

NATIONAL CONFERENCE OF CPA PRACTITIONERS

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Mr. Chairman and members of the Committee, thank you for inviting me to testify today. My name is Stephen Mankowski. I am a Certified Public Accountant, member of the American Institute of CPAs (AICPA) and the National Executive Vice President and National Tax Policy Chair of the National Conference of CPA Practitioners, (**NCCPAP – the countries’ second largest CPA organization**). **NCCPAP** is a professional organization that advocates on issues that affect Certified Public Accountants in public practice and their small business and individual clients located throughout the United States. **NCCPAP** members serve more than one million business and individual clients and are in continual communication with regulatory bodies to keep them apprised of the needs of the local CPA practitioner and its clients. Accompanying me is Ms. Sandra Johnson, National President of **NCCPAP**.

My firm has been preparing tax returns for over 30 years. My firm annually prepares well over 2,000 small business and individual tax returns as well as sales tax, payroll tax returns, highway use tax returns and 1099 informational returns. We are in the trenches with clients discussing their tax, financial and personal issues, and the impact events and proposed tax law changes may have on them. Although our clients are mostly in the Pennsylvania, New Jersey and Delaware area, we serve clients in over 30 states and also provide services to clients in

Canada and Europe. In this respect our practice is the same as many members of **NCCPAP** and other smaller CPA firms throughout the United States.

Tax compliance burden has been defined in the GAO report “SMALL BUSINESSES IRS Considers Taxpayer Burden in Tax Administration, but Needs a Plan to Evaluate the Use of Payment Card Information for Compliance Efforts” as the time and money spent by the taxpayer to meet tax obligations. This includes federal, state and local obligations, but NOT liabilities. The time spent on tax compliance related activities can include working with paid professionals, tax planning, record keeping, filing and submitting tax forms, learning tax laws, and working with the IRS and other jurisdictions on tax related issues. The monetary burdens can include the expenses of accounting and tax professionals, tax and accounting software, payroll services, and legal fees. An objective of the Administration and the IRS has been to minimize these burdens and eliminate unnecessary ones. For purposes of my testimony, I will simply use the term taxpayer burden to refer to tax compliance burden.

My first exposure to taxpayer burden was in November 2012. I was invited to represent **NCCPAP** and participate in an IRS panel with other tax professionals at IRS headquarters to discuss compliance burdens for both individuals and small businesses. As a CPA, I had always viewed my role as one to reduce client burden. I had not viewed my role as a source of taxpayer burden as indicated in the GAO report, which says that CPAs and tax services are part of the monetary burden of business owners. We take many of the above tasks away from the business

owner to allow him/her to focus on running their business. So it is easy to see how this term can be easily mistaken. This new appreciation of what comprises taxpayer burden has allowed me to be an even better resource for my clients.

It seems that every year business owners are more in tune with how specific tax legislations could affect their business. Clients often ask how the Tax Extender legislation will affect their operations and what the Section 179 deduction limit is for the current year. While the answers tend to be similar – if you need a piece of equipment, you should buy it – that answer is not always the right answer for a business owner. Often the tax impact of the Sec. 179 deduction can be a deal-breaker. Equipment costing \$100,000 could have a net cost of \$60,000 with these write-offs. The \$40,000 tax savings is often the deciding factor when making the purchase. While the IRS does not have control over which of the Extenders are passed, it is still a significant factor in assessing taxpayer burden.

Over the last few years, there has been a decided change in how business is conducted. As consumers have been more reluctant to carry cash, customers have forced the hand of many businesses that have historically limited payment options to cash or checks to now accept credit cards. Initially, business owners might have added a surcharge for these transactions, but with savvy consumers, credit cards and the related fees have simply become yet another cost of doing business. And another element of taxpayer burden. These business owners quickly realized that they cannot simply apply one rate for these transactions. Even after researching the processing firms to obtain the best processing rates,

they learn that MasterCard and VISA have different merchant fees when compared to American Express and Discover. If the consumer uses a credit card that includes member programs or “points”, an even higher processing rate may be charged by the merchant bank. In addition, there might also be monthly and compliance fees as well as equipment rental costs. And if that’s not enough, the processing companies do not always deposit funds in the same manner. Most will simply deposit the gross amount of the charge and deduct the processing fees as a separate transaction. Yet many companies will deposit the net amount after deducting the processing fees, which makes the merchant’s record keeping more complicated.

Most business owners have accepted these changes in how to conduct their business and accurately report their income. The IRS questioned the voluntary compliance of reporting all revenue, especially with the surge in online sales through PayPal. Under a 2008 law, the processing companies had to begin reporting credit card receipts to the IRS and the merchant in 2011 and had to add the reporting of the number of monthly transactions for 2012. This data appears on Form 1099-K, Merchant Card and Third Party Network Payments. This form must be issued once a payment processor once a merchant annually has 200 transactions and sales of at least \$20,000.

Initially, the IRS had added rows onto personal returns on Schedule C and Schedule E as well as the business returns to incorporate the revenue information from Form 1099-K. However, prior to the start of the filing season, the IRS

eliminated the requirement to complete these fields because too many issues arose creating much confusion. Specifically, there was confusion on how to treat sales tax, gratuities, cash back and returns on the 1099-K. Those same concerns still exist and are just some of the reasons that the IRS hasn't taken a stronger view on the use of the information on these forms.

The Form 1099-K has been a new source of taxpayer burden for the small business owner. Business owners track revenue by specific categories (i.e. sales, repairs, consulting, rent, etc.). They have not needed to track revenue based on how they are paid. Trying to accurately track revenue in the same way as the 1099-K presents data would result in an accounting nightmare. To further complicate the record keeping, businesses receive a Form 1099-K for each specific payment processor. So, if the business accepts MasterCard/VISA and American Express they would receive a form from MasterCard/VISA and one from AMEX. If they also use PayPal, they would receive a third form. If they changed their payment processing company during the year, additional forms would be received from the new processing company. The overall burden to accurately track revenue by each credit card type can be significant and generate no results that benefit the owner.

Another issue with the Form 1099-K revolved around payments for vendors that would receive a Form 1099MISC. Any payments related to these services would not be included on the Form 1099MISC. This adds a different and unique level of taxpayer burden as this would relate to both the payer and recipient. Just as

businesses are not setup to track revenue by payment source, the payer would have an additional burden to exclude credit card payments from the total payment they are required to report on Form 1099MISC to the recipient.

From the IRS viewpoint, however, this form has helped increase voluntary compliance among small businesses. Many virtual businesses that had previously flown under the radar (part of the underground economy) are now filing income tax returns and paying taxes. In addition, the Form 1099-K has allowed the IRS to establish a database whereby they can obtain a better understanding of the revenue sources of a particular industry. Even though the IRS has not been able to assess taxpayers based solely on these databases, the IRS has been sending letters to taxpayers whom they feel have significantly under reported revenue. Initially, the IRS was accepting reasonable responses to these notices, but with the additional data in their databases, the IRS has a better understanding of the egregious filers, specifically those businesses reporting that 100% of their revenue was from credit card transactions.

To assist tax professionals, the IRS instituted a pilot program for the 2015 filing season called the Payment Mix Comparison Tool (PMCT). **NCCPAP** was invited to participate in the program. This program allows our members to enter selected data from the client's Form 1099-K (Merchant Category Code (MCC), zip code, total transactions and total revenue) along with the total business income into a tool. PMCT accesses the IRS database and compares various ratios for a business with a specific MCC code against the Form 1099-K. The result tells the CPA if the

results are within specifications of the database. A common flaw with the Form 1099-K is that if the payment processor applies an incorrect MCC code for a business, the PMCT results could be beyond the standard deviation which may result in an IRS notice.

The results from the PMCT have been strictly for the benefit of the taxpayer and is for informational purposes only. Currently, the IRS is not capturing data from this tool. The database will continue to improve as the volume of historical data input into the tool increases. The PMCT, unfortunately, did not get the expected usage due to a few practitioner concerns. Specifically, the name of the tool was not the best, many practitioners did not believe that the IRS was not tracking the results and the fact that PMCT did not go live until the beginning of February 2015 after most CPAs have completed their training and had already begun preparing tax returns. In addition, many felt that there should be a better result besides “typical” or “unusual” depending on where in the range their client’s data fell. Hopefully, this program will continue next year and will see more usage by tax professionals. If used properly, PMCT could actually reduce taxpayer burden by addressing issues of credit card revenue while the data is still fresh in the business owner’s mind.

In conclusion, taxpayer burden exists on two primary levels – time and money – to remain in compliance with today’s complicated tax codes. Often, both components are viewed as one, except when contacting the IRS. Staffing and budgetary issues have resulted in longer than expected wait times and reaching

IRS employees that are not able to address the caller's issues and concerns. Compliance with tax codes and dealing with new forms adds to taxpayer burden. New forms, such as Form 1099-K, are a prime example. The results may be of use to the IRS, but does not have any practical use for the business owner. Businesses do not tracked revenue by number of transactions or type of payment. Any attempt at verifying the data on the Form 1099-K would be fruitless, especially in industries, such as restaurants where customers charges often include gratuities and sales tax, neither of which are revenue to the business.

Accepting credit cards has become the norm. Most businesses historically have included all of their sales, regardless of source. With the information on Form 1099-K, the IRS now has a means to ensure that all business, especially virtual ones, are tax compliant with regard to credit card sales. With this form comes additional burdens to the taxpayer including how to reconcile sales to the revenue reported on these forms. The question that the taxpayer needs to answer is how to best run his or her business. If the business owner has systems in place to accurately track all revenue, the burden of reconciling the Form 1099-K data should be minimal. It is extremely important that the IRS has the tools to determine tax compliance and reduce the tax gap.

As various states learned that the IRS was beginning the income matching program, many decided to use this as a tool to understand the sales mix of credit cards vs. cash and checks. Currently these states have also indicated that they have no plans to use this information for audit selection or any purpose other

than the collection of information. However, neither the IRS nor the participating states have assured the tax practitioners or business communities that this information will not be used in the future as a tool for audit selection despite its flaws.

This program has the potential of a disaster. This is a repeat of warnings from **NCCPAP** and others in the tax practitioner community when the Form 1099-K matching program was first proposed. It is well understood that the IRS should use all tools possible to find tax cheats. However, as the GAO has correctly indicated, this is a flawed system with no real ability of matching gross income with Form 1099-K reports. Additionally, the ratio tools now being used are very imperfect as certain assumptions used (such as NAICS codes) will skew the information.

Thank you for the opportunity to present this testimony.