E. Martin Davidoff, CPA, Esq.

E. Martin Davidoff is a Certified Public Accountant and Attorney at Law with offices in Dayton, New Jersey. Mr. Davidoff is licensed to practice both professions in New York and New Jersey and is active in many associations. Mr. Davidoff acts as a professional tax advisor to hundreds of small businesses and counsels clients on how to organize and structure their small start-up businesses.

Mr. Davidoff was appointed by Governor Christie Whitman to the 1995 White House Conference on Small Business and was elected as a delegate to the 1986 Conference. He served as the New Jersey delegation's Tax Issues Co-Chair and Treasurer for both conferences.

Mr. Davidoff serves on the Leadership Council for the New Jersey chapter of the National Federation of Independent Businesses (NFIB), having been a member of NFIB for well over a decade. As a small business advocate in New Jersey, Mr. Davidoff co-authored New Jersey's S Corporation legislation (1992-93) and participated in the 1994 Governor's Conference on Small Business, where he served as Chairperson of the Taxes and User Fees session. Mr. Davidoff actively participates in the Middlesex Regional Chamber of Commerce and has testified on New Jersey and Federal legislation impacting small business.

Among the honors he has received are the 1998/1999 New Jersey Society of CPAs Distinguished Service Award for his dedicated service and commitment to the Society; the SBA 1997 Accountant Advocate of the Year for New Jersey and Region II (New York, New Jersey, Virgin Islands, and Puerto Rico); and the 1998 Nicholas Maul Leadership Award from the Southern Middlesex County Chamber of Commerce. Mr. Davidoff also appears in several editions of "Who's Who in the East" and "Who's Who in American Law."

Mr. Davidoff serves on the national Internal Revenue Service practitioner's Liaison Committee for the American Association of Attorneys-Certified Public Accountants ("AAA-CPA"), and chairs the AAA-CPA IRS Liaison Committee. As a member of the AICPA's Tax Division, he has served on the Tax Legislative Liaison Committee. He served two years on the Executive Committee of the New Jersey Society of Certified Public Accountants, having served as the organization's Secretary and as Vice-President for Taxation and Legislation. In addition, Mr. Davidoff served as President of the Middlesex/Somerset Chapter of the NJSCPA. He is also a former chairperson of the NJSCPA Federal Taxation and Membership Committees. Mr. Davidoff is also member of the tax section of the New Jersey Bar Association.

Mr. Davidoff's complete curriculum vitae appears along with his written testimony.

Testimony of

E. Martin Davidoff, CPA, Esq.

before

Michael Barrera,
SBA National Ombudsman

January 29, 2003, Trenton, New Jersey

Mr. Barrera, thank you for inviting me to speak this morning.

I am critically concerned with the potential breakdown in the American system of taxation.

1. Complexity;
2. An audit rate too low to ensure equitable compliance;
3. A perception of unfairness; and
4. An inability to resolve routine problems or handle routine transactions easily

threaten our system of self-assessment. The issue of complexity was a hot topic in the 1996 presidential election campaign. At that time, supporters of the Flat Tax or a National Sales Tax had a national platform. However, since the 1996 elections, Congress has insisted on making our tax laws more complex in, what appears to me, the interest of political expediency rather than in the interest of good tax policy.

The solution to complexity lies with Congress. And, as I understand it, Mr. Barrera, this hearing today is to address regulatory problems.

The Internal Revenue Service is given the task to enforce our tax laws. In light of the complexity of our laws, their task is daunting. For the most part, they are doing a good job. However, I am proposing below significant revisions of some of their methods. These changes will help small businesses as well as individual taxpayers throughout our nation.

Although some of the ideas I bring to you today have been presented by other organizations I have worked with, such as the National Federation of Independent Businesses ("NFIB") and the American Association of Attorneys-Certified Public Accountants, I do not represent any organization today. I am here as a small businessman, an advisor to small businesses, and a small business advocate.

I. ELIMINATE SECTION 179 ELECTION TAX TRAP

In the year 2003 businesses may, generally, take a current year deduction for up to $25,000 of capital assets. The trap is that an election under the Treasury Regulations governing section 179 (using form 4562) is required. I urge the U.S. Treasury to revise the regulations under section 179 so as to deem the election as having been made if the taxpayer takes the deduction.

Here is the problem. Taxpayer X knows that he can write-off up to $25,000 of capital assets in year 2003 pursuant to section 179. Accordingly, he purchases a computer and a photocopier for a total of $4,500 and classifies those items as an office supply when he prepares his/her return. On audit, the IRS auditor correctly disallows the $4,500 and allows only a depreciation deduction of $900 in year 2003. The auditor points out that an election using form 4562 was not made. Also, because of the manner in which the regulations are written (§1.179-5), the election may not be made on an amended return. (The normal rules for amending a return give a taxpayer 3 years from the normal due date. For section 179, the taxpayer is given only 6 months.)

The IRS position has been upheld under several tax court cases (see V.J. Genck, 75 TCM 1984, TC Memo. 1998-105 and R.C. Fors, 75 TCM 2221, TC Memo. 1998-158).

Congress can correct this unintended inequity by amending Section 179(c). Alternatively, the regulations under the Internal Revenue Code can be revise to include the following language:

"An election shall be deemed made by a taxpayer by the filing of a return which claims deductions for any section 179 property acquired during the year, whether or not such deductions are identified as section 179 property on the return."

With the additional regulation which I propose, the unfair results of Genck and Fors will be avoided. However, the taxpayers will still have the burden of proving the expenditure and that the property acquired is, indeed, section 179 property.

II. OFFERS IN COMPROMISE

Ask the IRS management how the Offer in Compromise program is doing and they appear to be thrilled. The Ending Inventory is down and the disposal time is faster. Well, I am here to tell the bad news. The dollars collected are down, the number of cases evaluated has fallen, and the number of cases returned without evaluation has nearly doubled from nearly 27,000 cases to just over 50,000 cases. [See Exhibit #1 summarizing statistics presented to various practitioner groups at an October 21, 2002 working group meeting with the IRS.]

Of all the processible offers disposed of for fiscal 2002, only 26.4% of the cases were accepted. This compares to 39.8% for fiscal 2001. Only 8.4% of the cases in Centralized OIC were accepted! Add to those numbers above, that with less then 17,000 cases rejected during the year ended September 30, 2002, over 8,000 are in Appeals.

Add to this, the fact that the IRS does not keep any statistics or information whatsoever on returned or rejected cases to determine whether the IRS ultimately rejected an offer for more money then they ultimately collected or visa versa. The IRS has not even made a statistical sampling of what transpires subsequent to an offer being rejected or returned? They don't even keep any statistics on the dollars rejected. For example, the IRS agreed to offers in compromise for $300 million. How much was offered in total for the offers rejected, returned, withdrawn, or terminated?

Something is wrong. Actually, many things are wrong with the Offer in Compromise program. As part of this testimony, and as attached in the form of letters we have previously sent, you will find some of our recommendations for changes.

1. Keep track of rejected and returned cases.

For all processible cases, the IRS should track how much is offered against how much of a liability in the same manner it does for accepted offers. Thus, how much was offered in returned cases? How about in rejected cases or withdrawn cases?

The IRS should also determine (whether through complete tracking or statistical sampling) how much the IRS ultimately collects from processible cases returned, withdrawn, or rejected. It would be helpful to know, for example, that if the IRS disposed of some 80,000 cases through non-acceptance how much money was represented by those cases.

2. <u>Be fair about evaluating IRS Management on processing time and be more reasonable with respect to requests for additional time by Taxpayers and their representatives</u>

The push to shorten time lines is having a negative effect on certain taxpayers. The impact has been a lower acceptance rate and a reduction in the number of offers being evaluated (because the number of cases being returned without evaluation has skyrocketed).

When the Administration, the Oversight Board and the IRS Management evaluates the time in which Offers are processed and completed, we would ask that you separate Offers in which delays are attributable to practitioner or taxpayer requests. In many cases, practitioners and taxpayers have a need for an additional 30 days from time to time in the course of the process. These requests, if granted, could add up to 60 days to the Offer in Compromise process at no fault of the Internal Revenue Service ("IRS").

Current policy requires the IRS to return an Offer if an individual does not provide information requested in a 30 day period. Generally, there will be no extensions granted unless reasonable cause is established. Due to the pressure of Congress and this Oversight Board, the IRS is often hesitant to find reasonable cause. Then, once the case is rejected, the taxpayer has to re-submit and go to the end of the line. There is no additional warning, just the return of the case. What would be so terrible about allowing a one-time automatic extension of 30 days if requested? Unfortunately, the pressure your Board is bringing on behalf of taxpayers to accelerate the review process is a double-edged sword.

In evaluating statistics, I would ask that you have the IRS segregate its processing time. First, they should process offers in a reasonable time when taxpayers do not request extensions of time. A second measurement of processing time could cover situations in which taxpayers request additional time. (We are talking up to two 30 days extensions throughout the entire process....such additional time enables everybody to work more effectively in that the information being provided will be more comprehensive. In addition, practitioners can better fit the numerous demands on their time within the new more flexible parameters. Also, the frequent debates on allowing additional time are eliminated, thus enabling the IRS to spend more time on substantive issues.)

3. Eliminate the use of the Rejection with Options Policy and clarify correspondences.

Attached hereto you my letter of November 19, 2002 written on behalf of the AAA-CPA Tax Liaison Committee to the National Public Liaison and the SB/SE. In that letter we discuss our opposition to the Rejection with Options policy of the IRS. This policy, provides both a rejection and an option to offer a larger amount into a single letter. I do not believe that the first substantive contact from the Offer Examiner should be a rejection. Rather, if there are options, those options should be presented clearly and allow discussion to ensue between the IRS and the Taxpayer and his/her representative without the ticking of an appeals deadline over their heads.

Also, in my letter of November 19, 2002 I provided specific comments on the wording of the Rejection with Options letter.

4. Encourage more communications between the IRS and taxpayers/representatives. The measurement of this will be a reduction in cases merely returned.

Why is it that over 75% of the processible cases in Centralized OIC are returned? My common sense tells me that the procedures being used are flawed. In the "old" days, a Revenue Officer would make a call and say, "I am still waiting for that information I asked you about. When can I expect to receive it?" Today, a clerk sends a letter requesting information. If that letter is lost, misplaced, or just not promptly attended to, the case is returned. A return is worse then a rejection because it has no appeal rights!

I think the IRS has to take dramatic action to minimize the number of cases returned without a substantive decision. One suggestion would be to mail such requests via certified mail. Another would be to initiate a call to the taxpayer at the time the letter is being mailed emphasizing the fact that a response is required within 30 days or the case will be returned. The IRS can test the various approaches to see if a reduction in returned cases (and, hence, an increase in cases accepted and monies collected) is achieved.

Also, as I have suggested above, if a call is made by the Taxpayer or Practitioner within the thirty-day time-frame requesting additional time, another 30 days should be granted. Why not? The IRS has enough cases to work on. And, the delay in getting the information will merely delay the decision to the taxpayer. We are certain that many of the cases returned by the IRS are legitimate offers that should be considered. So, we ask, why be so quick to get rid of them.

I have found that the attitude of the Centralize OIC process in particular has been arbitrary in

dealing with requests for time. This arbitrary attitude spills over in substantive issues. We learned this first hand in our meeting with the Commissioner last summer when we found that the Centralized OIC sites were being much more rigid in applying transportation standards then was the office in charge of those standards. My July 31, 2002 lett
+r to Janet Waldman on behalf of the AAA-CPA, which discusses this and several other issues regarding allowable expenses, is enclosed.

III.COLLECTION INFORMATION STATEMENTS

To facilitate Offers in Compromise, Forms 433-A and 433-B were revised by the IRS, effective May of 2001 to be more comprehensive. In addition, the forms required numerous attachments to substantiate claim deductions and liabilities.

The extensive information is suitable for the Offers in Compromise program due to the fact that the user thereof is requesting the Internal Revenue Service, ("IRS") waive the collection of amounts due. However, the same forms are also being used in connection with Installment Agreements and other collection activities. In these cases, the full amount of the tax, along with related interest and penalties, will be paid in full. The requirements of the current Forms 433-A and 433-B are too rigorous for mere Installment Agreement arrangements.

The IRS has Form 433-F which is a simpler form. However, the IRM (at 3.1) provides that 433-F can be substituted only if the tax involved is less than $100,000. In using the wording "can be" the IRM appears to place the burden on the Revenue Officer to justify the use of the Form 433-F in lieu of the Form 433-A. We believe that, outside the Offer in Compromise program, the use of the Form 433-F should be the rule and the Forms 433-A and 433-B should be the exception.

I recommend that the IRS use the existing Forms 433-A and 433-B exclusively for

1. Offers in Compromise; and

2. Cases involving $100,000 or more in tax due for which a Revenue Officer has cause for requesting more detailed information.

In all other cases Form 433-F should be used or a simpler set of Forms 433, more closely aligned to the pre-2001 format for Forms 433-A and 433-B.

IV. THIRD PARTY CONTACT NOTIFICATION:

I understand that the 1998 tax act requires a notification of such third-party contacts. I have been disappointed to find that the notification for new collection cases is being satisfied through general language provided in publications and notices rather then specific notification to the taxpayer and his or her representative. We believe that this is inappropriate and not in line with the intent of the legislation. We believe that this methodology fails to provide "reasonable" notice as required by section 7602(c)(1) of the Internal Revenue Code.

From a taxpayer point of view, the ideal situation would be one in which he or she receives a specific notification with respect to each contact which the revenue officer wishes to make (e.g. I intend to contact your neighbor, Mrs. Jones). However, I understand that this would place an undue burden upon our nation's tax collection system. Accordingly, I recommend the procedure set forth below.

At the time a revenue officer believes it is necessary to make third-party contacts to investigate a matter, the taxpayer and his/her representative should receive a notification of the potential third party contact, which states with as much specificity as possible:

5. The reason for the third party contact (e.g. we have been unsuccessful in our attempts to speak to you regarding the above-referenced tax liability);

6. Who is being contacted or the class of people being contacted (e.g. we will be contacting your employer, the ABC Company; you life insurance agent, John Smith; your coworkers; and your neighbors);

7. When the contacts will take place (e.g. our contacts will be made during the period May 1 through August 31, 2003); and

8. The tax liability and amount involved (e.g. your debt due to the U.S. Treasury of $10,000 with respect to your 1997 individual income taxes (form 1040)).

These third-party contact notifications should not be made as a matter of course when a revenue officer first receives a case. Such notifications in anticipation of some future contacts without a specific intent to make those contacts has many of the same flaws as a general notification.

V. EXTENSIONS FOR PARTNERSHIPS, TRUSTS, AND ESTATES

Generally, businesses operating a corporation may file their return on the nomal due date (March 15th) or six months later (September 15th) by filing an automatic extension request. As such, corporations in the United States enjoy a simplified exentsion filing process.

Unfortunately, partnerships, trusts, and estates, whose returns are normally due on April 15th each year, are required to file two extension requests to secure the six-month extension period. Not only does this place an additional burden on small business, it requires the IRS to handle millions of additional pieces of paper.

I propose that all tax returns of partnerships, trusts, and estates receive automatic six month extensions following a process similar to that followed by corporate return filers.

VI. NOTICES OF INTENT TO LEVY

Frequently, the CP-504 notice (see sample enclosed) is sent to taxpayers in instances when a good faith effort is being made to pay the liability or when an appeal is in process. Since the current notice is misleading, threatening and overused, the AAA-CPA has drafted a recommended version (also enclosed) of the letter, which clearly states that the taxpayer's state tax refund is at risk. Attached hereto as exhibits you will find the CP-504 as it is currently used and the proposed form. I also encourage the I have worked for over three years with representatives at IRS headquarters to affect changes to the wording and usage of Form CP 504, the notice of intent to levy a taxpayer's assets. The current notice opens with bold letters stating "Urgent!! We intend to levy on certain assets." In reality, it is a notification that the IRS will be taking only the taxpayer's state tax refund, a fact that is buried in the text of the notice. In addition, the issuance of the levy has the impact of increasing the penalty for the late payment of taxes from one-half percent (½%) per month to one percent (1%) per month.

In order to levy any other assets, the IRS must send other official letters to the taxpayer. IRS to use the notice less frequently, only in situations where the taxpayer has made no effort to contact the agency or pay the overdue taxes.