

**Oral Testimony of Robert Kerr
Senior Director, Government Relations
National Association of Enrolled Agents
before the House Small Business Committee
Subcommittee on Finance and Tax
June 18, 2008**

Thank you, Madam Chair and members of the Subcommittee, thank you for the opportunity to testify before you today. My name is Bob Kerr and I am the head of government relations at the National Association of Enrolled Agents.

Enrolled agents are the only tax practitioners for whom IRS directly attests to their competence and ethical behavior. NAEA represents the interests of some 46,000 enrolled agents across the country. Our members usually work with those on the smaller end of small businesses and more typically see gross incomes in the tens of thousands rather than the tens of millions.

I will discuss two issues today—reasonable compensation and recordkeeping—and provide several approaches that would help S-corps, and to some extent all small businesses, operate more easily.

Reasonable Compensation

One of the advantages of an S-corp is that shareholder employees can receive both wages and profit distributions, both of which are subject to the shareholder's personal income tax rate, but only the wages are subject to payroll taxes. Not surprisingly, the tax advantage for distributions leads to challenges for the corporation, namely in determining what constitutes the "reasonable compensation" required by IRS. In the absence of clear guidance, people disagree on what constitutes reasonable and many EAs find themselves enmeshed in or refereeing 'spirited' discussions with their S-corp clients as a result. Meanwhile, other small S-corps are completely unaware of the reasonable compensation requirements, which can, my members assure me, lead to a very unpleasant surprise during an audit.

With respect to reasonable comp, EAs are in a quandary when asked what is reasonable or when raising the issue to a client. I know there are those who believe that treating S-corp and partnership income similarly would solve the problem. I'm not at all certain that we would buy into that solution. In the near term we suggest practitioners and S-corps could be helped by practical IRS guidance—perhaps in the form of an audit technique guide—in determining what is reasonable compensation.

Recordkeeping

As to my second point, I can't imagine that I am the first person to come before this committee stating that recordkeeping is the bane of a small businessman's (or woman's) existence. Recordkeeping is burdensome and the Code requires small businesses to keep a myriad of records. For instance, Section 274(d) requires stringent documentation for deductions for both business cell phone use and business use of an automobile. Section 280A requires in-home offices to be used solely for business activity and for deductions to be made as a proportion of the entire home. Further, there is no *de minimis* amount for expensing rather than depreciating business assets.

At the end of the day, small business owners are not tax experts, though the complexity of our tax code really does dictate that small businesses retain tax experts to advise them of their obligations and to help them take advantage of tax code provisions, such as §179 expensing or the business provisions of the recently-passed stimulus bill.

NAEA has advocated for years for simplification wherever possible in the tax code. To that end, we applaud and encourage the conversations recently underway with respect to a safe harbor for in-home offices, and particularly note Chairwoman Velazquez's bill. Further, Chairman Rangel (in HR 5719) recently proposed removing cellular phones from §274(d) listed property, a move that would dramatically lower recordkeeping requirements. We enthusiastically support such provisions.

If I may be so bold, S-corps and small businesses would be greatly assisted if Congress measured complexity and gave it weight when considering various tax law changes.

Further, both IRS and tax professionals are well placed to provide information to S-corps and to small businesses as they organize. EAs far too often find these businesses in tax trouble not because of malice aforethought but because of sheer ignorance—or bad advice from unqualified preparers.

Congress could act to improve competence in the tax preparation industry by enacting HR 5716, the Taxpayer Bill of Rights Act of 2008, introduced by Rep. Becerra. We believe greater competency leads to better advice and better compliance.

For its part, IRS has in recent years made decided efforts to educate small businesses and should be supported and encouraged as it moves forward and as it continues to balance its compliance obligations with its assistance obligations.

This concludes my testimony and I will be happy to answer questions.