



July 20, 2015

Susan Marshall, Clerk  
Committee on Small Business  
2361 Rayburn House Office Building  
Washington, DC 20515

Dear Ms. Marshall and Members of the U.S. House Committee on Small Business:

Thank you for the opportunity to provide commentary to the House on matters affecting small business at the full Committee hearing on Wednesday July 22, 2015.

### **Background**

McGladrey is a leading provider of assurance, tax and consulting services focused on the middle market with nearly 8,000 professionals in 80 cities nationwide. The firm is one that is designed to meet the needs of local and middle market businesses.

We also operate a member network of independent firm's known as The McGladrey Alliance comprised of more than 90 independently owned accounting and business consulting firms in 42 states and Puerto Rico.

The size of our practice and the large concentration of small to medium sized clients in the middle market segment demonstrate our frequent exposure to the compliance challenges facing small businesses today.

### **Personal Background**

My own practice concentration is the smaller end of the middle market that we refer to as the Local Markets Group (LMG). Our Boston LMG practice is made up of approximately 50 professionals. As a practitioner with 40 years of experience working in this sector, my day to day work consistently exposes me to the compliance requirements of my client base which is made up approximately for some 40 small businesses ranging in size from under \$5 million to \$100 million in revenue with workforces from less than 10 employees up to about 200. All of the clients are privately owned and many are family owned. My client base is representative of the others in my practice made up of a dozen partners and senior managers. We collaborate and share our experiences regularly including sharing of resources, training and researching together.

In that regard, a recent poll of members from the LMG group was conducted in order to obtain some of the more common challenges we face with the current tax code, compliance and reporting requirements. Following are a few of subjects that had recurring themes. On behalf of my firm and the many clients we serve, we respectfully submit these subjects for your review and consideration.

### **Depreciation - TARS Legislation and the De Minimus rules**

Depreciation has been around since the beginning of the tax code. In its simplest form it was designed to spread the deduction for a taxpayer's acquisition of large capital items over a period of time and over the estimated useful life of the acquired property. Periodically, Congress incited businesses to acquire more capital equipment by allowing more generous depreciation deductions. The result was simple, a small business owner would buy equipment and write all of it off immediately and the rest of it off over a reasonable period of time. The rules and reporting are no longer simple, despite that the intended result has not changed.

The de minimus safe harbor limits are provided in Treasury Reg. §1.263(a)-1(f)(1)(ii)(D) for taxpayers without an applicable financial statement (AFS) further prescribed in Rev. Proc. 2015-20. Because McGladrey is one of the largest CPA and advisory firms in the U.S., with offices all over the country we work with thousands of small businesses that DO NOT have an AFS.

In some cases, like the safe harbor rules, a taxpayer can take advantage of the rule by simply putting it into practice. In other cases, an election will need to be filed with a return. However, in order to be in full compliance with the regulations, most taxpayers will need to file a Form 3115 to adopt new accounting methods. Many experts believe that almost all taxpayers with fixed assets or repairs will be required to file at least one accounting method change to be in compliance with the new rules. If a Form 3115 is required, it will need to be filed by the due date (including extensions) of the current year return, assuming the taxpayer is a calendar-year taxpayer. At McGladrey, tax professionals have been advised to recommend preparation of the 3115 which is at great cost and consequence to the taxpayers.

Rather than requiring a Form 3115 to be filed with most returns, an alternative solution might have been to simply change the current Form 4562 to include a series of check boxes, elections and the additional information required by the standards to conform simplifying the entire process.

We also believe in reducing the burden of compliance with these rules by increasing the De Minimus Safe Harbor Amount for Taxpayers without an AFS. From discussions with our business clients that do not maintain an AFS (as defined in Treasury Reg. §1.263(a)-1(f)(4)), we have learned that many have capitalization policies in excess of \$500. Historically, these clients rarely have been challenged under IRS examination of maintaining a policy that does not clearly reflect income. As such, a \$500 safe harbor does not appear to be a practical solution for taxpayers without an AFS.

To distinguish, one should compare a taxpayer with an AFS to those without. The current rule does not take into consideration the complexity or size or sophistication of the taxpayer and their accounting department. A large closely held business that does not have a financial statement audit could have an accounting department just as sophisticated as that of an SEC company. However, this similarly situated taxpayer is limited to a capitalization threshold of \$500 under the de minimus threshold, rather than the more generous \$5,000 amount provided to taxpayers with an AFS.

Granted, a taxpayer without an AFS is not handcuffed by the \$500 threshold so long as they can prove under examination that deducting items in excess of \$500 is a clear reflection of income. Unfortunately, due to the subjective nature of the "clear reflection of income" determination, taxpayers fear that an IRS examining agent may have a different opinion as to whether or not the expenditures are a clear reflection of income, which could lead to lengthy and costly disputes at the examination and appeal level—or even litigation—over an item that is nothing more than a timing difference. Increasing the safe harbor amount for taxpayers without an AFS would reduce taxpayer anxiety and potential future conflicts under examination.

We suggest increasing the de minimus safe harbor threshold for taxpayers without an AFS. Potential alternatives include a general increase in the amount across all business types, different thresholds based upon industries or a threshold based upon a certain percentage of average gross receipts for the three preceding tax years. Regardless of the method selected to increase the de minimus safe harbor, the threshold for taxpayers with and without an AFS should be indexed for inflation.

### **Reviewed Financial Statements Included as an AFS**

In the preamble of Treasury Decision (T.D.) 9636, Treasury states that it does not believe reviewed financial statements as defined in the AICPA's Statement of Standards for Accounting and Review Services "provide sufficient assurance to the IRS that such policies are being followed and, accordingly, that the taxpayer is using a reasonable, consistent methodology that clearly reflects income" and should not qualify as an AFS.

A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. While a review is less in scope than an audit, the certified public accountant is performing analytical procedures to provide some assurance, even though it is limited, that they are not aware of any material modifications that should be made to the financial statements. Arguably, such assurance of no material modification supports the position that reviewed financials meet the AFS expectation that a taxpayer is using a reasonable, consistent methodology that clearly reflects income.

We respectfully suggest a review of the current Treasury and IRS provisions and reconsider their position and include reviewed financial statements as an AFS under Treasury Reg. §1.263(a)-1(f)(4) for purposes of the de minimus safe harbor election.

### **Taxpayer Privacy - Breached IRS Authorization System**

The cost and consequence of data breaches today is substantial. Recent data breaches to the IRS system, affecting thousands of taxpayers has magnified the effect of the breaches. Within our own small service line of 50 professionals we recently conducted a poll that indicates we are currently assisting clients with more than 20 cases of breach and compromise. Though we are not professing or prescribing a fix to the data security problem, what is clear is that substantially more resources are needed to stem the tide of this problem in addition to developing a streamlined and comprehensive solution to the problem. We have clients who have been waiting for months to obtain their refunds, while in the meantime the hackers have already taken the money and run.

The current remediation plan is not effective or comprehensive enough. The current program includes notification by the IRS to the taxpayer recommending they obtain Publication 4535, Identity Theft Prevention and Victim Assistance. If the taxpayer has there is a refund pending, there is no mention in the correspondence as to the status of that refund or the likelihood of when the refund will be issued. In the correspondence the IRS attempts to provide comfort to the taxpayer by indicating that their tax return and future returns have been "flagged" to monitor future activity.

The IRS correspondence goes on to inform the taxpayer they are provided the "option" to obtain and "IP Pin #." The taxpayer is further instructed to file a complaint with the Federal Trade Commission (FTC) and to contact the Social Security Administration (SSA) to validate earnings with the Administration. Finally a toll free hotline is also provided to the taxpayer. That is simply not enough.

Given the severity of data breaches today and the amount of compromised information, we believe the IRS should be providing greater guidance around security and prevention measures. We believe that social security numbers now create such a worldwide target that an accelerated plan to cease using them may be in order in an effort to create a more secure alternative. Obtaining an IP Pin should be considered mandatory, not optional. We also suggest the Service consider providing additional instructions to the taxpayers on the additional measures they can take to protect their privacy with things like their bank and investment accounts, credit cards, and related credit and investment arrangements. Those steps require a sense of urgency and should be undertaken immediately. For example the Service should consider advising taxpayers to implement a credit "freeze."

### **Do what the Hackers do**

Our practice recently obtained the services of an expert to speak to our team on the subject. He provided recommendations worth sharing. In summary, he suggested that because the system is broken, any individual can access a free annual credit report from a public site, [annualcreditreport.com](http://annualcreditreport.com), from each of the 3 most common credit bureaus. Therefore, once a year a taxpayer needs to take 15 minutes and pull their own credit report from the bureaus. In doing so the taxpayer has the opportunity to thwart the hacker from obtaining your credit history thru these free credit reporting sites. If the taxpayer senses foul play, they would be equipped with the information required to prevent further compromise.

Susan Marshall, Clerk  
Committee on Small Business  
July 20, 2015  
Page 4 of 4

Even if the taxpayers' credit is "frozen" they still need to take steps like this because existing lines of credit can be taken over by simply calling the issuer and requesting a new card, changing an address, or even adding stolen payment card to a digital technology like ApplePay by leveraging "knowledge based authentication" questions that can only be found in the credit report.

Below is more information on security freezes. Reducing the chances of becoming a victim takes about 15 minutes of effort. We believe the Service would be serving the taxpayers well by recommending measures such as these.

The websites to freeze files are:

<https://www.experian.com/freeze/center.html>

[https://www.freeze.equifax.com/Freeze/jsp/SFF\\_PersonalIDInfo.jsp](https://www.freeze.equifax.com/Freeze/jsp/SFF_PersonalIDInfo.jsp)

<http://www.transunion.com/securityfreeze>

Freezing your credit files won't protect you from having your Personal Identity Info used for tax return fraud, thus the reason why obtaining a Tax Pin should be mandatory and done in tandem with credit freezing.

Our firm is spending hundreds of hours of time at taxpayer expense to help them manage the maze to assist them in obtaining refunds and protect them from further fraudulent activity. This problem is severe and therefore requires an equal or greater effort and resources to manage the problem. The toll free number does little to resolve taxpayer fears and resolve status. One often stays on hold for hours before obtaining a live contact. There is no shortcut to this solution; it requires a dedicated team with dedicated resources empowered to help the taxpayer, or their designee, to obtain what is rightfully theirs.

Thank you once again for the opportunity to present these examples that challenge taxpayers and their tax professionals.

Sincerely,



Leslie P. Vitale, CPA, MST  
Partner Local Markets Group



HOUSE COMMITTEE ON SMALL BUSINESS  
Witness Disclosure Statement  
Required by House Rule XI, Clause 2(g)

Your Name: <u>LESLIE P VITALE</u>		
1. Are you testifying on behalf of a Federal, State, or Local Government entity?	YES	NO <input checked="" type="checkbox"/>
2. Are you testifying on behalf of an entity other than a Government entity?	YES <input checked="" type="checkbox"/>	NO
3. Other than yourself, please list what entity or entities you are representing: <u>McGladrey LLP</u>		
4. Please list any offices or elected positions held or briefly describe your representational capacity with the entities disclosed in question 3. <u>PARTNER LOCAL MARKETS GROUP IN TAX PRACTICE FOR OVER 30 YEARS REPRESENTING SMALL BUSINESSES</u>		
<i>(For those testifying on behalf of a Government entity, ignore these questions below)</i>		
5. a) Please list any Federal grants or contracts (including subgrants or subcontracts), including the amount and source (agency) which <u>you</u> have received and/or been approved for since January 1, 2013:		
b) If you are testifying on behalf of a non-governmental entity, please list any federal grants or contracts (including subgrants or subcontracts) and the amount and source (agency) received by the <u>entities listed under question 3</u> since January 1, 2013, which exceeded 10% of the entities' revenues in the year received:		
6. If you are testifying on behalf of a non-governmental entity, does it have a parent organization or an affiliate who you specifically do not represent? If so, list below:	YES	NO <input checked="" type="checkbox"/>

Signature: *Les Vitale*

Date: 7/24/15

## **Leslie P. Vitale, CPA, MST**

Partner, Tax Services  
McGladrey LLP  
Boston, MA  
leslie.vitale@mcgladrey.com  
617.241.1235



### **Summary of Experience**

Les is a partner in McGladrey's assurance practice and brings 40 years of professional experience to his clients. His broad base of knowledge includes specialties in the traditional accounting, auditing, tax, and assurance services. In addition, he has excelled at improving the business results for his clients by providing them with value added services such as performance measurement, strategic planning, business continuity plans, estate, gift and financial planning services, accounting system reviews, automated systems design and implementation, executive compensation and benefits planning, executive management recruiting, and a variety of other business advisory services to a diverse client base. He co-leads a team of dedicated professionals at the firm who counsel and advise business owners on succession and exit strategy (BOSS) and has helped numerous privately held and family-owned companies analyze and solve their business issues to ensure success.

In addition to his client responsibilities, Les assists with the firm's intensive college recruiting program. He has authored various technical articles and developed policy and procedural manuals for the firm in the areas of quality control, staff training and evaluation, recruiting, technology and industry-related issues. He has also lectured for the MSCPA at various academic institutions.

### **Professional Affiliations and Credentials**

- American Institute of Certified Public Accountants
- The AICPA Information Technology Division
- Massachusetts Society of Certified Public Accountants
- Certified Public Accountants in Massachusetts
- MSCPA Academic & Career Development Committee
- Bentley College Business Advisory Council for Graduate, Executive & Professional Education
- Chair of the Bentley College Executive Club
- Member of the Bentley College Hockey Alumni Association
- Advisory Board Member to the Bentley College Board of Trustees Development Committee
- Member of the Construction Financial Managers Association
- Associate Member of the Surety Association of Massachusetts
- Honorary Professional Member Beta Alpha Psi, Theta Gamma Chapter of Bentley College
- Saugus Chamber of Commerce
- Officer Harold L. Vitale Memorial Fund
- Marie C. Petrilli Memorial Cancer Research and Treatment Fund
- Founding member of the UNICO Foundation Boston Chapter
- Advisory Board Member of the Boys & Girls Club of Boston – Jordan Club
- Trustee and a chair of the Finance Committee for Saint Mary's – Lynn High School

### **Education**

- Bachelor of Science, accounting, Bentley University
- Master of Science, taxation, Bentley University