

**INTERNAL REVENUE SERVICE
ADVISORY COUNCIL**

**SMALL BUSINESS/SELF-EMPLOYED
SUBGROUP REPORT**

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I. INTRODUCTION

The IRSAC Small Business/Self-Employed Subgroup (hereafter “SB/SE Subgroup”) consists of a diverse group of tax professionals who have significant professional experience and organizational affiliations. The SB/SE Subgroup has representation from CPAs, Enrolled Agents, Tax Attorneys and Software Developers. Each member, along with specific areas of expertise, has wide experience with both the taxpaying public and the Internal Revenue Service (IRS). We are pleased that the IRS has requested our views on issues of importance to both the general public and the IRS.

The SB/SE Subgroup thanks the IRS for providing us the opportunity to attend the IRS Nationwide Tax Forum of our choice. We believe that this is an important interaction between the IRSAC members, tax professionals and IRS personnel and would like to see the practice continued.

During the past year, the SB/SE Subgroup has met for four working sessions in Washington, D.C. We want to thank the IRS personnel with whom we have had discussions for their availability and candor. The SB/SE Subgroup has focused its attention on five issues as summarized below:

1. Employment Tax Pyramiding - Employment tax pyramiding is a serious problem. It continues despite significant efforts by the IRS to curb it. As listed in our recommendations, there are a number of steps that could be taken to eliminate pyramiding.
2. Enhancing Communication with Tax Practitioners - Given scarce resources, the IRS should place more emphasis on cooperation with tax professionals to encourage taxpayer compliance. This can be done more efficiently through enhanced communication and relationships.

3. E-services for Reporting Agents - E-services have not been provided to Reporting Agents, a significant IRS partner, even though they have been available to others since 2003. Providing e-services to Reporting Agents is a good business decision and should be undertaken immediately for the benefit of IRS, Reporting Agents, and Taxpayers.
4. Tax Professional Best Practices - The IRS wishes to improve the quality of practice of tax professionals, as evidenced by the amendment to the Circular 230 Regulations concerning practice before the IRS. The IRS can improve best practices of tax professionals by providing additional guidance, providing more clearly defined expectations, and improving its working relationship with the tax professional community.
5. Underreported Income - Underreported income is the largest contributor to the tax gap. Improving compliance requires both a carrot and a stick. We recommend additional taxpayer and preparer education, facilitation and improved use of third-party reporting, and increased contact between the IRS and a broad spectrum of taxpayers.

For each issue, we have provided recommendations. Some are easily implemented; others might take an “Act of Congress.” In addition, some recommendations may have significant impact beyond the specific issues that they address. Nonetheless, regardless of the level of complexity, we felt that each recommendation deserved to be documented and considered. We are hopeful that each will generate meaningful dialog within the IRS.

II. ISSUES AND RECOMMENDATIONS

ISSUE ONE: Employment Tax Pyramiding

Executive Summary

Employment tax pyramiding is a serious problem. It continues despite significant efforts by the IRS to curb it. As listed in our recommendations, there are a number of steps that could be taken to eliminate pyramiding.

Background

The IRS requested the input of the SB/SE Subgroup with respect to education, prevention, detection, intervention and enforcement in the context of the “pyramiding” of unpaid employment tax assessments. “Tax Pyramiding” is defined by the IRS as the accumulation of more than one quarter of unpaid employment taxes for the same business. It has also been defined to include the “musical corporation” fact pattern where a business has an outstanding employment tax liability; closes down; and, then, the same business starts up again within a new entity and with a new employer identification number.

The IRS has already initiated significant changes to address tax pyramiding. The changes are in definitions, statistical analysis, managerial communication, management - Revenue Officer communication, Revenue Officer training, monitoring criteria including FTD Alert selection criteria, and consumer alerts. However, despite these efforts, tax pyramiding continues to increase.

Recommendations

1. Partner with the Department of Education, "Office of Innovation and Improvement," for the purpose of developing a Tax Education Module to become part of the core curriculum for all high school students.
2. Introduce a single, semiweekly deposit frequency for all 941/943 depositors to encourage

quick payment of employment tax liabilities. In view of this recommendation, it should be determined whether the policy and reasoning underlying the new Form 944 are consistent with the actions which need to be taken to eliminate pyramiding.

3. Change the signature line on the Form SS-4 to indicate that the individual signing the form is, by his or her signature, agreeing that he or she is a "Responsible Person" within the meaning of that term under Section 6672 of the Internal Revenue Code for the purpose of the Trust Fund Recovery Penalty. Provide a space next to or under the signature line for that individual's Social Security number. Implement programming to ensure that the signer's Social Security Number is linked with the Employer I.D. number issued.
4. Implement better data mining and action from the answers to the question on the current Form SS-4 which asks: "Has the applicant ever applied for an employer identification number for this or any other business?"
5. Consider adding the following questions to the SS-4: "Do any of the control individuals for this business have any personal outstanding tax liabilities to the Internal Revenue Service? Do any other corporations, which name any of these control individuals as a "Responsible Person," have any outstanding tax liabilities? If so, please state the name, Social Security number, address and telephone number of each such individual."
6. More closely monitor payment coupons and/or electronic filing for small businesses. In this connection, lower the threshold of the FTD alert program to cover smaller payrolls; cause notices to be sent out earlier; and cause telephone contact to occur sooner.
7. Increase the use of Form Letter 903 concerning failure to deposit employment taxes, Notice 931 entitled "Deposit Requirements for Employment Taxes," and Form 2481 entitled "Notice to Make Special Deposits of Taxes" together with the Certificate of Delivery of

Form 2481. Furthermore, an increase in enforcement of violations of the terms of the Form 2481, and other applicable criminal offenses that might apply in this context, should be implemented by partnering with the Justice Department, Tax Division, Criminal Section to develop an enforcement program that includes a series of prosecutions that includes smaller employers. Publicize the compliance initiative on the website, through push email and press releases.

8. Partner with representatives of the various practitioner groups to develop a core set of CPE/CLE materials on tax pyramiding that can be used to make presentations to and by practitioners.
9. Use the current push email capability and the IRS website to send out a warning to practitioners concerning tax pyramiding.
10. Amend the Circular 230 Regulations to include a specific example showing that it is not proper for an individual to aid and abet a tax pyramider.
11. Partner with the Department of Justice, Tax Division, Criminal Section to develop an enforcement initiative that targets professionals that aid and abet tax pyramiding. Publicize the formation of the partnership.
12. Coordinate more closely with agencies such as the Small Business Administration, State Workers' Compensation Boards, and the various Departments of Revenue of the 50 states in order to facilitate early detection of tax pyramiders.
13. Partner with the National Payroll Reporting Consortium to develop a bonding requirement for reporting agents. Currently there is no such requirement. When a reporting agent fails to remit the paid in withheld funds to the IRS, a series of procedural difficulties occur. A bonding requirement for the reporting agents would go a long way toward eliminating those

difficulties.

14. Increase the training of Revenue Officers with respect to their understanding and use of transferee liability procedures. While subsection 6334(a)(13) provides for an exemption from levy in certain circumstances if the amount of the levy does not exceed \$5,000, it does not prohibit utilizing the transferee liability provisions, Section 6901 et seq, to pursue the assessment against a new, successor entity which may, in essence, be the same business. Use of the transferee liability procedures would be particularly helpful in the context of “the musical corporation” scenario.
15. Revisit the criteria, and increase Revenue Officer training, for applying the status: Code 53 ("Currently Not Collectable") to an employer where tax pyramiding is present.
16. Include bold warnings in Publication 15, “(Circular E), Employer’s Tax Guide,” showing the civil and criminal consequences of negligently and/or willfully violating laws pertaining to employment taxes.

ISSUE TWO: Enhancing Communication with Tax Practitioners

Executive Summary

Given scarce resources, the IRS should place more emphasis on cooperation with tax professionals to encourage taxpayer compliance. This can be done more efficiently through enhanced communication and relationships.

Background

The tax practitioner can be a valuable ally to the IRS in the effort to enhance compliance. Tax practitioners encourage their clients to comply with IRS rules and regulations and help a taxpayer come back into compliance after the IRS has discovered a discrepancy. Tax practitioners, however, need the help and guidance of the IRS to assist their clients.

Recommendations

1. The IRS should return more personnel and authority to the field offices. Tax practitioners are frustrated by the inability of local IRS personnel to resolve issues and want local IRS personnel that have authority to make decisions. The concept of “remote management,” whereby a manager in Dallas manages an office in Colorado, frustrates tax practitioners who do not have direct access to IRS personnel with the ability to resolve issues. Many issues could be resolved more quickly and efficiently through face-to-face meetings and pre-existing relationships between the IRS and tax practitioners. A return to regions and districts could provide more authority to local IRS personnel, enhance timely communication, and decrease the cost of repeat paper notices that generally do not bring about a resolution.
2. When planning internal changes, particularly those that involve renaming IRS functions, the IRS needs to be more sensitive to the impact any such changes might have on the efficiency of IRS/practitioner communication.
3. Currently, certain IRS field offices provide local tax practitioners with a list of names and telephone numbers of key IRS personnel in their particular area. This is a valuable tool to increase communication between tax practitioners and the IRS. A uniform program should be created to ensure that all IRS field offices provide this information to tax practitioners. The information could be provided to the local industry groups twice a year for dissemination to tax practitioners.
4. The IRS Nationwide Tax Forums are informative, but do not provide the practitioner with an opportunity to meet people from the local IRS office. Tax practitioners want to build personal relationships with the local IRS personnel. Practitioners want to know whom to call locally in collections, exam, etc. in order to get an issue resolved. The practitioners want

to work with someone who has an interest in, and understands, the community. To build these relationships, the IRS should have annual or semi-annual “meet the IRS” meetings with the tax practitioner community. These meetings could provide updates to the local practitioner community and provide the practitioners with access to real people within the IRS. These meetings should be open to all practitioners and advertised to all members of local enrolled agent, CPA and bar associations. Currently, the formal IRS meetings with tax practitioners are limited to certain committee members of the local associations hosting the event.

5. The IRS should send local tax practitioner groups a list of available IRS speakers and the subject each can speak on. The list should include a contact name and telephone number to arrange for a speaker. With the bigger groups, e.g. state Bar Tax Sections and state Institutes of Certified Public Accountants, the IRS should appoint liaisons to each group. The scope and activities of the liaison would have to be explored subject to the usual concerns of time, budget, National Treasury Employees Union rules, etc. This type of outreach would provide strong evidence of the IRS’ willingness to partner with tax practitioners.
6. Subject to Section 6103 concerns, Form 2848 should be revised to permit a taxpayer to approve e-mail communication between the IRS and the taxpayer’s representative.
7. Training should be improved to ensure that IRS personnel have a more technical understanding of tax law and the IRS structure. IRS personnel should be provided timely updates on changes in the tax law, IRS forms and notices. IRS call centers should be provided access to a database which contains contact information for IRS personnel, including industry specialists, to whom the call centers could refer a tax practitioner for more technical guidance.

8. IRS exam personnel should better utilize IRS personnel with industry specific knowledge and information, especially during the exam process. The IRS has expertise through Market Segment Specialization Papers (MSSP) and Industry Specialization Papers (ISP), which are being underutilized.
9. Tax Talk Today is an excellent program, but not enough tax practitioners are aware of it. The IRS should adjust the marketing strategy to include advertisements in trade publications and an emphasis on the fact that Tax Talk Today is hosted by the IRS. If logistically feasible, Tax Talk Today should be the launching pad for major IRS announcements, so that it becomes a significant source of information for practitioners.
10. The current IRS listservs should be streamlined to provide participants with updated information in a more concise format. For example, currently a tax practitioner that subscribes to the IRS listserv for various states receives e-mails, that often contain repetitive information, for each state. These various e-mails could be combined into one e-mail that contains links to each state specific tax update. Similarly, the IRS could send an e-mail with links to recent federal tax updates. These links could be categorized by practice area (e.g. non-profits, pass-through entities, etc.) to afford easy access.

ISSUE THREE: E-services for Reporting Agents

Executive Summary

E-services have not been provided to Reporting Agents, a significant IRS partner, even though they have been available to others since 2003. Providing e-services to Reporting Agents is a good business decision and should be undertaken immediately for the benefit of IRS, Reporting Agents, and Taxpayers.

Background

Reporting Agents do not have the benefit of utilizing those e-services that individual tax practitioners have had since October 2003. Since their roll out, e-services have been made more useful to individual tax practitioners through expanded offerings (Transcript Delivery Service, Electronic Account Resolution, and Disclosure Authorization) and more widely available through a lowering of the entry level threshold from 100 e-filed individual returns to 5 e-filed returns - either individual, business, or a combination of both.

Nevertheless, despite this broadening of accessibility to e-services, the IRS has not yet provided e-services to an important IRS partner – Reporting Agents (RAs). There are currently over 3,300 registered RAs who provide payroll and tax services to more than 1.9 million employers and more than one-third of the nation’s private sector workforce. RAs transmit over 30 percent of all depository taxes received by the U.S. Treasury. The success of the EFTPS and employment tax e-filing initiatives is largely due to the cooperation of RAs, who make all federal tax payments via EFTPS and submit all employment tax returns electronically.

For FY2005, a request for e-services funding was prepared by IRS personnel. The funding request estimated the development cost of e-services to RAs (at an equivalent level to those offered to individual practitioners) at \$1.5 - \$2 million. Based on recent conversations with IRS personnel, even this amount may be more than is needed. Yet, IRS states that e-services for RAs cannot receive approved funding prior to FY2007 – at the earliest. **This is too long to wait for a program that would be of such benefit to all stakeholders.** It should be noted that the IRS budget request for Business Systems Modernization (BSM) funding in FY2006 was \$199 million – \$4 million less than the FY2005 appropriation of \$203 million. The cost to implement e-services for RAs is less than half the decrease in BSM funds that IRS has requested from 2005 to 2006. In other words, if BSM

were simply funded at the same level as in FY2005, there would be more than enough money to implement e-services for RAs.

Recommendations

1. Fund e-services for RAs immediately and by whatever means available – including the possibility of incremental funding. There are several reasons for not waiting:
 - a) There is strong financial justification to provide e-services for RAs. Currently, RAs use the Toll-Free Practitioner Priority Services (PPS) to resolve most issues. RAs estimate that, as a result of notices, they make more than 300,000 calls to PPS annually and that 30% of these calls could be eliminated if Transcript Delivery Services were available. Therefore, the implementation of just Transcript Delivery Services, without regard to other enhancements that could be easily made available, would eliminate 90,000 telephone calls annually. If each of these calls were conservatively estimated at 15 minutes each, that would be a savings of over 11 FTE or nearly \$800,000 per year – approximately one half the development cost in personnel savings in the first year alone. In addition, there would be other cost savings such as the printing and mailing costs of transcripts. Admittedly, there will be new costs associated with e-services, but we believe, given the e-services infrastructure already in place, that these costs will be minimal.
 - b) Maintain the goodwill and cooperation of RAs by rewarding them for their help in maintaining tax compliance. RAs originate over 95% of all electronically filed employment tax returns, and, by IRS measures, their clients are 20 times more compliant than the general population.
 - c) E-services for RAs will be easy to implement and quickly accepted. Analysis and

prototyping have already been done, development cost is reasonable, and RAs are a highly computer-literate community that has been requesting e-services for years. Therefore, e-services would be used immediately for the benefit of both the IRS and taxpayers.

- d) Because there is already a communication avenue between IRS and RAs, marketing and startup costs would be negligible.
 - e) E-services for RAs would lead to paperwork burden reduction for both IRS and RAs, since transcripts and other correspondence could be delivered via the internet.
2. Complete the current development phase. In cooperation with the National Payroll Reporting Consortium (NPRC), an organization representing RAs, IRS personnel have been developing requirements and prototypes, tailored to the needs of RAs, for Transcript Delivery Services and Electronic Account Resolution. The requirements stage of the development process is nearing completion, and IRS should:
- a) allow and encourage these tasks to be completed.
 - b) provide an avenue to continue with the design and development of RA e-services products.
3. Consider development of RA e-services by in-house personnel. The expertise exists in-house to develop e-services. The advantage to implementing in-house is two-fold:
- a) In-house development would further enhance web-based systems development expertise within the IRS.
 - b) In-house development would provide IRS personnel, who have been working on existing legacy systems, a career path into more modern systems technology without leaving IRS for the private sector.

4. Partner with RAs to identify other e-service products that would reduce IRS costs, e.g. ability to verify RA authorization, entity (EIN, name) verification, taxpayer deposit frequency lookup, and electronic notice delivery. All of these pre- and post-filing applications will drive further IRS cost reductions by eliminating much telephone and mail interaction between RAs and IRS. Furthermore, the pre-filing applications would allow verification of taxpayer information before making payments and filing returns, thus reducing mistakes and preventing notices before they occur. Just to call out one of these items, electronic notice delivery (by eliminating mailing costs to RAs and by providing early receipt, faster resolution and reduction in subsequent notices) has the potential to save the IRS over \$1.2 million annually in direct costs associated with notice delivery.

ISSUE FOUR: Tax Professional Best Practices

Executive Summary

The IRS wishes to improve the quality of practice of tax professionals, as evidenced by the amendment to the Circular 230 Regulations concerning practice before the IRS. The IRS can improve best practices of tax professionals by providing additional guidance, providing more clearly defined expectations, and improving its working relationship with the tax professional community.

Background

The Internal Revenue Service has requested the SB/SE Subgroup to provide recommendations regarding how the IRS can improve the quality of practice of tax professionals. Since this is such a large issue, we have chosen, in this report, to focus primarily on tax professionals subject to Circular 230 Regulations. The IRS request to investigate the improvement of tax professional standards is consistent with the amendment to the Circular 230 Regulations, effective June 30, 2005, which include in Section 10.33 aspirational “best practices for tax advisors.” Tax

advisors are urged to provide clients with the highest quality representation concerning Federal tax issues by adhering to best practices in providing advice and in preparing submissions to the IRS.

Section 10.33 provides that best practices include:

1. Communicating clearly with the client regarding the terms of the engagement.
2. Establishing the facts by determining which are relevant facts, evaluating reasonableness of assumptions or representations, relating applicable law and arriving at conclusions supported by the law and facts.
3. Advising the client regarding the import of conclusions.
4. Acting fairly and with integrity in practice before the IRS.

Under Section 10.33(b), tax professionals with oversight of a firm's practice must take reasonable steps to ensure members employ "best practices" consistently.

Recommendations

1. Additional guidance and clarification concerning the scope of "best practices" and Circular 230 would be helpful to tax practitioners.
2. The IRS must work closely with the tax practitioner community in developing examples and guidance to address such issues as balancing the practical compliance burden on the practitioner, while enhancing public confidence in the tax system, and promoting with integrity and honesty. Timeliness of this guidance is vital to increase compliance and reduce confusion, already evident in the tax practitioner community, related to these new requirements.
3. The IRS must work with the tax professional community to more clearly define the line between "tax avoidance or evasion" and "tax advice and planning." In an effort to achieve this goal, we recommend the IRS implement the following:

- a) Establish a toll free hotline to receive complaints and answer questions concerning ethical and unethical behavior by tax professionals.
 - b) Establish an ethics ruling request procedure, preferably within the Office of Professional Responsibility (OPR).
 - c) Expand, update and supplement the FAQ section of the OPR web page with questions and answers obtained from sources such as email submissions, the toll free ethics hotline, and the ethics ruling process (i.e. allow ethics questions to be asked and answered via email request as long as no section 6103 privacy issues are involved).

Once the foregoing is established, also include an ethics search engine on the OPR web page.
4. Work with the American Institute of Certified Public Accountants (AICPA), the American Bar Association (ABA), the National Association of Enrolled Agents (NAEA) and other similar tax professional groups in the development of tax practice standards.
 5. The current relationship between the IRS and the tax professional community must become less “adversarial” and more “cooperative.” Programs implemented by the IRS, such as the Tax Professional Forums and advisory committees, are important steps to improving the relationship, but the public as a whole still has an “us vs. them” perception of the IRS. Although we realize that the IRS has heard this recommendation many times and in various forms, we feel that it is worth repeating. The IRS must continue to strengthen the relationship with the tax professional community in developing tax policies and procedures. A joint effort in the development and dissemination of the “purpose,” “benefit,” and “procedures requirements” for actions taken by the IRS is essential to facilitate “buy-in” by the tax professional community and the general public as a whole.

ISSUE FIVE: Underreported Income

Executive Summary

Underreported income is the largest contributor to the tax gap. Improving compliance requires both a carrot and a stick. We recommend additional taxpayer and preparer education, facilitation and improved use of third-party reporting, and increased contact between the IRS and a broad spectrum of taxpayers.

Background

The IRS and its overseers have devoted much attention to the “tax gap,” the estimated shortfall between what the IRS collects from taxpayers annually and the amount taxpayers actually owe. A National Research Program study of individual income tax returns, completed in December 2004, estimated the gross gap at over \$300 billion a year. Of this amount, approximately 80% is believed to be attributable to underreported income.

Income reporting compliance is highest in the areas in which there is third party reporting and/or withholding at the source: wages, interest, and dividends. Reporting of net business income and associated employment taxes by small businesses and self-employed individuals is significantly less accurate, despite the fact that a large proportion of these entities utilize professional tax preparers.

Some underreporting occurs as a result of the complexity of the tax system. Taxpayers do not understand their responsibilities or do not allocate time and energy to comply. Other underreporting represents more deliberate tax avoidance.

The SB/SE Operating Division asked IRSAC’s SB/SE Subgroup to consider (1) ways to encourage taxpayers to report all income and (2) methods to detect unreported income. The

phrasing of this request is worth noting because it suggests an understanding that both “carrot” and “stick” are vital to improving taxpayer compliance. We concur wholeheartedly with this philosophy.

Recommendations

1. It is important for the legislative and executive branches of government, who set tax policy and fund tax administration, to understand the nature of the tax gap. In dealing with the general public, however, excessive emphasis on the shortfall may actually encourage non-compliance the “everyone else is doing it” mentality. We would urge IRS management and communications professionals to consider their audiences, putting more emphasis on the Service’s compliance successes in dealing with the taxpaying population.
2. We believe that compliance will improve if taxpayers, and the professionals who assist them, more clearly understand their responsibilities. We recommend development of industry-specific “self audit guides,” a one or two page checklist of key issues affecting specific industries that could be mailed to taxpayers whose Schedule C/F, 1120S or 1065 contains applicable business codes. These guides would be based on, and would refer to, Audit Technique Guides developed under the IRS Market Segment Specialization Program. The guide mailed to bars and restaurants, for example, might cover tip reporting. It would briefly outline employer/employee responsibilities, provide information about median tip rates, and describe remedial actions, such as Employer Only Assessments, available to the IRS. A similar “back to the basics” guide covering issues applicable to all small business or self-employed taxpayers could also be developed.

This information should be disseminated through industry and tax professional organizations. If the taxpayer, and his preparer, know that the IRS is shining a light on certain areas, they will be more likely to pay attention to those matters.

3. Compliance with existing third party reporting requirements could be enhanced by making Form 1099-MISC more available and easier to use. Converting to a reproducible form by eliminating the requirement for red “dropout” ink would be an important first step. Developing an online interface for filers of less than ten 1099’s (similar to the interface developed by the Social Security Administration for W-2 filers) would also be helpful. Extending the deadline for filing the IRS copy of Form 1099 from February 28 to March 31 would encourage professionals (whose first glimpse at their client’s “shoebox” might not occur until the spring deadlines for filing small business and individual returns approach) to prepare any 1099’s that may have been overlooked without fear of penalty.
4. The IRS should consider replacing one of the less useful questions in the Other Information section of Form 1120S and Form 1065 with the question, “Have all required Form 1099’s been filed?” Adding this question to a form that is signed under penalty of perjury would encourage taxpayers to take their information reporting responsibilities more seriously. It would also give tax preparers a tool for encouraging recalcitrant taxpayers to report both payments and receipts.
5. Consideration should be given to eliminating the exemption for payments to corporations from 1099-MISC reporting. Choice of entity should not provide similar businesses with dissimilar opportunities for evasion. Many businesses already prepare Forms 1099 for all applicable vendors, regardless of their business structure. Elimination of the need to differentiate between corporate and non-corporate payees would be a burden reduction that would somewhat offset the burden created by having to produce additional forms.
6. The IRS could gain a valuable tool by requiring credit card processors to report aggregate credit card payments to merchants on a new Form 1099. Reporting the data by month of

payment would facilitate use with respect to fiscal year taxpayers. This information is already captured by computer, and the programming needed to provide summary data to the IRS annually should be minimal. Credit card receipts would allow data-matching and enhanced audit selection criteria to be developed in industries not presently touched by 1099-MISC reporting.

7. We are somewhat reluctant to make any suggestions regarding improved or additional third-party information reporting until the IRS has the resources to utilize this data effectively. Currently, under 30% of the individual returns for which potential discrepancies are identified by the Automated Underreporter Program are selected for review. There is no systematic match of third-party information returns and Forms 1120S or 1065. We believe developing and utilizing models for testing gross receipts will be at least as productive as ensuring that K-1 data flows through to 1040's.
8. Throughout our discussions with IRS personnel, we frequently heard that review, exam, and prosecution criteria target "the big fish," the higher dollar situations in which there is likely to be more bang for the buck. While this approach is efficient on one level, we are concerned that ignoring a large number of smaller taxpayers can have a significant negative effect on compliance. The little guys should not feel they have a free pass. It is unlikely that a generally compliant taxpayer will become abusively non-compliant. Slipping from 87% compliant to 83% compliant is far more possible. A small loss of compliance across a large part of the taxpayer population may have impact comparable to egregious non-compliance in a rather small segment. Conversely, a small improvement in compliance across the broad spectrum of taxpayers can have a measurable positive effect on the tax gap. We feel strongly that random "touches" across the board will have a beneficial impact on taxpayer

compliance and should be more strongly weighted in the selection criteria than they currently seem to be.