



# Journal of the CPA Practitioner

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## UPDATE...FROM THE NCCPAP PRESIDENT



Ed Caine, CPA

**Since this is being printed in the midst of tax season, President Ed Caine has sent us his photo instead of writing a message.**

## MAY CONFERENCE ON THE HILL

Thursday, May 8, 2014

### CONGRESSIONAL AGENDA

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- IRS Needs Authority to Regulate Tax Return Preparers
- Health Insurance Premiums for S Corporation Shareholders
- Health Insurance Premium Deductibility
- Deductibility of Long-Term Health Care Premiums
- Identity Theft and Tax Refund Fraud
- Identity Theft and Tax Refund Fraud (2)

### IRS AGENDA

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- Identification for the Individual ACA Mandate
- Withholding Table Modification
- Form 8879, E-File Signature Authorization Bank Information
- IRS Should Modify the Compliance Rules for E-Signatures
- Identity Theft and Tax Refund Fraud
- Identity Theft and Tax Refund Fraud (2)
- Natural Disasters Relief
- Modification to Form 1098
- Line for Federal ID (EIN) on Form 1040, Schedule E, Page 1
- Modification to the Rules Regarding 501(c) 4 Organizations
- Refund Processing Issues



*Ed Caine, CPA*  
President

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## NCCPAP Begins to Award Grants to CPA Candidates

The National Conference of CPA Practitioners is awarding a limited number of competitive merit-based \$500 awards to outstanding college students who have completed their undergraduate program in a U.S. accredited college and have sat for the certified public accountant exam.

Applications are on-line at

<http://www.accountingtoday.com/conferences/technology-forum/>

The grant applications are accepted on a rolling basis throughout the year. Annually, all grant applications received by December 15th are awarded the following January. Applications received after December 15th will be reviewed and may be awarded in the following year.

Any questions, please email [execdir@nccpap.org](mailto:execdir@nccpap.org).

## WELCOME! New NCCPAP Members

January 2014 – March 2014

|                                      |                     |
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## Message from the Editor

**T**here is nothing sure in life except death, taxes and change. Boy, are things changing.

We all cut our inventory teeth on LIFO. The International Accounting Standards Board has disallowed the use of LIFO. The FASB has considered following suit.

Can you imagine a life without LIFO? If the FASB does ditch LIFO, the transition has promised to create a tax nightmare. Dov Fischer and Peter Harris have written a very thoughtful article about this potential change.

Labor issues are also undergoing big changes. Many local governments have become very activist in this area. Several states, most recently Connecticut, have raised the minimum wage without waiting for the federal government to do so. The president, by the stroke of his pen, has raised the minimum wage for federal contractors. New York City's sick leave act is now in effect. Most businesses are now required to give employees at least five paid sick days. Payroll guru Hadley Margolis has written about this change for all our members that have clients in NYC.

Fresh from dealing with minimum wage, the president is now attacking overtime issues. He signed a Presidential Memorandum directing Secretary of Labor Tom Perez to update and modernize America's overtime pay system. If and when changes do become law they could have a tremendous impact on how we, and our clients, pay employees. The *Journal of the CPA Practitioner* has someone watching this developing issue very carefully; we'll let you know what you'll need to know to continue practicing and serving your clients.

FinCEN has also been making logistical changes to their required reporting. This was the topic of a hot discussion at a recent Nassau/Suffolk Chapter Tax Season Roundtable. Carol Markman, CPA, a past president of NCCPAP has summarized some of the issues for all the membership in this issue.

By the time you read this issue another milestone in the implementation of the Affordable Care Act will have passed. By March 31, 2014 most Americans will be required to have health insurance or face penalties. Next year's tax season will be lots of fun. Some of us will have to add non-compliance penalties to our clients' tax burdens.

As always, the NCCPAP is here to help you weather any and all changes in the practice of accounting.

Frimette Kass-Shraibman, CPA, Editor

## The Importance of Practice Continuity...

**A**s many of you may already know, on March 13th we lost a dear friend and colleague, Sheldon Kronowitz. Shelly served our organization on both the local and national levels, as a director and committee chair.

Shelly Kronowitz and I had a great deal in common. We each had two wonderful children, one in each flavor, and hit the jackpot on spouses. We both volunteered our time and effort to NCCPAP at the same time. I remember that Shelly was interviewed by the Nominating Committee right before me. Both of us subsequently served as directors of the Nassau/Suffolk Chapter.

In the hours and days following Shelly's passing, there was a tremendous outpouring of both grief and offers of assistance by NCCPAP members and staff, wanting to help in any way they could. While many were surprised by the extent of the outpouring, it would not have surprised Shelly. That is why he volunteered. That is why we volunteered. The smile was Shelly knowing his back was covered. The smile was Shelly knowing he had the admiration, respect, and affection of his colleagues.

While so much has changed in the 35 years since NCCPAP was founded, the principal on which our organization was founded, "practitioners helping practitioners," has always remained.

Shelly's passing is a painful reminder of the importance of planning for continuity of the practices we have all worked so hard to develop. Having had many personal experiences myself, which both threatened and impacted the practice, planning is needed from the day one hangs out the shingle.

With this in mind, we have scheduled a special MAP meeting for April 29th on practice continuity and practice continuity agreements. We are extremely fortunate to have Joel Sinkin, of Transition Advisors, LLC, to give us his practical insights into practice continuity.

Please join Leilani Elias, my new co-chair, and myself, in what promises to be a very special program from one of the premier experts in the country, and to honor our friend and colleague, Sheldon Kronowitz.

Robert N. Brown, C.P.A.  
NCCPAP Executive Vice President &  
MAP Co-Chair, Nassau/Suffolk Chapter

**Join your  
friends and  
colleagues!**



### **NCCPAP ON THE HILL**

**Wednesday, May 7 • Thursday, May 8 • Friday, May 9**

HYATT REGENCY, One Bethesda Metro Center, Bethesda, MD

For hotel reservations, call (888) 421-1442

NCCPAP rate: \$235 single/double

(Hotel block ends April 20, 2014 or until block at capacity)

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## Can Going Green Also Mean More Space?

by *Stephen Mankowski, CPA;*  
*National Secretary & Tax Committee Chair*

**B**efore the start of tax season, I always like to take some time to reflect on how to make operations more efficient. This year was actually a little different. Not only did I think about efficiencies, but also how to become greener. Now, don't get me wrong. I'm not running out and hugging trees during my breaks. I am, however, trying to become a little more environmentally responsible. We have all been recycling for many years now, so that part is a non-factor. From an office standpoint, there are many ways to achieve this task.

While preparing my first return of the season, I saw that my tax software (Drake) had a new button at the top of the page. Drake was now supporting e-signing for selected tax forms. Being the typical CPA, I wasn't exactly looking to spend \$250 for the e-pad when I could quite easily scan the two pages. After doing some research, I saw that the IRS was supporting e-signing, but not the facsimile signatures that you can add through Adobe. Plus, if I was going to scan the pages anyway, I would then have to shred the pages, thus wasting both money AND time.

Then I realized that if I bought the e-pad, I would be reducing the number of pages that I needed to print—saving money on paper AND toner!! Further, I have been “suggesting” to my clients that unless they need a hard copy of the return, why not allow me to send it to them as a pdf file? This would increase my savings on paper and toner, too!!

My last deciding point related to storage. We are required to store the 8879s for three years, then responsibly dispose of them—i.e., shred. These forms take up quite a bit of space, especially when you realize that you still have forms dating back to 2006.

**I realized that if I bought the e-pad, I would be reducing the number of pages that I needed to print—saving money on paper AND toner!! Further, I have been “suggesting” to my clients that unless they need a hard copy of the return, why not allow me to send it to them as a pdf file? This would increase my savings on paper and toner, too!!**

These changes, especially the e-sign pad, have been great additions to my tax preparations. Many clients have commented about the new technology and often mention that they rarely open their returns during the year. I've been impressed by how well it works and how little space the pages take up on my hard drive. And this space is certainly less than the space needed to store the 8879s.

## FinCEN Introduces New Forms

by *Carol Markman, CPA;*  
*Past National President & Chair of the Public  
Relations Committee*

**T**he U.S. Department of the Treasury, Financial Crimes Enforcement Network (FinCEN), has created a new electronic form for reporting ownership of foreign accounts. FinCEN Form 114, which is only available online, replaces Treasury Form 90-22.1.

On September 30, 2013, FinCEN posted on their Internet site a notice announcing FinCEN Form 114, Report of Foreign Bank and Financial Accounts (the current FBAR form). FinCEN Form 114 supersedes TD F 90-22.1 (the FBAR form that was used in prior years) and is only available online through the BSA E-Filing System website. The system allows the filer to enter the calendar year reported, including past years, on the online FinCEN Form 114. It also offers an option to “explain a late filing,” or to select “Other” to enter up to 750 characters within a text box where the filer can provide a further explanation of the late filing or indicate whether the filing is made in conjunction with an IRS compliance program.

**The new FinCEN Form 114a, Record of Authorization to Electronically File FBARs, is not submitted with the filing, but instead is maintained with the FBAR records by the filer and the account owner, and made available to FinCEN or IRS on request.**

FinCEN has posted a notice on their Internet site that introduced a new form to filers who submit FBARs jointly with spouses or who wish to have a third party preparer file their FBARs on their behalf. The new FinCEN Form 114a, Record of Authorization to Electronically File FBARs, is not submitted with the filing, but instead is maintained with the FBAR records by the filer and the account owner, and made available to FinCEN or IRS on request.

FinCEN Notice 2013-1 extended the due date for filing FBARs by certain individuals with signature authority over, but no financial interest in, foreign financial accounts of their employer or a closely related entity, to June 30, 2015.

The link to the Financial Crimes Enforcement Network BSA filing system website is:

<http://bsaefiling.fincen.treas.gov/main.html>

Editor's note: This article is the result of Ms. Markman's presentation at a Tax Season Roundtable at the Nassau/Suffolk Chapter.

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## – CONGRESSIONAL AGENDA –

### **IRS NEEDS THE AUTHORITY TO REGULATE TAX RETURN PREPARERS**

#### *PROBLEM*

The ruling on February 11, 2014 by the U.S. Court of Appeals for the District of Columbia stated that the IRS does not have the authority to regulate tax return preparers practicing before the IRS.

CPAs are governed by their respective states to implement continuing education requirements. The IRS accepts this level of training as fulfilling their requirements to practice. There are also educational requirements for Enrolled Agents. The IRS was looking out for the interest of all taxpayers with regard to tax preparer regulations. In our current filing season, there have been changes including several new forms related to Medicare surtaxes and changes in AMT. In addition, many taxpayers are concerned with how the individual mandates under the Affordable Care Act might affect their returns.

#### *RECOMMENDATION*

The IRS should be granted the authority to regulate all tax preparers. Further, all tax preparers should pass a one-time competency exam and then complete at least 15 hours of education annually with a focus on federal taxation. We urge Congress to enact legislation immediately to allow the IRS to regulate tax preparers.

### **HEALTH INSURANCE PREMIUMS FOR S CORPORATION SHAREHOLDERS**

#### *PROBLEM*

The health insurance premiums paid on behalf of all S Corporation shareholders with more than a 2% interest in the corporation are required to be reported on Form W-2 for that shareholder, with the amount being included on Line 1 – Gross Wages. In the case of many small, closely-held businesses, payroll tax reports and W-2s are usually prepared by an outside service, such as a payroll service, or the accounting firm that is engaged by the corporation's shareholders. Depending on the condition of the books and records, this information may not be readily available to the outside party at the time they are preparing the W-2 forms. In addition, this amount for health insurance is then deducted on Page 1 as an adjustment from Gross Income to Adjusted Gross income (Line 29 on the 2009 Form 1040) on the individual's tax return. This can be a burden on the preparer of the W-2 Forms as they will need to determine the amount of the health insurance premiums paid that needs to be allocated to the shareholders.

#### *RECOMMENDATION*

As stated above, the amount for health insurance premiums is taken in full as a Page 1 adjustment on Form 1040. Since it is taken in full, there is no reason for it to be incorporated with the shareholder's gross wages, as it will also be deducted on the same form. We recommend that health insurance premiums no longer be required to be incorporated in the shareholder's W-2

for this purpose since there is no tax impact to the current procedure and it is burdensome.

**We recommend that health insurance premiums no longer be required to be incorporated in the shareholder's W-2 ... since there is no tax impact to the current procedure and it is burdensome.**

### **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.

## **DEDUCTIBILITY OF LONG-TERM HEALTH CARE PREMIUMS**

### *BACKGROUND*

Long-Term Care Insurance (LTCI) helps a taxpayer protect his/her assets and maintain their financial security should long-term care be needed later in life. While no one likes to think about the escalating costs of nursing homes and other elder care expenses, planning can provide taxpayers peace of mind now and in the future.

### *PROBLEM*

A taxpayer has three limitations with regard to the deductibility of LTCI. First, it is based on the age of the covered individual (i.e., the taxpayer, his/her spouse or a dependent). The deduction for 2011 ranges from a low of \$340 per year for an individual under 40 years old, to a high of \$4,240 for an individual age 71 and over. Secondly, this deduction is currently added to all other deductible medical expenses, the total of which is limited to the amount in excess of 10% of the taxpayer's adjusted gross income. The third limitation is whether the taxpayer has the ability to take itemized deductions, as opposed to the standard deduction. Therefore, the total expenditure for the LTCI premiums faces three limitations before a tax savings is realized. This does not encourage taxpayers to purchase long-term care for themselves.

### *RECOMMENDATION*

NCCPAP's proposal is to allow a full deduction for all expenditures for LTCI premiums as an above-the-line deduction, similar to the self-employed health insurance deduction. We believe that this will be revenue neutral immediately and a revenue enhancer for the U.S. Government for the long term.

This change would give individuals the incentive to purchase this important insurance. While this would reduce the taxable income for some, it will, on the other side, increase the income of others. As more individuals purchase long-term care insurance, those who are involved in the selling of these policies, including insurance companies, agents and financial advisors, will see an increase in their income. This would result in an increase in payroll taxes and business as well as personal income taxes. Those selling these policies may find themselves in a higher tax bracket and this would, currently, increase the monies received by the Internal Revenue Service. Corporate income and commission income would increase, resulting in a possible increase in both corporate and personal income taxes. This would not only benefit the Federal Government, but State Governments as well. Our proposal would also strengthen the Medicare/Medicaid systems as more people take advantage of having LTCI. It would be less of a financial strain to the Federal Government's aid to the individual states, as the costs would shift over to the private sector.

Insurance companies have been dropping Long-Term Care policy sales due to cost and consumer interest. Jobs have been lost as well. We believe that this will reverse this trend and bring in even more jobs and tax dollars as sales and income to that industry increase.

The assistance of a current tax savings would eliminate the need for some long-term planning and avoid some Government participation in long-term health costs in the future. It avoids the transfer of assets amongst family members, solely to qualify the ailing individual for some type of government assistance. It will allow for future cost reduction for Medicare and Medicaid assistance. We believe it is revenue neutral now. In the long run, the amount of tax dollars saved will far exceed the short-term loss, if any, and will actually be a substantial savings to the Government over the next several years as the baby boomers reach an age where assisted care and/or living facilities become necessary for the individuals.

## **IDENTITY THEFT AND TAX REFUND FRAUD**

### *PROBLEM*

As the shift continues toward e-filing of all tax returns for individuals, the growth of identity theft in the area of tax returns and tax refunds continues at an alarming rate.

### *BACKGROUND*

According to the Javelin Strategy & Research 2011 Survey Report, the number of adult victims of identity fraud decreased from 10.1 million in 2003 to 9.3 million in 2005 and 8.4 million in 2007. The total one-year fraud amount decreased from \$55.7 billion in 2006 to \$49.3 billion in 2007. There are numerous reasons for these decreases. Much of the change can be attributed to the Identity Theft and Assumption Deterrence Act of 1998. However, identity fraud increased by 13% from 2010 to 2011 when more than 11.6 million adults were victims. Approximately 1.4 million more adults were victimized by identity fraud in 2011, compared to 2010. Much of the increase in identity theft can be attributed to social media and mobile phone behaviors as consumers are still sharing a significant amount of personal information.

**Much of the increase in identity theft can be attributed to social media and mobile phone behaviors as consumers are still sharing a significant amount of personal information.**

The National Taxpayer Advocate's office has also reported growth in identity theft in relation to tax refund fraud. The Identity Protection Specialized Unit (IPSU), which was created by the IRS in 2008, has seen a continuous increase in the number of cases reported to the IRS since the inception of the unit. In Fiscal Year 2009, IPSU had a total of 80,637 cases. In Fiscal Year 2010, this increased to 184,839 cases, and in Fiscal Year 2011, 226,356 cases. This is an increase of over 280% in just two years

During the week of January 23, 2012 the Internal Revenue

*{continued on page 8}*

Service and the Justice Department engaged in a massive national sweep to crack down on suspected identity theft perpetrators as part of a stepped-up effort against refund fraud and identity theft. Working with the Justice Department's Tax Division and local U.S. Attorneys' offices, the nationwide effort targeted 105 people in 23 states. The coast-to-coast effort included indictments, arrests and the execution of search warrants involving the potential theft of thousands of identities and taxpayer refunds. In all, 939 criminal charges were included in the 69 indictments and information related to identity theft. In addition, IRS auditors and investigators conducted extensive compliance visits to money service businesses in nine locations across the country. Approximately 150 site visits occurred to help ensure these check-cashing facilities were not facilitating refund fraud and identity theft. This national effort was part of a comprehensive identity theft strategy the IRS has embarked on that is focused on preventing, detecting and resolving identity theft cases as soon as possible. In addition to the law-enforcement crackdown, the IRS has stepped up its internal reviews to spot false tax returns before tax refunds are issued as well as working to help victims of the identity theft refund schemes. To help taxpayers, the IRS created a new, special section on its website ([www.irs.gov](http://www.irs.gov)) dedicated to identity theft matters, including YouTube videos, tips for taxpayers and a special guide to assistance. The information includes how to contact the IRS Identity Protection Specialized Unit and tips to protect against "phishing" schemes that can lead to identity theft. The IRS recommended that a taxpayer who believes he/she is at risk of identity theft due to lost or stolen personal information should contact the IRS immediately so the agency can take action to secure their tax account. The taxpayer should contact the IRS Identity Protection Specialized Unit. The taxpayer will then be asked to complete the IRS Identity Theft Affidavit, and "follow the instructions on the back of the form based on their situation."

The Internal Revenue Service has, for many years, recognized the serious issue of identity theft and has instituted measures to combat identity theft and continues to do so. However, many of the IRS "fixes" can be cumbersome and time consuming. Beginning in 2008 the IRS implemented Service-wide identity theft indicators which are placed on a taxpayer's account if the taxpayer claimed they were a victim of identity theft. But these indicators are implemented only

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after the taxpayer contacts the Service with certain required substantiation documentation. The IRS can then issue an "Identity Protection PIN" which allows the legitimate taxpayer's return to bypass the identity theft filters. In mid-November 2011 selected taxpayers received an IP PIN Notice

letter notifying them that they would be receiving an IP PIN for use when filing their 2011 return. In mid-December 2011 these taxpayers received a second letter with their IP PIN which was a single-use 6 digit PIN. Some of these letters caused confusion when returns were filed partly because the program was so new. Some letters were lost which caused problems with filing returns. Some taxpayers forgot to tell their preparers that they received a letter with an IP PIN. Since this was a limited program the negative impact was very limited. Obviously, better communication could result in better outcomes.

In its final report issued on May 3, 2012 the Treasury Inspector General for Tax Administration (TIGTA) indicated that The Federal Trade Commission reported that identity theft was the number one complaint in calendar year 2011, and government documents/benefits fraud was the most common form of reported identity theft. As of December 31, 2011, the IRS's Incident Tracking Statistics Report showed that 641,052 taxpayers were affected by identity theft in calendar year 2011 versus 270,518 in 2010—a 137% increase. The TIGTA report concluded that the IRS is not effectively providing assistance to victims of identity theft, and current processes are not adequate to communicate identity theft procedures to taxpayers, resulting in increased burden for victims of identity theft. TIGTA found that identity theft cases are not worked in a timely manner, and some cases can take more than a year to resolve. Sometimes communications between the IRS and identity theft victims is limited and confusing, and some victims are asked multiple times to substantiate their identity.

TIGTA recommended that the IRS: 1) establish accountability for the Identity Theft Program; 2) implement a process to ensure that IRS notices and correspondence are not sent to the address listed on the identity thief's tax return; 3) conduct an analysis of the letters sent to taxpayers regarding identity theft; 4) ensure taxpayers are notified when the IRS has received their identifying documents; 5) create a specialized unit in the Accounts Management function to exclusively work identity theft cases; 6) ensure all quality review systems used by IRS functions and offices working identity theft cases are revised to select a representative sample of identity theft cases; 7) revise procedures for the Correspondence Imaging System screening process; and 8) ensure programming is adjusted so that identity theft issues can be tracked and analyzed for trends and patterns.

The Government Accountability Office (GAO) indicated, in a report issued on June 8, 2012 that the quality of customer service at the IRS has declined noticeably because of budget cuts over the past year and may get worse as the agency is tasked with additional implementation work related to the health care overhaul. The IRS was hit with a 2.5 percent budget cut in fiscal year 2012, with cuts mainly to Enforcement and Operations Support. The cuts took the form of the elimination of 3.1 percent of its full-time employees through attrition, a hiring freeze, and targeted buyouts of more than 900 workers. GAO said data from the Congressional Budget Office justification for the IRS's budget fiscal year 2013 budget request shows that the percentage of phone calls that reach IRS customer service representatives is expected to have fallen to 61 percent in fiscal year 2012, down from 70.1 percent in fiscal year 2011.



While all of this action on the part of the government and the Internal Revenue Service, there is more that can be done.

#### RECOMMENDATIONS

1. Effective immediately, there should be no further issuance of income tax refunds by check. All refunds should be issued via direct deposit. This is part of a “going green” initiative; the IRS can claim that by ceasing to issue income tax refunds by check will save on the cost of printing and mailing.
2. The direct deposit is to go into an account at a bank or other recognized financial institution that is in the name(s) of the taxpayer(s).

This is in order to ensure that income tax refunds are going to the taxpayer claiming the refund. At a recent hearing (June 28, 2012) held by the House Judiciary Subcommittee on Crime, Terrorism and Homeland Security, a witness testified that they went to a tax preparation office for a consultation on the preparation of their income tax return. They then went to another location to have their tax return prepared, only to discover when that office attempted to submit the prepared and completed tax return electronically, that it was rejected due to the fact that the first location had prepared a tax return without their permission and had the fraudulently calculated refund deposited into an account controlled by that office. In addition, this would prevent businesses that offer refund anticipation loans to modify an approved tax return to create a refund greater than is actually due to the taxpayer, thereby defrauding the government.

3. Since the IRS transmits direct deposits funds via ACH, there are only certain fields that are verified. Specifically, the financial institution ensures that the account number on the transmission is an active account. We recommend that additional fields be included to ensure that the refund is being applied to the correct account. This would include name and the last 4 digits of the account holder’s social security number, which was verified when the account was opened.
4. It will become the responsibility of the financial institutions to verify that the individual(s) opening an account for the purpose, among others, of receiving an income tax refund is actually the individual(s) opening the account. If it is determined that a refund has been issued due to fraud, the financial institution will return the funds immediately to the Internal Revenue Service. If the account has been closed, or there are insufficient funds to make full restitution, it will become the responsibility of the financial institution to recover the funds from the individual(s) or other financial institution where the funds were sent.

When identity theft began (and it has been going on for years), those committing identity theft were taking out credit cards and other financial instruments in the names of others, running up huge balances/liabilities, and leaving the individual whose name they were using to deal with lenders. Identity theft can prevent an individual from getting a legitimate loan, purchasing items such as a vehicle or a residence due to the fact that they have a poor credit rating not of their doing. Now these individuals have gone to the next step—fraudulent income tax refunds. By defrauding the

government, they force the government to spend additional time and funds in order to recover the monies taken fraudulently. In addition, if the refunds deposited into an account are then transferred to another location, it has to be questioned for what are those illegally-obtained funds being used for. This then becomes a homeland security issue. The simple act of verification of an individual’s identity by the financial institution where they wish to open an account could help federal and state governments in deterrence.

#### IDENTITY THEFT AND TAX REFUND FRAUD (2)

##### PROBLEM

The growth of identity theft, especially in the area of tax returns and tax refunds continues at an alarming rate. As Congress debates the issue and potential solutions to the issue, NCCPAP has addressed the problem and possible solutions. Despite a concerted effort by the IRS, many of their notices still contain full social security numbers. In addition, most tax forms (W2, 1099DIV, 1099R, etc.) also contain full social security numbers.

##### RECOMMENDATIONS

5. Full social security numbers should be redacted (displaying only the last four digits of a taxpayer’s identification number) from all documents and correspondence letters that are mailed to taxpayers by the Internal Revenue Service.
6. Full social security numbers should be redacted (displaying only the last four digits of a taxpayer’s identification number) from documents (such as Form 1099R, 1099 DIV and 1099 INT) which are mailed to taxpayers by institutions such as banks and investment services.
7. Social security numbers should be completely masked on copies of tax returns that are provided to clients. This should include copies of income tax returns which are submitted to taxpayers for e-file authorization.

The Internal Revenue Service should immediately establish an IRS Form 14039 (Identity Theft Affidavit) fax line for victims of identity theft. This would speed up the notification process and would also provide an additional level of security compared with the present system of mailing documentation to the IRS. Additionally, the Service should establish some form of positive acknowledgement be sent to the individual within 48 hours to provide an additional level of assurance that the problem is being addressed.

**It will become the responsibility of the financial institutions to verify that the individual(s) opening an account for the purpose, among others, of receiving an income tax refund, is actually the individual(s) opening the account.**

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## – IRS AGENDA –

### **IDENTIFICATION FOR THE INDIVIDUAL ACA MANDATE**

#### *BACKGROUND*

As of January 1, 2014, the individual mandate under the Affordable Care Act came to being. Code DD on Form W2 has been required to include employer paid benefits for large employers starting in 2012, but most employers do not include payments by their employees.

#### *PROBLEM*

In preparing 2014 tax returns, there is currently no definitive means to determine compliance with the individual mandate under ACA. In addition, there is not a requirement for employers to identify the employee contributions regardless of pre- or post-tax. An identification of the nature of the payments would also benefit the IRS in determining if the costs included on Schedule A for health insurance premiums are accurate.

In addition, with the recent delay in the implementation of the employer mandate, there will be more individuals paying for health insurance. There should be a means to track the employee payments

**NCCPAP recommends that the IRS create two new Box 12 codes for employee health insurance premiums one for pre-tax payments and the other for post-tax payments.**

#### *RECOMMENDATION*

The IRS should require employers to identify employee payments for health insurance on the W2 as well as addressing whether the payments were pre- or post-tax. NCCPAP recommends that the IRS create two new Box 12 codes for employee health insurance premiums one for pre-tax payments and the other for post-tax payments.

### **WITHHOLDING TABLE MODIFICATION**

#### *PROBLEM*

The IRS withholding tax tables often do not provide enough withholding to insure either a no balance due or a refund for a taxpayer. This is especially true when married taxpayers, who earn similar amounts, may now be required to pay additional taxes under the 2010 Affordable Health Care Act.

#### *BACKGROUND*

Many tax preparers have experienced this while preparing personal income tax returns for higher income taxpayers who owe money with their tax filing. This has been true despite the taxpayer's efforts to withhold the correct amounts using Form W-4 and choosing what should be the correct withholding status. The under-withholding problem has become increas-

ingly prevalent with the addition of the high income and investment income tax surcharges under the Affordable Health Care Act of 2010. This will, most definitely, result in tax underpayments and potential penalties for many taxpayers.

#### *RECOMMENDATION*

Tax tables must be revised to more accurately reflect current tax rates for higher income taxpayers

### **FORM 8879, E-FILE SIGNATURE AUTHORIZATION BANK INFORMATION**

#### *PROBLEM*

The bank account information is currently listed on page 2 of Form 1040 near the signature page. However, with more taxpayers e-filing, which is being encouraged by the Internal Revenue Service, they no longer look at the signature page of Form 1040 but do look at and sign the Form 8879.

Although the tax return preparers include the bank information on tax organizers they provide to clients, or in their instruction letters, many times the client will forget that they are using a particular bank account for their taxes. Sometimes a month or two may go by between the time that the client confirms the bank account information and the time that the tax return is ready for submission. During this period of time, clients may switch banks or just close the account. Many tax return preparers verbally confirm the banking information when the client signs Form 8879, but the information should be on the form and not just confirmed verbally.

#### *RECOMMENDATION*

Place the bank account information on Form 8879, IRS e-file Signature Authorization. For purposes of protection from identity theft, only the last 4 digits really need to be placed on the form. Currently, there are many states that include banking information on their respective authorization forms.

### **IRS SHOULD MODIFY THE COMPLIANCE RULES FOR E-SIGNATURES**

#### *BACKGROUND*

Electronic Signatures became effective in the United States on October 1, 2000, when Congress passed the Electronic Signatures in Global and National Commerce Act ("E-Sign"). E-Sign was enacted to ensure that any agreement signed electronically would not be denied legal force, effect, validity or enforceability solely because an E-Signature was used. This resulted in the use for both personal and commercial transactions being granted the same legal status as a written signature (i.e., they now have the same legal standing as a hand-written signature).

#### *PROBLEM*

Many accounting firms have been using E-Signatures for many years to obtain client signatures on many documents, including engagement letters. The use of this technology allows firms to

have better control over the flow and receipt of documents from their clients. In addition, it also provides a secure storage and eliminates excess paper.

On March 11, 2014, the IRS revised their rules for electronically signing a tax return to allow the use of electronic signature pads for signing Forms 8878 and 8879. Although this is a step in the right direction, it is inefficient in its application. Specifically, the ERO has the e-pad in their office, thus requiring the taxpayers to go to their office to sign the forms. This is not possible for most CPA tax preparers as many of our clients are not local and clients receive their copy of their tax returns and e-file authorization forms through the firm's portal or through the mail.

#### *RECOMMENDATION*

The IRS should again revise their rules for electronically signing a tax return to allow the use of industry-tested E-Signature solutions. This would allow taxpayers to easily and securely return the E-File Authorizations to the ERO where it can be stored for the required 3-year period.

### **IDENTITY THEFT AND TAX REFUND FRAUD**

#### *PROBLEM*

As the shift continues toward e-filing of all tax returns for individuals, the growth of identity theft in the area of tax returns and tax refunds continues at an alarming rate.

#### *BACKGROUND*

According to the Javelin Strategy & Research 2011 Survey Report, the number of adult victims of identity fraud decreased from 10.1 million in 2003 to 9.3 million in 2005 and 8.4 million in 2007. The total one year fraud amount decreased from \$55.7 billion in 2006 to \$49.3 billion in 2007. There are numerous reasons for these decreases. Much of the change can be attributed to the Identity Theft and Assumption Deterrence Act of 1998. However, identity fraud increased by 13% in from 2010 to 2011 when more than 11.6 million adults were victims. Approximately 1.4 million more adults were victimized by identity fraud in 2011, compared to 2010. Much of the increase in identity theft can be attributed to social media and mobile phone behaviors as consumers are still sharing a significant amount of personal information.

The National Taxpayer Advocate's office has also reported growth in identity theft in relation to tax refund fraud. The Identity Protection Specialized Unit (IPSU) which was created by the IRS in 2008 has seen a continuous increase in the number of cases reported to the IRS since the inception of the unit. In Fiscal Year 2009, IPSU had a total of 80,637 cases. In Fiscal Year 2010, this increased to 184,839 cases, and in Fiscal Year 2011, 226,356 cases. This is an increase of over 280% in just two years.

During the week of January 23, 2012 the Internal Revenue Service and the Justice Department engaged in a massive national sweep to crack down on suspected identity theft perpetrators as part of a stepped-up effort against refund fraud and identity theft. Working with the Justice Department's Tax Division and local U.S. Attorneys' offices, the nationwide

effort targeted 105 people in 23 states. The coast-to-coast effort included indictments, arrests and the execution of search warrants involving the potential theft of thousands of identities and taxpayer refunds. In all, 939 criminal charges were included in the 69 indictments and information related to identity theft. In addition, IRS auditors and investigators conducted extensive compliance visits to money service businesses in nine locations across the country. Approximately 150 site visits occurred to help ensure these check-cashing facilities were not facilitating refund fraud and identity theft. This national effort was part of a comprehensive identity theft strategy the IRS has embarked on that is focused on preventing, detecting and resolving identity theft cases as soon as possible. In addition to the law-enforcement crackdown, the IRS has stepped up its internal reviews to spot false tax returns before tax refunds are issued as well as working to help victims of the identity theft refund schemes. To help taxpayers, the IRS created a new, special section on the IRS website ([www.irs.gov](http://www.irs.gov)) dedicated to identity theft matters, including YouTube videos, tips for taxpayers and a special guide to assistance. The information includes how to contact the IRS Identity Protection Specialized Unit and tips to protect against "phishing" schemes that can lead to identity theft. The IRS recommended that a taxpayer who believes he/she is at risk of identity theft due to lost or stolen personal information should contact the IRS immediately so the agency can take action to secure their tax account. The taxpayer should contact the IRS Identity Protection Specialized Unit. The taxpayer will then be asked to complete the IRS Identity Theft Affidavit, and "follow the instructions on the back of the form based on their situation."

The Internal Revenue Service has, for many years, recognized the serious issue of identity theft and has instituted measures to combat identity theft and continues to do so. However, many of the IRS "fixes" can be cumbersome and time consuming. Beginning in 2008 the IRS implemented Service-wide identity theft indicators which are placed on a taxpayer's account if the taxpayer claimed they were a victim of identity theft. But these indicators are implemented only after the taxpayer contacts the Service with certain required substantiation documentation. The IRS can then issue an "Identity Protection PIN" which allows the legitimate taxpayer's return to bypass the identity theft filters. In mid-November 2011 selected taxpayers received an IP PIN Notice letter notifying them that they would be receiving an IP PIN for use when filing their 2011 return. In mid-December 2011 these taxpayers received a second letter with their IP PIN which was a single-use 6 digit PIN. Some of these letters caused confusion when returns were filed partly because the program was so new. Some letters were lost which caused problems with filing returns. Some taxpayers forgot to tell their preparers that they received a letter with an IP PIN. Since this was a limited program the negative impact was very limited. Obviously, better communication could result in better outcomes.

In its final report issued on May 3, 2012 The Treasury Inspector General for Tax Administration (TIGTA) indicated that The Federal Trade Commission reported that identity theft was the number one complaint in calendar year 2011, and

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government documents/benefits fraud was the most common form of reported identity theft. As of December 31, 2011, the IRS's Incident Tracking Statistics Report showed that 641,052 taxpayers were affected by identity theft in calendar year 2011 versus 270,518 in 2010—a 137% increase. The TIGTA report concluded that the IRS is not effectively providing assistance to victims of identity theft, and current processes are not adequate to communicate identity theft procedures to taxpayers, resulting in increased burden for victims of identity theft. TIGTA found that Identity theft cases are not worked in a timely manner and some cases can take more than a year to resolve. Sometimes communications between the IRS and identity theft victims is limited and confusing, and some victims are asked multiple times to substantiate their identity.

TIGTA recommended that the IRS: 1) establish accountability for the Identity Theft Program; 2) implement a process to ensure that IRS notices and correspondence are not sent to the address listed on the identity thief's tax return; 3) conduct an analysis of the letters sent to taxpayers regarding identity theft; 4) ensure taxpayers are notified when the IRS has received their identifying documents; 5) create a specialized unit in the Accounts Management function to exclusively work identity theft cases; 6) ensure all quality review systems used by IRS functions and offices working identity theft cases are revised to select a representative sample of identity theft cases; 7) revise procedures for the Correspondence Imaging System screening process; and 8) ensure programming is adjusted so that identity theft issues can be tracked and analyzed for trends and patterns.

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While all of this action has been taken by the government and the Internal Revenue Service, more can be done.

#### RECOMMENDATIONS

1. Effective immediately, there should be no further issuance of income tax refunds by check. All refunds should be issued via direct deposit. This is part of a "going green" initiative; the IRS can claim that ceasing to issue income tax refunds by check will save on the cost of printing and mailing.

Currently, it is estimated by the federal government that there are approximately 10 million individuals in the United States who can be classified as "unbanked"; that is to say, these individuals do not have an account opened or active at

a bank or any other financial institution, and it would not be fair to these individuals to require them to do so in order to receive their income tax refund. However, the Social Security Administration makes payments totaling in the billions of dollars in the way of retirement, disability, and death benefits, and they REQUIRE that the payments be made electronically.

2. The direct deposit is to go into an account at a bank or other recognized financial institution that is in the name(s) of the taxpayer(s).

This is in order to ensure that income tax refunds are going to the taxpayer claiming the refund. At a recent hearing (June 28, 2012) held by the House Judiciary Subcommittee on Crime, Terrorism and Homeland Security, a witness testified that they went to a tax preparation office for a consultation on the preparation of their income tax return. They then went to another location to have their tax return prepared, only to discover when that office attempted to submit the prepared and completed tax return electronically, it was rejected due to the fact that the first location had prepared a tax return without their permission and had the fraudulently calculated refund deposited into an account controlled by that office. In addition, this would prevent businesses that offer refund anticipation loans to modify an approved tax return to create a refund greater than is actually due to the taxpayer, thereby defrauding the government.

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When identity theft began (and it has been going on for years), those committing identity theft were taking out credit cards and other financial instruments in the names of others, running up huge balances/liabilities, and leaving the individual whose name they were using to deal with lenders. Identity theft can prevent an individual from getting a legitimate loan, purchasing items such as a vehicle or a residence due to the fact that they have a poor credit rating

not of their doing. Now these individuals have gone to the next step—fraudulent income tax refunds. By defrauding the government, they force the government to spend additional time and funds in order to recover the monies taken fraudulently. In addition, if the refunds deposited into an account are then transferred to another location, it has to be questioned, for what are those illegally-obtained funds being used for. This then becomes a homeland security issue. The simple act of verification of an individual's identity by the financial institution where they wish to open an account could help federal and state governments in deterrence.

## **IDENTITY THEFT AND TAX REFUND FRAUD (2)**

### *PROBLEM*

The growth of identity theft, especially in the area of tax returns and tax refunds, continues at an alarming rate. As Congress debates the issue and potential solutions, NCCPAP has addressed the problem and possible solutions. Despite a concerted effort by the IRS, many of their notices still contain full social security numbers. In addition, most tax forms (W2, 1099DIV, 1099R, etc.) also contain full social security numbers.

### *RECOMMENDATIONS*

5. Full social security numbers should be redacted (displaying only the last four digits of a taxpayer's identification number) from all documents and correspondence letters which are mailed to taxpayers by the Internal Revenue Service.
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7. Social security numbers should be completely masked on copies of tax returns which are provided to clients. This should include copies of income tax returns which are submitted to taxpayers for e-file authorization.

The Internal Revenue Service should immediately establish an IRS Form 14039 (Identity Theft Affidavit) fax line for victims of identity theft. This would speed up the notification process and would also provide an additional level of security compared with the present system of mailing documentation to the IRS. Additionally, the Service should establish some form of positive acknowledgement be sent to the individual within 48 hours to provide an additional level of assurance that the problem is being addressed

## **NATURAL DISASTERS RELIEF**

### *PROBLEM*

Federal tax law provides relief to victims of natural disasters, but taxpayers generally have to wait until the government works its way through a lengthy process for each specific event. There is a need for permanent disaster relief legislation that will be triggered automatically.

### *BACKGROUND*

We are all too familiar with the devastating consequences of disasters, such as hurricanes and severe storms, fires, floods, landslides, and mudslides. There is a need to include permanent tax provisions in the Internal Revenue Code that will quickly aid affected taxpayers who are recovering from the impacts of future natural disasters. The number of natural disasters and the cost of these disasters is escalating. The federal government is already very aware of the impact of these events and has mounted numerous efforts to assist U.S. residents in their time of need. However, the process is lengthy at a time when relief is needed quickly. NCCPAP (and other organizations) have made recommendations related to the changes that would assist taxpayers affected by disasters. NCCPAP has advocated that the recommendations enumerated below become effective automatically and immediately when a federal disaster is declared.

### *RECOMMENDATIONS*

1. Waive the tax law limits of 10 percent of adjusted gross income (AGI) and the \$100-per-casualty floor.
2. Allow a five-year carryback period for net operating losses attributable to a disaster.
3. Increase the Section 179 limit in either the year of the disaster event or the following year by the lesser of a specified amount (\$100,000) or the cost of "qualified property."
4. Allow a five-year replacement period (increased from two) for property damaged or destroyed by a disaster event.
5. Impose no tax on victims of a disaster event who withdraw up to a specified amount (\$100,000) from a qualified plan or IRA and repay that amount within five years.
6. Allow a tax credit of 40 percent of qualified wages of up to \$6,000 in qualified wages per employee for specified disaster-damaged businesses.
7. Allow affected taxpayers in the disaster area to prepare and file their individual or entity income tax returns up to three years after the filing due date without penalty or interest charges.

## **MODIFICATION TO FORM 1098**

### *PROBLEM*

Some residences are owned by more than one individual, who may not be filing a joint tax return. Since the Form 1098 only has one box for a Social Security number of the primary individual on the loan documentation appears on the form. If the taxpayer(s) are filing a joint tax return, this is not a problem. However, should the taxpayer(s) not be filing a joint return, even though they are married, this can present a problem because there is no official reporting of the expense to the Internal Revenue Service for the deduction claimed by one of the property owners. The information needed by IRS matching programs to avoid the IRS sending notices to the taxpayer whose SSN is not on the Form 1098, disallowing the deductions being claimed resulting in burden on the taxpayer and costs to the IRS in resolving the issue.

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**RECOMMENDATION**

Form 1098 should be modified to allow more than one social security number to appear, thereby allowing the taxpayer(s), should they need or wish to, allocate the deduction for interest on their respective tax returns.

**LINE FOR FEDERAL ID (EIN)  
ON FORM 1040, SCHEDULE E, PAGE 1**

**PROBLEM**

When a taxpayer starts a business or purchases rental property, he/she may apply for a Federal Employer Identification Number (EIN). Many of these situations involve the creation of a Limited Liability Company (LLC). A single member LLC (SMLLC) is a disregarded entity for income tax purposes and the information regarding income and expenses is reported on the appropriate schedule of Form 1040. A business operating as a SMLLC is reported on Form 1040 Schedule C, Profit or Loss from Business (Sole Proprietorship). If the entity is involved in renting real estate, then the income or loss is reported on Schedule E, Supplemental Income and Loss (from Rental Real Estate, Royalties, Partnerships, S Corps, Estates, Trusts, REMICS, etc.). In situations involving real estate, when the taxpayer has obtained an EIN for the real estate entity, they may receive a Form 1098 for interest paid on a mortgage, with the EIN of the real estate entity. There is no place on Schedule E, Page 1, to indicate this EIN. Therefore, the taxpayer may receive a notice from the IRS indicating the reporting of an interest deduction, which does not match their Social Security Number (SSN).

Under the Patriot Act, when the taxpayer forms an LLC for liability protection, banks require an EIN that corresponds to that specific LLC in order to open a bank account.

**RECOMMENDATION**

A line for a federal identification number should be incorporated on Form 1040 Schedule E, Page 1 to avoid any confusion in the future, and provide the ability to match up federal identification numbers with the appropriate tax return to save time and expense to the IRS and the taxpayer.

**MODIFICATION TO THE RULES  
REGARDING 501(C)(4) ORGANIZATIONS**

**BACKGROUND**

During 2013, the IRS came under a great deal of criticism in the way they were dealing with applications by organizations for tax-exempt status under IRC Section 501(c)(4). The organizers of these would-be non-profit groups claimed that they were being singled out because of certain aspects of their organization, such as certain words being part of the organization name. Congress held multiple hearings regarding this matter, calling on both representatives of the IRS to defend their actions, and on non-profit organizers who in their testimony stated their complaints that the IRS was making unreasonable requests for additional information, and delaying the granting of the tax-exempt status.

**PROBLEM**

IRC Section 501(c)(4) deals with “tax-exempt social welfare” organizations. The problem lies in the definition of “what is social welfare?” These two words together can become vague and ambiguous. What is Social Welfare? There can be many interpretations of what it can mean. Social welfare can be interpreted operating a food bank; a shelter for the homeless; a shelter for those who are victims of domestic abuse. In more recent years, however, it seems to have become a means of attempting to influence elections on the federal, state and local levels. One of the requirements of being a tax-exempt organization is that the organization does not get involved in the political process. Yet is being seen that many organizations formed under Section 501(c)(4) are doing so. These organizations are not required to list who their donors are, therefore the public does not know who is actually backing their involvement, which is to the political ends of the donors.

The IRS has made recommendations to change the rules under which a tax-exempt organization can operate under Section 501(c)(4). Among these changes are restrictions on involvement in candidate-related political activity. According to the proposed changes, candidate-related political activity is to be restricted starting 30 days before a primary election, and 60 days prior to a general election. In reading the proposal, we see that it specifically mentions advocating for candidates, but not against their opposition. When a negative advertisement is run, saying “do not vote for Candidate A” because they support a certain issue, it is in fact saying “vote for Candidate B” because they are running on a platform in opposition to that issue. A negative ad against one candidate is in essence a positive ad for their opposition.

**RECOMMENDATION**

It is our opinion that when the final rules are issued, that this loophole be closed to state that such promotions cannot be done both for and against candidates. If the proposed changes are accepted, they should be modified to specifically state that both advertisements for candidates AND against the opposition are not allowed.

**REFUND PROCESSING ISSUES**

**PROBLEM**

Refunds due to errors or adjustments discovered by the Internal Revenue Service or due to requests from taxpayers are often processed by the Service before letters of explanation are sent. This often generates questions by taxpayers to the Service or to the taxpayer’s tax preparer because the payment is received before the explanation.

**RECOMMENDATION**

Refund notices should always be sent at least three (3) business days before the payment is processed. This will avoid many questions about the refund. Additionally, since many taxpayers will not cash or deposit IRS refund checks without being absolutely certain that they are entitled to the payment, this will not slow the receipt of the refund to the taxpayers.

# LIFO Survives, For Now

by *Dov Fischer, Brooklyn College (CUNY)*  
and *Peter Harris, New York Institute of Technology*

“Reports of my death have been greatly exaggerated.”

— Mark Twain

## ABSTRACT

Until very recently, the Last-in-First-out Method (LIFO) was under severe scrutiny from the financial community, and its repeal as an acceptable accounting method seemed imminent. However, an SEC Report issued in July 2012 has renewed the lifeline of LIFO indefinitely. In the unlikely case of its ultimate repeal, the authors present tax opportunities in a transition period.

## INTRODUCTION

The LIFO method has been an acceptable, popular accounting method since its inception in 1939. Since that time, however, many have argued against LIFO as a viable, economic accounting method. Until recently, LIFO faced a possibility of its elimination by the year 2015, as political forces coming from the International Accounting Standards Board (IASB), the financial-analyst community, the U.S. Congress, and the U.S. Administration strongly opposed this method. International Financial Reporting Standards (IFRS) prohibit LIFO as an acceptable accounting method, and the Obama administration proposed in its 2010 budget to repeal LIFO as an allowable tax method (Office of Management and Budget, 2009, 122). In fact, many U.S. companies voluntarily gave up LIFO in the past decade. The percentage of large public companies using LIFO declined from 48% to 36% from 2001 to 2012 (Kieso et al., 2013, 414).

Then, in July 2012 the U.S. Securities & Exchange Commission (SEC) issued its final report exploring a possible roadmap to adoption of IFRS by U.S. issuers of financial statements (SEC, 2012). The report was surprisingly negative in its assessment of IFRS as a viable set of standards relative to existing U.S. GAAP. With the push to IFRS off the table, LIFO has received a new lease on life.

The rest of this article reviews the tax advantages of LIFO as well as its limitations in faithful representation of inventory on the balance sheet. We then examine the current state of LIFO, followed by an investigation of its possible future. We conclude by previewing tax planning opportunities in the unlikely event of LIFOs ultimate repeal.

## Tax Advantages

The tax advantages associated with LIFO have been documented by tax laws, research literature, and Congress. Since its inception in 1939, the Internal Revenue Code has allowed for the LIFO method of inventory (IRC 1939; Section 472). To obtain ongoing tax benefits from LIFO, two elements must be satisfied: first, increasing inventory prices (inflation); second, a continuous buildup or increase in physical inventory, known as LIFO reserves or layers. LIFO-use in an inflationary environment will result in the expensing of currently purchased inven-

tory, resulting in the lowest possible income total as compared to other methods such as First-in-First-out (FIFO), weighted average or specific identification. The greater the inflation environment, the more pronounced the tax benefit. This was observed in the early- to mid-1970s, a period during which the U.S. experienced double-digit inflation. During that time period, more than 400 U.S. public companies elected to change their inventory method to LIFO.

Academic research confirms the anecdotal evidence that LIFO-use is motivated primarily by tax considerations. White et al. (2003) find that LIFO represents the rational inventory choice, considering the greater cash flows resulting from LIFO's tax advantages. Dopuch and Pincus (1988) confirm that companies that choose LIFO do so primarily for tax reasons.

## CRITICISM OF LIFO

Criticism of LIFO goes back to its earliest days when it was known as the “base stock” method (Lesard, 1987; Davis, 1982; Romeo, 2008). The criticisms of LIFO center on the following points:

- One criticism is that LIFO results in an unfair tax loophole for a few beneficial industries. According to *Bloomberg Business Week* the total LIFO Reserve for the S&P 500 was \$62 billion. This figure, multiplied by the tax rate, represents the cumulative tax benefit for companies using LIFO. According to the study by Bloomberg Government, “Energy companies alone account for more than 82 percent of these reserves, and make up eight of the top 10 companies with the largest LIFO reserve.” ExxonMobil alone amounted to a \$21.3 billion of the \$62 billion in LIFO reserves. Assuming a tax rate of 35%, this represents a cumulative tax subsidy of approximately \$8 billion for the oil giant.
- Another criticism of LIFO is that it leads managers to make inventory and sales choices for reasons other than maximizing cash flows. A business with a large LIFO reserve must take care not to liquidate its inventory, or it would be hit with a large tax charge representing the accumulated LIFO tax savings. Consider a situation where a business has a merchandise sales opportunity that it could meet from its existing inventory. If it were using FIFO, the business would rationally pursue the sale. Under LIFO it might forego the sale if it cannot quickly obtain replacement inventory to avoid the LIFO liquidation. This compulsion to maintain inventory can lead to sub-optimal decision-making from a macro- and micro-economic perspective. This is why efficient just-in-time inventory methods do not match well with LIFO.
- A third criticism of LIFO is that it requires the maintenance of two sets of books. For companies using LIFO, GAAP requires the disclosure of both FIFO and LIFO inventory, which increases the cost of record keeping.

{continued on page 16}

- A fourth criticism of LIFO is that it hinders the comparability of financial information across companies when some use FIFO and others use LIFO.

### RECENT THREATS TO LIFO

From 2006 to early 2012, LIFO faced a perfect storm of pressures from the U.S. Congress and Administration on the one hand and from the SEC and IFRS on the other hand.

#### Tax Pressures From Congress and the Administration

In 2007, Rep. Charles Rangel (Democrat, NY) introduced a bill to eliminate LIFO (AccountingWeb.com 2007). In arguing against LIFO, Rangel asserted that only 15% of publicly-traded companies use LIFO, purportedly for its tax benefits. He estimated that the tax rate for all firms could be lowered to 30.5% if LIFO were eliminated, and that the elimination would bring in \$100 billion in revenue over ten years. This estimate seems wildly inflated, and other estimates range from a low of \$35 billion (assuming an economy-wide LIFO-reserve of \$100 billion) to \$80 billion.

#### IFRS -Convergence Pressures from the SEC

For the period 2006 to early 2012 LIFO was facing a real threat of elimination as the SEC seriously explored a roadmap for the adoption of IFRS for U.S. issuers. On November 15, 2007, the SEC for the first time allowed domestically-listed foreign firms to file IFRS financial statements without reconciliation to U.S. GAAP. This move seemed to set the ball rolling for ultimate convergence between IFRS and U.S. GAAP.

#### IFRS CONVERGENCE LOSES STEAM

IFRS seemed to be gaining momentum. By early 2011, more than 100 countries have adopted IFRS or a variation of thereof, including our neighbor country Canada. IFRS penetrated the college curriculum of U.S. universities as the major testing agencies began to incorporate IFRS in their exams. The Uniform CPA exam includes IFRS questions, and the Certified Financial Analyst (CFA) examination now highlights IFRS and deemphasizes GAAP (CFA Institute, 2014). U.S. business schools now routinely offer International Accounting courses to meet the accreditation guidelines of the Association to Advance Collegiate Schools of Business (AACSB), and textbook publishers have followed suit with offerings such as Doupnik and Perera (2011).

So what happened to stop the IFRS juggernaut? Our theory is that the financial crisis, which hit European banks even harder than American banks, revealed that IFRS's purported superiority in measuring fair values was not superior to U.S. GAAP. Furthermore, the financial crisis brought to light differences within countries in their so-called adoption of IFRS. We attribute these two factors as an explanation for the SEC's decision in July 2012 to reject IFRS as a viable accounting system.

One of the SEC's major concerns was a lack of comparability across firms using IFRS. The SEC also cited significant gaps in IFRS standards for such issues as contingency losses. Additionally, the SEC also identified several accounting issues

in which GAAP and IFRS are so far removed as to make gradual convergence unlikely. In addition to these questions on the substance of IFRS, the SEC also questioned whether the IASB would be able to provide adequate funding needs to ensure the continued development of IFRS.

These anti-IFRS developments have put LIFO-repeal on the back burner. As a result, the political pressures against LIFO have eased significantly and the likelihood of its eventual repeal is now minimal.

#### TAX STRATEGY IN THE EVENT OF RENEWED THREAT TO LIFO

There are four possibilities of LIFO going forward, and illustrated as follows:

| <b>LIFO Remains an option for</b> |                              |              |
|-----------------------------------|------------------------------|--------------|
| Case                              | Financial-Reporting Purposes | Tax Purposes |
| 1                                 | Yes                          | Yes          |
| 2                                 | No                           | Yes          |
| 3                                 | Yes                          | No           |
| 4                                 | No                           | No           |

Case 1 is the status quo in which LIFO remains an option for both financial and tax reporting. Case 4 describes an extreme scenario in which LIFO is disallowed for both financial and tax reporting, and this option has been relegated to a remote possibility. Cases 2 and 3 describe scenarios under which LIFO is disallowed for either financial reporting or tax reporting. We predict that for tax reporting, LIFO will not be raised again as a political issue until after the 2016 election. Considering that GAAP/IFRS convergence has been shelved by the SEC for now, the status quo (case 1) will remain in effect into the foreseeable future.

Having said that, what are some possible tax strategies to keep on the back burner in the event LIFO is eliminated for tax purposes? We present some tax planning opportunities available to taxpayers to help ease such a hypothetical transition:

- **Extended Payment Adjustment Period:** Under current tax rules, if a taxpayer changes its accounting period from LIFO to another acceptable method, and it results in a higher inventory value, the difference in additional tax is payable over a period of four years. Under the Obama Administration's 2010 Budget Proposal, the difference would have been spread to taxable income and payable over eight years. We expect that if LIFO were eventually eliminated as a tax method, the IRS would offer an eight-year transition period.
- **Inventory Management:** By gradually reducing the level of inventory, taxpayers can effectively reduce the tax consequences of using FIFO rather than LIFO. Lower inventory levels, besides offering protection against an unlikely repeal of LIFO, also offer operational advantages in the form of lower inventory carrying costs.

#### CONCLUSION

The probability of the elimination of LIFO as an acceptable accounting method is very unlikely any time in the foreseeable future. This paper addressed the present and future outlook of



LIFO. In the authors' opinion, LIFO will continue as is for the indefinite future due to the July 2012 SEC report rejecting IFRS. We predict that LIFO will not be addressed again until after the 2016 election at the earliest. IFRS and GAAP will continue to have differences in areas such as LIFO. Although it currently appears as unlikely, the SEC and FASB may at some point resume their interest in convergence. In the event of LIFO's eventual repeal, the authors recommend a strategy to help ease the burden of this change.

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*Peter Harris, CPA CFA, is Professor and Chair of the Accounting and Finance department at the New York Institute of Technology. Previously, he had worked for Ernst and Young LLP. He is an author of over 70 refereed journal articles and 175 intellectual contributions. He has presented and continues to present seminars to nationally and global audiences on topics relating to financial reporting and taxation. He is a member of several professional organizations. He can be reached at [pharris@nyit.edu](mailto:pharris@nyit.edu).*

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## Overview of the NYC Earned Sick Time Act

by Hadley Margolis

### Effective Day and Accrual

Effective April 1, 2014 all employers of five or more employees or an employer of one domestic worker must provide paid sick time. All other employers must provide unpaid sick leave of up to forty hours. Part time workers are also covered. Business size will be determined by counting all workers in a business.

Workers will earn one hour of sick time for every thirty hours worked, up to forty hours of sick time a calendar year. An employee will be entitled to begin using sick time on the 120th day of employment or on July 31, 2014, whichever is later.

### Eligible Use of Sick Leave

Under the Act, sick time may be used for an employee's own health needs or to care for a family member (child, spouse, partner, parent, sibling, grandchild or grandparent, or the child or parent of an employee's spouse or partner).

Sick time may also be applied when there is a public health emergency.

### Type of Paid Leave

Any type of paid leave—paid time off, vacation, personal days, etc. will count for purposes of complying with the law as long as they can be used for sick leave.

### Employee Notice & Documentation

An employer may require reasonable notice of planned use of sick time and may require an employee to provide notice of unforeseeable use of sick time as soon as practicable. A note signed by a licensed health care provider indicating the need for the sick time taken is considered reasonable. An employer may not demand documentation specifying the nature of the employee's injury, illness or condition.

Employers may discipline employees who attempt to use sick time for improper absences.

The Department of Consumer Affairs is charged with enforcing the Act. Employers are required to retain records documenting their compliance with the act for three years. Employers of between six and nineteen employees will have a grace period for violations until October 1st, 2014.

*Hadley Margolis is the Chief Operating Officer at Best Payroll, a full service payroll and human resource solutions company. He can be reached at (347) 729-2355*

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## From ACCOUNTING TODAY: Letters to the Editor

(page 3)

If I had planned to write a promotional article about the National Conference of CPA Practitioners, I could not have penned a better one than your editorial, “Lunching with the enemy” in the January issue of *Accounting Today* (page 3).

Thirty-five years ago, NCCPAP established a process which encouraged and enabled CPAs to work together and talk about opportunities, problems and situations that occur daily in an accounting practice. If a practicing CPA comes upon a circumstance that he or she is somewhat uncertain about, or would like an opinion or help in a matter, a phone call to a colleague can settle the question. The exchange will be honest and forthright, without fear of losing a client to a “competitor.”

Of course, this type of exchange is clearly visible at the NCCPAP meetings. The open exchange of ideas and solutions to practical operational and professional questions is a vital part of every NCCPAP meeting.

The idea of “Practitioners Helping Practitioners” has been one of the many accomplishments of NCCPAP.

Thank you for pointing out so clearly that CPAs can and should be colleagues.

Edwin J. Kliegman, CPA  
Founding partner, Marcum & Kliegman  
(now Marcum LLP)  
Past president, NCCPAP

Editors note:

This is a reprint (with permission) of a letter to the editor of *Accounting Today*

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 The Woodlands, One Southwoods Road, Woodbury  
 (in the Town of Oyster Bay Golf Course)  
 Chapter Meetings: Registration / Dinner / Networking  
 – 5:30 p.m.; Seminar – 7:00 p.m.

*Thursday, May 1, 5:30 – 7 p.m. — Chapter Meeting*

**CRIMINAL TAX LAW AND HOW IT AFFECTS YOU**  
 – 2 CPE credits (TAX)

*Wednesday, May 14, 5:30 p.m.*

**MEMBERSHIP APPRECIATION MEETING –  
 BUY SELL AGREEMENTS** – 2 CPE credits (TAX)  
 New York Life, 576 Broad Hollow Road, Melville

*Thursday, May 22, 8 a.m. – Noon*

**ACCOUNTING & AUDITING** – 4 CPE credits (A & A)  
 New York Life, 576 Broad Hollow Road, Melville

*Wednesday, May 28, 8 – 10 a.m.*

**CLOUD COMPUTING, APPS & SECURITY**  
 – 2 CPE credits (MAP)

*Thursday, June 12, 5:30 – 7 p.m. — Chapter Meeting*

**VOLUNTARY DISCLOSURE; OFFER & COMPROMISE – WHAT  
 YOU NEED TO KNOW ABOUT FBARS** – 2 CPE credits (TAX)

*Thursday, June 19, 8 a.m. – Noon*

**ACCOUNTING & AUDITING** – 4 CPE credits (A & A)  
 New York Life, 576 Broad Hollow Road, Melville

*Tuesday & Wednesday, June 24 & 25*

**2nd ANNUAL LITPS ACCOUNTING TECHNOLOGY FORUM**  
 Crest Hollow Country Club, 8325 Jericho Turnpike, Jericho

*Friday, June 27, 8 a.m. – 10 a.m.*

**TIME MANAGEMENT** – 2 CPE credits (MAP)

**LONG ISLAND EAST, NEW YORK**

Contact: James Diapoules, CPA (631) 547-1040  
 Airport Diner, 3760 Veterans Memorial Hwy, Bohemia

*Tuesday, May 27, 8 a.m. – 10 a.m.*

**BRANDING YOUR PRACTICE** – 2 CPE credits (MAP)

*Tuesday, June 17, 8 a.m. – 10 a.m.*

**SALES TAX UPDATE** – 2 CPE credits (TAX)

**NEW YORK CITY, NEW YORK**

Contact: Anthony Candela, CPA (646) 328-1943  
 All meetings: 100 Park Avenue South (between 40  
 & 41 Streets), Conference Room 8 A, New York, N.Y.  
 5:30 – 6:15 pm, Cocktails & Networking  
 6:20 – 8 pm, Presentation

*Thursday, May 15*

**FBAR UPDATE: WHAT TO KNOW** – 2 CPE credits (TAX)

*Thursday, June 19*

**RETIREMENT PLAN OPTIONS** – 2 CPE credits (TAX)

**WESTCHESTER / ROCKLAND, NEW YORK**

DoubleTree Hotel, 455 South Broadway, Tarrytown

*Thursday, May 1, 6 – 8 p.m. (dinner & cocktails)*

**AFTER THE 15TH — Best “Busy Season” Story  
 Wins the Prize** – 2 CPE credits (TAX)

*Tuesday, May 13, 5:30 – 7:30 p.m.*

**GIFT TAX, LINE BY LINE** – 2 CPE credits (TAX)

*Tuesday, June 10, 5:30 p.m. – 7:30 p.m.*

**TECHNOLOGY & INTERNET SECURITY** – 2 CPE credits (MAP)

**NEW JERSEY**

Contact: Fred Bachmann, CPA (973) 377-2009

E-mail: bachmanncpa@msn.com

Victor's Maywood Inn, 122-124 West Pleasant Ave, Maywood  
 Phone (201) 843-8022; E-mail: www.maywoodinn.com

6 – 8 p.m. – Dinner and Seminar

*May, June:* To be announced.

**CENTRAL NEW JERSEY**

Contact: John Raspante, CPA – (732) 216-7552

The Cabin, 984 Route 33 East, Freehold

6–8 p.m. Dinner and Seminar

*Tuesday, May 13*

**FINANCIAL PLANNING** – 2 CPE credits (TAX)

*Tuesday, June 3*

**SUCCESSION PLANNING** – 2 CPE credits (TAX)

**MASSACHUSETTS**

Contact: Jeffrey Winer, CPA (508) 879-0408

*May, June:* To be announced.

**DELAWARE VALLEY**

Contact: Joseph Lowe, CPA (610) 489-8007

Usual Meeting Location: Peppers Italian Restaurant,  
 239 Town Center Road, King of Prussia, Pennsylvania

*May, June:* To be announced.

**FLORIDA**

Contact: Lynne Marcus, CPA (561) 625-9550

1880 North Congress Avenue, #316, Boynton Beach  
 8:45–10:45 a.m., Registration 8:30 a.m.

*Thursday, May 1*

**ROUNDTABLE DISCUSSION: TAX SEASON WRAP-UP**  
 – 2 CPE credits (Tax)

*Thursday, June 5*

**ESTATE PLANNING AND ELDER CARE LAW**  
 – 2 CPE credits (Tax)



## National Conference of CPA Practitioners, Inc.

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