



## TESTIMONY BEFORE THE IRS OVERSIGHT BOARD

### *Panel 2: What Can My Organization Do Differently than it Has in the Past to Reduce the Tax Gap?*

March 7, 2007

#### **Overview/background**

The National Association of Tax Professionals (NATP) is honored to speak before the IRS Oversight Board and comment on our organization's plans to help reduce the tax gap. NATP appreciates the opportunity to partner with the IRS in addressing this serious problem and to contribute toward its resolution.

NATP lends tremendous influence to taxpayers' decisions about compliance through its educated membership of 18,000 tax professionals. NATP is a "grassroots" organization formed by tax professionals for tax professionals in 1979. Its founders envisioned a support organization that could explain the complex tax code, its regulations and other pronouncements in understandable language. From NATP's humble beginnings, its leaders built an association that has continually supported tax professionals through a 28-year history of tax education, research, and information. NATP develops and sponsors over 200 education programs in every facet of taxation for professionals that primarily serve the small business community. NATP's education is delivered in live presentations at approximately 100 cities throughout the United States. In addition, NATP offers an Annual National Conference featuring up to 28 continuing education credits over a four-day period. Our education is also delivered over the internet through online interactive courses, webinars, and self-study.

NATP employs 14 staff who are CPAs, EAs and attorneys that specialize in tax research for its members. Approximately 40,000 federal tax questions are answered annually. NATP publishes a weekly e-mail newsletter, a monthly "how to" magazine that speaks to IRS pronouncements, Tax Court cases, etc. and a quarterly technical journal. Membership is governed by NATP's Code of Ethics and Standards of Professional Conduct. The Board annually appoints an Ethics Panel that hears and adjudicates ethics and practice complaints.

Mr. Paul B. Jones noted, in his letter of invitation, that the IRS cannot be expected to solve the tax gap problem on its own, that it doesn't have the resources to do that. He pointed out that taxpayers themselves decide upon their own posture of compliance. We agree. NATP understands that the IRS has limited funds with which to achieve its goal of compliance such that all citizens pay their fair share of taxes. We would like to point out, however, that NATP also has limited resources and limited

volunteer capital. It forces us to pick and choose those efforts toward which we can make a commitment outside our mission to our members. NATP's Mission is:

*"...to be an invaluable, efficient partner for all tax professionals, working together to achieve business success in a competitive, changing environment through effective education, resources, industry updates, tax information, and other services pertinent to the tax preparation business."*

Helping close the tax gap is an effort in keeping with NATP's mission to its membership and is a problem we would like to help solve.

### **The Need for Specificity**

Publicity surrounding the gross and net tax gap is ubiquitous. We do not feel the need here to dwell on the \$345 billion shortfall in the American taxpayers' remittance of its tax bill other than to point out that it is estimated. Indeed, the National Research Program has a methodology to "estimate the tax gap." Last year, the IRS in a paper entitled "Federal Tax Gap: New Estimates, New Approaches" stated the following on page 8:

*"Currently, the IRS is examining subchapter S corporations as part of the NRP. The IRS estimates that a large portion of the tax gap is attributable to small businesses including subchapter S corporations. The random sample consists of approximately 5,000 returns covering two tax years, 2003 and 2004. The case building and classification phases of the study are completed. The examination phase of the study began in October 2005 and is expected to be completed in approximately 36 months. The results are scheduled to be available in December 2008."*

The problem with "estimates" or "approximations" and other such broad concepts is that they do not provide "real world" examples or teachable moments that hit the experience of tax preparers and become therefore relevant. Specificity is required in order for tax professionals to efficiently focus their efforts on eliminating or reducing the tax gap. As greater study is given to the tax gap, more information becomes available regarding those behaviors (or the lack thereof) which cause the gap. To fulfill our mission and partnership with the IRS, our members need specific information from the IRS on exactly what is causing the gap. Our members need to know what they are to look for in working with their clients...then they can take specific action to reduce or eliminate the causes of the gap.

In some instances, the IRS is specific such as when it publishes its famous "dirty dozen" tax scams. They deal mainly with fraud. NATP members, on the other hand, are servicing the majority of taxpayers who are trying to comply with the complexity of our tax code. The IRS needs to enhance their marketing efforts to tax professionals, as well as taxpayers, on specific "real world" tax gap problems. It would help tremendously to get the same specificity contained in the "dirty dozen" tax scams to be brought to bear on problems faced by well-intended and compliant-oriented taxpayers. If, for example, the IRS were to better inform the public that "these three things are causing a gap in the service station business" or "these four items are the cause of a gap in automobile dealerships," tax professionals would immediately go about addressing those problems and rectifying them with their clients.

The Commissioner stated on February 16, 2007, before the House Committee on the Budget:

*“...the most recent NRP study did a good job of updating our numbers, but we need more research to better identify the sources of non-compliance on a timely and continuing basis....Despite all of our progress, there is still much we do not know about the tax gap. Although the updated estimates provided by the NRP study are more accurate than our previous estimates, and more accurate than the estimates made at various times by others using more indirect methods, they have many limitations.”*

NATP supports enabling the IRS to develop the technology to provide more specific and timely information concerning where the tax gap occurs and what is causing it. That will ultimately enable tax professionals to address those causes and influence taxpayers accordingly.

### **NATP Members’ Viewpoint on Reducing the Tax Gap**

NATP surveyed its member leaders in February, 2007 to determine their thoughts regarding the tax gap. They were asked the following four questions:

1. Do they agree with the premise above that more specifics regarding the tax gap would help them in combating it?
2. What measures would help them influence a reduction in the tax gap?
3. How could the IRS make it easier for them to help reduce the gap?
4. What other suggestions or comments might help reduce the tax gap?

#### **Question 1 -**

NATP members have their own view “in the trenches” of what may be contributing to the tax gap. With regard to question 1 we found that 80% of those responding indicated agreement that it would be very helpful to have more specific information so that they could be active in helping reduce the tax gap. Here are some useful and interesting comments indicating the need and desire for more specifics:

- *“I would like to know what the IRS is doing to track down unreported income and where their thresh-hold is for studying overstated deductions.”*
- *“Where does the IRS believe the tax gap is originating from? How much in under-reported income is from different segments of the self-employed community, i.e. carpenters, plumbers, fisherman, Etc.?”*
- *“Are self-prepared returns contributing more to the problem or is it consistent across the board between licensed preparers/unlicensed preparers/self-prepared returns?”*
- *“What should preparers look for that might indicate under-reporting?”*
- *“I just believe that the talk about a tax gap is too vague.”*
- *“Identify the problem and what the cause is. All I hear is the tax gap but no details.”*

## Question 2 -

We asked members what measures would help them influence a reduction in the difference between taxes paid and taxes fairly owed by taxpayers. We offered the following series of suggestions and asked the respondents to check those items that would help narrow the tax gap:

- **Third party basis reporting** - 58% said that the reporting of basis is a significant problem and that it would help to reduce the gap if reporting of customer basis in securities transactions was required. Several offered qualifying comments, however, like the following:
  - *“Do agree with this, but not sure how it can be done. People transfer stock to brokers without knowing anything about basis – Some do not even know what basis means. They were given stock years ago by parents who are dead and no one kept track - not inherited, even inherited basis is sometimes lost if they do not get basis at the time of death. Financial institutions will pass the high cost of developing systems to do this to their clients – and some will not be millionaires who help pay for it – and what will this all be for? A few extra million in taxes to the IRS where they will spend millions tracking it!”*
- **Deterrent brochures from the IRS** - 59% said they would like to have brochures and other materials from the IRS that they could share with clients indicating the negative consequences of not reporting income and/or overstating deductions to include audit and prosecution results.
- **Uncomplicated communications from the IRS** - 51% said that communications concerning what’s causing the gap and non-compliance should be simpler and to the point.
- **Seminars for taxpayers** - 50% said they would like to be able to direct clients to outreach and education regarding the proper paying of taxes. Seminars or other materials should demonstrate the benefits of keeping good records.
- **Easy, effective access to the IRS** - 48% said that it should be easier to access the IRS for anonymous or other “whistle-blowing.” There were comments here by several members indicating a fear of the abuse of “whistle-blowing,” and a need for a system to protect honest professionals and taxpayers against unfounded or frivolous complaints.

They also offered additional comments regarding measures that could and should be taken:

- *“Radio, television and other media advertising about the need to comply.”*
- *“Simplify the tax code! The easier it is to comply, the more likely compliance will be met.” (Many comments similar to this were made.)*
- *“Greater scrutiny given to the “seasonal” tax preparer offices. This time of the year we see used car lots, convenience stores, etc. hanging out their banners “Tax Returns Prepared here!” Later, when a problem arises with these returns, ‘seasonal locations’ have folded up their card tables and are nowhere to be found for accountability.”*
- *“Need more publicity on punishments for cheating. I think people are getting away with a lot because they think ‘everyone is doing it’ and no one gets caught.”*

- *“Reduction of the regulations facing small (and I mean truly small) businesses. So many of my clients get out of the business due to complicated regulations. I would not be surprised if a few remain in the business, but underground.”*
- *“Penalizing employers who contribute to the problem by not properly reporting wages paid to workers.”*

### **Question 3 -**

NATP also asked its member leaders how the IRS could help them in reducing the tax gap. The number one response was that more cooperation from the IRS would enable them to point the IRS to unscrupulous and/or criminal behavior. They would like a visible response from the IRS that the information they provide is acted upon. Many IRS offices will not take a complaint about a fraudulent paid preparer from another paid preparer. Whereas it is true that safeguards must be addressed to prevent abuse, unfounded allegations and frivolous complaints, the IRS is missing valuable and worthy “tip information” concerning bad actors in the profession. Some members stated that they never saw the IRS act on any information that was provided, so they do not volunteer it anymore. Others said the IRS doesn’t have time for “small situations” so people think they can “cheat a little.” There were many suggestions. Here are a few:

- *“Don’t publish information about average deductions for income ranges. Some taxpayers believe these are allowable guidelines that field agents use to select returns for audit.”*
- *“Mandatory withholding on 1099’s (or at least those who process payroll already).”*
- *“Better instructions on 1099....”*
- *“I believe requiring issuing 1099s to corporations for non-employee compensation may be a big issue. In my practice I have clients who have been required to incorporate before they can get contracts with companies. If this is widespread there is a lot of untracked income.”*
- *“Other 3rd party reporting requirements of income items.”*
- *“The IRS being more accessible and accountable. What I mean is that there is no one person that you can communicate with at the IRS that will take a problem from beginning to final resolution. Correspondence seems to be sent into a black hole from which generic responses are sent.”*
- *“Preparer registration & regulation. It is less likely that registered preparers will be scamming the system.”*
- *“...Closer review of Schedule C’s in certain industries (building and construction trades, for instance)....”*
- *“Increased audit efforts, particularly on personally prepared returns, whether manual or computer prepared.”*

- *“Questions concerning individuals answered and helped through the IRS centers instead of fear – taxpayers are afraid to ask questions.”*
- *“IRS Quicker response to delinquent returns not being filed.”*

#### **Question 4 –**

At the end of the survey, member leaders and volunteers were asked what other suggestions or comments they might have to help reduce the tax gap. Respondents offered a variety of other comments and ideas too numerous to catalog here completely. Comments point out that these members understand there are serious problems to be resolved. The first one below makes a nice counterpoint to Mr. Jones’ comment that the IRS can’t resolve the tax gap all by itself:

- *“I believe all honest preparers know who the preparers in their community are that stretch or cheat for the client – We can’t do anything about this ourselves.”*
- *“Lobby Congress to avoid last minute tax changes. Tax law is difficult enough without making quick changes after instructions and forms have been printed.”*
- *“I hate to say this but we have had an audit vacation now for the last 10 + years.”*
- *“It is one thing to not follow the rules intentionally and another to find out that you weren’t following the rules when you made every effort to do so.”*
- *“Somehow make it more public that people are getting caught with this and justice is being served. The general belief seems to be that those who are not paying their fair share continue to get away with it...”*

#### **NATP’s Future Plans Toward Reducing the Tax Gap**

NATP has a valued ongoing relationship with the IRS and we plan to enhance our partnership in pursuing the reduction of the tax gap. We have examined the significant issues contributing to the tax gap and will be preparing effective topics for instruction throughout our education season. For example, we know that basis is a significant issue and that errors in basis reporting contribute to the tax gap. In our partnership with the IRS this year, NATP will be instructing in the proper calculation and determination of basis at the IRS Tax Forums around the country. We will be teaching similar topics throughout our education offerings, to include our National Conference where the IRS will reciprocate as a teaching partner. Deborah Wince-Smith from the IRS Oversight Board will keynote that Conference and the IRS will present a panel discussion on tax compliance.

In addition to its role as a source of education and research, NATP also acts as a liaison in communicating issues between the IRS and tax professionals, sending information in both directions. This testimony, resulting from a direct survey of member leaders, is an example of how that process can contribute toward solutions to reducing the tax gap. It’s apparent, from some of the survey commentary we shared with you, that we will be working closely in the future with the new Office of the Whistle Blower.

**Summary**

NATP urges the IRS to provide more specific information regarding the causes of the tax gap. Our member leaders and volunteers have stated that it is necessary in order for them, and consequently NATP, to influence a reduction in the tax gap. NATP will communicate this information to its members through its considerable education, research and communication system. Thank you for your time and consideration of these comments. NATP is privileged to have had the opportunity to provide these insights. We look forward to our continued dialog and your questions on these issues.