

**WRITTEN TESTIMONY OF  
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BEFORE THE  
HOUSE SMALL BUSINESS COMMITTEE  
ON TAX SIMPLIFICATION  
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**INTRODUCTION**

Chairman Chabot, Ranking Member Velazquez and Members of the Committee, thank you for the opportunity to discuss the IRS's ongoing efforts in the area of tax simplification.

Because tax law simplification requires changes in tax policy, which is the domain of Congress, the White House, and the Treasury Department, the IRS as tax administrator does not have a direct role in simplifying tax laws. We do, however, have a responsibility to make it as easy as possible for taxpayers to fulfill their tax obligations, and in that way, we can contribute to tax simplification.

Against that backdrop, the IRS recognizes the critical role played by small businesses and self-employed taxpayers in our country as engines of economic growth, and we understand the need for the IRS to do its part to ensure these businesses can flourish. While the complexity of the tax code and the limits of our constrained resources create challenges for us in this area, I can assure this Committee that the IRS is committed to doing everything possible to help small businesses and self-employed taxpayers fulfill their tax obligations.

**SIMPLIFYING TAX COMPLIANCE FOR SMALL BUSINESSES**

Small businesses, from sole proprietors who file Form 1040 with a Schedule C to small corporations and partnerships, must not only familiarize themselves with complex aspects of the tax code but also keep up with tax code changes, creating challenges for them in complying with the tax laws. As a result, the IRS is continually seeking ways to help these business owners in their efforts.

The compliance assistance the IRS provides to small businesses takes many forms, and includes: simplifying tax forms and notices; streamlining policies and procedures; providing regulatory relief; easing recordkeeping requirements; and voluntary compliance programs aimed at small business. We rely on feedback from a variety of sources in the tax industry and small business community to help us determine what actions we can take that would be most helpful.

Following are just a few examples of recent actions the IRS has taken to reduce burden on small businesses and help them comply with the tax laws:

***Tangible Property Regulations.*** In February 2015, the IRS announced a simplified procedure for businesses to use to make it easier for them to apply regulations issued in 2013 governing tangible property. The regulations clarify when expenses for tangible property are deductible repairs or capital improvements. The new procedure, requested by businesses owners and tax professionals, allows small businesses to change a method of accounting under the regulations on a prospective basis. The new simplified procedure is generally available to small businesses, including sole proprietors, with assets totaling less than \$10 million or average annual gross receipts totaling \$10 million or less.

***Increased Expensing Thresholds.*** In issuing the tangible property regulations described above, the IRS requested comment on the \$500 safe harbor threshold on amounts spent to acquire, produce or improve tangible property that would normally qualify as a capital item. The threshold can be used by businesses without an applicable financial statement, and allows them to take an immediate deduction on such expenditures rather than depreciating them over many years. Small businesses told the IRS that the \$500 threshold was too low to have its intended effect of reducing paperwork and recordkeeping requirements. In response, the IRS in November 2015 increased the threshold to \$2,500.

***Voluntary Compliance Program for Certain Retirement Plan Sponsors.*** Since 2014, the IRS has been offering certain small business owners with unfiled retirement plan returns the opportunity to come into compliance and reduce potential penalties. The voluntary compliance program, which began as a pilot and was made permanent in 2015, is designed to help small businesses that may have been unaware of reporting requirements that apply to their plans. Businesses that fail to file required annual retirement plan returns can face stiff penalties — up to \$15,000 per return. But under this program an eligible small business that voluntarily comes into compliance pays only \$500 for each delinquent return filed, up to a maximum of \$1,500 per plan for multiple delinquent returns. The voluntary compliance program is generally open to small businesses with plans covering a 100-percent owner or the partners in a business partnership, and the owner's or partner's spouse (but no other participants), and certain foreign plans.

***Streamlined Application Process for Tax-Exempt Status.*** The IRS created Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, in 2014 to give small organizations a less-cumbersome option for qualifying for tax-exempt status. Most organizations with annual revenue of \$50,000 or less and assets of \$250,000 or less are eligible to use the 1023-EZ, which is three pages long, compared with the standard 26-page Form 1023. Prior to introduction of the 1023-EZ, all organizations seeking tax-exempt status went through the same

lengthy application process, regardless of size, creating delays for applicants. It now takes organizations using the 1023-EZ an average of less than two weeks to receive a determination on their application, compared to several months before the form was introduced. Use of the 1023-EZ has also helped contribute to a decline in the inventory of pending applications for tax-exempt status. Open inventory at the end of Fiscal Year (FY) 2015 was 11,616, compared with 65,719 at the end of FY 2013, a reduction of approximately 82 percent.

**Home Office Deduction.** In 2013, the IRS began offering taxpayers the option of using a simplified method to calculate the home office deduction, a tax break that is widely used by individuals who operate home-based businesses. Normally, taxpayers claiming the deduction are required to fill out a 43-line form, Form 8829, *Expenses for Business Use of Your Home*, which often involves complex calculations of allocated expenses, depreciation and carryovers of unused deductions. Instead, taxpayers choosing the simplified method need only complete a short worksheet in the tax instructions and enter the result on their income tax return. This simplified method has substantially reduced the paperwork and recordkeeping burden for small businesses.

## **ENFORCING THE TAX LAWS AND ENSURING FAIR TREATMENT**

Even as we seek to provide top-quality service to small business taxpayers, the IRS also must carry out a robust enforcement program. While the IRS has an obligation to make sure all individuals and businesses pay the taxes they owe, it is especially critical in the small business community, in order to maintain a level playing field for all business owners.

The enforcement activities we conduct help ensure that those small business owners who are fulfilling their tax obligations are not disadvantaged by others who may be cutting corners, whether that involves income taxes, employment taxes, or the classification of workers as employees or independent contractors.

In many cases, actions taken to improve enforcement can also help taxpayers and increase voluntary compliance. An excellent example is our new Employment Tax Early Interaction Initiative, which was launched last December.

Under this initiative, the IRS seeks to identify employers who appear to be falling behind on their interim employment tax payments before they file their annual employment tax returns. We offer helpful information and guidance through contacts such as letters and automated phone messages. In the past, the first attempt by the IRS to contact an employer having payment difficulties often did not occur until much later in the process, after unpaid tax obligations were already beginning to mount. This initiative is designed to help employers stay in compliance and avoid interest and penalty charges. This initiative can be seen as

a more efficient enforcement activity or a form of improved taxpayer service, but we believe it is both.

Within the employment tax area, another important component of our efforts to ensure small businesses meet their obligations involves helping businesses that outsource some or all of their payroll and related tax duties to third-party payroll service providers (PSPs). While most PSPs do a good job of helping small businesses meet filing deadlines and deposit requirements, businesses sometimes can fall prey to unscrupulous PSPs that defraud clients and abscond with their payroll tax deposits, leaving the employer liable for amounts they thought had been remitted to the IRS but were not.

We have taken many steps to help protect employers from becoming victims of unscrupulous PSPs, and to provide assistance when fraud does occur, including the following:

- Unscrupulous PSPs sometimes change the address of their clients (without their clients' consent) to that of the PSP, so that the client never sees tax delinquency notices sent by the IRS. In 2015, the IRS began sending identical notices to both the old and new addresses on file for an employer after an address change is received.
- In 2014, we created the Inquiry Personal Identification Number (PIN), which is used by business owners who use PSPs. They can use their Inquiry PIN to access the Electronic Federal Tax Payment System (EFTPS) to check whether tax payment submissions were made timely on their behalf by their PSP. Additionally, we are working to modify the EFTPS to allow for the issuance of emails to business owners when their PSP makes or cancels tax payments.
- We made changes to our offer-in-compromise (OIC) program to make it easier for a business defrauded by a PSP to obtain an OIC. Revised document requirements for such offers allow our OIC specialists to process offers submitted by these taxpayers more expeditiously than they otherwise would be.

In conducting our enforcement programs, the IRS strives to ensure all taxpayers, including small businesses, receive fair treatment in their dealings with us. One important aspect of ensuring fair treatment involves raising taxpayers' awareness of their rights when interacting with the IRS, especially when tax disputes arise. In 2014 the IRS adopted a Taxpayer Bill of Rights that we believe is a cornerstone document that will help taxpayers, including small business owners, understand their rights in the tax process.

The Taxpayer Bill of Rights contains 10 fundamental rights that every taxpayer should be aware of, such as the right to receive quality service from the IRS, the right to pay no more than the correct amount of tax, and the right to retain representation when a taxpayer has a disagreement with the Service. Each one

of these 10 rights is in our tax code, but the length and complexity of the code make it difficult to understand these rights or even find where they are in the code. Our employees believe in these rights and are doing their best to advise taxpayers about them and to support them in their day-to-day activities. To further strengthen these efforts, the IRS is working expeditiously to implement the provisions passed in the Protecting Americans from Tax Hikes Act of 2015, which adds to the Commissioner's duties the requirement to ensure that employees of the IRS are familiar with and act in accordance with taxpayer rights as afforded by other provisions of the Internal Revenue Code.

## **NEED FOR ADEQUATE RESOURCES AND LEGISLATIVE SOLUTIONS**

It is important to note that continuing initiatives like the ones that I have described in my testimony depends on the IRS receiving adequate resources to fund them. Our efforts to assist small business taxpayers are challenged by the difficult budget environment we are in. The IRS's funding was cut significantly for the five years from 2011 to 2015, and those reductions have taken a toll on both taxpayer service and enforcement programs.

Congress did approve \$290 million in additional funding for the IRS for FY 2016, which we appreciate. The additional funds were directed to be used to improve service to taxpayers, strengthen cybersecurity and expand our ability to address identity theft. This was a major step in the right direction. But even with this additional funding, we are still under significant financial constraints, as the IRS appropriation remains \$900 million below the FY 2010 enacted level, and the reductions are more significant in inflation-adjusted terms.

As a result, we will need to continue the exception-only hiring policy that began in FY 2011, leaving us unable to replace most employees we lose this year through attrition. In fact, we expect the IRS workforce to continue to shrink by another 2,000 to 3,000 full-time employees during FY 2016, equaling a loss of over 17,000 full-time employees since FY 2010.

Therefore, I continue to urge Congress to approve the President's FY 2017 Budget for the IRS, which requests a base increase of \$530 million over the FY 2016 enacted level. This would support improvements to a wide range of taxpayer service activities and investments to help prevent identity theft and refund fraud and to reduce improper payments. The Budget also proposes a multi-year program integrity cap adjustment to restore and improve tax enforcement activities, including a \$515 million investment in FY 2017 to reduce the deficit and narrow the tax gap. If approved, the cap adjustment would yield an estimated net taxpayer savings of \$46 billion over the next 10 years.

As important as adequate funding is to improving our efforts to help small businesses, Congress also has an important role to play by passing legislative

proposals that would simplify tax administration. In that regard, let me highlight several important legislative proposals in the President's FY 2017 Budget in the area of small business:

- ***Simplified Accounting Methods.*** Although current law contains various provisions granting relief to small businesses from complex tax accounting rules, the eligibility requirements for these forms of relief are not uniform. They rely on varying forms of gross receipts tests, with widely different exception thresholds, and different rules depending on the classification of a taxpayer's business activities. Therefore, a uniform definition of a small business for determining applicable accounting rules would simplify tax administration and taxpayer compliance. The Administration's proposal would create a uniform business threshold, set at \$25 million in average annual gross receipts and indexed for inflation, for qualifying for exceptions from certain accounting rules.
- ***Increased Expensing Limitation.*** Section 179 of the Internal Revenue Code allows taxpayers to elect to deduct up to \$500,000 of the cost of qualifying depreciable property placed in service during a taxable year, rather than depreciating the asset. The Administration's proposal would increase the \$500,000 limit to \$1 million. This would not only reduce the after-tax costs of tangible depreciable assets, but also provide accounting simplification for many small businesses, by allowing them to avoid the complexity of tracking depreciation. As with the current limit, the proposed \$1 million cap would be adjusted for inflation.
- ***Increased Deduction for Start-Up Expenses.*** Current law allows new business owners to deduct \$5,000 of start-up costs for the first year they are in business. Businesses organized as corporations or partnerships may also deduct \$5,000 in organizational costs in their first year. To support new business formation and job creation, the Administration's proposal would allow up to \$20,000 of new business expenditures, including organizational costs, to be deductible in the first year. As under current law, businesses would be allowed to amortize, over 15 years, start-up costs that exceed the deductible limit. The proposal would also consolidate various Code provisions related to new business expenditures, reducing burden on new business owners.
- ***Improving the Small Business Health Care Tax Credit.*** The Affordable Care Act permits small employers to take a tax credit for a portion of the cost of providing health coverage for their employees. To be eligible, employers must have no more than 25 full-time equivalent employees and pay at least half of the employees' health premiums. Also, the employees' average annual wages must not exceed a specified level, indexed for inflation. That amount for 2016 is \$51,800. The credit is phased out on a sliding scale between 10 and 25 full-time employees, as well as between

an average annual wage of \$25,900 and \$51,800 in 2016. The administration's proposal would raise the 25-employee limit to 50 and begin the phase-out at 20 employees, rather than 10. The proposal would also change the way the phase-out rules are coordinated to provide a more gradual, combined phase-out.

Chairman Chabot, Ranking Member Velazquez, and members of the Committee, this concludes my statement, and I would be happy to answer your questions.