

Paying Taxes 2015



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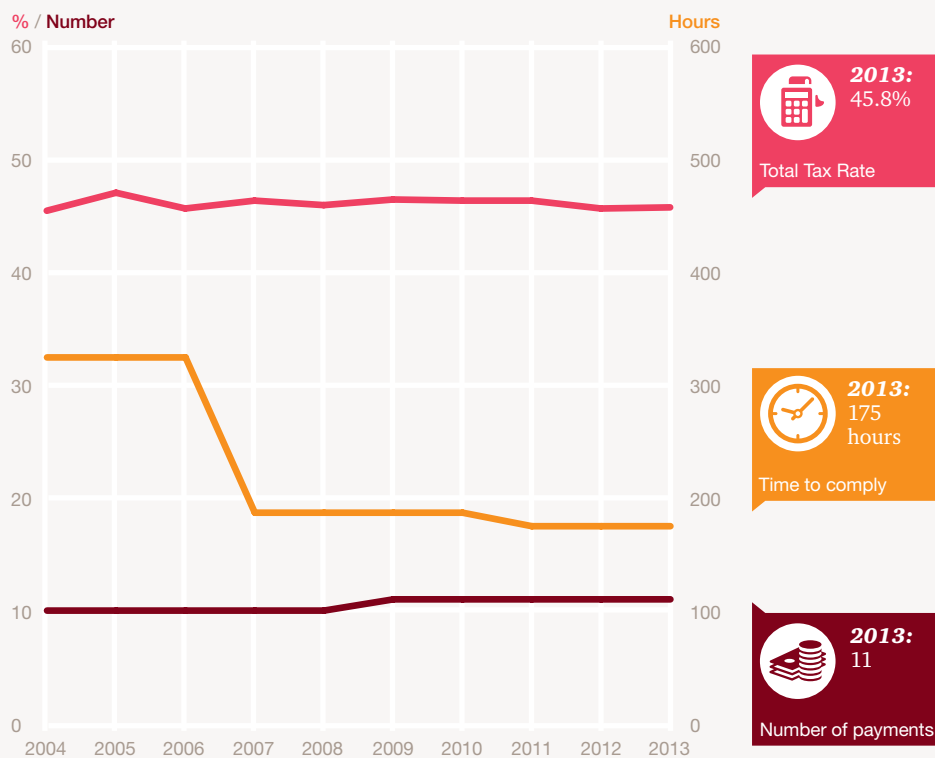
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United States

Efforts to reduce tax compliance burden hampered by mounting complexity and resource scarcity

Mark Mendola, PwC US

Figure 3.29
Trend in the *Paying Taxes* sub-indicators for United States



Source: PwC *Paying Taxes 2015* analysis

In recent years, the government has increased its focus on formal initiatives to reduce the tax compliance burden.

The Internal Revenue Service (IRS) wants to make it easier for US taxpayers to pay their proper federal tax liability and achieve greater tax compliance. In recent years, the government has increased its focus on formal initiatives to reduce the tax compliance burden. As a result, the IRS has made successful strides streamlining and increasing the efficiency of specific areas within its compliance programme resulting in benefits not only for taxpayers, but for the IRS as well – a win-win for both parties.

One might assume that under the *Paying Taxes* study, the time to comply for the United States would show a steady decline over the past several years due to these initiatives. However, this year's survey shows this as 175 hours. While this is lower than the world average (264), the OECD average (185), the G8 average (192), and the region average (213), it is the same as the previous two years and down only slightly from 187 hours for the four years before that. So why doesn't the US' ranking show improvement over this period? Unfortunately, no one factor can explain this stagnation. In fact, the IRS continues to face numerous obstacles that are hampering these welcomed efforts for taxpayers.

A primary challenge is that the complexity surrounding tax compliance in the United States has been mounting for decades. Another hurdle is that US lawmakers have continued to reduce the agency's budget and resources while at the same time adding new requirements. The former is not necessarily the case with the actual process of submitting a tax return, but rather with what information is reported on it. A telling statistic is that between 2000 and 2010, the IRS was tasked with implementing over 4,000 tax code changes enacted by the US Congress. Sometimes contributing to this complexity is the fact that the US Treasury Department has added numerous sets of regulations and other guidance that taxpayers must understand and act on.

How the IRS is easing taxpayer burden

The IRS has streamlined specific compliance processes within various stages of the tax compliance cycle – pre-filing, filing, audits, and disputes. While the benefit of these initiatives depends on the specific taxpayer's circumstances, they generally help taxpayers reduce compliance burdens by providing real-time information through online channels. These initiatives have enabled greater upfront certainty by facilitating early communication with the IRS to reduce risk. Initiatives to leverage technology for the filing of returns have had a tremendous impact, while other efforts have led to more consistency with respect to audits and quicker resolutions for disputes. The following describes some of the agency's more significant endeavours.

Real-time information through online resources

Pre-filing tools aimed at educating and helping taxpayers

A core IRS focus has been so-called 'outreach and education' initiatives so as to enhance voluntary compliance and provide tools for taxpayers to file accurate returns. Striving to meet taxpayers' desire for service, the IRS has offered a range of self and electronic service technology options on the IRS website (IRS.gov) since its re-launch in 2012. Taxpayers are utilising these tools and information – in 2013, taxpayers viewed IRS.gov web pages more than 450 million times. The following is a non-exhaustive list of digital applications and capabilities that aim to save time and taxpayer effort:

- IRS forms, once finalised, are uploaded and immediately available.
- calculators help taxpayers compute employer withholding obligations and alternative minimum tax.
- tax identification numbers may be applied for and obtained online.
- the 'IRS en Espanol' Spanish-language website helps taxpayers with limited English proficiency understand and meet their tax responsibilities.
- 'Where's My Refund?' provides an electronic tracking tool and was used 200.5 million times in 2013.
- 'IRS Direct Pay' was introduced in 2014 to provide taxpayers with a secure and free way to make tax payments.
- 'Get Transcript' allows taxpayers to view and print a record of their IRS account in minutes.

The IRS also has made tremendous strides creating mobile phone applications that help make tax compliance more user-friendly. A primary example is the agency's award-winning mobile application IRS2Go that was downloaded 1.6 million times in 2013. Also, the IRS has expanded its use of social media, such as YouTube, Twitter, and Facebook, to connect with taxpayers while maintaining its presence in traditional channels.

The role of electronic filing to save time and resources

Primary driver of burden reduction continues to expand

A principal focus of the IRS over the past two decades has been the expanded use of electronic filing – an endeavour that has yielded tremendous efficiencies for both taxpayers and the IRS. While some taxpayers still prefer to submit their returns by mail, the vast majority now prefer the convenience of electronic filing. In 2013, 83% of individual taxpayers chose to file electronically, a significant increase from 71.3% in 2010, with a goal of 90% by 2017. In the same year, business returns were filed electronically at a rate of 36.7%, up from 27.5% in 2010, with a goal of 50% by 2017.

The IRS also has invested in the systems required to process electronically-filed returns, expanding the types of returns it can accept, and increasing the efficiency of the electronic filing and payment processes. Greater expansion of electronic filing should be pursued, such as the agency's ability to accept amended Form 1040s that must now be filed in paper form.

Reducing unnecessary taxpayer contact

Leveraging the agency's readily-available information promises to have a positive impact not only on the accuracy of tax computations but also on the effort to reduce unnecessary contacts with taxpayers. As an example, stock basis reporting now requires investment brokers to report the adjusted cost basis for certain publicly traded securities and whether a gain or loss is short or long-term. Merchant card reporting also requires payment settlement entities, such as banks, to report fiscal year information and the gross amount of reportable payment transactions, such as payment card and third party network transactions. This information collected by the IRS can be cross-checked, potentially eliminating the need to contact other taxpayers for incomplete or missing information, saving time and resources.

Earlier communication to drive more upfront certainty

Pre-filing agreements (PFAs)

The PFA process is an area of renewed IRS focus because it enables the agency to work collaboratively with taxpayers to resolve contentious issues before the filing of a prior, current, or future year tax return. Generally, a PFA is used to determine the tax treatment of a completed transaction or event where an issue represents a factual determination, an application of well-established legal principles to known facts, or a computation methodology. The process provides certainty to the taxpayer and allows them to conserve precious controversy resources and better manage their reserves and uncertain tax positions. While once confined to straightforward, non-controversial subjects, the PFA process has recently been used to resolve more complex issues.

Compliance assurance process (CAP)

CAP is a 'real time' examination programme designed to identify and resolve issues prior to the filing of a taxpayer's return. Designated a permanent programme in 2012, CAP requires the contemporaneous exchange of information related to proposed tax return positions and completed events and transactions that could affect federal tax liability. Because CAP reduces the likelihood of post-filing examination and prolonged litigation, taxpayers are able to achieve greater certainty sooner with less administrative burden than in the traditional post-filing examination process.

The benefits of CAP may not arise without some initial effort and strain by the taxpayer. Under CAP, the IRS works with the taxpayer in the traditional post-filing examination process to close all open tax years. Going forward, participating taxpayers work collaboratively with the IRS to identify and resolve potential tax issues as they arise and before the return is filed. This process requires taxpayers to disclose tax positions as they complete significant business transactions. Taxpayers that have complied with the CAP process may be invited to move to the maintenance phase where they continue to disclose material items impacting their tax liability, but generally face a reduced level of IRS scrutiny.

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Industry issue resolution (IIR)

The IRS more recently has emphasised the IIR programme to resolve frequently disputed or burdensome tax issues affecting a significant number of taxpayers within a specific industry. This resolution is shared through the issuance of guidance such as a regulation, revenue procedure, revenue ruling, or notice. Depending upon the issue, the programme can enable greater certainty of issues before taxpayers prepare their returns. It also reduces the time and expense associated with the resolution of issues on a taxpayer-by-taxpayer basis.

Greater consistency and reduced timeframes for audits

Changes to the quality exam process (QEP)

Launched in 2010, QEP is a required systematic approach for engaging and involving taxpayers in the tax examination process, from the earliest planning stages through resolution of all issues and completion of the case. It is intended to set the foundation for improved communication between the IRS and taxpayers and supports greater consistency in the exam process. Based on recent comments from IRS executives, the agency will continue to revamp QEP to make audits more issue focused.

Additional focus on the limited issue focus examination (LIFE) programme

The IRS has placed additional emphasis on the LIFE programme, which is a streamlined, focused examination process designed to limit the scope and reduce the cycle time of an audit in an effort to reduce resource utilisation. In a LIFE examination, the taxpayer and examiner work together on the most significant issues on the tax return. Initial issue selection is based on risk analysis and materiality thresholds are applied to both the IRS expansion of the audit scope and the taxpayer's claims. Both parties must sign a memorandum of understanding detailing the process, roles and responsibilities, issues selected, materiality thresholds, and timelines.

New information document request (IDR) issuance and enforcement process

The IRS recently introduced a new IDR issuance and enforcement process to increase efficiency and transparency during an audit. Specifically, the new process provides that all IDRs issued after 30 June 2013 must be issue focused and discussed with the taxpayer in advance. In addition, both the IRS and the taxpayer are required to determine a reasonable timeframe for the taxpayer's response. This upfront communication can result in reduced taxpayer burden by narrowing and refining the precise information that the IRS is requiring, avoiding unnecessary work. However, this burden reduction will likely depend upon the taxpayer's relationship with the IRS audit team and negative consequences can occur if the taxpayer does not respond within the agreed upon timeframe (e.g., delinquency notices, pre-summons letters, or even a summons.)

Eliminating the coordinated issue case (CIC) designation

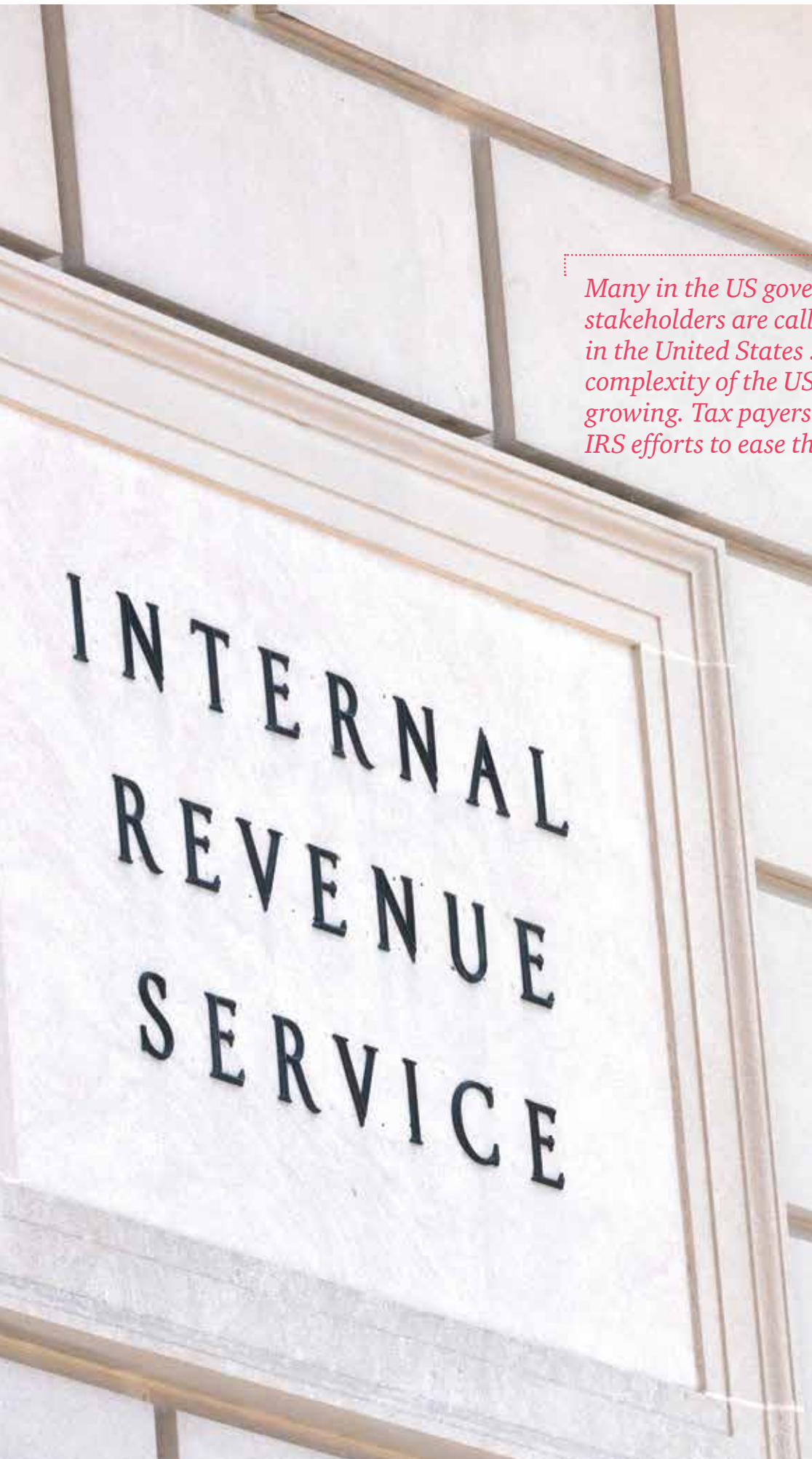
In an attempt to streamline the examination process, the IRS is considering eliminating the CIC designation and moving away from continuous audits towards an issue-focused approach. Under this new approach, the IRS would rely largely on Schedule UTP (Uncertain Tax Position Statement), to identify issues and allocate appropriate resources to conduct targeted issue-specific audits. This risk-based approach may provide reduced audit times for those companies that have traditionally had to dedicate resources to address a continuous audit process.

Quicker resolution if a dispute arises

Fast-track settlement (FTS) and the rapid appeals programme (RAP)

The IRS Office of Appeals (IRS Appeals) has recently aimed to improve the efficiency of the appeals process by expanding the use of the FTS programme. FTS is a non-binding, voluntary negotiation process between a taxpayer and the IRS to help taxpayers resolve disputed issues before a formal administrative appeal. FTS may be initiated once an issue has been fully developed in the examination process and is intended to be completed in approximately 120 days – a much faster timeframe than the multi-year process of a traditional appeal.

IRS Appeals has also attempted to improve the efficiency of the appeals process by expanding the use of the RAP programme. RAP is a relatively new voluntary procedure intended to improve the efficiency and timeliness of IRS Appeals resolutions. In RAP, the pre-conference meeting is used as a means of resolving issues using the techniques of the FTS process. If agreement is not reached, the traditional IRS Appeals process continues.



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The road ahead

Continued vigilance to reduce compliance burdens

Keeping up with taxpayer's appetite for online services

The IRS has set forth plans to reduce tax compliance burden by pursuing a number of core initiatives such as the expansion of electronic filing and the acceleration of the receipt of information returns to improve document matching and validation of return accuracy. But a significant area of focus has been and will continue to be the expansion of online resources and self-service tools. A primary driver has been taxpayers' appetite for self-service and electronic service options. While the IRS has made great strides in this area, the strong demand by the global tax community for tools to ease compliance burdens is mounting at a rapid pace. Many agree that the IRS still has a way to go to reach their vision of an interactive, fully integrated online tax administration agency.

Driving a 'simplification' mindset

Outside of efforts relating to online resources, there are a host of other endeavours that could reduce taxpayer burden. For example, cutting the amount of information that a taxpayer must report to the IRS is a fundamental way of reducing the burden. Accordingly, the IRS may want to consider amplifying its efforts to simplify reporting for more taxpayers. As an example, similar to efforts made with respect to individual income tax returns (Form 1040), a streamlined Form 1120 for mid-sized corporations could be very effective for reducing the compliance burden of smaller businesses.

The IRS may also consider adopting a more 'plain English' approach with respect to all guidance and regulatory projects. While many IRS publications and form instructions strive to describe technical tax requirements in simple terms, not all guidance is developed with this mindset. Even sophisticated taxpayers with seasoned tax departments must closely analyse IRS guidance, taking significant time and resources to build expertise and understanding. This time could be minimised by issuing easier-to-understand guidance, which may take more upfront effort to craft, but could ease taxpayer burdens for years to come.

Expanding options for tax resolution

Controversies and disputes between the IRS and taxpayers require significant time and resources to achieve resolution. And the non-filing of tax returns and non-payment of tax due continues to be a challenge for the agency. Not surprisingly, the IRS wants to expand the options available for tax resolution, including new alternative dispute resolution programmes, streamlined payment agreements, and fresh start collection and payment processes. These are aimed at providing various opportunities for taxpayers to become compliant and easing their burden for doing so. But these compliance initiatives are only the tip of the iceberg and there are many other avenues that could enhance opportunities for taxpayers to get back on the compliance track.

Budget constraints and rising complexity loom

Prioritising resources means slower progress

IRS budget constraints over the past three years unfortunately may have lasting impacts on the agency's efforts to pursue positive change to tax compliance processes. Unfunded mandates are also taking priority as resources are being shifted to implement two major pieces of US legislation: The Affordable Care Act and the so-called Foreign Account Tax Compliance Act (FATCA) regime. The result is that resource constraints are likely to hamper various initiatives relating to the pre-filing, filing, audit, and dispute stages of the tax compliance life cycle, even those that are ready for implementation. Basic communication between taxpayers and the IRS also will likely suffer. Only about 74% of taxpayers who called the IRS during this past filing season got through to IRS personnel and the agency has noted that it is concerned that the average level of phone service may drop below 70%.

Is it time for a revamp?

While the IRS seeks creative ways to reduce compliance burdens, the underlying complexity of the US tax rules keeps growing. Taxpayers will benefit from IRS efforts to ease their burdens, but they must face the continuing need to analyse, plan for, and comply with the US federal tax rules and regulations – an often daunting task requiring increasingly specialised resources and expertise. Many in the US government and other stakeholders are calling for tax reform in the United States, which could entail not only a potential rate change, but also the simplification of the rules for both companies and individuals.

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