

**Testimony**

**Pennsylvania House of Representatives**

**FINANCE COMMITTEE**

Presented by

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**Pennsylvania Society of Tax & Accounting Professionals**

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Good morning, Chairman O’Neill, Chairman Wheatley, and distinguished members of the House Finance Committee. My name is Richard Kelly; I appear before you today as the current President of the Pennsylvania Society of Tax & Accounting Professionals. I am a Certified Public Accountant, and a practitioner from Chadds Ford, PA. With me today is Maurice Brubaker, an Enrolled Agent whose firm is located in Lewisburg, PA. Maurice is the Chairman of our organization’s committee that works in cooperation with the Pennsylvania Department of Revenue.

By way of background, the PSTAP is a growing professional membership organization that was founded in 1946 as the Pennsylvania Society of Public Accountants; we underwent a name-change several years ago. Today we represent more than 2000 Pennsylvania tax and accounting practitioners who are almost exclusively in public practice. Our membership base is comprised of Certified Public Accountants as well as Public Accountants, Enrolled Agents, Certified Financial Planners, educators, attorneys and tax and accounting professionals.

Our members provide professional services to tens of thousands of individual taxpayers, small business owners and employers. Tax practitioners are on the front line and in the business of educating taxpayers about the complexities of federal, state and local tax law and how to comply with it; we are fundamentally an external tax collection arm for the government. As such, we are extremely pleased to provide input on this issue and thank you for affording us this opportunity this morning.

Let me start by stating that we understand the current economic climate in Pennsylvania and the pressure to generate additional revenue in these challenging times. We do not question the Pennsylvania Department of Revenue’s authority to collect tax revenue that is rightfully due the Commonwealth, nor do we challenge the Department’s ability to review, question, or require substantiation from taxpayers in their effort to promote and enforce tax compliance. However, beginning as far back as 2014, the Department’s enforcement posture and methodology has been what can only be described as a “fishing expedition” approach to tax collection that is inconsistent, unorganized and arbitrary. My comments will examine the Pennsylvania Department of Revenue’s collection practices as it relates to unreimbursed business expenses, the recent Desk Review Program for Schedule C, the 2017 Tax Amnesty Program and their newest program which we have only recently begun to encounter, the Sales, Use and Hotel Occupancy Tax Desk Review Program.

**Unreimbursed Business Expenses** In 2014, the Department hired Revenue Solutions Inc. of Pembroke, Massachusetts to develop a process that used technology, metrics and analytical tools to search out potential intentional or accidental tax evaders and the target became unreimbursed business expenses. This third party company, RSI, retained 32% of the total collections that were brought in under this program. As one might expect, the contingency arrangement resulted in little consideration being given as to the legitimacy of the business expenses, and many Pennsylvania taxpayers received notices that their unreimbursed business expenses were denied across the board. Expenses such as union dues, uniforms, small tools, work related vehicles, professional journals and publications, travel and lodging and home office expenses, all of which are legitimate and allowable expenses under Pennsylvania statute, were and continue to be called into question. Advising and representing clients regarding legitimate business deductions is difficult without consistent enforcement practices on the part of the Department of Revenue.

The unreimbursed business expenses continue to be scrutinized and denied by the Department of Revenue. In many cases the expense deduction amounts to only a small tax savings for the taxpayer. As a result, it may not be cost effective for the client to pay their tax professional to appeal the denied expense and pursue the deduction; many taxpayers simply forfeit the money to the State. For example, $3,000 worth of business expenses equates to $92.10 in tax savings; the taxpayer must weigh the tax savings against the cost of substantiating the expense and in many cases the appeal does not make fiscal sense. The bottom line is that while the Department’s ongoing approach to challenging UE expenses may result in tax collections for the state, the revenue in many cases rightfully belongs to taxpayers who have simply given up. This puts a very unfair burden on our clients and it is nothing short of stealing money out of the pockets of hardworking Pennsylvania taxpayers.

**Schedule C Desk Reviews** In 2017, the Department began the *Schedule C Desk Review Program*. We have submitted supplemental practitioner comments regarding the Schedule C Desk Reviews because we think it is important that you see detailed accounts of how the *Reviews* impact Pennsylvania self-employed business owners. The various practitioner comments illustrate how these desk reviews have created confusion and expense for small business owners and practitioners alike.

I would like to address various aspects of the Department’s approach:

1. **Confusing, unclear and unreasonable requests for information**. The notices that were sent to Schedule C taxpayers who were suspended for review (about 8% of all Schedule C filers) were vague and guidance from the Department on how to respond and/or what documentation was required to satisfy their request was very minimal. The Schedule C notices request “detailed breakdowns” which Revenue initially defined as “all receipts”, throwing self-employed business owners and the practitioner community into a time-consuming frenzy. After weeks of receiving volumes of requested receipts and invoices, the Department modified their position to accept copies of general ledgers, summary information and QuickBooks files. The Department’s approach was illogical and scattershot and taxpayers paid the price in both time and money. You will see multiple accounts in the attached material of taxpayers spending hundreds of dollars and hours of time photocopying receipts.
2. **Inadequate examiner knowledge/training**. The Department’s use of metrics and data analytics is only as good as the individuals conducting the analysis. The examiners conducting the reviews exhibit little practical understanding of Schedule C and/or are inadequately trained for this project. For example questioning $5,000 of auto expense for an outside salesperson, or $18,000 of office expense for a $700,000 dental practice seems misguided given the collection potential and is not an adequate use of taxpayer resources.

Further, as determination letters and assessment notices are only now beginning to surface, the reality is that many legitimate business expenses are being denied across the board. Examiners are disregarding the taxpayer documentation that was provided or they are not requesting additional documentation or explanation from the taxpayer when they have further questions.

1. **Inadequate staffing and backlog issues**. The Department added no additional telephone lines, nor staff to handle the increased call volume. The more than 45,000 Schedule C taxpayers undergoing review are forced to get in que using the general Department of Revenue telephone number.

In addition, it is apparent by their backlog that Revenue does not have the manpower to adequately and timely review the information they are requesting from taxpayers. When taxpayer responses are received, it can take the Department as many as 8 weeks to log the response into their system, and months beyond that to receive a determination/assessment letter or a request for additional information. Our members who replied to April/May review letters have only recently begun to receive responses back from the Department. We are quickly approaching the year end and because new Schedule C letters are continuing to be disseminated, the backlog and the potential for adjustments will likely hamper our ability to file tax returns for these taxpayers.

To make matters even more confusing, despite their backlog, the Department is mailing second and sometimes even third notices to the taxpayer requesting the same information that was already sent or indicating that they have not received a response to their initial letter. In actuality the information has not been logged into their system yet. This is a very frustrating and time-consuming process for the taxpayer and/or the tax professional and a complete waste of taxpayer money to generate second and third notices that we are being told to ignore.

Meanwhile, the Department is asking taxpayers to submit their responses within 15 days of receiving the initial request (a timeframe that the Department says is only a guideline, but which the notice does not indicate).

1. **Beyond the Scope of a Desk Review**. The nature and the volume of information being requested suggests the Department should be sending field auditors to review the information. The Department of Revenue is certainly justified to ask for substantiation for every purchase in a $40,000 Cost of Goods Sold line item, but it is not practical to have practitioners and business owners send this information to the Department. HB 1867, P.N. 2580, sponsored by Representative Zimmerman (Referred to Finance October 16, 2017) addresses the issue by putting a field audit requirement on Revenue information requests that exceed 25 pages. PSTAP has not taken a formal position on this legislation but I mention it because it is further evidence of taxpayer outcry to collection procedures that are out of control.

Because Schedule C has been deemed a “desk review” as opposed to an audit, the process is devoid of a guaranteed structure that ensures fairness to the taxpayer. The Department is under no required timeframe to notify the taxpayer of the outcome. As I mentioned earlier, as we approach the year end, it is essential that taxpayers know if there are adjustments from the previous year and given the backlog situation that currently exists, this is unlikely.

Moreover, the desk reviews are not assigned to a specific examiner so the taxpayer cannot establish a line of communication with the individual who will ultimately make the final determination. When an assessment letter is issued, the taxpayer’s only recourse is to go through the arduous appeals process. Taxpayers should be afforded an interview opportunity (this opportunity is provided in a field audit via the Taxpayer Bill of Rights) to discuss the deductibility of the expense/deduction. The unfortunate reality is that many of these Schedule C Reviews are going to end up in appeals, when they could have been resolved. This is a costly process for the state as well as the taxpayer.

**Tax Amnesty**

The 2017 Tax Amnesty Program, like amnesty programs of the past, exposed collection inefficiencies within the Pennsylvania Department of Revenue.

Many taxpayers received delinquent notices that were erroneous or that went back more than ten or fifteen years. As you might expect, the likelihood of taxpayers retaining records that span decades to prove tax compliance is small in these cases.

While tax amnesty is a trend that provides a quick boost of revenue, keep in mind that the collection of this tax is not without cost. Tax evaders as well as the unknowing tax delinquents get a chance to settle their debts and are in effect granted a loan between the time the tax deadline actually occurred and the amnesty period. They are provided a further discount by the waiving off of the entire penalty and half of the total interest due on the tax.

Unlike the Federal Government and most other states, Pennsylvania has no statute of limitations on tax collection and thus no inherent pressure to collect the tax as it is due. Department collection procedures should be ongoing and not be predicated on an amnesty period. In one example, the Department of Revenue had 5 years of earning history of business return filings. No prior notices were issued to the taxpayer that there were unpaid taxes due on the returns that were filed. However, during the 2017 Tax Amnesty Program, a notice was issued to the taxpayer. The Department has come to utilize amnesty periods to clean up their records; PSTAP supports a Pennsylvania statute of limitations which would serve to hold the Pennsylvania Department of Revenue accountable to consistent, on-going collection efforts that center on timely compliance thus eliminating the need for future tax amnesty periods.

**Sales, Use and Hotel Occupancy Tax Desk Review Program**.

This is a new program being initiated by the Department that utilizes data analytics and industry standards to calculate a threshold for estimating what a business’ ideal ratio of cash sales should be based on the amount of credit card sales reported for the business on the 1099K. When the reported cash sales doesn’t fit their industry standard, the taxpayer will receive a letter suggesting that their cash sales may be underreported and additional sales tax may be due the state as a result.

The issue is best explained through an actual example. A fast food franchise based in a college town, in 2014, reported total sales of $908,000; $756,000 of the sales were reported on the 1099K and the remaining sales were reported as cash sales. The letter from the Department informed the taxpayer that based on their “analysis” their total sales should have been $1.6M; the Department estimated that the cash sales were underreported by $500,000. The taxpayer has 30 days to respond to the notice and prove that their sales were in fact as they reported them.

The Department’s metrics are not relevant to current lifestyle conditions. The use of credit cards is on the rise for all consumers, particularly college students. The overall sales were down in June and July just as one might expect when the majority of the restaurant’s patrons are college students and they are home for the summer during this time period.

We anticipate that thousands of similar notices have been sent to Pennsylvania business owners. The amount of time that business owners and practitioners will spend to respond to these letters will be significant. The amount of time and taxpayer resources the Department will spend will also be significant and based on our initial impressions it is unlikely to yield large collection results.

As I have outlined, there has been a noticeable shift in the Department’s collection procedures and methodology that has placed a burden on taxpayers that is unprecedented and is beyond what is reasonable. This approach to collection makes compliance difficult and renders Pennsylvania an unattractive state in which to do business. The PSTAP is very interested in partnering with you to offer insight and guidance on issues that affect Pennsylvania taxpayers and the business community. We once again, appreciate the opportunity afforded us today to appear before the Committee. We will continue to work hard to build strong working relationships with all Pennsylvania elected officials. We welcome any questions you may have with regards to our comments today.