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IRS AGENDA
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Prepared By:

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TAX POLICY COMMITTEE

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IRS CORRESPONDENCE LETTERS

PROBLEM:
Many times letters are issued to taxpayers giving them thirty days to respond to a particular issue. Failure to respond within that time frame may lead to the filing of liens or levies, which have an adverse affect on the taxpayer's daily life and credit reports.

Taxpayers must look for certain documents such as social security cards, duplicate stock purchase orders, and birth certificates that may be needed. Sometimes these items must be requested from a foreign country. Thirty days is often insufficient to obtain the necessary data.

In other cases, the taxpayer has submitted the data but it has not reached the proper examiner in time.

RECOMMENDATION:
The IRS should allow sixty days to answer notices where corroborating documentation must be obtained.

All correspondence should have the name and direct telephone number of the individual handling the case. A fax number is also helpful as well as an e-mail address. Many issues can be resolved quickly with a telephone call, a fax or an e-mail.

CONFUSION ON FORMS

PROBLEM:
Correspondence from the Service continues to arrive with confusing language or the form letter is not issue-specific enough for the taxpayer to comprehend what response is required. The letters are often difficult to understand as standard paragraphs are used.

RECOMMENDATION:
All notices should contain the complete calculation utilized in determining additional tax due. The notices should contain a name, telephone number and fax number of someone to contact for a quick resolution. The language of the correspondence also should be simplified and personalized for expeditious resolution of issues correspondence.

EXPANSION OF "CHECK THE BOX" AUTHORIZATION

PROBLEM:
Many tax returns permit a taxpayer to indicate a third party designee with whom the IRS can discuss issues related to a particular tax return. This limited authority has been called a "check the box" authorization. Under current IRS regulations, this authority expires one year from the due date of the tax return. When the IRS issues a notice, such as a CP2000 requesting clarification of information on a tax return, the third party designee is frequently unable to resolve the issue with the IRS without obtaining a new authorization from the taxpayer as these notices are always issued after the one-year period has expired.

RECOMMENDATION:
The check the box authority should be expanded to include CP2000 notices and should run as long as the statute of limitations is open as to a particular tax year.

EFTPS

PROBLEM:
If a business taxpayer is using a payroll service, the taxpayer's EFTPS account is established through the payroll service's bank. If an employee of the taxpayer withdraws funds from the taxpayer's qualified retirement plan (subject to Federal withholding tax) the taxpayer cannot use the "payroll service" EFTPS account to pay the pension withholding. The taxpayer is required to obtain another EFTPS account for tax deposits to be made from the business operating account. It can take up to four weeks to obtain the new EFTPS account, which may result in a late filing penalty.

RECOMMENDATION:
No penalties should be assessed against a taxpayer who makes an occasional timely tax deposits using an FTD coupon for a tax payment out of the ordinary course of business, such as an occasional pension withholding payment or Form 945 deposit.

E-FILING AND E-SERVICES

PROBLEM:
Many tax preparers do not prepare 100 or more tax returns that can be filed electronically and desire to use e-services.

RECOMMENDATION:
Tax preparers, who prepare more than 100 Federal tax returns of any kind electronically, should be permitted to use e-services.

OFFICE IN HOME -S CORPORATION SHAREHOLDERS

PRESENT LAW:

IRS Code Section 280A(a) states generally that "***in the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.***"

Section 280A(c) provides for certain exceptions (deductions are allowed) when a portion of the dwelling unit "***is exclusively used on a regular basis - ... as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business***" [280A(c)(1)(B)] Accordingly, allocated expenses are deductible when one of the three exceptions provided under Section 280A(c) are met.

Section 280A(c)(3) provides an additional exception (deductions are allowed) to the extent that the deductions ***"are attributable to the rental of the dwelling unit or portion thereof***".

Section 280A(c)(6) provides an exception to the exceptions, to wit "***deductions shall not apply to any item which is attributable to the rental of the dwelling unit (or any portion thereof) by the taxpayer to his employer during any period in which the taxpayer uses the dwelling unit (or portion) in performing services as an employee of the employer.***"

The Committee Reports on P.L. 99-514 (Tax Reform Act of 1986) indicate that this law was structured in reaction to the Feldman Case 84 T.C. 1 (1985). The Committee Report states that: "***allowing employees to use lease arrangements with employers as a method of circumventing the restrictions on home office deductions might encourage some taxpayers to arrange sham transactions whereby a portion of salary is paid in the form of rent. Moreover, it is questionable whether lease transactions between an employer and employee are generally negotiated at arm's length, ...Accordingly, the committee believes that no home office deductions should be allowable ... if the employee rents a portion of his or her home to the employer.***"

PROBLEM:

Some taxpayers have become the unwitting victims of Section 280A merely by their choice of entity which, in many cases, was made without knowledge or consideration of Section 280A. Specifically, a taxpayer, for example a chiropractor, forms a corporation for his practice and makes an election to be taxed under Subchapter S. The practice operates in a portion of the home that is clearly used regularly and exclusively for business purposes. In fact, significant modifications have been made to the residence to accommodate the practice. While the tax code [Section 1372(a)] treats taxpayers that

own more than 2% of the stock of an S Corporation as self-employed for fringe benefit purposes, no such language is provided with regard to the use of a home office. Accordingly, S corporation shareholders are caught between various Code Sections. The individual cannot claim home office deductions on Form 8829 because there is no Schedule C associated with the tax return; therefore no qualified business use exists. However, if the corporation pays the owner rent for the use of the property, the individual can't claim deduction on Schedule E against the rent income due to the limitations provided under Section 280A.

One of our members has discussed this issue with a Revenue Agent on audit. He was told to have the corporation make proportionate payments for mortgage, real estate taxes, utilities, maintenance, etc. with a separate corporate check and that the corporation can deduct those payments. We believe that this advice is contrary to the Tax Code for several reasons. Interest deductions are not allowed for payments on a loan for which the entity is not obligated. Principal payments are never deductible. The associated depreciation expense is not available because the corporation does not have an ownership interest in the property and 280A thwarts that treatment in its opening paragraph if the corporation did have an ownership interest. Furthermore, we believe that the payments made by the corporation directly would be properly classified as a distribution or compensation to the shareholder under the Tax Code.

Had the entity been formed as a single owner LLC instead, the business would be reported on Schedule C and all of the allowable home office deductions under Section 280A would be available. Section 280A was enacted prior to the existence of the LLC under state business laws. In many cases, corporations were formed prior to the availability of the LLC as a choice of entity or prior to the "check the box" regulations that delineate the proper treatment of a single owner LLC. Furthermore, the dissolution of the S Corporation and immediate reformation as an LLC would have a number of adverse tax consequences.

Accordingly, taxpayers in situations similar to this are denied fair and equitable treatment under the Tax Code.

RECOMMENDATION:

Section 280A should be revisited. In general, we believe that 280A should be coordinated with the rules under Section 1372 for S corporation shareholders. Adverse consequences also exist when a taxpayer rents a portion of the residence to a closely held C Corporation due to Section 280A(c)(6). A fair and equitable result could be achieved by requiring any rental to the employer to be made at fair market value. IRS has already used the reasonable compensation rules successfully to stop taxpayers from converting compensation into Sub S dividends. We understand the need of IRS to collect a proper amount of FICA, Medicare, Unemployment and Withholding taxes. This need, however, should not obviate the need to provide fair and equitable tax administration to all taxpayers.

NON-PRESCRIPTION DRUGS

PROBLEM:
Many important, necessary and sometimes life-saving drugs, such as aspirin, are available without a prescription. Some drugs are available without a prescription that were previously available only with a prescription. The IRS has held reimbursement is permitted for non-prescription drugs to taxpayers who participate in Section 125 plans, "Cafeteria Plans", at their place of employment. These taxpayers get a double benefit because amounts designated for cafeteria plans are "pre-tax" and non-prescription drugs can be reimbursed. Taxpayers who do not have access to Section 125 plans and pay out-of-pocket with after-tax dollars for their prescription drugs are not permitted to include the cost of non-prescription drugs with their other medical costs and claim them as an itemized deduction.

RECOMMENDATION:
Taxpayers who do not have access to Section 125 plans should be permitted to include the cost of non-prescription drugs with their other medical costs and claim them as an itemized deduction.

UPDATE ON LAST YEAR'S NCCPAP ISSUES

a. Matching of Form K-1s
b. All Necessary Information on All Notices
c. Annual Transcript of Installment Payments
d. EFTPS Rejected Payments
e. IRS Regulation of Unenrolled Preparers
f. Applicability of Form 990-T
g. Practitioners Hotline
h. Form 1041 Not Crediting Beneficiaries with Taxes Paid
i. Direct Deposits