

Statement

of

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on behalf of

Tax Executives Institute, Inc.

on

Reducing Taxpayer Burden

before the

IRS Oversight Board

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Good afternoon. I am Bob Ashby, Vice President, Taxation (U.S.) for Nortel Networks in Nashville, Tennessee. I appear before you today as the President of Tax Executives Institute, the preeminent association of corporate tax professionals in North America. I am accompanied by the Institute's Executive Director, Timothy McCormally, and by our General Counsel and Director of Tax Affairs, Fred Murray. The Institute is pleased to participate in the panel on reducing taxpayer burden.

Background

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 53 chapters in the United States, Canada, and Europe. Our 5,200 members are accountants, attorneys, and other business professionals who work for the largest 2,800 companies in the United States and Canada; they are responsible for conducting the



tax affairs of their companies and ensuring their compliance with the tax laws. Hence, TEI represents the business community as a whole, and our members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. TEI is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike.

The companies that employ TEI's members have almost without exception been assigned to the IRS's Large and Mid-Size Business (LMSB) Division. The largest 1,600 taxpayers within LMSB are subject to ongoing audits as part of the Coordinated Industry Cases (CIC) program. This testimony is largely based upon our experience with this segment of IRS operations. For example, whereas in some sectors the IRS may be more focused on enforcement efforts, for TEI's constituency LMSB promises more effective and efficient examinations, as well as a more pronounced customer-service orientation. We also offer our views on reducing taxpayer (and government) burden and improving operations within LMSB.

The Need for Innovative Ways of Doing Business

LMSB has several projects underway to improve efficiency that can serve as a model for future improvements in that division, and in other areas of IRS operations. In addition, the IRS should consider routinizing the use of statistical sampling, increasing the use of records retention agreements to further reduce taxpayer burden, and expanding the application of electronic technology.

Pre-Filing Initiatives. A key focus of LMSB is to move from a "back-loaded" (post-filing) to a "front-loaded" (pre-filing) system. TEI strongly agrees with Commissioner Rossotti that the IRS should move away from the "archeological dig" aspect of current post-filing examinations.

LMSB's emphasis on pre-filing represents bold thinking, and the agency has responded admirably with several initiatives to resolve issues *before* the return is filed. The introduction of the pre-filing agreement (PFA) and industry issue resolution (IIR) programs demonstrates that the LMSB Division is experimenting with new ways to resolve controversies in an efficient and effective manner. TEI supports these procedures, which focus increased attention to "front-end" activities and emphasize resolving issues on an industry basis.

In order to substantially complete its change to pre-filing activities, there must be an improvement in the currency of IRS audits. The backlog of cases needs to be addressed before efficiencies can be obtained. Further, the IRS must ensure that the use of resources in pre-filing



activities does not by itself increase the overall audit time for LMSB taxpayers. In addition, field agents must be trained in, and encouraged to use, alternative dispute resolution (ADR) techniques to resolve issues, and rules and regulations must be applied consistently. Balanced performance measures for IRS examiners also need to be developed that stress efficiency and the use of ADR techniques. Finally, measures must be taken to preserve the confidentiality of taxpayer information submitted in a pre-filing regime.

Use of Statistical Sampling. TEI has met with the LMSB task force investigating whether procedures can be established for the use of statistical sampling by taxpayers in preparing their returns. Areas under consideration include travel and entertainment expenses, the research tax credit, and cost segregation studies.

TEI believes that the use of sampling techniques in preparing corporate tax returns holds great promise for reducing tax payer burdens. The IRS should be encouraged to move forward with this project by issuing a revenue procedure establishing safe harbors for the use of statistical sampling.

Records Retention. Some of the most significant burdens imposed on corporate taxpayers relate to the requirement that extensive records be maintained in respect of taxable years subject to audit. Although taxpayers clearly have a responsibility to maintain records to support the positions taken on their tax returns, much can be done to minimize the burden that currently exists (especially for those taxpayers that have many years open for IRS examinations).

Record retention burdens can be best reduced by increasing the currency of audits; if taxable years are closed in a more timely manner, there will be less need to retain records relating to those years. Absent that, the IRS should make better use of records retention agreements. TEI has long supported the use of agreements that recognize the challenge of constantly changing technology (including limitations on the ability to convert data created on legacy systems). The IRS recognizes that the current procedures provided by Rev. Proc. 98-25 need revision. The agency should be encouraged to expeditiously develop new procedures and periodically revise them.

Electronic Technology. The business community is interested in utilizing technology to reduce tax compliance and recordkeeping burdens. Thus, TEI is pleased to have met with IRS representatives to discuss the need for electronic filing of corporate tax returns. Electronic filing by itself, however, offers modest relief to taxpayers; the real key to reducing taxpayer burden lies in streamlining the core reporting requirements (whether the information is reported on paper or electronically). Hence, the goal should be to reduce the reporting that must be done by migrating to a financial statement-based return — that is, a simplified two-page Form 1120 that contains only



summary and reconciling information. Indeed, there is merit in piggybacking on other electronic reports, such as those required by the Securities and Exchange Commission, which uses the so-called Edgar system.

The Institute also believes that the IRS should make greater use of electronic communications. Because of disclosure concerns, IRS agents are currently unable to send information document requests and other documents and to answer questions from taxpayers by electronic means. Although security issues must be resolved, the IRS should be encouraged to implement an electronic mail system capable of interacting with taxpayers as soon as possible.

The Need for Prompt and Effective Guidance

One goal of the IRS's reorganization is to provide taxpayers with more upfront guidance and to make that guidance more practical. The recently re-proposed research tax credit regulations demonstrate that the IRS (and the Treasury Department) can work with stakeholders to streamline reporting requirements and make the rules more workable for both taxpayers and IRS personnel. By abandoning the controversial "discovery" test, providing modified guidance on the process-of-experimentation rules, and rationalizing the recordkeeping rules of the previous regulations, the revised regulations hold promise for easing the burden of claiming research tax credits. We are pleased that the government responded to taxpayer concerns.

The Institute also commends the IRS for its response to the events of September 11. Within days of the terrorist attacks, the IRS issued several notices granting extensions of time for filing tax and information returns. TEI is pleased to have worked with the IRS and other stakeholders in developing and refining the guidance. The agency's reaction demonstrated its ability to respond in a prompt and efficient manner.

Although TEI supports LMSB's emphasis on upfront guidance, we believe that the agency needs to balance the need for generic (broad-based) guidance against the desire for taxpayer-specific and industry-focused guidance. Although procedures such as IIR may lead to the issuance of generally applicable guidance (such as a revenue procedure), the question remains whether more formal guidance — *i.e.*, regulations — should be developed. Proposed regulations in particular provide taxpayers with an opportunity to comment on the issues.

Clearly, many factors come into play in deciding the form in which to issue guidance to taxpayers. Regulations carry more weight, but take longer to develop and issue than rulings or notices. In addition, generalized guidance may of necessity contain gaps or produce unintended consequences. In contrast, guidance such as revenue rulings (for example, in the area of





capitalization) often leaves taxpayers (and agents) with questions in other contexts. LMSB's pre-filing initiatives should not serve as a substitute for generally applicable guidance.

The Need for Sufficient Funding

Although much progress has been made, the challenges faced by the IRS are substantial. TEI is concerned that the IRS receive the funding it needs to develop and implement new procedures and audit processes. Money and patience are also required for the agency to recruit, train, and retain qualified personnel. What's more, funds are necessary to ensure the acquisition, installation, and effective utilization of state-of-the-art technology.

Stated simply, whether the promise of the reorganization can be realized depends in large measure on the IRS securing sufficient funds to do its job. TEI has consistently supported both adequate funding for the Internal Revenue Service and adequate oversight by this Board, the Treasury, and Congress. If the IRS is to succeed in rebuilding the agency's credibility and effectiveness, the agency must be assured that the programs needed to implement its mission will be fully — and consistently — funded. The IRS in turn has the responsibility to utilize those funds in an effective manner.

Conclusion: A Plea for Simplification

Finally, TEI would be remiss if we did not mention the most obvious way to reduce taxpayer burden: Simplify the tax laws. The IRS can do only so much to minimize the burdens placed on taxpayers.

The National Taxpayer Advocate also has a role to play here. In December, the Advocate issued her report to Congress, outlining several areas in the taxation of individuals where the law can be simplified. Although the primary focus of the Taxpayer Advocate's Office may properly be on individual taxpayers, the challenge facing business taxpayers should not be ignored. Steps must be taken to achieve a balance.

Last year, the staff of the Joint Committee on Taxation produced a comprehensive three-volume study on ways to simplify the tax law for *all* taxpayers. In December, TEI joined with the American Bar Association and the American Institute of Certified Public Accountants to sponsor a conference on simplification. It is now up to Congress.



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Tax Executives Institute commends the IRS Oversight Board for holding this public hearing. TEI looks forward to working with the Board and the IRS itself to improve tax administration and reduce taxpayer burden.

TAX EXECUTIVES INSTITUTE, INC.

By:



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