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UPDATE…FROM THE NCCPAP PRESIDENT

Ed Caine, CPA

Not happy with what you read and see that is going on in our nation's capital? Do you believe that nothing you say will help effect change?

Guess what? That isn't correct.

If you want to effect change in Washington, D.C.…want to have a say on tax issues that are impacting you and your clients…want to meet with top IRS executives and suggest ways to improve issues impacting us during this current tax season, then you have that opportunity this spring.

Join us May 8th through May 10th as we hold our annual spring meeting in Washington, D.C. NCCPAP on the Hill is the quarterly Board meeting you do not want to miss. Attend and have a say on issues impacting you, your fellow CPAs and your clients. And remember that all it takes is one spark: a spark that starts out as a feeble glow, igniting into a flickering flame, becoming a mighty blaze, ever increasing in speed and power. All it takes is you to effect change! And it does work; many people in Washington, D.C. will listen. You have that unique opportunity to be heard! NCCPAP will be there living its tag line, *Practitioners Helping Practitioners*, and taking it one step further, Practitioners helping Clients and the entire community. But to make it succeed we need you! We need your thoughts and ideas on how to effect change. We need you to help fan that feeble glow into a mighty flame.

Can't make it? Please email your ideas to me, **ecaine@cainecpa.com** so I can take your concepts to the appropriate committees to discuss while we are there.

Better yet, looking forward to seeing you May 8th–May 10th in Washington, D.C.!

Ed Caine, CPA
President

> "NCCPAP on the Hill is the quarterly Board meeting you do not want to miss."

What's All the Buzz About MAP?

by Sandra Johnson, CPA; Nassau/Suffolk Chair of MAP and National Membership Chair

Tax seasons come and tax seasons go. Each year you sit through 40 hours of CPE to ensure you are the best CPA you can be. What have you done lately to improve the profitability of your practice? What have you done to work more efficiently? Is the technology in your office state of the art or in a state of disrepair?

NCCPAP's MAP committee (Management of an Accounting Practice) discusses the "soft topics." Recent discussions include billing procedures, improving cash flow, time management, keeping up with technology, IRS security rules and more. Upcoming topics are future planning, using social media to expand your practice and succession planning. If you have not been to a MAP meeting, you owe it to the health and profitability of your practice to try us out.

Part of the mission of NCCPAP is "Practitioners Helping Practitioners." This is the heart of MAP. And our MAP team has taken the show on the road! To date we have presented MAP in Philadelphia, Boston, Tarrytown and recently, South Florida.

"Gearing up for Tax Season" was the MAP topic at the Westchester / Rockland Chapter in January and in the South Florida Chapter in February. Back by popular demand, the Westchester/Rockland chapter has another MAP meeting planned for May 7th, from 8 a.m. – 11 a.m.

If your chapter doesn't have a MAP committee yet, start one. You don't have to be an expert on practice management to chair the committee; you only need a willingness to search for possible solutions.

If you would like help in bringing MAP to your chapter, contact Sandy Johnson at sjohnson@sgjcpa.com.

MAY CONFERENCE ON THE HILL

Thursday, May 9, 2013

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– CONGRESSIONAL AGENDA –

IDENTITY THEFT AND TAX REFUND FRAUD

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.

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, in Fiscal Year 2011, to 226,356 cases; and in Fiscal Year 2012 to nearly 450,000 cases. As of September 30, 2012, the IRS had an inventory of almost 650,000 identity theft cases servicewide.

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) 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 they are 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 six-digit PIN. Some of these letters caused confusion when returns were filed, partly because the program was so new.

> **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.**

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

(continued on page 4)

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 has been taken on the part of the government and the Internal Revenue Service, there is more that can be done.

In addition to all this, tax refund fraud is now being perpetrated not only by the "criminal" element, but by "legitimate" tax return preparers as well. In October, 2012, it was reported that a tax return preparer was sentenced to five years in prison, three years on probation and ordered to pay restitution in excess of $750,000. This individual would go to his clients' homes and prepare their tax returns. If there was a refund due, he would issue them a check for the refund. He would then take the information back to his office, modify the data to create a larger refund, and submit the tax return. The inflated refunds would then be deposited into bank accounts under his own control.

A similar situation also came to light in 2012. At a hearing of the House Judiciary Committees' Subcommittee on Crime, Terrorism and Homeland Security held on June 28, an individual taxpayer related the story that they were referred by relatives to go to a tax preparation office of a company called "Mo Money Taxes" to have his tax return prepared. He met with representatives of the company, but decided to go elsewhere to have his return prepared. When he did that, the return submitted electronically was rejected. Upon investigation, it was discovered that "Mo Money Taxes" had taken the information that this person provided, and prepared an income tax return on their behalf without their knowledge or authorization, and the refund was deposited into an account that the company controlled. It was announced on April 10, 2013 that the Department of Justice was suing the company and requested an injunction to prevent it from serving as a federal tax preparer.

Tax refund fraud is now being perpetrated not only by the "criminal" element, but by "legitimate" tax return preparers as well.

National Taxpayer Advocate Nina Olson was also a panelist at the June 28, 2012 hearing, and her testimony covered the areas of unauthorized filing, altered return information, and misrouted refunds in regard to direct deposit.

One last item that has not yet been discussed is the refund that is issued via the "debit card."

It is suggested that there are at least 10 million people living in the United States who are classified as "unbanked," meaning that they do not have an account of any kind at a bank or other financial institution. For these individuals to get their refund by check would require them to go to a "check-cashing" location in order to have access to their refund. The first issue here is that these locations can charge excessive fees to process the refund checks, leaving the taxpayer with less of their refund. The alternative is to issue the refund via the debit card, which is accepted widely. The first problem is that when issued, debit cards are automatically "live," meaning that they can be used immediately without any requirement to have them activated. With a credit card, for example, the user must make a phone call to a number provided by the institution issuing the credit card to activate the card for use. With the debit card, not only does this add to the problem of tax refund fraud by fraudsters, but these cards, if stolen out of a mailbox, can be used immediately by the thief. Many years, ago, thieves would wait for retirees to receive their checks from Social Security, and attempt to steal the checks from the mailbox or wait for the individual to collect their mail, and steal the check from their person. Today, the Social Security Administration issued virtually all of their monthly payment via direct deposit.

RECOMMENDATIONS

1. 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.
2. 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) that are mailed to taxpayers by institutions such as banks and investment services.
3. 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 that are submitted to taxpayers for e-file authorization.
4. 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 to be sent to the individual within 48 hours to provide an additional level of assurance that the problem is being addressed.
5. An IP PIN should be issued immediately once the Internal Revenue Service determines that a taxpayer was a victim of tax fraud, not when a case has been finally resolved.
6. Tax refunds that are to be issued via "direct deposit" into an account at a bank or other financial institution should only go into an account that is under the direct control of the taxpayer(s), and not any other individual or organization. This would restrict the use of Federal Form 8888, "Allocation of Refund" to only such accounts as previously mentioned.
7. We acknowledge that there is a serious problem with debit cards being used for the issuance of tax refunds. We encourage there to be further discussion by the IRS on this issue, and that they speak with outside organizations to come to a meaningful resolution.

Effective tax administration is the key, the focal point of all of these issues. We encourage the Internal Revenue Service and the United State Congress to have a meaningful dialogue on these matters. As an organization whose members are dealing with these and other related issues on a daily basis, NCCPAP welcomes the opportunity to be a part of any such discussions and to provide practical background, knowledge, and recommendations for possible solutions.

> **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 and…by institutions such as banks and investment services.**

TAX SIMPLIFICATION

PROBLEM

There are many interrelated components to tax administration that must be managed by the Internal Revenue Service. These include information processing, enforcement and providing taxpayer knowledge and assistance. As currently structured, the federal income tax code contains many different pieces that need to interact under each tax provision. As an example, there are four or five different provisions allowing tax deductions or credits to help offset the cost of higher education. Several of these credits are available to many individual taxpayers, but choosing the individual credit may have different resulting net credits to different individual taxpayers. Instead, this issue could be structured as one deduction with different phase outs or limitations to get to the same results. Other examples are contained in the body of this discussion.

BACKGROUND

Congress puts forth a great effort in "scoring" potential new tax regulations to insure revenue neutrality. An additional focus is also placed on tax simplification. Growing numbers of taxpayers have voiced concerns and consternation that the tax laws are too complex. Presently, for many taxpayers, it is impossible to fully understand the law and properly prepare their own tax return. The Senate Finance Committee has acknowledged this in its March 23 report "Simplifying The Tax System For Families And Businesses." Congress cannot always properly gauge the effect any new tax law will have, because of the interaction of various other components of the tax law. As an example, when Congress passed the Affordable Health Care Act of 2010 they provided for tax credits for small business taxpayers that offered their employees medical insurance. However, when the law was implemented very few small businesses qualified for the tax credits. This was because of the three different phase outs required before the credit would be allowed. Simplification of many provisions of the tax code is warranted. In her report to Congress, the National Taxpayer Advocate indicated that the tax code imposes a "significant, even unconscionable burden on taxpayers." The report noted that, since 2001, Congress has made nearly 5,000 changes to the tax code. It can also be inferred that the increased complexity of the tax code has caused many less-informed taxpayers to use unscrupulous tax preparers who have contributed greatly to the problems of tax fraud and identity theft.

Further examples of tax complexity include (but are not limited to):

Deductions for health insurance premiums are treated differently for C Corporations, S Corporations and partnerships or sole proprietors. There should be no difference in the treatment of the health insurance premiums based just on the type of entity formed.

A home office deduction is allowed for a sole proprietorship against the business income. This same deduction is not allowed for partnerships or corporations. When a client discusses starting a new business they shouldn't first have to determine what type of deductions they will have before they decide what

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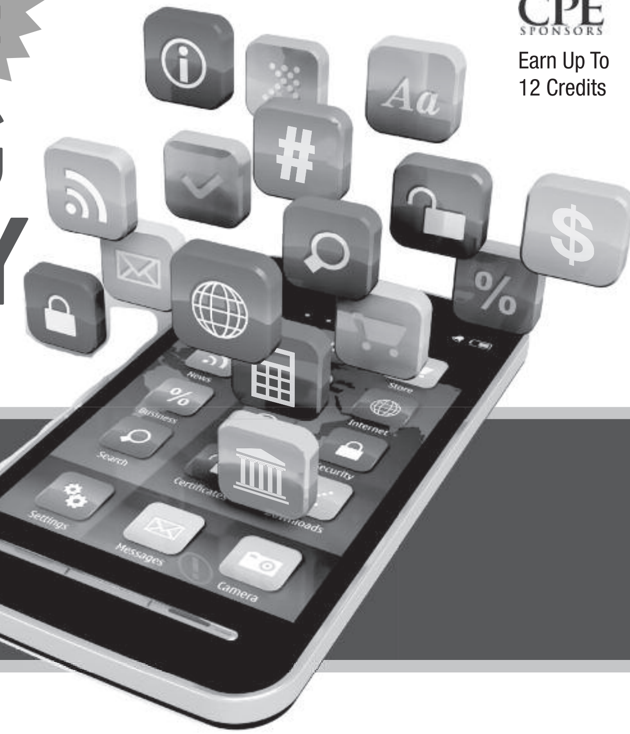

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Congressional Agenda *(continued from page 5)*

type of business entities they will use.

The tax code has multiple definitions of dependents used by different tax provisions. This could be reduced down to one definition of dependent and if needed it could be defined with different levels, i.e. immediate family is a level one dependent, immediate family and other decedents would be level two dependent and so on.

RECOMMENDATION

There are many provisions of the tax code that could be simplified without having any major tax effects. We need to define provisions in the tax code in a consistent manor. There are many provisions of the tax code that could be adjusted to add simplification to the tax law. As has been reported in many different studies, tax simplification would help increase compliance and increase tax revenue. NCCPAP members have extensive experience preparing tax returns and understanding the tax code, and we are willing to help with suggestions on simplifying the current tax code.

TAX SEASON COMPRESSION

PROBLEM

Tax return preparers have an obligation to employ due diligence to insure that all tax returns are submitted with correct information and reported on the proper schedules. Those obligations, and the difficulty preparers often experience in obtaining required client information (either directly from the client or from third party reporting sources), has increased the burden to submit correct tax forms on a timely basis.

BACKGROUND

NCCPAP has previously made recommendations focused on easing the "Tax Season Compression," a burden many practitioners experience. The requirements to process most income tax returns within a relatively short period of time, coupled with the obligation to e-file these returns, has made the filing season very difficult for CPAs and other tax preparation professionals. This problem was also recognized by the AICPA, which also recommended modification of some tax return due dates. Their recommendations to help address the problem were incorporated into H.R.2382 and S.845. The issue of "Tax Season Compression" was compounded this year by late issuance of forms. Still, even without this issue, a serious problem exists in the tax preparation arena.

Since "corrected" brokerage statements can be printed and mailed to the taxpayer by March , these documents are not received by the tax preparer until the last few days of March or first few days of April. Many diligent preparers have opted to hold returns until they are sure that all correct documentation is received. This has already caused backlogs in the processing ability of the IRS and this problem, if left unchecked, will only get worse.

Partnerships are required to submit Form 1065 and provide the corresponding Form K-1 to the individual partner(s) by March 15. The partner must timely forward the form to the individual's income tax preparer and the tax preparer must complete that individual's personal income tax return within a very short time to enable the authorization for e-filing to be received by the due date. The same issue is even more problematic when considering the time line for S Corporations, which (under the proposed legislation) would be filed two weeks later. Effectively, a shareholder of an S Corporation would automatically have to annually request an extension of time to file the individual income tax return every year.

NCCPAP members have extensive experience preparing tax returns and understanding the tax code, and we are willing to help with suggestions on simplifying the current tax code.

RECOMMENDATION

We have come to the conclusion that this issue is not a budget issue but a real "Tax Season Compression" issue for tax preparers that severely impacts the small practitioner and the operations of the IRS. No proposed changes should impact the Federal Budget, but the current status will. NCCPAP recommends an open and honest discussion with all invested parties to resolve this issue.

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. Firstly, it is based on the age of the covered individual (i.e., the taxpayer, their 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 7.5% 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. In addition, under the Patient Protection and Affordable Care Act, the medical deduction will be subject to a 10% of adjusted gross income starting in 2014. 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

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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.

> **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.

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.

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.

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.

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.

S CORPORATION INCOME SUBJECT TO SOCIAL SECURITY TAX

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

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

UNINCORPORATED BUSINESSES: PARTNERSHIPS AND SCHEDULE C

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

INCORPORATED BUSINESSES

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

THE ISSUE

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

HISTORY

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

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

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

REASONABLE COMPENSATION

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

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

Some taxpayers may seek to pay unreasonably low salaries to themselves and artificially increase the net income in order to reduce their liability for FICA taxes. The IRS has the right to reclassify a distribution of profits as salary if it determines that compensation is not reasonable. However, the term "reasonable compensation" is a very subjective term. What may be reason-

(continued on page 11)

Congressional Agenda (continued from page 9)

able in one part of the country might be considered to be excessive in another. Also, one entity might show greater gross revenue than another in the same field of business, and therefore provide a greater compensation. The IRS has determined that reasonable compensation is to be determined by "facts and circumstances" within each individual case.

PROBLEMS

There are several problems with the current situation. First, there are S Corporations that have more than one shareholder. In some of these cases, some of the shareholders may not be active participants in the business of the corporation. According to the Treasury Inspector for Tax Administration, a difficulty that the IRS has encountered in the examination of officer compensation is the determination of the level of shareholder services rendered to the corporation (TIGTA 202-30-125).

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

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

NCCPAP POSITION

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

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

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

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

– IRS AGENDA –

IRS WITHHOLDING TABLES MODIFICATIONS

PROBLEM

The IRS withholding tax tables often do not provide enough withholding to insure either a no balance due or a refund to 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 prepared 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 increasingly 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.

WITHHOLDING PENALTY ISSUES

PROBLEM

Taxpayers will be subject to potential penalties for under-withholding.

BACKGROUND

The Affordable Health Care Act of 2010 added additional taxes for upper income taxpayers. These taxes cannot be paid through correct withholding in many cases because withholding tables are not correct. The withholding tax tables do not consider the additional tax based on higher income resulting from both married spouses being employed. The issue is further compounded when the taxpayers earn investment income.

RECOMMENDATION

Penalties should not be assessed on taxpayers for underpayments caused by the increase in tax resulting from the additional tax related to the Affordable Health Care Act of 2010. The service has already noted that there will be relief in the current year. But the Service should provide assurance that this relief will not be withdrawn in the current or subsequent year.

TAX ID NUMBERS ON TAXPAYER DOCUMENTS FROM THE IRS

PROBLEM

Individual taxpayer identification numbers appear on documents that are mailed to taxpayers. This greatly increases chances of identity theft and tax fraud.

BACKGROUND

Despite the concerns of many, including numerous recommendations from NCCPAP, numerous documents are sent through the mail containing taxpayer identification numbers. This includes all correspondence from the Service to taxpayers. Theft of this information, along with name and address information, can easily fall into the wrong hands. Additionally, some documents, such the New York State Income tax return, contain other sensitive information such as birth dates.

RECOMMENDATION

We commend the Service's actions of truncating or redacting individual Social Security numbers on all future computer generated correspondence. We still recommend that similar safety measures be taken for ALL correspondence (including letters) sent by the service from all locations.

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

PROBLEM

When a taxpayer starts a business or purchases rental property, they 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 can be 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 single-member LLC 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.

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 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 the Social Security number of the primary individual, multiple identification numbers do not appear. 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.

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.

TAX SEASON COMPRESSION

PROBLEM

Tax return preparers have an obligation to employ due diligence to insure that all tax returns are submitted with correct information and reported on the proper schedules. Those obligations, and the difficulty preparers often experience in obtaining required client information (either directly from the client or from third party reporting sources), has increased the burden to submit correct tax forms on a timely basis

BACKGROUND

NCCPAP has previously made recommendations that are focused on easing the "Tax Season Compression"; a burden many practitioners experience. The requirements to process most income tax returns within a relatively short period of time, coupled with the obligation to e-file these returns, has made the filing season very difficult for CPAs and other tax preparation professionals. This problem was also recognized by the AICPA, which also recommended modification of some tax return due dates. Their recommendations to help address the problem were incorporated into H.R.2382 and S.845. The issue of "Tax Season Compression" was compounded this year by late issuance of forms. Still, even without this issue a serious problem exists in the tax preparation arena.

Since "corrected" brokerage statements can be printed and mailed to the taxpayer by March 15, these documents are not received by the tax preparer until the last few days of March or first few days of April. Many diligent preparers have opted to hold returns until they are sure that all correct documentation is received. This has already caused backlogs in the processing ability of the IRS and this problem, if left unchecked, will only get worse.

Partnerships are required to submit Form 1065 and provide the corresponding Form K-1 to the individual partner(s) by March 15. The partner must timely forward the form to the individual's income tax preparer and the tax preparer must complete that individual's personal income tax return within a very short time to enable the authorization for e-filing to be received by the due date. The same issue is even more problematic when considering the time line for S Corporations, which (under the proposed legislation) would be filed two weeks later. Effectively, a shareholder of an S Corporation would automatically have to annually request an extension of time to file the individual income tax return every year.

The requirements to process most income tax returns within a relatively short period of time, coupled with the obligation to e-file these returns, has made the filing season very difficult for CPAs and other tax preparation professionals.

RECOMMENDATION

We have come to the conclusion that this issue is not a budget issue but a real "Tax Season Compression" issue for tax preparers which severely impacts the small practitioner and the operations of the IRS. No proposed changes should impact the Federal Budget, but the current status will. NCCPAP recommends an open and honest discussion with all invested parties to resolve this issue.

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, the client 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 four digits really need to be placed on the form. Currently, there are many states that include banking information on their respective authorization forms.

Eminent Domain:

The Basics Every CPA Should Know to Effectively Help Their Clients

by Toby Birnbaum, Esq.

One cannot help but notice the debate surrounding the recent plethora of cases involving the use of eminent domain by the government to seize property from private landowners. Eminent domain is the power of the federal, state or local government agencies or quasi-government agencies (such as airport authorities, highway commissions, community development agencies, and utility companies) to seize property for public use in exchange for payment of just compensation to the property owner. Searles, Sidney Z. 1995. "The Law of Eminent Domain in the U.S.A." American Law Institute-American Bar Association C975 (January). The government may exercise its power of eminent domain even if the property owner does not wish to sell the property.

This article is intended to assist CPAs to gain a better understanding of various accounting and tax issues their client may encounter when they come face to face with a government agency that wants their property and will not take no for an answer. (This does not constitute legal advice and should not be relied upon for that purpose.)

The Governmental Action and Proceedings

The formal process or proceeding initiated by a government agency to take property through eminent domain is generally referred to as a condemnation proceeding or eminent domain taking or action. A condemnation proceeding will only be used by the government agency after all attempts to reach a mutually satisfactory agreement through negotiations have failed.

Eminent domain laws and condemnation proceedings are challenging and complex. Should your client's property become the subject of an eminent domain or condemnation action, you should strongly recommend that your client seek the advice of a qualified attorney with experience in this highly specialized area. Eminent domain is a specialty that is beyond the expertise of many real estate and land use attorneys.

Although it is within your client's rights to challenge the government's attempts to seize his/her property, it is rare for a property owner to prevail in a condemnation proceeding and halt the appropriation of the property. Nevertheless, qualified legal counsel will help protect your client's best interests and ensure that he/she receives the maximum compensation for the property and any losses he/she incurs.

As your client's CPA you may be asked to provide important accounting and tax advice. Your primary focus should be to help protect your client's pecuniary interests. It is important to remember that your client may be experiencing feelings of uncertainty, confusion and fear. Your support and guidance will be instrumental in helping he or she understand their options and in navigating through this difficult and daunting process.

Eminent Domain: The Role of Tax Revenue on the Evolution of Its Use

Historically, eminent domain had been used to forcibly take private property for the construction of highways, railroads, schools and other large public works. The Fifth Amendment of the U.S. Constitution clearly states that "property can only be appropriated for public use." However, in due course, the definition of "public use" was interpreted broadly by the courts, which amplified the power of eminent domain and generally required only that a public benefit must result from the seizing or that the taking fulfill a public purpose.

In the 1954 landmark eminent domain case of *Berman v. Parker*, the U.S. Supreme Court redefined the definition of public use to grant local governments extensive power to condemn blighted areas in an effort to improve them. This ruling paved the way for urban renewal projects in the 1960s and 1970s, as the definition of public use evolved and gradually expanded to include economic development purposes.

Most notably, in 2005, the U.S. Supreme Court's controversial ruling in the case of *Kelo v. City of New London*, 125 S. Ct. 2655 (2005), gave local, state and the federal governments the authority to condemn private property for development by private, for-profit investors.

Essentially, the Court interpreted eminent domain as applicable to the taking of private property for the benefit of other private investors. The Court reasoned that the redeveloped or improved property's value would increase and consequently generate higher property taxes on the property and thus deliver a public benefit. Under this paradigm, increased tax revenue has become synonymous with economic development and serves in part as a basis for property acquisition.

The Kelo decision led to much debate about property rights and caused a national uproar. Many of our nation's state legislatures responded by passing new eminent domain legislation aimed at halting eminent domain abuses in an effort to prevent acquisitions that would improperly deliver properties to private developers.

The issue of Just Compensation

The Fifth Amendment of the U.S. Constitution provides that private property may not be taken for a public use without payment of just compensation. (*Searl v. School District No. 2 of Lake County*, 133 U.S. 553, 10 S. Ct. 374, 33 L. Ed. 740 [1890]). Just compensation is intended to fully indemnify a property owner for what he or she has lost and has generally been defined as the fair market value of the property. Fair market value is not the value that your client places on the property or the amount that the property is actually worth to the owner.

Fair market value has been defined in Federal Jury instructions as "the amount a willing buyer would have paid a willing seller in an arm-length transaction with both parties being fully informed concerning all the advantages and disadvantages of the property and with neither acting under any compulsion to buy or sell." See 3A Fed. Jury Prac. & Instr154.31 (5th Ed). In other words, fair market value is regarded to be the highest price somebody would pay for the property, were it in the hands of a willing seller. Your client should take note that although fair market value is favored by the courts it is not the exclusive measure of valuation.

At times, fair value may include more than the price of your client's parcel of real estate. If a business is operating from the condemned property, the owner may also be entitled to compensation for the loss or disruption of the business resulting from the seizure. A minority of jurisdictions provides that the owner may also be entitled for compensation for the loss of "goodwill" the value of the business in excess of the fair market value due to such factors as its location, reputation or good customer relations.

If your client does not actually own the property but leases the premises, he/she may be entitled to compensation for the value of the lease, for any fixtures he/she may have installed at the premises and for any loss or decrease of value in the business.

Since the determination of the fair market value of real estate requires an appraisal, the condemning agency will obtain an appraisal of your client's property at the outset. Armed with the appraisal, the government agency will make a reasonable effort to negotiate with your client prior to commencing a condemnation action. Generally, most conflicts with the government in a condemnation proceeding or eminent domain actions concern the valuation of the besieged property. In a condemnation proceeding, the determination of the value of the property and just compensation is typically a very significant issue for the property owner.

Since real estate appraisal is not an exact science, appraisers may differ greatly in their opinions about the value of a particular property. Your client should not be surprised and can readily expect a significantly lower property valuation from the government's appraisal then their own.

If your client disagrees with the value provided in the government's appraisal, he/she client has the right to secure a separate appraisal and challenge the government's value in court. Although you may have an understanding of real estate valuation, given the unique and complex nature of determining value in an eminent domain proceeding, compounded with the difficulty of contesting a government's appraisal, your client should retain a knowledgeable appraiser with expertise in eminent domain takings.

Eminent Domain: Involuntary Conversion and Non-Recognition of Gain under Section 1033

When a local, state or federal government takes your client's property via condemnation under eminent domain, the property is treated as involuntarily converted. Section 1033 of the IRS Procedural Code ("1033 Exchange or Rollover") includes special provisions for property that is forcibly taken by the government via eminent domain and provides two qualifications your client must meet to defer the payment of the depreciation recapture and capital gain taxes on the involuntary conversion.

Specifically, under Section 1033 of the Internal Revenue Code your client may elect to replace the involuntarily converted property with similar or like kind property and defer paying tax on the gain. This allowance is similar to the rules that apply to like-kind exchanges under Section 1031. However, in the case of eminent domain, the property must be replaced within three years after the end of the first taxable year in which any part of the gain is realized [IRC Section 1033]. To the extent that the proceeds your client receives from the forced sale are used to purchase a replacement property, they will not be taxed on the gain.

Moreover, in order to be deemed like-kind under Section 1033, any proceeds received must be reinvested in property that is "similar or related in service or use" to the property lost. Consequently, Section 1033 involves a more stringent "like-kind" standard then the standard set forth in Section 1031.

If your client chooses not to defer the gain, then the usual capital gains rules apply and your client would be required to pay tax on any gain as in normal circumstances. If your client chooses to elect to apply the involuntary conversions rules, they need not include the gain on their return.

When preparing your client's return, you should provide a statement attached to the return demonstrating the particulars of the sale and the resulting gain with a statement that that the rules of Section 1033 (like-kind exchange) apply to the conversion. In the event that your client does not replace the property in the time allowed, the return will need to be amended and your client will have to pay the back taxes and interest.

Conclusion

It is likely that, if the government begins an eminent domain proceeding against your client, the government will succeed. However, because of the complexities of eminent domain, it is important to make sure that you are providing your client with the correct and best advice. Therefore, seek guidance from professionals with experience in this area. Although this may seem like a costly and time-consuming undertaking, it will help your client clearly understand the process and ensure that he/she gets the best results. As the government has experts in this area intent on saving itself the most money, your client should have experts in this area intent on making sure that he/she is properly protected and fully compensated.

Ed. note: For tax transactions practitioners may want to refer to Rev. Proc. 59-60 for the definition of fair market value.

Toby Birnbaum is an Assistant Professor of Business Law at Brooklyn College

COSO's New Internal Control Framework:

Components and Principles

by Dov Fischer, Ph.D., CPA

Abstract

The COSO Framework is the de facto standard for internal controls. Today, businesses of all sizes, nonprofits, and governments must pay increased attention to internal controls. This article describes the revised COSO Framework, specifically the 17 principles that are being added on to the five existing components of internal control listed in the original COSO Framework, which was issued in 1992. Practitioners should familiarize themselves with these 17 principles to better design effective internal controls in conformity with the COSO Framework.

Introduction

This article describes recent changes to the COSO Internal Control Framework. The Framework, which was introduced in 1992, gained prominence in the wake of Sarbanes-Oxley in 2002. The Framework takes an expansive view of internal controls as processes that help an organization meet objectives in operations, reporting, and compliance. An effective internal control system consists of five components: control environment, risk assessment, control activities, information and communication, and monitoring activities. The proposed revisions to COSO's Framework contain 17 principles that relate to the five existing components. This article highlights these 17 new principles.

Importance of COSO: Sarbanes-Oxley

Since the passage of Sarbanes-Oxley by Congress in 2002, the "Committee of Sponsoring Organizations of the Treadway Commission," or COSO for short, has become a familiar term in the financial community. Passed in the wake of internal control breakdowns at Enron and WorldCom, Sarbanes-Oxley (Sections 103 and 404) requires that outside auditors issue an opinion not only on the fairness of the financial statements but also on the effectiveness of internal controls. The Public Company Accounting Oversight Board (PCAOB) that was established by Sarbanes-Oxley to set standards for the auditing profession specifically refers to the COSO Framework as a recognized set of criteria for effective internal controls (Auditing Standard 5).

> **Practitioners should familiarize themselves with the 17 principles being added on to the five existing components of internal control**

COSO is now in the process of updating the Framework for the first time since its original publication in 1992. Interestingly, the genesis of COSO has its roots in corporate scandals in the 1970s that related to bribes paid to foreign governments. In reaction to those bribery scandals, the Foreign Corrupt Practices Act of 1977 required public companies to maintain proper internal controls to prevent corrupt practices. At the same time, the accounting profession became increasingly concerned about fraudulent financial reporting. This led to the formation of COSO, an organization dedicated to thought leadership on internal controls. The sponsoring organizations behind COSO include academic and professional accounting, auditing, and finance associations.

COSO Framework: Reporting, Operations, and Compliance Objectives

Although the auditor's report focuses specifically on internal controls over financial reporting, COSO takes the broader view of internal controls as helping the organization achieve objectives in reporting, operations and compliance. In reality the three areas are different in focus but ultimately interrelated. A company that fails to safeguard its assets is vulnerable to fraud and will likely fail to reach its objectives in all three areas.

COSO Framework: Five Components of Internal Controls

COSO defines internal controls as a process that helps achieve the organization's operational, reporting, and compliance objectives. To achieve these objectives, the company must maintain the following five components of internal control. Each of the five components relate to all three objectives:

- Control Environment: Leaders create the proper organizational environment for internal controls to work effectively.
- Risk Assessment: Before implementing control activities, the organization assesses the areas of greatest risk to the operations, reporting, and compliance objectives.
- Control Activities: This component is the "meat and potatoes" of internal controls and includes the actual activities of an internal control system. Examples include verifications, reconciliations, authorizations, approvals, and physical controls.
- Information & Communication: The organization obtains and generates relevant, quality information about internal controls and effectively communicates that information to appropriate internal and external parties.
- Monitoring: The organization monitors the effectiveness of the five components and effectively addresses deficiencies.

One can view the five components as a sandwich. Accountants and auditors have traditionally concerned themselves with the middle "control activities" component. The first two components represent introductory planning steps that must take place before control activities can be effectively designed and implemented. The last two components represent follow-ups to the control activities.

Reference

Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2012). Internal Control – Integrated Framework, exposure draft, retrieved December 17, 2012 from http://ic.coso.org/download.aspx

Table Listing the Five Components and 17 Principles

The accompanying table lists the five components and their 17 related principles. The wording of the principles is taken directly from COSO (2012), but we have added emphasis on the key words within each principle. COSO uses a color scheme for the five components. The table also highlights key words associated with the components and principles.

The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective actions, including senior management and the board of directors, as appropriate.

Dov Fischer is an Assistant Professor of Accounting at SUNY–Empire State College

Components and Principles in the Proposed Revisions to the COSO Internal Control Framework (2012)

Component (key words)	Principles (key words highlighted)
Control Environment: • Integrity • Ethics • Board of Directors • Independence • Oversight • Authorities • Responsibilities • Competency • Accountability	1. The organization demonstrates a commitment to **integrity** and **ethical** values. 2. The **board of directors** demonstrates **independence** of management and exercises **oversight** of the development and performance of internal control. 3. Management establishes, with board oversight, structures, reporting lines, and appropriate **authorities** and **responsibilities** in the pursuit of objectives. 4. The organization demonstrates a commitment to attract, develop, and retain **competent** individuals in alignment with objectives. 5. The organization holds individuals **accountable** for their internal control responsibilities in the pursuit of objectives.
Risk Assessment: • Specific objectives (*operations, reporting, compliance*) • Identify risk • Analyze risk • Fraud • Assess changes in environment	6. The organization **specifies objectives** with sufficient clarity to enable the identification and assessment of risks relating to objectives. 7. The organization **identifies risks** to the achievement of its objectives across the entity and **analyzes risks** as a basis for determining how the risks should be managed. 8. The organization considers the potential for **fraud** in assessing risks to the achievement of objectives. 9. The organization identifies and assesses **changes** that could significantly impact the system of internal control.
Control Activities: • Relate to risks • General controls over technology • Policies and procedures	10. The organization **selects** and develops **control activities** that mitigate, to acceptable levels, **risks** to the achievement of objectives. 11. The organization selects and develops **general control activities over technology** to support the achievement of objectives. 12. The organization deploys control activities as manifested in **policies** that establish what is expected and in relevant **procedures** to effect the policies.
Information and Communication: *Note: This component should not be confused with the Reporting* objective. *Rather, the component relates to information required to enable internal controls to function properly.*	13. The organization obtains or generates and uses **relevant, quality information** to support the functioning of other components of internal control. 14. The organization **internally communicates information**, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control. 15. The organization **communicates with appropriate external parties** regarding matters affecting the functioning of other components of **internal control**.
Monitoring Activities: • Ongoing evaluations • Separate evaluations • Address deficiencies	16. The organization selects, develops, and performs **ongoing** and/or **separate evaluations** to ascertain whether the components of internal control are present and functioning. 17. The organization evaluates and communicates internal control **deficiencies** in a timely manner to those parties responsible for taking corrective actions, including senior management and the board of directors, as appropriate.

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CHAPTERS' CALENDAR OF EVENTS — MAY – JUNE 2013

NASSAU / SUFFOLK, NEW YORK

Chapter Office (516) 997-9500
The Woodlands, One Southwoods Road, Woodbury
Registration & Buffet Dinner – 5:30 p.m.; Seminar – 7:00 p.m.

Thursday, May 2, Chapter Meeting
PARTNERSHIP ISSUES – 2 CPE credits (TAX)
Woodlands at Woodbury, One Southwoods Road, Woodbury

Tuesday, May 21, 8 a.m. – 10 a.m.
USING LINKEDIN AS PART OF YOUR MARKETING PLAN
– 2 CPE credits (MAP)
Capital One Exec. Dining, 275 Broadhollow Road, Melville

Wednesday, May 29, 8 a.m. – 10 a.m.
WHAT IS THE DIRECTION OF YOUR PRACTICE?
THE FIVE YEAR PLAN – 2 CPE credits (MAP)
On Parade Diner, 7980 Jericho Tpke. Woodbury

Thursday, June 6, Chapter Meeting
TOPIC To be announced – 2 CPE credits (TAX)
Woodlands at Woodbury, One Southwoods Road, Woodbury

Wednesday, June 26, 8 a.m. – 10 a.m.
HOW TO WORK ON YOUR PRACTICE AND NOT IN YOUR PRACTICE – 2 CPE credits (MAP)
On Parade Diner, 7980 Jericho Turnpike, Woodbury

Thursday, June 27, 8 a.m. – 5 p.m.
ALL DAY ACCOUNTING & AUDITING UPDATE
– 8 CPE credits (A & A)
Woodlands at Woodbury, One Southwoods Road, Woodbury

LONG ISLAND EAST, NEW YORK

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

Tuesday, May 28, 8 a.m. – 10 a.m.
SALES TAX UPDATE – 2 CPE credits (TAX)

Tuesday, June 18, 8 a.m. – 10 a.m.
TECHNOLOGY FOR CPA'S / PAPERLESS OFFICE
– 2 CPE credits (MAP)

NEW YORK CITY, NEW YORK

Contact: Anthony Candela, CPA: (212) 807-4161
May & June: To be announced.

WESTCHESTER/ROCKLAND, NEW YORK

Contact: Chapter Office (914) 708-9404
DoubleTree Hotel, 455 South Broadway, Tarrytown

Tuesday, May 7, 8 a.m. – 11 a.m.
MAP – CURRENT ISSUES, TREPIDATIONS AND IRRITATIONS – 3 CPE credits (MAP)

Tuesday, June 11, 9 a.m. – 5 p.m.
MALPRACTICE INSURANCE & RISK CONTROL AND ETHICS – 8 CPE credits (4 MAP & 4 ETHICS)

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 p.m. – 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 p.m. – 8 p.m. Dinner and Seminar

Tuesday, May 7
UNREASONABLE COMPENSATION – 2 CPE credits

Tuesday, June 4
COMPILATION AND REVIEW UPDATE – 2 CPE credits

DELAWARE VALLEY

Contact: Steve Palmerio, CPA – 609-209-6149 / 609-945-0523
Peppers Italian Restaurant,
239 Town Center Road, King of Prussia, Pennsylvania

Wednesday, May 1, 6 p.m. – 8 p.m.
COMPILATIONS & REVIEWS – 2 CPE credits

Wednesday, June 12, 6 p.m. – 8 p.m.
A & A – 2 CPE credits

MASSACHUSETTS

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

Tuesday, May 21, 7 a.m. – 11 a.m.
ETHICS – 4 CPE credits
Bella Costa Restaurant, 147 Cochituate Road, Framingham

June: **To be announced.**

FLORIDA

Contact: Lynne Marcus, CPA (561) 625-9550
1880 North Congress Avenue, #316, Boynton Beach
8:45 a.m. – 10:45 a.m., Registration 8:30 a.m.

Thursday, May 2
YOU'VE SURVIVED TAX SEASON, NOW WHAT?
– 2 CPE credits

Thursday, June 6
TOPIC To be announced. – 2 CPE credits

Mark Your Calendars!
NCCPAP SUMMER CONFERENCE
August 7, 8 and 9, 2013
DoubleTree Hilton, Tarrytown, N.Y.

National Conference of CPA Practitioners, Inc.
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