

STATEMENT OF JENNIFER E. BREEN
ON BEHALF OF THE
AMERICAN BAR ASSOCIATION SECTION OF TAXATION
BEFORE THE
COMMITTEE ON SMALL BUSINESS
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES
FOR THE HEARING ON
IRS AUDITS OF SMALL BUSINESSES
SEPTEMBER 14, 2016

Good morning, my name is Jennifer Breen, and I am honored to be here today. I have been a tax practitioner for over fifteen years and have spent time as an attorney for the Internal Revenue Service (the “IRS”), in-house as a member of a corporate tax department, and as an outside advisor to taxpayers. I am currently a tax partner with the law firm of Morgan, Lewis & Bockius, LLP, in Washington, D.C., where my practice includes representing taxpayers involved in examinations before the IRS.

I appear before you today in my capacity as Vice Chair for the Administrative Practice Committee of the American Bar Association Section of Taxation. This statement is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the policy of the Association.

The Section on Taxation appreciates the opportunity to appear before you today to discuss examinations of small business taxpayers by the IRS, and it is honored to serve as a resource to the Committee on this topic.

American Bar Association Section of Taxation

The Section of Taxation is comprised of more than 17,000 members. Our members include attorneys who work in law firms, corporations and other businesses entities, government, non-profit organizations, academia, accounting firms, and other multidisciplinary organizations.

Our members provide advice on virtually every substantive and procedural area of the tax law, and interact regularly with the IRS and other government agencies and offices responsible for administering and enforcing such laws. Many of our members, including myself, have served in positions at the IRS, the Department of the Treasury, the Tax Division of the Department of Justice, and the Congressional tax writing committees.

Examinations of Small Business Taxpayers: A Background

The IRS's Small Business/Self-Employed Division ("SB/SE") is one of four IRS operating divisions. It has responsibility for approximately 57 million taxpayers, including 41 million self-employed individuals and 9 million small corporations (those having \$10 million or less in assets)¹. SB/SE's enforcement responsibilities include examining individual and business tax returns to detect misreporting². Examinations, or "audits" as they are often called, consist of a review of a taxpayer's books, records, and other data to ascertain the correctness of any return or to make a return where one was not made by the taxpayer. Examinations are authorized by

¹ The IRM states the mission of SB/SE is "to help small business and self-employed taxpayers understand and meet their tax obligations, while applying the tax law with integrity and fairness to all." IRM 1.1.16.1.1.

² SB/SE also has enforcement responsibility for estate, gift, fiduciary, excise and most employment tax returns.

Internal Revenue Code section 7602, which gives the Secretary of the Department of the Treasury, the IRS's parent agency, authority to conduct such examinations.

In the IRS's 2015 fiscal year³, the IRS closed approximately 1.3 million examinations.⁴ Of those examinations, over 300,000 were examinations of small business returns, with the majority of those returns reflecting a total income of under \$1,000,000, and over 200,000 of these returns reflecting income of under \$200,000.⁵ These audits resulted in over \$4 billion of the \$25 billion in total recommended additional taxes across all IRS examinations during the 2015 fiscal year.⁶

Examinations provide the IRS with an important tool to identify noncompliance in reporting tax obligations and help to enhance voluntary reporting compliance. In so doing, examinations help to reduce the "tax gap," which is defined as the amount of tax liability that is not paid voluntarily and timely. Earlier this year, the IRS estimated that the gross tax gap for the 2008-2010 time period (the most current estimates available) was \$458 billion and that \$52 billion would eventually be collected, resulting in a net tax gap of \$406 billion.⁷

³ The IRS operates on a fiscal year running from October 1 through September 30.

⁴ Statistics from the IRS 2015 fiscal year, *Internal Revenue Service Data Book, 2015*, Publication 55B, March 2016. For purposes of the numbers contained herein as they pertain to small business returns, the following categories of returns were included: 1) individual income tax returns reporting Schedule C business activity with positive income of \$1,000,000 or less and small corporations with total assets of under \$10,000,000. These numbers do not include partnership returns, as the data presented by the IRS to date does not distinguish between large and small business partnerships for the IRS's 2015 fiscal year.

⁵ *Id.*

⁶ *Id.*

⁷ *Tax Gap Estimates for Tax Years 2008-2010*, Internal Revenue Service, April 2016.

The Examination Process

I. Selection for Examination⁸

After a return is filed, SB/SE uses a variety of methods to identify whether a return should be identified for potential examination. These methods include the use of a computer scoring program (called the “Discriminant Index Function” or “DIF”⁹) and other methods, such as internal and external referrals, the use of data matching (where the information reported to the IRS from third parties is matched against the information reported by the taxpayer), and random identification. Many of the methods used by the IRS use some form of automation to determine which returns should be selected, and most, but not all, involve some form of manual review to further evaluate which returns have audit potential. These selection methods create a pool of returns that the IRS has identified for possible audit.

Revenue Agents and other IRS employees then conduct a review of the pooled returns in a procedure known as “classification”.¹⁰ During the classification procedure, an employee determines whether a return warrants an audit through a review of the information reported on

⁸ This testimony focuses on the general processes utilized by the SB/SE operating division of the IRS, as it is the division responsible for conducting examinations of small business taxpayers. Other operating divisions, such as the Large Business & International (“LB&I”) division, may utilize different or additional processes not addressed herein.

⁹ DIF, as referenced in the IRS’s procedures manual, the Internal Revenue Manual (“IRM”), is a mathematical technique used to score income tax returns for examination potential. These formulas were developed based upon National Research Program data. Each return measured under DIF receives a DIF score by assigning weights to certain basic return characteristics. Generally, returns with the highest DIF scores are screened for examination potential. The DIF formulas are confidential in nature and for official use only. See IRM 4.1.3.2.

¹⁰ See IRM 4.1.5, *Classification and Case Building*, for more detailed information regarding the classification process.

the return.¹¹ During this stage, the taxpayer is not notified of the potential for selection, and if the employee classifying the return finds no issues, the IRS will take no further action on the return at that time. The returns that are identified during this process as warranting further review then become available to assign for examination. The IRS reviews more returns than are selected for audit to ensure that it has enough returns that are available for examination when staff become available to be assigned to an examination.¹² Due to limited resources, the IRS will only examine a limited number of the returns filed, making the classifier's role critical to ensure resources are used effectively.

II. The Examination

During the classification process outlined above, returns selected for potential examination are also sorted for one of two types of possible audit, a "Correspondence Audit" or a "Field Audit," based upon guidelines set forth by the IRS. Both of these examinations are discussed in detail below. Of the over 300,000 examinations completed for small businesses in 2015, approximately 160,000, or over half, were conducted as a correspondence audit and the remainder were conducted as a field audit.¹³

A. Correspondence Audits

Correspondence audits, also called "Campus Examinations," are the most basic type of audit and are conducted exclusively by mail. These examinations are conducted through one of

¹¹ The criteria that classifiers use to decide what issues should be sent for audit are generally set forth in IRM 4.1.5 and IRM 4.19.11.

¹² GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should be Strengthened*, GAO-16-103: Published December 16, 2015 (Publically Released January 13, 2016).

¹³ Statistics from the IRS 2015 fiscal year, *Internal Revenue Service Data Book, 2015*, Publication 55B, March 2016.

four “campus” locations, commonly referred to as “service centers,” that are located in Brookhaven, New York; Cincinnati, Ohio; Memphis, Tennessee; and Ogden, Utah.

Once a return has been selected for a correspondence audit, an IRS analyst will review the return to ensure it adheres to the selection rules embedded in the automated processes, and then the return is assigned to a campus through automated processes. Generally, this means there is no further review by a manager or oversight group to determine whether to assign, hold, or screen out returns.¹⁴

Once assigned to a campus, examinations are initiated by a standard boilerplate letter, the “initial contact letter,” which is mailed to the taxpayer to notify them that they have been selected for examination, provide them with a list of items to be verified, and with a copy of IRS’s Publication 3498-A, *The Examination Process (Audits by Mail)*. As these notices are computer generated, there is virtually no customization with respect to the taxpayer, the taxpayer’s business activities, or the possible issues that have triggered the examination. Rather, the initial request is generic in nature and requires the taxpayer to provide a variety of records to the IRS.¹⁵ A taxpayer must respond within 30 days by mailing copies of the requested documentation to a general address for the campus conducting the examination. Should a taxpayer have any questions regarding this initial letter, they are directed to call a general number or write to the campus’s general address, as the case has not yet been assigned to a specific campus examiner at this point in the process.

¹⁴ GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should be Strengthened*, GAO-16-103: Published December 16, 2015. Publicly Released January 13, 2016.

¹⁵ Generally, the first request seeks general records including the following: chart of accounts; Year-end workpapers which reconcile the taxpayer’s books to the tax return; adjusted closing trail balance; year-end adjusting journal entries and closing entries, the general ledger; bank statements, duplicate deposit slips and canceled checks for all bank accounts; and copies of financial statements.

Once a taxpayer responds, the correspondence is placed in a queue to be assigned to a campus examiner, who will notify the taxpayer that the response was received. This process can take months, often due to the number of cases in the queue. Sometimes, a taxpayer is forced to resend the correspondence as the original information mailed cannot be located by the IRS.

In some instances, after submitting the requested information, taxpayers will receive notification that nothing more is needed and that their examination is being closed with no changes. However, in many instances, the examiner will contact the taxpayer with further issues or requests due to the records provided or a dispute over a matter of law. Unfortunately, in many examinations, the quality of the taxpayer's response to the requests made by the IRS, as well as the agent's understanding of the position taken by the taxpayer, is impacted by the fact that all discussions between the two parties are undertaken through correspondence and limited telephonic communication (if any), rather than face-to-face conversations.

If a taxpayer fails to respond at any point in the process, the IRS will send a second notice. If it receives no reply at that time, the IRS will then issue a statutory notice of deficiency, also known as a "90-day letter." At the end of 90 days, the IRS will assess the tax, and any penalties and interest associated therewith and send a Notice and Demand for payment, unless the taxpayer petitions the Tax Court for a redetermination of the asserted deficiency.

As a whole, the IRS conducted the majority of its 2015 audits, 72.6 percent, via correspondence. As noted above, with respect to small businesses, over half of these audits were done via correspondence. For some types of small business taxpayers, this percentage is even higher. For example, of the nearly 170,000 small business taxpayers reporting gross receipts of under \$100,000 that underwent an audit in 2015, more than 65% underwent a correspondence audit.

B. Field Audits¹⁶

Field audits are generally conducted through direct contact with the taxpayer or the taxpayer's representative through a combination of face-to-face meetings, telephone calls, and written correspondence. SB/SE conducts these types of examinations through field offices located in seven regional areas across the United States. When classifying a return to determine whether to identify it for a potential field audit, the employee considers whether the issue would likely require an on-site inspection of a taxpayer's books, records, or assets, whether extensive time is anticipated to complete an audit, and whether the issues appear complex. In such instances, IRS guidance recommends that a field audit should be considered over one conducted via correspondence.

For cases that are referred to the field for examination, the inventory provided to each office is generally reviewed by a group manager, who has the discretion to assign, hold, or screen out returns for audit based upon resource constraints or priority of the workload.¹⁷ The group manager then assigns each case to an agent who will conduct the examination. Once assigned, the agent will notify the taxpayer that its return has been selected for examination and will provide it with a list of documents the agent has identified for review through an Information Document Request ("IDR"). While these lists are often customized with documents the agent has identified as required based upon his or her preliminary review of the return, this request also contains boilerplate items agents are required to seek regardless of the issue or

¹⁶ This testimony focuses on the general processes utilized by the SB/SE operating division of the IRS, as it is the division responsible for conducting examinations of small business taxpayers. Other operating divisions, such as LB&I, utilize different or additional processes not addressed here.

¹⁷ GAO, *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should be Strengthened*, GAO-16-103: Published December 16, 2015. Publically Released January 13, 2016.

issues the agent has identified for examination or the nature of the taxpayer's business.¹⁸ The letter will suggest a date and time for the first meeting with the taxpayer or the taxpayer's representative, at which the taxpayer is expected to produce the records requested for the agent's review.

At the outset of the examination, and generally at the first meeting with the taxpayer, the agent will also spend time asking the taxpayer a series of questions. Some of these questions will have been customized through the agent's development of the case. However, often these questions are boilerplate and are required by SB/SE guidelines for procedures and techniques that should be used in every examination, regardless of the issues or type of taxpayer involved.

After the agent has reviewed the initial information and met with the taxpayer, in some instances, taxpayers will receive notification from the examiner that nothing more is needed and that their examination is being closed with no changes. However, in many instances, the examiner will contact the taxpayer with further issues he or she has identified or for additional documents to be requested through subsequent IDRs.

C. Completion of an Audit

Both correspondence and field audits can be concluded in one of three ways: as a "No Change," as "Agreed," or as "Unagreed."

¹⁸ Similar to the boilerplate requests made in a correspondence audit, the first request in a field audit generally seeks general records including the following: chart of accounts; year-end workpapers which reconcile the taxpayer's books to the tax return; adjusted closing trail balance; year-end adjusting journal entries and closing entries, the general ledger; bank statements, duplicate deposit slips and canceled checks for all bank accounts; and copies of financial statements. In addition, this request also usually seeks all related returns. For example, if the taxpayer under audit is a partner in a partnership, the initial request will seek copies of the partnership's returns, or if the taxpayer under audit is a partnership, the initial request will seek copies of all of the partners' returns as well.

A No Change resolution means that during the examination the taxpayer was able to substantiate that all of the items being reviewed on the return were correctly reported and the examination results in no changes. While the IRS did not tabulate data reflecting the total percentage of No Change examinations that occurred in 2015, it did report statistics as broken down by specific types of taxpayers. In nearly every instance of small business taxpayer examinations, No Changes occurred more frequently in cases for which a correspondence audit was conducted. Additionally, for some groups of small business taxpayers, the likelihood of completing a correspondence examination that resulted in no changes was high. For example, of the 13,684 business returns with total positive income of under \$200,000 and total gross receipts of over \$200,000 that were selected for examination, 2,135 were subjected to a correspondence audit and over half of the examinations resulted in no change.¹⁹

An examination that has concluded as Agreed means the IRS has proposed changes and the taxpayer understands and agrees with the changes. If a taxpayer agrees with the audit findings, the taxpayer will be asked to sign the examination report or a similar form, depending on the type of audit conducted. If money is owed, the taxpayer will be required to make a payment or seek to utilize one of the payment options offered by the IRS, if one is available.²⁰ Of the over 300,000 small business cases closed in 2015, roughly 4% closed in agreement.

Finally, cases that are closed as Unagreed are those where the IRS has proposed changes with which the taxpayer has disagreed. If the taxpayer does not agree with the findings, a conference with a manager may be requested for further review, the taxpayer may seek review by the IRS Office of Appeals or may seek to use one of the IRS's Appeals Mediation Programs.

¹⁹ Statistics from the IRS 2015 fiscal year, *Internal Revenue Service Data Book, 2015*, Publication 55B, March 2016.

²⁰ See *Publication 594, The IRS Collection Process*, for more information regarding these options.

Conclusion

In 2015, the IRS examined a total of approximately 1.4 million tax returns, and a large part of these returns were associated with small businesses across the United States. Although the experience of an examination by the IRS can require time and attention and cause uncertainty for the taxpayer, examinations are an important tool for the IRS to identify noncompliance in reporting tax obligations, help to reduce the tax gap, and enhance voluntary reporting compliance.

The IRS outlines the examination process on its website and in Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, for taxpayers who have never experienced an examination. The examination process nevertheless can be confusing and time consuming. Consequently, taxpayers often are unsure about what to expect and how to proceed. Unlike the Large Business and International (“LB&I”) Division, SB/SE does not have a public “Examination Process” statement whereby the Division provides an organizational approach for examinations from the first contact through the final stages of issue resolutions, nor does it have directives requiring discussions with taxpayers around certain examination procedures, such as the issuance of IDRs.

Regardless of the type of examination a small business taxpayer experiences, establishing good accounting and recordkeeping will help a taxpayer prepare for an examination, should one arise, and help to put the taxpayer in a position to effectively and efficiently respond to any issues raised by the examiner. Good record keeping is not enough, however. It is also important to be cooperative and responsive to all IRS notices and requests for information.

Last year, the IRS, including SB/SE, announced its “Future State Initiative.”²¹ Through this initiative, SB/SE has indicated that it is looking for ways to find better and more efficient ways of doing business, including using technology to transform the examination process. It has identified possible changes to include the use of digital notifications of possible examination at early stages shortly after filing, the use of limited-issue examinations based upon specific aspects of a taxpayer’s return, and the ability for taxpayers and their representatives to exchange necessary information electronically with an agent during an examination. Efforts such as these should lead to improvements in the examination process and help the IRS examine taxpayers more effectively and efficiently.

Thank you for affording me the opportunity to be here today to provide the Committee with this information. I look forward to your questions.

²¹ “Future State Initiative” Internal Revenue Service, February 22, 2016.
<https://www.irs.gov/uac/newsroom/future-state-initiative> (September 11, 2016).

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0315

To: Members, Committee on Small Business
From: Committee Staff
Date: September 12, 2016
Re: Hearing: “IRS Puts Small Businesses through Audit Wringer”

On Wednesday, September 14, 2016, at 11:00 a.m. in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet to explore the Internal Revenue Service’s (IRS) conduct in the context of small business audits. This hearing will be a follow-up to the June 22, 2016 hearing conducted by the Committee’s Subcommittee on Economic Growth, Tax, and Capital Access. That hearing focused on broad systemic problems across the IRS’ authority with regard to small businesses and laid the foundation for further exploration of these issues.

The IRS is in the unique position of being both tax collector and tax code enforcer. The enforcement part of its responsibility is achieved primarily through the examination, or audit, process. The IRS has fairly clear internal guidelines when auditing large businesses, but the conduct of small business audits is less well regulated, often resulting in confusion and frustration on the part of small business taxpayers. The Committee will meet to examine how small businesses are being treated during the audit process.

I. Introduction

The income tax and the IRS, then called the Bureau of Internal Revenue, both trace their roots back to the Civil War.¹ The income tax was created to help fund the war effort and was repealed 10 years later, in 1872.² Congress tried to revive it in 1894, but the Supreme Court ruled it unconstitutional.³ While a variety of other types of taxes were collected in the interim, the income tax did not make a reappearance until February of 1913 when the Sixteenth Amendment to the Constitution was ratified.⁴ The Amendment granted Congress the ability to levy taxes on personal income and to do so at its source, i.e., withholding.⁵ The first income tax form, the 1040, made an appearance soon thereafter.⁶

In the 1950s, the IRS was reorganized and the patronage system was replaced with career, professional employees. Only the IRS commissioner and chief counsel remain subject to

¹ <https://www.irs.gov/uac/brief-history-of-irs> (Oct. 8, 2015).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

Presidential appointment and Senate confirmation.⁷ The name was also changed from the Bureau of Internal Revenue to the Internal Revenue Service.⁸

In administering the tax code, the IRS performs two distinct functions: 1) collection of revenue and 2) enforcement of the tax laws. The agency has evolved from administering a tax code that levied 1 percent tax on incomes above \$3,000 and a 6 percent surtax on incomes over \$500,000 in 1913⁹ to administering statutes, regulations, and case law totaling around 70,000 pages.¹⁰

At the same time, the face of business has also changed, especially small business. For example, the number of pass-through businesses has nearly tripled since 1980, while the number of C corporations has declined.¹¹ The environment in which the IRS has to perform is also constantly evolving.¹² Unfortunately, the IRS itself has not evolved as quickly. This hearing will focus on the IRS' enforcement function and how it treats small businesses during the examination process.

II. Background

Small business owners and tax practitioners have raised several issues of concern. First, the IRS, by its own admission, is failing to provide adequate support for taxpayers trying to comply with the law. For example, phone lines are open only during “tax season,” and “tax season” does not include “extension season.” Also, many taxpayers’ questions are deemed “out of scope,” and the IRS won’t answer them by phone at all. Second, the Committee has heard anecdotal evidence that the IRS is becoming much more aggressive in its audit techniques. The question here is whether small business taxpayers are being treated fairly and whether IRS internal procedures are being followed.

III. Evolutions in Auditing

The Committee is concerned about anecdotal reports of the IRS’ increasing use of aggressive litigation tactics during audit. While the IRS certainly has broad authority to examine returns to ascertain their accuracy, it is governed in those activities by administrative materials such as the Statement of Procedural Rules,¹³ the Internal Revenue Manual,¹⁴ and other IRS internal guidance. The purpose of an audit is to determine the appropriate amount of tax, but some small business taxpayers have reported audits that feel more like fishing expeditions or a bid to put them out of business altogether.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ Joseph Henchman, *How Many Words are in the Tax Code?*, THE TAX POLICY BLOG (Apr. 15, 2014), available at <http://taxfoundation.org/blog/how-many-words-are-tax-code>.

¹¹ Kyle Pomerleau, *An Overview of Pass-through Businesses in the United States*, TAX FOUNDATION SPECIAL REPORT No. 227 (Jan. 21, 2015), available at <http://taxfoundation.org/article/overview-pass-through-businesses-united-states>.

¹² ELECTRONIC TAX ADMINISTRATION ADVISORY COMMITTEE, ANNUAL REPORT TO CONGRESS 11 (June 2015) [hereinafter ETAAC].

¹³ 26 CFR Part 601.

¹⁴ <https://www.irs.gov/irm/>.

The IRS is currently organized into several different divisions to address the unique needs of various types of taxpayers: Large Business and International (LB&I), Small Business/Self-Employed (SBSE), Wage and Investment, and Tax Exempt and Government Entities.¹⁵ The IRS has put together an internal (but publicly available) guidance document, the Internal Revenue Manual (IRM), that covers almost all aspects of IRS operations.¹⁶ It includes everything from the IRS mission and organizational structure to examination (audit) guidelines, the collection process, customer service, litigation, etc.¹⁷ Part 4 of the IRM is devoted entirely to the examining process. Chapters 30, 46, and 51 are devoted entirely to LB&I (referred to by its prior name, “LMSB,” in Chapter 30). While there is one chapter devoted to pass-throughs,¹⁸ there are no chapters devoted to SBSE.

IRM chapter 46 lays out standards for the conduct of an LB&I audit. These procedures help to ensure transparency and certainty. They establish the scope of the exam and timelines for issue resolution, as well as other parameters. By contrast, an SBSE audit seems to fall largely within the more general guidelines laid out various other chapters.

This lack of well-developed guidelines in the SBSE area results in very uneven application of audit procedures, leading to lack of transparency and taxpayer frustration. Audit issues that have been raised with the Committee in the small business context include third party contacts, “hide-the-ball,” unreasonably short document turnaround, unreasonable delay, fishing expeditions once the issue flagged for audit is successfully resolved, and misapplication of payments, among others.

For example, the third party contact issue arises when, in some cases, small business taxpayers that the IRS has chosen to audit have not been approached directly by the IRS, but their customers, business partners, etc. have been approached first, prior to the company having the opportunity to respond to and potentially resolve the audit issue(s).¹⁹ Sometimes, the taxpayer is not even notified of this activity or given a chance to respond directly. Particularly in a small town, this type of activity can be devastating to the company’s reputation and future viability.

“Hide-the-ball” in the exam context can manifest in several different ways. First, in an LB&I audit, the taxpayer is generally presented with an outline defining the scope of the audit and an anticipated timeline. This courtesy does not seem to extend to SBSE exams. The issue can also manifest in the IRS not being upfront about what the actual concerns are and/or what IRS personnel are engaged in the decision-making regarding various audit issues. This lack of transparency can cause great frustration and confusion on the part of the taxpayer.

In some cases, the IRS itself is negligent, but the taxpayer bears the consequences. One example of this is when a taxpayer is diligently paying a deficiency in accordance with an agreed-upon payment plan, and the IRS misapplies the payments, then throws the taxpayer into default. While the payment misapplication is the fault of the IRS, it can have devastating consequences for

¹⁵ CHART – ORGANIZATION AND TOP OFFICIALS, DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE (Apr. 2015), available at www.irs.gov/irm/part1/30376001.html.

¹⁶ INTERNAL REVENUE MANUAL, INTERNAL REVENUE SERVICE (June 2, 2015), available at www.irs.gov, search IRM.

¹⁷ *Id.*

¹⁸ *Id.* at 4.31.

¹⁹ Committee staff conversation with local tax professional (June 9, 2016).

the taxpayer. The Committee was made aware of at least two cases in which the IRS so aggressively audited small businesses that they went out of business, and in at least one case, IRS misapplication of payments played a crucial role.²⁰

These are but a few of the issues that have been brought to the Committee's attention. One potential solution that will be explored in the context of this hearing is whether the better developed LB&I procedures might be applied to SBSE exams as well.

IV. Conclusion

As Congress and the Committee pursue the goal of overall tax reform, tax enforcement issues should also be kept at the forefront of the discussion. Often, the administration of the tax code can have just as significant of an impact on a small business taxpayer as the substantive provisions of the law. The Committee will explore some of these exam issues in the context of this hearing.

²⁰ Committee staff conversation with Committee Member personal staff (June 20, 2016).

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0315

NOTICE OF HEARING

September 14, 2016

11:00 A.M. 2360 Rayburn House Office Building

TO: Members, Committee on Small Business

FROM: Steve Chabot, Chairman

DATE: Wednesday, September 7, 2016

The Committee on Small Business will meet for a hearing titled, *IRS Puts Small Businesses through Audit Wringer*. The hearing is scheduled to begin at **11:00 A.M. on Wednesday, September 14, 2016 in Room 2360 of the Rayburn House Office Building.**

The Internal Revenue Service (IRS) is in the unique position of being both tax collector and tax code enforcer. The enforcement part of its responsibility is achieved primarily through the examination, or audit, process. The IRS has fairly clear internal guidelines when auditing large businesses, but the conduct of small business audits seems less well regulated, often resulting in confusion and frustration on the part of small business taxpayers. The Committee will meet to examine how small businesses are being treated during the audit process.

A staff briefing will be held at 2:00 P.M. on Monday, September 12, 2016 in Room 2360 of the Rayburn House Office Building.

If you or your staff have any questions, please contact Kimberly Pinter, Tax Counsel for the Committee, at 202-225-5821.

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Committee on Small Business
“IRS Puts Small Businesses through Audit Wringer”
Wednesday, September 14, 2016, 11:00 A.M.
2360 Rayburn House Office Building

Witness List

Ms. Kathy Petronchak
Director of IRS Practice and Procedure
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Houston, TX

Mr. Warren Hudak
President
Hudak & Company
Lemoyne, PA
*Testifying on behalf of the National Association of Enrolled Agents

Mr. Don Williamson
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Kogod Tax Policy Center
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Ms. Jennifer E. Breen
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Morgan, Lewis & Bockius LLP
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*Testifying on behalf of the American Bar Association Section of Taxation