

**INTERNAL REVENUE SERVICE
ADVISORY COUNCIL**

GENERAL REPORT

**DONNA K. BAKER
DAVID L. BERNARD
MICHAEL CASEY
TERESA K. DOUGLASS
ANN ESARCO
WILLIAM FRAZIER
DAVID F. GOLDEN
ERNEST HICKS
SANFORD D. KELSEY
MARC J. KORAB
RICHARD G. LARSEN
DAVID A. LIFSON
JANICE LUCCHESI
ROBERT E. MCKENZIE
CHARLES J. MULLER
WILLIAM E. PHILBRICK
AMEEK A. PONDA
CHARLES P. RETTIG
CHRISTOPHER T. RILEY
BONNIE SPEEDY
JONI K. TERENS
MADELEINE SAVAGE-TOWNES
NEIL TRAUBENBERG
CYNDI P. TROSTIN
DEBORAH WALKER
CECILY V.M. WELCH
PETER S. WILSON
BRIAN YACKER**

NOVEMBER 16, 2011

GENERAL REPORT
OF THE
INTERNAL REVENUE SERVICE ADVISORY COUNCIL

The Internal Revenue Service Advisory Council (the “IRSAC”), the successor to the Commissioner’s Advisory Group established in 1953, serves as an advisory body to the Commissioner of Internal Revenue. The purpose of the IRSAC is to provide an organized public forum for Internal Revenue Service (the “IRS”) officials and representatives of the public to discuss relevant tax administration issues. The IRSAC reviews existing tax policy and recommends policies regarding both existing and emerging tax administration issues. In addition, the IRSAC suggests operational improvements, conveys the public’s perception of professional standards and best practices for tax professionals and IRS activities, offers constructive observations regarding current or proposed IRS policies, programs, and procedures, and advises the Commissioner and senior IRS executives on substantive tax administration issues.

The IRSAC has 28 members with substantial, disparate experience and diverse backgrounds. The members represent large and small firms from urban and rural settings across all regions of the United States. Members include representatives from the taxpaying public, educators, the tax professional and appraisal community, volunteer income tax community as well as small and large businesses. In addition to representing different industries and geographic regions of the United States, members also represent several occupations that interact with the IRS in a variety of ways. Current members include accountants, lawyers, enrolled agents, and academics. Each member has a unique tax policy perspective and is committed to providing meaningful input and feedback to

the IRS.

The IRSAC is organized into four subgroups - the Wage and Investment (W&I) Subgroup, the Small Business/Self-Employed (SBSE) Subgroup, the Large Business and International (LB&I) Subgroup, and the Office of Professional Responsibility (OPR) Subgroup. The members recognize the invaluable assistance, dedication and support provided by personnel from the IRS Office of National Public Liaison (NPL) and the operating divisions - Candice Cromling, Director, NPL; Carl Medley, Chief, Liaison Advisory Groups, NPL; Lorenza Wilds, IRSAC Program Manager, NPL; Rose J. Smith, NPL; Anna Millikan, NPL; Maria Jaramillo, NPL; Brian Ward, NPL; Johnnie Beale, W&I; Tonjua Menefee, SB/SE; and Kate Gregg, LB&I. The IRSAC members were honored and privileged for the opportunity to be able to work with each of these truly remarkable individuals!

Issues selected for inclusion in the annual report represent those to which IRSAC members have devoted particular attention during four working sessions and numerous conference calls throughout the year. The issues included in the IRSAC annual report are issues that members consider especially important and include issues that IRS personnel brought to our attention. Nearly all issues involved extensive research efforts.

We acknowledge the many challenges that the IRS has recently experienced and, knowing the demands of the IRS executives and operating division representatives, we sincerely appreciate the time and effort extended to the IRSAC during the year. The economic downturn in the United States and in the global community continues to be a significant factor in some of the issues addressed by IRSAC, and this downturn is explicitly noted in some of the Subgroup reports.

The 2011 W&I Subgroup, chaired by Bonnie Speedy, prepared the attached report that reviews and makes recommendations for the possible simplification of Schedule D, new guidelines and notices for Installment Agreements and other collection tools, more clarity from the IRS at different stages of communication concerning the Refundable Adoption Credit, and changes to process and forms to increase compliance for the American Opportunity Tax Credit.

The 2011 LB&I Subgroup, chaired by David L. Bernard, prepared the attached report focusing on how the use of remote work concepts by the IRS can be expanded and improved to more efficiently deploy the Service's limited resources, identifying ways LB&I may gain greater commercial awareness, additional guidance regarding Schedule UTP, how distance learning methods employed by the IRS may be improved, insights regarding expanding usage of fast track settlement in order to facilitate earlier resolution of issues and to assist in managing the workload of IRS Appeals, and how the IRS could take advantage of the mandated research conducted within the academic community.

The 2011 SBSE Subgroup, chaired by David A. Lifson, focused on how to use technology to improve the examination process, use of Appeals Fast Track by SBSE, use of performance measures and behavioral effects/ACS, fairness and increasing compliance in worker classifications, increasing efficacy of online payment agreements and direct debit installment agreements, system and process enhancements including recommendations on effective use and advancement of personnel and improving the Reasonable Cause Assistant with respect to penalty waivers.

The 2011 OPR Subgroup, chaired by Charles J. Muller, prepared the attached report focusing the authority to sign complaints and discipline practitioners remaining

exclusively under OPR, coordination of administrative responsibility over discipline between OPR and the Return Preparer Office (RPO), expanding the guidance available to all tax practitioners concerning their ethical and professional obligations, rescission of changes to the final regulations permitting flexibility in the allocation of disciplinary authority within the IRS, adoption by OPR of the Uniform Standards of Professional Appraisal Practice, or equivalent, as one of the standards for judging appraiser conduct.

The 2008 and 2010/11 General Reports included recommendations within the SB/SE Subgroup Report for the IRS to consider a pilot program to offer tentative independent contractor status to compliant taxpayers that provide notice to the IRS. We commend the IRS for recently implementing the Voluntary Classification Settlement Program (VCSP), designed to increase tax compliance and reduce burden for employers by providing greater certainty for employers, workers and the government. Under the program, eligible employers can obtain substantial relief from federal payroll taxes they may have owed for the past, if they prospectively treat workers as employees. The VCSP is available to many businesses, tax-exempt organizations and government entities that currently treat workers or a class or group of workers as nonemployees or independent contractors.

The following discussion points were not assigned to a specific IRSAC subgroup but are being presented due to their broad-range importance throughout our system of tax administration.

ISSUE: THE IRS MUST RECEIVE CONSISTENT, ADEQUATE AND APPROPRIATE FUNDING TO ACHIEVE THE PROPER ADMINISTRATIVE BALANCE BETWEEN SERVICE, COMPLIANCE AND TAX ENFORCEMENT

Executive Summary

The IRS must receive adequate funding commensurate with its ever-increasing responsibilities and workload to remain effective. The IRSAC is concerned that both taxpayers and the tax system will suffer without consistent and adequate levels of funding.

Background

The rapidly increasing responsibilities and workloads of the IRS continually surpass any corresponding increase in resources. The IRS has sought and continues to seek ways to improve taxpayer service while reducing taxpayer burden, add new and improved technology, and increase their visibility and tax enforcement efforts. The IRS has become expert in the art of “flexecution” (flexibility in the execution of their planned operations) while regularly called upon to redeploy precious resources to emerging areas of tax noncompliance throughout the world. The IRSAC commends these efforts and encourages them to continue performing these important tasks.

Limited resources are forcing the IRS to continually streamline its services. An example of this approach is the limited ability of taxpayers to interface with a local IRS representative when responding to a notice, when seeking resolution of an issue, or during the process of tax collection or the processing of offers in compromise. Instead, taxpayers and representatives often encounter numerous erroneous notices and lengthy holding periods on the telephone followed by a non-discretionary approach that sometimes fails to comprehend the unique issues involved. Every taxpayer is not alike and the need for face-to-face interaction should not be overlooked or ignored in favor of budgetary concerns.

Limited resources are also forcing the IRS to streamline its enforcement efforts. An example of this approach is the 2011 Offshore Voluntary Disclosure Initiative (the “OVDI”). The IRS is to be highly commended for encouraging some 30,000 voluntary disclosures under the OVDI and a similar program, the 2009 Offshore Voluntary disclosure Program (the “OVDP”), while collecting what will likely, in the aggregate, far exceed \$3 billion in taxes, interest and penalties. These programs represented a streamlined “one size fits all”, non-discretionary approach to the voluntary disclosure by U.S. persons having previously undisclosed interests in foreign financial accounts and assets. Throughout, the IRS analyzed information received from taxpayers and practitioners and, on occasion, made changes in program processing. Some complained that their suggested changes were not implemented while others benefitted from changes following the implementation of each program. Although the IRS attempted to be responsive and understood the need for certain program modifications, we acknowledge that it is simply not possible to be responsive to every concern within a “one size fits all” approach. Unfortunately, many believe these programs did not properly provide enough discretion for the differences in culpability existing among those who came forward and among others who, for whatever reason, decided not to come into compliance.

Heightened tax enforcement efforts and increased penalties for non-compliance must be coupled with ongoing efforts to encourage taxpayers to voluntarily come into compliance. Further, the public must perceive that heightened future civil and criminal tax enforcement efforts will effectively ferret out a significant proportion of the remaining non-compliant taxpayer community. These efforts are resource intensive and require appropriate attention and funding to protect the integrity of the OVDP and the

OVDI. The IRS has extremely capable personnel throughout who should be given the ability to utilize their experience in analyzing and resolving tax issues, rather than blindly processing paperwork.

The future is uncertain, at best, for eligible U.S. persons who failed to participate in the OVDP or the OVDI and have any remaining undisclosed interests in foreign financial accounts. There are perhaps millions of taxpayers who failed to take advantage of the certainty and perceived benefits afforded within the OVDP or the OVDI. The IRS should continue to pursue efforts designed to encourage these taxpayers to voluntarily come into compliance while perhaps recognizing that a “one size fits all” approach may not be fully appropriate.

Finally, the hiring of new IRS employees and retention of experienced employees is critical to the mission of the IRS. Due to competing views on the appropriate budget regarding the future funding of the IRS personnel, it is difficult for those IRS employees responsible for planning future hiring initiatives to prepare with any degree of certainty. It also can make it difficult to extend offers to desirable recruits and may result in offers to desirable recruits being delayed. The entire process is made even more difficult by the fact that frequent changes to the Internal Revenue Code occur with little consideration to the staffing needs of the IRS.

IRSAC is concerned about the loss of experienced IRS employees due to retirement, reassignment and transfers out of the IRS, coupled with budget restraints imposed. This combination of events poses a significant concern for the operational efficiency in the area of taxpayer service and tax enforcement as well as the ability to replace personnel lost to attrition.

Recommendations

1. Congress should appropriately fund the IRS to assure continued success in service, compliance and enforcement. Without adequate funding, both taxpayers and the tax system will continue to suffer. IRS personnel must receive the appropriate tools and technology to perform effectively. Advances in private sector technology are outpacing a resource challenged IRS at a time when it is most important for the IRS to continue to improve its technology (and increase its full-time staff) if it is to operate effectively. The IRS will continue to face difficult decisions with respect to allocating limited resources between the compliance, enforcement and service functions. While IRSAC recognizes the extreme importance of service to taxpayers, we also recognize that increased compliance and enforcement efforts are critical to the proper functioning of our voluntary tax system and cannot be ignored due to budgetary constraints.
2. The IRSAC recommends that resource allocation decisions focus on ensuring that the service, compliance and enforcement efforts of the IRS are properly balanced. Inappropriately allocated limited service or enforcement resources may serve only to foster future noncompliance. Encouraging future compliance is of parallel importance to punishing prior non-compliance. Tax administration is a constantly evolving process that must be able to react quickly, efficiently and effectively.

Conclusion

The IRSAC members are grateful for the opportunity to serve the Internal Revenue Service and taxpayers. It is readily apparent that the IRS is continually required to “do more with less” resources while operating in a complex, ever changing environment throughout the world. The IRS is to be highly commended for its historical and recent efforts and vast accomplishments on behalf of tax administration.

Finally, the IRSAC appreciates the invaluable assistance provided by the IRS executive and support personnel. Thank you for your dedicated service to the IRSAC and the IRS - it was an honor and privilege to get to know and work with each of you!