2004, e-services were available to tax professionals who e-filed 100 or more individual returns. The IRS lowered the threshold in 2005 by making the e-services suite available to tax professionals who e-file 5 or more individual and business income tax returns. The AICPA supports further expansion of e-services. We see the program as an excellent way of addressing the tax gap, creating a process whereby the IRS's interaction with tax professionals is more efficient and generates significant cost savings to the Service.

Enforcement Initiatives

Like other stakeholders, the AICPA is concerned about the extent of the gross and net tax gap, estimated at \$345 billion and \$290 billion respectively. On a gross tax gap basis, the IRS estimates that individual (including Schedule C) taxpayers are responsible for an underreporting of \$285 billion in income taxes; and employment taxes and corporate income taxes are underreported by \$54 billion and \$30 billion respectively.

These numbers reveal that a significant portion of the tax gap involves the small business and self-employed communities. Although we are not in a position to recommend a specific funding level, we do support increasing the budgetary resources provided to the Small Business/Self-Employed Division for enforcement purposes. By increasing the number of SB/SE examination and collections personnel, the AICPA believes the IRS can make a reasonable dent in the tax gap.

As a general principle, we believe the recruitment, development, and retention of a quality workforce is essential for the IRS, whether we are talking about SB/SE personnel or the workforce of another IRS division or function. Unfortunately, the IRS is experiencing a higher than normal attrition rate among its mid-level and rank-and-file employees, primarily through retirements. Replacing these retirees and the resulting loss of “institutional memory” is a major challenge for the IRS. The AICPA stands ready to support the IRS in achieving its goals for staffing over the coming years. In this context, we have found there are a number of CPAs in mid-level positions and recent accounting graduates who are interested in government and public service.

To further enhance the Service’s enforcement effectiveness, Congress must also allocate sufficient resources for employee training. The AICPA can be of immense help to the IRS in this area. First, we suggest that the Service seek prior input from key stakeholders on the details and development of training programs, including suggestions from the AICPA and other stakeholders regarding training materials for new initiatives. Second, we recommend that the Service utilize CPAs and other stakeholders in teaching IRS personnel. By including outside tax professionals in the training process, we believe IRS employees become more sensitized to the burdens that taxpayers face due to complicated tax laws and regulations. Private sector involvement in the training process helps IRS employees conduct new tax administration programs effectively, while minimizing intrusion and taxpayer burdens.

Private Debt Collection Efforts

The IRS has launched the private debt collection program authorized by the *American Jobs Creation Act of 2004*. We appreciate how private debt collection agencies could help the IRS address the tax gap through resolution of a portion of its collection inventory, and that the program has the potential of enabling the Service to focus the energies of its employees on the more difficult or complex collection cases. The Service has announced that private debt collection agencies will be held to the “same standards of service and protection of taxpayer rights” as required of IRS employees.

We believe that this program is a critical test program for the Service, especially in terms of enabling the IRS to leverage private sector involvement with a reallocation of vital resources towards critical needs. Nevertheless, because collections is a program which has historically been an area of chronic taxpayer complaints and alleged taxpayer rights abuses, we strongly urge Treasury and the IRS to: (1) closely monitor implementation of the private debt collection program and (2) establish positive and realistic performance measures for the private debt collection firms.

5. ENHANCE TAXPAYER SERVICE

The AICPA commends Treasury for making enhancement of taxpayer service a central strategy for closing the tax gap. We believe this strategy is critical to helping taxpayers be aware of their legal rights and obligations under the tax law, as well as avoid inadvertent errors. Our discussion of taxpayer service focuses on: (1) the Taxpayer Assistance Blueprint, (2) the pre-filing phase and taxpayer education, and (3) the National Taxpayer Advocate.

Taxpayer Assistance Blueprint

The AICPA supports the Taxpayer Assistance Blueprint (TAB) – a congressionally mandated initiative calling for development of a comprehensive taxpayer service program for the IRS. TAB involves a collaborative effort by the IRS, the IRS Oversight Board, and the National Taxpayer Advocate. Phase 1 of the Blueprint, delivered to Congress in April 2006, identified five strategic themes for improving customer service: (1) improve and expand education and awareness activities; (2) optimize the use and support of partner services; (3) enhance self-service options for taxpayers; (4) improve and expand training and support services; and (5) develop short-term performance and long-term outcome goals and metrics.

We understand that Phase 2 of the Blueprint will be delivered to Congress in the near future. As the IRS develops programs to implement the TAB recommendations, we continue to stress the need for the Service to maintain the appropriate balance between customer service and enforcement – a balance that the government, Congress, and stakeholders recognize and support on a conceptual basis.

In his February 16, 2007 testimony before Congress, Commissioner Everson referred to projects that the IRS envisions implementing as part of TAB, including enhancements to the Service's telephone service and www.irs.gov, as well as multi-year research studies designed to promote an understanding of optimal service delivery and the effect of service on compliance.¹³ The AICPA views these projects as laudable, and we stand ready to provide input for TAB throughout the implementation process.

Pre-Filing Phase and Taxpayer Education

As the IRS rolls out projects to implement TAB, the AICPA continues to stress the importance of continuing the Service's commitment to the pre-filing phase within all four operating divisions. We believe this is one of the most critical areas for ensuring an effective customer service philosophy.

Excellent examples of IRS efforts in the pre-filing phase include: (1) the Stakeholder, Partnership, Education and Communications Office (SPEC) in the Wage and Investment Division (W&I); and (2) the Communications, Government Liaison and Disclosure Office (CGL&D) in the Small Business/Self-Employed Division, and SB/SE's broad commitment to

¹³ IRS Commissioner Everson, Statement on the Internal Revenue Service's FY 2008 Budget, before the House Committee on the Budget, February 16, 2007, page 2.

improving communications through websites, conferences, and newsletters. Another critical component is taxpayer education about recordkeeping responsibilities and major areas of noncompliance.

Although SPEC and the predecessor organization to CGL&D were downsized in 2005, with the personnel reassigned to enforcement, the customer service provided during 2006 by these two organizations remained generally very positive. The AICPA and the stakeholder community will continue to monitor these changes and will share any further observations that may develop with the Treasury and IRS with respect to these very important customer service oriented offices within the Service.

National Taxpayer Advocate

We find the two yearly reports issued by the National Taxpayer Advocate to be excellent compendiums of systemic problems and evolving trends within the tax administration and tax policy implementation arenas.¹⁴ In addition to a significant discussion of the tax gap, the major areas of focus within these reports include taxpayer rights proposals, the alternative minimum tax, the Service's Private Debt Collection (PDC) initiative, small business outreach, and collection issues facing low income taxpayers and others.

In addition to systemic advocacy, the Taxpayer Advocate's office performs a vital function of providing taxpayers with an independent channel for resolving individual tax problems. The Advocate assists taxpayers by reviewing requests for assistance with respect to enforcement related cases involving "significant hardship;" and where appropriate, helps craft solutions to relieve such hardship.

6. REFORM AND SIMPLIFY THE TAX LAW

Simplifying the tax laws is a high priority of the AICPA. We fully concur with Treasury's identification of tax simplification as an important element for reducing the tax gap. Commissioner Everson shared similar views when he publicly stated that "the complexity of our current tax system is a significant reason for the tax gap and that fundamental reform and simplification of the tax law is necessary in order to achieve significant reductions."¹⁵

A significant source of complexity is the almost yearly changes in tax law through new legislation. These constant changes not only make it difficult for tax professionals to keep up technically, but the changes also cause tax software developers to struggle with the production of software updates for taxpayers and tax professionals during the filing season.

¹⁴ See "The National Taxpayer Advocate's Fiscal Year 2007 Objectives Report to Congress," June 30, 2006; and the "National Taxpayer Advocate, 2006 Annual Report to Congress," December 31, 2006.

¹⁵ IRS Commissioner Everson, Statement on the Internal Revenue Service's FY 2008 Budget, before the House Committee on the Budget, February 16, 2007, page 13.

We have worked closely with the American Bar Association and the Tax Executives Institute in recent years to jointly identify specific proposals for simplification. Moreover, our 2005 report, *Understanding Tax Reform: A Guide to 21st Century Alternatives*, discusses how many of the goals of tax reform can be achieved by modifying the current income tax system through significant simplification.

The AICPA's 2005 report states that many goals of tax reform can be achieved through "bottom-up reform," which the report refers to as significant simplification of the current income tax system. The report makes a number of simplification recommendations, including: (1) repealing the individual and corporate alternative minimum taxes; (2) consolidating education and retirement savings incentives; (3) simplifying the earned income tax credit; and (4) eliminating phase-outs and temporary provisions when drafting tax legislation.¹⁶

IRS statistics estimate the net tax gap to be about \$290 billion. We believe tax simplification can play a significant role in helping to reduce the overall tax gap, as simplification would: (1) result in fewer errors on tax returns; and (2) reduce taxpayer susceptibility to the marketing of abusive tax shelters.

7. COORDINATE WITH PARTNERS AND STAKEHOLDERS

The AICPA supports Treasury's call for the federal government to coordinate with partners and stakeholders to address the tax gap. We believe this coordination should involve a positive focus on: (1) professional responsibility; (2) a continuing commitment to continuing professional education; and (3) pro bono tax assistance.

Tax Practitioners and Professional Responsibility

We support a strong emphasis on personal integrity and professional responsibility for counteracting the tax gap. In this context, we applaud Commissioner Everson's commitment to high standards for tax professionals and his efforts to upgrade the Office of Professional Responsibility.

The AICPA has a long-standing track record of establishing high professional standards for our CPA members, including the AICPA Code of Professional Conduct and enforceable Statements on Standards for Tax Services (SSTSs). These standards provide meaningful guidance to CPA members in meeting their professional responsibilities.

The AICPA actively communicates with our membership and state CPA societies about the personal integrity of tax professionals, particularly through discussions about our SSTSs and Circular 230. For example, we have strongly promoted the 2005 Circular 230 (final) provisions governing "best practices" for tax advisors and tax shelter, i.e., "covered" opinion standards. We agree with the preamble to the final regulations that: "Tax advisors play a critical role in the

¹⁶ *Understanding Tax Reform: A Guide to 21st Century Alternatives*, American Institute of Certified Public Accountants, September 2005. See Chapter 4 of the report entitled, '*Bottom-Up*' Reform of the Current System.

Federal tax system, which is founded on principles of compliance and voluntary self-assessment. The tax system is best served when the public has confidence in the honesty and integrity of the professionals providing tax advice.”¹⁷

With respect to abusive transactions, the AICPA has a clear position – we unequivocally support their eradication. We have consistently supported protection of the public interest and prohibitions against misuse of the tax system, as exemplified by our enforceable SSTSs. We continue to be actively engaged in proposing and evaluating legislative and regulatory measures designed to identify and prevent taxpayers from undertaking, and tax advisers from rendering advice on, transactions having no purpose other than the reduction of federal income taxes in an abusive manner.

We also support initiatives focused on ethics training for Service employees. We believe that IRS examination and collections employees must be able to “step into the shoes” of tax professionals and vice versa. Government workers and professional tax practitioners must be able to understand each other to ensure greater strides in tax compliance.

The AICPA needs to point out that our ethical rules do place limits on our members with respect to their professional relationships with clients and what our members can disclose to taxing authorities. For example, under SSTS No. 7, if a CPA is representing a taxpayer in an administrative proceeding with respect to a return, and the professional then becomes aware of an error on the return, the CPA should recommend to the taxpayer the corrective measures to be taken to address the error. However, under our ethical rules, the CPA is *not allowed* to inform the taxing authority without the taxpayer’s permission, except where required by law. The SSTSs also state that: (1) it is the taxpayer’s responsibility to decide whether to correct the error and; (2) if the client does not correct the error, the CPA should consider resigning as the taxpayer’s representative.

Commitment to Continuing Professional Education (CPE)

Consistent with our strong support for high professional standards, we stress that practitioner continuing professional education programs are an important means for mitigating the tax gap. We firmly believe that this commitment helps ensure positive technical competency, values, and ethics among CPAs.

In general, the state boards of accountancy mandate CPE under the purview of protecting the public, particularly given the complexity of the field of accountancy in general, and the scope of the tax law in particular. Moreover, almost all state boards require CPAs to take a professional ethics course. Due to the dynamics of the tax profession, continuing education helps CPAs to maintain and learn the skills necessary to perform in the business world. In this context, the AICPA and the state CPA societies work closely to develop appropriate continuing professional education programs for CPAs that address the technical competencies and standards of professional conduct demanded by the marketplace.

¹⁷ Internal Revenue Service Bulletin, 2005-4, January 25, 2005, on T.D. 9165, Regulations Governing Practice Before the Internal Revenue Service, see section entitled “Explanation of Provisions.”

Similarly, the IRS has developed a series of yearly National Tax Forums designed to address the knowledge and ethics base of mainstream tax professionals. We support the IRS's National Tax Forum program, and, as we did last year, we look forward to participating in the Service's tax forums being planned for 2007. Clearly, a strong commitment to continuing professional education is one of the best ways of promoting strategies for reducing the tax gap.

Pro Bono Tax Assistance and the Tax Gap

The AICPA supports the Service's efforts to partner with professional organizations in the area of pro bono tax assistance. We believe this pro bono tax assistance is a critical element of any strategy to address the tax gap, enabling the IRS to both leverage scarce resources and increase customer service.

Our members are active in their local communities through pro bono activities. They serve at Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, community and academic-based low-income tax clinics, and other non-profit organizations.

We view pro bono activities by CPAs and other practitioners as an important way for the Service to promote customer service and in ensuring the proper and timely filing of tax returns and payment of taxes, critical components of closing the tax gap. This is particularly true in light of the joint efforts of the IRS, AICPA, and several state CPA societies in response to the devastation caused by Hurricane Katrina and other natural disasters during the Fall 2005 and throughout the 2006 filing season. We joined forces with the Service in programs designed to utilize CPA volunteers: (1) at disaster relief sites in various states and (2) in preparing tax returns for low and moderate income persons affected by the devastating hurricanes. In addition, the IRS has asked CPAs within our state societies to teach local tax practitioner courses and small business tax workshops that IRS staff may have otherwise taught in the past.