INTERNAL REVENUE SERVICE
ADVISORY COUNCIL
PUBLIC MEETING

NOVEMBER 17, 2005
1111 CONSTITUTION AVENUE NW
WASHINGTON, DC

INTERNAL REVENUE SERVICE ADVISORY COUNCIL (IRSAC)
PUBLIC MEETING AGENDA
1111 CONSTITUTION AVENUE – RM. 3313
THURSDAY, NOVEMBER 17, 2005

Time	Topic	IRSAC/IRS Representatives
8:30 - 9:00	Coffee & Refreshments	
9:00 - 9:15	Opening Remarks	Frank Keith Chief, Communications & Liaison Paul Mamo Director, National Public Liaison Gary Rohrs Chair, IRSAC
9:15 - 10:15	Report Overview	Mark W. Everson Commissioner of Internal Revenue Gary Rohrs
10:15 - 10:30	BREAK	
10:30 - 11:15	Wage & Investment Subgroup Report	Rich Morgante Commissioner, W& I Judy Akin Chair, W&I Subgroup
11:15 - 12:00	Large & Midsize Business Subgroup Report	Deborah Nolan Commissioner, LMSB Jon Contreras Chair, LMSB Subgroup
12:00 - 12:45	Small Business & Self Employed Subgroup Report	Kevin Brown Commissioner, SBSE Kenneth Nirenberg Chair, SBSE Subgroup
12:45 - 1:00	Closing Remarks	Gary Rohrs Paul Mamo
1:00	Adjourn	

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL
PUBLIC MEETING
BRIEFING BOOK
NOVEMBER 17, 2005

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ADVISORY COUNCIL

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NOVEMBER 17, 2005

GENERAL REPORT
OF THE
INTERNAL REVENUE SERVICE ADVISORY COUNCIL

The primary purpose of the Internal Revenue Service Council (IRSAC) is to provide an organized public forum for IRS officials and the representatives of the public to discuss relevant tax administration issues. The council advises the Service on issues that have substantive impact on the administration of federal tax law. Suggestions are made regarding improvements to operations as well as critiquing current and proposed programs, procedures and policies. The Council is a place where the IRS executives may bring their concerns to a select group of tax professionals from the private sector seeking input to the solution of critical issues of tax administration.

The current Council continues to reflect a group of well-suited individuals for this task. With twenty-two members spread across the spectrum of tax practitioners, tax attorneys, corporate tax counsels, providers of special services to taxpayers as well as tax professionals, small business owners and service providers, it is difficult, if not impossible, to find an area not covered by these members. When you review their individual accomplishments professionally you are assured of a conscientious and professional effort for the task at hand.

From this core group of individuals three subgroups are created which correspond to three of the IRS Operating Divisions. They are: the Small Business and Self-Employed Subgroup (SBSE); the Wage and Investment Subgroup (W&I); and, the Large and Mid-Size Business Subgroup (LMSB). The Council and these subgroups met in Washington, DC at the headquarters of the IRS. These meeting were held in January, May, July and September. During this time their respective issues were developed, researched and reported upon in the following pages. Each of these meetings consisted of two days. One day was devoted to the subgroup working session and one day

was devoted to a general session where all attended and heard reports from various executives on topics of interest to all. During the subgroup sessions various individuals from the respective operating division presented reports on the issues chosen. Often conference calls were required in researching the issue between subgroup meetings.

The members of the IRSAC wish to extend their thanks and appreciation to those representatives of the operating divisions who participated in this year's efforts. The subgroups were ably assisted in their efforts by support staff of the Office of National Public Liaison. These devoted staff members, whose knowledge of the operating divisions was most helpful, made the subgroup's effort much easier. They provided all of the resources required to complete the task.

On February 1, 2005 the IRSAC was invited to testify before the IRS Oversight Board. Three areas of concern were highlighted in that testimony. First, concern was expressed over the lack of effective oversight, control and regulation of the entire tax preparation community. Circular 230 effectively deals with Enrolled Agents, Attorneys, CPAs and Enrolled Actuaries. However, there is a large body of people providing preparation services who have none of the above credentials. These people fall outside the jurisdiction of Circular 230. The Department of Justice is left to be the enforcer of the law for these preparers. They are bound by no ethical standards or rules of professional conduct and, in some cases, have no education in the field of endeavor prior to entry.

The general public has the perception that the preparation of tax returns is a regulated and licensed profession. With this comes the expectation of educational accomplishment, ethical standards, and rules of professional conduct, oversight and control. Since well over 50% of returns are prepared by paid preparers it is past the time for this myth to become reality. The IRSAC

endorses the registration of those not covered by Circular 230 and at the same time accept that debate exists as to the exact method of implementation. Incorrect or underreporting of income, as revealed by the tax gap, would be improved by this change.

Second, the Offer in Compromise program is another area of concern. There have been improvements to the alleviation of the backlog in processing. It is not certain whether this is real or artificial. The centralization of effort has certainly helped in this process. The assessment of an application fee to help stem the filing of frivolous Offers has achieved results. But it does not necessarily prove that the downturn is in what would have been frivolous applications. The program is for those who are unable to pay, not for those who simply do not want to pay. Those administering the program come from a collection background and perhaps would be well served if more training were provided in the art of compromise as the title of the program indicates.

Third, IRSAC is concerned that with modernization and centralization, the Service needs to be careful to not go so far that the taxpayers who interact with the Service become befuddled by it. The need for access to a real, live person is still a very important issue.

Fourth, IRSAC continues to be concerned about the loss of seasoned Service professionals due to retirement, reassignment and transfers out of the Service, coupled with budget restraints imposed. This combination of events poses a real concern for the operational efficiency of the enforcement area of the Service as well as the ability to compensate other existing personnel. In order to carry out the enforcement initiative an additional 4,100 enforcement personnel have been projected. Commissioner Everson has discussed this in detail in a letter to Senator Baucus. In order to appropriately carry out the above and other strategic initiatives full funding is required.

The IRSAC was asked to review the modeling criteria developed by the Service to be applied in recommending closure of Taxpayer Assistance Centers. This was accomplished on short notice. Budgetary concerns prompted this study and ultimate recommendation in order to realize cost savings by eliminating underutilized centers.

Each Subgroup is requested to concentrate on specific issues relevant to the operating divisions represented and requested by them. The subgroups have direct interaction with top-level executives in receiving reports, exploring issues and developing insight to the issues of concern so that advice and commentary may be offered. It is in this way that the IRSAC is most helpful to the Service in providing the public perception.

The IRSAC, as a council of the whole, met on the second day of the meetings, as reflected above. During this time reports were presented that transcended the interest of specific subgroups. We were fortunate to hear from a wide range of individuals. Some of these were:

- Nina Olson, Taxpayer Advocate
- Michael Chesman, Director, Office of Taxpayer Burden Reduction
- Lisa McLane, Project Manager, Office of Taxpayer Burden Reduction
- Rebecca Mack Johnson, Project Director, Filing & Payment Compliance
- Russell Geiman, Acting Director NRP
- Mark Mazur, Director, Research Analysis & Statistics
- Brinton Warren, Special Counsel Procedures & Administration
- Robert Brown, Program Manager, National research Program
- Beth Tucker, Director, Communications and Liaison Disclosure

Our thanks to these and others who took the time to prepare and present their special concerns. The candor that they exhibited and their willingness to disclose, in detail, these important issues was well received.

Conclusion

The IRSAC has completed the task it set before itself at the beginning of the year. Each of us appreciates the opportunity afforded us in serving the Service and the general public. Commissioner Everson, the Operating Division Commissioners and the other IRS personnel who facilitated the efforts of the IRSAC are greatly appreciated. We look forward to seeing the impact of this council's efforts and will continue to track the implementation of its recommendations and those of predecessor councils. The real work of this council lies with the subgroups.

WAGE & INVESTMENT
SUBGROUP REPORT

JUDITH AKIN – SUBGROUP CHAIR
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NOVEMBER 17, 2005

WAGE AND INVESTMENT
SUBGROUP REPORT

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I. INTRODUCTION

The members of the Wage and Investment Subgroup (W&I Subgroup) of the Internal Revenue Service Advisory Council appreciate the opportunity to interact with the Internal Revenue Service to improve communication and compliance with the taxpaying public. In addition, the members applaud the Service for the time and cooperation of the W&I Division representatives and management with whom we have met to discuss and resolve issues. We look forward to our continued involvement with the W&I Division of the Service in order to create a winning situation for the Internal Revenue Service, practitioner community and the taxpayers.

Our report addresses issues identified by the Commissioner of Wage and Investment, as well as those identified by the W&I Subgroup.

II. ISSUES AND RECOMMENDATIONS

1. REDESIGNED NOTICES AND POSTAGE REDUCTION

The Internal Revenue Service (IRS) has embarked on an important initiative to make notices clearer and taxpayer-friendly. We support IRS's endeavor for it is long overdue. In reviewing several redesigned notices, we have three suggestions:

1. We recommend essential information specific to the taxpayer's refund or balance due that could result from the proposed changes of the notice be stated on the front page. Often pertinent information is buried in the back of the notice.
2. We recommend that notices include reference to the availability of taxpayer assistance. For example,

   In responding to this notice, you can seek assistance from:

   a. a qualified tax professional,
   b. an IRS Taxpayer Assistance Center, or,
   c. a low income tax clinic, if you qualify.

   Obtain information about where to find IRS centers or tax clinics at www.irs.gov or 1-800-829-1040.

3. We recommend IRS replace the wording "Your return is done incorrectly, or, You have errors on your return" with a comment such as, "There are inconsistencies in your tax return" or "In your tax return are the following differences. We need your help to resolve these differences."

With respect to the postage reduction initiative, we recommend that the IRS:

a. Discontinue the Form 940 mail-out.
b. Reduce the number of pages in notices by replacing the frequently asked questions and instead replace with a reference to the IRS website www.irs.gov, or to 1-800-829-4477, topic 652.

We applaud IRS for redesigning these notices and cutting postage waste by discontinuing many unused taxpayer and practitioner forms, booklets, etc. We encourage IRS to continue redesigning notices.

2. NEXT GENERATION E-SERVICES

E-Services were developed to enable the tax professionals and payers to communicate electronically with the IRS. These services were intended to make it easier for tax professionals to communicate with the IRS and obtain information to help their clients.

The history of e-Service product availability is as follows:

October 2003:

E-Services Registration,

Preparer Tax Identification Number (PTIN) applications,

E-file applications (form download only)

Interactive Taxpayer Identification Number (TIN) matching.

Year 2004:

E-file applications include electronic submission for practitioners

The ability to match bulk submissions of TINs.

Incentive launched for those who e-filed 100 or more individual returns

Disclosure Authorization (DA) forms,

Electronic Account Resolution (EAR), and

The Transcript Delivery System (TDS).

Year 2005:

Reduced the incentive threshold to five or more accepted tax returns in a calendar year.

Updated E-Services Next Generation top ten priorities, elevating the priority of expanding e-Services to Reporting Agents and EITC e-Services. These proposed services, however, are not expected to be funded prior to FY 07. In the interim, the W&I Division is establishing a team to define the business requirements and build a business case for funding justification.

Recommendations

1. We recommend that funding be provided for inclusion of Reporting Agents e-services in the FY 06 budget.
2. E-Services should be available to all Circular 230 professionals without regard to the number of electronically filed returns. This would allow those practitioners who do representation only the ability to obtain information and resolve cases more expeditiously.

3. AUTOMATED UNDER REPORTING (AUR) SYSTEM

The Automated Under Reporting (AUR) System Scripts used in answering the AUR telephone call in system should be user friendly and give the taxpayer sufficient information to assist in resolving problems as quickly as possible.

The Internal Revenue Service Advisory Council W&I Subgroup thanks the IRS personnel that engaged in writing the telephone scripts for the Automated Under Reporting (AUR) System. We recognize that a lot of effort went into the original writing and even more effort into the evaluation and subsequent changes. During its review, the Subgroup found the flow of the scripts to be logical. However, we noted during the review that no mention is made of representation by a third party.

Recommendations:

1. The taxpayer should be immediately informed that they are entitled to representation by a qualified tax professional. Some of the taxpayers who are dealing with the AUR are uneducated as to tax laws and the right to have representation. This will assist the taxpayer and the Service by getting issues resolved sooner and lowering the inventory of unresolved cases.
2. In order to make the system more user-friendly, we recommend early in the script a statement of the estimated wait time for an assistor. We realize this recommendation may take some time to implement since an investment in additional equipment and software will be needed.
3. The caller should be allowed to drop out of the script and leave a message for a call back. The scripts should list all of the information that the taxpayer must provide, including best time to be contacted.

4. IDENTITY THEFT

According to a recent report to Treasury Inspector General for Tax Administration (TIGTA), the IRS currently has no corporate strategy to combat identity theft. The cost for the victims of identity theft is estimated at approximately $5 billion and almost 300 million hours a year trying to restore their good names.

Other government agencies have implemented ways to help victims of identity theft. The Federal Trade Commission (FTC) has developed a Complaint Input Form and acts as a clearinghouse for complaints of victims. The Social Security Administration (SSA) provides an ID Thief Affidavit on their website to be completed and sent to each creditor. The SSA can issue a new number in extreme circumstances with some restrictions.

In addition, federal and state criminal statutes may apply to data collection, use, disclosure, and notification to consumers.

Recommendations:

1. Develop policies and procedures that assure IRS compliance with existing regulatory and legal frameworks
2. Disseminate this information to the practitioner community through annual tax forums, Tax Talk Today, and tax season advertising
3. Assign a new reject code to show that an attempt at filing has already been made. This would alert the preparer to take extra steps in due diligence.
4. Because of the accelerated growth of identity theft and the scope of the issue, IRS should accelerate its modernization plan to put into place additional safeguards to protect taxpayers.

5. STRENGTHENING EITC COMPLIANCE AND OUTREACH

For the last 30 years, the Earned Income Tax Credit has been a valuable tool in reducing poverty in America, earning bi-partisan support. Today, it delivers $38 billion to 22 million workers and their families who have low earnings every year.

Improving compliance and participation would make the EITC even more effective. Compliance is a challenge because the EITC is among the most complex parts of the tax code, and taxpayers as well as tax practitioners have difficulty interpreting and meeting its requirements. Participation is relatively strong, yet studies show that approximately 15-25% of eligible individuals do not claim the credit and some taxpayers, whose claims are denied, are, in fact, eligible.

Recommendations:

1. **Balanced Enforcement:** Compared to other areas of tax noncompliance**,** EITC has been singled out for disproportionate emphasis as compared to other areas of tax noncompliance (48% of the million returns audited in FY04 involved an EITC, suggesting a disproportionate emphasis). We urge the IRS to maintain balanced enforcement. Taxpayers pre-filing and filing assistance programs can play a larger and more cost-effective role in improving compliance, as can cooperation with qualified tax practitioners.

2. **Improved IRS Procedures:** The IRS can contribute to EITC simplification with clearer forms schedules, instructions, and notices. EITC examination and recertification procedures should be improved, including greater efforts to make contact with taxpayers to ensure that qualified claimants are not denied the credit.
3. **Certification Burden Reduction:** The pilot Certification Program imposes a substantial hardship on taxpayers. Extra effort is needed to minimize the burden by clarifying notices and letters so that both taxpayers and tax practitioners can better understand and comply.
4. **Improved Preparer Training:** The IRS should partner with tax professional groups to develop an interactive training module aimed at improving EITC compliance that could be used by professional and volunteer preparers. It should strengthen its program of oversight visits to EITC preparers and strengthen training for volunteer preparers.
5. **Revitalized IRS Outreach:** The IRS should strengthen its outreach program by working with community groups, employers, and tax practitioners to ensure that all qualified taxpayers receive the EITC. In addition, IRS should:
    a. Expand the use of the excellent EITC outreach television advertising.
    b. Target outreach efforts to hard-to-reach groups, including non-English-speaking taxpayers for whom foreign language media may be most effective. Additional research to better target those eligible but not receiving the EITC is needed.
    c. Provide educational materials to describe program changes.

6. IMPROVING VITA QUALITY

Volunteer income tax assistance programs contribute significantly to the IRS mission and to serving the needs of low-income taxpayers. As with any seasonal program staffed by volunteers using temporary locations and with limited resources, issues of organization, training, participation, and quality can arise.

Several initiatives, some underway, could strengthen the VITA program:

1. **Role of IRS and Partners:** Volunteer program leaders and participants have expressed concern with IRS program administration and its emphases. The IRS and volunteer leaders agree that an improved program requires:
    a. Better training and software,
    b. Funds for more computers, printers and copiers, and
    c. Tools for volunteer management and leadership training and development.

    We urge the IRS to provide sufficient resources including performance-based grants to ensure the program can meet needs and produce high quality results.

2. **Training Improvements:** Many VITA volunteers have only limited training and work at sites that may be open only a few hours weekly, often with inadequate tools. We recommend that training be strengthened through:
        i. Development of a uniform curriculum that can be delivered in an interactive online version. The curriculum should include complex case examples and state tax law.
        ii. More cooperation with foundations, community groups, schools, and tax professionals in developing training resources.
        iii. A tax training campus for an intensive train-the-trainer program.
        iv. Scholarships to enable volunteer leaders to attend tax-training courses.
        v. Work with community colleges to integrate tax training into their programs. The goal is to expand the pool of qualified volunteers.
        vi. Software improvements including interview-based screening tools.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

LARGE & MIDSIZE BUSINESS
SUBGROUP REPORT

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NOVEMBER 17, 2005

Internal Revenue Service
Large & Mid-Size Business
Subgroup Report

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I. INTRODUCTION

The Large & Mid-Size Business Subgroup (hereinafter the "LMSB Subgroup") consists of professionals who represent large and mid-sized businesses, accounting and legal professionals, and large multinational firms. The members of the LMSB Subgroup come to the task force without personal agendas. Rather, the overriding LMSB Subgroup role is to provide assistance to the Internal Revenue Service ("IRS" or "the Service") and more specifically the Large and Mid-Size Business Operating Division (LMSB). The guiding principles of the LMSB subgroup are to assist IRS and LMSB to ensure efficient and fair tax administration and the development of equitable tax policy.

The LMSB Subgroup has been busy since January 2005 with five separate multi-day meetings conducted in Washington D.C. Each meeting was a collaborative session with LMSB personnel, Counsel, and Appeals that resulted in genuine and frank discussions of relevant issues between LMSB and the LMSB taxpayers.

The LMSB Subgroup is most grateful for the time devoted by the executives and personnel of LMSB and the staff of the National Public Liaison. Without their time and assistance, the year would have been less meaningful.

We have structured this Report around the four issues of primary importance to the LMSB Subgroup and LMSB that were identified throughout the year. Although not exhaustive, the list of issues helped us to focus on areas where we could be the most effective in providing assistance to LMSB. The report identifies the issues and recommendations that were developed by the LMSB Subgroup during this year.

II. ISSUES AND RECOMMENDATIONS

A. Modernized e-File

Discussion

Beginning in 2006, IRS will require Corporations with assets of $50 million or more or that file at least 250 returns per year to file their Form 1120 and/or 1120S electronically for tax years ending on or after December 31, 2005. In 2007 this requirement will be extended to apply to Corporations who have assets of $10 million or more for tax years ending on after December 31, 2006.

Unlike current IRS antiquated technology, Modernized e-File will use XML technology and IRS will process corporate tax returns as received versus in batches. Taxpayers, who utilize Modernized e-File, will receive a prompt electronic acknowledgement receipt once their information is received by the IRS.

IRS believes Modernized e-File will increase organizational capacity to enable full engagements and maximum productivity of LMSB employees. In addition, the IRS will modernize information systems to improve service and enforcement, modernize business processes and align the infrastructure to maximize resources devoted to frontline operations. The LMSB Subgroup recognizes the importance of the Initiative and believes it is moving in the right direction.

1. Software limitations, system capacity and 3rd party vendors

LMSB has been in discussion with software vendors who will play an integral role in assisting LMSB taxpayers to comply with the IRS mandated E-Filing requirements. LMSB in a

presentation to the LMSB Subgroup communicated that the IRS Product Assurance group has performed tests on approximately 14,000 test cases.

The LMSB taxpayers currently use multiple nonintegrated software packages, spreadsheets, and/or other internally developed programs to produce Forms 1120 and 1120S tax returns. Several LMSB taxpayers have expressed concerns regarding issues such as firewall restrictions, technology capabilities, integration of software, and information security. The LMSB Subgroup believes that mandating Modernized e-Filing in 2006 will create an additional burden to LMSB taxpayers who are already overly extended implementing legislative requirements under Sarbanes-Oxley, and Schedule M-3 requirements into their tax processes as well as state electronic filing requirements.

2. Communication

The IRS issued proposed and temporary regulations on January 11, 2005. Since that time LMSB has actively solicited feedback from industry groups that represent the interests of LMSB taxpayers. IRS has created a link to Corporate e-File FAQ on their website. In addition, the IRS plans to host a Tax Talk Today session on the subject of Corporate E-Filing on November 8, 2005.

The LMSB Subgroup commends IRS for its diligent effort to inform taxpayers about the 2006 Modernized e-Filing requirements. Although much information has been published, we believe that LMSB taxpayers currently do not have enough information to adequately plan for the resources (people, money, technology, and time) needed to meet the 2006 e-Filing requirement. LMSB Subgroup is also unaware of any 3rd party software vendor who has

formally communicated to LMSB taxpayers about the additional costs or resource requirements

LMSB has communicated that further guidance will be issued by late October or November. The LMSB Subgroup is concerned that this does not provide taxpayers or tax software developer's adequate time to fully develop, implement and test Modernized e-Filing software or internal system capabilities.

3. Waivers and PDF Forms

IRS has acknowledged that some taxpayers will not be able to meet Modernized e-Filing requirements in the first year. Taxpayers can apply for a waiver of the e-Filing requirements in the 1st year according to procedures to be issued. During the 1st year of the mandate, LMSB taxpayers, who file electronically, will have the option to submit certain tax forms that do not affect financial calculations in PDF format. The LMSB communicated in a presentation to the Subgroup that under the PDF rules, no single file can be larger than 500 pages and total pages cannot exceed 5,000 pages.

We believe this option will be well received by taxpayers and reflects the IRS's conscientious effort to address taxpayer's concerns.

Recommendations:

In order to ensure the effectiveness in complying with this Initiative, the LMSB Subgroup has the following recommendations:

1. Defer the "mandatory" requirement of Modernized e-Filing Corporate Forms 1120 and 1120S for one year.

2. Reduce the corporate e Filing mandate in the 1st applicable year to pages 1 through 4 of the Forms 1120/1120s and Schedule M-3.
3. Widely communicate the IRS test site by the 1st quarter in 2006. Note that such site can be used by taxpayers to test transmission of data for those LMSB taxpayers who will not use 3rd party providers.
4. Publish future communication related to Modernized e-Filing in publications commonly used by taxpayers. (BNA, Tax Notes, CCH, IRS Website, etc.)
5. Test Modernized e-Filing in the 1st year with a few taxpayers who voluntarily chose to participate in Modernized e-File in 2006.
6. Provide an infrastructure plan showing how the data transmitted will be handled and housed within the Service. For example, what do you plan to do with the information, how will it be used within the scope of an examination, and who is given responsibility for managing the data?

B. LMSB/Appeals Initiatives

Appeals, LMSB, and General IRS Objectives

Discussion

The operational objectives of the IRS and its Appeals and LMSB divisions are consistent and call for the resolution and/or settlement of tax matters on a fair and impartial basis at the lowest level possible with the ultimate goal of determining a taxpayer's correct

tax liability. These goals are embodied in the mission statements of the IRS and the Appeals and LMSB functions.

The mission of Appeals is:

> To resolve controversies, without litigation, on a basis which is fair and impartial to both the Government and the Taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

The LMSB Vision Statement includes "applying innovative approaches to customer service and compliance" and applying "the tax laws with integrity and fairness."

The mission of the IRS is to:

> Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Emphasis on Timely Case Closings

While perhaps sometimes overlooked, a fundamental component of achieving these objectives includes doing so in an efficient and timely manner that is consistent for similarly situated taxpayers. Reducing overall cycle time maximizes utilization of the parties' resources, reduces "hot interest" costs where applicable, and achieves certainty for financial reporting purposes. The LMSB Subgroup believes the Service's emphasis on timely case closings is a commendable objective if quality of case handling is not impugned in the process.

Appeals and the LMSB Examination function are currently working together on a process initiative ("the Initiative") to reduce the post-filing 30-day letter/appellate process

time. The Initiative focuses on what is best for the IRS and the Taxpayers rather than what is best for Appeals or LMSB. In order to reduce cycle time, the Service is considering viewing the entire time a case spends in compliance and Appeals as a whole rather than designing processes that are "inwardly focused." The Service's consideration of the total time a case spends in both Exam and Appeals as an organic whole may eliminate any incentive either division would otherwise have to reduce time the case spends in its own function without an eye towards the larger picture of utilization of IRS resources. Based upon briefing sessions provided to IRSAC, we understand that LMSB cases currently spend about five years in the Examination division ("Exam") and about two years in the Appeals division. The goal of the Initiative is to decrease the total time from 86 months to less than 48 months for cases worked by both LMSB Exam and Appeals. The focus of the Initiative is eliminating areas of duplication (*e.g.*, both Appeals and LMSB doing tax computations) and smoothing out the process of transferring information between Exam and Appeals.

Focus on Reducing/Eliminating Premature Appeals

One of the areas targeted by the Initiative is the elimination of cases, that are not ready for conference, being forwarded from Exam to Appeals. This is not a new area of focus, but rather an ongoing, significant issue. Reduction of premature Appeals should make the process more cost and resource effective. Our understanding is that twenty percent of the cases sent to Appeals are initially rejected for consideration since they are not

adequately developed, *i.e.* the facts are not appropriately developed, the legal framework not adequately researched, etc. Many of these cases return to Appeals after further development by Exam. This situation is likely a product of Exam not being fully knowledgeable about the scorecard Appeals uses to determine whether a case is sufficiently developed for its consideration.

One way to decrease the number of premature Appeals is to provide the Exam team that worked an issue ultimately settled at Appeals with a copy of the Appeals Closing Memorandum (ACM) via a formal post-Appeal conference with the Taxpayer. This information may be helpful to Revenue Agents in planning examinations and understanding the manner in which issues are evaluated and considered at Appeals, including how the facts are applied to the relevant legal precedent and how uncertainties regarding the law and proof of fact are addressed. While closing conferences have long been a part of the procedural tapestry on paper, in practice they are often not conducted at all or address only skeletal content.[1] Exposure of the process to the maximum degree of sunlight will provide all parties to the process with greater clarity regarding the roles played and nature of issue evaluation. This clarity, which inures to the benefit of all, will aid in the efficient handling of future matters and remove any perceived mystery in the process.[2]

[1] Of course, such sharing of information does not vest, nor should it entice, Exam to engage in future discussions of issue settlement regarding other matters whereby hazards of litigation are taken into account.
[2] The same copy of the ACM would have to be furnished to the taxpayer to avoid *ex parte* issues.

Streamlined ACMs

Another suggestion to reduce use of Appeals' resources and expedite case handling is to eliminate the drafting of extensive draft ACM's prior to conferencing of the case and/or after settlement of a matter. To the extent a reasoned summary of the facts and settlement can be memorialized in a form that is useful for the government, we believe this may alleviate burden on the Service and move cases more rapidly, thereby serving the interests of taxpayers as well.

Minimization of Continued Dialogue with Exam Once An Issue is Ripe for Consideration by Appeals

Another means of reducing overall cycle time proposed in the Initiative is to increase the involvement of the examination function during the Appeals process. The LMSB Subgroup believes Exam input is appropriate if the taxpayer raises new issues or new facts in the protest. Excess involvement, however, has the potential to frustrate the function of Appeals and may engender unnecessary independence concerns regarding the role of Appeals. Such a practice is also likely to increase taxpayer requests that Appeals objectively demonstrate satisfaction of the *ex parte* rules. Appeals is an institution of the highest integrity. Taxpayers and tax practitioners recognize and respect its objective evaluation of issues. Inserting Exam into the Appeals process beyond traditional involvement jeopardizes one of the cornerstones that has made the Appellate process reliable and successful. Appeals has gained this respect because of its actual and perceived, independence. Therefore, any change that would cause concern regarding independence should be

approached with the utmost care and sensitivity. It is difficult to separate perception from reality; and, once the wave of perception is in motion, it is difficult to reverse.

The LMSB Subgroup also notes that such a practice may have the impact of unduly prolonging the process via the creation of new case theories and arguments from Exam while the case is at Appeals, which may carry a potential toll-charge of additional "hot interest" to the taxpayer.

The contemplated process of involving Exam in the traditional Appellate hearing to address substantive matters is appropriate for Fast Track Mediation or Settlement, in which the taxpayer and Exam function are both parties to the process and apply for participation in it. One of the reasons the Appeals process is so successful is that it provides the Service and taxpayers a means of reviewing issues through new lines of communication. Sometimes the mere fact that different individuals are driving the process leads to a better understanding of relative merits of positions and/or increased or meaningful dialogue. Inserting another participant, e.g. Exam, into the traditional Appellate process may likely frustrate the process.

Finally, the LMSB Subgroup understands that an additional means of reducing cycle time is to materially limit the granting of extensions of time for protest. We propose that taxpayers and Exam be held to the same 30 day window for protest rebuttal and forwarding to Appeals so long as no new issues or facts were presented in the protest. The LMSB subgroup is aware of no rational basis for differentiation. The normal restrictions on raising new issues would continue to apply to protest rebuttals. This appears to be a practical and

simple means of reducing overall cycle time and is consistent with the principles of fairness embodied in typical administrative and litigation proceedings.

Moving Closer to a "One Meeting One Issue" Rule in Practice

A fourth area targeted by the Service in the Initiative is to move towards using a "one meeting one issue concept" whereby one conference is held to settle each individual issue (with the potential to settle more than one issue per conference). Then, a joint closing conference would be held covering all issues. This has long been a stated goal. However, this may be inconsistent with sound tax administration since issues might settle at different times and some might require more time than one conference -- especially if an issue were a coordinated issue or factually and/or legally complex. Placing focus on the substantive issues, with a "one conference one issue" goal, and moving the computational aspect to a specialized function in which the computations are performed once by the most experienced personnel is a laudable means of reducing time in Appeals and overall cycle time. The LMSB Subgroup understands that there are issues for which the nature of the matter itself is computational or the settlement framework is so complex that the settlement cannot be properly memorialized in an ACM until a final computation is performed. With the exception of those cases, however, the streamlined ACM approach is practical.

The LMSB Subgroup notes that there is a growing concern amongst tax practitioners and taxpayers that Appeals is being excluded from much of the Appeals process because of the increased focus on the settlement initiatives and coordination of issues. Where issues are

coordinated formally or informally, or where particular settlement or resolution initiatives exist, it is critical that Service decision makers be identified and actively participate in the Appellate process. In addition, matters should not be accepted into the Appellate process when it is known that the Service is not in a position to settle the matter. Where the Service has formulated strict guidelines regarding range of settlement, both the existence of the guidelines as well as their terms should be clearly communicated to the taxpaying public. This method, when previously used, has worked successfully from a process and resource management perspective. These techniques reduce error in communication, provide a necessary openness to the settlement process and ensure that expectations are well articulated and managed on both sides. This effort also should have the effect of reducing cycle time since, where applicable, it places the decision makers at the table together and identifies when a decision is not possible through traditional Appeal.

Recommendations

1. LMSB and Appeals should continue to pursue significant improvements in cycle time.
2. The Initiative should be developed in such a way as to protect the independence and objectivity of Appeals as well as the perception of such.
3. The Initiative should require that Appeals timely provide Revenue Agents and Taxpayers with a copy of any Appeals Closing Memoranda to help in planning future examinations.

4. Appeals should revise its form for the Appeals Closing Memorandum in a manner useful to Exam in order to help reduce cycle time.
5. The Initiative should not increase involvement of Exam in the Appellate process.
6. Appeals should mandate a 30-day window for Exam to provide any rebuttals to taxpayer protests when the taxpayer has not raised new facts or new issues.
7. The Initiative should use test groups to develop methods of standardized tax computations.
8. The Service should continue to seek assistance from stakeholder groups in designing the post-filing process.

C. TAX SHELTER STRATEGY

TAX SHELTER SETTLEMENTS AND PENALTIES

Discussion

The LMSB Subgroup strongly supports and commends the IRS in its "crackdown" on abusive tax shelters and tax shelter promoters. Abusive tax shelters are destructive to the underlying fabric of the tax system and strong administrative action is appropriate in response to abusive tax shelter activity.

The IRS began last year to take a much harder line with taxpayers who engaged in abusive tax shelter activity, and it has maintained that approach. This approach is evidenced best by the settlement offers that were made in connection with various listed transactions. In order for a taxpayer to settle the case without trial, the IRS required the imposition of

penalties except in the case of taxpayers who had voluntarily disclosed their abusive tax shelter activities during the limited period provided in Notice 2002-2.

We strongly support the initiative taken by the Service and generally support the approach utilized. Taxpayers who engaged in abusive tax shelters should not benefit from the audit lottery and/or abusive interpretations. Claimed losses from abusive tax shelters must be disallowed. On the other hand, the Service must recognize that taxpayers can engage in planning to reduce their tax liability from legitimate transactions. Care must be exercised by the Service in drawing and recognizing this distinction.

In addition, consistent application of penalties is an important aspect of tax administration. Taxpayers who engage in abusive tax shelter activities need to know that they will have to pay significant penalties (and not just tax plus interest which in turn is tax deductible) if they are caught. The threat of penalties provides a significant deterrent to taxpayers.

In this respect, the Service should recognize the value of "divide and conquer" and the value of differentiating between abusive and non-abusive taxpayers. The Service's limited resources are more efficiently used by developing allies. The Service should recognize that non-abusive taxpayers, who represent the backbone of our voluntary compliance tax system, also suffer both professionally and personally from the actions of abusive taxpayers. The Service should actively attempt to ally themselves with non-abusive taxpayers (possibly from settlements with less aggressive tax shelter users). By allying itself

wherever possible, the Service's resources can be utilized to identify and combat abusive tax shelter developers and users, without diluting available resources on non-abusive taxpayers.

In this sense, the Service should:

1. Actively encourage the support of non-abusive taxpayers in the abusive tax shelter examination and settlement program.

2. Actively review and clearly define abusive tax shelter activities. The Service needs to appreciate the ineffectiveness of creating so wide a net as to overload enforcement activities. The Service should exercise utmost care before any transaction is "listed."

3. Expend greater resources providing training and education in this area so that legitimate tax planning that is either not understood or for which the result is not clear is not falsely classified as an abusive tax shelter.

4. Avoid using so-called shelter initiatives or listing of transactions to gain undue leverage in attempting to force resolution of an issue or in an attempt to impose and sustain penalties.

5. Aggressively pursue methods of identifying existing and new abusive tax shelters.

The most important aspect of tax shelters is to prevent them before they happen, which occurs only if the IRS targets the promoters as well as the taxpayers involved. The only way to inhibit future tax shelter activity is to find and penalize the persons who sell

them. That appears to be the approach that the IRS is taking, and we commend it. The imposition of penalties against promoters may be just as, if not more, important in preventing a re-occurrence of the tax shelters that emerged over the last decade as any other single step that the IRS has taken. While users must be penalized, the Service must remember that a problem is best cured at its source. We also believe that the focus on mid-market compliance, as discussed below, is an integral aspect of this issue, because "touching" more taxpayers makes it more likely that abusive tax shelters will be identified before they spread. Letter inquiries are low cost alternatives and serve the same purpose. Touches inform taxpayers that they are not hidden within the tax system and forgotten about by the IRS.

We remain concerned, however, that the "hard line" that has been taken with respect to taxpayer penalties may also result in a strain on the IRS's resources and benefit tax promoters and tax abusers, if the IRS is unable to settle a large percentage of individual and corporate tax shelter cases. Some individuals and corporations may have legitimate arguments that they are not subject to penalties because they relied upon recognized tax professionals. Whether or not these arguments will be persuasive in court is not certain, creating the potential for the IRS to eventually be subject to some unfavorable decisions. The Service needs to be sensitive to the adverse effect of the headlines associated with unfavorable decisions, which affect future settlements and the public's confidence in the tax system. The Service should not pursue risky cases where failure may undermine the Service's enforcement program as a whole. Settlement initiatives are generally the most

efficient and fair way to resolve the remaining disputes, and some forgiveness or reduction of penalties may be required. The Service should be aware of the advantage to the most egregious abusers of clogging the system with numerous, less abusive cases.

Recommendations

1. The Service should continue to pursue abusive tax shelters as a top priority, with particular emphasis on promoters, including the imposition of penalties.

2. The Service should prepare guidelines under which Appeals can resolve each type of abusive tax shelter, taking into account the IRS's view of the law and each taxpayer's particular circumstances.

3. The Service should continue to be diligent with regard to the tension between taxpayer rights and its right to penalize improper taxpayer behavior.

4. The Service should focus more attention and resources on individual or mid-market taxpayers. Agents should be on the lookout for abusive tax shelter activity in this segment.

5. The Service should recommend that the interest associated with abusive tax shelter assessments be non-deductible or only partially deductible.

6. The Service should encourage the support of non-abusive taxpayers in its fight against abusive tax shelters.

7. The Service should encourage settlements among less abusive tax shelter users if they agree to specific actions such as:

    a) Forbearance of future abusive activities,

    b) Disclosure of all past tax shelter activities, and

    c) Disclosure of other tax shelter products of which they are aware.

8. The Service should recognize the strategic advantage accorded abusive tax shelter users and promoters when the enforcement and judicial systems are overloaded and justice is delayed for a long period of time, often until the perpetrators are retired and have had time to hide their assets.

9. The Service should recognize the vital importance of preventing future abuses. This will reduce the requirement for resource utilization to identify and attack abuses after they occur and will encourage confidence in the tax system among non-abusers. The settlement process should be used to help accomplish this goal.

10. The Service should continue to increase its active participation with state and local tax administrators in information sharing and resource coordination. This is particularly true with states that have or will implement local tax amnesty programs.

11. While we encourage sharing of information, the Service must recognize that many of the state disclosures were protective to avoid penalties on items that were clearly not tax

shelters. The Service should also ensure it properly educates its employees and provides internal resources that understand the nuances of the state disclosure regimes and that some of the voluntary disclosure procedures were clearly geared to raising needed revenue rather than identifying abusive transactions.

12. The Service should encourage active coordination regarding abusive transactions among LMSB, SB/SE, and W&I. The Service should analyze if there is a correlation in abusive tax shelter use between individuals and the businesses that they control or manage. It is likely that individuals who employ abusive tax shelters in their businesses also employ abusive tax shelters on their individual returns and vice-versa.

TAX SHELTER DISCLOSURES

Discussion

The Jobs Creation Act of 2004 increased the information available to the Service concerning potential tax shelters as a result of the disclosure requirements under Sections 6011 and 6111 of the Code. Under these provisions, taxpayers and their material advisors are required to make certain disclosures concerning all listed and other reportable transactions. We understand that the Service has received a significant number of disclosures under both provisions, and that the Service is establishing procedures to review and respond to these disclosures.

We believe that the Service should give special emphasis to disclosures concerning listed transactions. It is essential that taxpayers, and their advisors, understand that any filings made

with respect to listed transactions will be immediately addressed. Based on anecdotal evidence, we are concerned that the Service may not have the resources necessary to promptly contact taxpayers, or material advisors, who makes a disclosure with respect to a listed transaction. The efficacy of the new disclosure regime as a limitation on undesirable taxpayer behavior may depend upon taxpayers, and their advisors, knowing that there will be an immediate follow up on any disclosure concerning a listed transaction.

We recognize that there are different considerations regarding other reportable transactions. For example, a corporation may have entered into a completely non-abusive transaction which generates a substantial book-tax difference, or a loss may be fully allowable notwithstanding disclosure was required. We believe that the Service needs to devote the resources necessary to review the disclosures made under Sections 6011 and 6111 with respect to other reportable transactions. Again, in order to increase compliance, it is important that taxpayers know that any disclosures that are filed concerning other reportable transactions will be reviewed in order to determine whether a further examination is appropriate.

Recommendations

1. The Service should promptly contact all taxpayers and material advisors who make disclosures with respect to listed transactions under Sections 6011 and 6111, respectively.

2. The Service should implement procedures to promptly review the disclosures made with respect to other reportable transactions so that it can:

    a) Timely determine whether further examination is appropriate.

    b) Identify disclosures which are unnecessary and dilute resources so that such disclosures can be eliminated from future filings and reduce the compliance burden on non-abusive taxpayers.

3. The Service should continue to emphasize publicly that sufficient resources are being allocated to reviewing disclosures in a timely manner.

JOINT INTERNATIONAL TAX SHELTER INFORMATION CENTER

Recommendation

We received limited information concerning the initiative for domestic and foreign taxing authorities to share information and engage in dialogue regarding potential tax shelters where the sharing of information would not violate local disclosure rules. However, given the growth of tax shelters from a domestic to an international problem, this seems like an excellent idea to further the

goals of consistent and sound U.S. tax enforcement efforts. However, we note that tax arbitrage is a natural result of different nations employing different tax standards and definitions and should not be confused with tax shelter activity. Business transactions entered into in the ordinary course of business may be treated differently under the tax laws of different tax jurisdictions, and U.S. taxpayers may lawfully structure business transactions with these differences in mind to achieve economic benefits. The mere existence of tax arbitrage itself is not, and should not be viewed by the IRS, as nefarious. It is only when the arbitrage encroaches on the U.S. tax laws that there is a potential for questioning the soundness of the structure. These points should be clearly articulated and disseminated in training materials and published guidance related to this initiative.

D. FOCUS ON MID-MARKET TAXPAYER COMPLIANCE

Discussion

The LMSB Subgroup has continued to express concern that the mid-market taxpayer base has been under-audited for many years. The Service has dedicated significant resources to auditing the largest LMSB taxpayers on a continual basis, simply because they are the largest taxpayers. We continue to believe that this is not the best use of resources.

As an example of this focus, for fiscal year ended 2004, LMSB was comprised of 159,320 taxpayers. Of these, 102,437 (64.3%) were either subchapter S corporations, partnerships, or limited liability companies (LLCs) -- collectively "flow-through entities." The Service audited approximately 2.9% (2,963) of these flow-through entities during the fiscal year ended 2004. On the other hand, there were 11,018 LMSB taxpayers that were subchapter C corporations with more than $250

million of assets. The Service audited approximately 37.9% (4,181) of these taxpayers during fiscal year-ended 2004.

The LMSB Subgroup continues to believe that as a result of the Sarbanes-Oxley legislation, focusing a significant amount of resources on the largest of the LMSB taxpayers is not in the best interest of the Service. Based on the Service's own projections, the population of flow-through entities is expected to grow to over 150,000 in the year 2008. If the Service is not able to increase its 2.9% audit rate on these taxpayers, an increasing number of taxpayers will go un-audited.

With the tax gap continuing to increase and the largest component of the tax gap being under-reporting of income, failure by the Service to increase audits or "touches" of the mid-market taxpayers (LMSB taxpayers with less than $250 million in assets and flow-through entities) promotes an attitude of under-reporting among this group of LMSB taxpayers because there is a belief amongst these taxpayers that they will never be audited. In order to be effective, audits of mid-market taxpayers need to increase in terms of number of taxpayers audited as well as percentage of taxpayers audited.

The LMSB Subgroup is also concerned about the increase in the number of "transactional" flow-through entities that have been formed in recent years. A "transactional" flow-through entity is an entity that begins a tax period with negligible assets, conducts a significant transaction during the tax period, and ends the tax period (as a result of the transaction) with negligible assets. As it stands currently, these "transactional" flow-through entities are not considered LMSB taxpayers; however, some LMSB taxpayers use these entities to conduct certain transactions. Failure to account for and audit these entities could reduce the effectiveness of increasing coverage on the overall population

of mid-market taxpayers since these entities may be used to shift the reporting of aggressive tax transactions from the mid-market taxpayer to this type of "transactional" entity.

As the population of LMSB taxpayers continues to increase (almost entirely through the increased number of flow-through entities), risk assessment in selecting taxpayers to audit will be crucial. Because of the relatively low level of assets required to qualify a taxpayer as an LMSB taxpayer (at least $10 million), many taxpayers included in LMSB may be inherently lower in risk due to their purpose (for example an LLC that owns a commercial rental property) than others, making risk assessment critical.

There is a fiscal year 2007 resource initiative regarding enterprise risk within LMSB. This initiative will provide additional resources (approximately 153 full-time equivalent Revenue Agents) to increase examination coverage for flow-through entities. However, this initiative is still a year away and is based largely on the Service receiving substantial increases in its annual budget for 2006 and 2007. We believe this initiative will go a long way toward increasing audits of mid-market taxpayers, but also believe that LMSB should develop a contingency plan to carry out this initiative in the event that the requested budget increases are not received.

We commend LMSB on their other initiatives designed to improve currency, reduce cycle time, and shift resources away from auditing the largest of the LMSB taxpayers including Schedule M-3, mandatory electronic filing, remote examinations, and the Compliance Assurance Program ("CAP"). We believe that all of these efforts should continue to be aggressively pursued, and that they should result in the ability to reallocate resources to audit mid-market taxpayers. Re-focusing

resources to this basically untouched taxpayer base should pay dividends to the IRS by significantly increasing taxpayer compliance.

Recommendations

1. Continue to explore ways to leverage the Sarbanes-Oxley legislation in order to release more resources, currently devoted to auditing the largest of the LMSB taxpayers, to audit mid-market taxpayers.
2. Develop a contingency plan in the event that the requested level of funding under the fiscal year 2006 or 2007 budget is not received in order to carry out the current initiatives to increase audits of mid-market taxpayers.
3. Continue to develop tools and initiatives--such as remote examinations, Schedule M-3 and mandatory electronic filing--to assist with risk assessment and selection of LMSB taxpayers for audit.
4. Include "transactional" flow-through entities in the population of LMSB taxpayers and devote resources to both understanding and auditing these entities.
5. Increase training of Revenue Agents in the field of flow-through taxation including training related to TEFRA audits, subchapter S corporations, and partnership taxation.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

SMALL BUSINESS/SELF-EMPLOYED
SUBGROUP REPORT

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SMALL BUSINESS/SELF-EMPLOYED

SUBGROUP REPORT

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I. INTRODUCTION

The IRSAC Small Business/Self-Employed Subgroup (hereafter "SB/SE Subgroup") consists of a diverse group of tax professionals who have significant professional experience and organizational affiliations. The SB/SE Subgroup has representation from CPAs, Enrolled Agents, Tax Attorneys and Software Developers. Each member, along with specific areas of expertise, has wide experience with both the taxpaying public and the Internal Revenue Service (IRS). We are pleased that the IRS has requested our views on issues of importance to both the general public and the IRS.

The SB/SE Subgroup thanks the IRS for providing us the opportunity to attend the IRS Nationwide Tax Forum of our choice. We believe that this is an important interaction between the IRSAC members, tax professionals and IRS personnel and would like to see the practice continued.

During the past year, the SB/SE Subgroup has met for four working sessions in Washington, D.C. We want to thank the IRS personnel with whom we have had discussions for their availability and candor. The SB/SE Subgroup has focused its attention on five issues as summarized below:

1. Employment Tax Pyramiding - Employment tax pyramiding is a serious problem. It continues despite significant efforts by the IRS to curb it. As listed in our recommendations, there are a number of steps that could be taken to eliminate pyramiding.
2. Enhancing Communication with Tax Practitioners - Given scarce resources, the IRS should place more emphasis on cooperation with tax professionals to encourage taxpayer compliance. This can be done more efficiently through enhanced communication and relationships.

3. E-services for Reporting Agents - E-services have not been provided to Reporting Agents, a significant IRS partner, even though they have been available to others since 2003. Providing e-services to Reporting Agents is a good business decision and should be undertaken immediately for the benefit of IRS, Reporting Agents, and Taxpayers.
4. Tax Professional Best Practices - The IRS wishes to improve the quality of practice of tax professionals, as evidenced by the amendment to the Circular 230 Regulations concerning practice before the IRS. The IRS can improve best practices of tax professionals by providing additional guidance, providing more clearly defined expectations, and improving its working relationship with the tax professional community.
5. Underreported Income - Underreported income is the largest contributor to the tax gap. Improving compliance requires both a carrot and a stick. We recommend additional taxpayer and preparer education, facilitation and improved use of third-party reporting, and increased contact between the IRS and a broad spectrum of taxpayers.

For each issue, we have provided recommendations. Some are easily implemented; others might take an "Act of Congress." In addition, some recommendations may have significant impact beyond the specific issues that they address. Nonetheless, regardless of the level of complexity, we felt that each recommendation deserved to be documented and considered. We are hopeful that each will generate meaningful dialog within the IRS.

II. ISSUES AND RECOMMENDATIONS

ISSUE ONE: Employment Tax Pyramiding

Executive Summary

Employment tax pyramiding is a serious problem. It continues despite significant efforts by the IRS to curb it. As listed in our recommendations, there are a number of steps that could be taken to eliminate pyramiding.

Background

The IRS requested the input of the SB/SE Subgroup with respect to education, prevention, detection, intervention and enforcement in the context of the "pyramiding" of unpaid employment tax assessments. "Tax Pyramiding" is defined by the IRS as the accumulation of more than one quarter of unpaid employment taxes for the same business. It has also been defined to include the "musical corporation" fact pattern where a business has an outstanding employment tax liability; closes down; and, then, the same business starts up again within a new entity and with a new employer identification number.

The IRS has already initiated significant changes to address tax pyramiding. The changes are in definitions, statistical analysis, managerial communication, management - Revenue Officer communication, Revenue Officer training, monitoring criteria including FTD Alert selection criteria, and consumer alerts. However, despite these efforts, tax pyramiding continues to increase.

Recommendations

1. Partner with the Department of Education, "Office of Innovation and Improvement," for the purpose of developing a Tax Education Module to become part of the core curriculum for all high school students.
2. Introduce a single, semiweekly deposit frequency for all 941/943 depositors to encourage

quick payment of employment tax liabilities. In view of this recommendation, it should be determined whether the policy and reasoning underlying the new Form 944 are consistent with the actions which need to be taken to eliminate pyramiding.

3. Change the signature line on the Form SS-4 to indicate that the individual signing the form is, by his or her signature, agreeing that he or she is a "Responsible Person" within the meaning of that term under Section 6672 of the Internal Revenue Code for the purpose of the Trust Fund Recovery Penalty. Provide a space next to or under the signature line for that individual's Social Security number. Implement programming to ensure that the signer's Social Security Number is linked with the Employer I.D. number issued.
4. Implement better data mining and action from the answers to the question on the current Form SS-4 which asks: "Has the applicant ever applied for an employer identification number for this or any other business?"
5. Consider adding the following questions to the SS-4: "Do any of the control individuals for this business have any personal outstanding tax liabilities to the Internal Revenue Service? Do any other corporations, which name any of these control individuals as a "Responsible Person," have any outstanding tax liabilities? If so, please state the name, Social Security number, address and telephone number of each such individual."
6. More closely monitor payment coupons and/or electronic filing for small businesses. In this connection, lower the threshold of the FTD alert program to cover smaller payrolls; cause notices to be sent out earlier; and cause telephone contact to occur sooner.
7. Increase the use of Form Letter 903 concerning failure to deposit employment taxes, Notice 931 entitled "Deposit Requirements for Employment Taxes," and Form 2481 entitled "Notice to Make Special Deposits of Taxes" together with the Certificate of Delivery of

Form 2481. Furthermore, an increase in enforcement of violations of the terms of the Form 2481, and other applicable criminal offenses that might apply in this context, should be implemented by partnering with the Justice Department, Tax Division, Criminal Section to develop an enforcement program that includes a series of prosecutions that includes smaller employers. Publicize the compliance initiative on the website, through push email and press releases.

8. Partner with representatives of the various practitioner groups to develop a core set of CPE/CLE materials on tax pyramiding that can be used to make presentations to and by practitioners.
9. Use the current push email capability and the IRS website to send out a warning to practitioners concerning tax pyramiding.
10. Amend the Circular 230 Regulations to include a specific example showing that it is not proper for an individual to aid and abet a tax pyramider.
11. Partner with the Department of Justice, Tax Division, Criminal Section to develop an enforcement initiative that targets professionals that aid and abet tax pyramiding. Publicize the formation of the partnership.
12. Coordinate more closely with agencies such as the Small Business Administration, State Workers' Compensation Boards, and the various Departments of Revenue of the 50 states in order to facilitate early detection of tax pyramiders.
13. Partner with the National Payroll Reporting Consortium to develop a bonding requirement for reporting agents. Currently there is no such requirement. When a reporting agent fails to remit the paid in withheld funds to the IRS, a series of procedural difficulties occur. A bonding requirement for the reporting agents would go a long way toward eliminating those

difficulties.

14. Increase the training of Revenue Officers with respect to their understanding and use of transferee liability procedures. While subsection 6334(a)(13) provides for an exemption from levy in certain circumstances if the amount of the levy does not exceed $5,000, it does not prohibit utilizing the transferee liability provisions, Section 6901 et seq, to pursue the assessment against a new, successor entity which may, in essence, be the same business. Use of the transferee liability procedures would be particularly helpful in the context of "the musical corporation" scenario.
15. Revisit the criteria, and increase Revenue Officer training, for applying the status: Code 53 ("Currently Not Collectable") to an employer where tax pyramiding is present.
16. Include bold warnings in Publication 15, "(Circular E), Employer's Tax Guide," showing the civil and criminal consequences of negligently and/or willfully violating laws pertaining to employment taxes.

ISSUE TWO: Enhancing Communication with Tax Practitioners

Executive Summary

Given scarce resources, the IRS should place more emphasis on cooperation with tax professionals to encourage taxpayer compliance. This can be done more efficiently through enhanced communication and relationships.

Background

The tax practitioner can be a valuable ally to the IRS in the effort to enhance compliance. Tax practitioners encourage their clients to comply with IRS rules and regulations and help a taxpayer come back into compliance after the IRS has discovered a discrepancy. Tax practitioners, however, need the help and guidance of the IRS to assist their clients.

Recommendations

1. The IRS should return more personnel and authority to the field offices. Tax practitioners are frustrated by the inability of local IRS personnel to resolve issues and want local IRS personnel that have authority to make decisions. The concept of "remote management," whereby a manager in Dallas manages an office in Colorado, frustrates tax practitioners who do not have direct access to IRS personnel with the ability to resolve issues. Many issues could be resolved more quickly and efficiently through face-to-face meetings and pre-existing relationships between the IRS and tax practitioners. A return to regions and districts could provide more authority to local IRS personnel, enhance timely communication, and decrease the cost of repeat paper notices that generally do not bring about a resolution.
2. When planning internal changes, particularly those that involve renaming IRS functions, the IRS needs to be more sensitive to the impact any such changes might have on the efficiency of IRS/practitioner communication.
3. Currently, certain IRS field offices provide local tax practitioners with a list of names and telephone numbers of key IRS personnel in their particular area. This is a valuable tool to increase communication between tax practitioners and the IRS. A uniform program should be created to ensure that all IRS field offices provide this information to tax practitioners. The information could be provided to the local industry groups twice a year for dissemination to tax practitioners.
4. The IRS Nationwide Tax Forums are informative, but do not provide the practitioner with an opportunity to meet people from the local IRS office. Tax practitioners want to build personal relationships with the local IRS personnel. Practitioners want to know whom to call locally in collections, exam, etc. in order to get an issue resolved. The practitioners want

to work with someone who has an interest in, and understands, the community. To build these relationships, the IRS should have annual or semi-annual "meet the IRS" meetings with the tax practitioner community. These meetings could provide updates to the local practitioner community and provide the practitioners with access to real people within the IRS. These meetings should be open to all practitioners and advertised to all members of local enrolled agent, CPA and bar associations. Currently, the formal IRS meetings with tax practitioners are limited to certain committee members of the local associations hosting the event.

5. The IRS should send local tax practitioner groups a list of available IRS speakers and the subject each can speak on. The list should include a contact name and telephone number to arrange for a speaker. With the bigger groups, e.g. state Bar Tax Sections and state Institutes of Certified Public Accountants, the IRS should appoint liaisons to each group. The scope and activities of the liaison would have to be explored subject to the usual concerns of time, budget, National Treasury Employees Union rules, etc. This type of outreach would provide strong evidence of the IRS' willingness to partner with tax practitioners.
6. Subject to Section 6103 concerns, Form 2848 should be revised to permit a taxpayer to approve e-mail communication between the IRS and the taxpayer's representative.
7. Training should be improved to ensure that IRS personnel have a more technical understanding of tax law and the IRS structure. IRS personnel should be provided timely updates on changes in the tax law, IRS forms and notices. IRS call centers should be provided access to a database which contains contact information for IRS personnel, including industry specialists, to whom the call centers could refer a tax practitioner for more technical guidance.

8. IRS exam personnel should better utilize IRS personnel with industry specific knowledge and information, especially during the exam process. The IRS has expertise through Market Segment Specialization Papers (MSSP) and Industry Specialization Papers (ISP), which are being underutilized.
9. Tax Talk Today is an excellent program, but not enough tax practitioners are aware of it. The IRS should adjust the marketing strategy to include advertisements in trade publications and an emphasis on the fact that Tax Talk Today is hosted by the IRS. If logistically feasible, Tax Talk Today should be the launching pad for major IRS announcements, so that it becomes a significant source of information for practitioners.
10. The current IRS listservs should be streamlined to provide participants with updated information in a more concise format. For example, currently a tax practitioner that subscribes to the lRS listserv for various states receives e-mails, that often contain repetitive information, for each state. These various e-mails could be combined into one e-mail that contains links to each state specific tax update. Similarly, the IRS could send an e-mail with links to recent federal tax updates. These links could be categorized by practice area (e.g. non-profits, pass-through entities, etc.) to afford easy access.

ISSUE THREE: E-services for Reporting Agents

Executive Summary

E-services have not been provided to Reporting Agents, a significant IRS partner, even though they have been available to others since 2003. Providing e-services to Reporting Agents is a good business decision and should be undertaken immediately for the benefit of IRS, Reporting Agents, and Taxpayers.

Background

Reporting Agents do not have the benefit of utilizing those e-services that individual tax practitioners have had since October 2003. Since their roll out, e-services have been made more useful to individual tax practitioners through expanded offerings (Transcript Delivery Service, Electronic Account Resolution, and Disclosure Authorization) and more widely available through a lowering of the entry level threshold from 100 e-filed individual returns to 5 e-filed returns - either individual, business, or a combination of both.

Nevertheless, despite this broadening of accessibility to e-services, the IRS has not yet provided e-services to an important IRS partner – Reporting Agents (RAs). There are currently over 3,300 registered RAs who provide payroll and tax services to more than 1.9 million employers and more than one-third of the nation's private sector workforce. RAs transmit over 30 percent of all depositary taxes received by the U.S. Treasury. The success of the EFTPS and employment tax e-filing initiatives is largely due to the cooperation of RAs, who make all federal tax payments via EFTPS and submit all employment tax returns electronically.

For FY2005, a request for e-services funding was prepared by IRS personnel. The funding request estimated the development cost of e-services to RAs (at an equivalent level to those offered to individual practitioners) at $1.5 - $2 million. Based on recent conversations with IRS personnel, even this amount may be more than is needed. Yet, IRS states that e-services for RAs cannot receive approved funding prior to FY2007 – at the earliest. **This is too long to wait for a program that would be of such benefit to all stakeholders.** It should be noted that the IRS budget request for Business Systems Modernization (BSM) funding in FY2006 was $199 million – $4 million less than the FY2005 appropriation of $203 million. The cost to implement e-services for RAs is less than half the decrease in BSM funds that IRS has requested from 2005 to 2006. In other words, if BSM

were simply funded at the same level as in FY2005, there would be more than enough money to implement e-services for RAs.

Recommendations

1. Fund e-services for RAs immediately and by whatever means available – including the possibility of incremental funding. There are several reasons for not waiting:
    a) There is strong financial justification to provide e-services for RAs. Currently, RAs use the Toll-Free Practitioner Priority Services (PPS) to resolve most issues. RAs estimate that, as a result of notices, they make more than 300,000 calls to PPS annually and that 30% of these calls could be eliminated if Transcript Delivery Services were available. Therefore, the implementation of just Transcript Delivery Services, without regard to other enhancements that could be easily made available, would eliminate 90,000 telephone calls annually. If each of these calls were conservatively estimated at 15 minutes each, that would be a savings of over 11 FTE or nearly $800,000 per year – approximately one half the development cost in personnel savings in the first year alone. In addition, there would be other cost savings such as the printing and mailing costs of transcripts. Admittedly, there will be new costs associated with e-services, but we believe, given the e-services infrastructure already in place, that these costs will be minimal.
    b) Maintain the goodwill and cooperation of RAs by rewarding them for their help in maintaining tax compliance. RAs originate over 95% of all electronically filed employment tax returns, and, by IRS measures, their clients are 20 times more compliant than the general population.
    c) E-services for RAs will be easy to implement and quickly accepted. Analysis and

prototyping have already been done, development cost is reasonable, and RAs are a highly computer-literate community that has been requesting e-services for years. Therefore, e-services would be used immediately for the benefit of both the IRS and taxpayers.

d) Because there is already a communication avenue between IRS and RAs, marketing and startup costs would be negligible.

e) E-services for RAs would lead to paperwork burden reduction for both IRS and RAs, since transcripts and other correspondence could be delivered via the internet.

2. Complete the current development phase. In cooperation with the National Payroll Reporting Consortium (NPRC), an organization representing RAs, IRS personnel have been developing requirements and prototypes, tailored to the needs of RAs, for Transcript Delivery Services and Electronic Account Resolution. The requirements stage of the development process is nearing completion, and IRS should:

   a) allow and encourage these tasks to be completed.

   b) provide an avenue to continue with the design and development of RA e-services products.

3. Consider development of RA e-services by in-house personnel. The expertise exists in-house to develop e-services. The advantage to implementing in-house is two-fold:

   a) In-house development would further enhance web-based systems development expertise within the IRS.

   b) In-house development would provide IRS personnel, who have been working on existing legacy systems, a career path into more modern systems technology without leaving IRS for the private sector.

4. Partner with RAs to identify other e-service products that would reduce IRS costs, e.g. ability to verify RA authorization, entity (EIN, name) verification, taxpayer deposit frequency lookup, and electronic notice delivery. All of these pre- and post-filing applications will drive further IRS cost reductions by eliminating much telephone and mail interaction between RAs and IRS. Furthermore, the pre-filing applications would allow verification of taxpayer information before making payments and filing returns, thus reducing mistakes and preventing notices before they occur. Just to call out one of these items, electronic notice delivery (by eliminating mailing costs to RAs and by providing early receipt, faster resolution and reduction in subsequent notices) has the potential to save the IRS over $1.2 million annually in direct costs associated with notice delivery.

ISSUE FOUR: Tax Professional Best Practices

Executive Summary

The IRS wishes to improve the quality of practice of tax professionals, as evidenced by the amendment to the Circular 230 Regulations concerning practice before the IRS. The IRS can improve best practices of tax professionals by providing additional guidance, providing more clearly defined expectations, and improving its working relationship with the tax professional community.

Background

The Internal Revenue Service has requested the SB/SE Subgroup to provide recommendations regarding how the IRS can improve the quality of practice of tax professionals. Since this is such a large issue, we have chosen, in this report, to focus primarily on tax professionals subject to Circular 230 Regulations. The IRS request to investigate the improvement of tax professional standards is consistent with the amendment to the Circular 230 Regulations, effective June 30, 2005, which include in Section 10.33 aspirational "best practices for tax advisors." Tax

advisors are urged to provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing submissions to the IRS. Section 10.33 provides that best practices include:

1. Communicating clearly with the client regarding the terms of the engagement.
2. Establishing the facts by determining which are relevant facts, evaluating reasonableness of assumptions or representations, relating applicable law and arriving at conclusions supported by the law and facts.
3. Advising the client regarding the import of conclusions.
4. Acting fairly and with integrity in practice before the IRS.

Under Section 10.33(b), tax professionals with oversight of a firm's practice must take reasonable steps to ensure members employ "best practices" consistently.

Recommendations

1. Additional guidance and clarification concerning the scope of "best practices" and Circular 230 would be helpful to tax practitioners.
2. The IRS must work closely with the tax practitioner community in developing examples and guidance to address such issues as balancing the practical compliance burden on the practitioner, while enhancing public confidence in the tax system, and promoting with integrity and honesty. Timeliness of this guidance is vital to increase compliance and reduce confusion, already evident in the tax practitioner community, related to these new requirements.
3. The IRS must work with the tax professional community to more clearly define the line between "tax avoidance or evasion" and "tax advice and planning." In an effort to achieve this goal, we recommend the IRS implement the following:

a) Establish a toll free hotline to receive complaints and answer questions concerning ethical and unethical behavior by tax professionals.

b) Establish an ethics ruling request procedure, preferably within the Office of Professional Responsibility (OPR).

c) Expand, update and supplement the FAQ section of the OPR web page with questions and answers obtained from sources such as email submissions, the toll free ethics hotline, and the ethics ruling process (i.e. allow ethics questions to be asked and answered via email request as long as no section 6103 privacy issues are involved). Once the foregoing is established, also include an ethics search engine on the OPR web page.

4. Work with the American Institute of Certified Public Accountants (AICPA), the American Bar Association (ABA), the National Association of Enrolled Agents (NAEA) and other similar tax professional groups in the development of tax practice standards.

5. The current relationship between the IRS and the tax professional community must become less "adversarial" and more "cooperative." Programs implemented by the IRS, such as the Tax Professional Forums and advisory committees, are important steps to improving the relationship, but the public as a whole still has an "us vs. them" perception of the IRS. Although we realize that the IRS has heard this recommendation many times and in various forms, we feel that it is worth repeating. The IRS must continue to strengthen the relationship with the tax professional community in developing tax policies and procedures. A joint effort in the development and dissemination of the "purpose," "benefit," and "procedures requirements" for actions taken by the IRS is essential to facilitate "buy-in" by the tax professional community and the general public as a whole.

ISSUE FIVE: Underreported Income

Executive Summary

Underreported income is the largest contributor to the tax gap. Improving compliance requires both a carrot and a stick. We recommend additional taxpayer and preparer education, facilitation and improved use of third-party reporting, and increased contact between the IRS and a broad spectrum of taxpayers.

Background

The IRS and its overseers have devoted much attention to the "tax gap," the estimated shortfall between what the IRS collects from taxpayers annually and the amount taxpayers actually owe. A National Research Program study of individual income tax returns, completed in December 2004, estimated the gross gap at over $300 billion a year. Of this amount, approximately 80% is believed to be attributable to underreported income.

Income reporting compliance is highest in the areas in which there is third party reporting and/or withholding at the source: wages, interest, and dividends. Reporting of net business income and associated employment taxes by small businesses and self-employed individuals is significantly less accurate, despite the fact that a large proportion of these entities utilize professional tax preparers.

Some underreporting occurs as a result of the complexity of the tax system. Taxpayers do not understand their responsibilities or do not allocate time and energy to comply. Other underreporting represents more deliberate tax avoidance.

The SB/SE Operating Division asked IRSAC's SB/SE Subgroup to consider (1) ways to encourage taxpayers to report all income and (2) methods to detect unreported income. The

phrasing of this request is worth noting because it suggests an understanding that both "carrot" and "stick" are vital to improving taxpayer compliance. We concur wholeheartedly with this philosophy.

Recommendations

1. It is important for the legislative and executive branches of government, who set tax policy and fund tax administration, to understand the nature of the tax gap. In dealing with the general public, however, excessive emphasis on the shortfall may actually encourage non-compliance the "everyone else is doing it" mentality. We would urge IRS management and communications professionals to consider their audiences, putting more emphasis on the Service's compliance successes in dealing with the taxpaying population.
2. We believe that compliance will improve if taxpayers, and the professionals who assist them, more clearly understand their responsibilities. We recommend development of industry-specific "self audit guides," a one or two page checklist of key issues affecting specific industries that could be mailed to taxpayers whose Schedule C/F, 1120S or 1065 contains applicable business codes. These guides would be based on, and would refer to, Audit Technique Guides developed under the IRS Market Segment Specialization Program. The guide mailed to bars and restaurants, for example, might cover tip reporting. It would briefly outline employer/employee responsibilities, provide information about median tip rates, and describe remedial actions, such as Employer Only Assessments, available to the IRS. A similar "back to the basics" guide covering issues applicable to all small business or self-employed taxpayers could also be developed.

   This information should be disseminated through industry and tax professional organizations. If the taxpayer, and his preparer, know that the IRS is shining a light on certain areas, they will be more likely to pay attention to those matters.

3. Compliance with existing third party reporting requirements could be enhanced by making Form 1099-MISC more available and easier to use. Converting to a reproducible form by eliminating the requirement for red "dropout" ink would be an important first step. Developing an online interface for filers of less than ten 1099's (similar to the interface developed by the Social Security Administration for W-2 filers) would also be helpful. Extending the deadline for filing the IRS copy of Form 1099 from February 28 to March 31 would encourage professionals (whose first glimpse at their client's "shoebox" might not occur until the spring deadlines for filing small business and individual returns approach) to prepare any 1099's that may have been overlooked without fear of penalty.
4. The IRS should consider replacing one of the less useful questions in the Other Information section of Form 1120S and Form 1065 with the question, "Have all required Form 1099's been filed?" Adding this question to a form that is signed under penalty of perjury would encourage taxpayers to take their information reporting responsibilities more seriously. It would also give tax preparers a tool for encouraging recalcitrant taxpayers to report both payments and receipts.
5. Consideration should be given to eliminating the exemption for payments to corporations from 1099-MISC reporting. Choice of entity should not provide similar businesses with dissimilar opportunities for evasion. Many businesses already prepare Forms 1099 for all applicable vendors, regardless of their business structure. Elimination of the need to differentiate between corporate and non-corporate payees would be a burden reduction that would somewhat offset the burden created by having to produce additional forms.
6. The IRS could gain a valuable tool by requiring credit card processors to report aggregate credit card payments to merchants on a new Form 1099. Reporting the data by month of

payment would facilitate use with respect to fiscal year taxpayers. This information is already captured by computer, and the programming needed to provide summary data to the IRS annually should be minimal. Credit card receipts would allow data-matching and enhanced audit selection criteria to be developed in industries not presently touched by 1099-MISC reporting.

7. We are somewhat reluctant to make any suggestions regarding improved or additional third-party information reporting until the IRS has the resources to utilize this data effectively. Currently, under 30% of the individual returns for which potential discrepancies are identified by the Automated Underreporter Program are selected for review. There is no systematic match of third-party information returns and Forms 1120S or 1065. We believe developing and utilizing models for testing gross receipts will be at least as productive as ensuring that K-1 data flows through to 1040's.
8. Throughout our discussions with IRS personnel, we frequently heard that review, exam, and prosecution criteria target "the big fish," the higher dollar situations in which there is likely to be more bang for the buck. While this approach is efficient on one level, we are concerned that ignoring a large number of smaller taxpayers can have a significant negative effect on compliance. The little guys should not feel they have a free pass. It is unlikely that a generally compliant taxpayer will become abusively non-compliant. Slipping from 87% compliant to 83% compliant is far more possible. A small loss of compliance across a large part of the taxpayer population may have impact comparable to egregious non-compliance in a rather small segment. Conversely, a small improvement in compliance across the broad spectrum of taxpayers can have a measurable positive effect on the tax gap. We feel strongly that random "touches" across the board will have a beneficial impact on taxpayer

compliance and should be more strongly weighted in the selection criteria than they currently seem to be.

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Gary C. Rohrs, EA, ABA, ATA

January 21, 2005

Raymond T. Wagner, Jr., Chair
IRS Oversight Board
1500 Pennsylvania Avenue, NW
Washington, D. C. 20220

Dear Mr. Wagner:

The Internal Revenue Service Advisory Council is pleased to present our comments today as a part of your first panel on "How can the IRS leverage its external stakeholders to achieve a more highly compliant taxpayer population?"

Authorized under the Federal Advisory Committee Act, Public Law No. 92-463, the first Advisory Group to the Commissioner of Internal Revenue-or the Commissioner's Advisory Group ("CAG")-was established in 1953 as a "national policy and/or issue advisory committee," Renamed in 1998 to reflect the agency-wide scope of its focus as an advisory body, the IRSAC's primary purpose is to provide an organized public forum for senior IRS executives and representatives of the public to discuss relevant tax administration issues. As an advisory body designed to focus on broad policy matters, the IRSAC reviews existing tax policy and/or recommends policies with respect to emerging tax administration issues. The IRSAC suggests operational improvements, offers constructive observations regarding current or proposed IRS policies, programs, and procedures, and advises the Commissioner with respect to issues having substantive effect on federal tax administration.

Conveying the public's perception of IRS activities to the Commissioner, the IRSAC is comprised of individuals who bring substantial, disparate experience and diverse backgrounds on the Council's activities. Membership is balanced to include representation from the taxpaying public, the tax professional community, small and large businesses, state tax administration, and the payroll community.

One of the significant areas of concern that at present lends to the inability to effectively achieve voluntary tax compliance is the lack of effective oversight, control, and

regulation of the entire tax preparation community. Circular 230 under which Enrolled Agents, Attorneys, CPA's and Enrolled Actuaries are regulated has been revised to address the concerns about the recent scandals in the profession. Sadly, there will always be those who choose to ignore the rules and regulations. The greater problem is that there are a significant number of tax preparers who operate under no such standards of professional conduct or entry-level educational standards or attainment of recognized credentials. They simply decide to become preparers and away they go. We have recently seen a high degree of activity from the Justice Department in prosecuting a number of these folks. This is called encouraging compliance by way of threat of prosecution. This is akin to closing the barn door after the cows have escaped.

These same individuals are relatively transparent to the outside observer since many do not sign the returns they prepare for pay. Having no initial qualifications upon entry to the field and not being required to participate in continuing education really gives them a license to steal. The public has the conception that the industry is regulated and so they are lulled into a false sense of security regarding the choosing of a paid preparer. The law being as complicated as it is simply mandates that assistance is required in order to prepare one's tax return. Best estimates say that there are, perhaps, as many as 900,000 individual preparers who are not governed by any licensing authority. The need to regulate the entire community of tax preparers is long over due, which should include the ability to remove the offenders from the preparation field. The Taxpayer Advocate has cited this need in several of her annual reports. The topic itself has bounced around for at least two decades. The proposal was a part of the Good Government bill introduced in the last Congress. Ultimate passage of this will raise the bar of competence of those preparing tax returns for pay as well as give the authorities the ability to more easily identify them.

E-services have been unveiled and initial implementation has begun. The SBSE subgroup believes that the utilization of these services by those directly involved in the field is essential. It is no less essential that it be expanded to include not only more services but also a greater array of stakeholders. We simply must embrace advancing technology more rapidly. It is the concept of spending money to make, save or collect money.

The Offer in Compromise program is still not where it should be. While improvement has occurred, the "mine field is still not negotiable." The backlog of inventoried offers may be down but the complete picture of exactly why is still unclear. Perhaps the filing fee has served to stem somewhat the influx of frivolous offers, or could it be that the taxpayer doesn't even have the $150? The rejection rate as opposed to the acceptance rate is disparate. Is this because the criteria for acceptable levels of living expenses is incorrect or is it the inability of the specialist to appropriately evaluate the offer? Is it appropriate for those administering the program to be heavily weighted from a collection background with little or no training in the art of negotiation or compromise? Good business says take what you can reasonably get, reduce your receivable and insure compliance for the next five years. In order for this program to succeed the validity of it needs to be embraced by the IRS. Once this occurs we will then see taxpayers caught

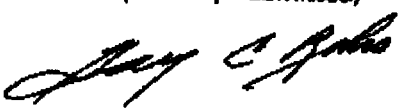
outside the system returned to the system. Thus becoming part of the good guys once again. There needs to be a strengthening of the tracking system of these folks as they go forward to see that they do not stray from the path in the future. The threat of revocation of accepted offers for those who continue to stray has to be real.

Modernization and centralization has both its good points as well as its bad. The Service cannot be so far removed from those it is intended to service that there is no place for the average taxpayer to turn and be able to see or speak with a real live person who can assist them without having to first seek representation. The ability to access by phone is frustrating to say the least. If multiple calls are required you will never reach the person you last spoke with. Navigating the multiple selections of the menu is daunting to the average taxpayer. Technology has its positive side but it also can create new problems that if not addressed, will become bigger than the initial problem.

I would commend to the Board the most recent Public Report of the IRSAC issued on November 10, 2004. It presents a clear picture of the areas of concern as addressed by the SBSE, W & I, and LMSB Subgroups as they worked with the operating divisions of the IRS this past year.

The Internal Revenue Service Advisory Council appreciates the opportunity to comment and we thank you.

Respectfully submitted,



Gary C. Rohrs, EA ABA ATA

Chairman IRSAC 2005

Internal Revenue Service Advisory Council
2005 Member Biographies

Judith A. Akin, EA

Ms. Akin is the owner and manager of Judith A. Akin, EA, Tax and Financial Services in Oklahoma City, OK. Some specialties of her practice include but are not limited to bookkeeping and tax preparation for individuals, small business, partnerships, corporations, estates, trusts, as well as tax planning, business and financial planning. She also specializes in taxpayer representation before the Internal Revenue Service and other taxing authorities. Judy is a graduate of the National Tax Practice Institute. Judy is the past President for the National Association of Enrolled Agents. **(W&I Subgroup Chairperson)**

Jon M. Contreras

Mr. Contreras is currently a Director with Deloitte Tax, LLP, in Fresno, CA, in their Internal Revenue Service Tax Controversy Practice and has been with the firm for seven years. Prior to joining Deloitte, Mr. Contreras was with the Internal Revenue Service for 15 years in the Examination Division, concluding his career with the Fresno Service Center. Throughout his professional career, Mr. Contreras has been extensively involved in compliance activities. He has a thorough knowledge of Examination processes, as practiced in the Internal Revenue Service field and service center operations. Mr. Contreras is both a Certified Public Accountant and Enrolled Agent, he holds a Bachelor of Science Degree in Accounting from California State University, Fresno. **(Vice Chair & LMSB Subgroup Chairman)**

John A. Glennie

Mr. Glennie completed his chartered accountant's designation in Toronto and shortly thereafter joined the Department of National Revenue. In 1978 he joined Shell Canada Limited in the Tax and Insurance Department in Calgary Alberta, Canada. Mr. Glennie is the General Manager, Tax and Insurance. Prior to becoming the General Manager he was the Director, Tax and Insurance. Mr. Glennie was the International President of the Tax Executives Institute for 2002/03 and he currently sits on the Board of Directors. Mr. Glennie is also a member of the Advisory Committee to the Minister of National Revenue in Canada. He holds a Bachelor of Arts Degree from the University of Toronto. **(LMSB Subgroup)**

Mary Harris, EA

Ms. Harris is an enrolled agent who, with her husband, co-owns Sirrah, Inc; an Arkansas Corporation dba Jackson Hewitt Tax Service in Little Rock, AR. Ms. Harris has been in the tax preparation industry since 1969 and is very involved in the day to day operations of her business. Of the twenty-five years she worked for H & R Block, the last 18 years she served as district manager with 18 city offices and 27 satellites operations across Arkansas for which she provided assistance. Her Jackson Hewitt operation includes 60 tax offices throughout Arkansas and Texas with approximately 300 employees. Preparing over 27,000

tax returns in the 2004 tax season, they e-filed over 98 percent. Ms. Harris served on the first ETAAC and served on the IRS Arkansas/Oklahoma Liaison Committee, and is a member of NAEA, and NSTP. **(W&I Subgroup)**

Karla R. Hyatt

Ms. Hyatt is an associate with Waller Lansden Dortch and Davis, PLLC and practices in the area of tax law in Nashville, TN. Prior to joining Waller Lansden Dortch and Davis, Ms. Hyatt served as a graduate research assistant at the University of Florida, Gainesville, Fl. She also served as a Judicial Law Clerk for the Honorable William J. Haynes, Jr., United States Magistrate Judge in Nashville, TN. Ms. Hyatt holds a BS Degree in Business Administration from the University of Tennessee and a LLM in taxation from the University of Florida School of Law and a JD from Tulane University School of Law, New Orleans, Louisiana. **(SBSE Subgroup)**

Angel Ingram

Ms. Ingram is a International Tax Manager for Tyco International, Inc. Prior of joining Tyco Ms. Ingram was a Senior International Tax Analyst for Eli Lilly and Company in Indianapolis, IN and was with the company for over seven years. Ms. Ingram is a CPA and is responsible for international tax compliance. She is the Central Region President and a current national board member of the National Association of Black Accountants, Inc. Ms. Ingram holds a BA in accounting from the University of Michigan and a Masters of Science Degree in Taxation from DePaul University, Chicago, IL. **(LMSB Subgroup)**

Joan C. LeValley

Ms. LeValley is the owner and President of JCL and Company a full accounting practice in Park Ridge, IL. Ms. LeValley has over twenty-nine years experience in taxation. Her firm specializes in accounting and tax preparation for businesses. She was President of the Independent Accountants Association and continues to actively serve on its committees. In addition, she is Vice Chair of the Federal Taxation Committee of the National Society of Accountants (NSA), having served six years on this committee. Ms. LeValley holds a BA Degree in Business Administration and Accounting from Manchester College, N. Manchester, IN and is an Accredited Tax Advisor and an Accredited Tax Preparer. **(W&I Subgroup)**

Richard M. Lipton

Mr. Lipton has been in practice for over twenty four years and is currently a partner with Baker and McKenzie in Chicago, IL. He has served as tax counsel in many of the largest transactions in the country, and in the City of Chicago has been closely involved in transactions concerning the Sears Tower, John Hancock Building Aon, Prudential, etc. He has expertise in representing large corporations in complex partnership transactions and has served as an expert witness on matters concerning partnerships and partnership taxation. He has written numerous publications and articles. Mr. Lipton is the former chair of the Tax Section of the American Bar Association as well as the former chair of the Chicago Bar Association;

Tax Committee and the Chicago Federal Tax Forum. He is a fellow and a regent of the American College of Tax Counsel. Mr. Lipton is a graduate of the University of Chicago Law School and received his B.A. from Amherst College. **(LMSB Subgroup)**

Kenneth C. Nirenberg

Mr. Nirenberg has worked in the payroll industry for over thirty years and is currently a Senior Software Developer for Intuit Inc., in Austin, TX, where he specializes in tax filing systems. Prior to this, and until its sale, he was President of Charter Information Corp, a payroll services firm with offices in Texas and Massachusetts. Mr. Nirenberg is a representative to the National Payroll Reporting Consortium and has been involved with the IRS RAF Modernization Committee and Reporting Agent Forum. He spent three years as a Peace Corps Volunteer in Malaysia, during which time the Malaysian government requested his services to assist in the computerization of its federal government payroll. Mr. Nirenberg received his B.A. in Economics from Brandeis University and serves on the Brandeis University Alumni Admissions Council. **(SBSE Subgroup Chairman)**

Deborah Cutler-Ortiz

Ms. Cutler-Ortiz is currently the Director of National Programs & Policy for Wider Opportunities for Women. Prior to joining Wider Opportunities for Women she was the Director of Family Income at the Children's Defense Fund in Washington, DC, and has over 17 years experience in taxation. Ms. Cutler-Ortiz served as the National point person to resolve tax preparation conflicts for 168 VITA sites. In addition, she has been a panel speaker at three Hill briefings on EITC. Ms. Cutler-Ortiz holds a Bachelor of Science Degree in Social Work from the State University College at Buffalo, NY and a Masters in Social Work from Fordham University, New York, NY. **(W&I Subgroup)**

Robert E. Panoff

Mr. Panoff is an attorney with the firm of Robert E. Panoff, PA in Miami, Fl. Mr. Panoff has over twenty-seven years experience in taxation. He limits his practice to civil and criminal tax controversies and related matters. He has been an adjunct Professor at the University of Miami School of Law for twenty-three years. He is a frequent speaker at CLE and CPE programs on tax litigation topics and has written a number of articles on this subject. Mr. Panoff is past chair of the Tax Section of the Florida Bar, the Continuing Legal Education Committee of the Florida Bar, and the Greater Miami Tax Institute. He is currently a member of the Tax Section's Board of Directors. He is a member of the American Bar Association and was the principal draftsperson of the American Bar Association's "Comments on the OECD Draft Convention on Mutual Administration Assistance in Tax Matters." Mr. Panoff was also chair of the IRS South Florida District Compliance Plan Study Group. Mr. Panoff holds an AB Degree from Brandeis University, a JD and LLM in Taxation

from the University of Miami. **(SBSE Subgroup)**

Cathy Brown Peinhardt Ms. Peinhardt is a CPA and Licensed Tax Consultant for Coast Business Services in Gearhart, OR. She has over twenty years experience in accounting and taxation, primarily working with individuals and small businesses. Ms. Peinhardt served as Controller/Treasurer for Information Science Incorporated in Montvale, NJ. She began her career with Arthur Andersen & Company, New York, NY. Ms. Peinhardt holds a BA Degree in Art History from Princeton University and a Masters Degree in Accounting from NY University. **(SBSE Subgroup)**

Joni Johnson-Powe Ms. Johnson-Powe is currently a managing Director at J.P. Powe & Associates, LLC in Greenwood Village, CO; she has been with the company for five years. Prior to joining J.P. Powe & Associates Ms. Johnson-Powe worked for KMPG, L.L.P. in Denver CO as the Managing Director-National Communications – State and Local Tax. She also worked for Ernst & Young, LLP in Denver, CO & San Jose, CA as a tax Consultant. Ms. Johnson-Powe expertise is in individual, small business & government audits, corporate tax, consulting compliance and legal services. Ms. Johnson-Powe is a CPA and holds a BS Degree in Accounting from the University of Nebraska-Lincoln and a JD from the University of Colorado School of Law. **(SBSE Subgroup)**

William F Reilly Mr. Reilly received his Enrolled Agents license from the Director of Practice in June 1981 and immediately opened his own practice, William F. Reilly, EA in Palo Cedro, CA. His practice currently serves more than 400 clients ranging from the simplest returns to partnerships, corporations, trusts and includes payroll, write up, representation and business consulting. He is an active participant in his local chapter of the California Society of Enrolled Agents (CSEA), a member of CSEA Board of Directors and is currently nominated for the office of Treasurer of the Society. In addition, he serves on the Board of Directors of the California Tax Education Council. Mr. Reilly studied math and physics at the University of San Francisco. **(W&I Subgroup)**

Patti M. Richards Ms. Richards is currently a Member Manager at the Richards Law Firm, LLC and The Tax Controversy Group, LLC in Atlanta, GA. Ms. Richards, who is also a CPA, has over fifteen years experience in taxation. Her expertise is in domestic and international tax controversy. Prior to starting her own firm, she was with Powell Goldstein, LLP in Atlanta, GA. She worked for Dewey Ballentine LLP and Burt Maner, Miller and Staples in Washington, DC. In addition, she worked as an Attorney-Advisory (Tax) for the Internal Revenue Service, Office of Chief Counsel, Income Tax & Accounting. Ms. Richards holds a BS Degree from Centenary College of Louisiana, an MA Degree from Louisiana State University, an a JD from Georgetown University Law Center. **(LMSB Subgroup)**

Margaret A. Roark

Ms. Roark is the owner and President of M&D Consulting, Inc in Fairfax Station, VA and has over 30 years experience in taxation. Ms. Roark's expertise is in payroll, sales audit, finance, operations, and accounts payable. Prior to starting her own business she worked as a Director of Payroll/Sales Audit for Woodward & Lothrop, Inc. Ms. Roark is a certified Payroll Professional and attended Virginia Commonwealth University. **(W&I Subgroup)**

Gary C. Rohrs

Mr. Rohrs owns and operates A. Clyde Rohrs & Associates, Inc. Accountants, in Independence, Missouri. This is a full service accounting, tax consulting, tax preparation and financial services firm of forty-eight years duration. In 1974 he became enrolled to Practice before the Internal Revenue when Donald C. Alexander was the Commissioner. He is an Accredited Business Accountant (ABA) and an Accredited Tax Consultant (ATA). Additionally, he is a Registered Representative for Terra Securities, Inc., which is part of Genworth Financial. He was President of the National Society of Accountants 1993-1994, and continues to actively serve. He was President of the Missouri Society of Accountants 1980-1981 and has served as its Legislative Chair for many years. He was actively involved in the rewriting of the Missouri Accountancy law adopted in 2001. Mr. Rohrs holds a BA Degree in Political Science & English from Central Missouri State University. **(IRSAC Chairman)**

Michael H. Salama

Mr. Salama is the Vice President of Tax Audits & Controversies with the Walt Disney Company in Burbank, CA, his expertise is in federal, state and local tax controversy matters. Prior to joining the Walt Disney Company, Mr. Salama was a Senior Manager at PricewaterhouseCoopers in the Washington National Tax practice group. In addition, Mr. Salama worked for the Internal Revenue Service, Office of Chief Counsel, as a Senior Trail Attorney in the Southern California District Counsel Office. Mr. Salama holds a BS Degree in Mathematics, Vassar College, Poughkeepsie, NY and a JD for the National Law Center at George Washington University. **(LMSB Subgroup)**

Mitchell S. Trager

Mr. Trager is currently the Senior Tax Counsel for Georgia-Pacific Corporation in Atlanta, GA and has been with Georgia-Pacific Corporation for 17 years. Mr. Trager has over twenty-three years experience in taxation. He has significant experience in research and planning, including work on compensation and benefits issues, IRS audit procedures, and issues involving capitalization. Prior to joining Georgia-Pacific, Mr. Trager was a tax attorney with The Joseph E. Seagrams Corporation in New York. In addition, he is the former chair of Tax Executives Institute's Federal Tax Committee and a two-time member of TEI's Executive Committee. Mr. Trager holds a BA Degree in Accounting from Queens College, NY, NY, a JD and a Masters in Taxation, LLM from the University of Bridgeport, School of Law. **(LMSB Subgroup)**

David A. Uhler

Mr. Uhler is a certified public accountant and a Partner in the tax department of Bartlett, Pringle & Wolf, LLP in Santa Barbara, California. He heads up the firm's Business Tax Group which assists businesses and their owners with active, strategic tax planning focused on entity structuring, compensation planning, and tax incentive optimization. Prior to joining Bartlett, Pringle & Wolf, Mr. Uhler was a manager in the tax department of Arthur Andersen, LLP. Mr. Uhler currently serves as an officer on the Board of Directors of the Central Coast MIT Enterprise Forum and Central Coast Venture Forum, two organizations focused primarily on fundraising for new business ventures throughout the Central Coast of California. Mr. Uhler has a Bachelor of Science in Commerce degree with an emphasis in accounting from Santa Clara University. **(LMSB Subgroup)**

Robert A. Weinberger

Mr. Weinberger is currently the Vice President for Government Relations for H&R Block, Inc. and head of its Washington Office. His responsibilities include liaison with the White House, the Treasury Department, IRS, Congress and business, consumer and public policy groups. Mr. Weinberger graduated from Oberlin College and the University of Illinois College of Law. In addition, he studied at the University of Illinois Institute of Government and Public Affairs and at Harvard's Kennedy School of Government. **(W&I Subgroup)**

Thomas Wharton

Mr. Wharton is currently the Vice-President of Tax at Pearson Inc. and US subsidiaries, located in New York City. He is responsible for Pearson's US income tax affairs, including nine billion dollars in assets and five billion in revenues. He has over twenty-eight years in corporate tax experience. Mr. Wharton is past-president of the New York Chapter of TEI and is currently the Chair of the Chapter's IRS Administrative Affairs Committee. He holds a BS Degree in Psychology and a minor in Chemistry from Rensselaer Polytechnic Institute, Troy, NY a BS in Accounting from New York Institute of Technology and a Masters of Science Degree in Taxation from C.W. Post University, Greenvale, NY. **(LMSB Subgroup)**