

Forbes

HEARING SPOTLIGHTS PROBLEMS WITH
IRS AUDITS OF SMALL BUSINESSES

September 21, 2016

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The House Small Business Committee, chaired by Congressman Steve Chabot (R-OH), recently held a hearing on the IRS audits of small businesses—the hearing title says it all: **“IRS Puts Small Businesses Through Audit Wringer.”** Hats off to the committee for holding this hearing—providing a hard look at the problems small business owners face dealing with the IRS in examination as well as raising serious questions about the protection of taxpayer rights.

While the hearing witnesses all provided good insights, I want to particularly note the thoughtful and informed testimony of my colleague at alliantgroup—**Kathy Petronchak**. It is rare for the Congress and the public to get on this topic the views of a respected 29-year IRS veteran who served as Commissioner, Small Business/Self Employed Division.

Of particular note is that Ms. Petronchak highlighted a number of areas where the IRS can be doing a much better job of auditing small businesses—better in many cases for both the IRS and small business owners. While Ms. Petronchak noted, rightly, that many issues that taxpayers face are due to budget shortfalls at the IRS, it was particularly important that she made clear though that a number of taxpayer-friendly changes can be made within the IRS’ limited budget.

Ms. Petronchak noted five issues in her testimony—in brief:

1. The Small Business/Self Employed (SB/SE) Division should emulate the IRS’ Large Business & International (LB&I) Division and have an upfront meeting between the taxpayer and the IRS that provides a clear picture of what

the issues are and the journey ahead for documents and interviews—as well as timelines. Such a step will ensure the IRS has a framework for the exam—and also that the taxpayer can be better responsive to requests for information. In addition, LB&I requires that Information Discovery Requests (IDRs) are issue focused – i.e. don’t launch the boats for the fishing expedition. The current SB/SE practice too often of “hide-the-pea” is not in keeping with the spirit and intent of the IRS Taxpayer Bill of Rights and the right of the taxpayer to be informed.

2. Allow for greater use of Alternative Dispute Resolution. The IRS appears to be less and less enthused about allowing small businesses to use Fast Track Settlement (FTS)(although budget may be partly at issue). We have found representing hundreds of taxpayers at alliantgroup, that FTS can be an important way to allow taxpayers and the IRS to resolve differences with the IRS exam team.

3. IRS and “the-man-behind-the-curtain.” Ms. Petronchak highlighted that a growing trend is the IRS using specialists (such as an engineer, appraiser, computer audit) to be a key player in the exam of the small business. Too often, the small business owner is not informed that a specialist is involved—and even in cases where the specialist is known—the small business owner is not allowed to meet or discuss the issues directly with the specialist. This situation—with the man-behind-the-curtain calling the shots raises a host of issues and concerns—and also raises questions about the IRS Taxpayer Bill of Rights—and the rights of the taxpayer to challenge the IRS position and the right to be heard.

4. The IRS Appeals process. The IRS Appeals process is a shop that has really worked for taxpayers—especially small business owners—providing small business owners a cost-effective way to have their issues heard by an independent reviewer. The concern here is one of “don’t screw it up.” (My words—Ms. Petronchak is much more thoughtful and considered in her testimony). The good work of IRS Appeals is threatened by tight budgets—potentially leading to long waits for an appeals conference and a reduction of face-to-face conferences. In addition, while Appeals has to consider hazards of litigation in reaching a decision—those hazards of litigation should be weighed equally for both large businesses and small businesses—and not weighted in favor of big businesses who are more likely to go to court.

5. Third party contacts. The IRS has, at times, the need to contact third parties in its examination of a taxpayer. However, Congress intended this to be a rare tool used by the IRS in extremis. Unfortunately, particularly in the examination of small business owners, the IRS is seemingly wallpapering the town at times with third party contacts (many of them unnecessary—and at times contacting individuals who don’t know anything about the issue) and running roughshod over the taxpayers’ rights to privacy and confidentiality provided under the IRS Taxpayer Bill of Rights. To her credit, the Taxpayer Advocate—Nina Olson—has conducted a detailed review of the IRS, third party contacts and taxpayer rights. The Advocate’s report makes for troubling reading—and IRS executives and Congress should be asking hard questions about what is going on here.

From the other panelists, I was particularly interested in the comments of Don Williamson, a law professor at American University, of the pressure that small business owners face—due to costs of litigation—to just settle with the IRS regardless of whether the exam issues are meritorious. It raises a long-held concern I’ve had since my days on the Senate Finance Committee conducting oversight about quality control at the IRS.

My hope is that this very useful hearing by the Small Business Committee will serve as a spring board for action by the IRS to make taxpayer-friendly changes, and for greater congressional review of these matters to ensure the right steps are taken by the IRS.



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