Members in Small·Local Accounting Firms

September 2007

AICPA

American Institute of Certified Public Accountants

Highlights

Using PEOs to Handle Human Resources and Assist in Employment Law Compliance

By George G. Early III, CPA

news update

When CPA John Maddox started Maddox Ungar in Bingham Falls, Mich., in 2004, he hired a professional employer organization, which does human-resource chores for small businesses. "We were starting from scratch," he says. "We did not have the benefits and staff tracking systems we needed. I thought the only way we could get running was to bring in a PEO." According to Maddox, this step allowed him to focus on the business, which he says grew 40% that first year.

From Ordinary Chores to Complicated Tasks

The PEO industry emerged in the 1980s as a new way for small businesses to outsource time-consuming rote chores and the more complicated human-resource tasks, such as setting up a 401(k) plan or handling a discrimination complaint. PEOs also take responsibility for payroll and remit payroll taxes for the worksite employees and process workers' comp and unemployment claims. The 25-year-old industry now handles about $53 billion in payroll a year for more than 100,000 small to medium-sized businesses, including CPA firms.

Practitioners challenged by the plethora of employment laws and regulations can consider PEOs as a way to cut human resources tasks and ensure compliance. In the ongoing struggle to attract and retain high-quality staff, PEOs also often

continued on page C2

Small Firm Solutions E-Newsletter Debuts

Last month marked the debut of *Small Firm Solutions*, a new AICPA quarterly e-newsletter designed to help members in the smallest firms make the most of their opportunities and keep track of important new developments in the profession. It offers news updates as well as articles with practical solutions to common practice challenges. A key feature in every issue will be "Hot Topics for Small Firms," a column written by James Metzler, AICPA Vice-President, Small Firm Interests. In the first column, Metzler gave the small firm perspective on subjects such as private company financial reporting; the International Federation of Accountants' exposure draft on independence; professional mobility; and the new business valuation standards. Other articles included:

- An introduction to new brochures that promote the Small Firm Advantage to potential clients and recruits.
- A look at some facts and fallacies associated with SAS No. 112.
- Sole practitioner Christine Lauber's successful strategy for working smarter with the staff she has.
- Ideas from author Ed Mendlowitz on expanding services to tax clients.
- Advice from consultant Joel Sinkin on how to begin the succession planning process.
- Productivity boosters from technology expert Roman Kepczyk.

To access *Small Firm Solutions*, go to the PCPS Firm Practice Center:

www.aicpa.org/pcps

continued from page C1—**Using PEOs**

make it possible for firms to offer generous benefits that make them more attractive employers. In addition, CPAs can alert their small business clients to the possible benefits of working with PEOs themselves.

Due Diligence

Because PEOs are handling payrolls and significant amounts of cash, due diligence is required when choosing one, as is the case with any outsourcing arrangement. "The big risk exposure can be payroll," says Darrel Whitehead, a CPA in Huntington Beach, Calif. "How do you know the PEO is reporting payroll taxes accurately?" If the taxes have not been paid or are underpaid, the Internal Revenue Service will consider the client responsible along with the PEO. Whitehead recommends that CPAs ask for an independent auditor's verification that the PEO has paid payroll taxes, including state unemployment taxes, for the firm's employees.

There have been a handful of cases where PEOs illegally underpaid payroll taxes. To review recent prosecutions, go to the Department of Justice Web site at:

www.usdoj.gov/tax/TaxFactSheet.doc

"These cases are egregious, certainly, but they are not typical of our industry," said Milan P. Yager, executive vice president of the National Association of Professional Employer Organizations (NAPEO). "This industry responsibly handles billions of dollars in payroll and payroll taxes every year, year in and year out."

In fact, NAPEO and the industry are asking Congress for a change in the tax code that would make PEOs solely responsible for their clients' payroll taxes when the IRS certifies them. "The industry wants to codify its responsibility for payroll taxes," Yager says. "That will help preserve the remarkable record we've accrued as responsible taxpayers for important client responsibilities."

Bonding and Accreditation

Maddox recommends that CPA firms check on a PEO's financial reserves and ascertain whether the PEO has a bond to cover losses. The 28 states with licensing or registration requirements for PEOs mandate minimum levels of financial reserves or a bond for the unlikely event of a problem. The PEO industry is pushing for registration in all of the states with requirements for audited financials and adequate financial capacity.

A few PEOs are accredited by the Employer Assurance Services Corporation, or ESAC, and thus backed by $6 million in surety bonds. They have met the highest standards for firms in the industry. During ESAC's 12 years, there has never been a default involving an accredited PEO. To find an accredited PEO, go to:

www.esacorp.org

Making a Choice

PEOs are not a panacea, but firms that pick PEOs that are well-suited to their practices can enhance their employee benefits. "Most people realize that PEOs make sense," said Maddox. "We have a PEO because we are competitive, and because of the PEO we stay competitive."

The industry is still something of a mystery to a lot of small companies. How should CPAs go about choosing one? More information on using and selecting one can be found on the trade association's Web site:

www.napeo.org

George G. Early III, CPA, is senior vice president, chief financial officer, for Adams-Keegan, Inc., a PEO in Memphis, and a director of The James Group, LLC.

Electronic Filing for Three Excise Tax Forms

The Internal Revenue Service said that it will add three excise tax forms this year to the ever-expanding list of federal tax returns and schedules that can be filed electronically.

"Electronic filing is a key component to modernizing our tax system," IRS Acting Commissioner Kevin M. Brown said. "Expanding e-file opportunities to include excise tax returns will help improve service to taxpayers using these forms."

The 2007 tax filing season set a number of electronic records, according to the IRS, highlighted by more than 77 million electronically filed individual tax returns. During the summer, Form 2290, "Heavy Highway Vehicle Use Tax Return," was to become the first available excise tax return that can be e-filed. Last year, more than 575,000 Forms 2290 were filed with the IRS.

As the IRS begins implementation of electronic filing for excise tax returns later this year, taxpayers may continue to file paper Forms 2290, including those reporting 25 or more vehicles. The IRS said it would issue further guidance regarding the applicable tax code section, IRC section 4481(e). In addition, Form 720, "Quarterly Federal Excise Tax Return," and Form 8849, "Claim for Refund of Excise Taxes," will be available to e-file later this year.

More information can be found at:

www.irs.gov/efile/article/0,,id=170570,00.html

Revisions Simplify Innocent Spouse Relief Form

The Internal Revenue Service announced a redesigned Form 8857, "Request for Innocent Spouse Relief," that it says will help reduce follow-up questions and reduce the burden on taxpayers.

According to the Service, the form will ask more questions initially, but collecting critical information early in the process will mean faster processing of the request. Previously, Form 12510, "Questionnaire for the Requesting Spouse," was separate from Form 8857, but the redesign will combine and streamline the two. The redesigned form will be easier to understand and complete and will help educate taxpayers about the process, the IRS says.

The new design will eliminate an estimated 30,000 follow-up letters annually, which, according to the IRS, will result in reduced

continued on page C3

Published for AICPA members in small firms. Opinions expressed in this supplement do not necessarily reflect policy of the AICPA.
Anita Dennis, Supplement Editor
973/763–2608; fax 973/763–7036; e-mail: adennis@aicpa.org
Ellen J. Goldstein, *CPA Letter* Editor
212/596–6112; egoldstein@aicpa.org

continued from page C2—**Revisions**

burden, quicker responses to taxpayers and less cost to the government. The revisions were based on suggestions from an IRS process improvement team led by the Office of Taxpayer Burden Reduction.

When a taxpayer files a joint return, both spouses are jointly and individually responsible for the tax. Innocent spouse relief provides an opportunity for a spouse to be relieved from the joint debt under certain circumstances. If a taxpayer believes that only his or her spouse or former spouse should be responsible for the tax, the taxpayer can request relief from the tax liability.

For more information:

www.irs.gov/individuals/content/0,,id=130302,00.html

Role of Appeals in Resolving Federal Tax Disputes

Web cast

During a recent Web cast of *Tax Talk Today*, an expert panel of Internal Revenue Service officials and tax practitioners provided an overview of appeals and how tax practitioners can best use this option to help clients resolve disputes over IRS actions—proposed or taken—without going to court.

Third-Party Authorizations

The different types of third-party authorizations that are available to practitioners and their clients include:

- The Power of Attorney (Form 2848).
- Tax Information Authorization (Form 8821).
- Third-Party Designation (via checkbox on the taxpayer's return).

Authorizations that can be established by telephone include the Oral Tax Information Authorization and Oral Disclosure Consent. Each authorization has its own unique requirements and limitations, and several publications are available for more complete information. The IRS recommends Publication 4245 for more information on powers of attorney.

"It covers the essential elements that have to be completed on that form, and some of the common errors," said Priscilla Hagan, chief, Policy, Procedures & Guidance, Accounts Management, Wage & Investment Division, at the IRS.

IRS forms and publications can be found on the IRS Web site at:

www.irs.gov

Processing for powers of attorney and tax information authorizations usually takes five business days for forms submitted by mail, compared with two business days when submitted via fax; qualifying tax practitioners who submit their Forms 2848 or 8821 using e-services can expect immediate processing, the panelists said. The IRS recommends Publication 4019, "Third Party Authorization, Levels of Authority," for more information on the various levels of authority.

Working with the Appeals Division

According to the panelists, the IRS Appeals Division gives tax practitioners and taxpayers an independent forum for a fresh look at a tax dispute. An Appeals Officer examines all of the facts of the case, considers all available information, viewpoints and perspectives and conducts an analysis of the litigation hazards to predict the outcome if the case were to continue on to court.

"We're charged with doing it in a way that is impartial and fair, with bias towards neither the government's position nor the taxpayer's position," said Sarah Hall Ingram, chief, Appeals, IRS.

The Appeals Division, which celebrates its 80th anniversary this year, reviews approximately 100,000 cases annually and resolves an average of 80% of the cases it reviews. The IRS estimates that about one-quarter of appeals cases are addressed in face-to-face meetings; most cases are disposed via telephone or correspondence.

Panelist Daniel J. Wiles, managing director, Washington National Tax Service, PricewaterhouseCoopers, pointed out that appeals can offer the taxpayer a more flexible viewpoint than a judge, who will only rule in terms of right and wrong according to the point of law.

"[Appeals] can recognize that there are gray areas," said Wiles.

Due to the complex nature of many tax disputes, industry professionals on the panel cautioned tax practitioners to prepare carefully for the rigors of the process and to have a clear understanding of appeals decision-making procedures.

"The cases that get completed at the examination level and then get to appeals are complex cases," said Eli J. Dicker, chief tax counsel, Tax Executives Institute, Inc. "A practitioner advising his or her client needs to have a very clear line of sight."

The Web cast panel also covered the statute on *ex parte* communications, which allows no oral or written communication about a particular case between the compliance and appeals divisions—with the exception of administrative communication, such as documentation requests—without the express knowledge of the taxpayer. If *ex parte* communication occurs, the IRS can either share the communication and all related content and give the taxpayer the opportunity to discuss or even rebut the communication, or the case can be reassigned to a new Appeals Officer to maintain the integrity of the appeals process.

Further Options

Aside from the standard appeals process, other options for dispute resolution are available, including fast track settlements, post-appeals mediation and arbitration. A pilot program is currently in place in Chicago, St. Paul and Houston to provide fast track settlements for SBSE taxpayers; the IRS expects to expand this program to other cities in the future.

A full transcript of this month's Web cast, "The Role of Appeals in Tax Administration," can be accessed at:

www.taxtalktoday.tv/index.cfm?page=5.73

Tax Talk Today, a free, live, monthly interactive Web cast aimed at educating tax professionals on the most contemporary and complex tax issues, is sponsored by the IRS. The next Web cast, "Campus Compliance Services and You," is scheduled for Sept. 11, from 2:00 to 3:00 p.m., ET. Viewers can ask the panelists questions via e-mail and receive on-air answers. Programs also are archived on the site for one year. For more information, go to:

www.TaxTalkToday.tv

Signature Process for Electronically Filing Individual Returns to Be Simplified

The Internal Revenue Service says it plans to simplify the signature process for electronically filed individual income tax returns submitted by tax practitioners. The simplification eliminates the need for a paper signature document to be sent to the IRS in support of electronically filed tax returns.

Beginning with the 2008 filing season, tax practitioners can e-file individual income tax returns only if the returns are signed electronically using one of two methods: either a Self-Select Personal Identification Number (PIN) or a Practitioner PIN. A Self-Select PIN allows taxpayers to electronically sign their e-filed return by selecting a five-digit PIN. A Practitioner PIN is used when a taxpayer authorizes an Electronic Return Originator (ERO) to input an electronic signature on behalf of the taxpayer.

Practitioner PINs require the use of Form 8879, "IRS e-file Signature Authorization," which is retained by the ERO.

"Nearly 90% of tax professionals already use electronic signatures to sign returns," Acting IRS Commissioner Kevin M. Brown said. "It's the right time to take the next step toward truly paperless filing."

Out of some 55 million e-filed returns that have come from tax professionals this year, the IRS said that more than 49 million used the Self-Select PIN or the Practitioner PIN. Overall, more than 77 million individual tax returns have been e-filed so far this year.

According to the Service, the change will simplify tracking, verification and follow-up on the paper signature documents, which were required for tax returns that did not use an electronic signature.

Tax practitioners will no longer submit a paper signature for e-filed returns by using Form 8453, "U.S. Individual Income Tax Declaration for an IRS e-file Return." Instead, a newly designed Form 8453 will be used to transmit supporting paper documents that are required to be submitted to the IRS with e-filed returns. The new Form 8453 will be released for use during the 2008 filing season, the Service said.

New Annual Electronic Filing Requirement for Small Tax-Exempts

The Internal Revenue Service in July began mailing educational letters to more than 650,000 small tax-exempt organizations that may be required to submit a new annual notice, Form 990-N, "Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ."

The IRS said it expects to mail the letters over a period of several months, finishing in Dec.

With the enactment of the Pension Protection Act of 2006, the majority of small tax-exempt organizations are now required to submit the e-Postcard. Previously, tax-exempt organizations with gross receipts of $25,000 or less were not required to submit information returns. The first e-Postcards are due in calendar year 2008. The IRS said it intends to have an option available for free electronic submission of the e-Postcard.

"We're sending these educational letters to all the small exempt organizations in our records because we want to make sure they all know about the new requirement," said Lois G. Lerner, director of the IRS Exempt Organizations division. "The new e-Postcard reporting requirement is simple and straightforward, but organizations shouldn't ignore it, or they risk losing their tax-exempt status."

Any organization that fails to meet its annual reporting requirement for three consecutive years automatically loses its tax-exempt status under the new law. An organization that wants to regain its exempt status will then have to reapply for recognition as a tax-exempt organization.

"The IRS calls the new form an e-Postcard because it is short, easy and electronic," Lerner said. "And organizations will be able to submit it free of charge."

The e-Postcard requires small organizations to provide a legal name and mailing address, any other names used, a Web address if one exists, the name and address of a principal officer and a statement confirming the organization's annual gross receipts are normally $25,000 or less.

In addition to sending out educational letters, the IRS is encouraging everyone—tax practitioners, individual volunteers, and larger organizations—to spread the word about the new e-Postcard reporting requirement.

"People do a lot to help their communities by volunteering their time and money to local charities. We're asking them to also offer a helping hand by making sure that charities know about the law change," Lerner said. "We don't want those organizations to lose their tax-exempt status because they didn't know about the new reporting requirement."

The IRS said it is developing a free reporting system for the e-Postcard and an application to make the information available to the public on its Web site (www.IRS.gov). The site's "Charities and Non-Profits" section also contains frequently asked questions and a copy of the educational letter:

www.irs.gov/charities/index.html

Treasury Department and IRS Report on Reducing the Tax Gap

The Treasury Department and the Internal Revenue Service have released an IRS report addressing the agency's implementation of the 2006 strategy to improve voluntary compliance with federal tax laws.

Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance details steps being taken by the IRS, as well as those under development, to address key elements of the "tax gap." For the 2001 tax year, the IRS estimates that over 86% of tax liabilities were collected, after factoring in late payments and recoveries from IRS enforcement activities. Nevertheless, the Service said that an unacceptable amount of the tax that should be paid every year is not, short-changing those who pay their taxes accurately and giving rise to the tax gap. The gross tax gap was estimated to be $345 billion in 2001. After enforcement effects and late payments, this number was reduced to a net tax gap of approximately $290 billion.

To access the report, go to:

www.irs.gov/pub/irs-news/tax_gap_report.pdf