



Padgett

October 27, 2022

The Honorable Richard Neal
Chairman
The Committee on Ways and Means
U.S. House of Representatives
1102 Longworth HOB
Washington, D.C. 20515

The Honorable Ron Wyden
Chairman
The Committee on Finance
U.S. Senate
215 Dirksen SOB
Washington, D.C. 20510

The Honorable Kevin Brady
Ranking Member
The Committee on Ways and Means
U.S. House of Representatives
1102 Longworth HOB
Washington, D.C. 20515

The Honorable Mike Crapo
Ranking Member
The Committee on Finance
U.S. Senate
215 Dirksen SOB
Washington, D.C. 20515

Dear Sirs:

I am writing on behalf of Padgett Business Services to provide feedback on the \$80 billion in funding for the Internal Revenue Service (IRS) that was recently included in the Inflation Reduction Act (IRA). As you well know, the IRS has struggled in recent years to provide basic service and keep up with its growing workload, a situation that was compounded by the unprecedented challenges created by the COVID-19 pandemic. Our hope is that the IRS will work with outside stakeholders to develop a plan to strategically and efficiently address the issues that have plagued the agency in recent years.

Padgett Business Services is a national accounting and tax preparation company with approximately 200 franchises across the U.S. that has served tens of thousands of small business clients for over 50 years. We have seen first-hand the many challenges faced by the IRS and the resulting negative impact on taxpayers, including massive backlogs, delayed refunds and credits, unanswered telephones, and the sending of inaccurate notices.

Like most IRS stakeholders, we believe that the immediate priority for the IRS is fixing these problems. It is incumbent on the IRS to reassure the public that the funds will be spent in an efficient and ethical manner that improves the taxpayer experience and does not increase the burden on American taxpayers. Most Americans want to stay in compliance with their taxes but need an IRS that can respond to their correspondence, answer their phone calls, and process their payments in a timely manner. The IRS should outline its plan on key issues such as:

- hiring and training new employees;
- customer service benchmarks;
- technology enhancements;
- the enforcement selection process (including protections for low-income taxpayers and ensuring that primarily those not in compliance are being targeted); and
- stakeholder engagement (including private sector feedback on enforcement, technology improvements, and customer service tools).

In an October 13, 2022, memorandum to Secretary Yellen, the Treasury Inspector General for Tax Administration (TIGTA) also shared its perspective on the most serious management and performance challenges confronting the IRS. Additional areas included protecting taxpayer data and IRS resources, administering tax law changes, and reducing tax fraud and improper payments.

While each of these are essential to a well-functioning IRS, they alone will not fix the problems with the agency. The IRS must fundamentally change the way they address and get ahead of problems, including working with stakeholders and being willing to adapt and make changes in real time to overcome foreseeable obstacles. Leadership within the agency must set the tone and establish a culture that thinks strategically about potential problems in advance, rather than letting narrow decisions snowball into greater challenges for the agency.

The implementation of the Employee Retention Tax Credit (ERTC) is a fitting example of a larger administrative problem at the IRS that could have been prevented through early problem solving. As you know, the ERTC was originally created by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which included a provision that small business owners could not receive both a Paychex Protection Program (PPP) loan and the ERTC. However, that provision was later reversed when the Consolidated Appropriations Act (CAA), which Congress passed in December 2020, retroactively allowed a small business to claim the ERTC even if the business had secured a PPP loan. This change opened up the opportunity for hundreds of thousands of businesses to go back and retroactively claim the ERTC for 2020.

The first critical decision made by the IRS in implementing this policy was that the retroactive credit needed be claimed on the 2020 tax returns, requiring businesses to amend their prior 941s in order to claim the credit. However, amended 941s (941-Xs) can only be filed on paper. There is no electronic option. Therefore, despite the warnings of many tax professionals, the decision by the IRS to not allow businesses to simply claim the retroactive credits on their upcoming quarterly 941 exacerbated an already massive paper backlog at the IRS and led most businesses to have to wait 9-12 months to receive a credit aimed at helping them weather the pandemic.

Furthermore, the IRS then provided guidance clarifying that the taxpayer must reduce the wage expense equal to the amount of ERTC credits received in the year the qualifying wages were paid and the credits were claimed. To comply with this IRS guidance, the small business taxpayers were required to undergo the additional costs and burden of amending their recently filed 2020 income tax return. At the time and since we have asked the IRS and Congress to take the needed action to give small business taxpayers the option to amend their 2020 income tax return or include the refunds as income on their 2021 return, removing cumbersome administrative work and additional costs. However, the IRS has taken no action to pursue such a solution.

Small businesses are finally starting to receive their ERTCs. Many practitioners and business owners, however, are still under the false impression that once they receive their ERTC money, they are finished with the ERTC. In addition to the burden of having to amend their 2020 tax returns places on small businesses and taxpayers, in most cases a penalty notice will automatically be generated since the tax liability will increase and will have been late.

The IRS acknowledged the potential penalties and the need for relief in a statement on April 18, 2022. As solutions, the IRS reminded taxpayers that they can seek relief by showing reasonable cause or under the IRS's First Time Penalty Abatement program. However, these are labor intensive and often time-consuming processes that are not available to all taxpayers (i.e., those that have already used their first-time penalty abatement). These options also lead to more paperwork and back and forth with the IRS for an agency that is already backlogged and overwhelmed.

In April, we sent a letter to the IRS with several suggestions for a potential framework for how to handle the related penalties. They included an education campaign to let taxpayers know they need to comply with the above-mentioned guidance; the need for the IRS to provide taxpayers with a time frame and safe harbor to amend their returns which would avoid the need for the IRS to send penalty notices and also eliminate the need for a taxpayer response; and, finally, if taxpayers did not amend their returns during the grace period, then penalties would still apply. Such guidance would give penalty relief to small businesses that are seeking to do the right thing. Nevertheless, the IRS has failed to take action on any of these issues, leaving many small businesses in a difficult situation.

The history of the ERTC should serve as an example and case study of how failing to proactively address issues as they become apparent will only compound and make existing problems worse for the IRS. If the IRS had been open to stakeholder feedback and shown a degree of flexibility in approaching the implementation of the ERTC, then the massive backlogs and delayed credits could have been avoided.

Padgett believes that the funding provided in the IRA does present a tremendous opportunity for improvement and change at the IRS. The additional funds provided over the next decade have the potential to vastly improve and even transform the U.S.'s tax administration system for the benefit of taxpayers and tax practitioners. However, the IRS will fail to achieve its goal of real transformation if it does not implement a strategic plan that promotes a new way of thinking and operating at the agency – one that aims to address problems early and prevent the predictable fallout of bad decisions. Padgett would welcome the opportunity to work with Congress and the IRS to further this goal for the benefit of small businesses and all taxpayers.

Sincerely,

A handwritten signature in black ink, appearing to read "R. Harris". The signature is fluid and cursive, with the first name "R." and the last name "Harris" clearly distinguishable.

Roger Harris
President
Padgett Business Services