

Steven T. Miller, Commissioner TE/GE

SPEECH TO IRS TAX FORUMS,

Houston, Texas, July 12, 2005

Thank you, Jan, and thank you all very much. Welcome to the 15<sup>th</sup> annual Tax Forum. It is a pleasure to see so many outstanding tax professionals in the same room. Every year you help make these forums a success. More than 137,000 people have attended these forums since the first one in Dallas – 15 years ago.

You and your colleagues are an important part of the world's most sophisticated tax system. We estimate that the 16,000 attendees at the six forums last year helped about five million Americans pay their taxes. I want to salute our partners who have been such a big help at these forums. I want to thank, in alphabetical order, the American Bar Association, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Association of Tax Professionals, the National Society of Accountants, and the National Society of Tax Professionals. Welcome to you all.

The Commissioner has asked me to express his regards to you, and also his regrets that he cannot be here today. In his absence, allow me to tell you a little about myself and what we do in the Tax Exempt and Government Entities Division of the Service. Jan Deneroff's very kind introduction gave you my background. Allow me to introduce TE/GE, the Tax Exempt and Government Entities Division of the IRS.

Although the TE/GE Division is the smallest of the Service's four operating divisions, we touch the lives of all of you. Our focus is not so much on collecting tax – although we do that – as it is on administering those portions of the Tax Code that exempt certain entities and activities from taxation. Thus, we are concerned with pension plans, 401(k)s and related entities. We are concerned with 501(c)(3)s – charities, hospitals, universities, and other entities upon which Congress has bestowed the privilege of tax exemption. That also includes entities like unions, country clubs, state tuition prepayment plans and political action committees. We are concerned with tax-exempt bonds, with state and governmental entities and Indian tribal organizations that are tax-exempt but still pay employment taxes.

We are responsible for approximately 3 million entities. They control nearly \$8 trillion in assets, and pay over \$200 billion in employment tax and income tax withholding. Collectively these entities employ more than 1 in 5 employed persons in the country.

The annual tax expenditure for these entities (that is, the cost to the government to forego tax) is estimated at \$ 283 billion per year. In a word, our job at TE/GE is to insure that those who are getting this enormous benefit are the kinds of entities, engaged in the kinds of activities that Congress intended when it granted the exemption.

I'm glad, personally, to be here. I have to confess that there was a time when I was skeptical about the value of these tax forums for TE/GE taxpayers. This was when I was the Director of the Exempt Organizations. Our excellent Customer Education and Outreach

staff wanted to present Exempt Organization topics at the Tax Forums. I was concerned that no one would be interested, that our natural audience of practitioners wouldn't be here.

The staff prevailed, however, and we made two very well received presentations at each forum in 2002. Folks were interested! So in 2003 we introduced our workshops – detailed, interactive presentations. These were instantly popular and completely over-subscribed. We initially planned to present one workshop for 75 people at each forum. We ended up presenting two or three workshops, each for 125 practitioners, at each of the six forums, and we left some people standing in the hall. So, happily, I was wrong. It seems that exempt organizations are represented by those in this audience, whether you are working pro-bono for your church or doing the Forms 990 for exempt organizations.

So, I learned the lesson about the value of these forums, and there has been no looking back. There never was any doubt about the need for Employee Plans participation so they are here as well.

TE/GE fully supports the forums. They are a wonderful place to meet our customers and to share information with you.

Let me turn now from these events to what the Commissioner has asked me to convey today.

I know this is a shock, but the mission of the Internal Revenue Service is to collect the revenues that fund the government. To do this successfully, we must administer the system efficiently, fairly and with respect for taxpayer rights. Our operating premise is simple: service plus enforcement equals compliance. Not service OR enforcement, but service AND enforcement. Both are essential to good tax administration.

Let me begin with service.

By service, we mean helping people understand their tax obligations and making it easier for them to participate in the tax system. Speaking for the community I regulate, I believe the vast majority of these organizations want to, and actually do, comply. We have an obligation to provide them the means to do so. If we succeed in that, most of the work is done. The same is true throughout the IRS.

And we are doing well in the service area.

For example, our telephone service – that is, answering questions from taxpayers – has improved dramatically in recent years.

Use of our website, IRS.GOV is also up sharply. During the filing season, it is one of the busiest websites in the world. We average more than one million visits a day.

Electronic filing is growing by leaps and bounds. Last year Americans filed 62 million electronic returns. This year, for the first time ever, more than half of all individual returns were e-filed. Last year, the IRS introduced what we call “modernized e-file,” giving corporations and part of my community of tax-exempt organizations the ability to file their

returns electronically. Now taxpayers can e-file complex, consolidated returns including attachments, elections and multiple subsidiaries and foreign entities.

In the first year, 50,000 businesses and tax-exempt organizations chose to e-file. That number will more than double in 2005. And we are not finished. We have issued regulations that will require the largest of those organizations to electronically file their Tax Year 2005 returns.

So in the area of service, we will do all we can to modernize, computerize and improve our services. But we also recognize – as a government agency -- that our funding resources are tight. We need to operate efficiently, consolidate operations and drive down costs wherever we can.

Now let me talk a little about enforcement. It is a necessary partner of service, and it is particularly important at this time.

During the late 1990s, IRS enforcement practices came under pretty tough scrutiny in Congressional hearings. There was significant debate about how much enforcement the IRS should carry out. There was a view among some that enforcement should be de-emphasized.

But in recent years, as surveys of the taxpayers reflect, I think a consensus has developed that strong enforcement is an essential function of the IRS and a necessary component of a successful tax system. Congress, tax professionals and citizens across the country have asked why we aren't doing more on enforcement.

This is true across the Service. In TE/GE we have had the pleasure of four Congressional hearings in the past two months on TEE enforcement issues along.

But everyone involved in this discussion agrees that, as we increase enforcement, we must do so with full respect for taxpayer rights.

We have a serious tax gap in this country. The tax gap is the difference between what taxpayers are supposed to pay and what is actually paid. By our best estimates, we lose almost \$300 billion each year due to non-filing, underreporting, and underpayment.

Fortunately, most Americans pay their taxes honestly and accurately. But they will only do so if they are confident that when they do so, their neighbors and competitors will do the same.

This is borne out by a study commissioned by the IRS Oversight Board, which revealed that 79 percent of taxpayers believe it is very important for the IRS to enforce compliance of high-income officials. Eighty-five percent of taxpayers believe it is very important for the IRS to enforce compliance from corporations.

So we are focusing on enforcement. To enhance enforcement, we have four enforcement priorities.

Our first enforcement priority is to discourage and deter non-compliance – especially corrosive activity by corporations and high-income individuals.

We are taking strong steps to increase enforcement with respect to the wealthy.

- In 2004, our audits of high income taxpayers jumped 40 percent from the year before. We audited almost 200,000 high-income individuals last year – double the number from 2000.
- Overall, audits for individuals exceeded the one million mark last year, up from 618,000 four years earlier.
- In 2004, audits of the largest businesses – those with assets of \$10 million or more – finally leveled off after years of decline.

And we are combating abusive tax shelters among corporations and high-income individuals. We seek to identify shelters sooner, address them sooner, and hold accountable those who game the system. And as we identify and act against shelters, we have opened our doors to those who entered into abusive transactions but would like to leave their problems behind them. Last year, we did this for the Son of Boss tax shelter.

Son of Boss was a particularly abusive transaction used mostly by wealthy individuals to eliminate taxes on large gains, often in the tens of millions of dollars. So far, the Son of Boss resolution brought in more than \$3.7 billion from taxpayers who stepped forward to settle up with the government.

And there's more to come: We recently announced a stock option resolution program for certain corporate executives.

The IRS is committed to ensuring that all taxpayers – including wealthy individuals and corporate executives – pay their fair share of taxes. When the IRS examines a corporation, we also inspect the tax returns filed by top officers and executives.

So we are sending a clear signal: We are balanced in our approach. We are also expanding coordination in the international arena.

Last year, Australia, Canada and the United Kingdom joined the United States in creating the Joint International Tax Shelter Information Centre. Since then, we have uncovered a number of transactions that may never have been found with this Group.

Our second enforcement priority is to ensure that attorneys, accountants and other tax professionals adhere to professional standards and follow the law.

Our system of tax administration depends upon the integrity of practitioners. Of the roughly 1.2 million tax practitioners in America, the vast majority are conscientious and honest. But even honest tax professionals suffered from eroding ethics in recent years by being subjected to untoward competitive pressures. The tax shelter industry has had a deeply corrupting influence. While you follow the rules and do your job properly, that less scrupulous operator down the street may steal your clients, straying over the line by offering

to prepare questionable returns, setting up questionable trusts, or taking inappropriate positions on returns.

That's why we're getting tough on enforcement – to protect the compliant, help the honest practitioner and pursue the guilty. In the last year, we have done much to tighten standards and help restore faith in the tax administration system and practitioners generally.

We strengthened Circular 230 regulations to discourage bad legal opinions on tax shelters. The new standards send a strong message to those who might consider selling a questionable product to clients.

Last year the government won a string of court opinions on privilege. The cases establish that promoters who develop and market generic tax shelters can no longer protect the identity of their clients by hiding behind a false wall of privilege.

And there is movement on penalties as well. Unfortunately, abusive tax shelters often flourished because penalties were too small. Some tax professionals actually weighed potential fees from promoting shelters against the risk of IRS detection and the size of our penalties.

Clearly, the penalties were too low. That time has passed.

Last October, Congress passed and the President signed the American Jobs Creation Act. It cracks down on abusive shelters and those who encourage and promote these shelters.

The IRS now has authority to impose a monetary penalty on an individual who violates Circular 230. Or a monetary penalty can be imposed on the employer, firm or other entity if it knew or should have known of the misconduct.

This Act created a new accuracy-related penalty for listed transactions and other reportable transactions having a significant tax avoidance purpose. And the Act created a new penalty for failing to disclose reportable transactions. It increased penalties on promoters for failing to register a tax shelter with the IRS. It increased promoter penalties for failure to maintain investor lists and increased the promoter penalties for false statements. Congress has given us the tools. We are going after promoters of tax shelters – both civilly and, where warranted, criminally.

Our third enforcement priority is to detect and deter domestic and off-shore based criminal tax activity, our traditional area of emphasis, and related financial criminal activity.

Last year, the IRS referred more than 3,000 cases to the Justice Department for possible criminal prosecution, nearly a 20 percent jump over the previous year.

Our fourth enforcement priority is to discourage and deter noncompliance within tax exempt and government entities, and the misuse of such entities by third parties for tax avoidance purposes. This is an area that is particularly important to me, and I would like to cite just a few examples of the problems we are seeing, and tell you how we are responding.

Some have asked whether the problems we are seeing in our area warrant such a high profile. Well, they do. Around a third of the IRS so-called Dirty Dozen schemes touch on uses and abuses of our community. Almost one half of all reportable transactions (those we find abusive and require disclosure about) may involve entities within our jurisdiction as facilitators or so-called accommodation parties. So, yes, we have our problems. In the charitable area what is at stake is the continued generosity of Americans—and a growing cynicism that may impact giving into the future.

Broadly speaking, one can divide noncompliance involving TE/GE organizations into two broad categories. We are acting with vigor in both categories.

The first category concerns charities that abuse their tax-advantaged status. One example consists of charities that are established in order to benefit their donors. Typically, these involve a donor who receives a charitable contribution deduction while maintaining control over the contributed assets, often using them for personal gain.

Examples of this include certain donor advised funds and section 509(a)(3) supporting organizations. We have formed compliance teams with respect to both these abuses. We are examining returns of 200 donors in donor advised fund cases and we have 100 exams underway of supporting organizations, with more planned.

Another abuse in this category are credit counseling organizations that have moved from their original purpose of counseling and educating troubled debtors to inappropriately enrolling debtors in proprietary debt-management plans and fee-charging credit-repair schemes. We have teamed up with the Federal Trade Commission and the states to attack this area, and are currently examining over 50 percent of the industry by gross receipts. We have, in fact, revoked or proposed to revoke 20% of the industry by gross receipts.

And more than just charities are involved. We have certain Employee Stock Ownership Plans formed to unconscionably benefit company owners that were never intended to deliver retirement benefits to employees.

The second category of abuse involves the misuse of our community by third parties. Sometimes this misuse is unknown, but often it is undertaken with the charity's knowledge and consent. One common problem concerns overstated or inflated deductions for a charitable contribution, especially when the donation is of something other than cash or readily marketable securities. Problems exist in such areas as conservation easements. We have hundreds of easement donors under audit now and we are also in the process of reviewing deductions taken for nearly 2,000 more.

Again, problems in this area are not limited to charities and charitable deductions. For example, one of the listed transactions involves an inappropriate acceleration of a deduction to 401(k) retirement plans. Problems with VEBAs exist as well. These and similar arrangements reflect an abuse of the tax advantage that our nation bestows upon TE/GE entities. We all share a common interest in bringing these practices to an end, before Congress or the public decides that the sector is no longer worthy of its support. TE/GE, like the rest of the Service, is moving aggressively to attack abuses.

That covers our four enforcement priorities. While we have made good progress over the past year, there is much more to be done.

Looking forward, the President is strongly committed to boosting enforcement at the IRS. In the proposed 2006 budget, the Administration has called for a 4.3-percent increase in IRS funding – with a nearly 8-percent increase for enforcement.

This boost in resources will allow us to further address complex, high-risk issues in abusive tax avoidance transactions, promoter activities, corporate fraud and aggressive domestic and off-shore transactions. This will mean increased audits of corporate and high-income taxpayers. This initiative strengthens enforcement and promotes better compliance among the largest corporate taxpayers.

Investments in the IRS budget pay for themselves several times over. Last year, the IRS produced direct enforcement revenues of more than \$43 billion from our collection, audit and document-matching efforts. This reflects better than a 4-to-1 return for every dollar invested in the total agency budget. Increased enforcement funding makes good sense and contributes to deficit reduction.

So much for my commercial message – as the Chairman of Ways and Means recently called it during a hearing-.

#### CONCLUSION

Let me conclude by thanking you all for being part of this forum. You are our partners in collecting taxes. You help your clients follow the law and understand their tax obligations and as I said, that is most of our battle. We will try to help you as best we can – by continuing to improve our electronic and information services, updating our computers, and vigorously enforcing the law against the unscrupulous few who threaten the integrity of your industry.

I thank you and welcome you to the Tax Forum.