April 11, 2013

The Honorable Max Baucus, Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Dave Camp, Chairman  
House Committee on Ways & Means  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Orrin G. Hatch  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Sander M. Levin  
Ranking Member  
House Committee on Ways & Means  
1236 Longworth House Office Building  
Washington, DC 20515

RE: AICPA Report on Civil Tax Penalties: The Need for Reform and AICPA Tax Penalties Legislative Proposals

Dear Chairmen Baucus and Camp, and Ranking Members Hatch and Levin:

With the possibility of tax reform in the near future, the American Institute of Certified Public Accountants (AICPA) recommends that civil tax penalty reform be included in efforts to bring more clarity and fairness to the Internal Revenue Code (IRC or “Code”). This letter and the accompanying materials are a part of the long history of the AICPA in advocating for reform of the civil tax penalties contained in the Code. In August 2009, the AICPA Penalty Reform Task Force issued a report (see attached update of the report), noting our concern that the government’s understandable interest in combating abusive tax shelters had resulted in a civil tax penalty regime that is not sufficiently geared toward encouraging voluntary compliance. The AICPA Report on Civil Tax Penalties: The Need for Reform (“AICPA Report”), revised and updated in 2013, is attached.

There are many aspects of the civil tax penalty regime that concern our members. Our highest priorities are to ensure that the penalties are sufficiently calibrated to the level of noncompliance, address the inconsistent application of reasonable cause in civil penalty administration, and minimize the presence of strict liability penalties in the Code.

In light of our concerns regarding a number of significant issues related to the civil tax penalty statutory and regulatory structures, the AICPA is submitting the attached AICPA Report and AICPA Tax Penalties Legislative Proposals (“Proposals”) to amend the Code to simplify the various tax penalty provisions. These documents set forth our members’ views concerning areas for improvement as tax reform is being considered.

1 See AICPA Report on Civil Tax Penalties: The Need for Reform (August 28, 2009), (the “Report”). Note: Included in this submission is the 2013 update to this report.
In addition, as part of our Proposals is a legislative proposal on tax shelters that includes an Addendum with an in-depth analysis on the definition of the term “tax shelter” for purposes of the taxpayer accuracy-related penalty in section 6662(d) of the Code and related provisions. We have found that the broad and uncertain definition of “tax shelter” in the Code and the Treasury Regulations is an impediment to the goal of voluntary compliance that the civil tax penalties are designed to achieve.

As comprehensive tax reform proposals are developed in the coming months, we encourage Congress to consider and include in such legislation the points covered in our attached Report and Proposals to revise elements of statutory penalty provisions relating to reportable avoidance transactions, reasonable cause exception, foreign information reporting for certain foreign trusts, and tax shelters.

The attached updated 2013 AICPA Report expresses our concerns about the current state of civil tax penalties and offers suggestions for improvement. Specifically, the AICPA Report addresses the following issues:

- The trend away from voluntary compliance as the primary purpose of civil tax penalties;
- The lack of clear standards in some penalties;
- The fact that some penalties are disproportionate both in amount and severity;
- The fact that some penalties are overbroad, deter remedial and other good conduct, and punish innocent conduct;
- The trend toward strict liability;
- An erosion of basic procedural due process;
- Inconsistencies between penalty standards and the role of tax professionals;
- The increase in automated assessment of penalties that can lead to unwarranted assessments;
- The need for better coordination and oversight of penalty administration;
- The bias in favor of asserting penalties;
- The need to improve Internal Revenue Service (IRS or “Service”) guidance and training; and
- The need for the IRS to increase its efforts to educate taxpayers and tax professionals.

2 The other Code provisions are section 6662A (which imposes an accuracy-related penalty on understatements attributable to listed transactions, and other reportable transactions with “a significant purpose” to avoid or evade Federal income tax), section 6694(a) (which incorporates the section 6662(d) definition of “tax shelter” in the penalty for tax return preparers), and section 7525(b) (which eliminates the federally authorized tax practitioner privilege for written communications in connection with the promotion of a section 6662(d) “tax shelter”). Although proposed to be removed, since 2005 the concept of “a significant purpose of tax avoidance” also is central to Circular 230’s covered opinion rules. See 31 C.F.R. § 10.35.
The attached simplification Proposals include:

1. Allow a reasonable cause exception to the IRC sections 6707A and 6662A penalties for all reportable transactions, and provide for judicial review where such relief is denied;

2. Allow a reasonable cause exception to the IRC section 6676 penalty for erroneous claim for refund or credit;

3. Provide that the Forms 3520 and 3520-A non-filing penalties under IRC sections 6677 and 6039F are consistent with other foreign information reporting penalties such as the Form 5471 penalty of $10,000 per violation if neither fraud nor bad faith are involved; and

4. Define the term “tax shelter” in the accuracy-related penalty provisions of the Code to clarify that the term only applies to abusive transactions.

The AICPA provides the updated Report and Proposals with an eye toward improving overall tax policy and administration. To that end, we strongly encourage an inclusive and transparent framework for approaching this difficult task, similar to the collaborative efforts that culminated in the 1989 penalty reform legislation. We urge Congress, Treasury and the Internal Revenue Service to work with taxpayers, practitioners, professional organizations and other stakeholders in developing a systematic and thoughtful approach to civil tax penalty reform and penalty administration.

The AICPA is the world’s largest member association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125-year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

We welcome the opportunity to discuss our Report and these legislative proposals or to answer any questions that you may have. I can be reached at (304) 522-2553 or jporter@portercpa.com; or you may contact Patti Burquest, Chair, AICPA Tax Penalties Task Force, at (202) 370-8236, or Patti.Burquest@mcladrey.com; or Eileen Sherr, AICPA Senior Technical Manager, at (202) 434-9256, or esherr@aicpa.org.
Sincerely,

Jeffrey A. Porter, CPA
Chair, Tax Executive Committee

cc: The Honorable Mark Mazur, Assistant Secretary for Tax Policy, Treasury Department
    Mr. Steven T. Miller, Acting Commissioner, IRS
    The Honorable William J. Wilkins, Chief Counsel, IRS