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Summaries for the 2017 IRS-SJSU Small Business Tax Institute

*Thriving in the Digital Economy-Best Practices for Small Businesses
and Their Tax Advisers*

Held on June 22, 2017 at the Biltmore Hotel, Santa Clara, California

Authors: Ruchi Chopra, Ophelia Ding, Surbhi Doshi, Nilesh Lad and Sara Sun

How to Successfully Deal with Correspondence Audits and IRS Notices

By: Ruchi Chopra, CPA, MBA, MST Student

The first topic discussed during the conference was on how to successfully deal with correspondence audits and IRS notices. The session speakers included various tax practitioners and IRS analysts: Ms. Torie Charvez, Enrolled Agent, Ms. Barbara Doherty, Tax Attorney, Ms. Gail Murphy and Ms. Susan Clark, Tax Policy Analysts from the IRS. The panel addressed the audit process, relevant Internal Revenue Manual (IRM) procedures, types of audit letters and notices, and ways to get help.

The panel started with correspondence audits, the most common type of audit the IRS conducts.¹ The taxpayer under the correspondence audit receives a letter from the IRS by mail, advising the taxpayer that his or her return has been selected for examination. This letter will also typically include a request of a list of additional documents and/or information to be provided to the IRS. Correspondence audit examinations, which cover a broad array of compliance areas, are highly automated, standardized and purportedly efficient.

Ms. Murphy commenced the discussion with an overview of the correspondence examination process and discussed the criteria the IRS uses to select the returns for an examination. As Ms. Murphy stated, the IRS typically uses a software program that compares returns against common norms and examines the selected returns that fall outside of these norms. Some of the common ways the IRS identifies returns for examination are based on results from prior year audits, third party information, entries on the return by the taxpayer, and referrals from criminal investigations or preparer actions. Correspondence audits typically have a defined scope and focus on documenting specific tax return entries. Some of the common issues discussed that trigger an examination audit are refundable tax credits claimed by the taxpayer such as the Earned Income Tax Credit,

¹ Internal Revenue Service. (2017). *IRS Audits*. Retrieved from: <https://www.irs.gov/businesses/small-businesses-self-employed/irs-audits>

Child Tax and American Opportunity Tax Credits. Other tax return entries with a high potential for an examination are employee business expenses, charitable contributions claimed on Schedule A, and business expenses claimed on Schedule C.

Ms. Clark from the IRS continued the discussion with types and uses of common initial letters and notices sent by the IRS. Notices such as the CP 75/75A for the Earned Income Tax Credit and the CP 06/06A for the Premium Tax Credit advise taxpayers that their returns are being audited and the IRS is requesting supporting documentation responding to the audited items. Some initial contact letters supplement a detailed examination report whereas others do not. For instance, Letter 1862 and Letter 2194 have forms and questionnaires enclosed that list the requested documentation. When a taxpayer fails to file a return, the IRS sends a Letter 1862 with a detailed examination report notifying the taxpayer that (1) a return is required to be filed and (2) a Federal tax liability has been calculated for the taxpayer by the IRS based on information the IRS has on the taxpayer. The IRS also sends some interim letters such as Acknowledgement Letter 3500 and Interim Letter 3501 to advise the taxpayer that they received the taxpayer's request and will be responding in 45 days. Other common follow-up letters that were discussed include Letter 525/692 which is sent with a computation report of the proposed adjustments to taxpayer's return outlining options for the taxpayer. Letter 525/692 are cover letters to Form 4549, a notice of deficiency used when the IRS determines that a taxpayer has unfiled returns and owes taxes. Form 4549 also gives a choice to the taxpayer of either submitting a return or filing a petition with the Tax Court within 90 days. The IRS also sends Form 886-A requesting information supporting documentation they propose to adjust during an audit.

Letter 3219, also termed as Statutory Notice of Deficiency or the "90 Day" Letter, is sent when the IRS receives information from third parties that is different from what is reported by a taxpayer on his return. The notice explains how the adjusted amount was calculated and how the taxpayer can challenge it in Tax Court should they not agree with the adjustments. Letter 555, a follow-up letter, is sent after the issuance of Letter 3219 if the information submitted by

Some key points about correspondence examinations that Ms. Clark highlighted were about the importance of responding timely to the notices and providing complete and organized responses, helping IRS to resolve issues efficiently. There was a brief mention of Publication 3498-A that gives an overview of the correspondence examination process for taxpayers and tax practitioners.²

The panel also discussed some of the current resources and future initiatives such as the Taxpayer Digital Communication (TDC) that the IRS is currently working on and the Practitioner Priority Service Hotline. The TDC is a pilot program launched in December 2016. The purpose of the program is to resolve correspondence examinations in a secure online environment where taxpayers are given an option to upload the requested documentation directly on an IRS portal instead of mailing it to them. The Practitioner Priority Service Hotline phone number (1-866-860-4259, prompt 6) is a service made available to practitioners for expedited access to a wide variety of client matters.

Ms. Doherty took over the next part of the session and shared some tips with practitioners on how to successfully deal with correspondence audits and protect themselves at the same time. Ms. Doherty advised that practitioners must disclose any potential conflict of interest and weigh the reliability of the underlying taxpayer data when dealing with IRS notices on behalf of their clients as there are potential preparer penalties. Tax practitioners must also consider if their continued representation violates any legal or ethical considerations. Practitioners must complete and file with the IRS Form 2848, Power of Attorney, after being engaged to represent taxpayers. The initial response made to the IRS in an examination should be in the form as indicated in the examination letter, and if the issue is beyond an accountant's competency or if there are potential criminal, practitioners should also consider the need to hire a tax or criminal tax attorney.

Ms. Doherty reiterated how important it is to respond timely to notices with clear and complete information printed and banded together with a detailed response. She also

² Internal Revenue Service. 2014. *The Examination Process (Audits by Mail)*. Publication 3498-A. Retrieved from: <https://www.irs.gov/pub/irs-pdf/p3498a.pdf>

suggested that a practitioner or taxpayer must be prepared for several exchanges of information, as not all adjustments will be seen in a single IRS response. Often there is a need for second, third or more adjustments during the examination process. In addition, practitioners must conduct research ahead of time for any items that are requested to be included in the correspondence to the IRS to reduce the chances of being challenged by the IRS. Finally, it is also important to replicate and keep original return data in the records of the client by the practitioner.

The discussion concluded with a Q&A session, where the audience brought some questions for clarification on the discussed IRS letters and notices as well as the Service's latest digital initiatives. At the end of discussion, the panelists pointed out Part 25, Chapter 1, Section 2 of the Internal Revenue Manual (IRM 25.1.2.3) and a list of fraud indicators within the IRM.³

Overall, the session was informative and interactive. It was a great learning experience hearing the insights of the knowledgeable speakers on how to successfully deal with correspondence audits and IRS notices. As tax practitioners, we must be diligent and proactive, while thoroughly understanding the importance of timely and proper responses to IRS letters and notices with complete and accurate information

³ Internal Revenue Service (2014). *Internal Revenue Manual*. Retrieved from: https://www.irs.gov/irm/part25/irm_25-001-002.html

FTB Taxpayer Advocate Update

By Ophelia Ding, *MST Student*

California's taxpayers' rights are protected through the California Taxpayer's Bill of Rights, which became law in 1988 and with it established the Taxpayers' Rights Advocate.¹ The Taxpayers' Rights Advocate services are independent of the California Franchise Tax Board's (FTB) audits and collection areas, they protect the rights of the taxpayers and help taxpayers with their tax issues that are unresolved through normal administrative channels. Taxpayers may contact the Taxpayers' Rights Advocate when they have any complaints, face any problems, or if they suffer an irreparable loss. The Taxpayers' Rights Advocate has the power to postpone the tax enforcement actions during the review of the taxpayer's case.²

Susan Maples, CPA, is the current Taxpayers' Rights Advocate of the California FTB. Ms. Maples has worked in the FTB for more than 20 years in both Sacramento and Southern California field offices. She started as a tax auditor in personal and corporate income tax before transitioning to the Tax Practitioner Liaison between the FTB and external stakeholders (i.e. the taxpayers and tax practitioners). Her main job function now as the Taxpayers' Rights Advocate is acting as an independent intermediary to resolve problems between taxpayers and the FTB to ensure that taxpayers' rights are protected. Ms. Maples focuses on education and outreach programs to provide information to taxpayers, tax practitioners, industry groups, and small business owners regarding the most common issues and problems faced by taxpayers while assisting them on how to avoid or resolve them.

Ms. Maples started her panel on FTB Taxpayers' Rights Advocate annual updates by providing some background information on identity theft and data security issues that the

¹ Cal. Rev. and Tax., §§ 21001 – 21028 and State of California, Franchise Tax Board. *California Taxpayers' Bill of Rights*. Retrieved from: <https://www.ftb.ca.gov/forms/misc/4058.pdf>

² State of California, Franchise Tax Board. *California Taxpayers' Bill of Right – An Overview*. R&TC Section 21004. Retrieved from: <https://www.ftb.ca.gov/forms/misc/4058C.pdf>

FTB has been recently dealing with after rolling out their MyFTB system. MyFTB is an online system that provides “tax account information and online services to individuals, business representatives, and tax preparers.”³ With MyFTB, taxpayers and tax practitioners can access their tax account information quickly and easily online as soon as it becomes available in the FTB computer systems. However, like everyone else in this digital age, the FTB faces prominent security issues challenges like never before. Hackers are relentlessly trying to access the sensitive and confidential information stored on MyFTB. While the FTB strives to provide easy access and communications to taxpayers and practitioners, it is difficult, like many organizations, for the FTB to find the desirable balance between data security and user convenience.

Fighting Tax Fraud

The FTB has launched a number of measures to combat identity thefts proactively. Taxpayers and practitioners might have noticed they are receiving more forms or notices from the FTB in the past few years, requesting verification of a taxpayer’s identity or a return filing status. Ms. Maples highlighted FTB Form 4734D and Notice 3904 in her presentation, as described below.

Identify Verification with Form 4734D, Request for Information and Documents

Since 2016, the FTB started sending out FTB Form 4734D, *Request for Information and Documents*, to verify taxpayers’ identities. The form specifically asks for more information from the taxpayer, such as physical copies of the taxpayer’s identification cards (e.g., driver’s license or social security card) for verification purposes, before approving their tax refund. The reason for this is because some identity thieves might have acquired electronic copies of taxpayers’ identification through criminal activities and have filed for a fraudulent tax refunds through fake California tax returns on these victims. The FTB needs to verify the taxpayer’s identity by asking for the physical identification cards directly from the taxpayer to help protect them (and the state) from tax-related identity theft.

³ State of California, Franchise Tax Board. *MyFTB*. Retrieved from: <https://www.ftb.ca.gov/online/myacct/index.asp>

Return Verification with FTB Notice 3904, Request to Confirm Tax Return Filing

Practitioners often wanted to know why their clients were getting notices from FTB when nothing has changed since their last filing. For instance, clients who are still working for the same employer with the same W-2 and withholdings suddenly got notices from FTB. Tax practitioners need to note that FTB started sending out FTB Notice 3904, *Request to Confirm Tax Return Filing*, to taxpayers when they highly suspected the particular taxpayer has fallen victim to tax-related fraud. Taxpayers who received the notice should contact the FTB immediately to notify them if he or she had indeed filed a tax return with the FTB.

Phishing

An increasing number of companies reported that they were victims to phishing scams. Common scams in this area include the Human Resource Department receiving a fake email from the Company's CEO asking for valuable personal or financial information of the employees such as their social security numbers. The FTB advises that if you are victim to any phishing scams, it is crucial to inform the FTB immediately. Upon notification, the FTB will flag the accounts that have been compromised to closely monitor the tax activities on the account. Tax practitioners themselves are also prevailing targets of identity thefts because they possess a large amount of sensitive and confidential information on their clients. Therefore, tax practitioners must take the necessary measures to safeguard their clients' information. Criminals frequently try to deceive tax practitioners with fabricated emails from the "FTB." Tax practitioners should never undermine the importance of due diligence and take the extra step to confirm with the FTB if they are truly requesting specific information of a particular client. Tax practitioners can do so by using the FTB identification number on the notices, or by verifying the fax number or mailing address on the notice with the FTB. Furthermore, tax practitioners should always ask FTB for a Secure Email Service if they are sending taxpayers' information via email. Secure email will encrypt the confidential data sent between the FTB and the taxpayers with high security standards without installing any software.⁴

Small Businesses– Rights and Responsibilities

With the prevalence of shared economy businesses such as TaskRabbit, Uber, and Airbnb in our current digital economy, clients who used to receive just W-2s for their services as employees are now receiving 1099s that they have never dealt with before. Thus, both the FTB and tax practitioners should do more educational outreach. Taxpayers involved in this new business model need to understand the tax implications they are facing, including the compliance requirements such as recordkeeping, deadlines, and self-employment tax.

Preparation and Representation

The FTB has done a massive re-training of its staff in the past year as a response to many tax practitioners' comments about the *Implied Consent* not working as well as it should. Implied Consent is a process that enables FTB staff to interact with tax practitioners easily and quickly to resolve urgent issues for their clients without a processed of Power of Attorney (POA). It occurs when "a taxpayer's representative can provide enough information from a Franchise Tax Board (FTB) notice or a taxpayer's account to infer that the representative has authorization to discuss specific account information."⁵ The FTB also had issues processing POA forms for the past year. It could take as long as 90 days for the FTB to process a POA form received by mail. They now prefer that taxpayers and practitioners use the POA Wizard on MyFTB to submit POA applications, which could shorten the processing days to 35 days. Tax practitioners should note that beginning January 1st, 2018, the FTB will only accept the California POA (Form 3520) and will not accept a modified copy of an IRS POA. In addition, the FTB will no longer revoke old POAs even after receiving a new POA from the same taxpayer. However, newly issued POA will now expire after six years. The FTB will send a letter to notify the taxpayer of the approval

⁴ "Secure email must be initiated by an FTB employee sending a secure email message to the recipient. First time recipients will be prompted to register. Returning customers only need to enter their passwords to view secure email messages. If a customer responds to a secure email message, the response is also encrypted." State of California, Franchise Tax Board. *Tax Practitioner Services - Electronic communication and data transmission*. Retrieved from: https://www.ftb.ca.gov/professionals/taxnews/tn_tps.shtml

⁵ State of California, Franchise Tax Board. *Tax News February 2017*.

of a recent POA. A list all other POAs associated with the taxpayer will also be provided. The taxpayer should contact the FTB to revoke any POA they no longer want to keep in effect.

Ms. Maples ended the presentation by stating that taxpayers and tax practitioners should always contact the Taxpayers' Rights Advocate Office with any issues they are facing using *FTB Form 914, Taxpayer Advocate Assistance Request*.⁶

Ms. Maple's contact information is:

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⁶ State of California, Franchise Tax Board. FTB 914 - *Taxpayer Advocate Assistance Request*. Retrieved from: <https://www.ftb.ca.gov/forms/misc/914.pdf>

Crowdfunding

By: Surbhi Doshi, *MST Student*

The post lunch session of the Fifth Annual IRS/SJSU Small Business Tax Institute on June 22, 2017 began with the interesting topic of crowdfunding. A three-member panel from Moss Adams LLP consisting of Mr. Andy Mattson, CPA, partner; Mr. Curtis Miyaji, Senior Manager and Ms. Dawn Rhea, J.D., LL.M, National Tax Director, threw some light on crowdfunding and its tax implications.

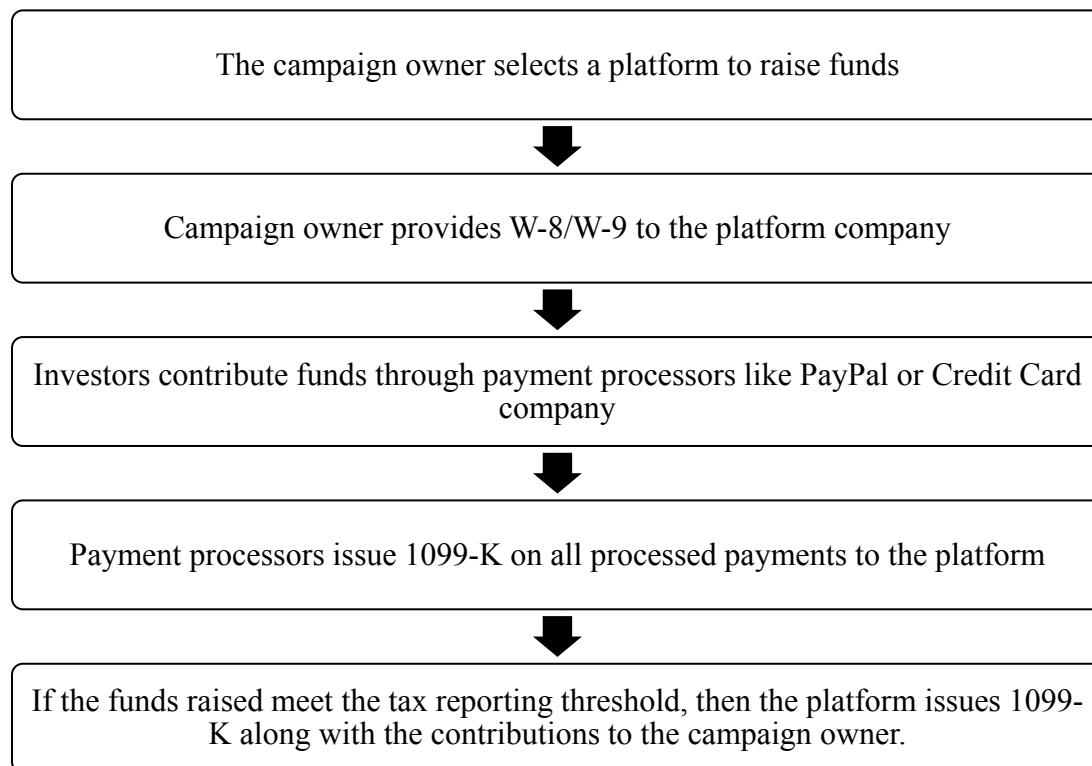
Mr. Mattson commenced the session and broadly explained the concept of crowdfunding. In crowdfunding, there is a fundraising campaign and a campaign owner who selects a crowdfunding platform as a way to raise funds to kick-start a business or introduce a new product or service in the market. Crowdfunding is increasingly being used in various activities include raising funds for personal medical expenses or funeral expenses.

The Process

Crowdfunding starts by the campaign owner selecting a crowdfunding platform on which he would like to initiate a campaign. After selecting a platform, the campaign owner provides a Form W-8 or Form W-9 to the platform to disclose necessary tax information.

- **Form W-8BEN** is for non-US based campaign owners and it certifies that the funds received are not associated with a U.S. trade or business.
- **Form W-9** is for US based campaign owners. The platform requires information like the Taxpayer Identification Number, name and address of the campaign owner before sending out Form 1099-K.
- **Form 1099-K** is used by the platform owners to report amounts received from third party organizations. IRC §6050W requires third-party settlement organizations, also called the payment settlement entities, to file Form 1099-K. These settlement organizations have a contractual obligation to turn over the funds to the payee.

- **Form 1099-K Issuance Threshold:** The number of transactions for the calendar year must exceed 200 and the gross value of all transactions must exceed \$20,000 in order for Form 1099-K to be required. If any one of the conditions is not satisfied, then the platform owner need not issue 1099-K to the campaign owner.



Importance

Ms. Rhea took over by giving an example of Mondelez International, Inc. who initiated the “Triscuit Maker Fund” and donated money to Food Maker Projects on the crowdfunding platform Indiegogo.com¹ This campaign gave a head start to many small food production businesses. She added that according to Forbes estimates, about \$16B was raised in 2014, while about \$34B in 2015 was raised through crowdfunding, and by 2020, raised funds are

¹ Watrous, Monica. April 26, 2016. *Small businesses get boost from Mondelez*. Retrieved from: http://www.foodbusinessnews.net/articles/news_home/Business_News/2016/04/Small_businesses_get_boost_fro.aspx?ID=%7B6CB531D6-4350-4175-A80B-5AC745FBC806%7D&cck=1

estimated to be \$90B.² Crowdfunding is unique because it is widely used to raise money for diverse purposes and covers numerous industries and areas.

Why Should Tax Practitioners Care?

In this increasing popularity of crowdfunding, there is a huge probability that taxpayers may have initiated one or more campaigns or have donated to such campaigns. As tax practitioners, we need to be ready to answer taxpayers' questions and identify the tax implications involving their crowdfunding activities. Clients may have one or more of the following questions:

- Why did I receive a Form 1099-K?
- Why did the platform ask me to provide tax information on Form W-8/W-9?
- Will the funds raised be included in my income?
- Will I get a deduction for the expenses of the campaign?

If the client has donated to some campaign, then the queries may be:

- Can I take a charitable deduction for the amount I contributed?
- Will the contribution be considered a gift? What about any filing requirements?
- Will I have to pay any gift tax?

IRS on Crowdfunding

On inquiry by the AICPA Task Force regarding any guidance on crowdfunding, the IRS responded that no guidance was forthcoming and general tax principles should be used to determine the effects of the transactions. Later in 2016, an Information Letter was issued by the Office of Chief Counsel in response to a taxpayer's request for guidance on tax consequences of crowdfunding.³ In this letter, the IRS referred to IRC §61 wherein all receipts, in the form of cash or property, are included in gross income subject to certain

² Barnett, Chance (June 9, 2015). *Trends Show Crowdfunding to Surpass VC in 2016*. Retrieved from:

<https://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016/-75e801574547>

³ Internal Revenue Service. Office of The Chief Counsel (March 30, 2016). *Information Letter Number 2016-0036*. Retrieved from: <http://www.irs.com/pdfs/4Info20160036.pdf>

exceptions. That said, crowdfunding receipts are includible in gross income if they are not in the form of loans or gifts made out of generosity. However, if the receipts in crowdfunding are for services rendered or sale of products then those must be included in income.

The major issue arises when the campaign threshold is not met, i.e. the number of transactions do not exceed 200 or the gross value of the transactions do not exceed \$20,000. Some platforms (e.g., Kickstarter.com) require that all the funds be returned to the contributors, while other platforms just deduct necessary fees and distribute the money to the campaign owner. To determine the nature of funds raised and expenses incurred, the IRS resorted to the basic IRC sections mentioned below:

- IRC §61, in addition to other sections of the IRC, generally provides that any money received is includible in gross income if one has dominion or control on the money, unless it is loan, a gift or a capital contribution to a business entity.
- IRC §451 provides for the timing of recognition of income. If the taxpayer follows the accrual method of accounting, income is recognized when the right to receive such income is established and the amount can be determined with reasonable accuracy.
- IRC §461 allows a deduction for expenses incurred in the taxable year in which the all events test is met by an accrual basis taxpayer. The all events test includes three prongs, which includes the occurrence of the event, ascertainment of the amount of expense with reasonable accuracy and if the performance has taken place with respect to the liability. Costs of any perks or gifts given to the contributors and other expenses related to the campaign are eligible for a deduction.
- The IRS also brought up IRC §162 to ascertain whether the expenses of a campaign would be deductible for business purposes. The factors to be considered include:
 - Is the campaign owner actively engaged in a trade or business?
 - Is it a startup or an established trade or business? (Startup costs like legal fees, employee training expenses, advertising costs can be either capitalized or amortized over a period of time. But the condition for deductibility is that the activity must be considered an active business)
 - Are there any expenses incurred which are deductible under IRC §162?

To illustrate deductibility of expenses under IRC 162, Ms. Rhea mentioned *Richmond Television Corp. v. United States*⁴, wherein the IRS disallowed deductions claimed under IRC §162 for all training costs incurred by the taxpayer after obtaining a television broadcast license. The issue was whether the expenses incurred by the taxpayer were deductible as capital expenditures amortized over the life of the asset or as ordinary and necessary expenses under IRC §162. According to the IRS, to qualify for a deduction under §IRC 162, expenses must be ordinary and necessary which must be paid or incurred in carrying on a trade or business within any taxable year. It was laid out that taxpayer is said to be engaged in a trade or business when it has “begun to function as a going concern and performed those activities for which it was organized.” *Richmond Television Corp. v. United States* 345 F.2d 901(1965)

Ms. Rhea added that IRC §183 applies when the activity is not engaged in for profit. IRC §183 provides that if an activity is not engaged for profit, then no deduction would be allowed for expenses incurred in relation to such activity. IRC §183 further states that expenses incurred that would be otherwise allowable if the activity was engaged in for profit may be deducted provided the expenses do not exceed the gross income related to the hobby. Also, the law presumes that an activity is not engaged in for profit, if there are losses in three or more years out of five consecutive taxable years.

Reg §1.183-2(b) provides nine factors for determining whether a taxpayer engages in an activity for profit. Some of them are the time and effort invested in the activity, the level of expertise, taxpayer’s history of income and losses with the activity, the relative amount of profit or loss, and the element of personal interest or recreation. Crowdfunding receipts may be treated as hobby revenues or income from trade or business depending on the time and effort invested or the frequency of transactions and the frequency of profit gained or loss suffered from the activity.

⁴ *Richmond Television Corp. v. United States*, 345 F.2d 901 (4th Cir. 1965), vacated and remanded per curiam on other grounds, 382 U.S. 68 (1965), original holding on this issue affirmed, 354 F.2d 410 (4th Cir. 1965), overruled on other grounds by *NCNB Corp. v. United States*, 684 F.2d 285 (4th Cir. 1982)

Donation to a Campaign - Is It a Gift or a Charitable Contribution?

The answer is ... it may or may not be a charitable contribution. Contributions made to crowdfunding websites are generally considered gifts and not donations. Crowdfunding websites like GoFundMe.com have Certified Charity campaigns which are considered as §501(c)(3) tax-exempt organizations. In such circumstances, the donated funds will be treated as a charitable contribution.

To determine whether the donation is a gift, the intent of the donor should be considered. To prove it is a gift, factors like generosity of the donor need to be considered. Any service or discount received by the donor in exchange for making the gift also impacts the nature of the donation. Also, if the amount of the gift exceeds the annual gift tax exclusion limit of \$14,000, filing of Federal gift tax return is required.

6.0 Crowdfunding and Sales Tax

Sales tax is imposed by majority of states in the USA. For any state to levy sales tax on tangible property sold, there should be nexus between the state and the business. Nexus refers to a minimum connection or a rational relationship between the state and the activities of the business. Nexus for sales tax is triggered by presence of an employee, office, warehouse, etc. in the state. In *Quill Corp. v. North Dakota*, 504 U.S. 298, a landmark case in reference to sales and use tax, the Supreme Court ruled that physical presence is required in a state to levy sales tax.

Sales tax issues come up when campaign owners having nexus in a state give away perks or gifts to the contributors. The campaign owners, sometimes, give gifts of nominal value or rewards to the contributors in exchange for their contributions. Such gifts may be in the form of an event ticket, a discount card or a t-shirt with their logo on it, etc. If an item is sold at concessional prices to the contributors, then sales tax is normally due on the selling price. If the item is given away as a perk or a gift, then sales/use tax is normally due on the cost of the item to the campaign owner.

Conclusion

With the increasing popularity of crowdfunding, many taxpayers are being involved either in initiating a campaign or donating to one. As tax professionals, we should inform clients that crowdfunding has specific tax filing and reporting requirements. For campaign owners, things need to be considered include: income recognition, year of deduction for expenses, and sales tax issues on products sold or gifts given during the campaign. We should also educate them on tax implications for contributions made to a campaign and how the filing requirements differ when the donation is categorized as a gift versus as a charitable contribution.

Digital Security - Expanding Your Technical Awareness

By: Nilesh Lad, CPA, *MST Student*

During the panel on Thriving in the Digital Economy-Best Practices for Small Businesses and Their Tax Advisers, John Giodano and Neal McCarthy, both cyber-security experts with SecureWorks, and Sean McLean, PMP, an IT Director with Petrinovich Pugh & Company LLP, discussed today's challenges in safeguarding digital information and best practices to protect this information.

Threats Today

Digital security is an ever-increasing concern for businesses of all sizes, including CPA firms. The perpetrating thefts of digital information are motivated by financial gain as this information has tremendous value in criminal markets. Threats come from individuals, criminal groups, and nation states. They target individuals, businesses, governments, and other types of organizations that keep confidential information that can be used for financial gain. The most common tactic for gaining access to confidential information is "phishing." Phishing attacks come from emails that appear to be legitimate, but they have attachments or links that, when opened, will give the perpetrator access to the computer and other devices connected to the internal network. Often, the ultimate target of the attack is compromised indirectly by gaining access to the target via vendors and customers with which the target does business, such as CPA firms and their CPA websites.

Types of incidents include theft of banking information, other financial information, Personal Identifiable Information (PII), ransomware, and computing power via botnets. Most threats are opportunistic (88%) rather than targeted to the specific victim (12%). Opportunistic threats are volume attacks that usually use phishing emails in the hopes of someone opening an attachment or clicking on a link.

Network breaches and data losses of PII are significant risk areas for any organization that keeps confidential information. Organizations must be aware of the various federal and

state laws that require specific industries like professional tax preparers to establish safeguards to protect taxpayer information. Organizations are also normally required to provide notifications and free credit monitoring for customers whose information may have been stolen.

Security Solutions

Organizations need to focus on three areas to protect against cyber threats: prevention, detection, and correction. Prevention is key as it requires proactive steps to stop the threats in the first place. Prevention is two-pronged: policy and technology. Policies ensure that the basics are in place to provide a solid security foundation. They include things such as robust password policies, computer usage policies, data retention and disposal policies, and user education. Policies are also critical as threats could come from insiders, like employees, and the loss of data paper sources. These issues are especially true for tax preparation businesses that have significant amounts of financial and PII information on printouts, so non-electronic data security is just as critical. Preventative technology includes keeping software and virus protection updated, reviewing security certificates, using a secure portal to share data with clients, implementing a firewall with the ability to filter content, keeping both offline and online backups, and applying proper user access privileges. Other options are available, but may not be viable for many small tax practices due to costs and technological expertise needed.

Threat detection is more challenging than prevention as solutions to detect existing security breaches are often costly and therefore not as viable for small businesses. Corrective actions are reactive and based on fixing the cause of breaches. Again, for small businesses, some corrective measures may not be viable.

The IRS has two publications that provide an excellent guide for protecting taxpayer data.¹ These guides are especially useful to smaller tax practices as they provide guidelines and tools that can be implemented and utilized by businesses of all sizes. In addition, the guides cover both non-electronic and electronic threat preventions.

Conclusion

Threat prevention is critical for all organizations that have financial and PII information, but it is especially critical for professional tax practices. Professional tax practices also have higher exposure to non-electronic threats due to the high volume of paper documentation. Implementing a good foundation of basic policy and technology solutions will protect most professional tax practices from the most common types of electronic and non-electronic threat.

¹ Internal Revenue Service. *Publication 4524 (Rev. 9-2015): Security Awareness for Taxpayers*, retrieved from: <https://www.irs.gov/pub/irs-pdf/p4524.pdf> and *Publication 4557 (Rev 10-2015): Safeguarding Taxpayer Data – A Guide for Your Business*. Retrieved from: <https://www.irs.gov/pub/irs-pdf/p4557.pdf>

IRS Future State

By: Sara Yaqin Sun, MST Student

The Fifth Annual IRS-SJSU Small Business Tax Institute was held to address tax-related topics faced by small business owners and tax practitioners in today's digital economy. By taking advantage of the digital age and the latest technology, the IRS has initiated a *Future State of Tax Administration* to promote a superior user experience for taxpayers and practitioners. A three-member panel, consisting of Vivienne Antal and Gerry Kelly-Brenner, both representing the IRS Stakeholder Liaison Office, and Claudia Hill, EA, MBA, President of Tax Mam Inc., focused on the IRS Future State at the conference.

Digital Security and the Role of Stakeholder Liaison

Ms. Hill is the Editor in Chief of Wolters Kluwer's *Journal of Tax Practice & Procedure* and served on the IRS Commissioner's Advisory Group to Larry Gibbs in the 1980s. As an active tax practitioner, she frequently speaks at seminars for EAs, CPAs, and tax organizations - including the IRS. Ms. Hill commented on the digital security issues discussed in the previous presentation of the conference and suggested when facing data theft and hacking, firms should talk to the IRS Stakeholder Liaison representatives and follow the available procedures to minimize the taxpayers' losses.

As part of the IRS Small Business/Self-Employed Division, the Stakeholder Liaison intends to establish relationships with small business owners and tax practitioners to provide them tax information and resources offered by the IRS.¹ As Senior Stakeholder Liaisons, both Ms. Antal and Ms. Kelly-Brenner represent the IRS at a variety of educational outreach events, conferences, seminars, and workshops on tax-related topics. Ms. Kelly-Brenner also commented that to avoid being negligent, tax practitioners should make the greatest efforts to safeguard their clients' information. More digital security issues were discussed throughout the panel as a primary component of the strategic plan of the Future State.

¹ Internal Revenue Service (2017). *Stakeholder Liaison Local Contacts*. Retrieved from: <https://www.irs.gov/businesses/small-businesses-self-employed/stakeholder-liaison-local-contacts-1>

IRS Future State

Ms. Antal commenced the official discussion on the IRS Future State. She explained that the purpose of the Future State is to improve taxpayer experiences by providing them with accurate information and timely services. Ms. Antal pointed out some of the key objectives they have been trying to achieve:

- Easy and correct access to information via different communication channels.
- Ability for taxpayers to self-adjust account information.
- Case-solving within the first year of filling of the returns.
- Higher rate of compliance.
- More satisfying interactions between the taxpayer and the IRS.

The Taxpayer Component

Ms. Kelly-Brenner continued the panel discussion and introduced the taxpayer component of the Future State. She specified that the IRS is working to serve the taxpayers effectively and efficiently by offering a complete online experience that is similar to what the taxpayers get at banks or retail businesses. The components of the full-cycle online operations are as follows:

- Access to an online account to get personalized guidance and notices.
- Strengthened security to protect taxpayer identification.
- Self-adjustments to taxpayer account information and self-correction of return errors.
- Secure messaging for taxpayers and IRS agents to interact online.
- Authorization for representatives to access client account information (specifically for business taxpayers).

Operational Efficiencies

Ms. Kelly-Brenner also illustrated the concept of providing the best taxpayer experience possible at all stages of return filing with more efficient operations. At the pre-filing stage, taxpayers would be able to get the information they need to file their return online, either from e-subscriptions or from speaking with an IRS agent. The IRS is expected to increase their educational outreach to keep taxpayers informed on the filing requirements as well. At the filing stage, the IRS would provide taxpayers with guidance with clear explanations in a plain language which would help them to understand the types of adjustment that will need to be made prior to filing. For the post-filing stage, the IRS would detect errors and promptly send an early notification to taxpayers. Certainly, these ideas would not be realized without more efficient operations.

The overall goal of these strategies is to be a model of efficient operations that is adoptable, adjustable, and flexible. As a part of the model, an efficient workforce would be able to identify highest priority activities early, and analytics-driven operations would help with the taxpayer outreach and deliver tailored information to taxpayers. Again, taxpayer files would be digitized over secure channels that are accessible online. The IRS hopes to build a solid foundation in the near future.

IRS Online Tools

Many taxpayers who have more complex compliance issues will need regular responses from the IRS. The very first and easiest step taxpayers can make is to look through the information and guidance available online at www.irs.gov. The IRS website has experienced technical updates and transformations and is now more user-friendly, interactive, and easier to navigate. According to Ms. Antal, the majority of online tools are accessible on one page. The most commonly used tools offered online to individuals and business taxpayers include requesting a copy of a tax transcript, making an electronic tax payment, and getting an Employer Identification Number (EIN).

Ms. Kelly-Brenner also pointed out there are numerous tools available for tax professionals as well. They can check the tax calendar, request or renew a Preparer Tax Identification Number (PTIN), and subscribe to the periodic e-News from the IRS.

Next Steps and Goals

The panel noted that besides combatting identify theft and improving taxpayer expectations, another goal of the Future State is to maximize the use of the Service's budget and resources. It was noted that 25% of the overall IRS workforce was eligible to retire in 2016, and the number will exceed 40% by 2019. The goal of these current and planned improvements is to continue to provide quality services to taxpayers.

It will require a lot of effort to realize the visions of Future State. The IRS will pursue priority initiative development with a continual focus on engaging its stakeholders. The IRS welcomes taxpayers and practitioners to track its performance towards the discussed goals and provide feedback as part of the process.