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WRITTEN STATEMENT OF JEFFREY A. PORTER

ON BEHALF OF THE

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

PRESENTED TO THE

INTERNAL REVENUE SERVICE OVERSIGHT BOARD

PUBLIC FORUM PANEL 2: WORKING TOGETHER TO COMBAT FRAUD

May 1, 2013

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The American Institute of Certified Public Accountants ("AICPA") thanks the IRS Oversight Board for the opportunity to appear today on the public forum panel on "Working Together to Combat Fraud." I am Jeffrey A. Porter, Chair of the AICPA's Tax Executive Committee; and a sole practitioner at Porter & Associates, a CPA firm in Huntington, West Virginia which concentrates in providing tax planning and business advisory services for local businesses and high net worth individuals.

The AICPA is the world's largest member association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state, and international tax matters and preparer income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We agree with the IRS Oversight Board's central premise that "the current budget environment makes more Internal Revenue Service ("IRS" or "Service") spending on tax enforcement a difficult task," resulting in a need for the IRS and other tax administration authorities "to address compliance risks up front, through education and outreach activities, including closer cooperation with stakeholders." In this context, I am pleased to participate on today's panel on combatting tax fraud, the panel which will take an in-depth look at ways to improve the federal government's response to tax identity theft.

The IRS Budget

Before addressing the issue of tax fraud, the AICPA expresses its strong support for the IRS Oversight Board and its quest to ensure full funding of the Internal Revenue Service's fiscal year ("FY") 2014 budget. However, the IRS's budget has been severely challenged in recent years. The IRS received an overall budget allocation of $11.8 billion in FY 2012, down from $12.1 billion for FY 2011. The challenge for the Service is even more dramatic as the $5.3 billion enforcement budget the Service received for FY 2012, was reduced by approximately $200 million from the year before.[1] These statistics are further highlighted by the reduction in IRS employment levels to 98,000 for FY 2012 from 104,000 in the prior year.

[1] Department of the Treasury, FY 2013 Budget in Brief.

We have long advocated funding levels for the IRS which would allow the Service to efficiently and effectively administer the tax laws and collect taxes. Giving the Service the resources necessary to properly process tax returns and enforce the tax laws is vital to maintaining our voluntary compliance tax system.

The AICPA expects the Service to identify responsible ways to allocate any additional resources it receives; and that Congress, through its oversight responsibilities, will ensure that those resources are properly utilized. Unfortunately, the budget process has become much more complicated for federal agencies in general and especially challenging for the IRS. In this context, National Taxpayer Advocate Nina Olson stated in her 2012 annual report that one of the most serious challenges facing American taxpayers is that "[t]he IRS is significantly and chronically underfunded to serve America's taxpayers and collect the amount of tax due under law. . . [t]he continued underfunding of the IRS poses one of the greatest long-term risks to tax administration today.[2] Ms. Olson goes on to point out that the lack of sufficient resources allocated to the IRS is the sole or significant cause of most of the other issues identified in her report.

The AICPA believes that the Service should be provided with the proper resources to fund its mission, which will in turn empower the Service to fulfill its customer service and enforcement responsibilities. Any increase in enforcement funding must be balanced with positive responses to the taxpaying public as customers, a balancing act which has become even more challenging for the Service when faced with the current era of "mission creep" beyond its core tax administration functions. Almost assuredly, IRS will have to allocate a significant amount of money to deal with identity theft issues. As we have stated in the past, all taxpayers must still have access to resources that enable them to fulfill their tax responsibilities, and adequate IRS budgetary funding must be provided to ensure this access.

Background

In discussing the topic of fraud, the AICPA must acknowledge the difficult tightrope the Service must traverse in combating fraud and identity theft. That is, the tension the IRS faces between the duty to protect the Treasury (by mitigating the payment of false refunds) with the need to promptly issue refunds to lawful taxpayers. Our statement principally focuses on mitigating tax identity theft, a critical component of the fight against tax fraud.

The IRS has made great strides in combating fraud as illustrated by its March 28, 2013 announcement that the Service is: (1) expanding its Law Enforcement Assistance Program to help state and local law enforcement obtain tax return data vital to investigating identity theft cases; and (2) continuing to emphasize criminal investigations. We also view as positive the IRS's expansion of the Identity Protection Personal Identification Number (IPPIN) pilot and its

[2] National Taxpayer Advocate 2012 Annual Report to Congress, January 9, 2013, Volume One, page 34.

resolution of over 200,000 identity theft victim related cases since the start of 2013.[3] Nevertheless, the fight against identity theft fraud is taking a toll on IRS resources, resources that could more productively be deployed to taxpayer service or other compliance initiatives.

Despite the IRS's successes in combating identity theft, we cannot over-emphasize the staggering dimensions of the tax identity theft problem. According to the National Taxpayer Advocate's 2012 Annual Report to Congress, identity theft cases handled by the IRS grew exponentially in FY 2012 over the prior year. The IRS's Identity Protection Specialization Unit (IPSU) received about 450,000 cases in FY 2012, a 78-percent increase over FY 2011. Moreover, the report reveals that identity theft cases amounted to 25 percent of all case receipts for the Taxpayer Advocate Service in FY 2012.

We are pleased to join in today's discussion regarding ways to expand the already positive approaches the IRS has implemented in addressing identity theft.

<u>What actions can be taken up-front, so that problems are prevented or addressed when they occur?</u>

The AICPA often receives emails and calls from members who have stories about how one of their clients has become a victim of tax identity theft and the person's refund has been put "on hold" until the government can sort things out. Some of these stories can be heart wrenching.

Identity theft victims may be alerted to the theft when they learn that their information has been used to file a false tax return to obtain a refund, or when the thief tries to use the taxpayer's identity to obtain a job. Once these kinds of events occur, the client's problems are just beginning.

With the dramatic upturn in identity theft cases, there are a number of actions CPAs and other tax professionals can take up-front to mitigate the potential for tax identity theft. First, as a trusted advisor, tax return preparers can inform their clients what to do if they receive an email or other communication that looks unusual. They can remind their clients that: (1) the IRS *never* uses email or social media to contact taxpayers directly; and (2) the IRS provides numerous ways for taxpayers to identify possible ID theft and telephone numbers to report it. Tax professionals and their clients should become familiar with the information at irs.gov; the website offers great advice about how to handle taxpayer identity theft.[4]

Second, CPAs and other tax professionals can also implement a number of steps to streamline their office procedures to mitigate the potential for identity theft. Our members highlight the need to avoid leaving confidential client information out in open view on a desk, and using shredders to eliminate obsolete paper. Practitioners should also consider:

[3] IR-2013-34, "IRS Expands Law Enforcement Assistance Program on Identity Theft to 50 States; Victim Assistance and Criminal Investigations Grow," March 28, 2013.
[4] See IRS Information Page on Identity Protection.

- Locking desk drawers and file cabinets (a basic but overlooked measure).
- Prohibiting the use of un-encrypted flash drives, which can easily be stolen or lost;
- Using encryption procedures, particularly when sending a client's information to a third party, such as a banker or attorney;
- Redacting or truncating Social Security Numbers, employer identification numbers, and other personal information from client tax organizers;
- Using couriers and certified mail (return receipt requested) to ensure that the correct person receives letters and mail;
- Training staff about proper handling of client information and how to avoid Internet schemes; and
- Installing and requiring the use of anti-virus and security software on all firm computers.

Potential tax identity theft victims can notify the IRS at (800) 908-4490 and complete Form 14039, *Identity Theft Affidavit*. Tax professionals should also suggest that the client notify banks, credit card companies, credit bureaus, and local police, and verify that their Social Security earnings record will not be affected.

Assuming the appropriate allocation and receipt of resources, the IRS can also take a number of steps to further mitigate the problems surrounding identity theft. The Service should continue to increase the level of staffing dedicated to identity theft cases, and improve its training of agency employees to ensure the proper response and assistance for identity theft victims. With proper staffing and training for IRS employees, taxpayers could receive timely notices of refund holds and speak with IRS telephone assistors to discuss the status of their tax return and resolve tax problems.[5]

However, some actions that we believe would reduce the threat of identity theft would require legislative or regulatory changes. The AICPA applauds the IRS's issuance of REG-148873-09, IRS Truncated Taxpayer Identification Numbers (TTINs). The proposed regulations implement the pilot program announced in Notices 2009-93 and 2011-38, which authorize filers of certain information returns to voluntarily truncate an individual payee's nine digit identifying number on specified paper payee statements furnished for calendar years 2009- 2012. We believe the proposed regulations are a positive step towards protecting the privacy and security of personal information. Over the last few years, we urged the IRS to make the taxpayer identification number truncation initiative permanent, as opposed to remaining a pilot program.[6] We appreciate that the proposed regulations: (1) make the truncation program permanent; and (2) extend the scope of the IRS truncation program to permit filers to furnish payee statements electronically. However, we support an extension of the truncation program to permit the use of truncated social

[5] The National Taxpayer Advocate's 2012 Annual Report to Congress, January 9, 2013, Volume 1, the Most Serious Problems Encountered by Taxpayers, page 106.

[6] The AICPA most recently submitted comments on truncated taxpayer identification numbers to the Internal Revenue Service on February 20, 2013.

security numbers (SSN) on all types of tax forms and returns provided to a taxpayer, employee or other recipient. Unfortunately, as described in more detail below, there may be current statutory or other limits placed upon the IRS's ability to expand the truncation initiative.

Under section 301.6109-4 of the proposed regulations, an IRS TTIN is defined as an "individual's SSN, IRS individual taxpayer identification number (ITIN), or IRS adoption taxpayer identification number (ATIN) that is truncated by replacing the first five digits of the nine-digit number with Xs or asterisks." However, the preamble of REG-144873-09 expressly states that the IRS's ability to extend the truncation program to a greater number of payee statements by regulation is limited by statute. Thus, the proposed regulations do not extend truncation of taxpayer identification numbers beyond certain types of information returns already permitted under the pilot program.

We understand that limitations exist currently with regards to truncation on a Form W-2, *Wage and Tax Statement*. Under Internal Revenue Code (IRC or "Code") section 6051(a)(2)[7], employers are required to provide employees a written statement (i.e., Form W-2) with certain information including the employee's SSN. We urge Congress to consider a legislative proposal to change the section 6051 reporting requirement to permit truncation of employee SSNs on all copies other than the copy filed with the U.S. Social Security Administration (SSA).

In the General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals, a revision to section 6051 is proposed to require employers to include an "identifying number" for each employee, rather than an employee's SSN, on a Form W-2. We generally support this concept, but strongly believe there is a need for more extensive legislation to extend the use of truncated SSNs to all types of tax forms and returns provided to a taxpayer, employee or other recipient. For example, tax preparers are required to obtain a Form 8879, *IRS E-file Signature Authorization*, from their clients in order to e-file their tax returns. This form is not submitted to the IRS, but merely retained in the tax preparer's records. However, the tax preparer must list a client's full social security number on the form and send the document to the client for signature. Then, the client will sign the form and return it to their tax preparer often through the U.S. mail or by scanning the document and submitting it via e-mail. Either process makes the client's SSN susceptible to theft. Because the form is not submitted to the IRS, or any agency for that matter, we do not believe a SSN should be required on the form.

Clearly, the need for this expansive legislation is supported by the growing concern over identity theft in general and the growth in the number of such cases being handled by the IRS. This important change to the current law will not solve all of our country's growing problems with identity theft; however, it will likely help tax practitioners from inadvertently providing criminals access to clients' identification numbers merely by sending their clients completed IRS forms.

[7] All references in these comments are to the Internal Revenue Code are to the Internal Revenue Code of 1986, as amended.

Finally, the AICPA supports civil penalties for tax-related identity theft, including penalties on fraudulent tax preparers.[8] In the 112th Congress, Representative Erik Paulsen introduced H.R. 5630, Fighting Tax Fraud Act of 2012, which would have amended section 6694 subsections (c), (d), (e) and (f) to provide an increased penalty in certain cases of a fraudulent understatement of a taxpayer's liability by a tax return preparer. This bill was in response to the National Taxpayer Advocate's 2011 Annual Report to Congress (pages 558-561), which noted a small number of tax return preparers defraud taxpayers and the IRS by altering the taxpayers' returns without their knowledge. In many cases, preparers claimed increased refunds – that the taxpayers were not entitled to receive – in order to pocket the extra money themselves. The AICPA fully supports efforts, such as H.R. 5630, to deter such outrageously unethical behavior. More recently, the Administration has proposed a similar provision which would assess a civil penalty in the amount of $5,000 on an individual who files a fraudulent tax return in tax identity theft cases.[9]

Are there ways to make it easier to comply and at the same time, more difficult not to?

As a fundamental tax administration goal for combating fraud, the AICPA supports former Commissioner Douglas Shulman's statement in 2008 calling for the establishment of one point of contact within the IRS for prompt resolution of identity theft cases.[10] This is consistent with National Taxpayer Advocate Nina Olson's belief that the current 21 units within the IRS for helping identity theft victims should be reduced to one. We conceptually support her suggestion that the current IPSU should serve as the centralized "traffic cop" for addressing a taxpayer's identity theft case among the multiple IRS departments.[11] Without such program relief, her 2012 report suggests that "One consequence of the IRS taking so long to resolve an identity theft case is that many victims will enter the following filing season with unresolved account issues…[with the] risk of having a perpetrator steal their refund again the following year…"[12]

Another suggestion, which we believe would enhance identity protection, is Congressional passage of legislation clarifying public access to the Death Master File, a data base which provides the Social Security Number and other personal information about a deceased person. We urge prompt action by Congress in this regard.

[8] The AICPA submitted comments to the House Committee on Ways and Means Chairman and Ranking Member on July 16, 2012.
[9] Department of the Treasury, General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals, page 212.
[10] Hearing on Identity Theft in Tax Administration, Senate Finance Committee, April 10, 2008.
[11] The National Taxpayer Advocate's 2012 Annual Report to Congress, Volume 1, page 46.
[12] Ibid, page 52.

How can the IRS and stakeholders make better use of technological developments and understandings of taxpayer behavior?

The IRS has made great strides in issuing IP PINs to 250,000 taxpayers victimized by identity theft in 2012, with approximately 770,000 issued during the 2013 filing season.[13] However, we believe the IRS could issue many more IP PINs and aid even more identity theft victims.

New technological developments may contribute greatly to a reduction in the Service's cycle time for addressing identity theft cases. Technology improvements should also focus on providing the IRS with an ability to conduct a global account review for an identity theft victim by identifying prior returns that have been impacted and subject to potential examination and collection actions.

How can the IRS and stakeholders work together to develop and implement initiatives to create a pro-compliance environment?

The AICPA believes the IRS and stakeholders should work more closely together to develop strategies to assist taxpayers who are in significant need of help. This is particularly important at a time when resource constraints are causing the IRS to close more Taxpayer Assistance Centers (TACs), as well as limit the hours of operations for the TACs. An excellent avenue in this regard is for stakeholders to assist the IRS in alerting the public about tax schemes which defraud the taxpayers and the Treasury.

For example, the IRS recently released its list of the "Dirty Dozen Tax Schemes for 2013," a list of tax scams which could result in some taxpayers unwittingly becoming subject to penalties, interest, and possible criminal prosecution.[14] Stakeholders could assist the IRS in publicizing this list which covers: (1) identity theft; (2) phishing; (3) return preparer fraud; (4) the hiding of income offshore; (5) false publicity about IRS "free money" and Social Security scams; (6) bogus charitable organizations; (7) false/inflated claims of income and expenses; (8) false Form 1099 refund claims; (9) frivolous arguments; (10) false claims of zero wages; (11) disguised corporate ownership; and (12) the misuse of trusts.

Helping the taxpaying public identify who is a competent, ethical tax professional is another avenue where the IRS and stakeholders should work closely together. In this context, the AICPA has launched a multi-year public awareness campaign promoting CPAs as premier providers of tax services. This effort is part of a larger campaign the AICPA calls "360 Degrees of Taxes," providing consumers with timely tax resources, tips, frequently-asked-questions (FAQs) and other tax information.[15]

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[13] Remarks of Acting Commissioner Steven Miller at a press conference call on an identity theft sweep, February 7, 2013.

[14] IRS Releases the Dirty Dozen Tax Scams, March 26, 2013.

[15] 360 Degrees of Taxes, at: http://www.360taxes.org/, is an extension of the AICPA's successful 360 Degrees of Financial Literacy program (http://www.360financialliteracy.org/), a free effort of the nation's CPAs to help Americans understand their personal finances through every stage of life.

Similar to the AICPA's efforts behind "360 Degrees of Taxes," the IRS has done a commendable job in alerting the public about carefully choosing a tax preparer, providing taxpayers with "10 tips" to keep in mind when choosing a tax return preparer." According to these tips, a taxpayer should (among others suggestions): (1) check the preparer's qualifications and whether he or she has a Preparer Tax Identification Number (PTIN); (2) review the preparer's history and whether he or she has been subject to any disciplinary actions; and (3) avoid preparers who base their fee on a percentage of the taxpayer's refund or claim they can obtain the taxpayer a larger refund than a preparer "down-the-street."

Finally, and as described more fully below, we believe the IRS has an obligation to the public in mitigating possible confusion with regard to the relative qualifications of paid income tax return preparers.

How could preparer registration, even if implemented on a voluntary basis, serve as a framework to address fraud in the tax preparation industry?

Another important item included in the topics for today's forum – which includes an issue of particular interest to our members – is the regulation of tax return preparers. Obviously, clarity in this environment is necessary due to the pending judicial situation. The AICPA has always been a steadfast supporter of the IRS's overall goals of enhancing compliance and elevating ethical conduct. Ensuring that tax preparers are competent and ethical is critical to maintaining taxpayer confidence in our tax system. Indeed, these goals are consistent with the AICPA's own Code of Conduct and enforceable tax ethical standards.

We believe the IRS should be commended for its efforts in the implementation of their return preparer program. Specifically, the IRS devoted an unprecedented amount of time to listening to stakeholder concerns and suggestions regarding the program, and made numerous changes and adjustments. We believe some of those changes confirm the Service's recognition of the inherent regulatory regime within which CPAs and other Circular 230 legacy practitioners already practice, as well as the fact that CPA firms must stand, as a matter of licensure, behind the work performed by the members and employees of the firm. We believe these changes appropriately focused the program on the "unenrolled" preparer community that was implicated in the U.S. Government Accountability Office (GAO) and U.S. Treasury Inspector General for Tax Administration (TIGTA) compliance studies cited in the IRS's preparer regulation report.

The AICPA generally supports the IRS tax return preparer program. Specifically, we support:

- Registering paid tax return preparers and the issuance of unique preparer tax identification numbers. Registration will allow the accumulation of important data on specific preparers, as well as classes of preparers in a way that will allow the IRS to tailor compliance and education programs in the most efficient manner.

- Expanding the ethical umbrella of Circular 230 over all paid income tax preparers. "Unenrolled" preparers had previously not been subjected to the ethical guidance of Circular 230 nor its sanctions for improper conduct.

- Creating a continuing education and competence construct geared towards the "unenrolled" preparer community who prepare Form 1040 series returns. Including a focus on the basics is the correct remedial approach for the "unenrolled" preparer community that was, again, implicated in the GAO and TIGTA compliance studies.

- Recognizing the potential for taxpayer confusion regarding the relative qualifications of different paid preparers through the issuance of Notice 2011-45, which constrains "registered tax return preparers" from misleading advertising and solicitation and will require these preparers to use the following statement in ads: 'The IRS does not endorse any particular individual tax return preparer. For more information on tax return preparers go to IRS.gov.'" We also believe that any public-facing IRS sources concerning preparers, including a return preparer database, should contain sufficient information that taxpayers will need to make appropriate choices concerning the selection of a tax adviser. IRS mitigation of any taxpayer confusion regarding relative qualifications should be a critical and ongoing component of any program.

With regard to the PTIN program serving as a framework to address fraud in the tax preparation industry, we believe the program will elevate to a basic level, the competence of all paid income tax return preparers. Also, PTIN registration will allow the IRS to accumulate important data on specific preparers as well as classes of preparers in a way that will allow the government to tailor tax return preparer compliance in the most efficient manner. Moreover, as suggested above, we strongly support the Service's extension and opening of the ethical umbrella of Circular 230 over all paid income tax preparers.

We will continue to provide feedback on the work the IRS undertakes with regard to its tax preparer program as we share the Service's interest in improving tax administration and protecting the taxpaying public.

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The AICPA looks forward to working closely with the IRS Oversight Board and the IRS on ways to combat tax fraud and promote good tax administration for the benefit of American taxpayers. We are pleased with the work the IRS Oversight Board has undertaken with regard to tax administration, as well as its support for an effective IRS budget. We share the Board's interest in improving tax administration and protecting the taxpaying public, and we thank you again for the opportunity to appear today on this most important topic of combatting tax fraud.