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REPEAL OF FORM 1099 REPORTING BURDEN UNDER SECTION 9006 OF THE PATIENT PROTECTIONS AND AFFORDABLE CARE ACT

BACKGROUND:

For certain distributions made after December 31, 2011, pursuant to Section 9006 of the Patient Protections and Affordable Care Act, all business will be required to prepare and submit 1099-MISC forms to any and all businesses for both merchandise and services in excess of \$600 per year.

PROBLEM:

The law that was enacted places a significant burden on all businesses and business owners, especially small business owners. We do recognize the need to close the revenue and reporting gap which currently exists and are in favor of taking actions to do so. However, small businesses that do not have the manpower nor the time or necessary resources to be able to meet the reporting requirements as enacted. In addition, the new rules will place an undue burden on CPAs and accountants, as it will place additional onus on them to assist in the preparation of these forms.

It should be noted, however, that the issuance of 1099-MISC (which reflects disbursements made on a calendar year basis) may be moot as many businesses operate on a fiscal year ending in months other than December. The matching process for these entities will prove to be useless as the information on Forms 1099 issued may be significantly different from what would be reported on their respective income tax returns.

It is not the position of the CPA to advise the client on how to not report income. We are only in a position to recommend that the business owner reports all income and expenses so that a true picture of a business may be presented, either on a tax return or a financial statement. Neither is it the responsibility of a business owner to ensure that those whom they do business with report all the income that is paid to them.

RECOMMENDATION:

H.R. 5141 was introduced on April 26, 2010, by Representative Daniel Lungren (3-CA). Known as the "Small Business Paperwork Mandate Elimination Act", passage of this bill would eliminate the financial and administrative burdens for business owners as discussed above. Subsequent bills have been introduced into Congress since then, calling for the repeal of Section 9006 of the Patient Protections and Affordable Care Act, all of which have failed to obtain passage.

Due to significant hardships that would be placed upon small business owners, without a significant corresponding increase in revenue to be generated for the Treasury or a significant increase in reporting compliance, we recommend the immediate and total repeal of Section 9006 of the Patient Protections and Affordable Care Act.

INDEPENDENT CONTRACTOR ISSUES

BACKGROUND

There is a bill in Congress, S.3786 and HR.1234, "The Fair Playing Field Act of 2010," which addresses the issue of the independent contractor vs. the employee. Currently, the Treasury Department and the Internal Revenue Service are prohibited from issuing guidelines for the determination as to whether a worker is an independent contractor or an employee. This restriction is in effect under Section 530 of the Revenue Act of 1978.

PROBLEM:

This bill is intended to ensure that workers are afforded protections already in the law and help the employers who play by the rules are not forced to compete against those businesses that do not. The purposes of this Act are to permit the Secretary of the Treasury to provide guidance allowing workers and businesses to clearly understand the proper federal tax classification of workers and to provide relief allowing for an orderly transition to new rules designed to increase certainty and uniformity of treatment. The legislation requires the Secretary of the Treasury to issue prospective guidance clarifying the employment status of individuals for Federal employment tax purposes.

We find that there are several issues that place NCCPAP in the position to recommend that this bill should not be passed into law:

1. It is our belief that this will not help close the "Tax Gap." Certain employers will still make use of illegal workers who do not have social security numbers and are undocumented
2. While some state legislatures have passed similar laws regarding workers in their respective states, other states have not. Such legislation is in the process of being challenged within the state courts.
3. If state legislation contradicts with federal legislation, which law will the employer be required to follow?
4. This legislation, if passed, would require additional paperwork for employers as they would be required to provide a written statement to independent contractors notifying of the Federal tax obligation, the labor and employment law protections that do not apply to independent contractors, and the right of such independent contractors to seek a status determination from the IRS.

We would like to point out that within our profession, there are many practitioners. who own their own corporations, who do work for colleagues on a per diem basis as independent contractors. Payments for these services are paid to the corporation, not the practitioner directly. The relationship may be constant or infrequent, depending on the need of both the practitioner needing help, and the one looking for additional work.

RECOMMENDATION:

We understand the need for such legislation. However, we believe that should this become law, additional discussions are needed in order to make this truly effective. NCCPAP would welcome the opportunity to participate in such discussions, as a blanket policy would be unfair to those who operate within the current required parameters.

We agree that The Fair Playing Field Act of 2010 should:

- end the moratorium on Internal Revenue Service (IRS) guidance addressing worker classification;
- require the Secretary of Treasury to issue prospective guidance clarifying the employment status of individuals for Federal employment tax purposes;
- amend the provisions of the Tax Code that provide for reduced penalties for failure to deduct and withhold income taxes and the employee's share of FICA taxes;
- not require persons who contract independent contractors on a regular and ongoing basis to provide a written statement to each independent contractor of the Federal tax obligations of independent contractors, the labor and employment law protections that do not apply to independent contractors, and the right of the independent contractor to seek a status determination from the IRS; and
- require the Secretary of the Treasury to issue annual reports on unresolved worker misclassification issues.

We strongly believe that the federal legislation to go one step further and have the classification apply to all state department of taxations, attorneys general, labor departments (federal and state) and other jurisdictions. For example, in Senator Kerry's home state, employer's are subject to different interpretations from the Internal Revenue Service, Massachusetts Department of Revenue and the Massachusetts Attorney General.

Taxpayers should be subject to the same Form SS-8 filing as employers.

Contracting entities should be given five years before any penalties are assessed. This will allow time for the IRS to release regulations and employers to review them for applicability.

INDEPENDENT CONTRACTOR ISSUES (Page 3)

Suggested guidelines for determination of employee or independent contractor status might include:

- Average hours worked per quarter over a certain period.
- Percentage of total business of the independent contractor with contracting entity.
- Structure of independent contracting unit – corporation, LLC.
- Rules for independent contractor operating business with partners, other shareholders and/or employees treated differently than sole providers.
- Rules for different types of industries, occupations, and professions.
- Safe harbor or unprotected occupations as outlined by the Internal Revenue Service Determination Unit.

CHANGE IN DUE DATES FOR RETURNS

BACKGROUND:

With the growth of tax and financial planning, there has in recent years been unprecedented growth in the creation of partnerships and trusts. Changes in tax law and the Internal Revenue Code have now allowed entities, who were previously prevented from becoming co-owners, shareholders, or members of such, to do so. In addition, other changes have allowed for an expansion in the number of owners of these entities. This has, in turn, placed an additional burden on the tax return preparers in providing information to these owners on a timely basis.

Two years ago, the Internal Revenue Service made a modification in the due date for Partnership (Form 1065) and Fiduciary (Form 1041) Tax Returns. These returns with a due date for the return of April 15th, had their period of extension shortened by one month, from October 15th to September 15th. This was done to allow the partners, or beneficiaries, to have their own tax returns prepared by October 15th, and these individuals would have to file either an incomplete return, to avoid the need for filing an amended tax return, or filing the completed return late, subjecting them to late filing penalty and interest charges.

PROBLEM:

The due date for the various income tax returns has not changed. There is still an overwhelming burden on the tax return preparer to meet these deadlines. Despite the development of technology, the human factor – getting the information from the clients, is still a burden on the preparer. The taxpayer, be it a business entity or an individual, operate at their own pace, making the gathering of information from them for the preparer difficult at times. Many a tax preparer has had a client come to them just before the due date for the tax return, expecting a return to be created immediately. In addition, simultaneous due dates make it difficult for returns to be completed on a timely basis. A business may hold an interest in a partnership, but may not be able to file a tax return timely as it is awaiting the information from the partnership to include in its tax return.

RECOMMENDATION:

NCCPAP recommends that the following changes be made in the due dates, both for an original filing and the extension, if necessary:

Form 1040 – April 15 and October 15
Form 1041 – March 15 and September 15
Form 1065 – March 15 and September 15
Form 1120 – April 15 and October 15
Form 1120S – March 15 and September 15

HEALTH INSURANCE PREMIUM DEDUCTIBILITY

BACKGROUND:

Businesses operating as an unincorporated entity with a single owner report their income and expenses on Form 1040, Schedule C. Unlike an incorporated business, they do not have the ability to claim any health insurance premiums as a deduction against the income that this business generates. A corporation, operating either as a Subchapter S or a C Corporation, is allowed to take health insurance premiums as a deduction in the determination of the entity's net income. An unincorporated business is not. In the Small Jobs Act of 2010, a sole proprietor is to take into account health insurance premiums as an additional deduction against unincorporated income (Form 1040 Schedule C and Form 1065) in the determination of the amount due for Self-Employment Tax for 2010 only.

PROBLEM:

With both the Subchapter S and the C Corporations, the owner(s), who are also employees, are paid a salary. Employee benefits, such as the payment of health insurance, may also be provided by the corporation, and are taken as a deduction against income to the extent that is paid by the employer. With an unincorporated business, no such deduction may be taken. The operator of such a business may take the health insurance premium as an adjustment against income on Form 1040, but unlike the corporate owner/employee, the amount paid for health insurance premiums is still subject to Self Employment Tax, as it is not an expense against business income. For example, an S Corporation owner has a salary of \$100,000, and the S Corporation has no profit. The expenses of the S Corporation include \$12,000 in health insurance premiums. While the premium is added to the shareholder's W-2, it is immediately deducted in the determination of Adjusted Gross Income, resulting in a net result of \$100,000 AGI ($\$100,000 + \$12,000 - \$12,000$). Using the same information, this time for an unincorporated business, the owner has to report \$112,000 of income. While they also can claim the deduction for health insurance premiums, their Self Employment Tax is calculated on \$112,000, not \$100,000.

RECOMMENDATION:

Health insurance premiums should be allowed as a full deduction against income for an unincorporated business. There should be no difference in the treatment of the deduction based on the type of entity formed. However, under the new law, this is for the year 2010 ONLY. NCCPAP recommends that this provision should be made permanent.

OFFICE IN HOME - S CORPORATION SHAREHOLDERS

PRESENT LAW:

Internal Revenue 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.”*

Code 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.

Code 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”*.

Code 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.

OFFICE IN HOME-S CORPORATION SHAREHOLDERS (Page 2)

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 not claim a deduction Schedule E against the rental income due to the limitations provided under Section 280A.

One of our members has recently 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 Section 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.

If the entity had 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 rules 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 Code Section 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 pursuant to Code 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 Subchapter S dividends. We understand the need of the 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.

S CORPORATION INCOME SUBJECT TO SOCIAL SECURITY TAX

In a report titled "Additional Options to Improve Tax Compliance", issued August 3, 2006, the Joint Committee on Taxation (JCT) has proposed modifying the determination of income subject to employment, or self-employment tax for the partners in Partnerships and shareholders of S Corporations.

Prior to stating a position on this matter, we should first examine how income is currently treated for Unincorporated Business and Incorporated Businesses.

UNINCORPORATED BUSINESSES: PARTNERSHIPS AND SCHEDULE C:

If a single individual operates an entity, the income is reported on Form 1040, Schedule C. If two or more individuals are involved, then the business is treated as a partnership, and Form 1065 is used to report the income. In either of these business situations, the business entity does not pay federal income tax, but rather the sole proprietor business operator in the case of a Schedule C, or the partners of the partnership report the income on their individual tax returns, self-employment tax (SECA) must be paid by the individuals if there is earned income.

INCORPORATED BUSINESSES:

A corporation is an artificial, legal entity created by state law, which may be owned by one or more individuals. The corporation itself has two options under which it can be treated for tax purposes, a C Corporation, or a S Corporation. With a C Corporation, the entity reports income and expenses and pays income tax on its net income. In addition, if the C Corporation makes a dividend distribution to a shareholder, these monies are taxed a second time, when the shareholders report the income on their individual income tax returns. If the corporation elects to be treated as a S Corporation, then the corporation pays no federal income tax and the shareholders report their share of the income on their individual income tax returns, pro rata, regardless of whether they receive funds from the corporation or not. Any monies that they receive (distributions) may be received tax-free because the income has already been taxed, subject to basis and at-risk rules.

THE ISSUE:

In recent times, many individuals have gone into business for themselves. The S Corporation has become a very popular vehicle for small business, in that it provides protection from liabilities while income is generally taxed once at the personal level. Salary from a S Corporation is reported on Form W-2 and is subject to FICA (payroll taxes) instead of self-employment tax. Net income passed through to S Corporation shareholders on Form K-1 is not subject to FICA or SECA taxes.

S CORPORATION INCOME SUBJECT TO SOCIAL SECURITY TAX (Page 2)

HISTORY:

The Subchapter S of the IRS Code, was enacted in the 1950s. In 1959, the Internal Revenue Service issued Revenue Ruling 59-221, which is the original revenue ruling that deals with the treatment of taxable income included in the gross income of shareholders of an S Corporation. The Internal Revenue Code of 1954, Section 1, Subchapter S, Sections 1371-1377 dealt with the taxable status of such corporations. Section 1373 of the Code specifically states that:

“Each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends, the amount he would have received as a dividend, if on such last day there had been distributed pro rata to it shareholders by such corporation an amount equal to the corporation’s undistributed taxable income for it taxable year.”

The IRS did not envision how the use of the S Corporation would evolve. It is apparent that the IRS in their 1959 ruling envisioned a small group of investors forming a corporation and reporting the income. It was not envisioned that a single individual would open their own business, make the S election, report the income, but in doing so, not report any compensation subject to FICA tax for themselves.

REASONABLE COMPENSATION:

The question is in the definition of reasonable compensation. It can be defined as:

“The theoretical compensation required to hire an outside person to perform the same duties as the shareholder in a similar circumstance.”

Some taxpayers may seek to pay unreasonably low or no salaries to themselves and artificially increase the net income in order to reduce their liability for FICA taxes. The IRS has the right to reclassify a distribution of profits as salary if it determines that compensation is not reasonable. However, the term “reasonable compensation” is a very subjective term. What may be reasonable in one part of the country might be considered to be excessive in another. Also, one entity might show greater gross revenue than another in the same field of business, and therefore, provide a greater compensation. The IRS has determined that reasonable compensation is to be determined by “facts and circumstances” within each individual case.

PROBLEMS:

There are several problems with the current situation.

First, there are S Corporations that have more than one shareholder. In some of these cases, some of the shareholders may not be active participants in the business of the

S CORPORATION INCOME SUBJECT TO SOCIAL SECURITY TAX (Page 3)

corporation. According to the Treasury Inspector for Tax Administration, a difficulty that the IRS has encountered in the examination of officer compensation is the determination of the level of shareholder services rendered to the corporation (TIGTA 202-30-125).

Second, whether a shareholder is active in the S Corporation or not, funds are not always available to be paid as wages even though the corporation has net income at the end of the year. A business entity may need the funds in order to meet its financial responsibilities for operating expenses, debt service, or they may have to use the funds to purchase inventory or other assets. This can result in what some call “phantom income,” income that must be reported but not received. While some funds may be available to be distributed to allow the shareholders to meet their tax responsibilities, adding SECA to this may prove to be an undue burden, both on the shareholder of the S Corporation, and the S Corporation itself.

Finally, some S Corporations have been formed to operate real estate ventures which employ professional managers who are not shareholders. The shareholders are passive investors and may not control the day-to-day operations of the corporation. This type of activity should not generate earned income subject to FICA or SECA tax.

NCCPAP POSITION:

The National Conference of CPA Practitioners recognizes that this is a serious issue. As the population of the United States ages, the ratio of contributors to recipients of Social Security/Medicare decreases. The strain on the Social Security system is real but economic crisis should not generate unfair tax policy.

NCCPAP does not believe that classifying all K-1 income from S Corporations as subject to SECA or FICA tax is the answer. Instead, the concept of “reasonable compensation” needs to be revisited so that it can be applied fairly across all levels. This can be accomplished through tests of “active engagement” in the business activity and providing guidance about how the IRS will apply the facts and circumstances concept in practice. While it may be tempting to provide salary ranges for reasonable compensation, this would be a daunting task based on geographical location, special skills and corporation profitability

In addition, the tax preparer community, in advising their business clients who are S Corporation shareholders, should indicate that the active shareholders **MUST** draw a reasonable salary.

This is an issue where the CPA profession and the federal government should work together, to achieve a proper balance.

THE ALTERNATIVE MINIMUM TAX (INDIVIDUALS)

BACKGROUND:

The AMT was originally enacted in 1969 to address the concerns that persons with substantial economic income were paying minimal or no Federal income taxes due to the clever use of "tax sheltered" investments. The AMT today is affecting an originally unintended class of taxpayer, namely the middle class taxpayers, who are not using what we would call "deferral strategies."

The AMT is a tax that eliminates many of a taxpayer's deductions and leaves the taxpayer paying more tax, sometimes much more, than they were led to believe they would pay especially in light of all of the tax cuts of recent years-many of which have been very well publicized.

The AMT is a special tax applicable only if the amount of alternately calculated tax due *exceeds* the regular income tax. Individuals must first calculate the regular tax and then modify the calculation with certain adjustments and add backs before subtracting an exemption amount which is determined based on filing status and adjusted gross income.

The individual AMT requires a second tax calculation that is a major compliance burden without a significant policy justification. The failure of the AMT to achieve the purpose it was originally designed for is due to the numerous changes that have been made to the Internal Revenue Code since 1969 which have limited tax shelter deductions and credits which many of the wealthier taxpayers took advantage of for many, many years.

Today, the AMT affects well over five million tax returns and within the next five years it will increase to about one-third of all taxpayers. Currently, it is projected that ninety percent of all households with an adjusted gross income in excess of \$100,000 will be subject to the AMT.

PROBLEM:

The failure of the AMT to achieve its original purpose can be traced to items that are "personal" in nature and not the result of shrewd, sophisticated tax planning. These items include the personal exemption, medical expenses, state and local income taxes and miscellaneous itemized deductions.

For a very long time most people outside of the professional tax preparer community did not even know that this so-called "second tax calculation" even existed. Today, as more and more middle class individuals are being snared into this trap, they exclaim- "What is an AMT?" when their tax preparer informs them of a much less than anticipated refund or an amount that is due to the U.S. Treasury when a refund was expected. Individuals who prepare their own return and are subject to the AMT are not prepared to calculate it and will eventually receive a bill for the underpaid tax plus interest and penalties.

THE ALTERNATIVE MINIMUM TAX (INDIVIDUALS) (Page 2)

While the regular tax rates were reduced and adjusted for inflation over the past decade, the AMT tax rates have been unchanged and have not been indexed for inflation; although there have recently been minor adjustments enacted to account for inflation. As the gap between the AMT and the regular tax narrows more people are subject to it.

The AMT is too complex and imposes a large compliance burden. Taxpayer Advocate Nina Olson, has since 2001, in her annual reports to Congress, stated that the AMT now functions "randomly and no longer with any logical basis in sound tax administration." She believes that the AMT impacts the "wrong" taxpayers. We agree with Ms. Olson in this regard. The record keeping requirements for two sets of records is burdensome and unfair. Tax simplification can be achieved by an immediate repeal of this tax.

RECOMMENDATION:

The tax code should be amended to repeal the individual AMT. It will reduce the complexities associated with the calculations and allow all taxpayers to have their tax calculated fairly and on the same playing field.

Congress is well aware that the alternative minimum tax is affecting a much larger portion of the population than it was originally intended to.

If a total repeal is not possible because of revenue considerations, the law could be amended to exclude taxpayers with adjusted gross income below a certain threshold from having to calculate any potential AMT liability. Each and every "preference item" should be reviewed to determine whether or not the item really belongs as part of the AMT calculation. All miscellaneous deductions should be deductible for AMT purposes as well. The tax rate brackets and exemption amounts for the AMT should be indexed in the same manner as the regular tax.

COMMENTS:

The National Taxpayer Advocate has recommended repeal of the AMT in her annual report to Congress every year since 2001. In addition, former President Bush's select committee on tax reform also advocated for repeal of the AMT. The rules for AMT are unnecessarily complex and result in affecting taxpayers not originally intended when the AMT was first enacted. Rather than a provision to prevent high-income taxpayers from avoiding tax through tax planning, the AMT has become a tax on the middle class burdening certain parts of the country greater than others. Repeal, adjustment or reorganization is desperately needed to restore equitable taxation to the middle class taxpayer.

TAX PREPARATION AND REPRESENTATION FEES

HISTORY:

The Internal Revenue Code and associated regulations, rulings, etc. have become extremely complex in recent years. A 2006 GAO report stated that over 80% of income tax returns filed with the SBSE division of the IRS were prepared by paid preparers, a greater portion of which were not regulated by Circular 230 (non CPA, Attorney, Enrolled Agent and Enrolled Actuary). Additionally, the National Taxpayer Advocate has reported that IRS studies have shown that a significant number of unlicensed preparers do not report all of their earnings and prepare less compliant returns. Since current law allows a deduction for preparer fees only as a miscellaneous itemized deduction subject to a floor of 2% of Adjusted Gross Income (AGI), most taxpayers do not benefit from this deduction and do not insist on reporting them on their tax return. Additionally, since miscellaneous itemized deductions are not allowed for Alternative minimum tax, taxpayers may lose the deduction totally.

On January 4, 2010, Douglas Shulman, Commissioner of the Internal Revenue Service issued the *Tax Preparer Regulation Proposal*, which requires all individuals who sign a federal income tax return as a paid preparer to register and obtain a preparer tax identification number (PTIN). In addition, paid preparers who are not CPAs, attorneys, or Enrolled Agents or supervised by a CAP, attorney or Enrolled Agent are required to pass a minimum competency test and complete continuing education requirements to maintain their registration.

On January 6, 2010, the Taxpayer Advocate released her Annual Report to Congress. While she complimented the IRS on the regulation proposal, it was pointed out that the regulation did not address the individual who prepares a tax return but fails to sign the return.

PROBLEM:

The Internal Revenue Service has implemented the PTIN program effective January 1, 2011. While legitimate paid tax return preparers have registered and received a new or refreshed an existing PTIN, there is still the problem of the underground economy where people provide services for cash, and then do not report the income. There are many tax return preparers who do not sign tax returns, nor do they report the income generated by the provided service.

RECOMMENDATION:

The deduction for tax preparation and representation fees should be deductible on Page 1 of Form 1040 as an adjustment to AGI, with the requirement that the preparers' ID number (SSN, EIN, PTIN) be listed in order to allow the deduction. This will generate a direct reduction to AGI and taxpayers will not lose the tax benefit due to the above-mentioned limitations. **NcCPAP** believes that more taxpayers would insist on deducting the fees if they were certain that there would be a tax benefit. Furthermore, unlicensed tax preparers would be more likely to sign returns and report the fee income. As alimony payments are currently a Page 1 adjustment with the requirement of the recipient's Social Security Number for cross-referencing purposes, such a mechanism is

TAX PREPARATION AND REPRESENTATION FEES (Page 2)

already in place. It is our belief that the IRS should collect enough currently unreported revenue from non-reporting preparers to mitigate the potential loss of tax revenue lost by allowing these fees on Page 1 of Form 1040.

By implementing the NCCPAP proposal, the IRS will have a mechanism to track paid preparers as to signing and reporting the income from tax preparation work. By requiring the ID number of the preparer and placing the deductibility of the preparation fees on Page 1 of Form 1040, the taxpayer will be more aware of the deduction and demand that the required information be provided. Additionally, the preparers will now be more aware of the requirement to sign the return and will be subject to the Tax Preparation Regulation Proposal for registration, competency, and continuing education, thereby improving tax compliance.

UPDATE:

The PTIN program is up and running, but it will take time to be fully implemented with regard to the CPE and testing requirements. The CPE requirement has been delayed until 2012 for initial implementation, and those who will have to submit to the testing have until December 31, 2013 to satisfy that requirement.