

Statement

of

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on behalf of

Tax Executives Institute, Inc.

on

Streamlining Tax Administration

before the

IRS Oversight Board

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Good afternoon. I am Timothy McCormally, Executive Director of Tax Executives Institute, the preeminent association of business tax professionals. The Institute is pleased to participate in today's hearing of the IRS Oversight Board.

BACKGROUND

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 53 chapters in the United States, Canada, and Europe. Our 5,400 members are accountants, attorneys, and other business professionals who work for 2,800 of the leading companies in North America and Europe; they are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. TEI represents the business community as a whole, and our members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. TEI is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and

equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike.

The companies that employ TEI's members have almost without exception been assigned to the IRS's Large and Mid-Size Business (LMSB) Division. The largest 1,600 taxpayers within LMSB are subject to ongoing audits as part of the Coordinated Industry Cases (CIC) program. The Institute's testimony is largely based upon our experience with this segment of IRS operations. We are pleased to offer our views on streamlining tax administration within the IRS and, more particularly, LMSB.

THE ROLE OF CORPORATE TAX DEPARTMENTS IN TAX ADMINISTRATION

One topic for today's hearing is the involvement of professional organizations in protecting the integrity of the tax system. The Board recognizes that tax professionals and the organizations to which they belong play a key role in ethical and effective tax administration. In addition, the subject is tied to the IRS's strategic objective to ensure that attorneys, accountants, and other tax practitioners adhere to professional standards and follow the law. TEI believes that corporate tax departments have a role in that process.

The Internal Revenue Service recently issued final regulations relating to the standards of conduct for tax practitioners. Section 10.33 of Circular 230 now provides certain "best practices" or "aspirational standards" for rendering tax advice, including "establishing the facts, determining which facts are relevant, evaluating the reasonableness of any assumptions or representations, relating the applicable law . . . to the relevant facts, and arriving at a conclusion supported by the law and the facts" and "acting fairly and with integrity in practice before the IRS." The changes to Circular 230 aim to emphasize the importance of aspirational standards to professionalism.

Part of TEI's mission is to promote professionalism in both the private and government sectors. Long ago, the Institute developed comprehensive standards of conduct requiring our members to adhere to the highest standards of professional competence and integrity. TEI's Standards of Conduct provide that a TEI member accepts not only taxes as a cost of civilization, but also the laws imposing taxes as "the mechanism for distributing that cost among businesses, individuals, and other entities." The Standards thus exhort members to "present the facts required in tax returns and all the facts pertinent to the resolution of questions at issue with representatives of the government imposing the tax."

As important, TEI members "recognize an obligation to make an affirmative contribution to the sound administration of the laws, and to the adoption of sound legislation, by cooperation and

consultation with the persons charged with those functions, having due regard for the interests of society, as well as the interests of the company and its employees.” In this latter regard, TEI works collaboratively with the IRS (and, specifically, LMSB) on numerous projects, consistently supports adequate funding for the IRS, and works with the IRS to educate our members about the requirements of the law to enhance taxpayer compliance.

Thus, TEI and its members have a six-decade tradition of working to protect the integrity of tax administration.

STREAMLINING TAX ADMINISTRATION

a. *Alternative Dispute Resolution Techniques.* The IRS’s strategic plan identifies enforcement of the tax law as one of its three primary goals for the next five years. One strategy for achieving that goal is the reduction of audit cycle time to improve audits and audit coverage. During the last few years, LMSB has developed several audit techniques to improve currency and enhance compliance efforts.

Last year we reported to the Board about a joint TEI-LMSB initiative, the Joint Audit Planning Process. This project compiled the “best practices” for conducting an audit and includes a planning and monitoring tool that lists the steps a taxpayer and audit team can take to enhance the quality and timeliness of tax examinations. A key to the initiative is the delineation of both the individual and the joint responsibilities of all participants — the taxpayer, team manager, audit team, specialists, and Counsel — thereby directing time and resources to the most important areas.

Several other innovative procedures — such as Limited Issue Focused Examination (LIFE), Pre-Filing Agreements, Fast Track Mediation and Settlement, Accelerated Issue Resolution, Advance Pricing Agreements, and Early Referral to Appeals — have also sought to improve the examination process and promote currency. LIFE in particular — with its focus on the resolution of material issues — holds great promise in reducing disputes and decreasing cycle time.

Recently, LMSB announced a pilot program, the Compliance Assurance Process (CAP), which employs real-time issue resolution. CAP requires the IRS to work with the taxpayer to resolve issues prior to the filing of a tax return. The goal is to eliminate or substantially reduce the need for a post-filing examination. TEI is pleased to have worked with LMSB in developing the CAP program, and we note that several members have volunteered to participate in the CAP pilot program.

These procedures all share a common denominator — a collaborative effort to resolve issues at the lowest level.

TEI is proud of its partnership with LMSB and we remain committed to a collaborative approach to streamlining tax administration and obtaining currency. In response to a recent informal poll, however, several members volunteered that the quest for currency had seemingly caused their team managers to send certain complex issues to Appeals in order to meet deadlines for closing the case. Although we agree with the IRS that currency is a laudable goal, it cannot come at the cost of other objectives. It should not, for example, interfere with the IRS and taxpayers' ability to resolve issues at the lowest level. The agency will not reach its goal of streamlining tax administration if the currency initiative pushes the resolution of issues from the examination team to Appeals. We note that, in her 2004 Annual Report to Congress, National Taxpayer Advocate Nina Olson has raised several concerns about the need to maintain both the fact and appearance of independence in Appeals.

b. *Mandatory E-Filing.* The IRS recently issued temporary and proposed regulations mandating the electronic filing of large corporate income tax returns for the 2005 filing year.

TEI wholeheartedly supports the goal of increasing the number of tax returns that are filed electronically. E-filing will give the IRS the information it needs to ensure compliance faster and without the transcription errors that may occur when data from paper returns are entered into IRS's computer system. The Institute is concerned, however, about three aspects of the regulations.

First, we are uncertain whether the IRS has made the case for mandatory e-filing and, more important, for issuing the guidance in the form of immediately effective temporary regulations (albeit for returns filed in 2006). Had the IRS issued proposed regulations, the process of soliciting comments not only from vendors (who will make money from the mandate) but also from taxpayers (who will have to spend it) could have been less hectic, more orderly, and in the final analysis, more helpful. In this regard, we contrast the approach taken here with the collaborative approach the IRS and Treasury took in developing the new Schedule M-3, which will impose similar requirements on companies to realign their information reporting systems.

Second, although the regulations assert that the e-filing mandate will benefit taxpayers, we question whether the IRS has adequately documented and demonstrated what those benefits are. This is especially the case since mandatory e-filing cannot help but exacerbate the burdens to corporate information reporting systems posed by the American Jobs Creation Act of 2004, the continuing demands of the Sarbanes-Oxley Act, the Schedule M-3, and other resource-draining mandates. We appreciate that the IRS will benefit from e-filing, and agree that for some — even

many — corporate taxpayers the mandate may represent little more than redirecting information from the printer to the Internet. For larger more sophisticated taxpayers, especially those with significant foreign operations or with multiple, nonintegrated legacy IT systems to contend with, that will not be the case, and may, for them, represent little more than shifting a burden from the agency to taxpayers. It thus may be contrary to the IRS's goal of improving taxpayer service by reducing burden. What is more, the IRS has only recently been able to receive electronic Forms 1120, and although numerous small companies have successfully filed their returns electronically, a legitimate question exists whether the IRS has the capacity to receive — and effectively use — electronic returns from larger companies.

Third, while the devil is in the details in terms of what will actually be required and how difficult it will be to transition from current practice to the e-filing of corporate returns (and to the IRS's examination of those returns), we regret that the regulations presume a level of uniformity and technological sophistication that does not exist, by taxpayers and perhaps also the IRS. Yes, most business taxpayers use computer programs to help prepare their returns, but preparing the return of a Fortune 500 taxpayer (which could easily exceed 10,000 pages in length) is not as easy as sliding a TaxCut or TurboTax disk into its PC. The programs used range from Excel spreadsheets, to off-the-shelf programs, to tremendously expensive and complicated customized programs, to a patchwork of "homebrew" solutions. Like many of us in the private sector, the IRS knows full well the challenges of meeting modernization objectives. Rather than simplifying the preparation of corporate tax returns, however, the regulations may even hinder tax administration; for example, if the schedules and attachments that have heretofore been filed with the tax return cannot be transmitted (or accessed) electronically, the quality of information available to field agents on examination may suffer if taxpayers can no longer attach these explanations to their returns.

Our point here is not to belabor the issue of electronic filing, but to point out that many of these issues might have been resolved if the IRS had considered how its mandate would compound the burdens of other governmental mandates (such as those imposed by the Sarbanes-Oxley Act) and taxpayers had been consulted *before* the regulations were issued. TEI is set to meet with the IRS later this month to discuss our concerns and possible solutions, including postponing the mandatory electronic filing of returns for the 2005 year.

Need for Simplification

In her 2004 Annual Report to Congress, National Taxpayer Advocate Nina Olson identified the overwhelming complexity of the tax code as the largest source of compliance burden facing taxpayers. Ms. Olson notes that business taxpayers face a "bewildering array of laws, for example, a patchwork set of rules that govern the depreciation of equipment, numerous and overlapping filing

requirements for employment taxes, and a vague set of factors that govern the classification of workers as either employees or independent contractors and that can keep businesses and the IRS battling each other for years with no obvious ‘correct’ answer.”

It is clear that meaningful streamlining of tax administration can only occur through the simplification of the tax law. A law that now consists of more than 1.3 million words places burdens not only on taxpayers, who must contend with how to interpret the laws, but also on the IRS, which must administer them.

Several years ago, TEI joined with the American Institute of Certified Public Accountants and the American Bar Association Section of Taxation to recommend changes to simplify the law not only for taxpayers — both large and small — but the government as well. We believe that even small changes — such as the recent harmonization of the various definitions of “child” — can have a positive effect on job performance. Larger changes — such as the repeal of the corporate and individual alternative minimum tax — can have significant effect on taxpayers’ ability to comply with the law and the IRS’s ability to perform efficient and effective audits.

TEI realizes it has mentioned this issue several times in past testimony before the Board. And we recognize that the Board’s mission does not include making recommendations about substantive changes in the law. We believe, however, that the Board plays a critical role in highlighting the complexity of the law as a prime villain in the war for effective tax administration. Thus, the Board should consider providing input to the President’s Advisory Panel on Federal Tax Reform.

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Tax Executives Institute commends the IRS Oversight Board for holding this public hearing. TEI looks forward to working with the Board and the IRS itself to improve tax administration.

TAX EXECUTIVES INSTITUTE, INC.

By: 

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