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TESTIMONY

OF

KENNETH W. GIDEON

CHAIR OF THE

AMERICAN BAR ASSOCIATION SECTION OF TAXATION

BEFORE THE

IRS OVERSIGHT BOARD

AT ITS

PUBLIC STAKEHOLDER MEETING

FEBRUARY 1, 2005

Good afternoon. My name is Ken Gideon. I appear before you today in my capacity as Chair of the American Bar Association Section of Taxation. This testimony is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the policy of the Association.

The Section of Taxation appreciates the opportunity to appear before the IRS Oversight Board (the “Board”) today to discuss important issues in tax administration. On behalf of the Section, I want to thank the Chair and the Members of the Board for your efforts to improve tax administration and the tax system.

ABA Section of Taxation

The Section of Taxation is comprised of more than 18,000 tax lawyers. Our members include attorneys who work in law firms, corporations and other business entities, government, non-profit organizations, academia, accounting firms and other multidisciplinary organizations. As the country's largest and broadest-based professional organization of tax lawyers, one of our primary goals is to make the tax system fairer, simpler and easier to administer.

Our members provide advice on virtually every substantive and procedural area of the tax laws, and interact regularly with the Internal Revenue Service (the “Service”) and other government agencies and offices responsible for administering and enforcing such laws. Many of our members have served in staff and executive-level positions at the Service, the Treasury Department, the Tax Division of the Department of Justice, and the Congressional taxwriting committees.

Overview

We appreciate the opportunity to provide input to the Board on ways in which the Service might more efficiently and effectively administer the internal revenue laws. The responsibility of the Service to collect nearly two trillion dollars per year to fund the obligations of the federal government while treating taxpayers fairly and processing tax returns and payments efficiently is

enormous. We commend the Service and this Board for their efforts to make the Service an efficient, modern and responsive agency. My testimony today focuses on what we believe to be an especially important administrative objective: to reduce audit disputes and otherwise achieve administrative efficiencies through administrative simplification.

Pre-Filing Resolution Programs

The Service deserves much praise for its development of programs and strategies to resolve disputes before returns are filed. The Tax Section strongly believes in programs and strategies that resolve issues with taxpayers and eliminate controversy earlier in the process. Post-filing examinations are costly, time consuming, and burdensome on operations. By their nature, they result in an uncertain tax liability for the taxpayer. Pre-filing agreement programs are beneficial to both the taxpayer and the Service. Such programs allow the Service and the taxpayer to engage in a pre-filing audit that is frequently faster than the post-filing audit because records are easily accessible and people with the most knowledge of the issue are often more readily available. Most importantly, when successful, such programs provide certainty of tax treatment and certainty of financial presentation for the taxpayer, and reduce the burden of audit on the Service.

In particular, the Tax Section believes the IRS Pre-Filing Agreement ("PFA") Program has been a tremendous success and strongly supports the continuation and expansion of the program. The PFA Program reduces taxpayer burden and makes more effective use of IRS resources by establishing agreed reporting of transactions before the tax return is filed. While recent revisions to the PFA Program providing taxpayers and the Service increased flexibility to enter into PFAs to resolve issues for the current taxable year and future taxable years are a step in the right direction, we would encourage the Service to continue to expand this program. In particular, the program should permit more types of issues to be resolved earlier in the process, including those involving some uncertainty as to developing law and regulations. Moreover, we encourage the Treasury Department and the Service to explore ways to permit taxpayers and the

Service to enter into multi-year closing agreements to provide certainty for both taxpayers and the Service as to the finality of determinations made through the PFA Program.

The Advance Pricing Agreement ("APA") Program is another example of a pre-filing program that has served the Service and taxpayers very well. It has evolved from a novel approach to resolving transfer pricing disputes into the forum of choice for resolution of the most challenging issues. The APA process provides the procedural framework for resolving transfer pricing issues on a prospective basis, and helps achieve administrative simplicity because it substantially reduces the burdens of transfer pricing documentation by focusing on agreed criteria. We strongly support the continuation of the program.

More recently, we have commented to the Service in its development of the pilot program referred to as the Compliance Assurance Process or "CAP." This program is intended to provide real-time audit coverage during the taxable year, with the goal of resolving all material tax issues before a return is filed. Although we understand that it will take some time before CAP can be made available on a more widespread basis, we applaud the Service for its willingness to take on bold new strategies such as CAP as part of its efforts to streamline tax administration.

We support the Service's goal to move from a post-filing system to a pre-filing system, and urge the Service and the Board to resist procedures that are contrary to this goal. For example, the Service's recent "no-ruling" policy for certain section 355 issues may be contrary to such goal, and make the resolution of certain issues in the post-filing period more difficult. While we recognize that the Service adopted this "no-rule" policy in the section 355 context to promote sound administration and in order to use its resources more efficiently, we are concerned that this type of move away from pre-filing advice will require a post-filing resolution which may ultimately be more costly to both the taxpayer and the Service. Whenever a taxpayer must wait until the post-filing period to resolve an issue, there are built-in inefficiencies such as the unavailability of personnel that were key to a particular transaction or the lack of readily available documentation. This added burden of retrieving all the necessary information for an accurate

review by the Service could be greatly alleviated when reviews are done before any filing takes place.

We also want to commend and encourage efforts such as the project underway in the office of Taxpayer Burden Reduction to simplify the forms and process for seeking tax return filing extensions. We look forward to working with the Service on this project.

Post-Filing Resolution Programs

Despite the growing availability and utilization of pre-filing resolution programs, we do recognize, however, that much of the interaction between the Service and taxpayers does, and will, take place during a post-filing period. Thus, we strongly encourage the Service to continue and to expand post-filing programs, such as the LIFE program, Fast-Track Appeals, Early Referral, Mediation and Arbitration that will expedite and improve the post-filing process. On the examination side, three important steps can regularly be taken to streamline the process: (1) agents should attempt to identify and focus the audit on the material issues in the return, (2) efforts should be made to explore alternatives to traditional broad and burdensome IDRs in favor of more targeted and efficient information assembly methods, and (3) significant resources should not be expended on auditing issues that were examined with little or no change in the prior cycle. The structure of the LIFE program and the new Schedule M-3 should help on these counts, but we would urge further efforts along these lines. These types of initiatives in the post-filing audit process are imperative if the Service is to achieve audit currency. Audit currency provides "win/win" benefits to taxpayers and the Service – prompt resolution achieved at a reduced burden on the resources of both.

Moving beyond examination, we would encourage the Service to continue its efforts to develop clear guidelines for resolving difficult issues, either through the Industry Issue Resolution program or through the issuance of global settlements. Finding ways to resolve cases affecting similarly situated taxpayers is never an easy task, but the benefits to both taxpayers and the Service in the past have proven to be worth the effort.

Error Correction Programs

Supplementing pre-filing agreements and resolutions and post-filing examinations and controversy are voluntary error correction programs that have been developed over the years. These programs, which permit taxpayers to come forward to identify and correct errors and resolve collateral issues such as penalties, status, and other matters implicated by the error provide an efficient and prompt resolution program not subject to the rigidities of the audit plan. For example, in the qualified plan area, the Service has developed a comprehensive self-correction program that allows sponsors of qualified retirement plans to correct operational problems with their plans. Likewise, the Service has identified other situations in which taxpayers can resolve issues via a simple procedure. For example, in the Subchapter S context, inadvertent terminations due to the failure to file a QSST election can be remedied through an automatic relief procedure. Absent this automatic relief procedure, taxpayers would have to seek relief through the private letter ruling process, which is more time consuming for the taxpayer, and an inefficient use of the Service's resources. The upshot of both of these programs is that when the Service permits taxpayers to come forward to identify and resolve relatively straightforward issues through simplified procedures, neither taxpayers nor the Service will be burdened with either a pre-filing or post-filing examination. We believe that there are many other opportunities for the Service to establish more of these resolution procedures, and we stand ready to work with the Service to continue to identify areas where streamlined correction procedures can be implemented.

In addition to such voluntary error correction programs, we believe there are opportunities for more efficient corrections and resolutions of errors - whether inadvertent technical or reporting errors or larger errors affecting the tax treatment of an item - between agents and taxpayers at the examination level. We recognize that such correction and resolution depends in part on how forthcoming taxpayers are during an examination, and we encourage the Service to continue its work in facilitating an audit environment that is conducive to the

disclosure of errors. Most importantly, we would urge the Service to develop programs and techniques that will allow agents the flexibility within the audit plan to help taxpayers resolve errors that are disclosed during the examination.

Adequate Resources

The Tax Section strongly supports Service efforts to promote simplification in the administration of the tax laws. We understand that efforts to continue to streamline tax administration at the Service cannot be accomplished without adequate resources. We have long advocated full funding of the Service's annual budget requirements because we know first-hand the detrimental impact that insufficient funding can have on the Service's ability to fairly and efficiently administer the tax law. Full funding is also necessary in order to provide additional training so agents and other Service personnel can explain and apply the administrative programs that the Service is implementing in order to simplify tax administration.

In this regard, we believe that it is essential that the Service continue its efforts to gather reliable and detailed statistics of income. This data is critical to an understanding of how our tax system is actually working and is fundamental to efforts to achieve administrative change as well as structural reform.

Finally, we also continue to believe that the Taxpayer Advocate Service is a vital resource in terms of helping the Service deliver taxpayer service. The report of the National Commission on Restructuring the IRS highlighted the importance of taxpayer advocates throughout the tax system, and recommended that the IRS Oversight Board hear directly from the National Taxpayer Advocate regularly to ensure that this important service receives the funding and resources it requires to ensure that taxpayers' problems can be resolved promptly and efficiently. We encourage the Board to follow through on this recommendation in the coming years, as we firmly believe that a strong taxpayer advocate service is fundamental to the delivery of improved taxpayer service.

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The ABA Section of Taxation hopes that the foregoing observations and suggestions are helpful to this Board in discharging its responsibilities. The Tax Section would be happy to meet with you to further discuss these views or any other matters. Thank you.