INTERNAL REVENUE SERVICE
ADVISORY COUNCIL
PUBLIC MEETING

NOVEMBER 6, 2003
1111 CONSTITUTION AVENUE NW
WASHINGTON, DC

INTERNAL REVENUE SERVICE ADVISORY COUNCIL
1111 CONSTITUTION AVENUE
PUBLIC MEETING
THURSDAY, NOVEMBER 6, 2003

AGENDA

Time	Topic	Presenters
8:30 - 9:00	Coffee/Refreshments	
9:00 - 9:15	General Remarks	Frank Keith Acting Chief, Communications & Liaison Beanna Whitlock Director, National Public Liaison
9:15 – 9:50	Opening Remarks Certificates to Departing Members	Mark W. Everson Commissioner, Internal Revenue
9:50 - 10:45	IRSAC Overview Report	Roger Harris, Chair, IRSAC
10:45 - 11:00	BREAK	
11:00 - 12:00	Wage & Investment Subgroup Report	Henry Lamar, Commissioner, W& I Gregory Steinbis, Chair, W&I
12:00 - 1:45	LUNCH	To Be Provided (Members Only)
1:45 - 2:45	Large & Midsize Business Subgroup Report	Frank Ng Deputy Commissioner, LMSB Betty Wilson, Chair, LMSB Subgroup
2:45 - 3:00	BREAK	
3:00 - 4:00	Small Business & Self Employed Subgroup Report	Dale Hart, Commissioner, SBSE Michael Evanish, Chair, SBSE Subgroup
4:00	ADJOURN	

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

PUBLIC MEETING
BRIEFING BOOK

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ADVISORY COUNCIL

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NOVEMBER 6, 2003

GENERAL REPORT
OF THE
INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

INTRODUCTION

The purpose of the Internal Revenue Service Advisory Council (hereinafter "IRSAC" or the "Council") is to provide an organized public forum for discussion of relevant tax administration issues between Internal Revenue Service (hereinafter "IRS" or the "Service") officials and representatives of the public. For fiscal year 2003, membership on the IRSAC consisted of twenty-three individuals who bring a wide breadth of experience, disparate expertise, and diverse backgrounds to bear on the Council's activities.

The IRSAC has organized itself into three subgroups, corresponding to three of the four IRS' Operating Divisions: the Large & Mid-Size Business Subgroup (hereinafter the "LMSB Subgroup"); the Small Business & Self-Employed Subgroup (hereinafter the "SBSE Subgroup"); and the Wage & Investment Subgroup (hereinafter the "W&I Subgroup"). Each Subgroup has issued a report that follows the general report of the entire IRSAC. All reports are a result of working sessions held in Washington during the year and numerous conference calls between IRSAC members and key IRS personnel. If not for the hard work of IRSAC members and the cooperation and efforts of representatives of the Service this report would not have been possible. We must offer special thanks to the staff of the Office of National Public Liaison for ensuring that IRSAC had all resources necessary to perform its advisory function.

ISSUE ONE: COMMUNICATION

Each year, the IRS gathers a great deal of information that in turn, it tries to communicate to both taxpayers and stakeholders. Effective communication increases stakeholder and taxpayer knowledge of the tax law and thus, increases their ability to successfully comply with the law and meet their compliance obligations. This suggests that effective communication ultimately gives rise to increased compliance. The Service utilizes many methods by which it attempts to communicate to stakeholders. Some of these methods: are stakeholder meetings; the IRS Web site; workshops, and the Nationwide Tax Forum Program. Although we commend the Service for its efforts, we are concerned that some messages do not reach the majority of the intended audience.

The IRSAC again attended the IRS Nationwide Tax Forums (hereinafter "Forums") during fiscal year 2003, partnering with members of the Information Reporting Program Advisory Committee (hereinafter "IRPAC") to conduct focus groups (hereinafter "Focus Groups") in Atlantic City, Atlanta, San Antonio, and Las Vegas. With upwards of 16,000 practitioners attending, we believe the Forums represent the best vehicle through which the IRS can reach practitioners as regards issues of importance. The IRSAC and IRPAC Focus Groups are intended to develop an understanding of issues that bear on practitioners, and to gauge the level of taxpayer/practitioner awareness as regards programs that impact these stakeholders in the ordinary course of their daily activities. We were disappointed to discover how little was known about programs such as the National Research Program and changes in the Offer in Compromise Program along with many other topics. We also found that the participants preferred smaller groups as they permit greater in depth discussions regarding topics of which they previously had little knowledge. If not for these Forums,

practitioners might not have received this necessary, additional information, contrary to the assumption of many Advisory Group members. The IRSAC believes that the Forums are a major tool that should be utilized to educate the practitioner community. The IRSAC also suggests that the Service continue to use such groups as the IRSAC and IRPAC to get their message out.

It was more difficult to determine the effectiveness of the IRS Web site. The IRSAC understands that those using the Web site found it much improved and very helpful. It was more difficult to judge however, how many practitioners actually use the Web site. Continued education provided by the Forums and other methods should be implemented to increase awareness of the benefits provided by the IRS Web site.

ISSUE TWO: INTERNAL REVENUE SERVICE BUDGET & WORKLOAD

For many years the IRSAC has recommended that the IRS receive adequate funding to implement its difficult tasks. We again reiterate our belief in the need for the IRS to receive adequate funding to operate effectively. However, the IRSAC believes that past budget issues faced by the IRS may be small compared to those the Service may potentially face in the coming years. The reality is that workloads are increasing and resources have not increased correspondingly. The Service has sought and continues to seek ways to improve service, increase enforcement, add new technology, and reduce taxpayer burden in the face of limited resources. The IRSAC commends their efforts and encourages the Service to continue performing all these important tasks. Unfortunately, without adequate funding, the IRSAC is concerned that both taxpayers and the tax system will suffer.

Tight budgets demand difficult decisions. One of these decisions may be to choose between taxpayer service and an increase in enforcement. As you will read in the reports of

our subgroups, the IRSAC is concerned that taxpayers have become more aggressive in taking chances as regards tax obligations and more willing to engage in the audit lottery. Practitioners we talked to in our Focus Groups verified this change in taxpayer attitude. In deciding how to prioritize IRS functions, the IRSAC believes that an effort must be made to enhance enforcement and begin insuring taxpayers that all taxpayers are being treated equally and that all are paying their fair share. The IRSAC commends Commissioner Everson for recognizing the need to find the proper balance between service and enforcement. However, the IRSAC must offer a word of caution; for many external stakeholders, talk of enhanced enforcement gives rise to the fear that the IRS will return to its old ways of doing business which created so many problems only a few years ago. The IRSAC recommends that the words and actions of the Service necessarily insure that enhanced enforcement will be a step forward not a leap back.

Limited resources have also forced the IRS to look for different ways to approach compliance problems. An example of this new thinking is the Offshore Voluntary Compliance Initiative and LMSB's Limited Issue Focus Exam Program. In these cases, the Service faced significant compliance problems that could not be addressed in traditional ways. These problems not only required attention, but a realization that budget issues required a solution that took into account the reality of limited resources. To date, the approaches taken by the Service in these areas have been successful and hopefully will serve as an example that new thinking can lead to new ways to address old problems. The IRSAC feels that in these times of tight budgets, all Operating Divisions must be challenged to create new, more efficient programs geared to improve compliance and enforcement.

ISSUE THREE: THE INTERNAL REVENUE SERVICE ADVISORY COUNCIL AND STAKEHOLDER INVOLVEMENT

Last year, a decision was made to extend IRSAC membership from two to three year terms. This decision was made to provide the IRSAC with greater continuity by replacing one third of its members each year. The IRSAC believes that the timing of this change was appropriate as it permitted experienced IRSAC members to be in place when the new Commissioner was confirmed. The IRSAC also feels that this change will allow the IRSAC to begin work immediately each year as the majority of its members and the leadership will be in place with people who have been involved with the Council for no less than one year.

The IRSAC is representative of many outside stakeholders and stakeholder groups upon whom the IRS depends for crucial feedback and/or input. During our tenure, the members of the IRSAC have seen outside input utilized to advantage and ignored to the disadvantage of the Service. Unfortunately, there appears to be no consistent approach or infrastructure in place in the Service to determine how best to utilize outside stakeholders. It appears to the IRSAC that the use of outside stakeholders is determined more on a person-by-person basis rather than as an agency-wide acceptance strategy. The IRSAC believes that until the entire IRS is comfortable partnering with and utilizing outside stakeholders, a huge resource and sounding board will remain untapped. The K-1 matching program is a perfect example of our concerns.

The IRSAC, along with other outside stakeholder groups, issued warnings early in the K-1 Matching Program design regarding problems that could be faced if the Service implemented a program without input from outside stakeholders. Unfortunately, these suggestions were ignored and the K-1 Matching Program was launched with dismal results. Ultimately because of many complaints from taxpayers, practitioners, other outside

stakeholder groups, and Congress, the program was stopped. This expensive and embarrassing mistake could have been avoided. The Service also failed to consult adequately with the Wage and Investment Subgroup and other stakeholders on two important topics: (i) the EITC Pre-certification initiative; and (ii) the revamping of ITINs. To the IRS's credit, however, they took the opposite approach in the design of the new K-1 Matching Program that launched this year. After much consultation with outside stakeholders, a modified program has begun that appears to be much more effective, and less burdensome on taxpayers. A more detailed discussion of this new program appears in the Small Business Self Employed Subgroup Report that follows this General Report.

We were also made aware of another example of how the use of outside stakeholders could provide the Service with additional benefits. In our presentations at the Forums, we discussed the EITC pre-certification program mentioned above. We found that many practitioners were willing to voluntarily pre-certify their clients if possible. By using practitioners in this manner, additional taxpayers would pre-certify with little or no additional cost to the Service. Further, because additional practitioners would be part of the process, their input could go a long way toward developing a program for use by all effected taxpayers which would therefore increase enforcement in a meaningful way.

The IRSAC hopes this perspective will serve as an example of how the use of outside stakeholders can be beneficial to the Service and ultimately to the taxpayers we all serve. We also hope that use of outside stakeholders will become consistent at all levels and in all IRS Operating Divisions.

CONCLUSION

This year's Council worked through the transition from Commissioner Rossotti to Commissioner Everson. We look forward to our continuing relationship with Commissioner Everson. We are in agreement with the goals and priorities he has set for the Service in the coming years. The IRSAC hopes that by working with Commissioner Everson and each of the business operating divisions we can contribute to achieving those goals.

INTERNAL REVENUE SERVICE ADVISORY COUNCIL

SMALL BUSINESS & SELF-EMPLOYED SUBGROUP REPORT

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NOVEMBER 6, 2003

SMALL BUSINESS & SELF-EMPLOYED SUBGROUP REPORT

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I. INTRODUCTION

The IRSAC Small Business & Self-Employed Subgroup (hereinafter "SB/SE Subgroup") consists of tax professionals who represent tax preparers and small and medium-sized businesses, having significant representation in professional organizations comprised of such preparers. The current SB/SE Subgroup has had two years of experience in their capacity as Subgroup members and, during this time, have had the opportunity to learn and become seasoned in their approach. The SB/SE Subgroup is thankful to the IRS as a whole, and to SB/SE Executives and Personnel in particular, for facilitating our meetings with key personnel, enabling our visits to program operations in campuses across the country, such as the Offers in Compromise program at the Brookhaven and Memphis sites. As discussed in the General Report, members of the SB/SE Subgroup also attended the Nationwide Tax Forums, as focus group participants, in four sites across the nation. The SB/SE executives have been cooperative and frank in their discussions with us and we thank them for their candor.

An Executive Summary of our Issues and Recommendations highlights several key observations:

1. Compliance. Enhanced enforcement must be weighted against taxpayer service to significantly improve eroding taxpayer compliance.

2. The National Research Program ("NRP"). The NRP launch involving Form 1040 individual audits is promising and well-planned; however, the NRP pass-through entity segment appears to be rushed and we strongly encourage proper planning and education of Revenue Agents.

3. Offer in Compromise Program ("OIC"). The OIC program has been improved significantly, which was in evidence during our visits to the Brookhaven and Memphis processing sites. However, more proactive taxpayer education is warranted to prevent the development of OIC cases. Likewise, settlement of more OIC cases at both Brookhaven and Memphis is encouraged to reduce the field office backlog of OIC cases.

4. K-1 Matching. The IRS is to be applauded for their cooperative approach in improving the K-1 matching program despite the early unannounced launch. The IRS has been extremely responsive to the SB/SE Subgroup and other stakeholder in providing feedback to improve the process. Additional enhancements will increase computer matching and reduce labor intensity for deployment to other initiatives.

5. Electronic Filing and e-Services. The concept of e-services to engage and incentivize e-file to the practitioner community is well-founded. The threat of mandates is not encouraged to increase e-filing activity. The benefits and incentives that accrue to practitioners as a result of e-filing should be marketed and explained to engage and transition practitioners.

6. Preparers. Poorly educated and unethical preparers are a serious compliance problem that the IRS must address through a tax preparer certification program applicable to all preparers. The Taxpayer Advocate has outlined such a preparer registration program.

The following list of SB/SE Subgroup recommendations is not all-inclusive; rather these items represent the issues the Subgroup deemed to be of primary importance, and thus were matters the Subgroup examined across the past year.

II. ISSUES AND RECOMMENDATIONS

ISSUE ONE: COMPLIANCE

The SB/SE Operating Division and the SB/SE Subgroup are well aware of the role enforcement plays in enhancing compliance which is necessary to ensure that our tax system is fair for all taxpayers. Over the past twelve months, the IRS has focused its attention on special programs currently marketed to taxpayers, such as Off Shore Credit Cards and Abusive Schemes, to identify fraudulent tax methods designed solely for the purpose of tax evasion. The taxpayer may not have been aware that the Off Shore Credit Card marketed to them was an illegal tax evasion scheme. However, when informed that such schemes are not in compliance with the tax law, taxpayers participating in such schemes wanted to become compliant and did so. The IRS must get the message out that improved customer service will be accorded the same emphasis as enforcement enhancements designed to increase compliance. There should be a balance within the IRS as between customer/taxpayer service and enforcement. For enforcement to be effective, it must be fair and balanced, yet the IRS must be careful not to create the perception that it is returning to its "old" ways. As such, it is important that the IRS distance itself from the methods employed before the Restructuring and Reform Act of 1998 that gave rise to significant criticism and the perception that the tax law was not being applied fairly or equitably. There are many effective ways to accomplish an increase in compliance yet prevent a return to the "old" IRS. When the taxpaying public becomes aware that the chances of detection for noncompliance have increased dramatically, compliance will rise. The taxpayer needs to believe that there exists a

sufficient likelihood of detection for noncompliance, fraud, and tax evasion schemes to believe the system is fairly administered. With budget restraints limiting available resources with which to launch new initiatives, the SB/SE Operating Division has a challenging and difficult task with respect to increasing compliance.

ISSUE ONE: RECOMMENDATIONS

The SB/SE Subgroup feels that the IRS should continue the educational outreach programs developed by the Taxpayer Education and Communication ("TEC") program.

The IRS should reach out and "touch" more taxpayers to increase compliance rather than spend long periods of time on fewer taxpayer cases. The more taxpayers that are "touched" by the IRS, the more the taxpaying public will believe the likelihood of fraud, abuse and evasion detection and the penalties associated with same. With help from the NRP, the IRS should align resources to produce an efficient audit program. The Large & Mid-Size Business ("LMSB") Operating Division is developing an innovative audit program called LIFE which focuses on taxpayers that have been cooperative in the past. Pursuant to the LIFE program, the IRS and taxpayer agree to focus audits based on certain parameters, and subject to materiality constraints. Similarly, SB/SE could develop such a program focused on high-income taxpayers for purposes of streamlining the audit process for cooperative taxpayers.

ISSUE TWO: NATIONAL RESEARCH PROGRAM

During the past year, the NRP has focused solely on Form 1040 taxpayers. The goal of the NRP is to update the profiles utilized to more accurately select returns for audit that are more likely noncompliant. The Questions and Answers booklet regarding

NRP states that "The purpose of the National Research Program is to ensure that our nation's tax system is fair." The Form 1040 individual tax return is the first stage in NRP and is well designed, employs well-trained Revenue Agents, and, accordingly results to date are very positive. While no taxpayer and/or preparer looks forward to an audit, the approach taken to date has helped greatly with the attitude of the taxpaying public.

Because the NRP has just launched and the number of Form 1040 NRP audits completed to date is small, the final impact and outcome of NRP's stage one cannot be determined at this time. As of August 15, 2003 examiners had completed 9,557 cases; which translates into twenty-two percent of the NRP Form1040 sample. National Research Program evaluation tools that will be rolled out soon that should enhance the program's probability for success; such as surveys that will be mailed to NRP participants (both preparers and taxpayers). The NRP information gleaned from the NRP taxpayer and preparer surveys should provide insights that will enable the IRS to maximize the success of the next NRP phase (pass-through entities).

The SB/SE Subgroup applauds all those involved in the Form 1040 NRP launch on what appears to be a job very well done.

Recently the SB/SE Subgroup was briefed on the pilot for the pass-through entity stage of the NRP. The IRS' attitude seemed to be that the Form 1040 NRP template could simply be used for the pass-through entity stage, with a few simple modifications. Pass-through entities (i.e., partnerships, subchapter S corporations, LLC corporations, etc.) represent an entirely different and extremely complex taxpayer base, entirely different Internal Revenue Code sections from those typically applicable to Form 1040 taxpayers, and require a much different level of expertise to effectively conduct pass-

through NRP audits. Although the SB/SE Subgroup expressed such concerns, we fear our concerns may have been taken lightly. Pass-through entity returns are among the most complicated returns to file, with taxpayers often comprised of and filing for multiple pass-through entities. If the design and implementation of this NRP stage is not carefully planned, and effective training of the revenue agents not employed (as was done with the Form 1040 stage) the effort may well fail. Poor planning of the NRP pass-through entities stage could waste resources, provide meaningless results with which to profile and select future returns for audit, and a perception among taxpayers and preparers that the IRS does not know what it is doing which would encourage fraud and abuse.

ISSUE TWO: RECOMMENDATION

The SB/SE Subgroup recommends that the IRS use even *greater* care in the design of the pass-through entity phase of the NRP than was utilized in the Form 1040 stage. The Internal Revenue Code is very complex as applied to pass-through entities; published instructions are confusing, many preparers and taxpayers have drifted far into the "gray areas" due to lax enforcement, and there exists a knowledge gap among many Revenue Agents that must be closed. In the long run, it will be far better to affect great care in rolling-out the pass-through entities stage of the NRP, for purposes of success. The IRS must design a unique program for pass-through entities and permit only those Revenue Agents having the proper knowledge and experience to perform such audits or effectively train other Revenue Agents similarly to perform such audits.

ISSUE THREE: OFFER IN COMPROMISE PROGRAM

The SB/SE Subgroup has followed the Offer in Compromise program very carefully for the past two years with the support and cooperation of the IRS. All of our members have visited at least one of the two centralized processing sites in Brookhaven and/or Memphis. We have seen the "wall" of offer packages waiting for missing information and observed the courteous manner in which the agents reviewing cases speak with taxpayers by phone. We have seen the full-pay calculation worksheet and have been periodically briefed on developments in the implementation of strategies for reducing the backlog of offers and decreasing processing time. We applaud the efforts being made to streamline the processing by centralizing, standardizing procedures, and training people in this specific collections area. We remain concerned that there are far too many valuable resources utilized in this area particularly as compared to the relatively small portion of the actual tax assessment collected. Thus, the return on resource investment is extremely low despite the professionalism of IRS employees engaged in OIC work. There continue to be offer filings by nonqualifying taxpayers, taxpayers who do not submit all required documents with the initial submission, and an apparent "churning" of offers (submitting more than one offer within a 180 day period). The IRS Web site now has an online self screening product to affect a reduction in the number of offers submitted by potential nonqualifying OIC taxpayers. When we visited the OIC processing sites at Brookhaven and Memphis, we were consulted regarding implementation of the application fee and the design of Form 656A regarding the low income fee waiver. We support the application fee as an effort to discourage frivolous

filers and to offset program costs, and we sincerely appreciate the efforts of the IRS to facilitate our visits to OIC processing sites and solicit our input regarding the details of the application fee process.

ISSUE THREE: RECOMMENDATIONS

The SB/SE Subgroup would like the IRS to take a harder look at the types of tax liabilities that place taxpayers in a collection position and thus, give rise to entry into the OIC program. A study should be commissioned regarding situations that ultimately give rise to a taxpayer's application/entry to the OIC program. The results of such a study would prove extremely useful in developing educational tools and collection processes that provide early intervention to prevent acceleration of a taxpayers resulting in an OIC position. In other words, identify common taxpayer scenarios that result in unpaid taxes and provide early IRS notification, intervention, tools, and collection processes that can assist a taxpayer in preventing its tax debt from accelerating out of control. As such, collection of taxes will increase and correspondingly reduce collection receivables and the OIC backlog.

The SB/SE Subgroup believes that there should be better follow-up on settled offers to ensure that the taxpayer remains in compliance for the required five year period, and some form of enforcement should apply to those who don't.

Implementation of the Application Fee will necessitate that offers be submitted to the Centralized Sites. Therefore, we recommend that these sites attempt to resolve more cases, thereby resulting in fewer cases that must be sent to the field where a backlog already exists. The Revenue Officers in the field should adopt some of the successful

procedures implemented in the centralized sites in an attempt to meet the six-month turnaround time goal for all offers.

The SB/SB Subgroup strongly encourages a signature line on Form 656 to determine the number of offers currently submitted by single persons who may need additional education and the number of offers submitted by individuals who should be prosecuted for fraudulent filings. If Form 656 could also provide a designated area to provide discussion as between the preparer and the IRS with respect to the return (notwithstanding that the preparer is not an enrolled agent, CPA, or lawyer), closure of OIC cases might be expedited.

The SB/SE Subgroup would like to strongly recommend that the processing centers be strict in assessing the Application Fee. We feel it a *privilege* to have the opportunity to submit an Offer In Compromise, and the least the taxpayer can do is submit a complete package. If the offer is not complete, it should be returned immediately as "not processable" and the Application Fee should be retained. If the Fee is not attached to a submitted offer, and no waiver accompanies the submitted offer, the entire package should be returned to the taxpayer.

ISSUE FOUR: K-1 MATCHING

The K-1 matching program should provide the model for the IRS when planning to undertake a major compliance initiative that affects both internal and external stakeholders. Although the program initially was problematic due to an early unannounced start-up that gave rise to negative responses, the IRS subsequently has

worked conscientiously with stakeholders to establish an effective operating compliance initiative.

Compliance in K-1 matching is extremely important based upon the increased level of abusive tax schemes that are often formed using flow-thru entities through which to transfer income. Internal Revenue Service estimates reveal that a one percent increase in compliant K-1 reporting could increase tax revenue by $500 - $750 million per year.

Feedback received at the Focus Groups conducted at the Nationwide Tax Forums, revealed that many practitioners are unaware of the K-1 matching program and its effect on their clients. The March 2003 Treasury Inspector General for Tax Administration ("TIGTA") audit report stated that in a sample of 100 returns containing Forms K-1, ninety two percent were prepared by practitioners.

There are several internal issues the IRS must consider. The modifications to the Schedule E are an important change that will enable matching to go smoothly and reduce labor costs required for matching. Since only partnerships with 100 members or more are required to e-file, the vast majority of K-1 filers *do not* e-file. Studies show that if partnerships with 10 or more members were required to e-file, 3.4 million Forms K-1 would be affected. The TIGTA audit also revealed that in some instances, IRS personnel incorrectly processed Forms K-1 to the wrong year's database. This causes significant problems and costs in the matching process.

ISSUE FOUR: RECOMMENDATIONS

The IRS should involve Stakeholder Partnership Education and Communication/ Taxpayer Education and Communication programs (SPEC/TEC) to increase tax

practitioner awareness of the K-1 initiative, and its affect on their clients. This educational outreach would complement upcoming changes in the Schedule E which is currently undergoing redesign to facilitate matching of K-1 income to income reported on the Schedule E.

The SB/SE Subgroup recommends that the IRS continue to review form and procedural changes to convert the K-1 program to a true computer matching program and thus, reduce labor costs involved in the screening process which would permit such resources to be deployed more efficiently. The IRS should also work with software vendors to ensure that the transmitted K-1 is in a form that can be easily matched.

Although the IRS can mandate e-filing for Forms K-1 with fewer than 100 members (as is the current mandate), it is best to utilize *incentives* to motivate practitioners and businesses to e-file. E-filing is a worthy goal, leading to burden reduction, and the provision of information that can be used to maximize other compliance issues and studies. The SB/SE Subgroup also recommends better training of IRS personnel to assist in reducing input errors.

The IRS has corrected most deficiencies in the initial K-1 matching program to such an extent that it is becoming a worthy taxpayer compliance program which results in increased tax revenues. Increased outreach to the tax practitioner community, along with e-filing initiatives will improve the program across time and permit re-allocation of IRS resources to maximum efficiency.

ISSUE FIVE: ELECTRONIC FILING AND E-SERVICES

The SB/SE Subgroup would like to commend the IRS on the inroads made in the past twelve months to increase enhancements with respect to Electronic Tax Administration and E-Services. The SB/SE Subgroup fully supports the need for such a program for purposes of providing *e-filing* incentives, and we will continue to provide our *full* support.

Tax practitioners file nearly sixty percent of individual and more than eighty five percent of business returns. Some segments of the tax professional community have now adopted *e-filing* as their principle way of doing business, a behavior that, if adopted by all practitioners, would put the IRS past its eighty percent by 2007 e-file goal. However, many practitioners have not adopted this practice, and although more than thirty million returns are computer generated, they remain submitted on paper. Tax practitioners produce seventy two percent of computer prepared individual returns yet only forty six percent of these same practitioners e-file.

At the Nationwide Tax Forums, the SB/SE Subgroup elicited responses from non-e-filing practitioners. Software costs, transmission costs, changing office procedures, and added workload, including additional staff time and related costs, as well as signature timing of clients comprise the principal reasons cited by practitioners as significant barriers to e-filing.

It should also be noted that taxpayers view practitioners as trusted advisors and are likely to follow a practitioner's advice regarding e-filing. Therefore, it is imperative that practitioners themselves are convinced of the added value provided by e-file or they will not sell it to their clients.

The SB/SE Subgroup supports the need for the E-Services program. The aim of the E-Services program is to provide practitioners who e-file valuable tools that assist them in reducing costs and improving services to customers. This program is likely to prove a *major incentive* to practitioners to e-file once it becomes operational and well-known among practitioners.

The SB/SE Subgroup was told that e-file mandates could be forthcoming, and that tax practitioners would have no choice but to comply. Coming from the IRS, this is perceived as especially negative and may well elicit increased push-back from the preparer community. Incentives for e-filing will be far more productive than mandates.

ISSUE FIVE: RECOMMENDATIONS

The IRS should:

- Streamline Federal/State E-filing – allowing multi-state returns to be e-filed for all states. E-file should be transparent by accepting all returns without limitations
- Eliminate the extra data entry required to e-file – such as Forms W-2 and 1099 data. The IRS should continue working on the 2D bar-coding to enable practitioners to scan the information.
- Continue with the increase of E-Service and provide additional value services on a timely basis as incentives to reach the eighty percent projection. Set the e-file requirement to increase the number of qualifying practitioners as regards the E-Service program.

- Understand how tax practices operate to remove hurdles, burdens, and significant costs of e-filing.

ISSUE SIX: PREPARERS

Paid preparers submit more than half of all tax returns filed and they prepare two-thirds of the Earned Income Credit returns filed. Paid preparers are estimated to number from 700,000 to 1.2 million. Of these, approximately half are subject to some form of professional accreditation or standards. Under the current system, Electronic Return Originators are held to higher standards than the remaining hundreds of thousands of tax preparers.

Any IRS effort to enhance enforcement should seriously consider the impact that *poorly educated and/or unethical preparers* are having on the increasing problem of non-compliance. The IRS should also consider the powerful and demoralizing message it sends to ethical preparers who lose clients to those with lower standards and fees by holding firm on standards for fraudulent and unethical return preparers. The SB/SE Subgroup's belief was validated by practitioners who attended the Nationwide Tax Forums. In our focus groups we heard many stories of taxpayers moving from preparer to preparer until they found a preparer who delivered the desired results. Taxpayers should be made more aware that the Service has public guidelines regarding choosing a reliable preparer (Tax Topic 254 and 1040 instructions).

The Service has available a system of preparer penalties, such as penalties for failing to sign a tax return they prepared. However, due to the lack of IRS enforcement, these penalties are not having the desired effect on the tax preparer community.

The Taxpayer Advocate, Nina Olson, has proposed a nationwide program for registering all preparers who file more than five returns for a fee. The recommended guidelines are: (a) register with the government; b) pass an initial examination based on the tax return, line by line; (c) annually pass a refresher exam on recent tax law changes and the most common errors from the previous filing season and d) receive a certification card.

The SB/SE Subgroup strongly supports a preparer certification program that will enhance the competency of individuals or firms that prepare tax returns for a fee. For a program to be effective it must receive adequate enforcement. This will, in turn, increase the morale of all tax return preparers.

ISSUE SIX: RECOMMENDATIONS

The SBS/E Subgroup believes that the Service should begin working with outside stakeholders to develop a program that immediately improves tax preparer competency. We believe this group must examine the following issues to be successful:

- Review existing preparer penalty and regulation policies and practices. Can they be used more effectively? Will they integrate with the program or stand alone?
- Can the program be self-funded with a user fee?
- Should the program address individual preparer, firm-level responsibilities or both?
- Which entity should manage the program? The IRS Office of Professional Responsibility? or a newly created entity established solely for that

purpose? Additionally, what role can existing tax professional associations play in the managing of the program?

- Deterrents, fines and suspensions, must be reasonable, consistently applied, and timely.

The SB/SE Subgroup does not foresee an increase in taxpayer burden or other harm to result from these actions. Taxpayer confidence will increase with respect to the competence of those who serve them. Many taxpayers are surprised to learn that many tax preparers are not regulated by the IRS or at all.

The SB/SE Subgroup looks forward to working with IRS representatives to assist in the development of a preparer program that can be effective and, therefore, enhance compliance.

INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

LARGE & MID-SIZE BUSINESS
SUBGROUP REPORT

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LARGE & MID-SIZE BUSINESS
SUBGROUP REPORT

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I. INTROCUCTION

The Large & Mid Size Business Subgroup (hereinafter the "LMSB Subgroup") consists of professionals who represent large and mid-sized businesses and in-house tax counsel from large multinational firms and associations. The members of the LMSB Subgroup come to the task without personal agendas. Rather, the overriding LMSB Subgroup agenda is to provide assistance to the IRS generally and LMSB specifically for the purpose of insuring efficient and fair tax administration and the development of equitable tax policy.

The Subgroup has been busy since January 2003; with five separate multi-day meetings conducted in Washington D.C. and several conference calls with LMSB personnel and executives. In addition, many LMSB Subgroup members participated in the Nationwide Taxpayer Program, partnering with Information Reporting Program Advisory Committee (hereinafter the "IRPAC") members, to conduct focus groups (hereinafter "Focus Groups") in Atlantic City, Atlanta, San Antonio, and Las Vegas. The LMSB Subgroup is most grateful for the time devoted by the executives and personnel of the Large & Mid Size Business Operating Division 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 three goals outlined by Commissioner Everson at our August 14, 2003 meeting. Although not exhaustive, the list of issues that follows identifies the primary issues and recommendations taken up this year by the LMSB Subgroup:

II. ISSUES AND RECOMMENDATIONS

A. REFOCUS ON ENFORCEMENT

1. EXAM CYCLE TIME AND AUDIT COVERAGE

DISCUSSION: In spite of the fact that the Large & Mid Size Business Operating Division utilized information gained from a 2001 strategic assessment to re-deploy its workforce in accordance with the determination of "top tier" taxpayers, doubled partnership entity audit coverage during fiscal year 2002, and projected an increased audit coverage in fiscal year 2003 of two and three-tenths percent, actual results thus far in 2003 reflect reduced audit coverage and no cycle time improvement. In fact, it continues to take an average of 60 months to complete an examination and the number of current cases has not improved significantly.

The LMSB Subgroup believes that the Large & Mid Size Business Operating Division (hereinafter "LMSB") should make increasing audit coverage (particularly for mid size businesses) and reducing the exam cycle time its top priorities. First, the LMSB Subgroup remains concerned with the low audit coverage of non-large case taxpayers, which we believe encourages non-compliance among mid-size businesses. Large & Mid Size Business's continued focus on the largest taxpayers is clearly preventing even minimum coverage for the remaining LMSB taxpayer community. The Large & Mid Size Business Operating Division reports that there has been considerable work on "enterprise risk assessment" for flow-through entities, Forms 1065 and 1120S. As such, close to sixty percent of the pass-through entity filing population involves a "tiering" paradigm such that the entity itself is either a member/partner/shareholder in/of a higher level entity, or it has members/partners/shareholders that are flow-through entities themselves. We realize that mandatory workload requirements for tax shelters, joint committee cases, and claim cases account for twenty five percent of LMSB's resources, and that CIC front end loaded staffing by industry components accounts for another fifty percent, leaving a mere twenty five percent to address discretionary high risk workload in the IC program. However, the LMSB Subgroup believes that this may not be maximizing resource allocation.

Second, the LMSB Subgroup believes that LMSB must instill a sense of urgency in the audit process. Although the various design teams, including new Breakthrough teams, feel the urgency to produce results, field agents continue to examine taxpayers using the same slow processes of the past. As the various design teams develop better tools for risk assessment and issue development, these tools must be implemented in the field without delay. Use of the Limited Issue Focus Exam process, or at least the tools inherent in the process, must be mandatory rather than optional to bring examinations current and reallocate resources appropriately. The LMSB Subgroup is highly encouraged by LMSB's establishment of the Breakthrough teams and their preliminary plans for improving currency. Success in the currency initiative should allow LMSB to re-deploy resources and improve audit coverage of mid sized businesses.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) re-deploy resources to improve audit coverage of mid size businesses; (ii) instill a sense of urgency in field agents and managers regarding completion of examinations; (iii) make use of Limited Issue Focus Exam (hereinafter "LIFE"), or at least the processes of LIFE, mandatory for all audits with but a few limited exceptions; (iv) use whatever means necessary to move away from the examination practices and processes of past years and close old cycles to examine current tax years; and (v) continue to refine risk assessment tools to enable agents to identify significant and key issues in each tax return examined.

2. POST-FILING PROCESSES

The Large & Mid Size Business Operating Division has initiated a number of new and revised procedures to make the post filing process more efficient. These include: LIFE, a redesigned claims process, and a myriad of tools that have been tested previously in pilot programs, including Pre-filing Agreements, Fast Track Appeals and Mediation, Industry Issue Resolution, and Comprehensive Case Resolution (hereinafter the "Tested Processes"). In addition, LMSB has

Breakthrough teams developing, among other things, a plan for improved cycle time and improvement in the number of current cases in exam years.

a. LIMITED ISSUE FOCUS EXAMINATION

DISCUSSION: Limited Issue Focus Examination rolled out in the fall of 2002 and is a process focused on specific issues and the concept of materiality. Using established guidelines as regards issues and materiality, a Team Manager may agree to an audit plan for each participating taxpayer, pursuant to which the IRS agrees to audit only certain issues based on a materiality threshold, in return for which the taxpayer agrees to refrain from filing a claim below the threshold. The agreement is documented in a Memorandum of Understanding (hereinafter "MOU") and the audit is scheduled for completion within a shortened and specified time frame.

The LMSB Subgroup strongly recommends LIFE because it: (i) focuses exams on material issues; (ii) enables (and we recommend) the "freed-up" resources to be re-allocated to less cooperative taxpayers and to groups of LMSB taxpayers for which the IRS has not had traditionally high audit coverage (e.g., mid size taxpayers); and (iii) acknowledges that certain cooperative taxpayers generate a lower audit risk.

During 2003 changes were made to the LIFE process: (i) the materiality threshold was clarified; (ii) the MOU was modified; (iii) and instructions for rollover and recurring issues were clarified. In addition the LIFE Design Team developed a bullet point list of "The Facts of LIFE" and written responses to frequently asked questions. The LMSB Subgroup is in general agreement with these changes. After we expressed our concern that "The Facts of LIFE" began with a bullet point that took emphasis away from using LIFE, the Team revised the bullet point to emphasize that LIFE should be considered for all LMSB exams including the largest CIC cases.

The LMSB Subgroup continues to believe that use of the LIFE process must be the default procedure rather than optional, with a few limited exceptions, if examinations are to be brought current and resources are to be reallocated appropriately. Unfortunately, we understand that preliminary numbers reflect that of the cases opened since January 2003, only about ten percent are LIFE.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) make LIFE, or the processes of LIFE, the standard procedure with few limited exceptions; (ii) insure that all written material places strong emphasis on utilizing any and all tools available to close old cases to increase the proportion of current cases; and (iii) insure that the Team Manager using LIFE is empowered to resolve and settle cases.

b. CLAIMS REDESIGN

DISCUSSION: The Large & Mid Size Business Operating Division's redesign of the claims process remains on-going, and the LMSB Subgroup understands there may be a pilot project rather than a full-blown roll out of the new process. The Large & Mid Size Business Operating Division's initial inclination is to have "two paths" for claims, allowing taxpayers to make informal claims with the audit team as opposed to making a formal claim on an amended return. The "first path" is for claims raised within six months of the beginning of the audit. The "second path" is for claims made after expiration of the "first path" time period. Claims made pursuant to the "first path" would be audited and resolved by the audit team. Claims made pursuant to the "second path" would be handled on a parallel track and be reviewed outside the audit time frame on a resource available basis.

The LMSB Subgroup is sympathetic and agrees with LMSB's early stage design. However, as LMSB continues the redesign, care must be taken such that final design

requirements function as an excuse for audit teams to limit audit claims to a resource-available basis only. As such, the design would effectively defer and/or preclude resolution, and negatively impact the beginning of the following exam cycle. The LMSB Subgroup also notes that the recently issued Treasury Inspector General for Tax Administration ("TIGTA") report determined that the proposed revenue procedure for LMSB's CIC case claims processing could "significantly" increase the interest the IRS is required to pay on claims. In addition, the LMSB Subgroup believes it important that LMSB and the IRS institutionalize the claims of non-large case taxpayers under audit, so that: (i) such claims are subject to the "two path" process; (ii) such claims must be submitted to the auditor; and (iii) a Service Center is prevented from processing a claim or granting a refund without the approval of the audit Team Manager.

RECOMMENDATIONS: The LMSB Subgroup believes that LMSB should insure that the final claims process is not a potential method for deferring and/or precluding the resolution of issues. Ensure the final claims process applies to all taxpayers both large and small.

c. THE TESTED PROCESSES

DISCUSSION: As stated above, LMSB has instituted a myriad of Tested Processes. The Industry Issue Resolution (hereinafter "IIR") program was made permanent by Notice 2000-20 and resolves issues that impact numerous taxpayers in particular industries. The program procedures were revised and incorporated in Revenue Procedure 2003-36. To date, published guidance recommended by ten IIR teams have been released. In addition, nine other IIR teams are currently resolving issues.

The Pre-filing Agreement (hereinafter "PFA") program permits taxpayers, before filing a return, to resolve issues that would likely be disputed in a post-filing examination. .The PFA program is intended to produce agreement on factual issues and apply

settled legal principles to those facts. A PFA is a specific matter closing agreement and as such resolves the subject of the PFA for a tax period or periods (We understand that originally the PFA was to apply to only one tax year and we strongly encouraged LMSB to allow the PFA to apply to multiple years going forward.). Execution of a PFA is intended to resolve issues prior to filing, thus reducing costs, burdens, and delays often incident to post-filing examination disputes. Since the PFA program was made permanent, LMSB has accepted seventy one of the 102 applications received. For cases closed in calendar year 2002 only, it has taken on an average, 183 days to evaluate an application, and 235 days to complete a PFA. The process has required more time than originally anticipated, has resulted re-deployment of resources from basic audits, and has produced relatively few agreements.

The Comprehensive Case Resolution ("CCR") pilot to date has resulted in the resolution of one case in two years. As a result, the program has been replaced indirectly with Fast Track. The Fast Track process was found to successfully handle cases having a prior cycle in Appeals, and has effectively accomplished the intended purpose of CCR for those cases.

Lastly, the Fast Track Appeals program has been highly praised and has resulted in resolution of cases in seventy three days, on the average. To our knowledge, the Fast Track Mediation program has not been utilized.

The Subgroup believes that IIR has been the most successful of the Tested Processes and strongly encourages LMSB and the IRS to continue using this useful program. Further, the LMSB Subgroup believes that the PFA program has not been successful, largely because the program is resource intensive as regards both the IRS and the taxpayer for a resolution that applies to one tax year only. The LMSB Subgroup has serious concerns regarding: (i) the

program's applicability to non-large case taxpayers; and (ii) the potential costs to both the IRS and the taxpayer as regards revisiting the same PFA issues in the future. This results from a closing agreement procedure that is applicable to a particular tax period or periods only. However, the LMSB Subgroup encourages LMSB to examine a possible redesign of the PFA program for purposes of addressing these issues. The Fast Track Appeals program should be emphasized and continued, and, for the time being, the LMSB Subgroup encourages LMSB to continue marketing the Fast Track Mediation program. Lastly, as noted last year, the LMSB Subgroup continues to believe that existing processes, such as Delegation Orders 236 and 246, and the Accelerated Issue Resolution, should be given new life, emphasized in equal proportion as the new processes, and measured to determine their effectiveness. The results of these measurements should be publicly reported.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) make PFA's applicable to multiple tax years on a going forward basis; (ii) continue to emphasize Fast Track Appeals; (ii) re-emphasize and revitalize Delegation Orders 236 and 246, and Accelerated Issue Resolution; and (iii) develop new processes that encourage faster resolution of issues, shorter examination cycles, and increase current exams.

d. REDESIGN OF ENTIRE POST-FILING PROCESS

DISCUSSION: At one time, LMSB had engaged an outside facilitator to assist an assembled team to review and redesign the post-filing process. However, however, due to a lack of funding, LMSB was forced to terminate the facilitator and discharged the team. Subsequently, the LIFE process was developed internally and the LMSB Subgroup commends LMSB for this project.

Last year the LMSB Subgroup strongly encouraged LMSB to recommence the redesign of the post-filing process notwithstanding budget constraints, and urged LMSB to seek assistance from its stakeholder groups and the IRSAC in the redesigning process. The new Breakthrough teams are moving in the right direction and the LMSB Subgroup encourages continued support of these teams. As part of the redesign, the LMSB Subgroup encourages LMSB to consider redesigning the process around "issues" and the "concept of materiality" (i.e., concepts used in LIFE) to streamline the post-filing process and "free-up" additional resources. The LMSB Subgroup believes that requiring that the LIFE process be mandatory in all LMSB exams, subject to limited exceptions, would prove most effective. A redesigned post-filing process (whether that be mandatory use of LIFE or some other process) is critical to managing IRS' limited resources more wisely. With respect to non-large case taxpayers, the LMSB Subgroup strongly encourages LMSB to mandate procedures such that, prior to commencement of an audit, the agent, working with the taxpayer, establishes a written plan that includes an estimated completion date.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) make the LIFE process mandatory, with limited exceptions; (ii) require an exam agent to work with the taxpayer to develop a written exam plan with a targeted completion date prior to commencement of an audit; (iii) continue Breakthrough team work and engage outside stakeholders in the design process, particularly the IRSAC LMSB Subgroup.

3. THE LARGE & MID SIZE BUSINESS OPERATING DIVISION BUDGET

Discussion: Based on actuarial data, LMSB estimates it will lose 250 agents in fiscal year 2003 and a substantial number of agents and employees across the next nine years. However, LMSB has budgetary funding to replace less than thirty percent of these agents. Without such agents, the LMSB Subgroup believes that a severe compliance problem will develop among

LMSB taxpayers, particularly as regards mid-size taxpayers. The LMSB Subgroup is encouraged by the number of significant new hires in 2003 and LMSB's plans to hire additional staff in 2004.

LMSB has developed numerous processes by which the number of personnel necessary to conduct audits will be reduced. However, given the extent of employee losses, these processes will operate as a mere band-aid for the problem. The IRS should fund LMSB adequately to meet its personnel needs, and it must develop training programs for new and remaining employees.

RECOMMENDATIONS: The LMSB Subgroup recommends that: LMSB: (i) receive adequate funding for personnel replacements; and (ii) develop state-of-the-art employee training programs

4. TAX SHELTERS

DISCUSSION: Curtailing abusive tax shelters has been a major LMSB priority. Several mechanisms have been deployed by Treasury and the IRS to identify shelter transactions, their promoters, and the taxpayers employing them. During 2002, LMSB undertook a voluntary disclosure initiative that resulted in 1,689 disclosures from 1,206 taxpayers. Across the past year, LMSB has made settlement initiatives available to close out certain common transactions. For example, the IRS conducted an initiative from October 2002 through March 2003 that allowed taxpayers engaged in certain abusive transactions to resolve the tax consequences arising from participation in such transactions. Further, the IRS has been very active in seeking to compel promoters to identify clients who have purchased tax shelters. The LMSB Subgroup commends LMSB for their success in attacking Tax Shelters and encourage the IRS to continue using appropriate means to identify abusive transactions, the taxpayers who use them, and the promoters who sell them. The LMSB Subgroup continues to believe that promoters are sources of useful

information and the key to curtailing the development and sale of abusive transactions. The LMSB Subgroup is concerned that certain promoters have refocused their efforts to market schemes to mid-size and small taxpayers, and the LMSB Subgroup recommends that the IRS seek new ways to cease the marketing of such transactions to these taxpayers.

At the same time, the LMSB Subgroup encourages LMSB to publicly recognize that many large corporate taxpayers do not engage in abusive corporate tax shelters. Such public acknowledgement would go a long way toward improving relationships between the field and taxpayers that are currently under examination. Large & Mid Size Business Operating Division representatives, including former LMSB Commissioner Langdon, have often said that they have no intention of curtailing ordinary tax planning. As a result, it would be helpful if guidance were issued defining transactions that LMSB considers ordinary tax planning transactions. The LMSB Subgroup believes that LMSB's reluctance to issue such guidance has resulted in legitimate tax planning classified as abusive transactions.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) continue to identify abusive tax shelters and vigorously prosecute promoters; (ii) focus its attention on mid-size and smaller taxpayers to which new abusive shelters are being promoted; (iii) publicly recognize that many corporate taxpayers have not engaged in abusive tax shelters; and (iv) issue guidance regarding transactions that are considered ordinary tax planning versus those considered to be abusive tax shelters.

B. CONTINUED CUSTOMER SERVICE APPROACH

DISCUSSION: The IRS has made a much-needed move toward a "customer service approach" in the last few years. However, it is feared that enforcement has suffered in the process. Commissioner Everson has stated that he intends to refocus the Service on enforcement yet

continue to pursue a customer service approach, and LMSB has embraced this goal. The LMSB Subgroup commends this focus and believe that a proper balance must be achieved for the IRS to effectively administer the tax system. The Large & Mid Size Business Operating Division has in fact been effective in the area of enforcement and Tax Shelters, but has been unsuccessful in increasing audit coverage of non-large case taxpayers and increasing the number of current cases in the exam cycle.

RECOMMENDATION: The LMSB Subgroup recommends that LMSB continue to "take a fresh look" at all processes, and involve stakeholders and the IRSAC in all process redesign initiatives.

C. STRENGTHENED MODERNIZATION EFFORTS

DISCUSSION: The Commissioner's third goal is to strengthen modernization efforts. Although much progress has been made toward modernization, the progress has not been sufficiently rapid to produce the intended results. The Large & Mid Size Business Operating Division has made strides in using interactive technology for training purposes, becoming part of the IRS Web site, and designing the 1120 e-file project, which is a part of modernized e-file. The LMSB Subgroup is particularly encouraged that business taxpayers will be able to file Form 1120 and attachments electronically for tax year 2003.

RECOMMENDATIONS: The LMSB Subgroup recommends that LMSB: (i) continue to press forward on the modernized e-file initiative for business returns; (ii) continue to enhance the Web site, to provide a more interactive site that can serve as a portal for (a) filing, including: Coordinated Issue Papers, pre-filing agreement procedures and forms, Forms S-4, Forms 966, S status elections, check-the-box elections, and ruling requests; (b) checking taxpayer accounts and filing status; and (iii) continue to utilize technology to enhance IRS personnel training.

INTERNAL REVENUE SERVICE ADVISORY COUNCIL

WAGE & INVESTMENT SUBGROUP REPORT

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WAGE & INVESTMENT SUBGROUP REPORT

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I. INTRODUCTION

The mission of the Wage & Investment Operating Division (hereinafter "W&I" or "Division") is to simplify compliance with the tax law for the diverse group of more than 144 million taxpayers served by the Division. Diversity within W&I can be found on many levels, including income, language, and education. The Wage & Investment Subgroup (hereinafter "W&I Subgroup" or "Subgroup") is pleased that W&I leadership, in the Division's Strategic Plan and Assessment, continues to recognize the Internal Revenue Service (hereinafter "IRS" or the "Service") goal of providing top-quality service to taxpayers. A significant amount of planning and energy remains focused on developing strategies and systems that meet the demands of an extremely diverse customer base to effect timely, accurate, efficient, and automated services.

Compliance continues to be the watchword. As long as more than twenty-five percent of the taxpaying community believes that the "tax man" can be cheated, the viability of our voluntary tax system is at risk. While modernization and staffing efforts of the IRS continue, it is clear that until information systems are modernized and full staffing is achieved, the integrity of our system will continue to erode.

ISSUE ONE: ON MEETING THE CONGRESSIONALLY MANDATED EIGHTY PERCENT ELECTRONICALLY FILED RETURNS BY YEAR 2007 GOAL

As we are all well aware, Congress has mandated that eighty percent of all returns filed be filed electronically by year 2007. Currently, over seventy-three percent of the Form 1040 family of returns come within the purview of W&I, and by year 2009, it is projected that seventy-one percent of these returns will fall under W&I. Of this seventy-one percent,

it is anticipated that only sixty percent will be filed electronically in year 2009. The W&I Subgroup believes that the Service does not yet recognize the complexities created by inconsistencies between electronic and paper filing that inure to both taxpayers and practitioners, i.e., requiring both practitioners and taxpayers to provide PINS respectively on Form 2688 (request for additional extension of time to file) whereas paper filing requires the practitioner's signature only. These inconsistencies have a chilling effect on *e-filing.*

ISSUE ONE: RECOMMENDATIONS [ON MEETING THE CONGRESSIONALLY MANDATED EIGHTY PERCENT ELECTRONICALLY FILED RETURNS BY YEAR 2007 GOAL]

While the W&I Subgroup is encouraged by IRS outreach efforts to practitioner organizations, the Subgroup believes that this effort, in and of itself, is insufficient. As in private business, the Service must reach out to the practitioner community. Last year the IRSAC recommended that the IRS create focus groups to determine why practitioners do not file electronically. We understand that the Service did conduct such Focus Groups at the Nationwide Tax Forum Program this year. Although it is too early to identify the results of these sessions, the W&I Subgroup recommends that the Service continue to conduct such Focus Groups until measurable results indicating the effectiveness of same can be obtained. The W&I Subgroup also recommends that the Service visit practitioner offices to see first hand what it takes to run an *e-file* office.

ISSUE TWO: "FREE" ONLINE FILING CONSORTIUM

The W&I Subgroup understands the need for IRS outreach to software providers for purposes of offering "free" online filing. However, as is the Taxpayer Advocate, we

are discouraged by the Service's oversight of this Consortium operation. The W&I Subgroup understands that all information has not been forthcoming from the Consortium which precludes statistical assessments. Another concern is the "pop-up" ads advertised by software providers. These ads offer additional services for a fee but do not make it clear that the services offered are not supported by the Service; i.e., Rapid Refund Loans (hereinafter "RALS").

ISSUE TWO: RECOMMENDATIONS – ["FREE" ONLINE FILING CONSORTIUM]

The W&I Subgroup recommends that the Service gather and study statistical information for purposes of determining the effectiveness of "free" online filing. The W&I Subgroup further recommends that the Service require disclaimers on "pop-up" ads – particularly those sourced in Consortium members - stating unequivocally that the additional services or products advertised are not offered nor supported by the Service.

ISSUE THREE: REGULATION OF PAID PREPARERS

An estimated fifty-four percent of all taxpayers engage paid preparers to complete their income tax returns. Data from the 1997 filing season estimates that 1.2 million tax preparers were identified on filed tax returns. Notwithstanding these figures, a minimum standard of competence for paid tax preparers does not exist. Present law does not address the need for tax preparers to possess baseline knowledge as regards tax law, procedure, and/or regulatory guidance. Likewise, imposition of minimum standards regarding skill, training and/or other basics necessary to reach a requisite level of competence does not exist among tax preparers. In general, taxpayers are not aware that

tax return preparers are not regulated, and that no threshold exists with respect to baseline competence. Few states regulate paid preparers and many are not likely to consider regulation due to the absence of a state income tax. The W&I Subgroup feels that this is not only a compliance issue but also a matter of public protection.

At present, no consistent data exists with which to compare error rates and the incidence of noncompliance as between regulated and unregulated paid preparers. In recent years, the Service has collected data regarding error rates and fraud as regards claims for the Earned Income Tax Credit (hereinafter "EITC"). The collected data provides that an estimated sixty-eight percent of all EITC claims are prepared by paid preparers. Through mid-October 2002, sixty-seven percent of the returns selected for EITC audit were filed and prepared by paid tax preparers, and the returns were selected due to a high probability of error. However, error rates among EITC paid preparers are not categorized by preparer type.

Recent support for regulating paid preparers has emerged from several sources. Included among supporters are the Commissioner's Advisory Group (1995 Report), the 1997 National Commission on IRS Restructuring, and New Mexico Senator Bingamen, who introduced the Low Income Taxpayer Protection Act of 2002. In addition to these and other proponents of paid preparer regulation, the National Taxpayer Advocate cites incompetent paid preparers as a significant source of noncompliance, particularly as regards EITC claims. In her 2002 Annual Report to Congress, Nina Olsen, the National Taxpayer Advocate, recommended paid preparer registration and certification.

Last year's W&I Subgroup Report cited as an issue of concern the low assessment rate of preparer penalties. The W&I Subgroup remains concerned that existing sanctions are not utilized to maximum benefit. Based on data reported by the Return Preparer Program (hereinafter "RPP"), as applied to EITC claims, only 101 due diligence penalties were assessed during fiscal year 2001. The RPP also reports that over the past three fiscal years, Criminal Investigation has identified at least 6,854 questionable returns from ninety-six criminal investigations of paid preparers related to EITC over-claims. During the same three fiscal years, fifty-three preparers have been convicted of ETIC fraud. The Subgroup believes that related data indicating a large number of incompetent and fraudulent paid preparers is much higher.

ISSUE THREE: RECOMMENDATIONS – [REGULATION OF PAID PREPARERS]

The W&I Subgroup recognizes that specific data must be captured and evaluated to determine the size of the paid preparer problem, as regards the type of paid preparer and the dollars attributable to incompetence and fraud. Data is currently being collected through the National Research Program (hereinafter "NRP") and EITC. The W&I Subgroup recommends utilizing the paid preparer information generated by these programs to separate data as between regulated and unregulated preparers. By segregating error types and rates by type of preparer, the Service can more realistically determine the impact of unregulated preparers on noncompliance and fraud. When appropriate data is analyzed, the Service will be able to determine the costs of incompetence and fraud as regards unregulated paid preparers compared to regulated paid preparers.

The W&I Subgroup recognizes that regulating paid preparers will come at significant cost to the Service. However, the substantial cost associated with incompetence and fraud among unregulated preparers is equally significant. There are financial consequences to the taxpaying public who fall victim to paid preparer incompetence, and an increase in tax dollars expended to cover the cost of compliance enforcement for incompetent preparers. The W&I Subgroup recommends that the Service determine the costs of noncompliance among unregulated paid preparers, as well as the cost of regulation. The results should be evaluated using a cost-benefit model to determine the ultimate cost or benefit emanating from the regulation of paid preparers. Well designed studies will provide detailed information, i.e. break down categories of costs and benefits by type of error/noncompliance, demographic differences, and preparer education or training level.

Recognizing that regulation is a long-term effort, the W&I Subgroup encourages the Service to increase the public's awareness of compliance as related to paid preparers immediately. While preparer convictions are published in limited media sources, these sources are of particular interest to tax professionals and interested individuals. The W&I Subgroup recommends that the Service broadcast such convictions across a broader range of media types accessible to the general public.

In addition to publishing convictions, the Service should develop and implement a media-wide public service campaign to educate taxpayers as regards their responsibilities regarding compliance and the consequences of engaging a paid preparer. The public must

be aware that a paid preparer should sign the return along with the taxpayer and understand the consequences of a paid preparer failing to sign the return.

Finally, the W&I Subgroup understands that regulating paid preparers is a great undertaking for the Service. Therefore, the W&I Subgroup recommends that the Service look to other regulation models i.e., the National Association of Securities Dealers (hereinafter the "NASD") and request Congressional authorization for such regulations.

ISSUE FOUR: MULTILINGUAL INITIATIVE

Data gathered from the 2000 census provides that over 10.4 million residents of the United States are Limited English Proficient (hereinafter "LEP"). Spanish speaking residents represent seventy-one percent of the LEP population, while a substantial component is eligible for the EITC, a complicated tax formula/calculation. When IRS notices, letters, and forms are not understandable, taxpayers have a difficult time meeting their tax obligations. Thus, translation initiatives for forms, notices, and letters should yield increased tax compliance.

Pursuant to Executive Order 13166, the IRS, like other federal agencies, was required to develop and implement a program by which LEP persons obtain meaningful access to services normally provided to English proficient taxpayers. To comply with this order, the IRS created the Multinational Language Initiative (hereinafter "MLI") in November 2000. One of the MLI projects was to identify and translate vital documents to assist LEP taxpayers.

The Multilingual Initiative

During Fiscal Year 2003, the MLI conducted an assessment of language needs. This assessment consisted of three parts. First, the MLI conducted a demographic assessment to identify: (i) the number, proportion and location of LEP taxpayers; (ii) the top languages spoken by LEP taxpayers; and (iii) the characteristic profiles of the top languages. Second, the MLI conducted an agency assessment through which it identified where MLI resources existed in the IRS and the demand and frequency of MLI contacts within the IRS. Lastly, the MLI assessed the effectiveness of current MLI products and services and identified additional needs.

Further, the MLI identified 139 vital documents for translation, although the Subgroup is unclear as regards how such documents were submitted. A recent audit report by the Treasury Inspector General for Tax Administration (hereinafter "TITGA") Report No. 2003-40-163 (August 2003), indicated that the MLI used informal surveys of external stakeholders to identify vital documents.[1]

The methodology used to prioritize translation of the 139 vital documents was a scoring system and evaluation form based on the criteria of Executive Order 13166. Applying this methodology to the 139 identified documents, 104 documents were identified as vital for translation, twenty-six were not recommended for translation, and nine were recommended for further analysis. Of the 104 documents identified as vital for translation, seventy-three have been translated thus far. In identifying the documents vital

[1] The TITGA report noted that the IRS had used informal surveys with external stakeholders to identify the documents most useful to assist LEP taxpayers comply with tax laws. However, the report noted that only 28 of the 58 documents identified through this process (or 28%) had been translated. The report recommended that the MLI develop a formal survey process to ensure that the IRS identify the documents that are the one LEP taxpayers believe are most useful to their ability to understand and comply with tax laws. TITGA also recommended that translation of documents would help taxpayers who may speak English well, but who may not be able to read and understand English.

for translation, the MLI assumed that the vast majority of taxpayers for whom Spanish is a first language use paid preparers to prepare returns.

ISSUE FOUR: RECOMMENDATIONS – [MULTILINGUAL INITIATIVE]

First, the W&I Subgroup shares the Inspector General's concern regarding the informality of the process used by the MLI to identify vital documents for translation and recommends that the process for identifying vital documents be formalized and publicized. While the W&I Subgroup applauds the MLI attempt to engage external stakeholders in the process of identifying vital documents for translation, such a process should be well developed and focus on engaging many disparate external stakeholders in diverse geographical areas of the United States. Further, the process should permit external stakeholders to contact the MLI if not contacted themselves.

Second, the W&I Subgroup is concerned as regards the assumption made by the MLI that Spanish speaking taxpayers often use paid preparers and the extent to which this assumption impacted the identification of documents. To the extent that this assumption gave rise to decisions not to translate documents, the W&I Subgroup urges the MLI to reconsider. Translation of documents, as with the initiative to rewrite IRS notices, letters and forms, should have focus on the ability of LEP taxpayers to comply with the tax law notwithstanding consultation with a tax preparer. Along these lines, the Subgroup supports the MLI recommendation of a pilot translation of Form 1040 instructions and the provision of teletax topic narratives in Spanish on the IRS Web site. Further, it seems to the W&I Subgroup that translated documents may assist preparers who do not speak the same language as their clients in preparing returns.

Third, the level of coordination between the MLI project and other IRS projects as regards rewriting of letters, notices and forms is not clear to the W&I Subgroup. The Subgroup believes that the MLI should coordinate with IRS rewriting initiatives to address low literacy rates of LEP taxpayers. The W&I Subgroup also urges the IRS to develop a formal process with which to identify various dialects within languages identified for translation for purposes of assisting low LEP literacy rates.

Fourth, regarding compliance recommendations, the MLI has recommended hiring Spanish-speaking employees, IRS budget permitting, providing limited Spanish language training, and providing a translation aid to non-Spanish speaking employees. The W&I Subgroup supports these recommendations. Within the LEP population, anecdotal information suggests that the inability of Spanish speaking taxpayers to communicate by phone is a source of non-response to IRS notices, letters, and forms. Increasing the number of Spanish speaking employees, and enabling employees to have, at the very least, a working ability to communicate with such taxpayers will positively impact responses to non-translated IRS notices, forms and letters.

ISSUE FIVE: EARNED INCOME TAX CREDIT

During the 2003 filing season, 20.6 million taxpayers received EITC benefits in excess of thirty-six billion dollars. Across the past ten years, this program has become the Nation's largest anti-poverty initiative and has also become a source of significant controversy due to its complexity and persistently high error rates.

In January, 2003, the W&I Subgroup was advised of plans for an EITC pre-certification initiative, although details of the plan were not available. In March, following

reports of briefings to other stakeholders, the W&I Subgroup conducted a conference call during which it learned that a new pre-certification initiative would consist of three components: (i) pre-certification of qualifying child status for up to twenty percent of taxpayers whose qualifying child was not a biological child (e.g., a grandchild, niece, step-child, foster child, etc). Two new forms, one verifying the qualifying child's residence, the other verifying the relationship of the qualifying child to the taxpayer would be sent to 45,000 taxpayers in the year 2003 and to several million taxpayers in subsequent years; (ii) filing status certification, to verify marital status for taxpayers suspected of filing incorrectly as single or head of household – 5,000 taxpayers targeted in the initial pilot phase; (iii) under-reported income certification, to verify the income of taxpayers who previously reported income incorrectly for purposes of inflating EITC benefits - 175,000 taxpayers targeted.

All taxpayers placed in the pre-certification program would have their EITC benefits frozen until adequate documentation of eligibility for EITC is presented to the IRS. In preparing for implementation of the pilot project, the IRS conducted focus groups consisting of taxpayers and income tax preparers in four cities for purposes of assessing the level of understanding as regards letters, forms and instructions.

In June, 2003 the IRS formally requested comments on the initiative. On August 5, 2003, following review of several hundred comments, the IRS announced a revised initiative to begin January, 2004, to coincide with the filing season. Further, relationship verification was eliminated from the initiative, and the number of taxpayers subjected to residence verification as regards the qualifying child was reduced to 25,000. Further, the

number of taxpayers subject to compliance review for suspected under-reporting of income would be raised to 300,000. The announcement omitted any reference to a status component of the certification initiative.

During 2003, other compliance activities continued: the IRS issued 821,000 Math Error Notices (hereinafter "MEN") and conducted examinations of 282,000 returns. Nearly $1.3 billion of EITC claims were retained. In addition, outreach and education was directed to 20,000 preparers. For fiscal year 2004, the IRS intends to initiate due diligence visits of 250 preparers; visits which have not taken place for several years.

ISSUE FIVE: RECOMMENDATIONS – [EARNED INCOME TAX CREDIT]

The development and design of the EITC certification initiative did not include consultation with the W&I Subgroup. An EITC Task Force, whose existence was unknown until January 2003, met during 2002 to consider options and to design the certification initiative. Details of the initiative were provided during the first and second quarter of 2003. When draft forms were made available, the W&I Subgroup was advised not to share the drafts with non-IRS stakeholders. This restriction limited the ability of IRSAC members to offer advice and constructive commentary. An example of this occurred in a June briefing of the W&I Subgroup regarding the series of focus groups. Meetings with taxpayers and practitioners pertained to EITC taxpayers who were randomly selected, of which eighty percent were biological parents and thus not subject to the certification initiative. The practitioner focus groups did not include representatives of the Low Income Taxpayer Clinics (hereinafter "LITC") and only one practitioner had experience in the VITA program. The W&I Subgroup members noted that the focus

groups should have been comprised of people from the twenty percent of EITC taxpayers whose qualifying children are not biological children of the taxpayer, and that practitioner groups should have included representatives of LITCs and community tax programs.

In its 2002 report, the IRSAC recommended increased attention to compliance by paid preparers through enforcement of civil penalties. The W&I Subgroup therefore welcomes due diligence visits to paid preparers planned for fiscal year 2004. The Subgroup is very concerned, however, by the number of visits. The Subgroup believes 250 is far too few, both as compared to the apparent scope of compliance problems among non-enrolled preparers, and to the 25,000 individual taxpayers who will be subject to the new certification requirements. The W&I Subgroup therefore urges that the number of paid preparers targeted for due diligence visits be increased substantially. The W&I Subgroup supports efforts to explore more efficient alternatives to the use of revenue agents making due diligence visits.

Use of Math Error Authority (hereinafter "MEA") has become an important and efficient tool in recovering over-claims of EITC benefits. However, the W&I Subgroup is concerned about the twenty-seven percent of notified taxpayers who failed to respond, and the additional twenty-three percent who responded but failed to follow through. While many taxpayers may have decided and/or assumed that the MEA notices were correct, a significant number likely failed to respond due to fear, confusion, or because they did not understand the notices as a result of literacy or language barriers. It is critical that the IRS conduct studies to determine reasons for the non- or incomplete responses. Our analysis of the MEA issue is incomplete due to the fact that information regarding types of MEA

notices, the volume of the notices by notice-type, the response rates by notice-type, and the disposition rate by MEA-type could not be provided in time to be included in this report.

Finally, the IRSAC welcomes the appointment of David R. Williams as Director of the EITC Program. In the past, multiple initiatives designed to address compliance, education, and outreach were fragmented under the jurisdiction of different managers. The IRSAC looks forward to working with Mr. Williams in the coming year to improve the effectiveness of EITC initiatives.

ISSUE SIX: NOTICE SIMPLIFICATION

During the past year, the W&I Subgroup has worked with the IRS Notice Strategy Group, headed by Ann Gelineau. The Notice Strategy Group is charged with: (i) identifying notices that are difficult for taxpayers to understand; (ii) prioritizing the order in which notices should be rewritten and implemented; (iii) ascertaining which notices should be eliminated (as duplicative or otherwise unnecessary); (iv) rewriting and simplifying notices such that the average taxpayer can understand the message being communicated; and (v) preparing a style guide to assist IRS employees in rewriting notices.

Thanks to Ms. Gelineau, the W&I Subgroup has had the opportunity to work closely with the Notice Strategy Group, along with several other stakeholders, to prioritize the notices to be rewritten and implemented. During the prioritization process, one member of the W&I Subgroup met with the Notice Strategy Group several times to establish the order in which notices are to be rewritten and implemented. The W&I Subgroup methodology for establishing the priority of rewritten notices considered: (i) the volume of the notice, on average; (ii) the extent to which the notice imposes taxpayer

burden, in terms of a required response or generating a response when none is requested; (iii) the burden imposed by the notice on IRS employees responsible for issuing the notice, in terms of the time and effort required to resolve the issues raised by the notice; and (iv) the impact of a particular notice on the IRS, in terms of business result (e.g., cost to resolve, dollars involved, impact on future compliance, etc.).

Following the prioritization of notices, the W&I Subgroup worked with the Notice Strategy Group to review the revised notices. In some cases, the W&I Subgroup suggested changes to notice language for the purpose of assisting taxpayers in understanding the notice. To date, the IRS has rewritten and implemented twenty-five notices. The IRS projects that it will rewrite and implement fourteen more notices during 2004 and 2005.

In addition, the Notice Support Group is working on a Style Guide to assist IRS employees in rewriting notices and other taxpayer communications. The Style Guide will cover language usage, punctuation, presentation characters (e.g., bullets), "red flag" language to avoid, and recommendations for improving the written product to ensure that communications with taxpayers meet certain basic standards. To identify language to avoid and language to use, the Notice Support Group plans to reach out to stakeholders and taxpayers for feedback regarding various aspects of the Style Guide. The Notice Support Group plans to deliver the final Style Guide in 2004.

ISSUE SIX: RECOMMENDATIONS – [NOTICE SIMPLIFICATION]

The W&I Subgroup is pleased with the manner in which the Notice Strategy Group has worked with the Subgroup this year. The Subgroup's work with the Notice Strategy Group is an excellent example of how the IRS can work effectively with outside

Although the W&I Subgroup attempted to address this issue during the year, the Subgroup was unable to make significant headway, due, in large part to changes in IRS staffing that precluded the Subgroup from meeting with IRS representatives who were intimately familiar with the issue. As a result, the IRS was unable to provide the W&I Subgroup with new information concerning the status of implementing TAC's recommendations. Because the W&I Subgroup views this as a significant tax administration issue, we discussed various aspects of the ITIN application process as well as the use of ITIN's and determined some recommendations for improving the efficiency of the process and curbing the opportunities for misuse of ITIN's. The Subgroup's recommendations are set forth below following a brief discussion of the particular aspects of the ITIN program which the IRS needs to address in the coming year.

1. From the IRS perspective, the misuse of ITIN's is problematic because it imposes significant additional administrative burdens on the administration of the tax law. For example, misuse requires the IRS to implement additional procedures to ensure that only those who apply for ITIN's qualify to receive them. In addition, where a mismatch occurs between an ITIN used on a tax return and the SSN listed on a Form W-2, the IRS must take additional steps to ensure that the rightful holder of the SSN is not taxed on the income earned by the alien who "purchased" the SSN. The IRS must then manually process the alien's return.

2. From the taxpayer's (and acceptance agent's) perspective, the ITIN application process is slow, often arbitrary, in terms of the documents required, and the proper use of an ITIN is poorly-understood. To obtain an ITIN, an alien must complete Form W-7, and

submit one document or a combination of documents to establish his/her identity and foreign status. *See* IRS Pub. 1915. Recently, taxpayers and acceptance agents have begun to encounter significant problems with the ITIN application process, including, for example, lengthy delays in ITIN application processing. Further, anecdotal evidence indicates that different IRS offices require submission of different documentation. For example, one IRS office or employee may deem a Mexican matricula consular card (a national identification card) sufficient to obtain an ITIN, while another may not. Other examples include: (i) different interpretations of the term "recent" as it pertains to the requirement that an alien provide a picture identification .(*see* IRS Pub. 1915); (ii) requiring aliens to provide *two* forms of documentation, notwithstanding that one document establishes both identity and foreign status; and (iii) requiring information beyond that requested on Form W-7. The IRS has begun to address this aspect of the ITIN problem through additional educational outreach and the development of standards for processing ITIN applications.

A second factor that contributes significantly to the difficulties nonresident aliens experience with the ITIN process is language barriers. The IRS has an insufficient number of bi-lingual speakers (English and Spanish, in particular) in most offices. The lack of adequate bi-lingual personnel has made it difficult, if not impossible, for aliens who apply for an ITIN to understand what documentation the IRS needs, particularly where the IRS has deemed the applicant's previously submitted documentation to be insufficient. This discourages aliens from obtaining ITIN's, and ultimately undermines IRS tax collection goals. This aspect of the ITIN problem is not addressed by TAC's recommendations.

3. ITIN misuse arises from states and other governmental entities permitting aliens to use ITIN's as a form of identification. This is the result of the lack of a consistent, well-publicized message to state and local government entities concerning the limited purposes for which an ITIN may be used. Currently, six states accept an ITIN as proper identification for obtaining a driver's license. Other states allow aliens to use ITINs to obtain governmental benefits, including in-state tuition, among others, and some employers accept ITINs as proof of eligibility to work in the U.S. Differing state treatment raises fairness issues, security concerns, as well as other policy issues. The IRS has begun to address this aspect of the ITIN misuse problem. As part of that effort, the Commissioner of Internal Revenue recently sent a letter to the governor of each state requesting that the state's motor vehicle department not accept ITIN's as a valid form of identification for purposes of obtaining a driver's license.

4. Finally, the ITIN problem is exacerbated by employers accepting false or stolen SSN's. Although many employers may be unaware that an employee has provided a false SSN, anecdotal evidence suggests that at least some employers know that given employees are not citizens or otherwise authorized to work in the U.S. Frequently, employers treat aliens as independent contractors notwithstanding the fact that aliens are performing work identical to that performed by employees. This practice avoids employment tax liability for such employers. This aspect of the ITIN problem is not addressed by TAC's recommendations.

ISSUE SEVEN: RECOMMENDATIONS – [INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS]

1. The W&I Subgroup commends the IRS for taking steps toward addressing the many problems associated with ITIN's. The Subgroup however, is disappointed that the Subgroup was not able to participate in the policy-making process. We strongly urge the IRS to involve the IRSAC in future ITIN issues to assist in the development of an effective program.

2. As the IRS has recognized, employees must receive better training as regards the ITIN application process, the types of acceptable documents with respect to demonstrating identity and foreign status, and the role of acceptance agents, among other aspects of the ITIN application process. Once the IRS implements standards for processing ITIN's and provides IRS employees with additional training, many problems should be alleviated.

3. The IRS must hire additional bi-lingual employees, or find a means through which it can provide better assistance to persons who do not speak English.[2] In the opinion of the W&I Subgroup, this is one of the primary causes of many problems associated with the ITIN program. In particular, the lack of sufficient bi-lingual employees has made it difficult for non-English speaking aliens to understand the ITIN application process.

4. The Subgroup concurs with TAC's recommendation that the IRS conduct a large-scale outreach campaign to states, other government entities, businesses, and the public in general regarding the legal purposes for which ITIN's may be used as well as the penalties for using an ITIN in an unauthorized manner. The Subgroup stresses that the

[2] One possibility would be to have a hotline that IRS employees could call when a Spanish-speaking individual brings an ITIN application to an IRS walk-in site. The IRS employee could call the number and then have the individual speak with the hotline operator to obtain any necessary instructions or explanation, and the hotline employee could translate the individual's statements, questions, etc. for the IRS employee.

IRS invest significant resources in this area to make the public and employers aware of the ITIN misuse problem.

In the Subgroup's view, however, outreach is not the only solution. The IRS must begin an enforcement campaign against unscrupulous employers who encourage or turn a blind eye to ITIN misuse or theft and/or fraudulent production of SSN's. Absent the provision of employment to aliens, there would be less incentive to purchase SSNs. Even mere acts of negligence in failing to carefully check an employee's documentation prior to employment enables the theft, fraudulent production, and sale of SSN's. And although the Subgroup agrees with the TAC recommendation that the IRS begin taking enforcement action against aliens who misuse ITIN's, the Subgroup disagrees with the implicit assumption that this will cure the underlying problem. Because the cause of the ITIN misuse lies at the door of employers (and those in the black market who produce/steal SSN's), enforcement against aliens deals only with the symptoms of the problem, as opposed to the root cause. Consequently, the Subgroup urges the IRS to work with the W&I Subgroup and other stakeholders to craft a workable, effective solution for curbing this aspect of ITIN misuse.

5. One of TAC's twenty-two recommendations is to treat returns with a mismatch as unprocessible and to require the alien individual who filed the return to provide additional documentation to substantiate a refund claimed.[3] A related recommendation is to prohibit IRS walk-in sites and VITA sites from processing returns containing such a mismatch. The recommended changes, however, will not likely reduce the administrative

[3] Currently, the IRS processes tax returns containing such a mismatch under the ITIN provided in the tax return.

burden on the IRS. In fact, this recommended change is likely to have the opposite effect. If such returns are not processed until the IRS obtains substantiation, there will be a significant slow down in the processing of such returns requiring employment or relocation of additional personnel to review submitted documentation. Precluding VITA sites from processing such returns will negatively impact the tax system by discouraging many alien individuals from filing tax returns, and causing others to spend hard-earned money on a tax return preparer, when they can ill-afford to do so. A decrease in the number of aliens who file tax returns will likely result in reduced tax revenues (one source estimates that the IRS collects about $200 billion annually in taxes from aliens' returns that contain mismatches). If aliens do not file tax returns, the IRS must allocate additional resources to its nonfiler initiative, thus increasing the cost of administering the tax law as applied to these individuals. Because the W&I Subgroup views these two recommendations as likely to cause counter-productive results, the Subgroup urges the IRS not to adopt them.

ISSUE EIGHT: STAKEHOLDER, PARTNERSHIP, EDUCATION, AND COMMUNICATION

The Stakeholder, Partnership, Education and Communication Program (hereinafter "SPEC") stood up in October, 2000 with the objective to achieve much of its taxpayer assistance and outreach initiatives through partnerships with community, regional, state and national levels. At that time, full staffing for SPEC was set at 972 FTE's. The IRSAC Public Reports for 2001 and 2002 expressed concerns regarding funding and staffing shortfalls that limited SPEC's ability to achieve its strategic goals. Staffing for SPEC in 2002 was 561 FTE's (57.7% of the target), and 650 FTE's in 2003. Projected staffing for 2004 is 675 FTE's, less than seventy percent of the target.

Despite these difficulties, SPEC has made significant progress in establishing fifty national partners, and 150 partnerships at the state and regional levels. Through leveraged resources of partners, SPEC has improved the scope of outreach, education, and tax assistance services to individuals. For example, during the 2003 filing season, SPEC reports a total of 1.372 million returns completed by tax assistance programs, an increase of twenty-eight percent over the previous year.

Also in fiscal year 2003, SPEC established eleven balanced measures and thirteen diagnostic measures that are intended to provide quantifiable baselines for purposes of measuring and improving service.

ISSUE EIGHT: RECOMMENDATIONS – [STAKEHOLDER, PARTNERSHIP, EDUCATION, AND COMMUNICATION]

1) The W&I Subgroup applauds the vision of SPEC strategies in developing partnerships at the national, state and local levels, and in leveraging massive resources that have been made available through these partnerships. However, the Subgroup remains concerned about SPEC's continuing staff shortage. The 2002 and 2001 IRSAC Public Reports expressed similar concerns. While the Subgroup notes that SPEC staffing increased by ninety in 2003, a projected increase of twenty-five in 2004 is allocated to the Child Tax Credit program. While the Subgroup supports the addition of staff to conduct outreach and education on this expanded and important credit, the Subgroup continues to urge the IRS to increase SPEC staffing to its targeted level.

2) One of SPEC's Balanced Measures concerns the coverage rate for low income tax assistance. The established measure for "coverage" is whether a county or city has low

income taxpayers within forty-five minutes of a SPEC or partner-sponsored tax assistance site. This measure is not accurate for access to tax assistance. For example, a rural county might have 10,000 families, twenty-five percent of whom are low income. That county might have a single tax assistance site, with a capacity for 100 returns during the filing season. To conclude that the county is "covered" provided all residents reside within forty-five minutes of the site is unreasonable.

3) The Subgroup is also concerned about a need for tax assistance that exists among low income taxpayers which has not been met. However, there is no consensus on the extent of that need. The Subgroup therefore urges that SPEC undertake to develop a process for assessing the extent of this need. Taxpayers in need of such assistance may include:

- non-filers eligible for EITC
- persons relying on paid preparers who have excessive error rates
- persons who prepare their own returns and have excessive error rates
- persons who are paying excessive fees
- persons for whom paying a "reasonable fee" is an unreasonable burden, due to extreme poverty or other extenuating circumstances.

The W&I Subgroup recommends that a process be designed to develop an assessment of this need and that this process involve SPEC partners and the IRSAC.

4) Another SPEC Balanced Measure concerns "Partners' Overall Satisfaction." Based on a survey of partners, reported satisfaction increased from 4.13 to 4.30 on a scale of 5. This positive trend is tempered by anecdotal reports received by W&I Subgroup

members from the low income taxpayer clinic (LITC) that indicate some dissatisfaction with uneven responses or lack of cooperation from local SPEC staff, and also concerns that pressure to establish new partnerships may in some cases limit essential support to recently created partnerships that are not yet self-sufficient. The Subgroup recommends creation of a communication link, either through an 800 number, or vis-à-vis email to SPEC headquarters such that local partners may communicate both positive and negative concerns about local SPEC support. Such a communication process would facilitate timely review and correction, if necessary. Further, a compilation of such reports and disposition of same would be a useful complement to other assessment tools.

III. CONCLUSION

The W&I Subgroup appreciates the opportunity to be of service to the Internal Revenue Service. The Subgroup appreciates the time, commitment, cooperation and resolve of the W&I representatives and management with whom the Subgroup has met to solve these many problems and issues. The Subgroup continues to be amazed at the leadership shown by W&I management, given their limited financial resources and staffing. The Subgroup is confident that future advisory members will continue to work closely in assisting W&I management.

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NOVEMBER 6, 2003

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Eugene R. Braam, EA, PA Mr. Braam owns and manages a large tax practice in Mankato, MN. His firm has prepared over 25,000 tax returns to date, and will prepare approximately 100 business returns and 1,000 individual returns this coming tax season. He is licensed as a public accountant, investment advisor, and insurance agent and is enrolled to practice before the IRS. Mr. Braam has been active in several professional associations including the National Society of Accountants, the National Association of Enrolled Agents, the National Association of Tax Practitioners, the Minnesota Association of Public Accountants, and the Institute of Certified Practitioners, where he held leadership positions in each organization. He was also the first Enrolled Agent to serve as Board Chairman of the Minnesota State Board of Accountancy. Mr. Braam has also held leadership positions in numerous civic organizations such as the United Way, regional library associations, Minnesota Historical Society, to name a few. He is an ardent public speaker, having spoken at numerous civic, business and professional organizations. (**W&I Subgroup**)

Timothy B. Clay Mr. Clay owns and manages Accounting & Business Consultants, Inc., a financial management company that serves small businesses and individuals. His firm assists businesses in QuickBooks set-up, organizational structure configuration, tax issues, preparation of SBA applications, IRS representation, payroll, and loan packages. Mr. Clay is also the Executive Director of the Birmingham Minority Business Development Center, where he organized weekly meetings for potential start-up businesses. Timothy provided a mechanism for information exchange among partners such as, the SBA, the IRS, and state and local governments. Mr. Clay holds a BS in Business Administration, with a minor in Accounting, from Oakwood College, and an MBA from the University of Alabama at Birmingham with a concentration in Accounting/Data Processing. **(SB/SE Subgroup)**

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Felecia Dixson is an Enrolled Agent and sole proprietor of Accounting Technologies, in Salem, MO. She is currently the Committee Chair of the Special Enrollment Examination Advisory Committee for the Internal Revenue Service, and an editor and writer of the Illinois Farm Tax School Manual, University of Illinois. A member of the National Association of Tax Practitioners, National Society of Accountants, and Accreditation Council for Accountancy and Tax Inc. Ms. Dixson has more than nineteen years experience in the tax business, working with clients, both for profit and nonprofit organizations. **(SB/SE Subgroup)**

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Ms. Dusenbery is an instructor for the National Association of Tax Practitioners ("NATP") and an adjunct instructor at Johnson State College. She formerly owned and operated a tax and accounting firm that specialized in tax preparation, representation and electronic filing issues. Prior to owning her business, Ms. Dusenbery held various positions in industry. Ms. Dusenbery is enrolled to practice before the IRS, holds a BS in Environmental Science and an MS in Education. She is an active member in the National Association of Tax Practitioners, the National Association of Enrolled Agents and other professional associations. She has published tax articles for local newspapers and other association publications, spoken on live radio programs, and presented entrepreneurial workshops on small business issues. **(W&I Subgroup)**

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Mr. Evanish manages MSC Business Services, a $3.5 million accounting, payroll, business analysis, and tax preparation business providing services primarily to farmers in a four-state area. Mr. Evanish formed alliances with a law firm, CPA firm, and lending, leasing and appraisal firm to provide advice/assistance to farmers his firm did not offer. Prior to holding his present position, Mr. Evanish served as Director of Training at MSC for several years. Prior to his employment with MSC, Mr. Evanish held positions in sales and accounting with other organizations. Mr. Evanish is enrolled to practice before the IRS, and has a BS in accounting and marketing from Clarion University. Mr. Evanish is active in community affairs, having served on the Hampden Township Planning Commission, and the Kingwood Homeowners' Association. He is also a member of the National Society of Accountants. **(SB/SE Subgroup Chair)**

Lester D. Ezrati, Esq.

Lester Ezrati is Vice President of Hewlett-Packard Corporation in Palo Alto, CA, where he is responsible for Domestic & International Taxation, Licensing, Customs and Audit. Prior to holding his current position, Mr. Ezrati worked in both International and Domestic Tax Counsel also at Hewlett-Packard. He is a past International President of the Tax Executives Institute where he led the establishment of a

strategic plan to guide the organization over a subsequent five-year period. He is active in other professional associations such as the California and Utah State Bars and the American Bar Association. He has a BA in Economics from the University of Rochester, a JD from Boston College, and an LL.M. in Taxation from New York University. **(LMSB Subgroup)**

Roger N. Harris, EA Mr. Harris is President of Padgett Business Services in Athens, GA and has been with Padgett for more than twenty years. Mr. Harris is a member of the National Society of Accountants, where he has served as Chair of the Federal Taxation Committee. In that capacity, Mr. Harris has testified extensively before congressional committees on issues such as EFTPS, IRS restructuring and reform, and small business issues. Mr. Harris is also affiliated with the National Association of Enrolled Agents, and is an accredited tax advisor and preparer of the Council for Accountancy and Taxation. He has a degree in accounting from the University of Georgia. **(IRSAC Chair & SB/SE Subgroup)**

Tracy Hollingsworth Tracy Hollingsworth is a Senior Attorney and Director of Tax Affairs with Manufacturers Alliance/MAPI in Arlington, VA. She has been with Manufacturers Alliance for the last twenty-plus years, providing technical, networking and meeting services to the corporate tax directors of their member companies. She has published numerous articles, i.e., Treasury Suspends Overarching Final Research Tax Credit Regulations; Asks for Comments, LAR-447 (February 2001), and Corporate Tax Shelters: Finding a Measured Response, LAR-433, (April 2000). Ms. Hollingsworth is active in the American Bar Association, District of Columbia and the Massachusetts Bar Associations, and holds a BA from Scripps College, Claremont, CA, and a JD from Boston University, Boston, MA. **(LMSB Subgroup)**

Ann K. Hubbard Ann Hubbard is an Enrolled Agent and the owner of Hubbard Financial Services, Inc. She is currently President of the Texas Society of Enrolled Agents, a member of the National Society of Enrolled Agents and an active member of NAEA's Leadership Committee. Ms. Hubbard is also a Fellow of the National Tax Practice Institute, and a well-known tax seminar speaker in the Houston area. Ann was the Treasurer for the Annise Parker Houston City Council Campaign and volunteered for the Houston Chronicle Tax Hotline. **(SB/SE Subgroup)**

Eliot L. Kaplan Eliot Kaplan is a member of the Phoenix, AZ., law firm of Squire, Sanders & Dempsey LLP, practicing in the areas of federal, state, and local tax law, and general business law. He has extensive experience in organizing joint ventures and other partnerships and has

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Pamela P. Kulish

Pamela Kulish is the President and Chief Operating Officer of Computer Accounting Service, Inc. Through her company, Ms. Kulish provides tax preparation services, financial analysis and planning relative to taxes and investment strategies, to nearly 300 individual clients. Corporate clients include approximately 50 retail and service organizations with gross revenues ranging up to $7 million. Services directed to corporate clients include: live payroll; monthly financial reporting; analysis and recommendations of cafeteria employee benefit plans; business plans; development of budgets and projects; and local, state, and federal tax preparation. Ms. Kulish is a member of the Maryland Society of Accountants, the National Association of Enrolled Agents, and the National Association of Accountants. (**SB/SE Subgroup**)

Diana L. Leyden

Diana Leyden is an Assistant Clinical Professor and the Director of the Tax Clinic at the University of Connecticut, School of Law. Ms. Leyden teaches and supervises law students representing low-income taxpayers in federal and state tax controversies, and trains law students in conducting conferences and hearings before the IRS and the Connecticut Department of Revenue Services. Prior to her current position, Ms. Leyden was a Tax Attorney with the Connecticut Department of Revenue Services. She is a member of the American and Connecticut Bar Associations and Chairs the Communication and Program Developments Subcommittee and the Low-Income Taxpayer Committee for the American Bar Association. Ms. Leyden holds a BA from Union College, Schenectady, NY, a JD from the University of Connecticut and an LLM from Georgetown University. **(W&I Subgroup)**

Susan W. Martin

Susan Martin is currently interim Assistant Vice-President for Academic Affairs and a Professor of Accounting and Taxation at Seidman School of Business at Grand Valley State University. Prior to her current position, Ms. Martin was the Commissioner of Revenue for the State of Michigan. She co-authored a textbook titled, *Today's Essentials of Government and Not-for Profit Accounting and Reporting,* and has published numerous articles. Ms. Martin holds a BS in public speaking from Central Michigan University, an MBA in Accounting

from Michigan State University, and a Ph.D. in Accounting from Michigan State University. **(SB/SE Subgroup)**

Marjorie L. Miller

Ms. Miller is a principal at The Miller Group in Portland, OR, where she provides informational presentations and analyses of business activities for tax credit potential for industries and accounting firms in the Northwest. Prior to her current position, Ms. Miller was a Tax Associate at Coopers & Lybrand, a law clerk for a Portland, OR law firm, an Adjunct Professor at Marylhurst Graduate School of Management and Concordia University, and a Graduate Teaching Fellow at the University of Oregon. Ms. Miller is a member of the Oregon State Bar Association and the Washington State Board of Accountancy, and has served as the Director of Public Relations at the Alaska Youth & Parent Foundation in Anchorage, Alaska. Ms. Miller is a member of the Washington State Society of CPA's and has served as Vice Chair for the Pacific Northwest Citizen's Advocacy Panel ("CAP"). She holds a BBA in Marketing, an MBA in Finance, and a JD from the University of Oregon.
(LMSB Subgroup)

Michael A. O'Connor

Mr. O'Connor is an attorney in private practice who has worked as a litigator, lobbyist, program administrator, and more recently as a consultant providing management assistance, policy analysis and technical assistance to public and private human service agencies and private businesses. Mr. O'Connor has designed and implemented outreach campaigns that promote greater participation by eligible families in Earned Income Credit and other tax benefit programs available to lower income families. Mr. O'Connor also established the Tax Counseling Project as a multi-site VITA program in Chicago, and while managing this project for several years, developed a total of fourteen sites across Illinois. In 1991, Mr. O'Connor developed the nation's first training and technical assistance resource guide regarding tax benefits available to foster and adoptive parents. In 1997, Mr. O'Connor developed a handbook and delivered a seminar on unique tax benefits available to families providing adult residential care to developmentally disabled persons. Mr. O'Connor has a BA in Political Science from the University of Illinois and a JD from DePaul University. He has published numerous tax articles for various law journals and other publications. **(W&I Subgroup)**

Michelle B. O'Connor Michelle O'Connor is an Assistant Clinical Professor and Director of the Quinnipiac University School of Law Tax Clinic. In her current position she developed an intake system, a new filing protocol, and a case tracking system, that ensures better, continuous representation of clients. Prior to her current position, Ms. O'Connor practiced law

with Arnold & Porter, where her work included tax planning, compliance, transactional, and litigation matters in the employee benefits tax and federal income tax areas. Michelle also worked at the Department of Justice, Tax Division, as an attorney, and clerked for the honorable Stephen J. Swift of the U.S. Tax Court. She is a member of the American, Virginia and District of Columbia Bar Associations. Ms. O'Connor holds a BA from the University of Connecticut and a JD from Washington and Lee University. **(W&I Subgroup)**

Albert C. O'Neill, Jr., Albert O'Neill is an attorney with the firm of Trenam, Kemker, Scharf, Barkin, Frye, O'Neill & Mullis. He is currently President of the American Bar Retirement Association, having served as Director for the previous five years. He also served as Chair of the American Bar Association's Section of Taxation and numerous other positions in both the American and Florida Bar Associations over a twenty-year period. Mr. O'Neill has an LLB, magna cum laude, from Harvard University and has published several articles in the Harvard Law Review. (**LMSB Subgroup**)

Charles W. Shewbridge, III Charles Shewbridge is currently retired. Prior to his retirement, Mr. Shewbridge was the Chief Tax Executive at Bell South Corporation in Atlanta, Georgia, and is a past International President of the Tax Executives Institute where he also served as a Director and member of the Executive Committee. Prior to his employment with Bell South, Mr. Shewbridge held executive positions at Dominion Resources, Inc., Universal Leaf Tobacco, Inc., and Davenport and Company. Previously Mr. Shewbridge was associated with two CPA Firms and taught at the Virginia Commonwealth University. He has an MBA in accounting & management and is active in other professional associations such as the United States Telephone Association, Chairman of the Tax Committee, and the Edison Electric Institute where he served on the tax Committee. (**LMSB Subgroup**)

Gregory H. Steinbis Greg Steinbis practices as a Certified Public Accountant in Morgan Hill, CA., at the southern end of the Silicon Valley. Mr. Steinbis is also enrolled to practice before the IRS. He performs accounting, payroll, tax, and estate work and more recently, financial advisory services. He is active in the National Association of Enrolled Agents (NAEA) and is the organization's immediate Past President, also serving as Vice President, Treasurer, and board member during the past seven years. During this period, he was a member of the Governance Restructuring Task Force that was instrumental in reorganizing NAEA's internal governance. Mr. Steinbis has also been active in civic organizations in and around the Silicon Valley.

(W&I Subgroup Chair)

Denise Strain

Denise Strain is Vice President and General Tax Counsel for Citicorp/Citibank and has been with the corporation for over 24 years. Ms. Strain directs all aspects of the global tax function through the management of over 120 tax professionals in eight countries. Denise is Vice Chairman of the Tax Committee for the National Foreign Trade Council, an active member of the American Bankers Association, and the Business Round Table Tax Committee. Denise Chairs the New York Bankers Association Tax Committee, and holds a BA in Psychology from Fairfield University, a JD from St. John's University, and an LLM in Taxation from New York University. **(LMSB Subgroup)**

Carol Tremble

For more than 13 years, Carol has owned her own practice, Carol B. Tremble, Certified Public Accountant, serving 450 clients; 200 of whom are small business owners. Ms. Tremble prepares taxes and provides general business consulting. Carol is a Selectman in her town, having been elected to this position consistently every three years since 1988, and is a member of the American Institute of Certified Public Accountants, the New England Peer Review Board, and the Vermont Society of CPA's. Ms. Tremble holds a BA in Mathematics from the University of Vermont. (**SB/SE Subgroup**)

Betty M. Wilson

Betty Wilson is Vice President of Taxes, MGM Mirage Corporation. In this role, Betty developed the Corporate Tax Department for MGM Mirage, and was named one of the 20 Most Influential Women in Southern Nevada for 2001 by "INBUSINESS LAS VEGAS". As the International President of Tax Executives Institute from 2000-2001, Ms. Wilson continued and enhanced the partnership among Tax Executives Institute, the Section of Taxation of the American Bar Association, and the Tax Division of the American Institute of Certified Public Accountants for the promotion of the joint tax simplification project. Ms. Wilson holds a BS in Accounting from Colorado State University. (**LMSB Subgroup**)