# TAXPAYER RIGHTS

## WRITTEN COMMENT

AND

## HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

## COMMITTEE ON WAYS AND MEANS
## HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

---

**Taxpayer Rights Proposals**

AND

**Recommendations of the National Commission on Restructuring the Internal Revenue Service on Taxpayer Protections and Rights**

SEPTEMBER 26, 1997

---

**Serial 105–62**

---

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
53–803 CC WASHINGTON : 1999

## COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM MCCRERY, Louisiana
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska
WES WATKINS, Oklahoma
J.D. HAYWORTH, Arizona
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM MCDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
WILLIAM J. JEFFERSON, Louisiana
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
KAREN L. THURMAN, Florida

A.L. SINGLETON, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

---

### SUBCOMMITTEE ON OVERSIGHT

NANCY L. JOHNSON, Connecticut, *Chairman*

ROB PORTMAN, Ohio
JIM RAMSTAD, Minnesota
JENNIFER DUNN, Washington
PHILIP S. ENGLISH, Pennsylvania
WES WATKINS, Oklahoma
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

WILLIAM J. COYNE, Pennsylvania
GERALD D. KLECZKA, Wisconsin
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
KAREN L. THURMAN, Florida

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

# CONTENTS


Page

**TAXPAYER RIGHTS PROPOSALS**

Advisory of September 8, 1997, announcing request for written comments ..... 1

American Society for Quality, Milwaukee, WI, statement and attachments ..... 4

**RECOMMENDATIONS OF THE NATIONAL COMMISSION ON RESTRUCTURING THE INTERNAL REVENUE SERVICE ON TAXPAYER PROTECTIONS AND RIGHTS**

Advisory of September 17, 1997, announcing the hearing ..... 10

WITNESSES

Internal Revenue Service, Hon. Michael P. Dolan, Acting Commissioner ..... 23
U.S. Department of the Treasury, Hon. Donald C. Lubick, Acting Assistant Secretary, Tax Policy ..... 49
Internal Revenue Service:
Hon. Stuart L. Brown, Chief Counsel ..... 61
Lee R. Monks, Taxpayer Advocate ..... 68
U.S. General Accounting Office, James White, Associate Director, Tax Policy and Administration Issues, General Government Division; Accompanied by Lynda Willis, Director, Tax Policy and Administration Issues; and Tom Short, Assistant Director ..... 80

American Bar Association, Pamela F. Olson ..... 100
American Institute of Certified Public Accountants, Michael E. Mares ..... 109
Community Tax Law Project, Nina E. Olson ..... 145
Computer Language Research, Inc., Stephen T. Winn ..... 155
Kingston, Hon. Jack, a Representative in Congress from the State of Georgia . 19
National Association of Enrolled Agents, Joseph F. Lane ..... 122
National Society of Accountants, Roger Harris ..... 139
National Taxpayers Union, Bob Kamman ..... 130
Padgett Business Services, Roger Harris ..... 139
Software Publishers Association, Stephen T. Winn ..... 155

SUBMISSIONS FOR THE RECORD

Caplin, Mortimer M., Caplin & Drysdale, statement ..... 169
Christian, George, Columbia, MD, statement ..... 172
Dillon, Wallace M., Jr., Blauvelt, NY, letter and attachments ..... 175
Price Waterhouse LLP, statement ..... 181
Securities Industry Association, statement ..... 183

# *ADVISORY*

## FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
September 8, 1997
No. OV–8

CONTACT: (202) 225–7601

# Johnson Announces Request for Written Comments on Taxpayer Rights Proposals

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee is requesting written public comments for the record from all parties interested in legislative proposals concerning taxpayer rights, including those contained in H.R. 2292, the "Internal Revenue Service Restructuring and Reform Act of 1997," which implements the June 25, 1997, Report of the National Commission on Restructuring the Internal Revenue Service (IRS).

**BACKGROUND:**

Congress passed the original Taxpayer Bill of Rights in 1988 (P.L. 100–647). It expanded taxpayer safeguards further by the passage of the Taxpayer Bill of Rights 2 (TBOR 2) in 1996 (P.L. 104–168). The Report of the Restructuring Commission builds on this foundation of taxpayer rights by proposing 21 additional measures to improve taxpayer rights.

The taxpayer rights proposals of the Restructuring Commission are contained in Title III (Taxpayer Protection and Rights) of H.R. 2292. In general the recommendations would:

1. Strengthen Taxpayer Assistance Orders by allowing the Taxpayer Advocate to consider more factors in determining whether or not a taxpayer is experiencing a "significant hardship."

2. Expand the rights of taxpayers to recoup legal expenses from the IRS by allowing a taxpayer who prevails over the IRS to seek reimbursement of expenses incurred after the receipt of a preliminary notice of deficiency; i.e., the 30-day letter.

3. Allow taxpayers to recover up to $1 million from the IRS for negligent collection actions.

4. Require the IRS to disclose to taxpayers the reasons their tax returns were selected for audit.

5. Improve the protection of IRS records by the National Archives.

6. Direct the Joint Committee on Taxation to study the provisions of the tax law regarding taxpayer confidentiality and third party access to tax return information.

7. Improve public access to IRS material under the Freedom of Information Act.

8. Direct the IRS to ensure that "offers-in-compromise" provide taxpayers with an adequate means to provide for basic living expenses.

9. Eliminate the interest rate differential on overpayments and underpayments of tax liability.

10. Eliminate the "failure to pay" penalty on taxpayers who enter into installment agreements with the IRS.

11. Provide most taxpayers with an automatic right to an installment agreement for tax liabilities of $10,000 or less.

12. Require that checks for the payment of taxes be made payable to Treasurer, United States of America.

13. Direct the IRS to make matching grants to support low-income taxpayer clinics.

14. Expand the jurisdiction of the U.S. Tax Court and increase the ceiling on "small cases" from $10,000 to $25,000.

15. Require the IRS to establish a toll-free "hotline" for taxpayers to register complaints about misconduct by IRS employees.

16. Improve the rights of taxpayers during IRS interviews.

17. Direct the IRS to establish procedures for alerting married taxpayers about their joint and several liabilities on all tax forms, publications, and instructions.

18. Direct the IRS to notify taxpayers of their right to refuse to extend the statute of limitations.

19. Direct the IRS Taxpayer Advocate to report to Congress on the administration and implementation of the tax penalty reforms contained in the Omnibus Budget Reconciliation Act of 1989.

20. Direct the Secretary of the Treasury and the U.S. General Accounting Office (GAO) to study the feasibility of treating individuals separately for tax purposes, including recommendations for eliminating the marriage penalty.

21. Direct the GAO to prepare a report for Congress on the burdens of proof for taxpayers and the IRS for controversies under the tax law.

Title I of H.R. 2292 contains several proposed changes related to the IRS Taxpayer Advocate. For example, it provides that the selection of the Taxpayer Advocate be approved by the Oversight Board, that the Taxpayer Advocate must agree not to accept further employment with the IRS for the five-year period after he or she ceases to be Taxpayer Advocate, and that the Taxpayer Advocate must monitor the coverage and allocation of local taxpayer advocates. The Subcommittee on Oversight is especially interested in receiving written comments on the 21 specific taxpayer rights proposals contained in Title III, and the changes proposed to the operation of the Taxpayer Advocate contained in Title I of H.R. 2292.

The Subcommittee is also interested in receiving written comments on legislation introduced during the 105th Congress which is relevant to the objective of improving taxpayers rights. Examples of such legislation include H.R. 1227, the "Internal Revenue Service Accountability Act," which would provide for increased accountability by IRS agents and other Federal officials in tax collection practices and procedures, and H.R. 367, which would place the burden of proof on the IRS in court proceedings and require judicial consent before the IRS could seize a taxpayer's property by levy.

Finally, the Subcommittee is interested in receiving written comments from the public regarding other legislative proposals concerning taxpayer rights which it may wish to bring to the Subcommittee's attention.

In announcing this request for comments, Chairman Johnson stated: "There will always be a need for stronger taxpayer rights as long as we continue to receive complaints from our constituents about their experiences in dealing with the IRS. The Subcommittee will be exploring various proposals in anticipation of a hearing later this month on the Commission's taxpayer rights recommendations."

**DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Any person or organization wishing to submit a written statement for the printed record should submit at least six (6) single space legal size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address and comments date noted on label, by the close of business, Monday, September 22, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

## Statement of American Society for Quality

### TAXPAYER RIGHTS: A CUSTOMER SATISFACTION ISSUE

If one considers the taxpayer as a customer of the Internal Revenue Service, then the taxpayer's most fundamental right is to expect good management and accountability on the part of the Internal Revenue Service. Other rights, such as the expectation of fair and courteous treatment, flow from this basic right and can be most reliably ensured only when this fundamental right has been secured. The way to accomplish that is through an effective quality system that is driven by customer satisfaction considerations and ingrained in the culture, management philosophies, and work processes of the organization.

A good customer service management program goes way beyond tracking customer satisfaction measures and responding to complaints. It treats its customers as a valuable asset and seeks their input and insight to drive not only continuous improvement but also innovation.

### TITLE III PROPOSALS

Among the 21 specific taxpayer rights proposals contained in Title III of HR 2292, proposal #15 offers the most reasonable opportunity for comment by the American Society for Quality. This proposal requires the IRS to establish a toll-free hotline for taxpayers to register complaints about misconduct by IRS employees.

The groundbreaking studies on complaint handling done by TARP (Technical Assistance Research Programs) documented the value of taking steps to increase the rate of customer contact for any type of organization. So a proposal to make it easy for people to complain or offer suggestions makes sense. But the TARP studies also revealed that relying too heavily upon complaints data is a mistake due to the high proportion of dissatisfied customers who never complain. Furthermore, ACSI data on the IRS indicate public dissatisfaction with the agency's handling of a high rate of complaints. The ineffectiveness of the IRS's complaint resolution process in general is a major contributor to customer dissatisfaction as revealed in the ACSI. Therefore, simply adding a new hotline feature on to an already poorly functioning process does not offer the prospect of any significant improvement and could make the situation worse. Nor is it reasonable to expect that a new, separate system for handling complaints of misconduct would be any more effective than existing complaint handling systems.

What would seem to be indicated is an improvement in the overall system of dealing with complaints. In our report to the National Commission on Restructuring the IRS, one of our recommendations was for the IRS to undertake a new analysis of the complaints its customers are making. While the serious nature of a misconduct allegation might warrant special handling (a sort of triage system for handling complaints of varying criticality, perhaps), we do not see merit in establishing a new, separate system for handling complaints of this nature. Rather, fix the whole system and ensure that it is capable of dealing with all types of complaints.

Many of the other specific taxpayer rights proposals contained in Title III of H.R. 2292 deal with procedures that are not within the area of expertise of the American Society for Quality. Our observation is that these recommendations deal with taxpayer relations at the point beyond which things have already gone wrong. We believe that the greatest long-term benefits from efforts to improve the IRS will be achieved when primary attention is given at the "things done right" stage, well before they reach this point.

Therefore, while we believe that the Title III proposals will help to solve some current problems, we urge this Committee also to advocate for fundamental upgrading in the IRS's customer service attitude and practices and to couple the upgrade with an organization-wide self-assessment of the IRS quality system according to the Baldrige criteria for performance excellence. A thorough review of this kind will help to identify performance measurements and customer satisfaction measurements that complement each other in order to enhance the taxpayer's interactions with the agency.

In addition, currently available data on customer satisfaction with the IRS from the American Customer Satisfaction Index (ACSI) can be used as a benchmark for overall satisfaction. Future changes in the ACSI ratings for the IRS should be compared to currently available baseline readings to see if there is any improvement in satisfaction after any of the Title III proposals have been implemented.

SUMMARY

In summary, we believe that the taxpayer rights proposals being considered by this Committee will solve certain immediate problems. But we believe the Oversight Subcommittee of the House Ways and Means Committee will be missing a good opportunity to cause more far-reaching improvement if it does not push for more fundamental change in the processes and management systems that play a large part in determining customer satisfaction with the Internal Revenue Service. Strengthen the systems that will ensure the taxpayer's basic right to expect good management at the IRS and you will do much to prevent problems in the future.

## EXHIBIT A

### Statement of Dr. Jack West, ASQC, National Commission on Restructuring the IRS, September 10, 1996

Doing the right thing right the first time is the universal objective for any organization with a goal of satisfying its customers. This goal applies equally to the public sector as it does to the private sector. My purpose is to share information on the two components of this basic principle that should be helpful to this Commission and the Internal Revenue Service. The two components are doing the right thing (which addresses the question of what to do) and doing it right the first time (which addresses the question of how to do it well).

DOING THE RIGHT THING

The last word in IRS is service, which implies there must be customers for that service. Accordingly, the views of the customers must play a big role in determining the way the agency achieves its mission, i.e., what it does.

Organizations, including the IRS, have a powerful new tool to help them better understand what their customers think of them. It is the American Customer Satisfaction Index (ACSI) the first uniform national measure of quality, which has been operational for about three years. (The attached Appendixes contain additional information on ACSI makeup and methodologies.) Briefly, the key point about this measure for this Commission's consideration is that ACSI compares customer experience to their expectations. It does this through thousands of interviews with customers of 200 companies and agencies whose products and services constitute close to half of the nation's gross domestic product. In addition to the IRS, other agencies from the public sector included in the ACSI are central city and suburban trash collection services, central city and suburban police services, and the US Postal Service.

IRS Data from the American Customer Satisfaction Index

| | 1994 | 1995 | 1996 |
|---|---|---|---|
| ACSI Rating | 55 | 54 | 50 |
| Perceived Quality | 66 | 65 | 62 |
| Expectations | 57 | 59 | 56 |
| Complaints (%) | 23 | 16 | 25 |

ASQC and the University of Michigan Business School, co-sponsors of the American Customer Satisfaction Index, were not surprised when the first ACSI released in October 1994 showed that users of the Internal Revenue Service gave that agency a lower customer satisfaction rating than customers gave any of the other 200 companies and government agencies in 34 industries measured in the index. On the zero to 100 scale used by ACSI, satisfaction with the IRS registered 55, compared to a national average of 75.

Unlike customers of the other 200 measured companies and agencies, users of the Internal Revenue Service do not choose the IRS as a supplier. Rather, use is required of them by law. However, the IRS is not the only monopolistic organization US taxpayers deal with. Other examples that the ACSI measures include the telephone and electric utilities as well as police and garbage collection. All of these organizations provide better customer satisfaction than the IRS. So it is clearly possible for organizations that customers must deal with to provide higher levels of customer satisfaction.

IRS is included in the ACSI because it is a major federal government agency with which the vast majority of US households have contact. ACSI is an indicator of the quality of goods and services available to household consumers. It is broadly representative of the US economy; government is 13% of the Gross Domestic Product.

While it is not surprising that IRS ranked lowest among measured organizations—in comparison with companies producing goods and services for which customers make brand preference choices—the story of customer satisfaction with the IRS is not a question of why it ranked lowest but why, after two years of stable customer satisfaction in 1994 and 1995, did its rating drop significantly in 1996?

In the second year of the ACSI, the IRS rated a 54, which is statistically unchanged from the prior year. This year, however, is markedly different. Satisfaction with the service provided by the IRS dropped to 50, which is the lowest score received by any measured organization in the three-year history of the index. The root of the dissatisfaction lies in three primary areas: low expectations, poor service quality as perceived by the taxpayers, and ineffective handling of a high rate of complaints.

Customer expectations affect overall satisfaction by setting the standard against which actual performance is measured. The IRS failed to meet even the low expectations set by the taxpayers, which is demonstrated by the low perceived quality score.

Customer complaints constitute the third indication of low satisfaction. Fully one out of four taxpayers reported that they complained either formally by phone or mail or by informally expressing a verbal complaint to IRS personnel. While the percentage of IRS customer complaints is not atypical for service organizations, the ineffectiveness of the IRS's complaint resolution process is contributing to customer dissatisfaction.

The IRS will need more detailed customer research than that provided by a macro indicator like the ACSI to identify precisely which attributes of its products (such as tax forms and instructions) and service (response to calls for information, filing convenience) are having the greatest effects on its decline in quality in the eyes of its users.

That the IRS is a public sector organization with no competition is no reason to dismiss its low customer satisfaction ratings, as the experience of other ACSI measured organizations shows. Other organizations measured by ACSI operate under monopolistic conditions, and all have higher ACSI ratings.

The US Postal Service has been using customer research, and operating on that research, to make change. USPS is succeeding, as reflected in its rising ACSI scores for mail delivery and counter services from 61 in 1994 to 69 in 1995 to 74 in 1996—the most dramatic improvement of the 200 ACSI measured companies and agencies.

To improve, the IRS will need to set a course similar to that of the postal service in obtaining customer feedback, prioritizing potential improvements, then taking actions to make the prioritized changes. A first step is for the IRS to analyze the complaints taxpayers are making.

## DOING IT RIGHT THE FIRST TIME

One of the most forceful messages I hope to leave with this Commission is that the principles of quality management can indeed be applied to a public sector agency such as the IRS.

In fact, within the quality profession we have seen documented evidence in recent years of IRS improvement activities and results. The Commission undoubtedly will hear about such activities from IRS representatives, so I will not elaborate on them. However, these efforts, reported in professional journals and magazines and at professional conferences, deserve to be recognized and applauded. Yet in spite of many good efforts, customer satisfaction with the IRS declines and we are left to wonder why.

From the viewpoint of an outside observer from the quality profession, the visible quality improvement activity appears to have reached a peak several years ago. It is not clear that the laudable efforts within various IRS units—efforts aimed at making a shift toward the encouragement of voluntary compliance, improving customer satisfaction, reducing burdens on taxpayers, maintaining a quality workforce, upgrading equipment, and improving financial performance—have been deployed throughout the organization. If there is a pattern of improvement efforts, it seems to be one of isolated pockets of excellence rather than a seamlessly integrated system in which organizational learning and diffusion of success are the norms.

To achieve such a system, there is no better guide than the criteria and the core values and concepts of the Malcolm Baldrige National Quality Award.

One of the primary objectives of the Baldrige award is to provide a vehicle for self-assessment. It is now widely recognized as the benchmark for organizational as-

sessment which is used by many organizations as a self-assessment and improvement tool.

Baldrige calls for a three-pronged focus: an integrated, systematic approach; deployment throughout the organization; and measurable results. It is grounded in the core values and concepts of quality; it demands a systems perspective and a process focus; and it calls for continuous refinement through cycles of learning about organization-wide improvement. The criteria themselves have been tested and refined and are broadly applicable to any organization.

### BALDRIGE CORE VALUES AND CONCEPTS

- Customer-driven quality
- Leadership
- Continuous improvement and learning
- Employee participation and development
- Fast response
- Design quality and prevention
- Long-range view of the future
- Management by fact
- Partnership development
- Corporate responsibility and citizenship
- Results orientation

Federal agencies find themselves facing mandates such as those spelled out in the Government Performance and Results Act of 1993 and the Executive Order on Setting Customer Service Standards, which aim to promote a new focus on results, service quality, and customer satisfaction. A Baldrige-type self-assessment could aid the agency in complying by guiding it in building a truly integrated and effectively deployed quality system rather than an odd mix of programs put together in order to meet various externally imposed requirements.

### CONFLICTING FUNCTIONS: CUSTOMER SERVICE OR COMPLIANCE?

Demands placed on the Internal Revenue Service to provide better customer service inevitably put it in conflict with its duty to ensure taxpayer compliance with the tax laws and regulations. From experiences in the private sector during the last decade, as businesses have struggled with becoming more data-driven, we have learned a simple truth: the things that get measured are the things that get emphasized. And we have seen that what appears most important to the managers who devise the measurement systems is not always most important to customers. The danger is magnified when tensions exist as a result of conflicting functions that compete for the limited attentions and resources of the organization. The lesson here for the IRS and for this Commission is to examine what is measured and determine if the things that are important to the customers of the IRS are the things that are being measured, monitored, and managed. Or is there an imbalance between what is measured and what is desired?

### PRELIMINARY RECOMMENDATIONS

As the Commission begins its review, there are a number of areas that we recommend be investigated and a number of questions to be raised, based on the foregoing comments regarding ACSI findings and the Baldrige-based model for organizational assessment and improvement.

Performance measurements and goals currently in use. An examination of performance measurements utilized by the IRS should be undertaken to determine if these measurements encourage the desired organizational behavior. Are they balanced—that is, properly focused on requirements critical to the agency's customers rather than being weighted toward internal requirements of interest to agency staff and management.?

*How does the IRS set priorities?*

What forms of assessment are used? Has the agency done a Baldrige-type self-assessment?

Analysis of existing customer complaint data. What does the IRS already know about sources of dissatisfaction? What else needs to be learned about dissatisfiers?

*Review of current improvement plans.*

What improvement activities would have greatest effect on satisfaction? In this regard, the ACSI impact model can be a useful guide.

Review of IRS mission. A careful re-examination of the IRS mission—and the ways in which the mission is interpreted by both the IRS management and the legislative and/or administrative bodies that write tax laws/regulations or have IRS oversight—may yield valuable insights. Most organizations have multiple constituencies and find themselves pulled in conflicting directions by the different expectations of each. Successful organizations are able to find a balance that satisfies the needs of all constituencies. The IRS needs to find that delicate balance.

Involving IRS personnel in solutions. While guidance and constructive criticism from above or from outside the agency are helpful in making major changes, it is necessary to ensure that ownership of the processes and their improvement becomes resident within the agency so that desired changes take root initially and become institutionalized.

Learning from previous IRS quality efforts. Lessons from both the successes and failures of previous activities undertaken by the IRS may shed light on reasons for isolated pockets of excellence that demonstrate accomplishments which have not spread throughout the agency.

ASQC has a reservoir of talent that could be tapped to assist the Internal Revenue Service in such areas as customer satisfaction research, self-assessment, and training in improvement techniques. We stand ready to offer this assistance and knowledge at the request of the agency and the Commission.

**EXHIBIT B**

**About the American Customer Satisfaction Index**

The American Customer Satisfaction Index (ACSI) is based on approximately 50,000 annual customer interviews with respondents screened and qualified as recent customers of 200 companies and agencies. The households from which respondents are screened are selected as random-digit-dial replicate national samples (48 samples per year) of telephone households in the continental United Sates. In each household, an adult 18–84 years of age is selected for screening, choosing the adult with the birthday date closest to the date of interview.

Qualified customers are asked multiple-choice questions about their expectations, perceptions of quality, complaints—and for customers of private-sector companies, perceptions of value, repurchase intentions, and price tolerance. All customers are asked three questions about satisfaction: (1) overall satisfaction, (2) whether goods or services met, exceeded, or fell short of expectations, and (3) how what was received compared to the ideal. Customer responses are modeled using an econometric model designed at the National Quality Research Center, University of Michigan Business School, to produce the ACSI and the variables that are drivers of satisfaction or are outcomes of satisfaction.

Each year 250 users are qualified for IRS interviews. This year's screening question was, "Did you file an income tax return for 1995 making use of forms and instructions, or information services of the Internal Revenue Service?"

Sampling error for the national ACSI is plus or minus 0.3 points, at the 90% confidence level, and for the IRS is plus or minus 4 points. The ACSI for the IRS in 1996 is significantly less than the 1994 and 1995 scores—greater than could be caused by sampling error.

# RECOMMENDATIONS OF THE NATIONAL COMMISSION ON RESTRUCTURING THE INTERNAL REVENUE SERVICE ON TAXPAYER PROTECTIONS AND RIGHTS

---

**FRIDAY, SEPTEMBER 26, 1997**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10:15 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# *ADVISORY*

**FROM THE COMMITTEE ON WAYS AND MEANS**

**SUBCOMMITTEE ON OVERSIGHT**

FOR IMMEDIATE RELEASE
September 17, 1997
No. OV–9

CONTACT: (202) 225–7601

## Johnson Announces Hearing on the Recommendations of the National Commission on Restructuring the Internal Revenue Service on Taxpayer Protections and Rights

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine the recommendations of the National Commission on Restructuring the Internal Revenue Service (IRS) with regard to taxpayer protections and rights. The hearing will take place on Friday, September 26, 1997, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include, among others officials from the U.S. Department of the Treasury and the IRS, and representatives from tax practitioner organizations and other stakeholders with expertise in IRS practice and procedural issues. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing [See Advisory No. OV–8].

**BACKGROUND:**

The National Commission on Restructuring the IRS was established by Public Law 104–52. Its purpose was to review the present practices of the IRS and to make recommendations for modernizing and improving its efficiency and taxpayer services. The Commission's June 25, 1997, report contains recommendations relating to Executive Branch governance and management of the IRS, Congressional oversight of the IRS, personnel flexibilities, customer service and compliance, technology modernization, electronic filing, tax law simplification, taxpayer rights, and financial accountability.

The Commission's recommendations are embodied in H.R. 2292, the "Internal Revenue Service Restructuring and Reform Act of 1997," which was introduced on July 30 by Reps. Rob Portman (R–OH) and Ben Cardin (D–MD). H.R. 2292 contains a number of provisions designed to build upon the original Taxpayer Bill of Rights passed by Congress in 1988 (P.L. 100–647), and expanded in last year's Taxpayer Bill of Rights 2 (TBOR 2) (P.L. 104–168).

On September 8, 1997, Chairman Johnson released an Advisory requesting written public comments on these taxpayer rights proposals [See Advisory No. OV–8]. On September 26, 1997, the Subcommittee will receive oral testimony on the taxpayer rights proposals contained in Title III of H.R. 2292 from invited witnesses.

In announcing the hearing Chairman Johnson stated: "I am enthusiastic about exploring more ways to strengthen protections for taxpayers in their dealings with the IRS. The combination of the written public comments and the testimony at our hearing will help us develop the best possible legislation to improve taxpayer rights. Our objective is to do the groundwork on taxpayer rights issues in anticipation of full Committee action on H.R. 2292 sometime in October."

**FOCUS OF THE HEARING:**

The Subcommittee will examine the Commission's recommendations for taxpayer rights, which are contained in Title III of H.R. 2292. The Subcommittee will also review other taxpayer rights initiatives which the witnesses may offer as part of their testimony.

**DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label, by the close of business, Monday, October 6, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

**FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested).

Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

---

Chairman JOHNSON. The hearing will come to order, please. The hearing will come to order. As we convene, I am going to recognize for an opening statement my Chairman, Chairman Archer of Texas, and I very much appreciate his taking the time to be here. He has held, at the Full Committee level, the hearings on the difficult governance issues, and I am very pleased to have him here today as we convene this hearing on the Taxpayer Bill of Rights provisions of the reform legislation.

Chairman Archer.

Mr. ARCHER. Thank you, Madam Chair. And my gratitude to all the Members of the Subcommittee on both sides of the aisle who have spent so much time, along with the Full Committee, in seeking a way to improve the way the IRS works.

Today's hearing marks the fourth and final hearing that our Committee will hold this year before we act. And as the Senate hearings have shown, the IRS does need major reform. And as Mrs. Johnson, our Chairman, has pointed out, many people at the agency do follow the rules and collect the Nation's revenues in an appropriate manner; but there are too many instances in which taxpayers are denied their fundamental rights. Money is coerced from people who do not owe it. And the defenseless and the weak can become IRS targets.

The time has come to get the IRS off the back of the American people. Even with the current income tax, it makes things hard on the IRS. I believe the IRS, its management, and its agents can do better.

Today's hearing focuses on 21 new measures that enhance taxpayer rights. These include making it easier for taxpayers to sue the IRS for negligence for amounts up to $100 million, allowing taxpayers who are wrongly accused by the IRS a greater ability to recoup their legal costs, and forcing the IRS to reveal to taxpayers the reasons that their tax returns were selected for audit.

Subjective, selective auditing of taxpayers in this country cannot be accepted. And it is our responsibility and stewardship to assure that that does not happen.

These recommendations are contained in bipartisan legislation offered by Congressman Portman and Senator Kerrey, as well as by Congressman Cardin on the Democrat side of this Committee. It should be no surprise that cosponsorship of their bill has surged recently. I am pleased to say that, when it comes to fixing the IRS, Congress is working for the American people. The Senate has pointed out the problems, and the House is working on these solutions.

Beyond these 21 steps, I believe the IRS at its most senior level is in need of new thinking. The agency needs a breath of fresh air. If ever there was a time to appoint a board of directors that includes nongovernmental people to fix the IRS, the time is now.

The Treasury Department proposal to maintain political control of the IRS has not and will not work. If Treasury was up to the

job, the IRS would have been fixed long, long ago. Because what has come out in these hearings has been reported anecdotally over and over again in every congressional office across this country for the last 15 to 20 years. It is not new. The American people, I am sure, are not shocked by what they have heard in the hearings that have occurred in the last week or two.

Let me offer one final thought. When Congress pointed out the fraud problems in Medicare, no one said we were HCFA bashing. When we complained about $1,200 toilet seats at the Pentagon, nobody said we were defense bashing. So why when Congress exercises its constitutional obligation to oversee the IRS, do some accuse us of IRS bashing?

Let me advise the defenders of the status quo, I do not intend to yield in my determination to fix the IRS. Of course, in the end, I think the ultimate fix is to tear the income tax out by its roots so that there is no need for an IRS to implement and enforce a virtually impossible Tax Code.

The American people expect no less from us, and that's why this is my top priority for this fall. I intend to mark up legislation as soon as the first week that we come back from the October recess. And I have received a commitment from the leadership that the Ways and Means bill will be considered on the floor of the House before we adjourn. I hope the Senate can find it in its wisdom to also take up this legislation this year.

Madam Chairman and Members of the Subcommittee, thank you so much for your efforts. I look forward to receiving your recommendations in the Full Committee.

[The opening statement follows:]

**Opening Statement of Chairman Bill Archer, a Representative in Congress from the State of Texas**

Good morning.

Thank you Nancy. Thanks to you and all the members of the Oversight Subcommittee who have worked since July on improving the Internal Revenue Service. Today's hearing marks the fourth and final hearing our Committee will hold this year on how to fix the IRS.

As this week's Senate hearings have shown, the IRS is in need of major reform. As the Chairwoman pointed out, many people at the agency follow the rules and collect the nation's revenues in an appropriate manner, but there are too many instances in which taxpayers are denied their fundamental rights, money is coerced from people who do not owe, and the defenseless and the weak become IRS targets.

The time has come to get the IRS off the backs of the American people. Even with the current income tax that makes things hard on the IRS, I believe the IRS, its management, and its agents can do better.

Today's hearing focuses on twenty-one new measures that enhance taxpayer rights. These include making it easier for taxpayers to sue the IRS for negligence for amounts up to $100,000 million; allowing taxpayers who are wrongly accused by the IRS a greater ability to recoup their legal costs; and forcing the IRS to reveal to taxpayers the reasons their tax returns were selected for audit.

These recommendations are contained in bi-partisan legislation offered by Congressmen Portman and Cardin. It should be no surprise that co-sponsorship of their bill has surged recently. I'm pleased to say that when it comes to fixing the IRS, the Congress is working for the American people. The Senate has pointed out the problems and the House is working on the solutions.

Beyond these 21 steps, I believe the IRS at its most senior level is in need of new thinking—the agency needs a breath of fresh air. If ever there was a time to appoint a Board of Directors that includes non-governmental people to fix the IRS, the time is now. The Treasury Department proposal to maintain political control of the IRS has not and will not worked. If Treasury was up to the job, the IRS would have been fixed long ago.

Let me offer one final thought. When Congress pointed out the fraud problems in Medicare, no one said we were HCFA-bashing. When we complained about $1200 toilet seats at the Pentagon, no one said we were Defense-bashing. So why when Congress exercises its Constitutional obligation to oversee the IRS, do some accuse us of IRS bashing?

Let me advise the defenders of the status-quo, I won't yield in my determination to fix the IRS. The American people expect no less and that's why this is my top priority for this fall. I intend to mark up legislation as soon as the first week back from October recess and I have received a commitment from the leadership that the Ways and Means bill will be considered on the floor of the House before we adjourn for the year.

Madam Chairman and members of the Subcommittee, thank you for your efforts. I look forward to receiving your recommendations.

---

Chairman JOHNSON. Thank you very much, Mr. Chairman.

And I would now like to recognize the Ranking Member, Congressman Rangel of New York, who also has taken the time to join us today. We welcome you and thank you for being here.

Mr. Rangel.

Mr. RANGEL. Thank you so much, Madam Chairlady, Mr. Chairman, and the Members of the Subcommittee that have worked so hard to oversee and try to bring some corrective measures to the Internal Revenue Service.

I was shocked by the testimony that I heard over television that took place in the Senate. I do hope that it is not representative of the service that most Americans have received over the years. I come to the table not defending the status quo, but seriously believing that we have one of the best tax systems in the world—where Americans acknowledge a responsibility to their government and, in a general way, pay their tax obligations in a voluntary way. Taxpayers must not be subjected to the type of cruel and, indeed, inhuman treatment as the Senate hearings demonstrated.

It would seem to me that, if I was a part of the IRS or Treasury, I would feel the need to strongly defend the agency and start a prosecution of those agents responsible for treating taxpayers in the horrible ways described by the Senate testimony.

I am very afraid that this issue might explode to become a campaign issue. Because we have become so accustomed to the Congress becoming the whipping boy of the Nation, it seems as though we are trying to transfer that anger to the IRS. If there is anyone that we all feel comfortable in taking a shot at, it is the tax collector.

I either want to see a prosecution of the IRS employees in these cases or some proof that that testimony that was received—which I think really throws a wet blanket over the hardworking IRS agents that are doing their jobs—was inaccurate. If we have some rotten apples there, I think we should take care of it.

Of course, if the hearings were just part of an overall scheme to pull the IRS up by the roots, then I think we ought to get on with that and not waste a whole lot of Federal dollars in trying to patch something that is basically broken and won't work.

And if it is really the complexity of the tax system, I don't think we should blame that on the IRS. As a matter of fact, if we were in the majority as Democrats, I wouldn't blame it on the Congress, but we are not here. We haven't been in charge for 3 years.

So the only answer, it would seem to me, is to simplify the system. All it takes are votes, unless they've changed it. You count; you get 218, and you change the system. So that everyone can follow it, put the Federal tax return on a postcard. I like that.

But for 3 years, we have been trying to pull this thing up by the roots. I hear that the next thing we are going to do is sunset the IRS. IRS employees would know that, in a few years, there wouldn't be an IRS. I don't know which is going to come first, elimination of the IRS, the pulling up by the roots, or elimination of the Tax Code. But I think it is unfair, really, for us to make the attacks and not to give people an opportunity to defend themselves.

I want to congratulate the way the House has handled this matter. We have done it in a civil way. Mr. Portman, Mr. Coyne and Mr. Cardin have really tried to find out what the problems are. They worked with the administration. And it appears to me there are some serious differences as to whether the control should be within the government or outside the government.

As the House debate continues, I certainly have every reason to believe that our Chairlady will pursue the issues in a manner that takes the heat out of the rhetoric and the effort to generate hostility toward public servants who are just trying to do their job. And if the process is broken, fix it. If it ain't going to work, pull it up. If the system is not working, change it.

I want to thank the Chairlady.

Chairman JOHNSON. I thank the gentleman from New York for joining us and for his comments.

Today we will explore the recommendations of the National Commission on Restructuring the IRS to improve the rights of taxpayers in their dealings with the IRS. The 21 taxpayer rights proposals embodied in title 3 of H.R. 2292, introduced by our colleagues in the Ways and Means Committee, Rob Portman and Ben Cardin, are the subject of this hearing.

It is sobering, and I think the Members of the Subcommittee, especially those who have served the last session as well as this session, would agree that it is very sobering, after all the work we did on the Taxpayer Bill of Rights 2 and the indepth discussions we had with the IRS during those years and the fruitfulness of those discussions, and the clear good will on the part of the IRS, that the kind of testimony heard in the other body is still possible.

Clearly, we knew at the time we hadn't finished the job. We knew at the time we were putting in place some taxpayer rights. We asked for reports. From those reports we will draw additional conclusions.

The Commission did an excellent job and has brought to us 21 proposals. But from the reports we asked for and the Taxpayer Bill of Rights 2, we will draw additional conclusions. And so this is an ongoing process.

And I would like to say that, for myself, I see the restructuring proposal of the IRS as part of the ongoing process of modernizing the IRS, one piece of which is making every IRS employee out there on the frontline that deals with the public a taxpayer service employee, not an enforcement officer.

So there is a whole culture change for the IRS to think of itself differently and to work differently, and that is what the taxpayer rights initiatives have been about. And that is what they are about.

I believe that the 21 proposals in H.R. 2292 are a good start. We will have good testimony on them today. But I would also say that that is not going to be the end of it, because there are issues we are working on with the IRS that will have a very—I think will be very helpful to us in getting at the kinds of issues that we saw on the other side in the hearings.

I mean, who is proud of the experience that Katherine Hicks had? Who can defend Tom Savage's treatment? Who can do anything but anguish as Nancy Jacobs cries? And who would defend the treatment of Monsignor Lawrence F. Ballweg?

So there is work to be done. We intend to do it. And this hearing is a big step along that path. The hearings portrayed an agency beset by problems, computer snafus resulting in innocent and incorrect assessments, which taxpayers were forced to pay because they couldn't find a single person in the IRS who was listening and would help them.

And I am proud to say that, in my area of the country, I have a lot of IRS employees who are very good, able folks, and I have never been confronted with this kind of problem. So I want to remember, we are not talking about the majority of IRS employees; we are talking about bad apples. But they are serious, and the problems are real: An agency dominated by numerical performance goals that drive revenue officers and revenue agents to improperly run up the tab on taxpayers, while failing to consider the quality of the work performed by the collections and examinations divisions, an agency where accountability for misbehavior is seriously lacking.

I know from my experience as the Chairman of this Subcommittee that the vast majority of IRS 103,000 employees are honest and hardworking Americans who perform a difficult public service with integrity and professionalism. But I recognize that like all law enforcement agencies, the IRS has attracted its share of bad apples, and fear and intimidation are a real experience for many taxpayers in our great Nation.

Acting Commissioner Dolan made a very good first step yesterday by acknowledging these problems directly and announcing some significant measures that he will immediately put in place to begin the process of reform. And I commend him. I hope we will learn more from Mr. Dolan this morning about those actions.

But administrative actions alone will not be enough to get the job done. We must also take a hard look at additional statutory changes to safeguard the rights of taxpayers.

I want to improve the tax treatment of innocent spouses who are unfairly held liable for taxes owed by a former husband or wife. TBOR 2 directed the Treasury Department to study this issue and report back to Congress by January 30, 1997. Eight months later, after repeated telephone calls, personal calls for myself, we are still waiting for that study.

This problem is simply too important. Too many people are abused. Too many lives are disrupted. Too many children can't get

sneakers because their mother is preoccupied with trying to deal with the IRS and pay unmerited tax bills.

I would rather make a good faith effort to pass a partial solution now than wait for many, many more months while the technical experts agonize over developing some ideal or perfect solution.

The Finance Committee's hearings strongly reinforce the conclusions reached by the IRS Restructuring Commission during its year-long investigation of the IRS. Thanks to the Commission, we have a much better understanding of the problems plaguing the agency and a roadmap for constructive solution. The 21 provisions are a good start, a good starting point for expanding taxpayer rights in dealing with the IRS.

This morning, we will hear from Commissioner Dolan and Treasury officials. We will hear from organizations representing taxpayers, to get their suggestions for additional statutory safeguards. We will also receive testimony from the GAO, which will report on work it is doing to evaluate the IRS use of performance measures in the audit process.

I will now recognize my Ranking Member, Bill Coyne, for comments before we proceed with the testimony.

Mr. COYNE. Thank you, Madam Chairman. Today we are going to hear important public testimony, developed partially within the Internal Revenue Service, and by Members of Congress that we will hear from here today. And we will also hear from numerous tax and accounting professional groups who want to improve the taxpayers' dealings with the IRS. I welcome their testimony and their continuing efforts to assist the Subcommittee in reviewing the IRS administration of our tax laws.

I also look forward to receiving the Department of the Treasury and the Internal Revenue Service's evaluation of the numerous taxpayer rights provisions before our Subcommittee. As the Subcommittee proceeds to discuss possible taxpayer rights proposals for consideration by the Full Ways and Means Committee, my hope is that we will develop a well-thought-out and constructive package of taxpayer rights provisions.

It is important, in my opinion, that the Subcommittee's work be directed toward addressing problems individual taxpayers face in their efforts to comply with the Nation's tax laws. I am particularly interested in working to address the 20 most serious problems facing taxpayers, as reported by the IRS Taxpayer Advocate earlier this year.

Included in the Advocate's list of major taxpayer problem areas are: Complexity of the tax law, inability to access the IRS by telephone, erroneous and unclear IRS notices, an inappropriate tone of IRS communications, compliance burden on small businesses, problems with the administration of penalties, lack of understanding of taxpayers' concerns, delays in IRS compliance contacts, problems in maintaining taxpayers' current addresses, problems in mailing forms and other tax materials, mailing math error notices separate from reduced tax refund checks, delays in the offer-in-compromise process, lack of acknowledgment of taxpayer submissions and payments, lack of one-stop service at the IRS, and inconvenient times and locations for doing business with the IRS. I think these should be our priorities.

I commend Subcommittee Chairman Johnson for holding these hearings and look forward to working with her, the Subcommittee Members and all Members on ways to assist taxpayers in their interactions with the IRS. Thank you.

Chairman JOHNSON. Thank you, Mr. Coyne.

And I will recognize Mr. Portman, who was the House Chairman for the Commission, for a very brief comment, and would ask unanimous consent for all Members to insert any opening statement they may have in the record.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. I do have a longer statement I would like to submit for the record.

I want to thank you and commend you for holding this hearing and for your oversight over the years. You have shown a real commitment to oversight, which the House Ways and Means Committee traditionally has had.

I also want to thank you for not just highlighting problems, but also for putting the focus on solutions; and I think this hearing today is very important in that regard. We have heard about a lot of very serious problems at the IRS. We have heard about it through the year-long Commission work. We have now heard it in the last few days in the Senate Finance Committee, which, as the Chair said a moment ago, really reinforced and confirmed what the Commission found over a year-long period.

Problems are much broader, of course, than just taxpayer rights, but today's hearing is focused simply on the issue of taxpayer rights, how to solve some of these problems, how to level that playingfield between the taxpayer and the IRS.

H.R. 2292 which was referred to earlier, the IRS Restructuring Reform Act that Ben Cardin and I have introduced, addresses many of these fundamental problems, head on, from the 21 taxpayer rights provisions that are included—that we will hear about today—in the structure reforms. It addressed really a lot of the issues that former Commissioner Bill Coyne just listed from the Taxpayer Advocate.

[The opening statement follows:]

**Opening Statement of Hon. Rob Portman, a Representative in Congress from the State of Ohio; and Cochairman, National Commission on Restructuring the Internal Revenue Service**

IRS REFORM BILL ADDRESSES TAXPAYER RIGHTS

At this week's Senate hearings, we all heard disturbing stories of IRS abuses. These stories have highlighted the need for real, substantive reform of this troubled agency. But they come as no surprise to those of us who have worked on the IRS Restructuring Commission for the last fifteen months.

Now that the American people better understand the real problems at the IRS, it's time for this Congress to focus on the real solutions. And the IRS Restructuring and Reform Act provides long-term solutions to the very problems that the Senate documented this week.

The goal of H.R. 2292, which I have co-sponsored with Congressman Ben Cardin (D–MD), is to transform the IRS into an accountable, taxpayer-friendly agency that provides twenty-first century customer service. Increased taxpayer rights are an essential component of this effort and an important part of the legislation.

H.R. 2292 levels the playing field between taxpayers and the IRS. It establishes new disincentives within the IRS for negligent or wrongful actions by IRS personnel. It increases the independence and powers of the Taxpayer Advocates at the IRS. It creates a new system, including taxpayer surveys, to evaluate IRS employees and

managers on the quality of the customer service they provide, not the amount of taxes they collect. It allows taxpayers to receive damages for IRS mistakes. It requires the IRS to explain to taxpayers the reason for audits and the rights of taxpayers. And, it implements a series of related reforms to IRS training, workforce practices and oversight.

I commend Chairman Archer for making IRS reform a top priority for the Ways and Means Committee this fall. And, I commend Chairwoman Johnson for holding this timely hearing on taxpayer rights today and for her commitment to meaningful reform.

---

Mr. PORTMAN. Again, I want to thank you, Madam Chair, for holding the hearing, and I look forward to hearing from our witnesses.

Chairman JOHNSON. Thank you. I would now like to recognize our first witness, Hon. Jack Kingston from Georgia.

Mr. Kingston.

**STATEMENT OF HON. JACK KINGSTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA**

Mr. KINGSTON. Thank you, Madam Chair, Mr. Coyne, Mr. Portman, Members of the Subcommittee. It is a great honor to be with you today.

I want to testify on legislation that I am drafting, along with Mr. McNulty and Mr. Hayworth, regarding the TRAC, our tip reporting alternative commitment that the IRS has developed and how it is impacting restaurants.

We have worked very carefully with your staff on it. Donna Steele Flynn has been tremendously helpful. And we have been trying to work through this very delicately.

But the TRAC system is a different kind of tip reporting system, and this legislation does not seek to eliminate TRAC; all we want to do is to make sure that, if it is, in fact, a voluntary program, that restaurants enroll in it voluntarily.

And we have reports from many restaurants across the country that they are being coerced into going into the TRAC system. It appears that TRAC works for some restaurants; for other restaurants, it does not.

I have a restaurant in my district that says the IRS basically came and said, You will do TRAC, but if you don't, we are going to audit you. Now, that sometimes is hard to prove. But we actually have a couple of letters to that effect, one from the IRS district office in Louisiana to a Texas restaurant. And it says, and I've submitted, but I'll read it directly, quote from the IRS letter:

"Failing to respond to this letter will be considered a decision on your part not to participate in the Tip Income Determination and Education Program. Nonparticipation will result in a Notice and Demand for the taxes due on Unreported Tip Income or a Tip Income Examination." In other words, we are going to audit you.

Here is another one from New York, quote from the IRS, "To participate in the program, please submit the enclosed. In the event we do not hear from you by this date, the Internal Revenue Service will conduct reviews to determine any additional FICA and income taxes due from you and/or your employees."

What our legislation is trying to do is to say, don't necessarily—don't eliminate TRAC; I think it can be improved. But don't coerce restaurants under the threat of an audit to enroll in a voluntary program. And that is the gist of it, Madam Chairman.

[The prepared statement and attachments follow:]

**Statement of Hon. Jack Kingston, a Representative in Congress from the State of Georgia**

Madam Chair and Members of the Subcommittee:

Thank you for allowing me the opportunity to testify on concerns I have raised with this committee over certain abusive practices of the Internal Revenue Service.

I commend the committee, especially Mr. Portman, for taking on the onerous but necessary task of restructuring the Internal Revenue Service (IRS).

A few months ago, a restaurant owner in my district was contacted by the IRS regarding the Tip Reporting Alternative Commitment agreement (TRAC). As you may know, the TRAC agreement is a voluntary agreement developed by the IRS to improve the reporting of tip income among the restaurant industry. Employers who sign the TRAC agree to take specific measures including educating their employees on tip reporting, and in turn the employers receive certain assurances by the IRS from employer-only assessments on tips not reported by the employees. However, the letter my constituent sent about his conversation with an IRS agent indicated that he would be audited if he did not sign the voluntary agreement.

I am concerned that the IRS is using the threat of an audit to pressure more restaurateurs to sign the voluntary TRAC agreement. And it has become evident that this practice of intimidation is not an isolated incident.

I have a copy of a letter sent by the IRS district office in Louisiana to a Texas restaurateur who had not yet signed the TRAC agreement that blatantly states: "Failing to respond to this letter will be considered a decision on your part to NOT PARTICIPATE...non-participation will result in a Notice and Demand for the taxes due on the Unreported Tip Income or a Tip Income Examination."

I have another letter from the New York district office to a restaurateur stating: "to participate in the program, please submit the enclosed....in the event we do not hear from you by this date, the Internal Revenue Service will conduct reviews to determine any additional FICA and income taxes due from you and/or your employees." This method of compliance through intimidation would not be acceptable in the real world and should not be allowed to continue. The job of the IRS is to enforce compliance with the law, not to be above the law.

At the beginning of August, I wrote a letter, signed by 56 other members of Congress, to the IRS asking Acting Commissioner Michael Dolan to look into this practice of intimidation. I did not receive a response until yesterday, and aside from going into a three page explanation of the TRAC program, nowhere in the letter does the IRS indicate that it will address the problem or even investigate it. In fact, the only sentence in the letter that refers to our request stated: "(I)t is not the policy of the IRS to pressure or intimidate any person or business with regards to any compliance." Certainly, if the letters I have just quoted to the members of this committee are not threatening or intimidating, I am afraid to find out what the IRS does consider pressure or intimidation.

I would like to make it clear that I understand that the IRS has the authority to perform audits for compliance with the tax code. However, I would encourage the IRS to work with restaurants, and other tipped-employee industries, to improve tip reporting rather than use its authority as a means of intimidation.

In closing, I request that this committee look into this problem further and make certain the types of intimidation I've cited would come to an end.

Internal Revenue Service

Person to Contact:
Don Radovich
Telephone Number:
(504) 558-3335 Ext 2612
Refer Reply To:
TRAC AGREEMENT
Date: Nov. 20, 1996

Dear Sir(s):

On OCT 16, 1996_____, The Internal Revenue Service mailed two (2) original "Tip Reporting Alternative Commitment" Agreements (TRACs) for your review and consideration. The purpose of the Tip Rate Determination and Education Program is to ensure maximum compliance of the employees of the Food and Beverage Industry with the tip income provisions of the Internal Revenue Code of 1986, as amended.

To date, your response has not been received. Upon receipt of this letter, contact this office at the number provided to discuss the Tip Rate Determination Program.

If the TRAC Agreement is selected, sign and date both TRAC originals and return them by Dec. 9, 1996_____ to:

Internal Revenue Service
600 South Maestri Place, Stop 15
New Orleans, LA 70130
Attn: Don Radovich TIP PROJECT

Pub 1875 has been enclosed for your reconsideration of either the TRDA [TipRate Determination Agreement] or the TRAC [Tip Reporting Alternative Commitment] Agreement.

Failing to respond to this letter will be considered as a decision on your part to NOT PARTICIPATE in the Tip Income Determination and Education Program. Non-participation will result in a Notice and Demand for the taxes due on Unreported Tip Income or a Tip Income Examination.

To respond to this letter call (504) 558-3335 Ext. 2612. Our Voice Mail system is available for messages in the event that I am out of the office or away from my desk.

Sincerely,

Don Radovich
Revenue Agent

Enclosures

We have also enclosed for your review a "Tip Facts" sheet, "Tipped Employee Participation Agreement ("TEPA") Summary Data" sheet, and a brochure entitled "How the Restaurant & Employees Compute the Tip Rate" (McQuatter's Formula).

If you have any further questions, please contact John Polesnak, Tip Coordinator, at (716) 263-3174.

Sincerely yours,

Steven A. Jensen
District Director

Enclosures:
Statement of Interest
Tip Facts
TEPA
McQuatter's Formula
Envelope

Chairman JOHNSON. Thank you very much for your testimony, Jack, and for your specific example. It is, indeed, incredible that a letter could basically say, If you don't do what we are telling you to do, which is to take part in a "voluntary program," we will audit you. And that is exactly the kind of agent action that we are concerned about, and why we feel the taxpayer rights provisions have to be strengthened.

I yield to Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman JOHNSON. Do any other Members of the Subcommittee have questions?

Mr. Portman.

Mr. PORTMAN. Just briefly, again, to thank you for bringing it to the attention of the Subcommittee. And I think it is really extortion; when you think about it, if you don't comply with a voluntary program, you get audited. I think we will hear later from the IRS perhaps on that issue.

There may be some even internal guidance that can be helpful on that because I don't think that is the intent of the program. But the fact that you do have evidence of it occurring, and I certainly have heard from my constituent restaurants on this issue as well, I think is something we need to address.

Mr. RAMSTAD. Madam Chair.

Chairman JOHNSON. Excuse me. Congresswoman Thurman, and then Mr. Ramstad.

Ms. THURMAN. Mr. Kingston, in the letter, they also put in some enclosures. Do you have those enclosures, or can you tell us what the enclosures said?

Mr. KINGSTON. The letter from Texas or Louisiana? Do you know which one? The names have been whited out for this reason.

Ms. THURMAN. I am talking about the enclosures that the IRS sent. It talks about tip facts, TEPA, some formula.

Mr. KINGSTON. I don't think that would be a problem to get for you. I don't have them right now.

[The material is being retained in the Committee files.]

Ms. THURMAN. I would just like to see those so I can see what also is being sent.

Mr. KINGSTON. I think the gist of them is how to comply with the law and so forth like that.

Ms. THURMAN. OK. Thank you.

Chairman JOHNSON. Mr. Ramstad.

Mr. RAMSTAD. Madam Chair.

Mr. Kingston, thank you for your testimony. Be sure to include me as a cosponsor of your bill.

Mr. KINGSTON. Thank you very much.

Chairman JOHNSON. Are there other comments or questions?

Thank you very much, Congressman Kingston. We appreciate your testimony, and it was very much to the point.

Mr. KINGSTON. Thank you very much, Mrs. Johnson, for having these hearings. And I wish you the best.

Chairman JOHNSON. Thank you.

Now we will start with the first panel: Hon. Donald Lubick and Hon. Michael Dolan, Hon. Stuart Brown and Lee Monks; including James White, the Associate Director of Tax Policy and Administration.

As the panel assembles, we are going to hear from Mike Dolan, the Acting Commissioner of the Internal Revenue Service, and then we are going to question Mr. Dolan because he has another engagement that he must leave for.

So, Mr. Dolan, if you will start, and then Members will know that they are going to question you, and then the rest of the panel will testify.

Mr. Dolan.

## STATEMENT OF HON. MICHAEL P. DOLAN, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. DOLAN. Thank you, Madam Chair. It is a pleasure to be back with this group. When I understood we were going to return today, I wasn't quite clear that we would return with as much of the texture as I return today, having been through the 3 days of hearings on the Senate side.

But I would tell you that I appreciate the way that a number of opening comments have been made, both with respect to your interests not only today, but sustained over the many encounters we have had of putting the issues and the problems in a context.

I think the Service has been very appreciative in the kind of constructive give and take we have had with the Subcommittee. And, clearly, I am here today not to defend the status quo, not to ignore the problems that exist, to repeat to this Subcommittee what I did

yesterday with respect to the acknowledgment of the errors that were made and the apologies that were made; but also with the urging that they be looked at in precisely the context that were described in your opening comments, the context of the millions of transactions that year in, year out go exactly correctly, the thousands of employees who are competent, professional, and do precisely as we would all be proud of them doing. And so that is not, again, to suggest that there haven't been real serious concerns raised the last 3 days.

What I wanted to do this morning, particularly out of respect for the long-term interests that this Subcommittee has had for taxpayer rights and the imminent activity that this hearing is about, is to explore the provisions of the restructuring bill that deal with employee rights; I thought, in particular, I ought to come this morning and talk about the specific announcements I made yesterday, and as you suggested, Madam Chairman, to talk about what was behind that and what we hope to achieve by it in the hopes that that may also inform the thinking that you will do around the provisions that are at issue in this bill and would be the kind of employee rights provisions that you have been interested in.

Yesterday, as I listened and read the testimony from the 3 days, three things jumped out at me. In the Senate, there were four very badly handled cases. And with them came the witnesses that you mentioned, Madam Chairman, who made very graphic presentations of the way our bad handling affected their lives.

And there is just no way in the world for me to sit here any differently than I did over there and say anything other than it is wrong. It shouldn't recur, and we should do everything in our power to prevent it from recurring.

The second area that struck me that came out in the 3 days was a general concern from a number of witnesses about the thing called the IRS culture and whether that culture had the right balance struck—in the terms that you mentioned in your opening comment, Madam Chair—the balance between customer service and the roles that Congress has asked us to play in collecting revenue.

And then third was an issue that I would style as questions about fairness and about the use of measures. As we went through the 3 days of hearings, it struck me that there were serious questions raised in all three categories.

In the first category, the case was made that those four cases were handled badly. But behind that was the obvious question for me and other people in the organization, how many more of those cases are out there? How many more opportunities are there to have taxpayers come forward and say, I have experienced the same frustration and stress?

We, as I think you know, worked for the Senate Finance Committee for a period of almost 8 or 9 months. We started with a large number of cases, and ultimately came to the four cases about which testimony was obtained in the 3 days. Those four cases were clearly cases that were badly handled. There were a number of other cases that, as we went through our examination, were handled correctly or were handled in better ways. But I am under no illusion that the four cases we saw the last 3 days are the only four

cases that could be brought forward as evidence of this system or individuals in the process not working correctly.

So our first reaction in the area of the cases is, we want to take those four cases, not only the voluminous case files we developed as we worked with the Committee over the last several months, we want to take the individual testimony that those taxpayers gave, because each and every one of the four gave dramatic testimony. I want to take the video and the transcript from the hearing that those taxpayers gave, and send those packages back to the regional commissioners under whose jurisdiction those four cases were worked.

And those four regional commissioners are going to take—in some cases, multiple offices that worked on that case—and they are going to go through that case step by step, even in the event those cases go back 16, 17 years, and they are going to look at, where were the various junctures that these cases messed up?

And in addition to trying to find accountability where that is appropriate, perhaps more importantly, where were the missed opportunities to pick up on the signals that this thing was off track? Where could or should somebody have earlier assumed the responsibility to correct it? Because I think, at the end of the day, there is no way I am ever going to sit in front of you and assure you that we won't make another mistake. But I ought to be able to sit in front of you and say that there is a level of diligence and vigilance about identifying mistakes and owning the ability to correct those mistakes.

The other thing that the case handling did for us was, we invited the Senate Finance Committee to give us however many other cases they have as a result of the publicity attached to that hearing; and we are going to identify a special project manager who will work those cases to completion, because we don't want to have to have another hearing to come up and work 4 more or 10 more cases that are in that hopper that deserve to be closed and closed today.

Part of what our review discovered as we went through these cases is there were indicators upstream in these cases that, if somebody had reacted differently, they might not have produced the ultimate result.

And so one of the things that I have asked each of our 33 district directors to do and our 10 service center directors to do is to get themselves personally involved in going back over the past several months of correspondence that has come into their district, not the correspondence that is already controlled in problem resolution, already being worked as a specific case, but look at the stuff that comes in there that has the badges or the indicia of a potential problem, and pull that stuff out, have somebody look at it, see what opportunities are sitting in our inventory today that, if handled correctly, won't be the kind of case that recurs 1 year, 6 months, or longer from now.

I am excited to tell you, Madam Chair, even overnight we have also had an offer of help from other people. Yesterday, the enrolled agents approached me last evening about trying to help us in our pursuit of getting some of these lingering cases up on the deck and dealt with.

And so as a result of conversations we had last night, we intend to work with the enrolled agents, who said they would put a pro bono together to create an opportunity for people who might want to come forward—some set of practitioners for some help in getting these things resolved. And we will try to create an opportunity for the work that comes through that pro bono effort to come in and be effectively handled by our problem resolution program.

Another thing we said we would do in order to, I think more than anything, deal with this question about culture, deal with whether our emphasis was right as we balance the mission you have assigned to us to raise revenue and the mission you have assigned to us to treat the taxpayer concerns appropriately, is, we have had, in two or three parts of the country particularly, good results when the district directors have gone out and consciously called for, within their States, the people to come forward with problem cases. We have had—this has worked particularly well in the Carolinas.

We just recently, 2 or 3 weeks ago, had all the practitioners serviced by the Ogden Service Center essentially come in, spend a couple of days, bring their problematic cases, and had special attention applied to that.

What I have done as of yesterday is require every district director to spend 1 day a month somewhere in their district with this form of problem identification day, so that, be it an individual taxpayer or practitioner, anybody who has got one of these cases that has thus far alluded resolution, to bring that in, and the directors and their key staff, capable of solving that will make themselves available in that setting.

In an instance where systems don't work right in an organization, you typically have to attribute accountability to management.

The management of an organization is the one that sets the tone. The management of the organization is the one that sets expectations for what is expected for frontline employees.

And so one of the things we have also said we were going to do is, in the next 45 days, we will assemble in Washington all of our key compliance, senior leaders, again with an eye toward working these cases, identifying for this group in very graphic terms what kind of pain and suffering were documented over the last 3 days, and what it is in their operations that ought to change in order to preclude this in the future.

The other thing that I think you have had fairly significant interest in, as a Subcommittee, is how well understood is the Advocate's role. In the first instance, what you have been very careful about is giving the Advocate the power to intervene appropriately, the power to really intervene in cases where things are off the track.

And I think—I hope, Madam Chairman—that other Members who have had an experience similar to yours, that when a case gets put into the hands of the professionals, the Problem Resolution Office, it gets dealt with and dealt with effectively.

But the question that is always out there is, do enough people know about the problem resolution program? Do enough people know about the Advocate's availability to assist them? So one of the things that we will revisit again as a result of some of the testimony is, have we done the job to get the Advocate and the problem

resolution program well enough understood so that the citizen who is having these kinds of troubles knows that, by law, we have created the capacity to help them.

Do you care if I continue?

Chairman JOHNSON. Please continue.

Mr. DOLAN. The third area——

Chairman JOHNSON. Just to let you know, we have about 10 minutes, and then there is a series of three votes, two 5-minute votes following the current vote. So there will be a recess of probably 20 minutes.

Mr. DOLAN. OK. Let me try to bring to a reasonably quick close the last area that I noted in several of the opening comments, and I specifically noted in the earlier conversation with Chairman Archer, a concern about some of the testimony.

And in this case, a lot of the concern arose from the employees—current employees' testimony about the way measures, goals, quotas might impact currently on the organization. And, I know I don't have to tell this Subcommittee, there has been long established as a result of, certainly, the 1988 passage of the Taxpayer Bill of Rights 1, but 10, 12 years prior to that, the initiation of a policy in the IRS that says that enforcement statistics cannot be used to set goals and quotas for frontline people and their managers and should not be used as an evaluative tool that affects their evaluation standing, promotion, or awards.

What we heard in some of the testimony over the last 3 days is, while that is indeed a policy that we have done a pretty good job of monitoring over the years, and policing using the quarterly certification process that this Subcommittee held right into law, we heard testimony from people that said that might be the case, but there are numbers out there, there are other measures, there are other goal-setting processes that have been used higher in the organization that have, in the eyes of some, become surrogates for the goals or the quotas that the laws were purposely designed to avoid.

One of the things that I have done, having heard that, is try to create some insulation. One of the things that our internal management processes historically have done over the last couple of years has put relative rankings on field offices, based on a whole amalgam of measures. Based on the testimony not only that I heard yesterday, but others that commented inside, that that has produced some dysfunctional reaction. People worried too much, where do I fit on a relative ranking? So I discontinued those.

The other message I heard was, to the extent you talk about measures of money in the organization, it is very easy for somebody to extrapolate from that down at the frontline and infer that, if this is a goal for my district, then I should take some percentage of that and assume it is mine as a group or mine as an individual.

That is not what was intended as we deployed our GPRA, Government Performance and Results Act, goals. But in point of fact what we heard was testimony that said, intended or not, that is what is happening in some places.

So what we have done is, we have said we will not move any dollar base goals down to the district level. We will continue to do as we have done in past budgets, make commitments to the Congress

as to what the investment of the resource that you give us in the budget will produce by way of dollar outcomes. But we will only deploy that with respect to the four regions at the national office. We will not deploy it down into the districts or the centers, again so as to avoid the potential that that kind of a breakdown of the revenue goal shows up as a quota or a goal in a way that is not intended.

Last what I would say is, there are two other things that we heard. One was, the way that we have collected information about penalties in the past and collected the dollar value of penalties and put those into our reports suggested to some that, again, there was an incentive for somebody to go out and establish a penalty and collect a penalty for its revenue potential, as opposed to the behavior direction that is written into the penalty legislation.

So we will in the future not include penalty revenues in any way that we report on the dollar achievements either in the examination program or the collection program. Again, to be clear that there are no mixed messages about Congress authorizing penalties for a discrete purpose, they don't authorize it as a way of generating revenue.

And the fourth area is one that we have talked a little bit about before. And this is part of a general move in the organization that has been under way now for some months, to gain more input from the actual taxpayer, the customer, in our various interactions.

We have had the experience thus far in appeals and in our general examination program of soliciting customer satisfaction at the end of an audit, at the end of an appeals process. And what we will do in the next 6 months is extend the same approach to the collection process inasmuch as that was the process that was highlighted and so much of the concern of the testimony that came out in the last 3 days.

So we hope at the end of the period what we will have is not only the productivity and performance data that we have, but we will have customer—taxpayer feedback about the way I was treated, the professionalism that I saw exhibited or nonexhibited in my audit, in my collection, or appeals.

And so with these steps, Madam Chairman, I am hopeful that—we have not taken the last action by any means, but taken a series of actions that respond immediately to the kind of concerns raised, not only in the Senate, but are embodied in the kind of work this Subcommittee has done. And I would look forward to the opportunity to both report to you about how these measures work, but also use them for further discussion in things we might do beyond this as we attempt, not only to react to 3 days of hearings, but as we attempt to move forward along the path of protection of taxpayer rights at the same time that the organization modernizes so many of its other customer service capacities.

[The prepared statement follows:]

**Statement of Hon. Michael P. Dolan, Acting Commissioner, Internal Revenue Service**

Chairman Johnson and distinguished Members of the Subcommittee:

I appreciate the opportunity to appear before you today as I did before the Senate Finance Committee yesterday.

Before I proceed, I want to say right up front how troubled I am by much of what I heard in the last three days. The Finance Committee has heard from taxpayers whose cases we handled very badly, and for that I am extraordinarily sorry.

As I listened to the statements that the Members of that Committee made on the first day and the testimony of this week's witnesses, several important themes were sounded:

1. First, as I said at the outset, individual cases were badly handled causing taxpayers to suffer significant distress and disruption of their lives. This is wrong—there is no excuse for it and we want to do everything we can to prevent other such cases.

2. The IRS "culture" has been mentioned prompting the question of whether the IRS approach to dealing with taxpayers is callous, overaggressive or something even more serious.

3. Witnesses have also raised questions about the fairness with which the IRS does its job, specifically alleging that we prioritize enforcement actions against "small" taxpayers and we use quotas and goals in ways which violate the law and compromise the rights of taxpayers.

These three themes may not cover all the testimony presented, but I believe they represent the most crucial issues and I would like to directly address each of them. Prior to doing so, however, let me tell you something you may already know. Secretary Rubin and Deputy Secretary Summers are vitally interested in these cases. In their oversight of the IRS during the last several years, both the Secretary and Deputy have focused on improving customer service as a central priority. I will be providing them both with an accounting for not only the corrective case actions required, but an overall plan of improvement warranted by their investigation.

SPECIFIC CASES:

We heard from four taxpayers who were legitimately frustrated by the way the IRS dealt with them. These taxpayers did not receive the treatment they deserved. While each case was different, the end result is indisputable: we were wrong in the way that we handled many aspects of their cases. I fully appreciate that an apology is little consolation when it comes at the end of the stress and obvious frustration these men and women have experienced. Nevertheless, I do apologize to each of them. They deserved far better treatment from the IRS than they received. Perhaps they will take some small measure of satisfaction in knowing that the unacceptable outcomes of their cases will result in keeping others from experiencing similar frustrations.

In all fairness to the workforce of the IRS who succeed at doing a very complex job well, these hearings should be placed in the larger context of the millions of successful taxpayer interactions that IRS has each year, as many of you urged in your opening statements. Notwithstanding that fact, we must immediately take specific actions to prevent the recurrence of these kind of circumstances.

In preparing for these hearings, many of us have seen first hand the frustration and stress our agency caused for the involved taxpayers. I believe I have to find some way to engage the entire organization in understanding the impact of our mistakes. Consequently:

- I am requiring that the Regional Commissioners who have jurisdiction for the four specific taxpayer cases discussed yesterday take the taxpayers' testimony, the hearing record and the case files we have assembled and in coordination with the responsible office(s), perform a complete review. Their review will be done to understand each of the errors in the case, the reason and accountability for the error, the missed opportunities that existed to correct the error and the actions necessary to eliminate the possibility of recurrence;
- I will appoint a special project manager to control and oversee the resolution of all other cases that have been identified as problematic by the committee in connection with this hearing and report back to the committee staff every thirty days until all the cases are correctly resolved;
- I am directing each of our 43 District and Center Directors to immediately review all complaint correspondence that has been received by their office during the last several months. They will be required to confirm, with the Taxpayer Advocate, that the cases have been resolved properly and that the taxpayer has no outstanding issues. They will also identify areas which appear to be causing repeat problems.

By these actions we will not only learn from the cases we have botched, but that we will also dramatically reinforce within the organization the high quality, professional and courteous standard of individual and organizational performance expected of the IRS; standards to which I know the vast majority of my colleagues are committed.

## CULTURE

The second area of concern, the question of the IRS culture, is a far more complex issue. Bad cases have happened. This is not acceptable and everything possible should be done to prevent their recurrence. This is, however, not the systematic and pervasive way taxpayers are treated by the IRS.

The vast majority of taxpayers meet their tax obligations. In most cases they encounter the IRS only when they file their return and either receive one of the 85 million refunds that are issued or pay the additional tax which they owe. For those people our goal is to make it as easy as possible to stay in compliance and we have implemented many initiatives which make it easier for these taxpayers to meet their obligations. Some examples include:

- electronic filing and payment including enabling over 25 million taxpayers to file their tax return with a ten minute phone call;
- most tax information, forms and publications are now available on the Web; and
- expanded telephone access and automation have been added to better answer the 100 million calls fielded each year.

For taxpayers who do not file and pay as they are required, the IRS takes enforcement action. As a matter of basic fairness for those who meet their obligations, the additional moneys owed but not voluntarily paid should be collected through enforcement. Responsible and appropriate enforcement action results in a smaller financial burden on the taxpayers who pay voluntarily.

We have heard testimony and concerns expressed this week about the extent to which some employees may have used enforcement tools to abuse the rights of taxpayers. To the extent such abuse happens, it is wrong and it is unacceptable and the Service has in place a number of things designed to prevent such abuse.

Our rules of conduct are explicit ..... "Any employee who has information indicating that another employee engaged in any criminal conduct or violated any of the rules of the Standards of Conduct shall promptly convey such information to the Inspector General or to the IRS Inspection." During the last three years 475 employees have been disciplined for mistreatment of taxpayers. While any incidence of this conduct is unacceptable, I do believe our referral and investigative processes effectively reinforce both the behavior that is expected and the consequences for misconduct.

Beyond enforcement of the code of conduct there are a number of other processes designed to protect taxpayers' rights. The Taxpayer Advocate and the Problem Resolution Program are probably the most obvious examples of IRS commitment to protecting taxpayer rights. The Service worked closely with Congress to formulate Taxpayer Bill of Rights II—in fact much of the bill was implemented administratively prior to enactment. The Advocate offices throughout the Service do an excellent job of finding cases that are "off track" and getting them into the hands of employees who can solve the problems. As you are aware, the taxpayer Advocatee also has the authority to intervene in cases in order to review the appropriateness of a particular action and or mitigate hardships. We have also implemented the Taxpayer Complaint Process called for under TBOR II and are using it as a key monitor of organizational performance.

The formal appeals process is also an effective avenue for taxpayers who seek independent review of the way an IRS employee has applied the law in a tax audit and some collection issues. Last year we created an additional right for taxpayers to appeal the issuance of a lien, levy or seizure actions when they think they have been used inappropriately.

Despite the existence of these systems, I have heard many concerns during the last three days which disturb me greatly. The outcomes that I saw in some of the taxpayer cases violate the standard of professional performance to which I know the vast majority of my colleagues are committed. Regardless of how small a minority of employees may have misused their authority or judgment—it is no less offensive. I believe it is my responsibility to sound an alarm within the organization. These kinds of instances erode confidence in the entire system. As a means to engage the organization's leadership and employees in changing the impression and, where it exists, the reality that we are callous, overly aggressive or worse:

• I am requiring each of the 33 District Directors to dedicate one day a month to forums held throughout their districts for the exclusive purpose of giving taxpayers and practitioners the ability to surface and solve problem cases;
• Every executive and senior Compliance manager will be convened in Washington in the next forty five days to review the findings of the Senate Finance Committee hearings and review our expectations in the area of responsiveness to taxpayers and protecting taxpayers' rights.
• I will personally remind every IRS employee of the requirement they have to identify cases that belong in the Problem Resolution Program and seek their commitment to use the Problem Resolution process to identify and resolve problematic cases;.
• I have asked the National Treasury Employees Union and its leader, Bob Tobias, to partner with us in designing a national meeting of front line employees who will help identify ways in which to respond to the serious concerns raised in the hearings;
• We will begin the capture of customer satisfaction feedback on collection actions following the model that has been recently implemented in the examination general program.

## FAIRNESS AND MEASURES

Nothing is more important to the health of the tax system than a sense that it is administered fairly. The IRS Management Board recently reviewed all the IRS performance measures and a central conclusion reached was that we need to strengthen the measures of customer satisfaction. Already over the last year we have instituted processes in the Appeals and Examination activities to obtain taxpayer feedback upon the completion of the appeal or the audit. These results will provide crucial baselines from which we can design improvements. During the next six months we will institute a similar process to cover collection activities. We realize that if we are to focus on improving our customer service it is absolutely essential that we measure customer satisfaction.

Beyond this, I am extremely concerned about allegations that have been made during the hearings. In addition to the testimony we heard, I have received allegations directly—no doubt prompted by the media coverage of the hearing. Some of these allegations have been referred to our Chief Inspector.

I intend to further examine the claim that we concentrate disproportionate attention on small taxpayers, but I am quite confident that most of the concern expressed was misplaced. Our audit activity results which would give the clearest picture of this issue reflect that the higher the income level of a taxpayer the greater likelihood of an audit. I offered to provide detailed audit data to the Committee, and I offer the same to you. I think it will satisfy any concerns. I am very aware that Ms. Long gave testimony before the Finance committee that contradicts my assessment. I have referred her allegations to the Chief Inspector and Inspector General and should they be substantiated I will take appropriate action.

The other important concern raised this week is about the use of quotas and goals. Using records of tax enforcement results to evaluate employees directly involved in compliance activities or to produce specific goals or quotas for those employees is forbidden. There has been an administrative policy to this effect in place well before it was included in the 1988 Taxpayer Bill of Rights (TBOR). Our managerial and technical training reinforce this prohibition and a quarterly review and certification process that was implemented with TBOR monitors conformance with this requirement.

In connection with these hearings I have received allegations that the policy and the law may have been violated. I have referred these allegations to the Chief Inspector and will see that the correct discipline occurs if violations are substantiated. In the meantime, these and other indicators cause me to take a number of actions that are designed to reduce the likelihood that measures or statistics will be used incorrectly. The Government Performance and Results Act (GPRA) requires a number of accountability measures on our performance as an agency. However, effective for FY 98 we will make the following adjustments to our measurement system.

• We will no longer comparatively rank our 33 district offices on their results.
• We will suspend the distribution of any goals relating to revenue production to our field offices. While the goal will be established and tracked nationally to conform with GPRA requirements, there will be no expectation of a local office having a "share" of a national goal. We will continue to distribute expectations relating to national goals aimed at quality improvement and burden reduction for the taxpayer.
• Some have said that the Service accumulates statistics on penalty results in a way that encourages assessments of additional penalties as a revenue raising tech-

nique. Therefore we will no longer include the penalty amount in our statistical results concerning audit recommendations, assessments or collection.

• Because of the breadth of concerns raised about enforcement of the policy which precludes enforcement goals and our dependence on the current quarterly certification process, I will ask the Government Accounting Office to validate the effectiveness of this self certification program.

I have tried to address the critical questions the hearings have raised. I know you will have questions and I look forward to answering them. Before I do so, however, I would like to offer a couple of closing points.

As a civil servant who has spent 26 years working in the IRS, this has been a very painful week. I am disappointed that we handled some of the taxpayer cases as poorly as we did and I am concerned that there are as many worries about our professionalism as have been expressed. I think it is important to recognize when we have erred and where we need to improve.

I have spent very little time talking about the millions of things that—week in and week out—go exactly as they should. You would probably be as impressed and gratified as I am to see how many citizens write the Commissioner's office to thank and compliment our employees. No one is more committed to serve the taxpayers of this country well than the men and women of the IRS.

We are an organization that is in the midst of a huge modernization. With the recent publication of the Modernization Blueprint I believe the Treasury and the IRS are on a path to bring the modernized technology to bear that the tax system so badly needs. Likewise, numerous customer service initiatives have been brought on line in the last couple of years and the joint IRS/Treasury/National Performance Review that will complete its work next month holds even more promise for dramatically improved service to the U.S. taxpayer.

We have heard the concerns expressed this week and will improve in areas where we have stumbled. We understand how crucial it is to this country's well being that our tax system be administered professionally and fairly.

---

Chairman JOHNSON. Mr. Dolan, I thank you very much for your testimony. As usual, it was thorough and indepth. You have thought a lot about the testimony that was given in the Senate. I think it isn't clear—it hasn't been clear to the public that your people worked closely with the Senators for many months in looking at problem cases. And I think that was the right thing for you to do. And it is the right thing for all of us to confront the enormity of the injustice imposed on those who testified in the Senate yesterday and, I guess, the day before.

As one who is sometimes too passionate, I can tell you that, as we hear cases like that, it is indeed hard to keep that balance between outrage and respect for the many really excellent IRS employees, that is so important to good governance. I am very pleased to hear of these numerous steps, which show a real sensitivity to the challenge that faces us not only to change the law, but to change the culture that has allowed such abuses to occur.

Now, I know you have a tough schedule. We will have to recess for 20 minutes. Can you stay for questions thereafter or not?

Mr. DOLAN. I will, Madam Chair.

Chairman JOHNSON. All right. Well, we will adjourn. And the last vote, folks, if you can vote early, come right back. We are going to start as soon after that last vote as we possibly can. Thank you.

[Recess.]

Chairman JOHNSON. The hearing will reconvene.

Mr. Dolan, I just want to pursue a couple of brief things and let other Members have an opportunity. First of all, may I just suggest, as you send the tape of the hearings and the transcripts out to the regional offices where problems evolved, that you encourage

the whole staff to take time to watch them, I mean everybody from the janitor right on up. Because when you work with companies where total quality management started, they got the continuous improvement. If everybody sees these tapes and—it is really required to confront the personal agony imposed on these people and the total unfairness of it all, I think; what would be those points be then search for solutions and the effort to see, where along the way could we stop this; where we didn't notice where it will be more fruitful?

Then at the end, when that is made, everyone—again, janitors right on up—everybody on the team needs to be there to see what in hindsight could have been done. Ultimately, as important as changing the law is, changing the team's ability to work together and notice those points early on is equally important.

I had a hospital, during the height of the explosion in malpractice and insurance costs, self-insure. And the different relationship it developed among the doctors was spectacular, because they said they were going to be liable if they saw one of their colleagues do something stupid or overlooking something or being casual or insensitive or whatever.

Big mistakes are results of teeny, tiny slips over and over again accumulating generally. I think it is important to look at this from a systems perspective and help everyone to understand how truly agonizing wrong decisions can be made and how destructive to people's lives. I would just make that one small recommendation.

Mr. DOLAN. Madam Chair, if I might, I don't think you can be more correct. I know that I spent several hours on those cases, and some of the folks behind me spent days and weeks, and we all came out believing we had felt at the capillary level some of that distress. And part of our objective is to have others confronted at that level. Because I don't think—when you do, you come away far different about wanting to see these things not recur. So I think your suggestion is right on the money, and we will take it.

Chairman JOHNSON. I also commend you on your encouragement of your directors to get out there, to go to Rotary meetings, give talks, have press conferences, attend small business events, reach out so that people know that if they have a problem with something that is going on, they can call someone and talk to them about it. Because one of the real problems in all of this is that someone will come to me, and then my intervention will make it worse and not better. And the fear of that out there is very, very real. I personally have not found that to be the case, but the fear is enormous.

In a sense, I think, I certainly have had that experience with justice, ironically in environmental enforcement and health and safety issues, where just the inquiry by a Member has actually made the bureaucracy more intractable and exacerbated the unfairness. I have some real horror stories along that line.

You do have to tend to this issue of customer satisfaction. If we can have the customers rate professors in the classroom, if we can have users rate their physicians, if we can require HMOs—not every one of those judgments is informed, but cumulatively they give a cumulative view—maybe everybody who comes into the IRS or deals with the IRS ought to have a chance to fill out a customer

satisfaction form. Everywhere you go now—restaurants, hotels, every place—there is this opportunity. I think we have to think through this differently.

I think one of the things that is interesting about what you are doing and it does in my mind demonstrate a need for a board with outsiders on it where these things have become routine in the last 10 years; and maybe if we moved more rapidly 5 years ago in this direction, we wouldn't be sitting here today.

I would invite you, although I am not going to ask you this, but you do in your testimony dedicate your comments to addressing the problems that were raised by taxpayers who have suffered at the hands of the IRS, and you do not address yourself to the recommendations of the Commission in regard to taxpayer rights. I imagine the others will.

Mr. DOLAN. They will.

Chairman JOHNSON. But I am going to yield to my Ranking Member, Bill Coyne, and then the others for questions at this time.

Thank you.

Mr. COYNE. Thank you, Madam Chairman.

Mr. Dolan, in your testimony before the Senate Finance Committee yesterday, you cited four cases that were very poorly handled. And I wonder if we can assume that what was testified to there yesterday, those accusations are true and correct.

Mr. DOLAN. Mr. Coyne, one of the things that I would like to remind the Subcommittee is, I had—yesterday I had the authority by virtue of the releases that those taxpayers executed to speak in the open hearing about those cases. I don't have such authority today. I could do that in executive session or if that is something that the Subcommittee wanted to do. But I am precluded from being specific about those cases in the open session here today.

Mr. COYNE. I see. The other thing that you mentioned in your testimony was that, for the last 7 or 8 months, you worked with the Senate Finance Committee to be able to bring these cases forward in yesterday's testimony. Is that a fair statement?

Mr. DOLAN. That is correct.

Mr. COYNE. So it probably would have been difficult, without the cooperation of your office, for the Senate Finance Committee to come up with those four specific cases. Is that fair?

Mr. DOLAN. I think that is a fair statement, Mr. Coyne.

Mr. COYNE. You state in your testimony that all the problematic cases identified by the Committee will be handled with a report within 30 days. Is that your testimony?

Mr. DOLAN. Yes. The Committee has some additional number of cases that they would still see as problematic beyond the four. And what I invited the Chairman to do yesterday is to give me those cases, and I will put those under a control and, while they are still open, report back on the status of those, so that the Committee knows that followthrough has occurred.

Mr. COYNE. Would you be able to give our constituent cases the same kind of treatment?

Mr. DOLAN. Well, what I am hoping is in many cases, you find your constituent cases are given that kind of treatment. One of the things that Mrs. Johnson said, I also heard yesterday. One of the Senators asked that when a constituent case came, was there a

negative reaction? And I said, I think just the opposite. I have quite often given the feedback that we headquarters types don't always do as the Congress would suggest we should; but that, please don't mess with my problem resolution, because for the most part I think the problem resolution program does a pretty good job of taking the constituent case and getting it worked. I would certainly want to hear from a Member if there was some breakdown in that.

So I would hope that those normal processes, the control processes and the proper resolution processes, would get that kind of attention paid to your constituent cases. If not, please tell me, and I will give you at least as good service of what we are trying to do with these problematic cases.

Mr. COYNE. How many returns, tax returns, both individual and business, does the IRS handle in 1 year's time?

Mr. DOLAN. It is in excess of 200 million, Mr. Coyne.

Mr. COYNE. Two hundred million. And I would guess that the vast majority are those returns that present no immediate problem either for the IRS or for the individual. What percentage do have problems?

Mr. DOLAN. Well, I don't want to give a specific percentage on the returns. Of course, we talk about the 83, 85-percent compliance level. And if you put that alongside what is a routine transaction for millions of Americans, which is—I file my return when it is due, and I either get one of the 85 to 90 million refunds that are issued on time, or I pay what is owed—the vast majority of the taxpayers have that as the experience.

Of course, the last conversation we had in here was, our goal for those compliant taxpayers is to make it easier to comply, to give them incentives to stay compliant. And so, without being able to put an absolute percentage on the population that fits in that category, it is a very high percentage of the American taxpayers that fit into that category.

Mr. COYNE. So it is pretty safe to say, then, that the very badly handled cases that you referred to in your testimony have to come from that 16 or 17 percent of noncompliant taxpayers?

Mr. DOLAN. It doesn't have to. You can be somebody who is—who has been or was trying to be compliant, and we made a mistake. I would say, even from that percentage of noncompliance, I would hope that in the vast majority of our transactions, where we are enforcing the law or where we are using one of these sensitive collection tools that the Congress has authorized day in and day out, that it is done in a way that the taxpayer feels is professional, feels is respectful to their rights.

So I think the mistakes could come anywhere. And the standard of our conduct should be equally good, whether it is for the compliant or the noncompliant.

Mr. COYNE. And there is no problem claimed by the taxpayer?

Mr. DOLAN. I am sorry?

Mr. COYNE. The vast majority of them, there is no problem with——

Mr. DOLAN. The vast majority; that is correct.

Mr. COYNE. Thank you.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. Having watched those hearings, I think those taxpayers were all compliant taxpayers, just to make that point.

Eighty percent of taxpayers pay their taxes and have no interaction at all with IRS other than filling out the form and having withholding. But I understand the point my colleague was trying to make.

Is that true, Mr. Dolan, the taxpayers we saw this week at the Senate Finance Committee would be taxpayers trying to comply with the system, not part of the 16 percent? Is that your understanding?

Mr. DOLAN. I would rather not run afoul of the disclosure provisions.

Mr. PORTMAN. OK. Well, I will just sort of stipulate that, at least from having watched those hearings for several hours. Thank you for being here. I have to commend you for surviving this last week. You look pretty good, no worse for wear.

Mr. DOLAN. I feel worse from the wear.

Mr. PORTMAN. Sometimes appearances are deceptive.

Mr. DOLAN. That is right.

Mr. PORTMAN. I also want to commend you for taking a lot of immediate actions. I think a number of them are absolutely necessary. And of course I believe that these are deeper problems, as I think you do, too, that we also need to take a longer range look at. But I do want to commend you for your actions this week.

In hearing your testimony, it was very interesting. I think you acknowledged that these cases and generally the concerns that have been raised over the last year with the Commission do illustrate some deeper problems.

You talked about culture. You talked about management and so on. I find, as I listened to your testimony, in fact, that management really is one of the issues you come up against again and again.

You mentioned upstream problems. The inference I drew from that was that this contributed then to the downstream costs in the sense that there was an upstream problem and notice was sent to the wrong person, some administrative mishandling that didn't create it, and then it was a larger problem. And I think that again is consistent and reinforces what we found over the last year in looking at the IRS.

Administrative problems, management problems really aren't going to be solved by more taxpayer rights. I think it is very important we have this hearing today. It is very important that we do have a Taxpayer Bill of Rights 3 to build on TBOR 2, but I don't think that will solve the larger problems.

Do you agree with that? Aren't there some larger structural problems you are talking about?

Mr. DOLAN. I think what I would prefer to do is say, any organization that has got a mission as complex as you all have assigned us and as many people doing it and as many customers involved in the interactions, there are countless processes and systems involved in that. Some of ours work a whole lot better than others.

And to the extent that those processes don't work as they should, they are rarely the fault of the person on the frontline, but almost always the fault of one of us who sits in the management process.

And that could obviously include, in a setting like this, the interaction with us and the Congress when we do the systems right.

Mr. PORTMAN. I will take you off the hook even further.

Often these are not the problems of an individual manager; these are the problem of the system. There is a computer system that is not working, so notices go out to the wrong person.

Mr. DOLAN. Sure.

Mr. PORTMAN. These are problems that are systemic and need to be solved. If you are going to get at taxpayer rights problems, obviously you need to change the law and put in some statutory protections, but you also need to change the system. You just mentioned the interaction with Congress; I want to just build on that because Congress is to blame here, also. I think you get mixed signals from the Congress because of the diffusion of responsibility and authority and oversight over the IRS, seven different Committees telling you what to do and what not to do.

Do you feel that you do get mixed signals in terms of your management responsibilities? To the extent there is a management issue, is that partly because you are not getting consistent direction?

Mr. DOLAN. I think we all agreed in the context of the restructuring work that there could be a lot more cogent way to reconcile the various Committees' interests. I think the short answer is yes. There are different signals.

Mr. PORTMAN. Do you think having more stability and continuity in the directions you get from downtown, being Treasury and Congress, would be helpful in your doing your job, solving some of these management problems you've identified today?

Mr. DOLAN. Stability would be a great asset, from wherever it came.

Mr. PORTMAN. Let me make one comment. My friend, Mr. Lubick, who is a tax policy expert and has a great deal to add on that front, is here. Mr. Lubick, you don't have management responsibilities at the IRS; is that correct?

Mr. LUBICK. That is correct, Mr. Portman. Our work with the IRS is primarily integrating policy and administration.

Mr. PORTMAN. OK. I would just make the point, again building on your testimony this morning, which I found intriguing, that here we have the IRS going through a grueling week of hearings highlighting the potential for serious mistreatment of taxpayers and a lot of administrative and management problems that you have talked about this morning, probably the most significant hearings in a generation for the IRS leading probably to what will be the most significant reforms of the IRS since 1952.

And I would ask: Where's Treasury? Where's the Deputy Secretary this week? Where is the Secretary this week? Are you getting direction? Are you getting stability and continuity in your direction from the top, from Congress or from downtown? Obviously, my view is you are not. And I just think it is an important point for us to make here this morning.

We are talking about taxpayer rights. But it is the people at the bottom, the taxpayers and the employees at the IRS, who are suffering from more systemic problems that have to do with oversight

management. If we don't solve that problem, all the taxpayer rights in the world are not going to solve the ultimate problem.

Mr. Dolan, do you have any comments on that issue?

My time is up. I don't want to indulge the Chair very much.

Mr. DOLAN. Just to this effect, Mr. Portman. Clearly the Treasury Department has been deeply involved as we prepared for the hearings yesterday, the Secretary and the Deputy both, the staff in the sense of understanding both what were the underlying issues, those that were anticipated and those that came out in the 3 days. And they worked very closely with us in trying to be sure that the kind of the corrective actions, not only that I announced yesterday, but that will qualify so that——

Mr. PORTMAN. Again, I am commending you for the corrective actions the IRS is taking. I would just ask a further question if I might, Madam Chair.

Have you seen any press accounts holding the Secretary or the Treasury responsible for the taxpayer rights abuses that we saw illustrated this week?

Mr. DOLAN. I have been so busy responding this week, I don't know that I could tell you.

Mr. PORTMAN. I know you have been held accountable. I have seen you be held accountable. And you talked about the lack of stability and continuity and direction that you are getting, and a lot of these are related directly to administrative problems. That is where they all start.

And I would just again make the point here this morning that it is important what we are doing here, and I can't wait to hear from Mr. Lubick on the tax policy idea. He has a lot to add. And Treasury should be doing what they were doing. They should be giving us good tax policy advice. And, frankly, I think the Treasury Department should be involved with fast track and with international trade agreements and with whatever else the Treasury is focused on this week. I think that is appropriate. It is probably more important than anything else. But I would say that you need help; you need assistance to be able to solve these deeper systemic problems.

Thank you, Madam Chair.

Mr. LUBICK. Mr. Portman, Secretary Rubin has been deeply involved in this matter.

Mr. PORTMAN. Deeply involved in——

Mr. LUBICK. In the matters that were the subject of the hearings in the Finance Committee this week.

Mr. PORTMAN. You mean the taxpayer problems?

Mr. LUBICK. The taxpayer problems. He has asked for a report. He is trying to make sure that where disciplinary action is appropriate that it is taken. He is trying to make sure that where there are lessons to be learned from this to make changes in the system, that they are taken into account.

Let me assure you that I know of no issue since I have been here, June 1996, where the Secretary has devoted himself with such attention to detail and with such deep interest as getting this matter behind us and getting changes made; and that is true of the Deputy Secretary as well. I——

Mr. PORTMAN. I have to move on.

Mr. LUBICK. They are deeply involved.

Mr. PORTMAN. The Chair has to go on.

You have heard me publicly compliment him for his focus in the last year on the IRS. I think this is a structural flaw in the system. I don't think it is personal to him, as you know, but I wish he were here this morning.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you, Mr. Portman.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Madam Chair. And like my colleagues, Commissioner Dolan, I commend you for not being in denial that there are serious problems within the Internal Revenue Service and for admitting the problems like you did yesterday and again today. I think that is a major breakthrough, a major first step in reforming and changing some of the procedures and the practices of the agency. And I really do commend you for your leadership. In fact, I, as one Member, wish that the "Acting" in front of your title were to be removed, but I guess that is not in the cards, given the nomination.

To get to a more substantive issue, that is, the issue of interest netting, as you know, Commissioner, last year's Taxpayer Bill of Rights 2 required both the IRS and Treasury to study the issue of interest netting on tax overpayments and underpayments. Every taxpayer who has been hit by this doesn't understand why the IRS penalizes taxpayers at a higher interest rate for underpayment, than they compensate taxpayers who overpay.

Now, Treasury's report concluded that legislation is required to implement netting procedures and offered a legislative fix to the problem in its tax simplification proposal. And that was certainly encouraging, but it doesn't go nearly far enough. It is prospective only, first of all, and would permit the IRS to continue its 10-year policy of charging taxpayers excessive interest until legislation puts an absolute stop to this unfair practice. And what I don't understand is why legislation is necessary to fix the interest netting problem when Congress has clearly given the IRS and Treasury a clear mandate, clear authority to net underpayments and overpayments before applying differential interest rates.

I have a letter that Chairman Archer has written to Secretary Rubin. I mean, as far as I am concerned, it is an issue of fairness. We have given IRS, Treasury, the authority. Why not do it?

Mr. DOLAN. With your permission, I would like to ask for some help from my colleagues on this, Mr. Ramstad. Both Mr. Lubick and Mr. Brown, our Chief Counsel, have been quite heavily involved in this.

Mr. RAMSTAD. I had the same question subsequently, after Mr. Lubick's testimony, but that is fine, if you defer.

Mr. LUBICK. Mr. Ramstad, we have gone as far as we believe we can go. Court decisions in *Northern States'* case limited our authority; and therefore, when we released our simplification proposals, which Mr. Portman endorsed—thank you, sir—last April, this was one of our proposals. And this would have solved the bulk of the problem.

If we change it and go back to the old method where there is a single interest rate, that is going to make some rather serious pol-

icy problems in terms of various taxpayers. There is going to be a greater burden on smaller taxpayers because if you want to at least make it revenue neutral, you are going to have to have a higher interest rate in some cases and a lower one in others to come out the same. And that is going to cause some very serious problems.

Mr. RAMSTAD. So, Mr. Lubick, you are arguing for the practice of charging—of compensating less for taxpayers that overpay than penalize taxpayers that underpay?

Mr. LUBICK. Yes. I think that is appropriate. It is appropriate for enforcement, as a matter of fact. In my practice, I know very many cases where taxpayers deliberately had overpayments because that was a better investment for them on the rate of interest they were getting on the ultimate refund.

Mr. RAMSTAD. My time is waning and I just want to ask a simple question. Then, you don't support the provision in H.R. 2292 to provide for interest netting—Mr. Lubick, first, and then Commissioner Dolan?

Mr. LUBICK. We support the proposal that we make, Mr. Ramstad, which we think provides an appropriate amount of netting so that at the——

Mr. RAMSTAD. But my question was, do you support section 309 of H.R. 2292, the tax reform bill before this Subcommittee, that would limit interest differential altogether.

Mr. LUBICK. No, we do not support that.

Mr. RAMSTAD. Commissioner Dolan, you do not support that?

Mr. LUBICK. That is not netting, Mr. Ramstad; that is eliminating the differential. It goes further than netting. We do support netting.

Mr. RAMSTAD. You do support netting, but you do not support eliminating the differential totally?

Mr. LUBICK. That is correct, sir.

Mr. DOLAN. That is correct.

Chairman JOHNSON. Thank you, Mr. Ramstad.

Just—Mr. Tanner.

Mr. RAMSTAD. May I have one more question—if I may, with the Chairman's indulgence, just a civil, straightforward question whether Treasury and the IRS would be willing to work with us to clear up this matter once and for all. This has been here ever since I have been on this Subcommittee, which—this is my third year, and we have the same dialog every time you come up here, and nothing happens.

Would you be willing to work with us once and for all to remedy this problem in this legislation, the context of this legislation?

Mr. LUBICK. We are always willing to work with you, and it is a pleasure.

Chairman JOHNSON. The fact that the recommendation is before us with the force of the bipartisan commission's endorsement assures that we will take action on this matter this year, Mr. Ramstad, and we will certainly have you involved in it.

Mr. RAMSTAD. I am counting on your leadership. Thank you, Madam Chair.

Chairman JOHNSON. Mr. Tanner.

Mr. TANNER. Thank you, Madam Chairman. I will be brief.

The problems in the enforcement of a sometimes unintelligible Code I understand and fully appreciate. It seems to me that until the Congress can simplify—which is, I guess, in the eye of the beholder—simply identify the Code from, sometimes, as I said, an unintelligible jumble of words, with all of that going on, it seems to me the vast majority of taxpayers have a cordial relationship with the Internal Revenue Service.

The problems that we see come up from time to time, Commissioner, I think are because there has not been enough attention given to the problem resolution area of your organization. I know, and we, as Members of Congress, get involved from time to time with people who have had very unpleasant, unsatisfactory experiences that frankly oftentimes are the result of either inattention or negligence or something from whoever is assigned to that case in the Service. It seems to me that if you gave much more attention to that part of it and had, as problems arise, competent, official help to bring these matters to resolution, that would go a long way, as the testimony has indicated in the last 3 days. I hope you will do that.

I would like to ask you, what are you doing? You identified in your statement that problem resolution had been an area that needed some improvement. I would like to know what your plans are there.

Mr. DOLAN. Thank you, Mr. Tanner. I wholeheartedly agree with you that the numbers of people available, the skill with which they approach the job, and then the commitment to solve the problem are all three things that can be worked on to improve on where we are today.

The other part of that, though, I think is, and I think it is a reason why you wrote into the Taxpayer Bill of Rights these reports on the larger problems, hopefully, at the end of the day, you don't have a Problem Resolution Officer that just keeps working this same problem in the form of different taxpayers.

I am quite hopeful that in the middle of October, when we are able to receive a body of work that has been done over the last 3 or 4 months by a joint Treasury-IRS national performance review team, that is looking at the entire suite of our customer service activities, looking at the way our notices go out, how the flow of notices and our capacity to answer people when those notices go out can be managed better.

And then you move to what is on the notice, how understandable it is, so that people don't have to contact us as much. So not only does the individual aberrant case need to be handled exactly as you say, with more attention; I think we have to learn better from those cases, fix some of the things further upstream that will keep fewer people from falling into that category.

Mr. TANNER. All of these reports are due in the middle of October that you will take and compile?

Mr. DOLAN. There are a series of things that I talked about at the outset. Many of those will be in place starting next week. The October report I talked about will be a whole new body of work that will help in many of these areas and that we will be happy to make available to the Subcommittee, probably toward the end of October.

Mr. TANNER. Good. Maybe we can help with that. Thank you.

Thank you, Madam Chairman.

[The information is being retained in the Committee files. It can be accessed at http://www.access.gpo.gov]

Chairman JOHNSON. Thank you. I am going to go now to Mr. Hulshof, who has an engagement that requires him to leave shortly.

Mr. Hulshof.

Mr. HULSHOF. Thank you, Madam Chair.

Chairman JOHNSON. And I thank the other Members of the Subcommittee for allowing this.

Mr. HULSHOF. As do I. Thank you, Madam Chairman.

Mr. Dolan, it is good to see you again. I sincerely respect the fact that you are here facing us as you did with the Senate Finance Committee to take personal responsibility. I respect that very much.

And I also note, as you have in your statement, that as a civil servant who has spent 26 years working for the IRS, for you, this has been "a very painful week," I think you wrote. But I would have to say to you that 1,000 mea culpas won't soften the sting suffered by those individual taxpayers, many of whom were trying to do their best to comply.

Now, I want to follow up on a point that Chairman Archer made at the beginning of this hearing, and something that I have heard. I am extremely concerned when I hear that through our responsibility of oversight, somehow we are piling—or somehow we are bashing your agency. As the most junior Member of this Subcommittee and as a newly elected Member of Congress, let me just briefly address some of the things or go back to some of the things that you have come before this Subcommittee on.

Early this year, individual IRS agents committed unauthorized inspections of individual taxpayer records. And we responded with legislation, the Taxpayer Browsing Protection Act, but it took an act of Congress to try to put some more space between your agency and taxpayers across this country.

We have had discussions about electronic filing of payroll taxes and the fact that apparently IRS didn't get on the ball as far as notifying businesses that they were going to have to comply with the mandate. And then again we go to the rescue of business by providing a grace period to allow businesses more time to get out from underneath this strong-armed tactic that many of them felt was an additional mandate.

We have had hearings on the 21-percent error and fraud rate in the earned income credit. Mr. Lubick, quite frankly, a Member of Treasury that was here, a young man with a very aggressive attitude when we began, in our oversight responsibility became very defensive that we would point out the fact that there is a 21-percent error rate in the earned income credit.

And I don't have the time to go into the Tax Systems Modernization problem.

So, Mr. Dolan, again I respect very much the fact that you are willing to take responsibility for your agency; but something Mr. Portman talked about earlier, and it is just a very simple question, why didn't the current set of taxpayer rights prevent these abuses

from happening? And as a followup, does it not show that the current set of taxpayer rights is weak and they should be strengthened?

Mr. DOLAN. That is the simple question you were going to ask me? It is real hard for me, Mr. Hulshof. Let me go back to your starting point.

I understand exactly your point that I can sit here and mea culpa all day long and it doesn't take away 1 second of the pain of those four cases or any other cases messed up. You and I aren't in any disagreement on that.

It is hard for me though, to generalize from those cases or others and say—I won't say it is hard for me. I don't think it is appropriate for me to sit here and generalize and say, I think the Taxpayer Bill of Rights doesn't work or that the taxpayer rights are, in general, not protected. I believe that, in the main, they are.

I think to the extent that one of those cases can exist is a serious problem, certainly for me, and a problem for us collectively. So I think this kind of inquiry about where next is legitimate—and you have never heard from me this week nor will you hear next week that any of the things you ticked off as matters of oversight between this Subcommittee and the IRS are inappropriate. They are perfectly appropriate.

So you have no argument from me about it being a venue for this kind of an interaction to talk about—does either one of the current rights need to be strengthened, or do rights not yet enacted need to be there? So we are not here in any way to resist the notion of using these cases, or current performance, to look at strengthening the rights.

Mr. LUBICK. Mr. Hulshof, I think what you pointed to, in large part, were violations of taxpayer rights. And I think—as Mr. Portman and Mr. Tanner have stated, I think it is not so much legislation that is needed, but it is getting the system right and having problem resolution remedies, persons involved in it. And I certainly agree with both of them in what they said.

Mr. HULSHOF. Well, I appreciate your being here.

Thanks, Madam Chair.

Chairman JOHNSON. Thank you very much.

Mr. English.

Mr. ENGLISH. Thank you, Madam Chair.

Mr. Dolan, welcome. I was intrigued by Congressman Kingston's testimony earlier. Did you have the opportunity to listen to his testimony?

Mr. DOLAN. I did.

Mr. ENGLISH. His reference to the coercion of supposedly voluntary tip monitoring agreements from restaurateurs is similar to comments and anecdotal evidence that I have received from very many of my own constituents. Mr. Kingston's district is not contiguous to mine, as I think anyone listening to the two of us speak would conclude.

Let me ask you, is there a policy within the Internal Revenue Service with regard to targeting restaurants, to coerce them into these voluntary agreements under threat of an audit?

Mr. DOLAN. There certainly is a policy, and the policy is not to do either—not to target and not to coerce.

Mr. ENGLISH. Do you have any plans to investigate this apparently widespread practice?

Mr. DOLAN. Well, I think I was struck by Mr. Kingston's comments this morning, and I also have come to understand that there have been some discussions already between the staff of this Subcommittee and our examination personnel about how some of the apparent issues that exist on this could be—either we need to clarify to our frontline agent or, collectively, there are some gaps out there.

I think this is an eminently solvable issue. This whole process grew out of an effort to take burden out of something that was historically a very intensive, manually intensive process for both the restaurants and for us. So to the extent it is being viewed as some kind of a threat, that is not its design; and we will work to rectify that.

Mr. ENGLISH. And I am gratified at that response.

I appreciated Mr. Tanner's comments. Mr. Tanner, my colleague, said that the vast majority of taxpayers have a cordial relationship with the IRS. I am struck by the fact that at least in our neighborhood, most neighbors have a cordial relationship with the local pit bull, even though only a few of them have had one clamp onto their hindquarters; and I guess what I am getting at is, for years the IRS has cultivated a public image of fear and intimidation among taxpayers. I have always sensed it as a way of increasing compliance.

Why now should we believe that the IRS wants to change its cultural attitude, become taxpayer friendly? Wouldn't it be best to guarantee that taxpayers won't be victimized any longer by the IRS by passing a strong taxpayer rights package? Your response?

Mr. DOLAN. Well, Mr. English, ultimately Congress has got to decide about the law. I am real disappointed that you would use the analogy, or metaphor, of a pit bull. I think that is not the relationship that the average American experiences with the Internal Revenue Service. And I darn well am sure that is not the way the typical Internal Revenue Service employee sees his responsibility and obligation to the taxpayer nor the way they practice it.

Now, do we have a considerable responsibility to enforce? We do. You have given it to us. We do our darnedest to balance that with the other side of our responsibilities to the extent we can—by all means, I am here to say we will do it. But I think that maybe that is a more colorful description than I would be willing to put on it.

Mr. ENGLISH. Well, I appreciate that, Mr. Dolan.

Final question, how does the IRS define the term "tax protester" or an "illegal tax protester"? And how does a person get to be labeled a "tax protester" by the IRS?

Mr. DOLAN. A "tax protester," Mr. English, is generally someone who has filed a tax return using one of the several statements or legends or theories, sometimes written across the tax return, sometimes submitted as a part of the tax return, sometimes submitted in lieu of a tax return, that claims some—either other authority than the Tax Code, some exemption from the Tax Code. Typically, it is that manifestation on the part of the taxpayer that would have it designated as a "tax protester."

Mr. ENGLISH. Quick followup, who attaches that label to a person? And can a system IRS employee have a person labeled as a "tax protester"?

Mr. DOLAN. It is not so much a label, Mr. English, as it is—to the extent a tax return is filed and is processed into the system as a tax protester return, a designation will go on that person's account for purposes of ensuring that people who will look at that will understand that, on the face of the return, the taxpayer has done something quite a lot different than you or I have done. They have not filled out the return. They have put some statement or evidence that they do not intend to fill out the return, as it is designed, or do not intend to follow the instructions as you or I would.

Mr. ENGLISH. Thank you.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you.

Mr. Weller.

Mr. WELLER. Thank you, Madam Chair.

Mr. Dolan, I want to thank you for being before our Subcommittee today and for holding yourself accountable over the last few days with the hearings that have been held both before the Senate Finance Committee, as well as the House Ways and Means Committee.

I have two questions I would like to bring to you. And the first one is, you kind of listen—as I listen to the folks back home, the folks I represent, whether I am at the Union Hall or the VFW or grain elevator or White's Cafe, Liberty Street in downtown Morris, of course the IRS is often a subject—of course, this week, something more, probably more obviously discussed than it has been over the last few weeks.

I also listen to the common complaints that I hear from folks who contact my office seeking help with dealings with Federal agencies; and one of the complaints that I hear deals with the case where a—someone is divorced and their former spouse has disappeared, and the IRS decides to pursue the former marriage partner that they can identify. In many cases, this is a single mom with a couple of kids; and in many of those same cases, the taxpayer deadbeat is also a child support deadbeat.

And so this poor mom is struggling to make ends meet and then along comes the friendly IRS saying, We want you to pay your former husband's tax bills. Now the Taxpayer Bill of Rights previously passed and signed into law directed the Treasury Department to submit a report to Congress by January of this year—now we are in September, almost to October—10 months ago to submit a report studying this situation particularly, which affects working single moms, with kids, that are being dunned for their deadbeat husbands' taxes. And apparently your agency has failed to submit that report.

Can you explain why you did not comply with Taxpayer Bill of Rights 2 in that direction.

Mr. LUBICK. I think that onus is on us, Mr. Weller, not on the Internal Revenue Service. Indeed, we received a draft in June from the Internal Revenue Service on this subject. It is—it is a very long draft. It is about 55, 60 pages. We believe that the draft needs seri-

ous further work, because there are some very different problems and very difficult choices to make on it.

And I know the Chairman is very interested in this, too, and unfortunately, I—if it is a day of apologies, we had a fairly rough summer. We are turning to it immediately to see what we can do. But it requires a lot of study.

We have talked with a number of the bar associations. They have wrestled with the problems. And I can assure you that there are—there are not any easy solutions that jump out. And we are——

Mr. WELLER. But you are saying, though, that the IRS gave you the report 6 months after the deadline, and that was the draft, and you are still working on it?

Mr. LUBICK. Yes, sir.

Mr. WELLER. How soon can we expect it?

Mr. LUBICK. I think in the next couple of months we should be able to come to some conclusion, get it up here. And then work with you to try and let you wrestle with some of these same problems, and make some decisions as well.

Mr. WELLER. It is an important issue, affecting a lot of working women in particular. And we will try to——

Mr. LUBICK. I do not downplay the significance. I started working on this problem in 1963, when it first came to the attention of the Treasury Department, and——

Mr. WELLER. Let me—and I am anxious to see that report. I am anxious to work with you, as I know a number of my colleagues are on this Subcommittee.

The second question I want to direct to Mr. Dolan is pretty fundamental, I believe; and it is clearly the number one issue when we talk about the IRS and the way the IRS operates when I have town meetings and talk about our tax system. And that is the—you know, when we talk about the rights that a taxpayer has and—of course, under our laws.

But the biggest complaint that the folks back home have with the IRS is, if they are one of the fortunate number who are audited by the IRS, the IRS operates as if those taxpayers are guilty until the taxpayer can prove themselves innocent. Now, if that taxpayer was charged with a crime, in a court of law, they would be innocent until proven guilty.

Now, Mr. Dolan can you justify why the IRS should treat a taxpayer differently than someone charged with a crime, why the IRS feels that a taxpayer is guilty until they are proven innocent?

Mr. DOLAN. Well, I don't think the IRS does believe somebody is guilty until they are proven innocent. I think the nature of the system we have, however, is that you and I file a tax return and we assert that this is the amount of income that we have received, these are the deductions, exemptions to which we are entitled. The tax return is processed and filed as we say it should be.

Now, along comes a 1099, a W–2, some information that says, Gee, this says Mike Dolan was paid twice as much as he claimed on his return. Along comes some other information that says, this deduction was half of what he claimed. At that point in time, the way our process works is it is incumbent on the IRS to ask the taxpayer, what is the support for the self-assessment for the claim that you made on your return?

That is the way the examination process works. For it to be otherwise, for it to be styled in a way that the IRS went out and proved categorically what Mike Dolan's income was or what his deductions or exemptions were would be a process that would be so extraordinarily intrusive and cumbersome that I don't think any of us would be satisfied.

So I think sometimes the dynamic of asking a taxpayer to support what he or she has said on a tax return is thought by some to be guilty until proven innocent. But that is clearly neither the intent nor the policy.

Mr. LUBICK. Mr. Weller, there is no crime involved here, with rare exceptions where there is a criminal investigation. And in that case, indeed the IRS has the burden of proving a crime beyond a reasonable doubt. But the ordinary tax proceeding is a civil proceeding. There is no question of guilt or innocence. It is a question of an accounting. That is the beauty of our system in this country.

I worked in Central and Eastern Europe, where the government was the adversary. This is a question where we rely upon taxpayers to self-assess themselves. They tote up the bill. Congress has passed a law. There is an obligation that is owing. It is up to the IRS to be—to honor that law. It is up to the taxpayer to honor that law. This is an accounting, and the person that has the facts has a duty to lay out the facts and determine what he owes. That is the only way our system works, if taxpayers are cooperative; and as you have seen, it only works if the IRS plays by the rules.

But we all have a common set of rules. If you go into a supermarket and you pick up a lot of groceries, you add up the bill and you—I assume you wouldn't want to pay any more or any less than you owe. And that is what we are asking of taxpayers, and that is what—we are asking that of the IRS.

Mr. WELLER. My time has expired. And let me just say that, you know, in a court of law, information is used as well; and that information is then used to determine whether someone has made a mistake or broken the law. You—do you honestly feel that the way that the IRS has operated when auditing a taxpayer—that they have treated every taxpayer as innocent until proven guilty?

Mr. LUBICK. Obviously not 100 percent. We have heard some cases. Generally speaking, it is—it has been my experience that the IRS, if it determines there has been an error in its favor, is very forthcoming in squaring accounts with the taxpayer. I come from a part of the country very close to Mrs. Johnson's, and the revenue agents I dealt with, I think, are the fine, high quality that they are in her district. I think, by and large, they have been fair to taxpayers. And I think if—to the extent they are not, we have to accommodate two things.

We have to accommodate the—that the IRS is customer friendly. And if you—and if—but that calls for a recognition that those persons who make out their own tax returns, as I am sure you do, account honestly and fairly for what you owe. And if that system breaks down, if the 83 percent of the people that are currently accounting fairly and honestly start to feel that there is not a sanction—how many people would observe the traffic laws if they didn't——

Chairman JOHNSON. Thank you, Mr. Lubick.

Mr. LUBICK [continuing]. Know there were policemen around.

Chairman JOHNSON. Thank you, Mr. Lubick. That is the difficult balance we draw.

Thank you, Mr. Weller.

Mr. Watkins.

Mr. WATKINS. Thank you, Madam Chair and Mr. Dolan, members of the panel. I appreciate the opportunity.

I don't have any major revelations. I sit here, though, and try to think, how do we solve some of these problems. And, you know, I think about you, though humans are more of a social science and not an absolute science, I also know in my office I spend untold hours trying to get them to understand how I would like for them to handle cases and handle problems, and try to go through that so we don't have foul-ups and mess-ups and things of that nature. And inevitably there are always a few that happen.

And I know, I think, as I look in your face, your agonizing over this past week's revelations. And let me say, there is a general, not only feeling, but there is a mindset that there is a culture there that has set in in the IRS. And I know you are probably wondering how you can overcome that, how you can find some solutions, how you can find some way, and a constructive way, to overcome it. And I—I have been trying to think that through, also.

And I want to ask a couple of elementary things that—you know 40, 50 years ago, by far the majority of the people in this country trusted their government; and today, it is down in the single digits. And that kind of concerns me because we are all in this together.

Then we start talking about trying to serve people. But, you know, WalMart, I have been told in talking to some individuals there, every single person they hire takes a test. I mean, that test is more aptitude in how they relate to other people; they are concerned about marketing.

I don't know if there is anything such as tests that are given early in life. I see a lady I have a lot of respect for nodding, yes, that takes place.

But I know in marketing, you have to do it nearly every—any business today of any size to try to hopefully prevent a lot of the problems that are occurring out there. Do you—do you analyze those tests? And do you analyze those that you get complaints from, that person that is—you have received several complaints by your customers or the taxpayers? Do you analyze, see what category they fit in? I mean, several variables there, like the number of years of service, how long they have been in that job. You know, there are certain things that cause some of the things to—reactions that we get.

Mr. DOLAN. Mr. Watkins, we use tests today in some limited way. I will tell you that one of the things that we have had under way for the better part of the last year is an entire competency-based process that will attempt to base everything from the initial hiring on through the advancement, the promotion and the training processes on what we have called the competency model. And what that has been doing for us is helping identify the competencies. In the past, we may have focused exclusively on what somebody's technical understanding is, how do they need to understand law

and accounting? What this is doing is focusing into our customer service industry, into the communications capability.

We have recently done an experimental training class of all of our collection personnel that takes some of what is out in the private sector, the communications and conflict resolution approaches, and building that into a training capability for our collection personnel.

Mr. WATKINS. Would it be too much to ask you to provide the Subcommittee a copy of that, and I would ask for a copy of it personally.

Mr. DOLAN. Certainly. We will be happy to put it together for you.

[The information is being retained in the Committee files.]

Mr. WATKINS. I have tried to do some analysis of various tests along the way professionally over the years, and I would like to look at that one also, because it is a real problem. You know, I don't know if it is the beginning agents, where this is a major problem, or is there more in the greatest number of years of service? But it is a concern, I think, of this Subcommittee.

I know it is—it has got to be a concern of yours, the unrest among the people about the problems they are encountering with the IRS. And I know, as I have indicated, by far the majority of the agents are committed, dedicated, trying to do a good job. And probably it is like my staff, probably they do an excellent job in their public relations work. But there are those that have created a lot of problems.

We get those. We get those. We don't usually get a lot of those that are satisfied; we always get those that are not satisfied.

So I look forward to getting that. And I would like to try to sit down and look at that and some other things to see if there are any places we could help.

Mr. DOLAN. Thank you, sir. I appreciate it, sir.

Chairman JOHNSON. Thank you very much, Mr. Dolan, for staying with us, for people to have a chance to complete their questions. I know you have to leave now.

The plan for the Subcommittee, in view of the fact that there are no more votes, is to work right through lunch. We will take testimony from Mr. Lubick, Mr. Brown, and Mr. Monks, have questions on that testimony, hear the testimony of the next panel and take questions. So we intend to have no break for lunch.

And, Mr. Dolan, thank you very much.

Mr. DOLAN. Thank you, Madam Chair.

Chairman JOHNSON. Mr. Lubick.

**STATEMENT OF HON. DONALD C. LUBICK, ACTING ASSISTANT SECRETARY, TAX POLICY, U.S. DEPARTMENT OF THE TREASURY**

Mr. LUBICK. Thank you, Madam Chair, Members of the Subcommittee. If you like, I have delivered to you a written statement in length. And I might perhaps give you a table of contents, very briefly, as to what is in it and then submit to your questions——

Chairman JOHNSON. That will be fine.

Mr. LUBICK [continuing]. So as not to be unduly repetitive.

In our written statement, we emphasize the importance of maintaining the integrity and smooth functioning of the voluntary self-assessment tax system which, as I stated a few minutes ago, turns on two things—continued confidence of the American people in the fairness of the IRS and, at the same time, the IRS having the tools to exercise its function of ensuring compliance in a fair and reasonable way. And I want to assure you that we do want to work with you in improving the fairness of the tax law and securing those objectives which I am sure all of us share together. We outline the major initiatives.

I think this administration has probably been more active than any previously in the last few years.

Chairman JOHNSON. Actually, Mr. Lubick, if I may, your testimony is very complete on past accomplishments——

Mr. LUBICK. Right.

Chairman JOHNSON [continuing]. And the administrative things you have done. But you do have some interesting comments on the specific proposals of H.R. 2292.

Mr. LUBICK. Correct.

Chairman JOHNSON. In view of time, I would appreciate it if you would go directly to those.

I do appreciate your review in the earlier part of your testimony of both what we did in TBOR 1 and 2 and the administrative actions that you have taken to enhance taxpayer rights.

Mr. LUBICK. There is a complete statement appended to Stuart Brown's testimony, which goes through, article by article, the joint position that the Internal Revenue Service and the Office of Tax Policy agree upon completely and cooperatively, and I would just like to mention a very few items of major concern.

First, the proposals dealing with the Taxpayer Advocate, we agree that the strengthening of the—that office is very important. We have listed the particular items in the Restructuring Commission's bill that we endorse, and some that we think are inappropriate.

On the question of taxpayer privacy and the disclosure to the archives, again, we do not object to that, but we think there must be a clear statement in the law that sets forth the conditions under which there can be proper redisclosure.

There are a number of other positive provisions that we have endorsed, as you will see. There are a few areas of concern that I would like to mention.

On the attorney's fees, we strongly endorse the proposal to allow them in pro bono cases. And we think that the three circuit loss provision with some safeguards is appropriate also. Any others, we find wanting and inappropriate, for reasons which we will be glad to elaborate on if you wish.

On the question of civil remedies against the United States, we think it is important to maintain the recklessly or intentionally disregards test, rather than the negligence. This question has been reviewed by Congress. And Congress has not adopted this test of negligence in order, presumably in order to discourage wasteful litigation over footfalls or good faith but erroneous actions.

We think, rather than broadening the current provision to—in a way that we think would encourage a lot of litigation over a very

murky standard, it should be broadened in another way, which is to make the remedy for reckless or intentional actions available to victims other than the taxpayer. For example, if property is seized and that property is someone else's, that person should have the remedy, even though not a taxpayer.

Basically, we are worried very much about a requirement that we disclose in detail all sorts of criteria by which returns are selected for audit. We think it is—it is a big mistake to give a potential roadmap to the least risky avenues of tax avoidance.

We—I just want to repeat, in concluding, that we do stand ready. This is an area where we have been very active. We appreciate working with you over the past several years. It has been very successful. And we want to continue that relationship, and hopefully, will be able to work out an agreement on the enhancement of taxpayer rights.

[The prepared statement and attachment follow:]

**Statement of Hon. Donald C. Lubick, Acting Assistant Secretary, Tax Policy, U.S. Department of the Treasury**

Madam Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss recent legislative and administrative initiatives to enhance the procedural rights and remedies that taxpayers have in their dealings with the Internal Revenue Service ("IRS") under various provisions of the Internal Revenue Code of 1986 ("Code"). In particular, I will be discussing certain taxpayer rights proposals considered by the National Commission on Restructuring the Internal Revenue Service, which are included in the Commission's Report dated June 25, 1997 and in legislation (H.R. 2292) that was recently introduced by Representatives Portman and Cardin. As you know, Secretary Rubin and I have previously testified concerning other portions of the legislation, in particular the governance and electronic tax administration provisions.

THE IMPORTANCE OF TAXPAYER RIGHTS

Let me begin by emphasizing that this Administration, including the leadership of the Department of the Treasury and the Internal Revenue Service, is thoroughly dedicated to improving taxpayer services, protecting taxpayer rights, and enhancing the public's understanding of our system. We believe that this Administration has an exceptionally strong record in enacting taxpayer protections and implementing them administratively. At the Administration's urging, Congress has passed two separate sets of significant taxpayer rights provisions in just the past 15 months, including the Taxpayer Bill of Rights 2, which President Clinton signed into law on July 30, 1996, and many provisions from the Taxpayer Bill of Rights 3 and Tax Simplification Proposals that the Administration announced in April, 1997 and that were enacted this summer as part of the Taxpayer Relief Act of 1997. We expect to be offering additional legislative proposals concerning taxpayer protections in the course of our next budget cycle early next year. We believe that there should be regular and comprehensive re-examination of the tax procedures and taxpayer remedies in the Code. The Treasury Department and the IRS regularly work together to develop new programs to ease taxpayers' contacts with our tax system. This is an area in which sound tax policy and fair and effective tax administration are closely intertwined.

This Administration has also undertaken a number of administrative efforts, such as our Administrative Taxpayer Bill of Rights initiative in January, 1996, and the updating of Publication 1 to include the "Declaration of Taxpayer Rights" in April, 1996. We have stepped up Treasury oversight and management of the IRS, and these efforts have resulted in more resources being devoted to customer service, a new "blueprint" for modernizing the IRS's antiquated computer systems, and our recent request for proposals as to how we can best increase electronic tax administration. Finally, the Administration's proposals for institutionalizing enhanced Executive Branch oversight and outside management advice have been introduced as legislation, H.R. 2428, by Representatives Rangel, Coyne, Matsui, Hoyer, and Waxman, and we would urge you to adopt those proposals.

This Administration's commitment to taxpayer service and procedural protections stems from our belief that treating taxpayers fairly is of paramount importance to

our self-assessment system of tax compliance. Our system relies, in large part, on taxpayers' belief that our tax laws are equitable and on their confidence in the fair and impartial administration of the tax laws. That confidence in the fair and impartial administration of the tax laws in turn depends on how taxpayers are treated on an everyday basis by the IRS. Poor taxpayer service can foster taxpayers' discontent, with a resulting adverse effect on their willingness to pay taxes voluntarily. Consequently, guaranteeing the fair and uniform application of our tax laws is absolutely critical to good tax administration. As responsible government officials, the members of Congress and the Executive Branch must maintain the continued success of our self-assessment approach to taxation and the ongoing viability of the Governmental functions that it supports.

Although we believe that most IRS employees perform the difficult job of administering our complex tax code in a fair and impartial manner, we also recognize that some IRS employees do not serve taxpayers as well as they expect and deserve. Such lapses are unacceptable to all of us. This week Acting Commissioner Dolan apologized to abused taxpayers whose cases have come to our attention. And Secretary Rubin has personally instructed the IRS to provide him information on the steps IRS plans to take in light of these cases, including possible disciplinary actions, and how we can use these cases as a teaching and prevention tool for the future.

We should recognize, however, that the IRS in fact serves most taxpayers very well and very successfully. For millions of Americans, the payment of taxes is straightforward. For many, contact with the IRS consists of nothing more than an amount withheld from their weekly or monthly paycheck and the once-a-year filing of a simple Form 1040EZ or 1040A, frequently followed by the receipt of a refund check a few weeks later. Through such withholding and self-assessment, we receive approximately 84 percent of what we believe is the proper amount of taxes due, and another 3.5 percent is obtained through the IRS's collection efforts. Each year, the IRS examines the returns of only one or two percent of individual American taxpayers.

As a result, our tax administration system is very highly regarded by other nations—indeed, Kenneth Kies, Chief of Staff of the Joint Committee on Taxation, recently described it as "the envy of countries and governments" around the world—and the Department of the Treasury and IRS are frequently called upon to provide advice to other countries about improvements that they can make in their systems. I served as Director of Treasury's Tax Advisory Program for almost two years, advising the countries of Eastern Europe and the former Soviet Union concerning their tax systems as part of their transition to market economies and free societies. This experience left me with a heightened appreciation for the truly "world class" fairness and effectiveness of our own system of taxation. It embodies some fundamental features—such as periodic self-reporting and self-assessment, withholding, information reporting, and collections strictly in accordance with statutory and constitutional protections—that many nations are struggling to copy.

Along with Americans' historic respect for democratic values and the rule of law, our system has given us a high level of tax compliance at a relatively low cost. While we must continually renew our commitment to improve efficiency and maintain correct and fair treatment of all taxpayers, we should be very careful not to discredit unfairly the efforts of the many dedicated public servants who administer and enforce our revenue laws in an independent and non-partisan fashion. We should work together in a constructive dialog and do our utmost to ensure that taxpayers' rights are protected.

## RECENT TAXPAYER RIGHTS INITIATIVES

The past decade has seen a series of significant Congressional and Executive Branch actions to maintain and enhance the rights of taxpayers in their dealings with the IRS. I will review this history briefly, in order to illustrate how far we have come in a short while.

*Omnibus Taxpayer Bill of Rights ("TBOR 1").*

After years of thorough study and hard work by many dedicated Representatives and Senators, including Members of this Subcommittee, Congress enacted the first Omnibus Taxpayer Bill of Rights in 1988. Among its many important provisions, TBOR 1:

- created the Office of Ombudsman and the Taxpayer Assistance Order procedure;
- required written notice to taxpayers of their rights; prescribed procedures for taxpayer interviews;

- specified the content of tax due, deficiency, and other notices;
- revised the levy and jeopardy assessment procedures;
- expanded the Tax Court's jurisdiction;
- created new administrative appeal remedies, enhanced taxpayers' ability to collect attorneys' fees, and instituted new civil causes of action for failure to release a lien and for certain unauthorized collection actions; and
- prohibited use of tax enforcement results to evaluate collection employees and their supervisors, or to impose or suggest production quotas or goals for them.

These provisions substantially increased the protections taxpayers have in their dealings with the IRS, and we believe that they have operated successfully. I would note, however, that a few of the proposals in H.R. 2292, which I will discuss in a moment, were considered by Congress but after thorough bipartisan study were not included in TBOR 1.

*"Administrative TBOR".*

In 1995, Treasury and the IRS worked to develop proposals for a Taxpayer Bill of Rights 2 ("TBOR 2") in a bipartisan, cooperative effort with the staff and Members of the Committee on Ways and Means, in particular this Subcommittee on Oversight, and the Senate Committee on Finance and Joint Committee on Taxation. Many of those proposals were ultimately included in the Revenue Reconciliation Act of 1995, which as you know was vetoed for other reasons. Nonetheless, the IRS announced on January 4, 1996, over two dozen administrative proposals to improve taxpayer rights. Through administrative actions such as revenue procedures, delegation orders, formal announcements, Internal Revenue Manual provisions, and similar vehicles, the IRS was able to implement roughly one-third of the TBOR 2 proposals without new legislation. These included, for example:

- several enhancements of the authority and power of the Taxpayer Ombudsman;
- new procedures to allow taxpayers to appeal liens, levies, and seizures;
- additional notice rules for overpayment situations, section 6672 "responsible person" cases, and cases involving divorced or separated spouses; and
- voluntary limits on certain investigative techniques such as the use of designated summonses and the investigation of disputed information returns.

The Administration also announced a number of further initiatives, including new administrative appeals processes, electronic filing and storage rules, a procedure for obtaining advance valuations of art, and new relief provisions for obtaining automatic extensions of time for payment or for changes in methods of accounting. The appendix to my testimony contains a complete list of these Administrative TBOR initiatives.

Also in January, 1996, the Administration directed the IRS to develop a new, concise statement of the rights that taxpayers have under our system. In April, 1996, we released a simple and straightforward 8-paragraph "Declaration of Taxpayer Rights," which is now included at the front of Publication 1. Publication 1 is the pamphlet that goes to all taxpayers who are audited or have other controversies with the IRS. Thus, every taxpayer subject to a potential dispute with the IRS is now reminded in writing, at the outset of contacts with the IRS, of the fundamental rights and remedies that are available under the Internal Revenue Code and Treasury Regulations. The Administration wants citizens to understand that they are entitled to fair treatment by the IRS, and to recognize that we are committed to operating the tax system in an equitable and impartial fashion.

*Taxpayer Bill of Rights 2.*

With the strong support of the Administration, a bipartisan TBOR 2 containing over 40 taxpayer rights provisions was eventually enacted as separate legislation by Congress and signed by President Clinton on July 30, 1996. In addition to codifying the administrative TBOR actions that the IRS had already taken, TBOR 2 made many other procedural changes, such as:

- changing the title of the Ombudsman to Taxpayer Advocate and statutorily enhancing that office's powers;
- providing additional statutory authority to abate interest and some penalties, to withdraw notices of federal tax lien, and to return seized property;
- increasing, and indexing for inflation, the amounts of certain property exempt from levy and the amount of attorneys' fees that can be recovered, as well as making several other changes in the attorneys' fees procedure; and
- creating or amending several causes of action, including remedies for unauthorized collection actions, for fraudulent information returns, and for contribution between persons responsible for withholding taxes.

The appendix contains a full list of these provisions. Again, it should be noted that in developing TBOR 2, Congress considered but rejected some of the same proposals that are now contained in H.R. 2292.

Immediately after TBOR 2's enactment, Treasury and the IRS began implementing those new taxpayer rights provisions that had not already been effected administratively. We proposed the simplest regulatory changes before year-end in 1996, and we included ten TBOR 2-related projects on our 1997 Treasury-IRS Priority Guidance Plan. The completion of these important implementation projects is underway.

*Taxpayer Bill of Rights 3.*

Most recently, in April, 1997, the Administration announced a package of 59 additional Taxpayer Bill of Rights 3 ("TBOR 3") and Tax Simplification Proposals. We were pleased that Congress adopted most of these proposals in the Taxpayer Relief Act of 1997 this summer. Two of our TBOR 3 proposals—to enhance the rights of disabled persons by providing for equitable tolling of the statutes of limitation on refunds, and to treat taxpayers more fairly by allowing "global" interest netting on under- and overpayments—have not been enacted, however. We would urge this Subcommittee to include our global netting and equitable tolling proposals in your recommendations to the full Committee. Both proposals would benefit taxpayers by relaxing some unnecessarily rigid rules in the Code in an administratively feasible manner. Some of our other proposals that would significantly enhance the efficiency and fair operation of our system, such as our proposed legislation authorizing federal and state tax authorities to streamline their contacts with taxpayers, also await Congressional action.

As this brief history shows, this Administration remains deeply committed to enhancing taxpayer rights and remedies through legislative and administrative actions. These actions, along with the passage of the original TBOR 1 legislation, have already had a profound and lasting impact on the IRS's administration of the tax law. In reviewing this record, the Restructuring Commission stated as follows:

The Commission found that the passage of the Omnibus Taxpayer Bill of Rights and Taxpayer Bill of Rights 2 have had an important effect on changing the culture of the IRS. The agency spends significant resources educating personnel to treat taxpayers fairly, and the Commission found very few examples of IRS personnel abusing power.

Report page 43 (emphasis added).

## Policy Criteria for Further Action

Our efforts to maintain and improve the treatment of taxpayers under our system cannot stop with these prior initiatives. Because we are all working toward the common goal of a fairer and more efficient tax system, the Administration is pleased to join with Congress and this Subcommittee in considering and developing additional taxpayer rights proposals. Let me discuss for a moment what I believe to be the sound tax policy criteria against which each proposal should be evaluated.

First, new proposals in the area of taxpayer rights and remedies should be subject to the same rigorous analysis we apply to all tax proposals. We should not forget the other many considerations that go into making good tax policy. Certainly maintaining and enhancing taxpayer protections is an essential element of sound tax policy. For the important reasons I discussed above, taxpayers must be treated fairly, courteously, and consistently by the IRS, and they must have legal and administrative remedies readily available to them to ensure such fair, courteous, and consistent treatment.

Another element of sound tax policy is that everyone should pay his or her fair share of taxes due. This requires the IRS to have the strong legal and administrative tools it needs to enforce and collect the correct amount of taxes from those taxpayers who, unfortunately, choose not to comply voluntarily. Responsible and appropriate enforcement action also results in a smaller financial burden on those taxpayers who do pay voluntarily. Thus, voluntary compliance and adequate enforcement mechanisms go hand in hand.

Thus, in evaluating taxpayer rights proposals, we must balance the rights and remedies available to taxpayers with the need for fair yet efficient IRS enforcement mechanisms. Each proposal must be evaluated separately in such a balancing process.

SPECIFIC PROPOSALS IN H.R. 2292

Many, but not all, of the proposals in H.R. 2292 meet these criteria. Many of these provisions need some drafting improvements, and Treasury wants to work with the Members and staffs of the tax-writing committees to improve them. I will focus my remarks in this testimony on only a few of the more significant proposals.

*Taxpayer Advocate*.

With the Administration's support, Congress just last year enacted several enhancements to the Taxpayer Advocate's powers, including adding the power to use a Taxpayer Assistance Order ("TAO") to direct the IRS to take affirmative actions and limiting the IRS officials who can overrule the Advocate to only the Commissioner and Deputy Commissioner. TBOR 2 also added new requirements for the Taxpayer Advocate to make independent reports to Congress, and we look forward to analyzing and discussing with this Committee the recommendations that the Advocate will make in his report due in December, 1997, the first full year of the new requirements.

Under the statute, the Taxpayer Advocate's office has authority to issue TAOs in cases of "significant hardship." The Restructuring Commission's report (page 45) criticized the IRS for interpreting the statutory term "significant hardship" "so narrowly" that "very few cases are eligible for relief." We believe this criticism is unfair, and that the regulation promulgated by Treasury and the IRS interprets the term in close accordance with the legislative history of the provision in which it was enacted. Nonetheless, we believe the Taxpayer Advocate should find some additional substantive standards useful in determining whether a TAO is appropriate. Therefore, Treasury supports enacting some additional defining criteria to the determination of whether a taxpayer is suffering a "significant hardship."

Section 301 of the bill proposes several such criteria, namely:

1) whether the IRS is following "applicable published guidance, including the Internal Revenue Manual";

2) whether there is an immediate threat of adverse action;

3) whether there has been a delay of more than 30 days in resolving taxpayer account problems; and

4) the prospect that the taxpayer will have to pay significant professional fees for representation.

We will suggest certain modifications in the wording of these standards. In particular, however, the first should be deleted. It would require the Taxpayer Advocate to interpret the substantive tax law to determine whether the IRS employee is acting appropriately, which arguably is irrelevant to the amount or "significance" of the hardship the taxpayer is allegedly suffering. Moreover, including reference to the Internal Revenue Manual is inappropriate and might be viewed as elevating the Manual to the status of binding legal authority in the interpretation of Congressional intent, contrary to the uniform holdings of the courts.

*Taxpayer privacy.*

Several provisions of H.R. 2292 address the taxpayer privacy and confidentiality policy that is embodied in section 6103 of the Internal Revenue Code. As you know, Treasury and the IRS have strongly supported this policy, and we continue to do so, even when that provision unavoidably restricts our ability to respond publicly to inquiries concerning particular taxpayers or allegations of taxpayer abuse. In general, we believe that the Code should continue to provide for strict confidentiality of taxpayer returns and return information.

Section 305 of H.R. 2292 would provide an exception to section 6103 that would clearly authorize the disclosure of IRS records to the National Archives and Records Administration for archival purposes. We do not oppose clarifying section 6103 this way. However, returns and return information should remain private; they should never be published in the New York Times, as occurred last year when some records containing such information were released by the Archives. We would urge Congress to eliminate the sentence authorizing the Archives to re-disclose information with the Secretary's consent and instead to add appropriate safeguards on the ultimate disposition of the records. These could include a permanent ban on re-disclosure of returns or return information by the Archives, non-disclosure for a specified period of years, or other safeguard terms in accordance with the remainder of section 6103's confidentiality policy. This might be an appropriate subject for the Joint Committee on Taxation's study of section 6103 that is proposed in section 306 of the bill.

*Other positive provisions*.

Other provisions of H.R. 2292 that we believe generally reflect sound tax policy, and which we support subject to some drafting changes, include:

- section 306, providing for a study by the Joint Committee on Taxation of the general policy of confidentiality inherent in section 6103;
- section 308, relating to allowances for offers-in-compromise;
- section 312, providing for payment of taxes to the "Treasurer, United States of America";
- section 314, relating to Tax Court jurisdiction (although provisions similar to subsections (a) and (b) were proposed by the Administration in April, 1997 and have already been enacted in the Taxpayer Relief Act of 1997);
- section 315, relating to taxpayer complaints; and
- sections 319, 320, and 321, requiring studies of, respectively, penalty administration, separate filing for married taxpayers, and burden of proof issues.

We believe that our respective staffs should be able to reach agreement on the technical drafting issues relating to these provisions relatively quickly and easily.

*Areas of concern*.

In our judgment, however, some of the proposals that the Restructuring Commission considered and that are incorporated into H.R. 2292 raise serious concerns and need closer scrutiny. Many of these proposals reflect prior ideas that Congress has already fully and carefully considered and chosen not to adopt in the course of enacting TBOR 1 or TBOR 2. Again, I will focus my testimony principally on those provisions that in our view are most clearly contrary to sound tax policy.

One provision of great concern to Treasury is section 302, which would further amend the attorneys' fees provision in the Code, section 7430, that Congress just amended last year in TBOR 2 and this year in the Taxpayer Relief Act. This provision would: allow higher fees because of difficult issues or the local availability of tax expertise; allow attorneys' fees during proceedings before the IRS Office of Appeals; authorize fees in cases where the attorney has been paid only a "nominal" fee (essentially pro bono cases); increase the "net worth" caps to $5 million for individuals and $35 million for corporations; and provide automatic attorneys' fees for taxpayers who prevail on an issue that the IRS has already lost in three circuit courts of appeal. We strongly support the pro bono proposal, and we could support the three-circuit rule, if certain important modifications were made.

We cannot support some of the other provisions. In particular, proposals to make attorneys' fees available during the Appeals process have repeatedly failed to receive approval from Congress, and have been opposed by Treasury and the IRS in both this and previous Administrations, because the Appeals process should not be considered an adversary proceeding like a court case. Appeals is supposed to be a forum for the compromise of disputes between taxpayers and the IRS, and it is the first stage within the IRS at which proposed adjustments are fully reviewed, expressly taking into account the hazards of litigation. The informal process of Appeals contrasts with formal litigation, in which the parties must thoroughly develop their legal cases and conduct discovery to ascertain the full facts. Payment of attorneys' fees at the Appeals stage, before the IRS had taken a final position on an issue, could jeopardize open communications between taxpayers and Revenue Agents, for taxpayers might withhold material favorable to their position until they commence an appeal (at which attorneys' fees would be available). We likewise believe that enhanced fees for certain issues or areas would be extremely difficult to administer fairly and consistently, and, like the increased net worth caps, would direct tax dollars to upper-income taxpayers and their representatives.

Section 303 of H.R. 2292 would amend section 7433 of the Code, which provides a civil remedy against the United States for certain unauthorized collection actions by IRS agents. Claims currently may be sustained only if an IRS officer or employee "recklessly or intentionally disregards" applicable statutory or regulatory provisions. This proposal would add "negligence" as grounds for relief. Treasury's serious concerns about this provision have consistently led us to strongly oppose this proposal, for it could seriously jeopardize IRS collections and subject the United States to numerous frivolous lawsuits. The "reckless or intentional" standard was consciously chosen by Congress in TBOR 1 in order to discourage wasteful litigation over "foot faults" or good-faith, but erroneous, actions by Revenue Officers in the course of collection activities. Similar proposals to relax these rules were considered, and rejected, just last year in connection with TBOR 2, which instead increased the maximum damages from $100,000 to $1 million. Treasury concurred in that approach, and we continue to believe that taxpayers have adequate remedies available to them without clogging the courts with allegations of negligence. As the IRS has suggested,

however, it might be appropriate to broaden the current provision in another way, to make the remedy for "reckless or intentional" actions available to affected persons other than the taxpayer. We would prefer to work with the Subcommittee on this approach. It might be appropriate to broaden the current provision in another way, to make the remedy for "reckless or intentional" actions available to affected persons other than the taxpayer. We would prefer to work with the Subcommittee on this approach.

Another provision of H.R. 2292, section 304, would require adding to Publication 1 an explanation "in simple and nontechnical terms" of the "criteria and procedures for selecting taxpayers for examination." Section 7521 of the Code, which was enacted by TBOR 1, already requires explanations of the audit or collection processes and the taxpayer's rights. We agree that the IRS could insert in Publication 1 some further discussion, in general terms, of the its examination processes, and we would support the intent of this provision. We have concerns, however, about the harm that might result to our overall tax system from disclosing to taxpayers detailed information concerning the sorts of return positions or items of income, deduction, credit, etc. that may trigger an examination—in effect, giving taxpayers a potential road map to the least risky avenues of tax avoidance or evasion. We are unaware of any other Federal law enforcement agency that promulgates its enforcement criteria in a detailed fashion. We would like to work with you to develop a suitable formulation for these disclosures.

Treasury is similarly concerned about section 316 of the bill, which would set out new procedures for taxpayer interviews, and we recommend further study. These new procedures would require:

1) A Miranda-type warning that the taxpayer is permitted a representative—which Publication 1 already contains—and an automatic suspension of the interview if the desired representative is not present;

2) An explanation that the taxpayer has the right to have an interview at a "reasonable place"—which, again, the regulations already require—and that it need not be the taxpayer's home;

3) An explanation of why the taxpayer's return has been selected for examination;

4) An explanation of applicable burdens of proof.

Most of this information is already included in Publication 1, and, although these explanations sound innocuous, they may in some cases hinder IRS investigations of non-compliant taxpayers. For example, the third requirement could lead to disclosure of examination methods or criteria or the existence of informants, and the first provision might make taxpayers perceive every contact to be a hostile, adversary proceeding. Comparable procedures were passed over for similar reasons in connection with TBOR 1, and section 7521 was enacted instead, which already permits a taxpayer to suspend an interview by asking for representation. We have heard no reason for adding these new requirements to the existing carefully balanced scheme that was only recently enacted and seems to be working well for all parties. (The text of the Restructuring Commission's Report does not discuss any taxpayer concerns in this area, relegating this proposal to the appendix.)

## CONCLUSION

As demonstrated by the history of taxpayer rights provisions that I discussed earlier, Congress, Treasury, and the IRS all share a commitment to treat taxpayers fairly in our administration of the internal revenue laws. In the past we have cooperated to develop important procedural remedies and guarantees in the context of sound tax policy and efficient administration. We are confident that we can again work with you and your staff regarding the important issue of taxpayer rights and needed improvements in the tax law in respect of this issue. The Administration will be making additional taxpayer rights proposals in our next budget, and we look forward to working with you on those as well. Our common goal is to ensure that American taxpayers get the best tax service in the world.

I would be happy to entertain questions or discuss particular provisions with you.

## APPENDIX—RECENT TAXPAYER RIGHTS INITIATIVES

"ADMINISTRATIVE TBOR" INITIATIVES.

These are measures that the Administration implemented administratively, without the need for legislation, in 1996.

1. Increased Taxpayer Ombudsman Authority to Address Taxpayer Concerns. This was initially accomplished via additional Delegation Orders from the Commissioner.

2. Commissioner's Directive to Track IRS Response to Taxpayer Ombudsman Annual Reports. This was also accomplished through a Delegation Order.

3. Greater Protection for Taxpayer Assistance Orders. A temporary Delegation Order, and regulations proposed in 1996, voluntarily limited the IRS officials who can overturn TAOs.

4. Increased Stature of Taxpayer Ombudsman Within the IRS. The salary and grade level of the Ombudsman (now the Taxpayer Advocate) were enhanced administratively.

5. Greater Participation of Ombudsman in Selection of Local Problem Resolution Officers. This was accomplished through a Commissioner's Directive.

6. New Procedures to Allow Taxpayers to Appeal Liens, Levies, and Seizures. A new appeals process was created, and IRS forms, publications, and the Internal Revenue Manual were updated to reflect it.

7. Notification of Collection Activity to Divorced and Separated Spouses. The Internal Revenue Manual now provides for such notice, subject to privacy concerns in this particularly sensitive area.

8. Prohibition on Compromising Informant's Tax Liability. The Internal Revenue Manual was amended to prohibit compromising an informant's liability in exchange for information about another taxpayer.

9. Voluntary Payor Telephone Numbers on Forms 1099. The IRS began asking payors in 1996 to include a telephone contact on the Forms 1099 that they provided to taxpayers.

10. Study of Interest Netting. This study was completed and released in April, 1997. It resulted in the Administration's global interest netting legislative proposal in TBOR 3.

11. Study of Joint Return Issues for Divorced and Separated Spouses. The information-gathering stage of this study was completed in late 1996, but a draft is still undergoing review within Treasury. This is the only uncompleted item from this list.

12. Increased IRS Investigation of Disputed Information Returns. The Internal Revenue Manual was amended to increase efforts to investigate information that a taxpayer challenges.

13. 30-Day Notice Before Terminating or Modifying Installment Agreements. This was accomplished through regulations.

14. Penalty for Trust Fund Taxes Under &#21; 6672. Internal Revenue Manual changes required that taxpayers get 60 days notice before the penalty is assessed, and an IRS policy statement prohibited penalties against honorary or volunteer trustees of an organization in most circumstances.

15. Annual Reminders of Outstanding Delinquent Accounts. The Internal Revenue Manual was amended to direct IRS personnel to provide annual, and sometimes semiannual, reminders to taxpayers.

16. Notice of Overpayments. The Internal Revenue Manual was changed to require a reasonable attempt to notify a taxpayer as soon as possible if the IRS receives a payment that cannot be matched to a taxpayer account.

17. Limitations on the Use of a Designated Summons. A policy statement was issued, requiring Regional Counsel to approve all designated summonses and in most cases limiting their use to audits of large corporations in the Coordinated Examination Program ("CEP").

18. Early Appeal of Certain Issues. A revenue procedure was issued to provide a mechanism for employers to obtain appeal of employment tax issues while an examination is still in progress.

19. Appeals Mediation Procedure. A test of an Appeals mediation procedure began in 1995 and has been continued through 1997.

20. Obtaining Advance Valuation of Art Works. Under a new revenue procedure, taxpayers can obtain an IRS expert's valuation in advance of filing the return in which the valuation is reported.

21. Making Taxpayer Identification Numbers Available. Regulations proposed in 1996 provide a method for taxpayers who are not eligible to obtain Social Security Numbers to still obtain Taxpayer Identification Numbers.

22. Obtaining Section 9100 Relief. The revenue procedure for granting taxpayers relief when the make certain requests for changes of accounting method or period was revised.

23. Allow Automatic Extensions Without Payment. Proposed regulations eliminate the requirement that the tax be fully paid with the application for an automatic 4-month extension.

24. Permit Use of Imaging Systems to Store Tax Records. This was accomplished by updating the revenue procedures on storing such records.

25. Electronic Filing of Form 941. A revenue procedure was issued setting forth the procedures to be used by taxpayers who wish to file Form 941 electronically.

26. Simultaneous Appeals/Competent Authority Procedure. A revenue procedure authorizes simultaneous Appeals/Competent Authority procedure.

TBOR 2 PROVISIONS.

The Administration worked with Congress in developing this legislation, which was signed by President Clinton on July 30, 1996.

Sec. 101. Taxpayer Advocate. This provision changed the "Taxpayer Ombudsman" to the "Taxpayer Advocate" and increased his authority in several respects.

Sec. 102. Taxpayer Assistance orders. This provision restricted the individuals who can overturn TAOs to the Taxpayer Advocate, Commissioner, or Deputy Commissioner.

Sec. 201. Notice of termination or modification of installment agreements. This provision required IRS to give 30-day notice before terminating or modifying installment agreements entered with taxpayers.

Sec. 202. Administrative review of termination of installment agreements. This provided an administrative review process or appeal if the IRS terminates an installment payment agreement.

Sec. 301. Expanded authority to abate interest. The Service was given authority to abate interest in more situations under this provision.

Sec. 302. Judicial review of failures to abate interest. The Tax Court can now review the Service's failure to abate interest, under an abuse of discretion standard.

Sec. 303. Extension of interest-free period. The period of time after taxpayers receive a bill from the IRS in which they can pay before interest starts to accrue was extended.

Sec. 304. Abatement of payroll deposit penalty. This provision lets the IRS waive the penalty for failure to make a timely deposit of payroll taxes in certain circumstances.

Sec. 401. Study of joint return issues. This study addresses several issues arising out of the joint and several liability that taxpayers incur when they file joint returns but later separate or divorce. It has not been completed.

Sec. 402. Joint return after separate return without full payment. Married taxpayers who file separately, but later determine that their tax would be less if they filed jointly, may now amend their return without fully paying the amount of joint tax due.

Sec. 403. Disclosure of collection activities with respect to joint returns. The IRS may now disclose to divorced or separated spouse the collection activities it has undertaken with respect to the other spouse, consistent with privacy concerns.

Sec. 501a. Withdrawal of notice of lien. The IRS can now withdraw a recorded tax lien in additional circumstances, e.g. when a taxpayer has made an installment payment agreement.

Sec. 501b. Return of levied property. This provision permits the IRS to return property it has seized in some additional circumstances, e.g. after an installment agreement is entered.

Sec. 502. Modification to levy exemption amounts. The amounts of certain property that is exempt from levy were increased and indexed for inflation.

Sec. 503. Offers in compromise. The amount of tax that can be compromised without an opinion from the IRS Chief Counsel's office was increased by this provision.

Sec. 601. Civil damages for fraudulent information returns. This provision creates a federal cause of action against a payor who has filed a "fraudulent" information return.

Sec. 602. Reasonable investigations of information returns. This provision requires the IRS to investigate and prove the accuracy of information returns that the taxpayer contests, so long as the taxpayer fully cooperates in the investigation.

Sec. 701. Attorneys fees—burden of proof on "substantially justified." The IRS must show that its position was "substantially justified" in the attorneys' fees stage of a case.

Sec. 702. Increase and index attorneys' fees dollar amount. The hourly amount of attorneys' fees that can be collected from the Government was raised and indexed for inflation.

Sec. 703. Failure to extend statute of limitations. Under this provision, the failure to extend the statute is irrelevant to whether the taxpayer exhausted administrative remedies for purposes of the attorneys' fees determination.

Sec. 704. Attorneys' fees in declaratory judgment actions. This provision made attorneys' fees and costs available in declaratory relief actions.

Sec. 801. Increase civil damages for unauthorized collection actions. The maximum damages for reckless or intentional IRS misdeeds went from $100,000 to $1 million.

Sec. 802. Discretion to award damages for unauthorized collection actions where administrative remedies not exhausted. This replaced the previous automatic bar if remedies were not exhausted.

Sec. 901. Preliminary notice of proposed 6672 penalty. This provision applies when corporate officers responsible for collecting employment taxes are penalized for failing to do so.

Sec. 902. Disclosure to other responsible persons. In certain circumstances, the IRS must advise such persons of its actions to collect the penalty from other responsible persons.

Sec. 903. Contribution between responsible persons. This provision created a federal right of contribution between persons who are jointly and severally liable for the penalty.

Sec. 904. 6672 penalty for tax exempt organizations. This proposal gave volunteer, unpaid board members of tax-exempt organizations some safe-harbors from the penalty.

Sec. 1001. Enrolled agents as 3rd-party recordkeepers. "Enrolled agents" get the same treatment as banks, brokerage houses, attorneys, and accountants for IRS summons purposes under this provision.

Sec. 1002. Safeguards related to designated summons. This provision limits use of the "designated summons" to the largest corporations and requires higher-level IRS review approval.

Sec. 1003. Annual report regarding designated summons. The IRS must provide Congress with an annual report concerning the uses of the designated summons procedure.

Sec. 1101. Retroactive regulations. This provision generally prohibits Treasury from issuing retroactive tax regulations, but contains a number of exceptions we requested.

Sec. 1201. Phone numbers on payee statements. This provision requires a telephone number of a contact person on payee statements.

Sec. 1202. Required notice for certain payments. This provision requires the IRS to make reasonable efforts to notify taxpayers who submit a payment that the IRS cannot associate with an outstanding liability.

Sec. 1203. Unauthorized "enticement" of information disclosures. This prohibits IRS agents from "trading" an informant's tax liability for information about the liabilities of others.

Sec. 1204. Annual reminders of delinquent taxes. IRS must send annual reminders to persons with outstanding tax accounts.

Sec. 1205. 5-year extension of authority for undercover operations. This provision allows the IRS to use amounts recovered in undercover operations to fund ongoing operations.

Sec. 1206. Disclosure of Form 8300 information. Information on Form 8300 (regarding cash transactions of $10,000 or more) can be disclosed to the same extent as the very similar information on Currency Transaction Reports.

Sec. 1207. Disclosure to designee of taxpayer. Under this IRS initiative, the IRS may, but need not necessarily, obtain written consent from the taxpayer before it can disclose information to the taxpayer's representative.

Sec. 1208. Study of interest netting. This study of the interest rate differential between overpayment and underpayment rates was completed in April 1997 and resulted in our "global interest netting" legislative proposal.

Sec. 1209. Expenses of detection of underpayments and fraud. This provision gave IRS authority to pay rewards out of amounts collected.

Sec. 1210. Use of private delivery services. Under this provision, a taxpayer who uses an approved private delivery service gets the benefit of the tax Code's "mailbox rule."

Sec. 1211. Reports on misconduct by IRS employees. This provision requires the IRS to provide an annual report concerning employee misconduct and disciplinary actions.

Sec. 1301. Treatment of substitute returns for purposes of failure to pay penalty. Under this provision, the failure to pay penalty runs from the original due date of the return even when the IRS prepares a substitute return.

TBOR 3 PROVISIONS.

The Administration announced these proposals in April, 1997. All but global interest netting and equitable tolling were enacted this year, mostly in the Taxpayer Relief Act.

1. Uniform "reasonable cause" exception for penalties. This provides a "reasonable cause" exception for all penalties that relate to failure to file a return, information statement, or similar document, or failure to pay or deposit required taxes.

2. Global interest netting of under- and over-payments. This proposal, which was the result of our interest netting study, would require the IRS to "net" tax balances in computing interest even if the balances have already been paid at the time of the interest computation.

3. Amend limitations period for refunds in Tax Court. This provision, which was a response to the Supreme Court's result in the Lundy case, corrects a technical defect in the limitations periods.

4. Repeal authority to disclose whether a prospective juror has been audited. The repealed provision was of little utility but caused unnecessary delays and confusion in both civil and criminal tax litigation.

5. Clarify statute of limitations for pass-through entities. This provision codified the result in Bufferd v. Commissioner, 113 S.Ct. 927 (1993), that the period for assessing tax against a partner or S corporation shareholder runs from the date the individual's return is filed, not the entity's filing date.

6. Clarify procedures for administrative cost awards. This provision clarified several ambiguities in the rules and makes the procedures for claiming such costs more uniform.

7. Equitable tolling. This provision would change the rule reached by the Supreme Court in Brockamp to provide that the statutes of limitations on refund claims may be "tolled," or extended, in certain particularly equitable cases.

8. Clarify prohibition on "browsing" of returns and return information. This provision provides criminal penalties for "browsing" and a civil remedy for taxpayers whose returns have been "browsed."

Chairman JOHNSON. Mr. Brown.

## STATEMENT OF HON. STUART L. BROWN, CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. BROWN. Thank you, Madam Chairman. In the interest of time, I am happy to let my prepared written statement take the place of extended oral discussion here.

I do think, however, that in light of the extraordinary events of this week, I want to just say something on behalf of the people at the IRS, such as myself who—I have been in the Service for 6 years now, 3 years in a career position, 3 years in my present position as a Chief Counsel, politically appointed. Before that I was—I spent 2 years with the Joint Committee staff. Before that I practiced tax law with a law firm in Washington for 12 years.

This has been a very disturbing week for all of us. We have a tremendous amount of respect and interest in making the tax system work as well as it possibly can.

I have spent the last 6 years stressing one major theme with all of the people at the Service I have talked to, with all the taxpayer groups that I have talked to, every time I have had a chance. And that theme is that our objective, from the perspective of the Chief Counsel's Office, is to get the right legal answer. We don't care whether the answer favors the government or favors the taxpayer. We want to interpret the law impartially, the way you wrote it, as

well as we can. And it is very disturbing to me personally, it is very disturbing to all of the people that I work with, when we see things that are inconsistent with that, but—with that approach to the tax administration.

I think we appreciate Mr. Dolan's willingness to step forward and take responsibility, and on behalf of the people who work with him, I want to assure you that we will do everything we can to make his efforts successful and to make sure that we don't have continuing problems of the kind that you have heard about this week.

Beyond that, I am prepared to answer questions about any specific provisions. But my testimony does largely track Secretary Lubick's testimony, and so I think in the interest of time, I am happy to let it stand there.

[The prepared statement and attachment follow:]

**Statement of Hon. Stuart L. Brown, Chief Counsel, Internal Revenue Service**

Madam Chairman and Distinguished Members of the Subcommittee:

I am pleased to join Acting Assistant Secretary Lubick, Acting Commissioner Dolan, and IRS Taxpayer Advocate Monks today to provide IRS comments on the proposals concerning taxpayer rights that are included in H.R. 2292, the "Internal Revenue Service Restructuring and Reform Act of 1997."

I want to begin today by stating that the Internal Revenue Service is committed to respecting the rights of all taxpayers. This commitment is reflected in the IRS Mission statement:

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

As the Mission statement makes clear, the goal of the Service is to collect the amount prescribed by law—no more, no less. Our self-assessment tax system depends on taxpayers to determine their own liability as accurately as they can, and to pay what they owe without any enforcement action by the IRS. To maintain this system, the Service is committed to ensuring that all taxpayers are treated fairly, courteously, and with respect and dignity in their dealings with us.

The IRS invests considerable time and effort educating both our employees and the taxpaying public about their rights and obligations. Given the size and scope of IRS operations, the complexity of the tax law, and the inherent law enforcement aspect of many IRS responsibilities, there will probably always be mistakes by IRS employees, and cases in which some individuals do not live up to the ideals of our Mission. We deeply regret these mistakes and welcome any constructive criticism about how to minimize the number of mistakes and mitigate the harm they cause taxpayers. Nevertheless, to put the issue in perspective, I note that the National Commission on Restructuring the Internal Revenue Service reached the following overall conclusion about the Service's efforts to protect taxpayer rights:

The Commission found that the passage of the Omnibus Taxpayer Bill of Rights and Taxpayer Bill of Rights 2 have had an important effect on changing the culture of the IRS. The agency spends significant resources educating personnel to treat taxpayers fairly, and the Commission found very few examples of IRS personnel abusing power.

Report of the National Commission on Restructuring the Internal Revenue Service, p. 43 (1997).

One aspect of our commitment to protecting taxpayer rights is a particular concern of the Chief Counsel's Office—our approach to litigation. Before providing comments on the specific taxpayer rights proposals in H.R. 2292, I would like to take a few minutes to discuss that here today.

In order to understand the Government's approach to tax litigation, it is important to understand how tax litigation fits into our overall system of tax administration. There are three basic messages:

First, the dollars we collect directly from cases in litigation represent an extremely small percentage of total federal revenues—approximately 0.1% of total collections.

Second, considering the size and complexity of our tax system, there is relatively little controversy between the IRS and taxpayers, and almost all of this controversy is resolved without litigation.

• More than 120 million individual and corporate tax returns are filed each year, and over 2 million returns are examined annually.

• Yet there are only 25,000 to 30,000 Tax Court petitions and fewer than 1000 refund suits filed each year. The vast majority of these disputes are settled, even while they are pending in court, so that the Tax Court tries and decides only about 1,200 to 1,500 cases each year. The District Courts and Court of Federal Claims add another 160 opinions and 800 closings.

• The universe of appellate litigation is even smaller, with only about 300–325 Tax Court and refund litigation appeals, of which only about 50 are government appeals. And, of course, only a few of these cases end up in the Supreme Court in any year.

Third, the Service's strategic approach to enhancing compliance in the future envisions continuing efforts to increase revenue from self-assessment, to reduce the number of controversies, to resolve controversies earlier in the administrative process, and to ensure that litigation is pursued only where that is the most appropriate approach to resolving an issue. To illustrate how these principles have been applied in practice, listed below are some of the controversy resolution techniques that are available now but that did not exist before 1990:

• In Exam: The IRS has developed the procedures for Accelerated Issue Resolution and has also expanded Examination settlement authority. This expanded settlement authority has been made applicable with respect to issues previously resolved by Appeals, with respect to issues that are the subject of ISP Coordinated Issue Papers and Settlement Guidelines, and in connection with the Worker Classification Settlement Program. The Service has likewise promoted the use of Market Segment Understandings in several industries as a mechanism to enhance compliance by groups of working taxpayers, through the joint outreach efforts of their employers and the Service.

• In Appeals: The IRS has instituted procedures for the Early Referral of certain issues to Appeals while the remaining issues in the case remain in Exam. It has also expanded Appeals involvement in both Competent Authority proceedings and Collection cases. And, Appeals is continuing its test of mediation as a means of resolving certain cases and beginning a test to expeditiously settle Service Center generated issues.

• In Counsel: The Advanced Pricing Agreement program for transfer pricing issues has been one of the Service's most notable successes in recent years to finding a new approach to resolving controversies in specific cases. The proposed procedures announced in Notice 97–7 for letter rulings dealing with environmental remediation expenditures is an effort to build on the APA experience. These procedures envision a letter ruling process that could cover both past and future years and would involve both the Field and National Office.

I want to emphasize the fundamental principle that guides how we handle cases in court: We only advocate positions that we believe to be legally correct.

The principle of seeking the correct legal answer starts with the IRS Mission: to collect the "proper" amount of tax revenue. Consistent with this objective, the first directive of the Chief Counsel Mission Statement is to "provide the correct legal interpretation of the internal revenue laws." This is more fully explained by the Statement of Principles of Tax Administration that appears at the front of every Internal Revenue Cumulative Bulletin. These principles emphasize the Service's obligation to "correctly" apply the laws and "to find the true meaning" of the statute, fairly and impartially, "with neither a government nor a taxpayer point of view."

We do not insist on 100 % certainty before we will take a case to litigation. It is not always easy to find the correct interpretation of the tax law. While we are looking for the answer that is more likely right than wrong, we are often called upon to take a position where there are good arguments on both sides of an issue. In those situations, the IRS and its Counsel have to be willing to take a position that we believe is correct, even though there is a chance that the courts may disagree with us. The important thing is that we apply our best legal analysis and impartial judgment to ensure the position we advance represents what we believe is the best interpretation of the law.

I think it is worth noting that the standards that govern taxpayers and their representatives are very different from the standards that apply to counsel for the IRS. The penalty provisions of the Code set forth a host of standards that describe for taxpayers and their advisers just how wrong they are allowed to be, in a variety of different situations, without incurring penalties. These standards range from "substantial authority" to "not frivolous;" and include "realistic possibility of suc-

cess" and "reasonable basis." The standards of practice of the ABA and other professional organizations, as well as the Tax Court Rules, and Circular 230, provide roughly comparable rules governing the professional conduct of those who represent taxpayers at various stages of the tax process—whether filing returns or claims for refund, or in controversies before the IRS and the courts.

Because the Service's primary concern in litigation is the systemic impact of any given case, our goal is to advocate only those positions that we believe make sense for the system as a whole. We make every effort to avoid arguments that might help us win a particular case, but would leave us with a decision that creates problems in other situations. The Tax Division of the Department of Justice shares this same approach. As former Assistant Attorney General Shirley Peterson told the Federal Bar in 1991, "[Tax Division attorneys are directed to advocate] the interpretation which makes the maximum contribution to a sound, wise tax system, not only immediately but over the long run."

Although much of our litigation focuses on the significant legal issues that most frequently occur in large cases, in the context of this hearing on taxpayer rights, it may be more relevant to focus on the role of the Tax Court in providing a forum for taxpayers with much smaller amounts at stake, but who feel strongly that they need an independent decisionmaker to resolve their disputes with the Government. Indeed, if you look at the statistics, somewhat over 80% of the Tax Court's inventory involves cases of less than $100,000 and pro se petitioners.

We stress how important it is for the attorneys handling these cases to show appropriate sensitivity to the needs of these taxpayers. In many instances, our attorneys are called upon to provide advice to these taxpayers, assist them in gathering the facts they need to support their position, and provide an understandable explanation of the applicable legal authorities. We took two steps last year to ensure that we are fulfilling that aspect of our responsibility as representatives of the Government:

• We issued manual instructions to our field offices in April 1996 that modified our procedures for dealing with cases involving a claim for relief based on either the innocent spouse provisions of section 6013(e) or the doctrine of duress. These procedures recognize the special sensitivity needed to deal with taxpayer claims for relief based on allegations of family disfunction, ranging from emotional disorders, to substance abuse, to domestic violence. While the instructions do not change the legal standard for dealing with these issues, we believe they ensure appropriate management oversight of cases involving these sensitive issues.

• In addition to these new instructions for handling innocent spouse issues, we have also reminded all of our field attorneys of the special procedures that we adopted some years ago for dealing with Tax Court cases involving pro se taxpayers. These procedures emphasize the need to handle pro se cases in a way that will avoid even the appearance that our lawyers are trying to gain an unfair advantage. They stress that communications should be as informal and nontechnical as possible in order to promote a more relaxed and cooperative environment.

We want these taxpayers to understand that our goal in every case is to reach the proper tax result. If the taxpayers can substantiate their facts, or persuade us that their arguments are legally correct, we will be more than ready to accept their position. Of course, we must also try to explain to them that it is our job to ensure that the tax law is applied even-handedly to all taxpayers.

In addition to its overall commitment to protecting taxpayer rights, both in the administrative and litigation contexts, I think the Service also has a good track record as a constructive participant in the legislative process in the consideration of proposals to enhance taxpayer rights. The Service worked with the Congress and Treasury in developing both the original Taxpayer Bill of Rights in 1988, the Taxpayer Bill of Rights 2 in 1996, and the Taxpayer Protection provisions that were enacted as part of the Taxpayer Relief Act of 1997. I would hope that a similar level of cooperation would attend the consideration of any new legislation in this area.

The appendix to my testimony provides our comments with respect to each of the sections of Title III of H.R. 2292. As a general matter, I would endorse the approach set forth in Secretary Lubick's testimony. Each proposal should be evaluated based on whether it strikes an appropriate balance in providing taxpayers with the legal rights they need while not unduly hampering the ability of the IRS to carry out its tax collection mission.

I would like to highlight here several of the most important items:

Two provisions of H.R. 2292 are intended to provide enhanced access to legal representation by taxpayers served by law school clinics or other pro bono associations. Section 302(c) would permit the recovery of attorney's fees for the efforts of these entities, even though the taxpayer would not otherwise be charged a fee. Section

313 would establish a program to provide funding to certain clinics that provide legal assistance to low-income taxpayers.

We strongly support the goals of these provisions. We believe that law school clinics and pro bono associations perform a very important service to tax administration by representing low income or indigent taxpayers. The Internal Revenue Service has a program to support college and university sponsored student tax clinics. This includes soliciting interest from schools in creating such programs, assisting schools in setting up a tax clinic and notifying taxpayers of the availability of such programs. This year, through the end of June 1997, 164 volunteers in the student tax clinic programs assisted 1,065 taxpayers at 20 sites across the United States. Our experience with other tax clinics (some sponsored by Bar Associations or tax-exempt entities who provide pro bono representation of taxpayers) has also been positive.

With only two small modifications, we support section 302(c): we believe the payment of fees should go directly to the clinic, and the statute should clarify the tax consequences of the payment to both the taxpayer and the clinic.

While we also support the concept of providing additional funding to tax clinics, we have somewhat greater concerns about section 313 as currently drafted. First, we do not think it is appropriate for the IRS or any other Treasury function to control the funding for entities whose purpose is to litigate against us. There is an inescapable appearance of a conflict of interest and we strongly suggest that some alternative funding mechanism be developed. Secondly, we are concerned that the current proposal contains numerous specific conditions that do not seem to be clearly related to achieving its intended purpose; we suggest that simpler guidelines would be more appropriate for a program of this magnitude.

The next two provisions of H.R. 2292 that I want to mention today deal with installment agreements. Section 310 would eliminate the failure to pay penalty for taxpayers who enter installment agreements; section 311 would create a statutory right for taxpayers to enter installment agreements with the IRS in cases where the liability is $10,000 or less. I want to comment on these provisions because the installment agreement program is a very important aspect of IRS tax collection efforts.

Installment agreements offer the IRS a unique opportunity to keep taxpayers in the tax system who would otherwise not be able to meet their full tax obligations. As a result of IRS efforts to expand the use of this technique, the number of installment agreements entered into increased from 1.52 million in FY 1992 to 2.67 million in FY 1996; approximately 2.3 million of these agreements involved amounts of less than $10,000. The Service collected approximately $5 billion from installment agreements in the first 11 months of FY 1997.

Section 311 generally reflects current IRS practice with respect to installment agreements. Accordingly, we would support its enactment, provided certain conditions are specified in the statute. We think it is important that the automatic availability of installment agreements be limited to individual taxpayers with respect to income taxes—and that it not be extended to employment or trust fund taxes of businesses. Moreover, we believe the statute should include conditions that will make it possible for the IRS to effectively manage this program (e.g., there should be a 36 month time limit for the installment agreements; direct debit arrangements should be established by taxpayers who desire an automatic agreement; and there must be appropriate protection for the statute of limitations). Finally, we suggest that the effect of the provision be made subject to review after a reasonable period of time.

The failure to pay penalty is intended to impose an appropriate cost on taxpayers who do not pay their taxes when they are due. The penalty is not imposed if the failure to pay is due to reasonable cause. Because we believe it is appropriate to maintain some differential (in addition to normal deficiency interest) between taxpayers who pay in full on time and taxpayers who pay late, we cannot support section 310 in its present form. At the same time, we would like an opportunity to work with the Committee to evaluate whether some modifications to the existing failure to pay penalty would be appropriate in light of other changes to the installment agreement program.

The final provision I would like to mention is section 303, which would expand the current statutory remedy for taxpayers to recover damages they suffer as a result of legally incorrect IRS collection actions. Section 7433 of the Code permits a taxpayer to recover up to $1 million of damages caused by an IRS collection action that recklessly or intentionally disregards the Code or regulations. Section 303 of H.R. 2292 would allow a taxpayer to recover up to $100,000 of damages caused by negligence in a collection action (even without a finding of reckless or intentional disregard).

We oppose this provision as drafted. We would, however, like to work with the Committee to explore the possibility of expanding the relief available under section 7433 in other ways. We would suggest that consideration be given to broadening the statute to allow parties other than the taxpayer to recover damages in appropriate circumstances. For example, as section 7433 is currently drafted, if the IRS levies on property of a person who is not the taxpayer liable for the tax, the person may recover the property and attorney's fees, but not damages.

Thank you, Madam Chairman. I would be pleased to respond to any questions you may have.

## APPENDIX

SECTION BY SECTION DISCUSSION OF TITLE III OF H.R. 2292

*Section 301*—Expansion of Authority to Issue Taxpayer Advocate Orders

Section 301 would add to the statute four specific factors that the Taxpayer Advocate should consider in deciding whether a taxpayer faces a "significant hardship" sufficient to justify issuance of a TAO. While we have concerns about some of the criteria in proposed section 301, if the Taxpayer Advocate would find some additional guidance helpful in determining what constitutes a "significant hardship," we would support adding appropriate factors to the statute.

*Section 302*—Expansion of Authority to Award Costs and Certain Fees

Section 302 proposes five separate amendments to the administrative and litigation costs provisions of I.R.C. &#21; 7430. We note that section 7430 was amended in 1996 as part of TBOR 2 and again in August of this year in the Taxpayer Relief Act of 1997. Wholly apart from the merits of any of the changes proposed by H.R. 2292, we think it would be desirable to gain some additional experience with the newly amended provision before making further changes.

In addition to this general concern, we have some specific concerns about several of the proposed additional changes:

- We oppose the provision that would allow for costs in excess of the stated statutory amounts under certain circumstances, for example, where the case is a difficult one. The Service supported the legislation that set fees at $110 per hour, indexed for future years. This rate established parity between section 7430 and the Equal Access to Justice Act and also was expected to eliminate a great deal of litigation over the consideration of additional factors to justify higher rates. The proposal would reintroduce this potential for litigation over the special factors.
- We oppose the provision that would move the starting point for the award of damages to an earlier stage of the administrative process because we believe this could tend to undermine taxpayers' incentive to cooperate with examination personnel prior to the issuance of the 30-day letter.
- We support the proposal to allow fees to be paid in cases where a taxpayer is represented by a student tax clinic or other pro bono organization. We suggest the tax consequences of such payments be clarified for both the taxpayer and the recipient organization.
- We oppose the proposal to increase the net worth limits on persons who may recover costs because we believe the limits that apply in tax matters should be the same as apply in other contexts under the Equal Access to Justice Act.
- With appropriate clarifications, we would support the proposal to create a presumption that Service position in litigation is not substantially justified if we lose an issue in a fourth circuit after having lost previously in three other circuits. The proposal should be clarified to exclude situations in which there is a split in the circuits and in which the litigation in the different circuits arises out of the same transaction or at approximately the same time.

*Section 303*—Civil Damages for Negligence in Collection Actions

Discussed in text.

*Section 304*—Disclosure of Criteria For Examination Selection

Section 304 would require the Service to provide the public with additional information about the criteria and procedures used to select returns for examination. We agree with the general intent of this provision—the public has the right to know generally how its Internal Revenue Service selects returns for examination, and has

the right to know specifically that no such audits are undertaken based on improper motivations. As the Committee is aware, this past February, Commissioner Richardson offered to provide Chairman Archer and Chairman Roth with any information they might request to investigate allegations that audits of certain individuals or organizations were based on improper political factors. We are confident that investigation will find those allegations were totally unfounded.

Apart from responding to the particular questions that have been raised this year, we support the intent of Section 304 because we believe that providing more information about our audit program would enhance public confidence in the integrity, efficiency and fairness of the IRS as a whole. We would like to work with the Committee to determine the most appropriate mechanism to provide this information; we are concerned that a meaningful description might be too long for Publication 1 and that there should be no disclosure of law enforcement tolerances or confidential informants.

*Section 305*—Archival of Records of Internal Revenue Service

Section 305 proposes rules governing the transfer of confidential taxpayer information to the National Archives. We do not oppose clarifying section 6103 in this way; however, we believe Congress should provide rules for the ultimate disposition of the records either after the expiration of a specified period of time or upon the satisfaction of other specified criteria.

*Section 306*—Tax Return Information

We support the study required by section 306. We would, however, recommend that the study be conducted by the Joint Committee Staff itself, with such outside assistance as it may require. We think it is desirable for the study to be directed by individuals who have experience dealing with taxpayer information, and who would have access to such information during the course of their work.

*Section 307*—Freedom of Information

Section 307 would require the IRS to adopt procedures to expedite handling of Freedom of Information Act requests submitted by the media. We oppose this proposal because it is inconsistent with the rules enacted by Congress last year as part of the Electronic Freedom of Information Act ("EFOIA"). The EFOIA rules become effective October 2, 1997, and will apply to the IRS as well as other Federal agencies. We believe it is highly desirable that there be a uniform set of rules for handling media FOIA requests.

*Section 308*—Offers-in-compromise

We support Section 308.

*Section 309*—Elimination of Interest Differential on Overpayments and Underpayments

We recognize that the equalization of interest rates on underpayments and overpayments would have substantial benefits in terms of administrative simplification. However, we also recognize that serious policy and revenue concerns support the several Congressional decisions over the past 10 years to establish, maintain and expand the differential interest rates. We are also concerned that the blended rate of proposed section 309 might be difficult to establish. Therefore, we recommend enactment of the interest netting proposal contained in the Administration's April 1997 simplification proposals.

*Section 310*—Elimination of Application of Failure to Pay Penalty During Period of Installment Agreement

Discussed in text.

*Section 311*—Safe Harbor for Qualification for Installment Agreements

Discussed in text.

*Section 312*—Payment of Taxes

We support this proposal.

*Section 313*—Low Income Taxpayer Clinics

Discussed in text.

*Section 314*—Jurisdiction of the Tax Court

Section 314(a) and (b) were enacted as section 505 and section 1452 of the Taxpayer Relief Act of 1997.

We support section 314(c), which would make the small case procedures of the Tax Court available in cases involving up to $25,000.

*Section 315*—Cataloging Complaints

We support this proposal.

*Section 316*—Procedures Involving Taxpayer Interviews

We are concerned that certain aspects of proposed section 316 will undermine the effectiveness of the IRS examination program. In particular, we strongly oppose the provision that would require a taxpayer to be informed of the reason for selection of the taxpayer's return for examination. The taxpayer will, of course, be informed of the items of income, deduction or credit that are the subject of the examination. However, requiring the Service to disclose the reason for selection of the return for examination has a high potential to disclose law enforcement criteria or other sensitive information.

We support the principle that taxpayers should be informed of their right to be represented at any interview with the IRS. This right is reflected in current law at Code section 7521(b), and is explained to taxpayers in Publication 1 which is sent to all taxpayers who are to be interviewed by the IRS. Under the Heading of "Declaration of Taxpayer Rights," Publication 1 lists "IV. Representation" as follows:

You may either represent yourself, or with proper written authorization, have someone else represent you in your place. You can have someone accompany you at an interview.

We believe it is preferable to provide taxpayers with this information in writing, on a uniform basis, rather than orally at the time of a scheduled interview.

*Section 317*—Explanation of Joint and Several Liability

We support the intent of section 317 insofar as it would require additional explanations of joint and several liability. Given the complexity of these rules, we believe the statute should provide the IRS some degree of flexibility in determining the most appropriate forms and publications to communicate this information.

*Section 318*—Procedures Relating to Extensions of Statute of Limitations By Agreement

Section 318 generally codifies current IRS practice by which taxpayers are provided a copy of Publication 1035 "Extending the Tax Assessment Period." We support this provision.

*Section 319*—Review of Penalty Administration

We support this provision.

*Section 320*—Study of Treatment of All Taxpayers As Separate Filing Units

We support this provision.

*Section 321*—Study of Burden of Proof

We support this provision.

---

Chairman JOHNSON. Mr. Monks.

## STATEMENT OF LEE R. MONKS, TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE

Mr. MONKS. Thank you, Madam Chairman and other Members of the Subcommittee. I, too, will briefly go through my testimony in the interest of time so that we can get to the questions.

As you are well aware, the original Taxpayer Bill of Rights and the Taxpayer Bill of Rights 2 did much to elevate the issue of taxpayer rights and put in place specific protections for taxpayers. And I guess the question is: Were those protections adequate? And I think to some degree, there is some more work that needs to be done, and I commend the work of the Subcommittee in that regard.

Obviously, one of the things that the Congress has charged me with as the Taxpayer Advocate is to serve as an independent representative for taxpayers within the Service.

Another responsibility that we have, and this is probably the most visible aspect of our program, is to work with taxpayers to assist them in resolving ongoing problems that they experience with the IRS. And Mr. Dolan, I think, has made it very clear to our field offices and executives and employees alike that we need to be more attentive to the kinds of problems that were raised in the hearings this past week and ensure that those problems are identified quickly and, where appropriate, getting them in the hands of the proper resolution program and the local Taxpayer Advocate so that we can take specific actions on those cases.

We work approximately 300,000 cases a year in the problem resolution program, and we also handle approximately 32,000 requests for hardship assistance. And a field executive—field people working in our program, I think, do an excellent job in serving taxpayers in that regard.

In response to your questions for comments on H.R. 2292, I do have a couple of specific comments. Section 301 attempts to expand the Taxpayer Advocate's authority to issue a taxpayer assistance order. One of the concerns we have is that this effort may actually have somewhat of a limiting effect. Taxpayer Advocates in the field currently have fairly broad discretion in determining whether hardship exists, including the ability to overwrite procedures where necessary and provide relief as appropriate, and it is not clear if this provision is intended to require an Advocate to effect a taxpayer assistance order if one of the specified conditions exist or to only take that into consideration in their decisionmaking process.

One of the things that I feel strongly about is it is important that the field Advocates continue to have broad discretion in this area, and we would like to work with the Subcommittee to structure the language in the bill to ensure that the Advocates have full authority to consider all relevant issues in determining if hardship exists and where relief is appropriate.

Section 308 directs the IRS to ensure that taxpayers are provided with an adequate living expense allowance and offers some compromise cases. I support this provision and would further suggest, since this concern has been expressed by a number of practitioner groups in a variety of settings, many of which I have attended, that the process for determining what constitutes adequate means be jointly developed by the IRS and a representative number of stakeholders, possibly from the Commissioner's Advisory Group, the CAG.

Section 309, as was previously discussed, proposes the elimination of the interest rate differential on the payment of tax liabilities, and as an advocate for taxpayers and also one for simplification, I would be in favor of this proposal, but would point out the obvious in that there is a potential revenue impact depending upon how this is resolved.

I want to cut this short because I know we are looking to save some time here. I did want to point out that the protection of taxpayer rights is certainly an important matter, both to the Congress and to the IRS, and for those of us who work in the problem resolu-

tion program. Having just gone through the hearing before the Senate Finance Committee with Mr. Dolan and others, this is one of the important challenges that we have, both within the IRS and within the Congress, to ensure that taxpayer rights are protected.

Where problems linger or where they are not being solved, it is important that we identify those problems quickly and, where appropriate, refer them to the problem resolution program so that we can handle those cases. That is the role that we have within this organization, and it is one that we take very seriously. Thank you.

[The prepared statement and attachments follow:]

**Statement of Lee R. Monks, Taxpayer Advocate, Internal Revenue Service**

Madame Chairman and Distinguished Members of the Subcommittee:

I'm pleased to be here today to discuss the important issue of taxpayer rights and actions that might be taken by both the Congress and the Service to ensure that the protection of taxpayer rights is accorded the same high priority as the important task of collecting the nation's revenue.

The original Taxpayer Bill of Rights and the second Taxpayer Bill of Rights—often referred to as TBOR1 and TBOR2—did much to elevate the issue of taxpayer rights and to put in place specific protections for taxpayers. It was obvious to most of us that more work still needed to be done in this area. I welcome the opportunity to share with you my views on the taxpayer rights proposals contained in H.R. 2292, which contains the recommendations of the National Commission on Restructuring the Internal Revenue Service. First, I want to note that the Congress has specifically charged the Taxpayer Advocate to serve as an independent representative for taxpayers within the Service. In that capacity, the Advocate is required to issue an annual report to the Congress on the most significant problems affecting taxpayers, what recommendations the Advocate has made to reduce those problems and what actions are being taken by the Service to implement solutions to those problems. The first Taxpayer Advocate Report to the Congress was issued this past January and the next report is due to be issued in just a little over 90 days. This Subcommittee, through the hearings process and other feedback, has made it clear that one of the key responsibilities of the Advocate is to produce administrative and legislative proposals to ensure improvement of IRS systems that produce unintended negative consequences for taxpayers. These proposals may, in turn, be used to assist the Congress in considering and developing subsequent taxpayer rights legislation. That is a very significant responsibility and one in which my staff and I have been highly involved over the past year.

To fulfil that responsibility, I have engaged our four Regional Advocacy Councils and my headquarters staff in the review of systemic problems encountered by taxpayers as identified by our casework analysis and our Problem Resolution Program (PRP) management information system, or PROMIS for short. We currently track 55 issues on the PROMIS system that focus on the primary problems experienced by taxpayers that make their way into our program. Although the majority of the casework is accomplished by our field advocates, much of the analysis and identification of systemic problems and resulting recommendations for potential solutions is the result of work conducted by my staff and our Advocacy Councils.

Another responsibility of the Taxpayer Advocate and our field advocates in districts and service centers—perhaps the most visible part of our program—is to work with taxpayers to assist them in resolving ongoing problems with the IRS. These problems may be systemic in nature or may involve taxpayers who are experiencing a significant hardship as a result of IRS action or who require IRS assistance in relieving a hardship. In FY 1996, we received about 300,000 cases from taxpayers that involved systemic issues and over 32,000 requests for hardship assistance through the Taxpayer Assistance Order program, which was established by TBOR1. In the vast majority of these cases, we were able to provide the taxpayers with assistance in resolving their case or were able to provide relief on their hardship request. I have provided a statistical breakout of our casework activity as attachments to my testimony.

In response to your request for comment on H.R. 2292—which is viewed by some as a TBOR3—there are several provisions about which I want to comment. Section 301 attempts to expand the Taxpayer Advocate's authority to issue a TAO. However, the expansion may actually have a limiting effect. Taxpayer Advocates currently have broad discretion in determining whether hardship exists, including the ability to override procedures, where necessary, and provide relief as appropriate. It is not

clear if this provision is intended to require an advocate to effect a TAO if one of the specified conditions exists or to only take that into consideration as part of their decision making process. I believe it is important that the advocates continue to have broad discretion in this area and would like to work with the committee to structure the language in the bill to ensure that advocates have full authority to consider all relevant issues in determining if hardship exists and when relief is appropriate.

Section 308 directs IRS to ensure that taxpayers are provided with an adequate living expense allowance in "offers-in-compromise" cases. I support this provision and would further suggest, since this concern has been expressed by a number of practitioner groups in a variety of settings, that the process for determining "adequate means" be jointly developed by the IRS and a representative number of stakeholders, possibly from the Commissioner's Advisory Group.

Section 309 proposes the elimination of the interest rate differential on over and under-payments of tax liability. I would be in favor of this proposal but would point out the obvious in that there could be a potential revenue impact depending on how this was resolved.

Section 310 proposes the elimination of "failure to pay" penalty on taxpayers who enter into and stay current on installment agreements with the IRS. While I generally support the concept of reducing penalties on taxpayers who agree to pay their delinquent taxes in installments, this could encourage some taxpayers not to full pay their full liability when they file, particularly if Section 311, which provides taxpayers an automatic right to an installment agreement is taken into account. The Committee might want to consider a 50% reduction in the "failure to pay" penalty for those entering into an installment agreement. Though reduced, the penalty would still serve as an incentive to pay the full amount at the time the tax is due.

I am also in support of Section 311, which would generally provide taxpayers with an automatic right to an installment agreement for income tax liabilities of $10,000 or less.

I am strongly in favor of Section 313 which would direct the IRS to establish grants supporting low income tax clinics since I am firmly of the belief that we should do everything within our power to ensure low income taxpayers are provided with additional assistance beyond what IRS has to offer in meeting their tax obligations.

Finally, I want to also comment on Section 319 of the bill. This provision requires the Taxpayer Advocate to report to the Congress on the administration and implementation of the tax penalty reforms contained in the Omnibus Budget Reconciliation Act of 1989. While I do not oppose this provision, we actually see very few of the penalties covered by this Act in PRP cases. Having said that, I do see this as a good advocacy initiative and would suggest the need for participation in this effort of the Office of Penalty Administration within the Chief, Compliance area at IRS.

In closing, I would like to emphasize that the protection of taxpayer rights is an important matter, both to the Congress and to the IRS. We have just completed a hearing before the Senate Finance Committee on possible violations of taxpayer rights, among other things. One of the important challenges that we have within the IRS is to ensure our employees are continually aware of the concerns that taxpayers have in dealing with the IRS. And, when problems linger or are not being solved, to recognize that these cases should be referred to the Problem Resolution Program and the local Taxpayer Advocate for special handling. That is our role and we take it very seriously.

This is the end of my prepared remarks. I invite any questions you may have.

Regular PRP Closures and the Top 10 Major Issues

FY 1996

| | Volume | Percent |
|---|---|---|
| Total Closures | 296,527 | 100 |
| 1) Audit Reconsiderations | 22,501 | 7.6 |
| 2) Refund Inquiry/Request | 21,120 | 7.1 |
| 3) Lost/Misapplied Payments | 20,933 | 7.1 |
| 4) Processing IMF Returns | 18,990 | 6.4 |
| 5) Processing Claims or Amended Returns | 17,749 | 6.0 |
| 6) Other Penalties | 16,292 | 5.5 |
| 7) FTD Penalties | 14,091 | 4.8 |
| 8) Earned Income Credit Issues | 14,070 | 4.7 |
| 9) Revenue Protection (RPS)Issues | 12,592 | 4.2 |
| 10) Installment Agreements | 11,974 | 4.0 |
| Subtotal Top Ten Major Issues | 170,312 | 57.4 |

TAO PROGRAM ACTIVITY

FY 1996

| | Volume | Percentage |
|---|---|---|
| ASSISTANCE PROVIDED TO TAXPAYER | | |
| TAO Resolved (voluntarily) | 14,862 | 46.2 |
| PRP Case Initiated | 2,114 | 6.6 |
| Referred to Function for Resolution | 4,052 | 12.6 |
| Resolved by the PRO Without TAO | 1,076 | 3.3 |
| Relief Provided Before TAO Issued | 2,514 | 7.8 |
| Enforced TAO | 5 | * |
| Subtotal | 24,623 | 76.5 |
| OTHER | | |
| Relief Not Appropriate | 5,546 | 17.3 |
| Law Prevents Relief | 1,147 | 3.6 |
| No Action Required(did not meet criteria) | 834 | 2.6 |
| Subtotal | 7,527 | 23.5 |
| TOTAL | 32,150 | 100% |

*Less than 0.1%

Chairman JOHNSON. Thank you very much. And thank you for the specifics of your testimony, which I know you did not have the time to go through.

I also want to comment, Mr. Brown, on the opening part of your statement, which I discouraged you from reading and appreciate that you didn't. But I do think it is important to put on the record that there are 120 million individual and corporate tax returns filed every year, and that of those, that there are only 25,000 to 30,000 Tax Court petitions and fewer than 1,000 refund suits filed each year. That doesn't go to the issue of problems, but it does set some outlying parameters that can serve to remind us that this is a very big project to collect the taxes in a nation this large and diverse as ours every year, and that most of it does go very well. I appreciated your opening with those statistics.

I want to just turn for a moment, Mr. Monks, to your comments. The authority issue and whether that actually limits you or not, will be one we will discuss. I appreciate that the recommendation in regard to section 301 to expand the Taxpayer Advocate's authority could actually limit it, and I will be interested in pursuing that with you in a different setting.

I would like, though, to hear you and the panel discuss this issue of the waiving of the penalty for the failure to pay. Mr. Brown mentions that in his testimony, Mr. Monks mentions that in his testimony, and I think that is a very significant issue. To what extent do we treat a taxpayer who has failed to pay his taxes on time differently from a taxpayer who has paid his taxes on time, and what is the role of penalties where there is the potential for a settlement and the settlement can be worked out quite easily?

Then the other issue that I do want to hear a little more discussion on, though briefly, because we do want to get to the other panel, is this issue of negligence and whether there is a sufficient way of dealing with taxpayers who have been the victims of negligent action on the part of the IRS.

When you get into reckless and intentional, our concern about that is that that is a rather high standard, and some of the most miserable cases were really negligence early on. If we are going to look at, in a sense, early intervention and prevention, we have to be able to look at negligence. We can't wait until it becomes reckless and intentional.

I appreciate your willingness to work with us on those things, but if you would just put a little bit on the record about how you feel on those issues, then the panel that testifies thereafter will be testifying in the context of your comments.

Mr. LUBICK. Can I address the negligence question first?

Chairman JOHNSON. Yes, that would be fine.

Mr. LUBICK. Then the others can chime in.

Negligence, as you know, is a big business in the United States. It is pretty easy to allege negligence, and the thing that I find very troublesome is that we would just open up a flood of charges that would really inhibit the proper working of the system by allegations of negligence. Then we would have to be—have determinations and trials, in effect. The IRS would be just one big defendant in negligence actions.

I think the answer is the one that Mr. Tanner alluded to. If there really is a problem, strengthening the Office of the Problem Resolution Officers to deal with that situation is going to be much more effective. I think the answer has to come from within the system. I think otherwise we are going to get very seriously bogged down.

Stu, do you——

Mr. BROWN. I would like to echo those comments. The problem with negligence as a standard in this context is that you are inherently talking about a situation where there is a conflict between the Service and the taxpayer. The taxpayer has an assessed liability on the books. There is no dispute the tax is due and owing.

The question is how does the Service—has the Service done something wrong in the way it went about in trying to collect that tax? And in that kind of an environment, where a taxpayer has no substantive legal objection to the collection—to the liability itself,

it seems to us that lowering the standard for damages to negligence is simply providing a backdoor way to give the taxpayer an opportunity to challenge what you have decided shouldn't be challenged on the front end.

So the question is perhaps we can look a little bit more deeply at the structure of the assessment and collection process rather than layering on top of what already exists a remedy for damages simply for negligence.

Chairman JOHNSON. Thank you.

Mr. MONK. I would like to comment on the elimination of the failure to pay penalty, and I may come, I recognize, froma different position from my colleagues on the panel.

I do support, generally support, the concept of reducing penalties, particularly failure to pay penalties, on those taxpayers who agree to pay their delinquent taxes through the installment agreement process. I recognize, however, and I think you do as well, that this could encourage some taxpayers not to fully pay their liability when they file, particularly if you also consider the fact that section 11 touches on providing taxpayers an automatic right to an installment agreement under certain conditions.

One of the things that I suggested in my written comments was perhaps to consider a reduction in the failure to pay penalty for those taxpayers that enter into an installment agreement, which would give some incentive, but yet not serve as a disincentive for filing a fully paid return.

Chairman JOHNSON. Does the IRS currently have much discretion in regard to penalties in the process of developing an installment agreement?

Mr. BROWN. Well, the penalty that is imposed in this case is a failure to pay penalty cost, which is not imposed if there is reasonable cause for the failure to pay. So in current law, if a taxpayer has reasonable cause for the failure to pay, the penalty should not be imposed.

My understanding is that the—in practice, a large number of the installment agreements that are entered into involve situations where under at least traditional standards there would not be reasonable cause for the failure to pay, and, therefore, I don't know how much activity there actually is in disputing the imposition of the penalty as opposed to simply accepting it as properly applicable in those cases.

Chairman JOHNSON. For instance, generally, does documented inability to pay represent reasonable cause?

Mr. BROWN. There are standards, I believe, in the penalty handbook, about reasonable cause, and I think the answer is if somebody—I may ask someone to correct me if I am wrong, but I think the answer is that if the—inability to pay currently may be reasonable cause or may not be depending on the circumstances which led up to the person being in that situation; in other words, that if the person could prove or demonstrate that their inability to pay was due to circumstances beyond their control and was—the inability to pay was truly inability to pay as opposed——

Chairman JOHNSON. Mr. Brown, I guess what I am thinking about is, one of the most difficult situations that I see people facing and one of the ones in which they feel abused by the IRS is a situa-

tion in which a small business man goes through a downturn, and, in fact, his overhead is higher than his revenues, and yet, for a variety of reasons, it appears he should pay taxes.

It appears there really is an inability to pay. Sometimes this has to do with cash flow and whether people are paying you. Certainly in New England that has been a very big problem in recent years.

Mr. BROWN. I think that the——

Chairman JOHNSON. There has been a sort of unwillingness on the part of the IRS to see that as a reason to waive penalties. I recently saw a business actually go under, not because the person couldn't pay the taxes from the past, but they couldn't pay the penalties and the interest that had accrued.

Mr. BROWN. Uh-huh. It certainly is a difficult balancing judgment that we have to make. I guess I would like to point out that our people hopefully have in mind that they are working on your behalf, and they have to try to be reasonable in evaluating when someone is making choices about who should be paid first, is it the IRS or is it another creditor, or, you know, is it their employees or whatever, you know, that they have to say, well, there has to be someone there to protect the government's interest, and perhaps they can't always be as lenient as people would like them to be.

Chairman JOHNSON. This is a longer discussion, and also it is very difficult to provide flexibility, and I appreciate that. But it is something that we do have to look at in terms of a taxpayer-friendly IRS.

I do commend you on the parts of your testimony that reflect the IRS work in recent years, and particularly in the last year, to write clear rules and governance of a number of complicated situations because, as you say, this does have to be a matter of law. But you have really tried through regulation—and through changes to try to clarify some of these situations, and I appreciate that.

Below that is this issue of judgment and enforcement and the interaction of all of these things that have to be addressed. Thank you, and I am going to yield to my colleague, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman.

Mr. Brown, what are your views on the proposal that we will hear about later from the American Institute of Certified Public Accountants for limiting the IRS access to taxpayer books and records to certain factual information?

Mr. BROWN. If you are referring to the proposal that I think you are, that was introduced, I understand, today by Mrs. Dunn and Mr. Tanner; the Taxpayer Confidential Act?

Mr. COYNE. Right.

Mr. BROWN. We have serious concerns about that act as currently—as proposed. In the first place, it would affect a lot of our ability to enforce the law where the issue itself depends on things that might not be considered purely factual. In other words, there are provisions of the Code that depend on someone's motive or intent or purpose. There are longstanding doctrines about business' purpose which may make a difference in the tax consequences of a transaction. And to the extent that we were unable to look for, ask questions about those kinds of issues, I think you would be creating an opportunity for people to stretch the boundaries of the tax

law in areas where I believe the Subcommittee would think it is most inappropriate.

For example, tax shelters, tax-motivated transactions, those are the kinds of transactions that our system has typically tried to police, at least in part, through tests of—that look to motive or intent or business purpose. And this provision, as I understand it is drafted, I think would severely interfere with our ability to get that kind of information.

Second, we are concerned that the provision as drafted seems to be tied to information on returns or tax returns, and a lot of the responsibilities that have been assigned to the IRS might not be seen as directly related to tax returns.

For example, you expect us to determine whether pension plans are qualified or not, whether charities are eligible for tax-exempt status or not, whether tax-exempt bonds are, in fact, eligible for tax exemption or not. And to the extent that the documents or the information that we need to make those determinations would suddenly become unavailable to us, I think it would make enforcement of whole sections of the tax law quite problematic.

Beyond that, I have to say, although I understand that this bill was introduced today, I actually haven't—I am not sure I have seen the draft of the actual language, and so we would like to have an opportunity to comment further once we have actually seen the bill itself.

Mr. LUBICK. We certainly concur with Mr. Brown's statement. We think this is a bad idea to be extending privilege where it doesn't exist today. In this area alone there is certainly no such privilege in SEC matters or anything else. And I think it may proceed from the assumption that there are—that lawyers have an unlimited privilege, and our research indicates that this may not be true; that there is a lot of history that is involved in privilege, and I think extending it is a mistake.

But beyond that, Mr. Coyne, as I indicated earlier, I think one of the things that is important to the working of the self-assessment, voluntary compliance system is that all the cards of both sides are laid on the table, the taxpayer as well as the government, and then we decide.

That is not to say that a taxpayer shouldn't take any reasonable legal position based upon his factual situation to his best advantage, but at least there should be full disclosure, and the Congress has provided that in many situations by requiring a disclosure on returns, and, therefore, I think that anything that cuts back on the ability of both parties to play with open hands, I think, is a mistake and jeopardizes this system.

Mr. COYNE. Thank you.

Mr. Lubick, I wonder if you would give us your views on Congressman Traficant's bill, which would shift the burden of proof to the IRS in civil tax cases.

Mr. LUBICK. We think that would be a gargantuan mistake. The question of burden of proof is such that the person who has control of the facts ought to be the one to come forward. The person who has control of the facts is obviously the taxpayer, and if that burden is placed upon the Service, you are going to end up with many more of these bad incidents as we have heard about, because the

Service will have to be much more intrusive to try and find out whether there is a liability.

It seems to me the Service would have at least one hand tied behind its back if it had to do this investigation of proving something without having the wherewithal.

The fact that the burden of proof is on the taxpayer is—means that the taxpayer has to lay out the facts, and that is what makes the self-assessment system work.

Now, what is the burden of proof you are talking about? If the IRS alleges unreported income, the burden of proof on the taxpayer is to show that the IRS—under the decisions, that the IRS proposal was wrong. Burden of proof is not necessarily to show what the correct amount of tax was, but simply to show that the IRS was wrong. And it seems to me, under the decisions, that is certainly a reasonable burden to put upon the taxpayer.

If you change the burden of proof, I don't know what would happen to many rules that have been longstanding. Right now, where a taxpayer claims an amount and doesn't substantiate it, there was a decision in the Second Circuit, *George M. Cohan,* where the court will make a decision based upon the evidence that it sees bearing heavily against the taxpayer who created this own—the situation of doubt through his own failure to keep records.

Now, if we shift the burden of proof, you are encouraging nonrecordkeeping or poor recordkeeping. It just seems to me it would be a very serious breakdown of the enforcement mechanism.

And remember that when we are dealing with criminal cases, or when we are dealing with fraud cases, the burden of proof indeed is on the Internal Revenue Service. But when we are accounting for the proper reckoning of the bill each year, it is really essential that the taxpayer come forward with the facts, and the burden of proof should stay where it is.

Mr. BROWN. Mr. Coyne, can I just reiterate the last point that Mr. Lubick made? Because this issue is often confused when it is presented, and people say, well, the IRS presumes you are guilty until you prove yourself innocent. And it is important to understand that in the context of any criminal proceeding, in the context of any proceeding alleging fraud, the IRS does bear the burden of proof. It is only in the context of making accurate accounting of your civil tax liability where the burden of going forward with the evidence preventing the facts to the court is on the taxpayer.

Mr. COYNE. I wonder if you could give me your views on the proposal that we will hear later on in this hearing from the Software Manufacturers Association that would prohibit the IRS from obtaining source code data from computer software manufacturers.

Mr. BROWN. We think that would be a serious mistake.

I have to be somewhat cautious here because there are matters pending currently in litigation, and I don't want to try to get into the facts of any particular case. However, when you talk about the source code for computer software that is used to prepare returns, it seems to me very difficult to understand how the IRS could decide whether a return is prepared correctly if it can't know the decisions that were made in preparing the return.

And when you are talking about complicated returns, particularly—any return that is prepared with the aid of a computer pro-

gram, those decisions are embedded in the program. And so it is not simply a matter of adding 2 + 2 = 4. It is a decision of the program will ask for certain inputs and then will make decisions about how those inputs are translated into—combined and translated into numbers on the return.

And the Service simply—I believe, simply has to be able to ascertain what those decisions are and how they are being made. If the Service can't look at the underlying documentation, the underlying software, you don't know whether or not someone is actually implementing the law correctly.

Mr. COYNE. Thank you.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. I have a lot of questions, and I know we want to get to the next panel, so I will try to be as brief as possible.

The Commission, as you know, worked very closely with this Subcommittee in coming up with these taxpayer provisions which ended up in H.R. 2292. There are 20-odd provisions, and as I count it this afternoon, the administration supports in full, without qualification, probably 9 or 10, and then there are probably another 7 that you support with some qualification in part, which is 16 out of 21; not bad.

Mr. LUBICK. That is pretty good.

Mr. PORTMAN. Yes, we are getting there. And Mr. Coyne has asked a lot of the questions that I think we need to hear from you on before we hear from some Advocates in the next panel with regard to some additional rights that we may want to add to this legislation.

If I have time, I am going to ask a couple of followup questions on that. But let me jump to the provisions that are in the legislation with regard to the Taxpayer Advocate.

Mr. Monks, your testimony was very good. It almost seemed independent of Treasury at times, which I thought was——

Mr. MONK. Yes.

Mr. PORTMAN [continuing]. Rather remarkable.

You know, just joking.

I think what you have told us is that you agree with almost everything in the legislation. Section 301, as you know, contains the Taxpayer Advocate provisions. The one I am a little unclear on is the TAOs. We want to give you the authority to issue more taxpayer assistance orders. As I understand it, last year we issued, what, five TAOs? Is that correct?

Mr. MONK. That is true. That was in terms of enforced TAOs. But we assisted substantially more taxpayers in that process. Where you have to issue a TAO is where you have strong disagreement from the functional area, and the Advocate, the local advocate, cannot negotiate an effective solution, and they are forced to——

Mr. PORTMAN. Correct.

Mr. MONK [continuing]. That that position be taken.

Mr. PORTMAN. Right. In many of the cases, you negotiated something that was acceptable to your Advocates out in the field.

Mr. MONKS. Right.

Mr. PORTMAN. But the bottom line is out of thousands, there were five issued. My inference from your earlier testimony is that you would like to expand that authority also, but you are concerned that our legislation may inadvertently perhaps result in fewer TAOs, or at least less authority, because of the stipulation of specific provisions that the court can then say weren't all met. Is that your concern? Is that it?

Mr. MONKS. My concern is that it might focus on a certain—specific set of criteria, and I would like to have the field Advocates be able to consider everything in terms of making that hardship determination and whether the relief is appropriate. And the important measure in that process is not the fact that five TAOs were issued, but how many taxpayers were provided relief through the process.

I don't want to have a limiting impact through that legislation, and we are very willing to provide some language that we think will cover this specific area.

Mr. PORTMAN. Well, we concur on the fact that we want to give you expanded authority. We want to give you expanded independence, as you know, and I am very pleased that you agree with the vast majority of these changes to try to strengthen what was strengthened in TBOR 2.

Mr. BROWN. Mr. Portman.

Mr. PORTMAN. Yes.

Mr. BROWN. In fact, the Advocate has prepared his testimony independently, and if I could comment on those provisions that you are just referring to in 301, the Service would have some concerns about the first factor that is listed, because——

Mr. PORTMAN. This is why I didn't want to hear from Treasury; I just wanted to hear from the guy who is actually supposedly advocating for the taxpayer.

No, I am sorry. Go ahead, Mr. Brown. I do not have much time, so don't go into a lot of detail, please, because I do want to ask a couple more questions.

Mr. BROWN. We can discuss this with your staff later, if that is acceptable.

Mr. PORTMAN. Go ahead.

Mr. BROWN. OK. It seems to us that the definition of a significant hardship shouldn't be affected by whether or not the decision is substantively correct, either in terms of following a law or following a procedure. That factor is relevant to whether a decision was right or wrong and should be resolved, perhaps with the assistance of the Advocate, through the management structure by making the decision on the merits. We shouldn't——

Mr. PORTMAN. Right.

Mr. BROWN [continuing]. Confuse hardship with the merits of the position.

Mr. PORTMAN. But that is an important criteria to be considered in the taxpayer's case, if the regulations had been followed, the rules had been followed.

Mr. BROWN. It is important for it to be considered, and I would expect that if Mr. Monks or his office became aware of a case where he thought the rules had been followed, that he would bring that to the attention of the management officials, and that ultimately, if necessary, the Commissioner would decide whether in

his or her view the rules had been followed or not. But that issue doesn't seem to bear on the question of whether application of the rules creates a hardship or not.

Mr. PORTMAN. On the taxpayer.

I agree with you, there is some distinction there, but both are important, and you want to give the independence and you want to give them the ability to exercise that TAO when appropriate or to have that leverage to negotiate.

On the qualifications for the Advocate, understanding that they don't apply to you, do you have any concerns about the qualifications listed in the legislation? It is a big change.

Mr. MONK. I think we did propose some additional language to insert, in effect, that knowledge of the tax administration process would be a critical requirement.

Mr. PORTMAN. In addition to the other——

Mr. MONK. In addition to the other two, or at least considered equal or even above the other two elements that you had written into your bill.

Mr. PORTMAN. OK. Again, I think this is one of the major improvements that we can make through this process. I want to thank Mrs. Johnson for working on this last time. I think we have made it even better this time, particularly the idea of independence.

Thank you, Madam Chair.

Chairman JOHNSON. I thank you all very much. We will have continuing discussions on those areas where you have concerns but are interested in working with us, and we look forward to those, and they will include interested Subcommittee Members.

Let me convene the final panel, and we will work through their testimony and then take questions.

My mistake. GAO is next.

Mr. White, out of respect for the following panel, since this has gone on longer than we expected, if you could move ahead to the parts of your testimony that pertain most directly to the issues before us, I would appreciate it.

**STATEMENT OF JAMES WHITE, ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY LYNDA WILLIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES; AND TOM SHORT, ASSISTANT DIRECTOR**

Mr. WHITE. Madam Chairman, I will be brief. We are pleased to be here to assist the Subcommittee. With me is Lynda Willis, Director of Tax Policy and Administration Issues, and Tom Short, an Assistant Director.

You asked us to discuss various issues related to IRS audits. I want to make four points. First, IRS has limited data on the treatment of taxpayers and the burdens imposed on them during audits. IRS has begun tracking taxpayers' complaints about improper treatment, but it does not have data representative of all taxpayers.

Second, an important indicator that IRS uses to measure its overall audit performance is how much additional tax is rec-

ommended. However, without an indicator to balance taxes recommended against those actually collected, IRS auditors could have an incentive to recommend additional tax, even though the support is weak, forcing taxpayers to go through burdensome appeals.

Third, our work on one set of controversial audit techniques, those examining taxpayers' financial status, showed that IRS used these techniques in less than a quarter of its audits. We found that about 16 percent of the audits where they were used, these techniques did help to identify unreported income. However, in over three-quarters of the audits using these techniques, no changes resulting from the techniques were made.

Fourth, IRS is concerned that its ability to target the potentially most noncompliant taxpayers for audits is deteriorating. IRS concern arises because it last collected the data on which its audit selection formulas are based through audits of a random sample of taxpayers for tax year 1988. And that concludes my statement.

[The prepared statement and attachments follow:]

**Statement of James White, Associate Director, Tax Policy and Administration Issues, General Government Division, U.S. General Accounting Office**

Madame Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its inquiry into the rights of taxpayers and their treatment during audits of their tax returns by the Internal Revenue Service (IRS). Recently, taxpayers, tax professionals, and Congress have expressed concerns about how IRS treats taxpayers during audits and whether audits are overly burdensome. You asked us to discuss IRS' data on taxpayer complaints and the burden imposed on taxpayers as well as IRS' indicators for measuring audit performance. You also asked us to discuss our ongoing work for the Chairman of the House Committee on Ways and Means on IRS' use of a particular audit technique—reviews of taxpayers' financial status (i.e., their flow of income and expenses)—and IRS' methodology for selecting tax returns for audit.

Today, I would like to make four points taken from this ongoing work as well as from previous reports and testimonies.

—First, IRS has limited data on both the treatment of taxpayers and the burdens imposed on them during audits. IRS recently created a system to track taxpayers' complaints about improper treatment but IRS does not solicit input on all improper treatment. Similarly, IRS has no comprehensive definition of, and little data on, the burden its audits impose on taxpayers. IRS has recently developed a survey that will ask individual taxpayers about their satisfaction with various parts of the audit process but results will not be available until 1998. While recognizing the difficulties in collecting data from taxpayers about treatment and burden, we believe that this survey may have the potential to provide better information than presently exists.

—Second, IRS' Examination Division has various indicators and standards on audit performance. One measure IRS uses for audit performance is how much additional tax is recommended. IRS does not have a corresponding measure on how much of the recommended tax is ultimately collected after taxpayer appeals. Without an indicator to balance taxes recommended against those collected, IRS auditors could have an incentive to recommend taxes that would be unlikely to withstand a taxpayer challenge. IRS has nine audit standards. The standards focus on the efficient use of auditors' time and not on when they should use particular audit techniques. To ensure adherence to the standards, IRS relies on oversight by the auditors' managers. However, their workload limits their time for doing oversight.

—Third, our work on one set of audit techniques—those used in analyzing taxpayers' financial status to identify any unreported income—provided several interesting statistics. We estimated that IRS auditors used these techniques in less than a quarter of the audits completed in the time periods covered by our review. When used, financial status techniques were always part of an audit that included other techniques or methodologies. In about one-quarter of the audits in which financial status techniques were used, IRS did not have to contact the taxpayer to obtain information on the taxpayer's financial status beyond what was reported on the tax return. We also found that the use of financial status techniques has not increased

in recent years. Regarding revenue impact, we found that in about 16 percent of the cases where they were used, these techniques did help to identify significant amounts of unreported income—$10,000 or more. However, of the total audits in which these techniques were used, in over three-quarters no changes resulting from the use of these techniques were made to the income reported, although most of the audits resulted in some tax change for other reasons. Data are not available to permit either us or IRS to determine the additional burden imposed on taxpayers from the use of financial status techniques in audits.

—Fourth, IRS is concerned that its ability to target the potentially most noncompliant taxpayers for audits is deteriorating. IRS' concern arises because it has not been able to rely on its past approach for developing statistically valid research data that allowed IRS to create and periodically update formulas to target the returns with the most potential for noncompliance. IRS last collected these data through audits of a random sample of taxpayers for tax year 1988. IRS subsequently abandoned that approach due to concerns about its costs and to concerns from the public and Congress about the taxpayer burden involved with those audits. For context, we note that from the 1960s, when IRS first created its research-based audit formulas until it stopped gathering that research data after 1988, it had reduced the rate to which its audits made no recommended tax change from more than 40 percent to around 10 to 15 percent, depending on the type of return and the year of the audit.

I would like to discuss each of these points in more detail after providing an overview on why IRS audits tax returns and how IRS is supposed to do the audits.

## Overview of IRS Audits of Tax Returns

IRS Examination Division audits tax returns to ensure that taxpayers report and pay the amount of tax they owe. Because our tax system is based on self-assessment, IRS also does audits to induce taxpayer compliance and promote public confidence in the tax system.[1]

The income tax gap—the difference between taxes owed and taxes paid voluntarily and on time—is one reason why IRS seeks to provide an audit presence. Under IRS most recent estimate, the 1992 income tax gap for individuals exceeds $90 billion, of which about two-thirds can be attributed to individuals not reporting income on their tax returns.

In recent years, IRS has been auditing about one to two percent of the 100-million plus income tax returns filed annually by individual taxpayers.[2] IRS' policies and procedures are generally directed at selecting returns that appear to be most noncompliant. After selecting the returns, IRS audits them either (1) through 1 of its 33 district offices by meeting with taxpayers or their representatives or (2) through 1 of its 10 service centers by corresponding with the taxpayers. Since fiscal year 1992, these audits have been recommending between $5 billion to $8 billion in additional taxes each year. Appendix I of my statement summarizes selected audit statistics since fiscal year 1992.

IRS auditors are instructed to not only verify the eligibility and amounts for various types of tax deductions, credits, and exemptions, but to also look for any indications of unreported income. If auditors find such indications, they are to exercise their judgment in deciding whether to do further probes in an effort to determine whether the taxpayer underreported income.

To guide auditors, IRS manuals and publications have identified the rights of taxpayers during audits and the manner in which auditors should treat taxpayers. For example, IRS documents say that taxpayers have the right, among others, to know why IRS is asking for information about the tax return and to authorize another person to represent them during the audit. Through its documents and training programs, IRS instructs its audit staff to explain these rights to the audited taxpayer and to protect those rights. In addition, audit staff are instructed to protect taxpayers' privacy as well as treat them with professionalism and courtesy.

## IRS Data on Audit Burden and Taxpayer Complaints about Treatment

Recently, taxpayers, tax professionals, and Congress have criticized IRS for treating taxpayers improperly and imposing unnecessary burdens during audits. At a

[1] IRS also induces compliance through taxpayer assistance, third-party reporting to IRS of payments (such as wages and interest) made to taxpayers, computer matching of tax returns to third-party data, income tax withholding, and penalties for noncompliance.

[2] IRS also annually audits tens of thousands of income tax returns filed by corporations and partnerships as well as thousands of other types of returns such as those filed to report estate tax, gift tax, employment tax, and excise tax.

general level, these criticisms have asserted that auditors lacked sufficient experience, training, motivation, or competence. Specific criticisms have focused on a range of asserted IRS behaviors, including:

- subjecting compliant taxpayers to unnecessary audits, resulting in no change to the tax liability reported on the tax returns;
- wasting taxpayers' time during the audit by asking for irrelevant documentation or by delving into issues that are minor or personal; and
- treating taxpayers unprofessionally or abusively, regardless of whether they underpaid their taxes, by lying, making threats, applying pressure, and the like.

IRS has limited data for use in responding to such assertions. With respect to unprofessional or improper treatment, in 1994 and 1996, we reported that IRS lacked comprehensive data on the nature and magnitude of the complaints as well as their resolutions.[3] Nor did IRS have clear definitions that allowed it to determine whether these complaints indicated auditor behaviors that were "abusive" or "unnecessary."

Since our 1996 report, IRS has developed a definition and tracking system for complaints about improper treatment. IRS defines a complaint as an allegation by taxpayers or their representatives that an IRS employee violated the law, regulation, or IRS rules of conduct or used inappropriate behavior (e.g., rude, overzealous, discriminatory, intimidating) or that an IRS system failed to function properly or within the prescribed time frame.

IRS' complaint tracking system does not systematically solicit input from taxpayers on their treatment during audits; rather, it records only those complaints initiated by taxpayers. As a result, neither we nor IRS have representative data on the extent to which auditors treat taxpayers improperly across the roughly 2 million audits.

Nevertheless, IRS does report the data the system collects on taxpayer complaints. For the first quarter of fiscal year 1997, IRS reported that taxpayers initiated 1,203 complaints, of which 290 (25 percent) involved audit staff. Of the 290 audit-related complaints, almost half involved assertions of inappropriate behavior by an auditor and about one-quarter of these complaints were addressed through counseling or administrative action or through the employee leaving IRS; for the remaining three-quarters of the complaints, IRS concluded that the employee's behavior was appropriate or that information provided by the taxpayer was not complete enough to take disciplinary action against the employee.

With respect to taxpayer burden, IRS has limited data on the burden—whether necessary or not—imposed by audits. For example, in fiscal year 1996, IRS tax auditors made no changes to 14 percent of the individual tax returns. However, IRS does not know the amount of burden imposed by these or other audits.

Data on burden can be difficult to collect for various reasons. Neither IRS nor its stakeholders have clear definitions or agreement on what constitutes audit burden as well as unnecessary burden. Further, our work has shown that taxpayers do not keep records on the amount of audit burden in terms of time or money.[4]

IRS has recently developed a survey that will ask individual taxpayers about their satisfaction with the audit process. Results will not be available until 1998. Recognizing the difficulties in collecting data about treatment and burden, we believe that this survey may begin to provide better information about taxpayer treatment and burden but its usefulness will need to be evaluated.

## IRS' Indicators To Measure the Impacts of Audits

IRS has established some indicators for measuring its audit performance. However, existing indicators primarily focus on interim results without also considering final results from the audits. Similarly, IRS has established nine audit standards to guide its auditors. However, the standards do not provide objective criteria on when to use particular audit techniques.

IRS' Examination Division has used additional tax recommended as an important indicator of audit performance (see app. II for the fiscal year 1997 indicators).[5] We

---

[3] *Tax Administration: IRS Can Strengthen its Efforts to See That Taxpayers are Treated Properly* (GAO/GGD–95–14), and *Tax Administration: IRS is Improving its Controls for Ensuring That Taxpayers are Treated Properly* (GAO/GGD–96–176, Aug. 30, 1996).

[4] *Tax System: Issues in Tax Compliance Burden,* (GAO/T–GGD–96–100, Apr. 3, 1996) and *Tax System Burden: Tax Compliance Burden Faced by Business Taxpayers,* (GAO/T–GGD–95–42, Dec. 9, 1994).

[5] Taxpayers do not necessarily have to pay the recommended taxes. Taxpayers may challenge them through administrative channels within IRS or the courts. If they win the challenge, the recommended taxes will not be assessed as owed. If they lose or raise no challenge, the recommended taxes are assessed.

expressed concerns in previous work that overreliance on additional taxes recommended as an indicator of performance could create undesirable incentives for auditors (and other Examination staff) to recommend taxes that would be unlikely to withstand a taxpayer challenge.[6] While we recognize the complexity of the Internal Revenue Code and the difficulties faced by both IRS and the taxpayer in determining the "correct tax," the fact remains that audit recommendations that do not withstand such a challenge may have imposed an unnecessary burden on the taxpayer. For this reason, in our previous work, we supported the need to measure taxes recommended but advocated balancing that indicator with others such as taxes ultimately collected.

Our work also pointed out that developing an indicator of taxes ultimately collected from audits would be challenging. For example, the time lag between an audit and the ultimate tax collected makes linking the two problematic. IRS is working on developing a way of determining the ultimate taxes collected.

In addition to indicators of audit performance, IRS also has nine audit standards to provide guidance to auditors on minimizing the time spent on an audit, checking large and unusual claims on tax returns, probing for unreported income, and preparing adequate audit workpapers (see app. III for all nine standards). These nine standards do not address the proper treatment of taxpayers. Further, although the standards provide guidance on the proper depth and breadth of audits given the time available, they provide little objective guidance to auditors on when to use particular audit techniques such as those related to an analysis of a taxpayer's financial status.

To ensure adherence to the standards, IRS relies on managers' oversight of auditors. However, according to IRS officials, these managers cannot review all audits because their workloads limit the time available for review. As audits close throughout the year, separate groups of IRS staff supplement the managerial review process by reviewing a small sample of audits to measure adherence to the nine standards (see appendix III for measurement results in fiscal years 1992 through 1996).

## IRS' Use of Financial Status Techniques

Given recent complaints about the asserted burdens and intrusions associated with IRS' financial status audit techniques, the Chairman of the House Committee on Ways and Means asked us to report on the frequency and results of IRS' use of these techniques. IRS uses these techniques to identify unreported income. During our analyses of audits done in 1992–93 and 1995–96, we found that IRS relied primarily on two financial status techniques:[7]

1) Cash transaction analysis (or cash-T), in which the auditor uses the tax return and other sources to ensure that adequate income has been reported on the return to cover expenses. In deciding to use this technique, auditors may first do a preliminary cash-T. It differs from the regular cash-T in that the auditor does it before meeting with taxpayers, relying on information reported on tax returns.

2) Bank deposit analysis, in which the auditor verifies that the taxpayer's bank deposits are consistent with the income reported on the tax return.

To do our work, we randomly sampled from the universe of audits closed in IRS districts in which IRS scheduled meetings with taxpayers to review their records. These samples covered 1992–93 and 1995–96 and were both projectable to universes of about a half million audits.

On the basis of our analysis of these two samples, we estimate that the use of financial status techniques had not increased over the time frames we reviewed—the techniques were used in about one-quarter of the audits in each of our two universes. Financial status techniques were never used alone; they were always part of audits that included other audit techniques to explore issues other than unreported income, such as overstated deductions.

These techniques imposed no or little additional burden on taxpayers in some of the audits where they were used. For example, IRS auditors used just the preliminary cash-T in 23 percent of the 1995–96 audits that used financial status techniques. The preliminary cash-T technique imposes no additional burden on the taxpayer because the auditor relies on the information on the tax return and does not

---

[6] *Tax Administration: Compliance Measures and Audits of Large Corporations Need Improvement* (GAO.GGD–94–70, Sept. 1, 1994) and *Tax Administration: Factors Affecting Results From Audits of Large Corporations* (GAO/GGD 97–62, Apr. 17, 1997).

[7] Other techniques include an analysis of (1) a taxpayer's net worth and (2) a business taxpayer's reported cost of goods sold and data on average markups within the specific business to estimate gross receipts generated by that taxpayer.

have to contact the taxpayer to obtain additional information or explanations to complete this technique.

We found that use of the financial status techniques in some cases helped to identify significant amounts of unreported income—$10,000 or more—that IRS would not have otherwise found. However, over three-quarters of the audits in which these techniques were used resulted in no changes that were directly attributable to the use of these techniques, even though IRS did find noncompliance in most of these audits through other techniques.

While neither we nor IRS know the actual burden imposed on taxpayers, our review of IRS' workpapers illustrated some conditions under which use of certain techniques may impose additional burdens. For example, a bank deposit analysis can be very burdensome if the auditor asks for records on many bank accounts and asks many questions about the deposits in those accounts. A regular cash-T may or may not be very burdensome, depending on the number of contacts with taxpayers to request information and the amount of information requested.

BARRIERS TO SELECTING THE MOST NONCOMPLIANT TAX RETURNS FOR AUDIT

As discussed in previous reports, IRS is concerned about its ability to objectively select tax returns so that it focuses on the most noncompliant taxpayers.[8] IRS' concerns arise because it has not been able to rely on its past approach for developing statistically valid research data that allowed IRS to create and periodically update formulas to target the returns with the most potential for noncompliance. IRS refers to these as discriminant function (DIF) formulas, which have served as the major method for selecting returns for audit.[9] IRS fears that its DIF formulas have become imprecise because the formulas use outdated statistical data.

In past years, IRS collected the statistically valid research data under its Taxpayer Compliance Measurement Program (TCMP). TCMP involved full-scale audits of a random sample of tax returns—usually for about 50,000 individual taxpayers every 3 years. In 1995, IRS abandoned this approach due to concerns about its costs and to concerns from the public and Congress about the taxpayer burden involved with those audits. As a result, IRS' last TCMP covered tax year 1988.

In a 1996 report, we discussed IRS' need for compliance data that are statistically valid and more current.[10] IRS needs the data not only to update its DIF formulas but also to support most of its compliance programs. Accordingly, we recommended that IRS develop a cost-effective, long-term strategy to ensure the continued availability of such compliance data.

Since IRS started to use DIF in the 1960s to better target its audits through fiscal year 1996, IRS has reduced the rate at which its auditors made no tax changes from more than 40 percent of the audited returns to around 10 to 15 percent, depending on the type of return and the year of the audit. IRS is concerned that as time passes, DIF's precision in identifying noncompliant returns may decrease unless IRS updates the formulas with valid data, and that as a result, more and more compliant taxpayers will be unnecessarily burdened with an audit. We are now designing a study of this issue at the request of the Chairman of the House Committee on Ways and Means.

Madam Chairman, this concludes my testimony. I would be pleased to answer any questions you or other members of the Subcommittee may have.

**Appendix I**

[8] *Tax Research: IRS Has Made Progress But Major Challenges Remain,* (GAO/GGD–96–109, June 5, 1996); *Tax Administration: Alternative Strategies to Obtain Compliance Data* (GAO/GGD–96–89, Apr. 26, 1996); *Tax Gap: Many Actions Taken, But a Cohesive Compliance Strategy Needed* (GAO/GGD–94–123, May 11, 1994); and *Tax Administration: IRS's Plans to Measure Tax Compliance Can Be Improved* (GAO/GGD–93–52, Apr. 5, 1993).

[9] *Tax Administration: Audit Trends and Results for Individual Taxpayers* (GAO/GGD–96–91, Apr. 26, 1996). IRS has up to 40 methods for identifying returns to audit. Appendix IV summarizes the number of audits selected by the major methods for fiscal years 1992 through 1996.

[10] *Tax Administration: Alternative Strategies to Obtain Compliance Data* (GAO/GGD–96–89, Apr. 26, 1996).

SELECTED INFORMATION ABOUT THE RETURNS FILED AND EXAMINED AND RECOMMENDED ADDITIONAL TAXES (Fiscal Years 1992–96)

| Description | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|
| Number of returns | | | | | |
| Filed | 152,031,900 | 153,453,600 | 152,732,800 | 154,293,700 | 155,279,600 |
| Examined | 1,452,009 | 1,300,230 | 1,426,573 | 2,100,144 | 2,136,819 |
| Percent coverage | .96 | .85 | .93 | 1.36 | 1.38 |
| Recommended additional tax and penalties (in billions) | $26.9 | $23.1 | $23.9 | $27.8 | $28.1 |
| Individual returns | 6.3 | 5.7 | 6.2 | 7.8 | $7.6 |
| Corporate returns | 18.1 | 14.7 | 15.1 | 17.7 | $18.0 |
| All other[1] | 2.5 | 2.7 | 2.6 | 2.3 | $2.5 |
| Average tax and penalty per return examined by | | | | | |
| Revenue agent for non-CEP[2] | $25,161 | $24,704 | $18,177 | $21,237 | $24,407 |
| Revenue agent for CEP | 3,940,148 | 2,700,352 | 3,279,298 | 4,032,528 | 3,998,409 |
| Tax auditor | 2,280 | 2,625 | 3,113 | 3,497 | 3,051 |
| Service center | 2,541 | 2,934 | 1,945 | 1,427 | 1,733 |

[1] Other includes fiduciary, estate, gift, employment, excise, windfall profit, and miscellaneous taxes.
[2] CEP = Coordinated Examination Program, under which IRS audits the largest corporations.

## Appendix II

IRS EXAMINATION DIVISION MEASURES FOR 1997

Basic measures across Examination activities include

1. Amount of additional tax and penalties recommended.
2. Percentage of additional recommended amounts plus interest amounts that were collected before IRS issued the second notice on the amounts that were assessed.
3. Average number of days that an audit case remains open.
4. Amount of additional tax and penalty recommended as well as the amount of tax protected in audits divided by the total full-time-equivalent staffing invested.

For the Coordinated Examination Program (CEP), additional measures include

1. Average number of tax years for tax returns filed by a CEP taxpayer that have not yet been audited.
2. Amount of additional tax and penalty recommendations that CEP taxpayers agreed to pay minus amount overassessed divided by the total full-time-equivalent staffing invested.
3. Amount of total adjusted revenues divided by the total full-time-equivalent staffing invested.

## Appendix III

IRS' EXAMINATION QUALITY MEASUREMENT SYSTEM

The Office of Compliance Specialization, within IRS' Examination Division, has responsibility for Quality Measurement Staff operations and the Examination Quality Measurement System (EQMS). Among other uses, EQMS measures the quality of closed audits against nine IRS audit standards. The standards address the scope, audit techniques, technical conclusions, workpaper preparation, reports, and time management of an audit. Each standard includes additional key elements describing specific components of a quality audit. Table III.1 summarizes the standards and the associated key elements.

Table III.1: Summary of IRS' Examination Quality Measurement System (EQMS) Auditing Standards (as of October 1996)

| No. | Standard | Key elements | Purpose | Overview |
|---|---|---|---|---|
| 1 | Considered large, unusual, or questionable items. | A. Balance sheet and Schedule M considered.<br>B. Income, deduction, and credit items considered.<br>C. Scope of examination was appropriate. | Measures whether consideration was given to the large, unusual, or questionable items in both the precontact stage and during the course of the examination. | This standard encompasses, but is not limited to, the following fundamental considerations: absolute dollar value, relative dollar value, multiyear comparisons, intent to mislead, industry/business practices, compliance impact, and so forth. |

Table III.1: Summary of IRS' Examination Quality Measurement System (EQMS) Auditing Standards (as of October 1996)—Continued

| No. | Standard | Key elements | Purpose | Overview |
|---|---|---|---|---|
| 2 | Probes for unreported income. | A. Consideration of internal controls for all business returns.<br>B. Consideration of books and records.<br>C. Consideration of financial status.<br>D. Appropriate use of indirect methods. | Measures whether the steps taken verified that the proper amount of income was reported. | Gross receipts were probed during the course of examination, regardless of whether the taxpayer maintained a double entry set of books. Consideration was given to responses to interview questions, the financial status analysis, tax return information, and the books and records in probing for unreported income. |
| 3 | Required filing checks. | A. Consideration of prior and subsequent year tax returns.<br>B. Consideration of related returns.<br>C. Compliance items considered. | Measures whether consideration was given to filing and examination potential of all returns required by the taxpayer, including those entities in taxpayer's sphere of influence/responsibility. | Required filing checks consist of the analysis of return information and, when warranted, the pick-up of related, prior, and subsequent year returns. In accordance with Internal Revenue Manual 4034, examinations should include checks for filing information returns. |
| 4 | Examination depth and records examined. | A. Adequate interviews conducted.<br>B. Adequate exam techniques used.<br>C. Fraud adequately considered and developed.<br>D. Issues sufficiently developed. | Measures whether the issues examined were completed to the extent necessary to provide sufficient information to determine substantially correct tax. | The depth of the examination was determined through inspection, inquiry, interviews, observation, and analysis of appropriate documents, ledgers, journals, oral testimony, third-party records, etc., to ensure full development of relevant facts concerning the issues of merit. Interviews provided information not available from documents to obtain an understanding of the taxpayer's financial history, business operations, and accounting records in order to evaluate the accuracy of books or records. Specialists provided expertise to ensure proper development of unique or complex issues. |
| 5 | Findings supported by law. | A. Correct technical or factual conclusions reached. | Measures whether the conclusions reached were based on a correct application of tax law. | This standard includes consideration of applicable law, regulations, court cases, revenue rulings, etc., to support technical or factual conclusions. |
| 6 | Penalties properly considered. | A. Recognized, considered, and applied correctly.<br>B. Penalties computed correctly. | Measures whether applicable penalties were considered and applied correctly. | Consideration of the application of appropriate penalties during all examination is required. |

Table III.1: Summary of IRS' Examination Quality Measurement System (EQMS) Auditing Standards (as of October 1996)—Continued

| No. | Standard | Key elements | Purpose | Overview |
|---|---|---|---|---|
| 7 | Workpapers support conclusions. | A. Fully disclose audit trail and techniques.<br>B. Legible and organized.<br>C. Adjustments in workpapers agree with 4318, 4700, and reports.<br>D. Activity record adequately documents exam activities.<br>E. Disclosure .. | Measures the documentation of the examination's audit trail and techniques used. | Workpapers provided the principal support for the examiner's report and documented the procedures applied, tests performed, information obtained, and the conclusions reached in the examination. |
| 8 | Report writing procedures followed. | A. Applicable report writing procedures followed.<br>B. Correct tax computation. | Measures the presentation of the audit findings in terms of content, format, and accuracy. | Addresses the written presentation of audit findings in terms of content, format, and accuracy. All necessary information is contained in the report, so that there is a clear understanding of the adjustments made and the reasons for those adjustments. |
| 9 | Time span or time charged. | A. Examination time commensurate.<br>B. Exam initiation.<br>C. Examination activities.<br>D. Case closing. | Measures the utilization of time as it relates to the complete audit process. | Time is an essential element of the auditing standards and is a proper consideration in analyses of the examination process. The process is considered as a whole and at examination initiation, examination activities, and case-closing stages. |

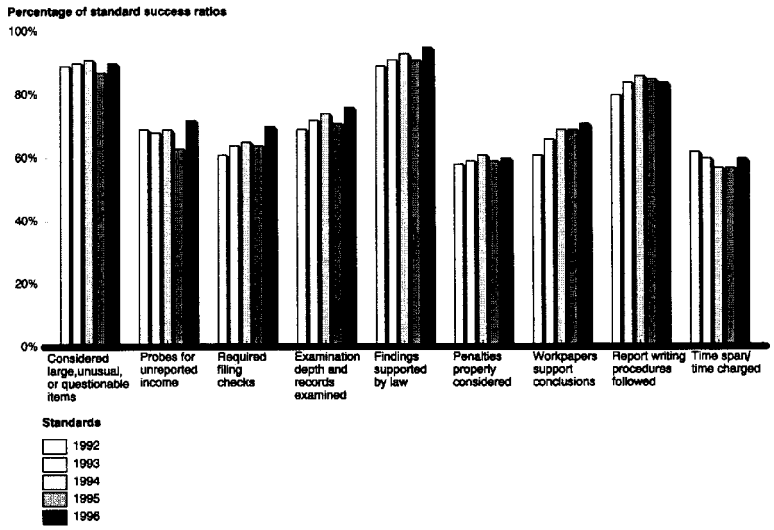
Source: IRS data.

*Standard Success Rate*

EQMS quality reviewers use the key element definitions to determine whether an audit adhered to the standard. Thus, adherence to audit quality is measured by the presence or absence of associated key elements. For a standard to be rated as having been met, each of the associated key elements must also be rated as met or not applicable. If the audit does not demonstrate the characteristics described by one of the key elements, then the standard is rated as not met.

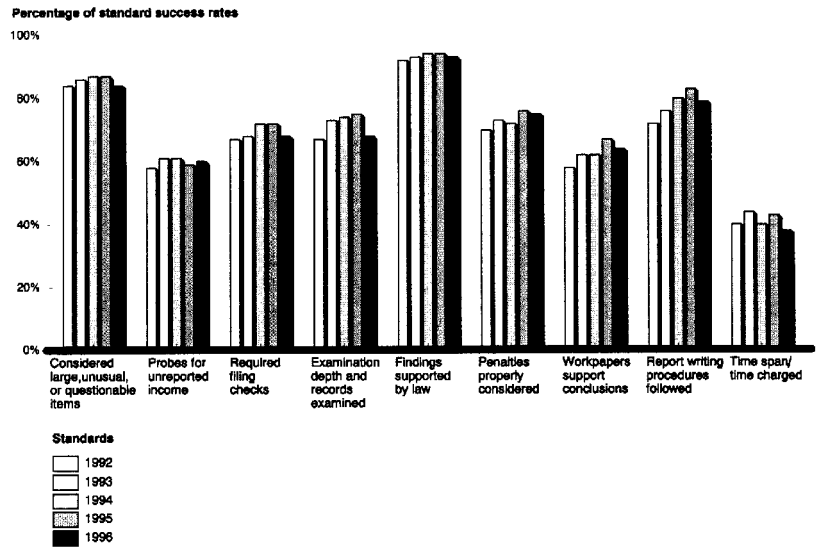
One measure that IRS uses to evaluate the audit quality is the standard success rate. It measures the percentage of cases for which all the underlying key elements of each standard are rated as having been met. According to IRS, this measure is useful for determining whether a case is flawed and in what area. Figures III.1 and III.2 show the standard success rates for each of the standards for fiscal years 1992–96 for office and field audits, respectively.

Figure III.1: Standard Success Rates for Office Audits (Fiscal Years 1992-96)




Source: IRS data.

Figure III.2: Standard Success Rates for Field Audits (Fiscal Years 1992-96)

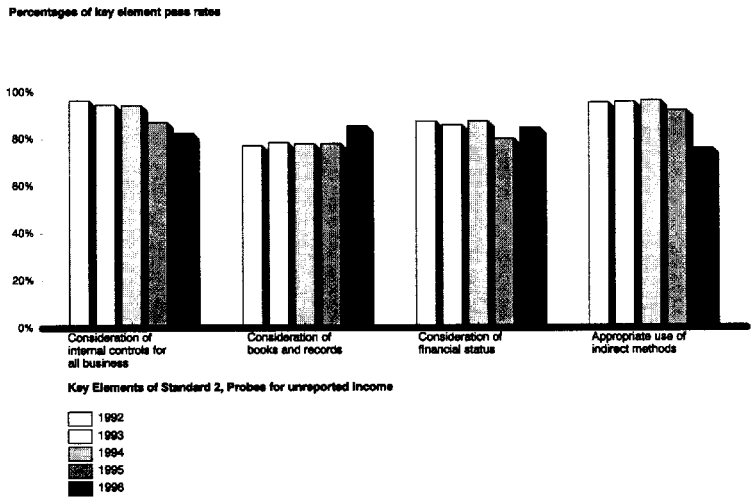



Source: IRS data.

*Key Element Pass Rate*

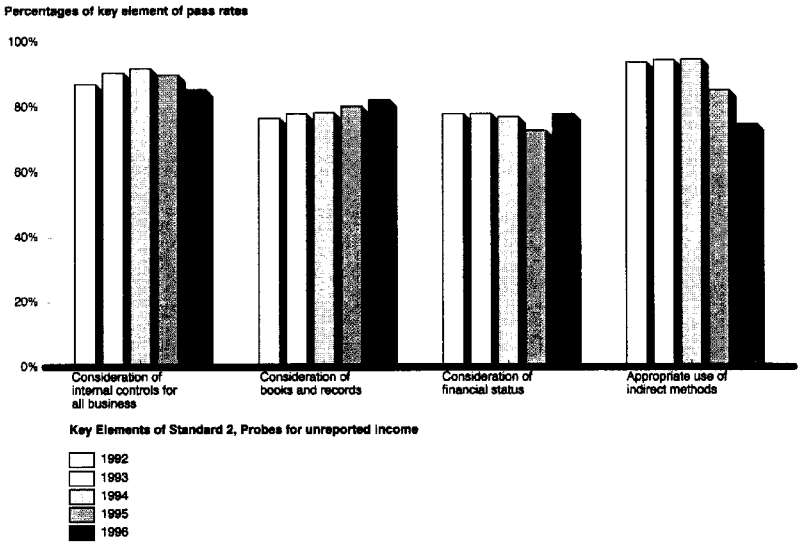
IRS also uses the key element pass rate as a measure of audit quality. This measure computes the percentage of audits demonstrating the characteristics defined by the key element. According to IRS, the key element pass rate is the most sensitive measurement and is useful when describing how an audit is flawed, establishing a baseline for improvement, and identifying systemic changes. Figures III.3 and III.4 show the pass rates for the key elements of standard 2 for fiscal years 1992 through 1996 for office and field audits, respectively.

Figure III.3: Key Element Pass Rates for Key Elements of Standard 2 for Office Audits (Fiscal Years 1992-96)




Source: IRS data.

Figure III.4: Key Element Pass Rates for Key Elements of Standard 2 for Field Audits (Fiscal Years 1992-96)




Source: IRS data.

**Appendix IV**

NUMBER AND PERCENT OF INDIVIDUAL RETURNS AUDITED BY AUDIT SOURCE (Fiscal Years 1992–96)

| Audit sources | Fiscal year 1992 | | Fiscal year 1993 | | Fiscal year 1994 | | Fiscal year 1995 | | Fiscal year 1996 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Number | Percent | Number | Percent | Number | Percent | Number | Percent | Number | Percent |
| DIF/DIF related | 452,445 | 38% | 372,116 | 35% | 239,557 | 20% | 263,200 | 14% | 351,867 | 18% |
| Nonfilers | 119,865 | 10 | 190,809 | 18 | 402,435 | 33 | 410,612 | 21 | 212,226 | 11 |
| Tax shelter related | 101,453 | 8 | 48,070 | 5 | 29,687 | 2 | 27,473 | 1 | 20,300 | 1 |
| Self-employment tax | 71,126 | 6 | 46,310 | 4 | 43,032 | 4 | 48,578 | 3 | 40,601 | 2 |
| Regular classification | 52,528 | 4 | 50,709 | 5 | 47,170 | 4 | 46,637 | 2 | 48,534 | 3 |
| State information | 48,418 | 4 | 3,564 | 0 | 4,573 | 0 | 3,2100 | 7 | 1,582 | 4 |
| Service center studies and tests | 43,333 | 4 | 20,059 | 2 | 22,825 | 2 | 25,026 | 1 | 18,684 | 1 |
| Compliance projects | 40,403 | 3 | 44,267 | 4 | 41,959 | 3 | 38,624 | 2 | 45,680 | 2 |
| Claims for refund | 33,163 | 3 | 37,203 | 4 | 26,412 | 2 | 23,175 | 1 | 31,495 | 2 |
| Return preparers | 27,706 | 2 | 28,231 | 3 | 27,708 | 2 | 26,542 | 1 | 33,637 | 2 |
| Non-DIF multiyear | 26,866 | 2 | 29,373 | 3 | 26,742 | 2 | 24,926 | 1 | 29,927 | 2 |
| Unallowable items | 13,117 | 1 | 12,099 | 1 | 134,007 | 11 | 761,886 | 40 | 824,721 | 42 |
| Other sources | 175,596 | 15 | 176,156 | 16 | 179,600 | 15 | 219,548 | 11 | 212,306 | 11 |
| Total | 1,206,019 | 100% | 1,058,966 | 100% | 1,225,707 | 100% | 1,919,437 | 100% | 1,941,560 | 100% |

Note 1: For this table, we used the format from our 1996 report on audit trends (GAO/GGD–96–91, Apr. 1996). That format listed the top 10 sources for each of the fiscal years 1992 through 1994. Using that format, we updated the numbers and percentages for those categories for fiscal years 1995 and 1996.

Note 2: See next page for definitions of terms used in this table.

Note 3: Percentages are the percent of total audits for the year and have been rounded to the nearest whole percent.

Source: GAO analysis of IRS data.

DEFINITIONS OF AUDIT SOURCES

*Claims for Refund*

Ammended returns audited because of taxpayers' claims for refunds.

*Compliance Projects*

Returns identified through IRS' information gathering projects.

*DIF/DIF Related*

Returns selected on the basis of a computer-generated score (the scoring is based on an analysis technique known as discriminant function). Also included are related returns identified during an audit of a DIF-source return and related returns from prior or subsequent years for the same taxpayer.

*Non-DIF Multiyear*

Related returns from prior or subsequent years for the same taxpayer, when the initial source was other than a DIF-source return.

*Nonfilers*

Audits initiated against known taxpayers who did not file a return with IRS.

*Other Sources*

Over 25 other audit sources, such as referrals from other IRS Divisions, which were not one of the 10 largest sources during the period of our review.

*Regular Classification*

Manually selected returns for audit that do not result from other specified audit sources.

*Return Preparers*

Returns identified for audit due to questionable tax preparers.

*Self-Employment Tax*

Returns involving self-employment tax issues identified by IRS service center examination staff.

*Service Center Studies and Tests*

Returns identified through service center projects initiated by the IRS National Office.

*State Information*

Returns identified from various state sources, generally under exchange agreements between IRS and the states.

*Tax Shelter Related*

Related returns of partners, grantors, beneficiaries, and shareholders identified during audits of either partnerships, fiduciaries, or Subchapter S corporations involving potential tax shelter issues.

*Unallowable Items*

Returns involving refundable credits and dependency exemptions, such as the Earned Income Tax Credit, identified by service center examination staff.

---

Chairman JOHNSON. We will hear testimony that will look to narrow the summons authority of the IRS and their right to ask for certain advice documents that they received. When you look at the conclusions that you have reached about their—use of some of their audit techniques, and particularly the result of seeking very extensive information, it suggests to me that perhaps they are looking for more information than is necessary.

Do you think that there is a need to reexamine the summons authority of the IRS?

Mr. WHITE. We have not done any work on that authority, so I am not in a position to comment.

Chairman JOHNSON. In the issue of targeting, you say in your testimony that the IRS is concerned that its ability to target the potentially most noncompliant taxpayers for audits is deteriorating. Is this because they have not done the kind of sampling investigation that they have been accustomed to doing?

Mr. WHITE. Part of their sample selection methodology was based on formulas that, in turn, were based on data that they collected from a random sample of taxpayers. They last did the audits of a random sample of returns for tax year 1988, and because of the length of time that has passed and the changes in the economy and tax law over time, they are concerned that their ability to target the most potentially noncompliant taxpayers is deteriorating.

Chairman JOHNSON. And you agree with that? You agree that their ability to target has deteriorated?

Mr. WHITE. We have work underway right now for the Chairman of the Ways and Means Committee looking at that issue.

Chairman JOHNSON. Thank you.

Would either of the others that are with you wish to comment? Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman.

I wonder if the GAO has any suggestions to make here today to the Oversight Subcommittee relative to the Taxpayer Bill of Rights legislation that we have before us, or that we are considering?

Mr. WHITE. I think what we have seen this week is that there are a whole range of problems that were uncovered. Some of them are policy problems that Congress will be dealing with. I would like to distinguish between the policy issues, though, and the administration of whatever reforms are enacted. And I think in terms of administration, the success of whatever reforms are enacted depends on successful implementation, successful administration, and successful management of those reforms by the IRS. And in turn, that administration and management depends on their having objective data, good performance indicators that they can track over time. The theme of my statement today is that they don't have enough of that kind of information.

Mr. COYNE. So we might want to take a look at that area for improved administration and management?

Mr. WHITE. Yes, because I think that is crucial to ensuring that any reform is successful.

Mr. COYNE. Thank you.

Chairman JOHNSON. Could I just follow up to ask you, the IRS does use performance standards to measure the performance of its employees and to motivate them to improve their performance. What is your evaluation of the influence of those performance standards?

Mr. WHITE. One example is taxes recommended, which are not used to evaluate the individual performance of employees, but we do have a concern there, because that is one of the primary measures that IRS examination division uses to report its performance. Our concern is that without a balance between taxes recommended and taxes ultimately collected after appeals, tax auditors at IRS may have an incentive to make weak recommendations that tax-

payers then have to go through a burdensome appeals process and ultimately get overturned, but only after going through that kind of process.

Chairman JOHNSON. You referred to the nine audit standards that the IRS has. Is any one of those associated with the taxpayer's rights?

Mr. WHITE. Not directly. The standards cover things like the scope of the audit, the length of time it took. Some of those standards get indirectly at things that impact taxpayers like the length of time that the audit takes, but there is not a standard that deals directly with proper treatment of taxpayers.

Chairman JOHNSON. That is interesting and useful for us to know.

Then just to enlarge briefly on your first point, because you were right, you were very short, you said the IRS has limited data on both the treatment of taxpayers and the burdens imposed on them during audits.

I want you to enlarge on that. Some of it I am familiar with, but I think we need on the record your evaluation of what information they do or do not have access to or have data on in regard to the treatment of taxpayers, and also the burdens imposed on taxpayers during audits.

Mr. WHITE. They have begun tracking taxpayers' complaints. They have a system that tracks taxpayers' complaints. However, they don't go out and solicit complaints from taxpayers, so they don't have representative data from taxpayers right now. Rather, they track the complaints that taxpayers take the initiative on and make to IRS.

Chairman JOHNSON. Do they track them by employee?

Mr. SHORT. No, they don't.

Chairman JOHNSON. Pardon?

Mr. SHORT. No.

Chairman JOHNSON. That was my understanding. So if complaints show up in an office, they don't know exactly who isn't paying attention, do they?

Mr. WHITE. They do investigate the complaints that they get, and there were 290 complaints in the first quarter of the year that were related to audits. And so they do make an effort to go back and try to see what the problem was; and if corrective or disciplinary action needs to be taken, they do that.

Mr. SHORT. Certainly they will know who the employee is to the extent they have enough information from that complaint, but they are not doing any kind of tracking of that employee through that system.

Chairman JOHNSON. Thank you.

Go ahead about other information in regard to the amount of work imposed on taxpayers during audits.

Mr. WHITE. As I said, they have little data, little representative data, on taxpayer complaints. They also have limited data on taxpayer burden. The information they do have is related to things like the number of no-change audits, audits where the auditors did not recommend a change to the tax due. They don't have good information on the burden that audits impose on taxpayers—and in

fairness to IRS, this kind of information is going to be very difficult to collect.

The reason that information will be difficult to collect is because the taxpayers themselves typically don't track the time that it takes them to go through an audit process with IRS.

Chairman JOHNSON. That is very useful to be reminded of at this point. In other words, they have data about the outcomes of audits, but not about the process of burden that audits impose. And during the last discussion in the Congress on the compliance audit process, that issue was a big issue, and we don't really know enough about it to be able to pull forward.

Actually, one of the suggestions that came out at that time was that we do a taxpayer compliance audit with people volunteering and being compensated for the time imposed. We certainly would then have learned a lot about that issue about which, as I take from your testimony, we know practically nothing.

Mr. WHITE. If the issue is the burden associated with audits, that is correct.

Chairman JOHNSON. Thank you.

Mr. Coyne.

Sorry. I recognized you, Mr. Portman.

Mr. PORTMAN. Thank you.

Ms. Willis, you were also before the Senate yesterday, I know. You survived the process.

I again appreciate your testimony on the exam program. I have one question for you with regard to H.R. 2292. One of the most important recommendations, I think, in the legislation has to do with setting new measures. Mr. Dolan talked about that being one of the three areas that he thought was most important taken from the testimony in the last few days in the Senate, that there needs to be new standards and measurements in place.

H.R. 2292, if you look at it, I think it is in title I, subtitle B, personnel flexibilities. Have you had a chance to look at that legislation with regard to the measurements, taking into account other factors such as taxpayer service, and taxpayer surveys?

Mr. WHITE. We are somewhat familiar with it, yes.

Mr. PORTMAN. OK. I just wondered if you had any comment on that, because I think the performance measurement and evaluation system for the employees is going to be a key to improving the exam program and the whole enforcement process. It is intended to take into account such factors as quality of service provided, accuracy of employees' work and taxpayer surveys. I just wondered if you could offer any suggestions as to other measures that might be appropriate or how you felt about those measures in H.R. 2292.

Mr. WHITE. I think the whole issue of measures is crucial, and I think it is much broader than just employee performance. It is organizationwide.

Mr. PORTMAN. Unit performance as well?

Mr. WHITE. Pardon me?

Mr. PORTMAN. When you say it is broader than employee performance, do you mean that units need to be measured also?

Mr. WHITE. Yes, the entire organization. And I think not just the bill, but also the government Performance and Results Act gets at this. I think the important thing here is to develop measures that

are connected to the ultimate goals that the Congress sets for the IRS, and that those measures then filter down, and then indicators are developed and data collected to allow objective tracking of performance with respect to those measures.

One key thing in that area, I think, is that outside stakeholders be involved in the process. This is not something that can be done internally by IRS. It is something that needs to involve outside stakeholders, and I think that is one of the strengths of the Results Act.

Ms. WILLIS. Mr. Portman, could I add something to that?

Mr. PORTMAN. Yes.

Ms. WILLIS. There has been a lot of discussion lately about IRS use of performance measures, and we focused on a specific performance measure yesterday. And I think it is important not to lose sight of the fact that what is key in developing performance measures is having a balanced set of performance measures; performance measures that measure everything that is important in terms of achieving the mission of the agency.

And one of the problems that we have with the performance measures currently on the board for IRS exam and collections is they don't have customer service-related performance measures, such as what we are talking about.

Mr. PORTMAN. That is what we are trying to address in the legislation.

Ms. WILLIS. And I think that is very important. Because in addition to collecting the money that is owed the government, which is obviously a very critical part of IRS mission, also part of their mission is providing service and reducing taxpayer burden. And we need to have countervailing measures to make sure that we are balanced across the board and we take all of these things into account.

And I think that is also very important in the cultural reforms that we are talking about. What we measure sends very important messages to employees about what is important, and when you only have one type or one set of performance measures, you are sending unbalanced messages; and that we not only need measures in terms of how well the process works, but also in terms of misconduct as it relates to taxpayers, how we treat taxpayers, and taxpayers' satisfaction with the system overall.

I would reiterate what Mr. White said; that is, a lot of this is going to be difficult. It is not easy to do. It is difficult to come up with measures, and it is difficult to come up with ways of actually quantifying change over time. But I think the difficulty does not mean we don't need to work on that and develop the measures so that we do have a balanced set of indicators to judge IRS performance.

Mr. PORTMAN. Ms. Willis, I know GAO is not in the habit of commenting on specific legislation, but I think you have just given an endorsement of the approach we are trying to take, and I would just say that the most important stakeholder is the taxpayer, and part of what we are trying to do is to provide a survey to the IRS supervisor of the actual IRS employee that is performing the audit, and that is part of the new standards that we would like to see ap-

plied, the new performance measurement that we would like to see applied to this legislation.

Thank you very much for your input.

Ms. WILLIS. Thank you.

Chairman JOHNSON. To that point, Ms. Willis, which I think is an excellent one, partly as a result of recent changes in Federal law, you really have a lot of experience now at looking across agencies at the effort to set performance goals. And we are really only at the beginning of looking at how do we help government set and achieve those goals. Thank you.

Thank you very much, Mr. White. I appreciate it.

We will now go to the final panel, and we will start with Pamela Olson, the vice chair of the section of taxation of the Bar Association. We have Joseph Lane from the Enrolled Agents; Michael Mares from the Tax Executive Committee, American Institute of Certified Public Accountants; Bob Kamman of the Taxpayers' Rights Project, of the National Taxpayers Union; Al Cors, Jr., the National Taxpayers Union; Roger Harris of the Federal Taxation Committee; Nina Olson of the Community Tax Law Project; and Stephen Winn, the president and chief executive officer of Computer Language Research of Carrollton, Texas. Welcome to all of you.

Pamela Olson.

**STATEMENT OF PAMELA F. OLSON, VICE CHAIR, COMMITTEE OPERATIONS, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION; AND PARTNER, SKADDEN, ARPS, SLATE, MEAGHER & FLOM, L.L.P.**

Ms. PAMELA OLSON. Madam Chairman and Members of the Subcommittee, my name is Pamela Olson, and I am appearing before you today in my capacity as vice chair of the American Bar Association section of Taxation. This testimony is presented on behalf of the section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and accordingly should not be construed as representing the policy of the Association.

On behalf of the section, I would like to commend Chairman Johnson and the Members of the Subcommittee for their ongoing efforts in monitoring the state of the administration of our Nation's laws. The section appreciates the opportunity to testify before you today on legislative proposals concerning taxpayer rights.

Our written statement contains detailed comments on the specific taxpayer rights proposals included in H.R. 2292, many of which we heartily support. It also contains several new taxpayer rights proposals that we believe should be included as part of any taxpayer rights legislative package.

I would add that we are pleased to be working with the IRS in its efforts to improve customer service. There are a number of steps that can be taken by the IRS to improve customer service and the protection of taxpayer rights without legislation, and we have recently, at the IRS request, provided a number of suggestions in that regard.

In order to stay within the allotted time, I will limit my remarks to two specific taxpayer rights proposals contained in H.R. 2292,

proposals to shift the burden of proof in Federal tax cases and some preliminary thoughts on the bill regarding confidentiality of taxpayer information that was just introduced.

First, the two specific taxpayer rights proposals that I want to comment on are the proposal to eliminate the interest rate differential and the expansion of authority to award costs and fees.

Under present law, as you know, there is a differential between the overpayment rate charged and the underpayment rate paid by the Service. We believe that providing the same interest rate for underpayments and overpayments is desirable and is an appropriate step toward addressing the inequities created by the absence of global interest netting. However, notwithstanding our general support for the proposal, we are concerned about how the Treasury would determine the revenue-neutral interest rate for a period.

We recommend that the taxwriting committees make clear that the Secretary should base his estimate of the revenue-neutral interest rate on the most recent historical information regarding the absolute and relative amounts of underpayments and overpayments, and that the percentage of such underpayments and overpayments that have been subject to "hot" or GATT interest rates should not be taken into account in determining the appropriate rate.

Unlike the Treasury Department, we do not support maintaining the differential. We believe that it has been a source of needless complexity and believe that it should be eliminated.

Section 302 of H.R. 2292 expands the ability of a taxpayer who substantially prevails in a controversy involving the Internal Revenue Service and/or the United States to receive an award of costs and fees. We support the parts of the provision that would allow the award of attorney's fees at a higher rate when justified by the difficulty of the issues presented in the case or the local availability of tax expertise; the awarding of attorney's fees when the individual representing the taxpayer has charged no more than a nominal fee; the increase of the net worth ceiling for individuals and for businesses.

We also support that part of the provision that would allow the award of reasonable administrative costs, including attorney's fees incurred after the date the Service issues a proposed notice of tax deficiency, if the taxpayer substantially prevails and the position of the Service was not substantially justified.

We are concerned, however, with how to interpret the rule that the United States will not be considered to be substantially justified if it has not prevailed on the same issue in at least three circuit courts of appeal. As presently drafted, the provision could be read as requiring the United States to pay costs and fees in any case decided in favor of a taxpayer until the point that the U.S. position has been accepted by three circuit courts of appeal. Such an interpretation would subject the United States to costs and fees in situations where, for example, it has prevailed in two circuits but lost in one. We think this would be inadvisable.

With respect to the proposals to shift the burden of proof in Federal tax cases, we understand that the Committee on Ways and Means may consider including in a taxpayer rights package a proposal similar to H.R. 367 to shift the burden of proof to the Sec-

retary of the Treasury in all court proceedings involving Federal tax matters. Such a proposal would reverse the longstanding and well-established position under current law that in general the burden of proof with respect to the correctness of the tax liability in question rests on the taxpayer.

The general allocation of the burden of proof to taxpayers is consistent with our self-assessment system of tax administration, which relies on taxpayers to maintain the necessary records to accurately record their income and expense. We strongly urge the Subcommittee not to include a burden-shifting proposal in any taxpayer rights package because of the adverse effects on tax administration we believe such a proposal would have.

The issue of confidentiality of taxpayer information raises very serious matters that require careful consideration. First, we have concerns about any effort to codify limits on the IRS investigative powers that would make it more difficult for it to perform its legitimate function. There are many provisions in the Internal Revenue Code, some of which were added in the 1997 act, the applicability of which specifically turned on motive or purpose, investigation of which would seem to be off limits under the legislation that was just introduced. Although one may question the wisdom of a number of the provisions that turn on such subjective elements, the fact remains that the provisions are in the Code, and Congress presumably expects the IRS to enforce them.

If that is the case, enacting a provision that makes it impossible for the IRS to do so would seem counterproductive. Second, I would note that there is currently no codified confidentiality privilege that the provision introduced would enter unchartered territory. At first blush, it would appear that it would raise a number of issues that would likely be the source of ongoing disputes. Third, the privileges that currently exist are quite properly very limited in scope, far more limited than the provision that has been introduced.

Broader privileges have been considered and rejected by the courts because they did not serve the public's interest. Congress must carefully consider the ramifications of any provision, the scope of which extends significantly beyond the existing privilege.

On the other hand, it is also clear from much of the recent legislation, particularly in the penalty area, that Congress holds taxpayers to extremely high standards of care in determining the correctness of the positions they have taken on their returns. In order to satisfy this standard of care, taxpayers must fully consider all of the potential issues and make a judgment as to which position is correct.

Taxpayers inhibited from doing so fully to the extent that the deliberative work they have undertaken must be made available to the IRS, Congress should be concerned about the potential chilling effect on compliance. Nevertheless, I do not believe that the answer to the, to this problem is a codified privilege. Rather, I would suggest that Congress consider as a model the procedures developed by the IRS with respect to accountant workpapers.

For accountant workpapers for which there is no privilege, the IRS has put in place a voluntary restraint policy pursuant to which they are to seek access to workpapers only as a last resort and then only as a source of factual information. The reason for this

voluntary restraint is so as not to impede the flow of information between a company and its auditors necessary for the auditors to be able to render an opinion on the company's financial statements.

The same sort of a policy might be put in place with respect to IRS access to information that is not factual information essential to determining the correctness of a taxpayer's return. Thank you again for the opportunity to present our views today. We would be happy to work with the Subcommittee as it develops any legislative recommendations on taxpayer rights. This concludes my prepared remarks.

[The prepared statement follows:]

**Statement of Pamela F. Olson, Vice Chair, Committee Operations, Section of Taxation, American Bar Association; and Partner, Skadden, Arps, Slate, Meagher & Flom, L.L.P.**

Madame Chairman and Members of the Subcommittee:

My name is Pamela F. Olson and I am appearing before you today in my capacity as Vice-Chair (Committee Operations) of the American Bar Association Section of Taxation. This testimony is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing policy of the Association.

The Tax Section of the American Bar Association is comprised of approximately 25,000 tax lawyers located throughout the United States. It is the largest and broadest-based professional organization of tax lawyers in the country. On behalf of the Section, I would like to commend Chairman Johnson and the Members of the Subcommittee for their ongoing efforts in monitoring the state of the administration of our Nation's tax laws. The Subcommittee's oversight responsibility is extremely important to the confidence that the American people have in their tax system and in their Government, and we compliment you for the time and effort you have devoted to performing this critical function.

The Section appreciates the opportunity to testify before you today on legislative proposals concerning taxpayer rights. Our comments are divided into five parts:

First, I will offer some general comments on enacting additional taxpayer rights legislation.

Second, I will comment on some of the specific taxpayer rights proposals contained in Title III of H.R. 2292, a bill introduced by two distinguished Members of this Subcommittee—Rep. Portman and Rep. Cardin. As explained below, the Section supports some of these proposals, but opposes, or has concerns about, others.

Third, I will comment on proposals to shift the burden of proof in Federal tax cases, such as that contained in H.R. 367, a bill introduced by Rep. Traficant. We believe that such a shift in the burden would have a significant adverse effect on tax administration and compliance. As such, we strongly oppose legislating a shift in the burden of proof.

Finally, I will describe several other provisions we believe should be included as part of any taxpayer rights legislative package. These provisions include: (1) requiring that 20 percent of the amount seized by the Internal Revenue Service ("IRS" or "Service") pursuant to a levy from pension plans be withheld; (2) reducing estimated tax penalties when the tax liability is reduced; (3) permitting husband-and-wife offers in compromise to remain in effect as to a compliant spouse; (4) requiring that statutory notices of deficiency specify the date on which a Tax Court petition must be filed; (5) granting the IRS access to the U.S. Postal Service's National Change of Address database to determine a taxpayer's last known address; and (6) disclosing certain IRS tax policies. All of these proposals would serve to increase the fair administration of the tax laws and protect taxpayers.

## I. Taxpayer Rights Legislation—General Comments

The Section commends the Subcommittee for its interest in examining whether or not taxpayers have adequate rights and protections in their dealings with the IRS. As we have testified previously, we believe it is critical to foster a tax administration system that:

- applies the tax laws in a fair and evenhanded manner,
- aids taxpayers in fulfilling their obligations under the law,

• is sensitive to the impact that taxes and tax administration have on people's lives, and
• operates efficiently and effectively.

However, we also recognize that caution must be exercised in legislating additional changes that affect the administration of tax laws, especially to the extent those changes may result in Congress attempting to micro-manage the Service. Although we respect the critical role that the Congress plays in making sure that the tax system is functioning satisfactorily, we believe that, as with any large organization, the day-to-day management of the Service is best left to its executives and key employees. In this way, the oversight responsibilities and skills of the Legislative Branch are blended with the management and operational responsibilities and skills of the Executive Branch.

Moreover, we are concerned that Congress not require the IRS to administer any new procedures or programs without ensuring adequate appropriations. To do so could jeopardize the ability of the IRS to perform its necessary administrative and collection functions; delay needed modernization efforts; and impede, rather than enhance, taxpayer service. Therefore, we respectfully encourage this Subcommittee to take into account the cost to the Government—and, ultimately, to taxpayers—of imposing any new requirements on the IRS.

## II. Taxpayer Rights Proposals Contained in H.R. 2292

As explained below, the Section supports the provisions in H.R. 2292 that relate to elimination of the interest differential, elimination of the "failure-to-pay" penalty during the period of an installment agreement, expansion of the jurisdiction of the Tax Court, and providing IRS matching grants to low-income clinics. In addition, we support the provision relating to the expansion of authority to award costs and certain fees, but have concerns about certain aspects of the provision. However, we oppose the provisions providing for civil damages for negligence in collection actions and a safe harbor for qualifications for installment agreements. We do not oppose the other taxpayer rights provisions in Title III of the bill, but have some concerns about the way some of those provisions currently are drafted.

### *A. Provisions We Generally Support*

1. *Elimination of Interest Rate Differential (Section 309).*—Under present law, there is a differential between the overpayment rate charged, and the underpayment rate paid, by the Service. This differential can range from one to four-and-one-half percentage points. Section 309 of H.R. 2292 would eliminate the interest rate differential by creating one rate for both overpayments and underpayments and eliminating the "hot" and "GATT" interest rates contained in Section 6621(c) of the Internal Revenue Code of 1986, as amended ("Code"). The new rate that would be created would be based upon the Federal short-term rate, plus the number of percentage points the Secretary of the Treasury estimates will result in the same net revenue to the Treasury as would have resulted without regard to the amendments made by the proposal.

We believe that providing the same interest rate for underpayments and overpayments is very desirable and is an appropriate step towards addressing the inequities created by the absence of global interest netting. However, notwithstanding our general support for the proposal, we are concerned about how the Treasury would determine the "revenue neutral" interest rate for a period. The proposal would require the Treasury to estimate the absolute and relative amounts of underpayments and overpayments it expects to receive for a given quarter, and the percentage of such underpayments and overpayments that would have been subject to "hot" and "GATT" interest rates under current law. While it is clear that the Treasury has historical information about absolute and relative amounts of underpayments and overpayments, it is not clear that the Treasury has adequate, if any, information about the percentage of such underpayments and overpayments that have been subject to "hot" and "GATT" interest rates. If this is the case, collecting or estimating this information on a prospective basis would be difficult and estimation of the "revenue neutral" rate would be subject to considerable judgment. Additionally, since the Treasury consistently receives more in deficiency interest than it pays, there might be a built-in bias to overestimate the required "revenue neutral" rate.

Therefore, if the proposal is included in legislation recommended by the Subcommittee, we respectively recommend that the tax-writing committees make clear that (1) the Secretary should base his or her estimate of the "revenue-neutral" interest rate on the most recent historical information regarding the absolute and relative amounts of underpayments and overpayments, and (2) that the percentage of

such underpayments and overpayments that have been subject to "hot"/"GATT" interest rates should not be taken into account in determining the appropriate rate.

2. *Elimination of Failure-to-Pay Penalty during Period of Installment Agreement (Section 310)*—Section 310 of H.R. 2292 would amend Code Section 6651 to provide that the penalty for failure to pay would be disregarded for the period of time during which an installment agreement is in effect. We think this is a desirable and appropriate provision. In addition, we respectfully recommend that the Congress direct the Service to prominently describe the rights of taxpayers pursuant to this provision in the appropriate tax return instruction booklet(s). This directive could be accomplished through Report language.

3. *Jurisdiction of the Tax Court (Section 314)*—Section 314 of H.R. 2292 increases the ceiling from $10,000 to $25,000 per taxable period for cases that can be resolved under the Tax Court's Small Case Procedure. These procedures are often a very efficient and cost-effective way of dealing with taxpayers who are not represented by counsel. The current limit of $10,000 was established in 1984 and has been seriously eroded by inflation. We support increasing the ceiling.

4. *Matching Grants for Low-Income Clinics.*—Section 313 of H.R. 2292 would direct the Secretary of the Treasury to make grants to provide matching funds for the development, expansion or continuation of "qualified low-income taxpayer clinics." We strongly support the policy underlying this provision and respectfully recommend that the provision be included in any taxpayer rights legislative package. However, as suggested above, we believe it is essential for Congress to provide adequate appropriations for the program to ensure that the IRS will have sufficient funds to perform its collection and enforcement functions. Further, in order to ensure that taxpayers are made aware of the availability of pro bono representation by qualified low-income clinics, we respectfully recommend that Congress instruct the Secretary of the Treasury to develop methods for publicizing the clinics, including, but not limited to, posters and brochures displayed in taxpayer service offices and examination, appeals and district counsel office waiting rooms, and notices inserted in pre- and post-examination correspondence.

*B. Provisions We Generally Oppose*

1. *Civil Damages for Negligence in Collection Actions (Section 303)*—Section 303 of H.R. 2292 would authorize taxpayers to bring suits against the IRS for unauthorized collection activities and to seek damages of up to $100,000 in the case of negligent actions of IRS employees. Under current law, a taxpayer may bring suits for unauthorized collection only in the case of reckless or intentional actions of IRS employees. In such cases, a taxpayer may seek damages of up to $1 million.

While we endorse the goal of making the IRS more accountable for the actions of its employees, we believe the proposal goes too far. Our principal concern is that the lower standard of negligence may serve to impede tax administration, rather than to foster accountability. If the proposal were enacted, IRS employees might be deterred from taking appropriate collection action. In addition, the lower standard might encourage the filing of frivolous suits by taxpayers who seek to obstruct appropriate collection action. The present law standard of reckless or intentional action appropriately balances the need for IRS accountability with the need to fairly and efficiently collect taxes that are properly due.

2. *Safe Harbor for Qualification for Installment Agreements (Section 311)*—Section 311 of H.R. 2292 would require the IRS to enter into an installment agreement for the payment of tax if the following requirements were met: (1) the agreement was requested by a taxpayer; (2) the tax liability did not exceed $10,000; (3) the taxpayer filed the required tax returns; (4) the taxpayer paid the correct tax liabilities for the five preceding taxable years; and (5) the taxpayer has not previously entered into an installment agreement under the provision.

We respectfully submit that requiring the IRS to enter into installment agreements for liabilities of less than $10,000, without taking into consideration case-specific facts, would be ill-advised. Our principal concern is that the Service might be required to accept an installment agreement from a taxpayer even where the taxpayer is able to make an immediate payment of the entire tax liability or where the amount of the installment payments suggested by the taxpayer is unreasonably low. We believe that the availability and terms of an installment agreement should be related to a particular taxpayer's ability to pay. Thus, if it is determined that legislation on this issue is appropriate, we recommend that the Secretary be directed to enter into an installment agreement only when the agreement reasonably reflects the taxpayer's ability to make payments consistent with his or her reasonable living expenses.

Finally, because the Code generally defines "tax" to include penalties and interest, there is a question as to whether the $10,000 threshold amount referenced in the

proposal relates only to the amount of tax due or whether it also includes penalties and interest. We suggest that this point should be clarified if this provision is included in a legislative package. We also believe that it would be appropriate to clarify that any time-sensitive underpayment penalties would not continue to accrue during the review process, but, instead, would again begin to run from the date of the notice of denial.

*C. Provision Which We Support in Part and Oppose in Part—Expansion of Authority to Award Costs and Fees (Section 302)*

Section 302 of H.R. 2292 expands the ability of a taxpayer who substantially prevails in a controversy involving the Internal Revenue Service and/or the United States to receive an award of costs and fees. We support the parts of the provision that would allow the award of attorney fees at a higher rate when justified by the difficulty of the issues presented in the case or the local availability of tax expertise; the awarding of attorney fees when the individual representing the taxpayer has charged no more than a nominal fee; the increase of the net worth ceiling for individuals from $2 to $5 million; and the increase of the net worth of a business from $7 to $35 million.

We also support that part of the provision that would allow the award of reasonable administrative costs including attorneys fees incurred after the date the Service issues a proposed notice of tax deficiency (i.e., generally a 30-day letter and Revenue Agent's report), if the taxpayer substantially prevails and the position of the Service was not substantially justified. This approach was originally contained in the Senate version of the Technical and Miscellaneous Revenue Act of 1988 but was dropped by the Conference Committee in favor of the current law provisions. History now confirms that the effect of the Conference Committee action limiting awards of reasonable administrative costs to those costs incurred after the decision of the Office of Appeals or issuance of the statutory notice of deficiency effectively excludes substantially all administrative costs from the possibility of any reimbursement. As a correlative change, we recommend that Congress also amend the definition of "position of the United States" to delete the reference to the date of receipt of the decision of the Office of Appeals and to refer, instead, to the date of issuance of the first notice of proposed deficiency.

Finally, we are concerned with how to interpret the rule that the United States will not be considered to be "substantially justified" if it has not prevailed on the same issue in at least three circuit courts of appeal. In general, a taxpayer's costs and fees are not awarded against the United States if its position was substantially justified. As presently drafted, the provision could be read as requiring the United States to pay costs and fees in any case decided in favor of a taxpayer *until* the point that the United States' position has been accepted by three circuit courts of appeal. Such an interpretation would subject the United States to costs and fees in situations where, for example, it has prevailed in two circuit courts, but lost in one. We think this would be inadvisable. Such an interpretation may deter litigation in cases of first impression where guidance is crucial. We believe the appropriate rule is that if three circuit courts of appeals have ruled *against* the IRS and none of the cases are accepted for review by the United States Supreme Court, the IRS would be bound by these decisions. Accordingly, this language in the provision should be clarified.

*D. Provisions We Do Not Oppose*

We do not oppose the sections of H.R. 2292: requiring the IRS to disclose the reasons tax returns were selected for audit (section 304); directing the Joint Committee on Taxation to study the provisions in tax law regarding taxpayer confidentiality and access to tax return information (section 306); improving public access to IRS material under the Freedom of Information Act (section 307); directing the IRS to ensure that "offers-in-compromise" provide taxpayers with an adequate means to provide for basic living expenses (section 308); requiring that checks for the payment of taxes be made payable to the "Treasurer, United States of America" (section 312); requiring the IRS to establish a toll-free "hotline" for taxpayers to register complaints (section 315); improving the rights of taxpayers during IRS interviews (section 316); directing the IRS to establish procedures for alerting married taxpayers about their joint and several liabilities on all tax forms, publications and instructions (section 317); directing the Treasury and General Accounting Office ("GAO") to study the marriage penalty (section 320); and directing the GAO to report on the burdens of proofs for controversies (section 321). We also do not oppose the following provisions of the bill, but have concerns about the manner in which they currently are drafted.

1. *Expansion of Authority to Issue Taxpayer Assistance Orders (Section 301)*.—The Taxpayer Bill of Rights 2 (Public Law 104–168) amended Code Section 7811 to provide the Taxpayer Advocate with broader authority to affirmatively take any action as permitted by law with respect to taxpayers who would otherwise suffer a "significant hardship" as a result of the manner in which the IRS is administering the tax laws. Treas. Reg. 301.7811–1(a)(4)(ii) defines the term "significant hardship" as "a serious privation caused or about to be caused to the taxpayer as the result of the particular manner in which the revenue laws are being administered by the IRS." The regulation further provides that mere economic or personal inconvenience to the taxpayer does not constitute significant hardship.

Section 301 of H.R. 2292 would further amend Section 7811 to identify four factors the Taxpayer Advocate should consider in determining whether a taxpayer is suffering significant hardship. These factors are: (1) whether the IRS employee to which such order would issue is following applicable published guidance, including the Internal Revenue Manual; (2) whether there is an immediate threat of adverse action; (3) whether there has been a delay of more than 30 days in resolving taxpayer account problems; and (4) the prospect that the taxpayer will have to pay significant professional fees.

We are concerned that specifying four particular factors in the Code would create an implication that these are the only relevant factors or that these factors should be weighted more heavily than other considerations. Thus, although we have no problem with the Taxpayer Advocate taking into account any of the particular factors specified in the proposal, we do not believe that any amendment to the Code is necessary. Instead, we believe the Taxpayer Advocate should continue to take into account the particular situation of each taxpayer, including factors beyond the four set forth in the proposal.

2. *Archival of Records to Internal Revenue Service (Section 305)*.—Section 305 of H.R. 2292 would require the Secretary of Treasury to disclose all IRS records to the Archivist of the United States, on request of the Archivist. Although we respect the Congressional interest in maintaining records of historical significance, we are concerned that the proposal, as currently drafted, does not adequately protect against the disclosure of confidential taxpayer information. We suggest that the provision not be enacted unless adequate safeguards are added to protect the integrity of confidential information so that taxpayers can be assured that personal information will remain private. We believe that failure to provide such safeguards would impede, rather than promote, taxpayer rights.

3. *Procedures Relating to Extensions of Statute of Limitations by Agreement (Section 318)*.—Section 318 of H.R. 2292 would require the Service to notify a taxpayer of his or her right to refuse to extend the period of limitations, or to limit such extensions to particular issues, on each occasion where the Service requests the taxpayer to extend the statue of limitations. Although this provision appears to be beneficial to taxpayers, especially individuals and small businesses, we are concerned that, as currently drafted, it will be of little value from a taxpayer rights perspective because it ignores the practical ramifications that occur if the taxpayer fails to agree to an extension. In most cases, the Service will issue a notice of deficiency. The taxpayer then will be required either to (1) petition the Tax Court or (2) pay the tax and file a refund claim so that the issues in dispute can be referred to the IRS Appeals Office for settlement negotiations. Furthermore, the Service's current policy for entering into restricted consents to extend the statute of limitations, as set forth in the Internal Revenue Manual, is limited to situations involving no more than two issues where the examination is already complete and/or the case is already under the jurisdiction of the Office of Appeals.

Accordingly, we suggest that, if the provision is included in a legislative package, it be expanded to require the Service to provide an explanation of the ramifications of not agreeing to an extension. In addition, the Secretary should be required to issue regulations describing under what conditions the IRS will enter into restricted consents and those conditions should be explained to any taxpayer from whom a consent is sought.

4. *Review of Penalty Administration (Section 319)*.—Section 319 of H.R. 2292 provides for a study and report by the Taxpayer Advocate reviewing the administration and implementation by the IRS of penalty reform recommendations made in the Omnibus Budget Reconciliation Act of 1989. Although we do not oppose the preparation of such a report, we believe that it should be prepared by the Secretary of Treasury and the General Accounting Office, rather than by the Taxpayer Advocate.

## III. Comments on Legislative Proposals Shifting the Burden of Proof in Tax Cases

We understand that the Committee on Ways and Means may consider including in a taxpayer rights package a proposal similar to H.R. 367, a bill introduced by Rep. Traficant, to shift the burden of proof to the Secretary of the Treasury in all court proceedings involving Federal tax matters. Such a proposal would reverse the long-standing and well-established position under current law that, in general, the burden of proof with respect to the correctness of the tax liability in question rests on the taxpayer. The general allocation of the burden of proof to taxpayers is consistent with our self-assessment system of tax administration, which relies on taxpayers to maintain the necessary records to accurately report their income and expenses.

We have serious concerns about legislating a change in the burden of proof and, therefore, respectfully encourage the Subcommittee to take no such action. Placing the burden of proof on the Government in tax litigation would require the Government to produce the business records, testimony or other evidence necessary to demonstrate the taxpayer's tax liability. This would place the Government at a fundamental disadvantage and likely would have at least three detrimental effects on tax administration. First, taxpayers might be inclined to be less forthright in preparing and filing their tax returns and, notwithstanding the potential for civil penalties (for which the Government would have the burden of proof), we believe that taxpayers would take more aggressive positions on their returns. Second, because taxpayers would have less incentive to volunteer the evidence supporting the positions reported on their returns, the Service would be forced to use its administrative summons power more frequently and intrusively during the audit process to gather the necessary information to support its determinations. This would be contrary to the objectives of taxpayer rights legislation. Finally, we believe that more taxpayers would litigate the Service's audit determinations, particularly in the Tax Court where prepayment of the contested amount is not required.

The potential adverse consequences of these effects on tax administration could be very dramatic. We would expect that the IRS no longer would be able to assure general compliance with the tax laws; that the high level of tax compliance in the United States would decrease, perhaps substantially; and that the revenues collected by the Federal Government from income and other taxes likely would correspondingly decrease, perhaps substantially. Further, additional litigation by taxpayers would require the expenditure of additional resources, increasing costs to the Government and, ultimately, to taxpayers in general. Thus, this single change in the law could significantly complicate the fiscal condition of the United States. Therefore, we strongly urge the Subcommittee not to include a burden shifting proposal in any taxpayer rights package.

## IV. Additional Taxpayer Rights Legislative Proposals We Support

### *1. Withholding When IRS Seizes Funds From Pension Plan*

Funds held in retirement plans are subject to levy by the IRS. Under Code Section 3405, certain distributions from retirement plans, including distributions resulting from an IRS levy, are subject to withholding in an amount equal to 20 percent of the distribution. However, in the case of a levy, the IRS does not allocate any of the funds paid in satisfaction of the 20-percent withholding requirement. As a result, the taxpayer can be subject to estimated tax penalties, failure to pay penalties, and interest. It is inequitable and onerous to subject taxpayers to these penalties and interest. Therefore, we recommend that Section 3405 be amended to require the IRS to set aside 20 percent of any funds in a retirement plan that are seized by levy.

### *2. Reduce Estimated Tax Penalty When Amount of Tax Due Is Reduced*

Estimated tax payments are equivalent to withholding on an employee's wages. The estimated tax penalty, which is generally self-assessed by the taxpayer, is imposed where the taxpayer has underpaid estimated taxes. Technically, the estimated tax penalty represents an interest payment to the Government because, to the extent the estimated taxes are underpaid, the taxpayer has retained the use of money legally belonging to the Government. In situations where the taxpayer's tax liability is subsequently reduced, resulting in an overpayment of the estimated tax penalty, a taxpayer should be entitled to a reduction in the penalty. In this case, the overpayment represents interest payments on monies the taxpayer never owed the Government. Under present law, taxpayers cannot request a reduction in their esti-

mated tax penalty in this situation. We believe that this inequity in present law should be corrected through legislative action.

*3. Revocation of Husband-and-Wife Offers in Compromise*

Offers in compromise contain an agreement by the taxpayer to comply with the tax law for five years. If the taxpayer fails to comply, the compromise is invalidated. In the case of a husband and wife, the offer is invalidated as to both if either one fails to comply. This is true even if the parties are separated or divorced. We propose that, rather than automatically invalidating the offer as to both spouses, separate notices be sent to each taxpayer and if, within 60 days, the taxpayer demonstrates compliance, the compromise be preserved as to the compliant taxpayer.

*4. Statutory Notice of Deficiency*

Under Code Section 6213, the Tax Court has no discretion to accept petitions filed after the expiration of the applicable 90-day or 150-day period for filing petitions with the court. This leads to dismissals of many cases where taxpayers were confused as to the correct date, or cases where taxpayers relied on erroneous advice given by IRS officials as to the correct date. Therefore, we believe Section 6213(a) should be amended to require that the statutory notice specify the date on which the petition must be filed, with both parties bound by that determination of the date unless the taxpayer can prove the date is incorrect.

*5. Communication With Taxpayers—Last Known Address*

The tax compliance system depends heavily on being able to communicate with taxpayers by mail, and taxpayers often are required to respond within a limited period of time. Too often, however, the system breaks down due to the use by the Service of an incorrect address. Therefore, we believe that the IRS should be granted statutory power to access the U.S. Postal Service's National Change of Address data base, and that the Code be amended to define the taxpayer's last known address in terms of all the facts and circumstances reasonably known to the IRS, including information in the U.S. Postal Service's database.

*6. Disclosure of Service Tax Policies*

Over the years, the IRS has greatly reduced the publication of Revenue Rulings and General Counsel Memoranda. The IRS should be required to disclose to a taxpayer, in any contested matter, any legal opinions from the Office of Chief Counsel that are relevant to the taxpayer's legal, as opposed to factual, issues. Such opinions should then be publicly disclosed, after deleting taxpayer identifying information, in the same manner as is currently done with private letter rulings and technical advice memoranda.

V. CONCLUSION

Thank you again for the opportunity to present our views today. We would be happy to work with the Subcommittee as it develops any legislative recommendations on taxpayer rights.

This concludes my prepared remarks. I would be pleased to answer any questions.

---

Chairman JOHNSON. Thanks very much, Ms. Olson.

Mr. Mares.

## STATEMENT OF MICHAEL E. MARES, CHAIR, TAX EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. MARES. Good afternoon, Madam Chair, and Members of the Subcommittee. My name is Michael Mares and I am chair of the AICPA tax executive committee. We welcome the opportunity to discuss and present our recommendations to you on taxpayer rights. We believe the taxpayer rights provisions of H.R. 2292 will shield taxpayers from unjust treatment without causing undue burden on the IRS.

Accordingly, we support the taxpayer rights provisions, but we believe much more could and should be done. Our written testimony sets forth our comments on each of the proposals, but also describes additional measures that need to be adopted. Because of the limited time available today, I will highlight only a few of these items. We welcome, however, the opportunity to meet with any of you or your staff to discuss in detail the material in our written testimony.

The primary source of factual data used to substantiate information appearing on the face of a return should be the taxpayers' original books and record. Recently, however, it has become more common for examining agents to seek records that are not factually based, but rather represent the taxpayers' thought processes. Tax decisions developed by taxpayers or recommendations or advice from tax professionals necessarily involve opinions, judgments, and even pure speculation as to the outcome of financial transactions and events over time.

Taxpayers expect, and as a matter of public policy should expect, privacy and confidentiality in discussing tax matters internally or with their external advisors, no matter what their professional classification.

IRC section 7602 currently does not distinguish between factual information necessary for a properly filed return and personal or proprietary information not needed for tax administration. The AICPA therefore supports the bipartisan bill sponsored by Congresswoman Dunn and Congressman Tanner providing a legislative change to IRC section 7602.

Under the proposal, the Internal Revenue Service would have access to the factual information upon which a return is based, but not the thought processes, theories, or analyses. If the IRS had a reasonable suspicion based on evidence that a taxpayer failed to fully report income, the Service would have broader authority to summons other factual information relevant to determining that income. And if taxpayers became the subject of a criminal investigation, they would face the same broad summons authority available to the IRS today.

In the examination area, there are a couple of issues we feel merit consideration. IRS statistics indicate that approximately 50 percent of all individual returns are prepared by paid preparers. Both our experience and IRS records show that the processing of notices during the return perfection and processing phase is a significant workload factor. We believe changes in the disclosure rules would reduce both IRS and taxpayer burdens. Specifically, we recommend that third parties be allowed to discuss a notice and its related account with IRS by the use of a personal identification or PIN number on notices sent to taxpayers.

This would reduce the time spent, the frustration and the cost for all parties involved. However, this discussion of notices, payments, and so forth, must be distinguished from representing taxpayers before the IRS for which there is and should be a need for a formal power of attorney.

Under Treasury Circular 230, IRS section 6694 and the professional ethics guidance of the AICPA and our colleagues at the American Bar Association, there is a provision that tax advisors

may not recommend a position on a return that lacks a realistic possibility of success. That is a 1 in 3 or greater likelihood of being sustained on its merits.

Unfortunately, the IRS has not chosen to instruct revenue agents to apply this same standard before raising issues in examinations. As a matter of fairness and consistency, we recommend that the IRS require its agents to have concluded that there be a realistic possibility of success before proposing an adjustment against a taxpayer. Implementing a policy such as this would be consistent with tax administration principles for the IRS as set forth in Rev. Proc. 64–22.

Finally, the vast majority of small cases under $10,000 in the Tax Court are currently pro se; that is, individual representation by the taxpayer. The need for greater access to representation by taxpayers is recognized both by the Tax Court and by the National Commission on Restructuring the IRS in its report. We recommend that in order to enhance the access of those taxpayers to representation, all CPAs be authorized to practice before the Tax Court in small tax cases.

Once again, the AICPA appreciates the opportunity to offer comments at today's hearing and stands willing as always to provide the Subcommittee with any additional assistance and comments as requested. Thank you for your attention.

[The prepared statement follows:]

**Statement of Michael E. Mares, Chair, Tax Executive Committee, American Institute of Certified Public Accountants**

## I. Introduction

Madam Chairman and members of the Subcommittee: Thank you for inviting the American Institute of Certified Public Accountants ("AICPA") to testify before you today. I am Michael Mares, Chair of the AICPA's Tax Executive Committee. The AICPA is the national, professional organization of more than 331,000 certified public accountants. The Institute's members advise clients on Federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's largest businesses. It is from this base of experience that the AICPA offers its comments.

As requested, our testimony addresses the taxpayer rights provisions in H.R. 2292, the Internal Revenue Service Restructuring and Reform Act of 1997, ("the Bill") and also sets forth additional AICPA proposals for taxpayer rights and protections.

## II. Internal Revenue Service Restructuring and Reform Act of 1997, Title III—Taxpayer Protection and Rights

### *A. Provisions Supported by the AICPA*

The AICPA supports, without reservations, the following provisions in the Bill:

- Expanded Authority to Award Fees and Costs (Section 302), expanding the authority of courts to award fees and costs under IRC section 7430 by: (1) allowing courts to consider the local availability of practitioners with tax expertise when determining whether to allow more than the $110 hourly rate for attorney's fees; (2) permitting an award of costs beginning from the date of the notice of proposed deficiency—i.e., the 30-day letter; (3) clarifying that fees can be allowed for pro bono services; (4) increasing the net worth limits from $2 million to $5 million for individuals and from $7 million to $35 million for businesses; and (5) requiring an award of fees and costs if the taxpayer prevails on an issue that the IRS has previously lost in at least three Courts of Appeals.
- Disclosure of Criteria for Examination Selection (Section 304), requiring the IRS to include in Publication 1, "Your Rights as a Taxpayer," the criteria and procedures used in selecting returns for audit.

• Disclosure of Records to National Archives (Section 305), allowing the IRS to disclose tax records to the National Archives for purposes of determining which records should be destroyed and which should be retained in the Archives.
• Study Regarding Confidentiality of Tax Return Information (Section 306), directing the Joint Committee on Taxation to establish a study of present protections for taxpayer privacy, the need for third parties to use tax information, and the ability to achieve greater levels of voluntary compliance by allowing the public to know who does not file tax returns.
• Expedited FOIA Procedures for Media Requests (Section 307), requiring the IRS to adopt expedited Freedom of Information Act procedures for expedited access to certain media requests, akin to provisions currently used by the Justice Department.
• Amendment to Failure to Pay Penalty (Section 310), eliminating the application of the failure to pay penalty while an installment agreement remains in effect with respect to the amount owed.
• Safe Harbor for Qualification for Installment Agreement (Section 311), providing a safe harbor for paying taxes by means of an installment agreement, provided the taxpayer does not owe more than $10,000, has not failed to file any tax return in the prior five years, and has not previously used this safe harbor provision.
• Taxes Made Payable to U.S. Treasurer (Section 312), requiring tax payments be made payable to the Treasurer, United States of America.
• Tax Court Jurisdiction (Section 314), clarifying that the Tax Court has jurisdiction over interest determinations, expanding the Tax Court's jurisdiction to issue declaratory judgments concerning an estate's eligibility for an extension of time under IRC section 6166 to pay estate taxes, and increasing the jurisdictional limit under the small case procedures from $10,000 to $25,000.
• Explanation of Joint Liability (Section 317), requiring the IRS to alert taxpayers on all tax forms, publications, and instructions, of their joint and several liabilities.
• Procedures Relating to Extensions of the Statute of Limitations by Agreement (Section 318), requiring the IRS to notify taxpayers on each occasion they are asked to consent to an extension of the statute of limitations, that they have the right to refuse to execute such consent or to limit their consent to particular issues.

*B. Provisions Supported by AICPA, but with Revisions or Additional Recommendations*

*Expansion of Authority to Issue Taxpayer Assistance Orders*

IRC section 7811 authorizes the Taxpayer Advocate to issue Taxpayer Assistance Orders ("TAOs") if the Taxpayer Advocate determines that the taxpayer is suffering or about to suffer a significant hardship. The Code, regulations, and other administrative guidance set forth a standard of hardship requiring that the basis for seeking relief is "undue" or "significant" hardship. Section 301 of the Bill would expand the authority to issue TAOs by allowing the Taxpayer Advocate to consider whether the IRS employee is following applicable published guidance (including the Internal Revenue Manual), the immediate threat of adverse action, a delay of more than 30 days in resolving taxpayer account problems, and the prospect that the taxpayer will have to pay significant fees for representation.

The AICPA supports this provision; however, we believe that the provision does not go far enough. The AICPA recommends that the Taxpayer Advocate's authority under section 7811 be further expanded by eliminating the qualifiers "undue," "significant," etc., thereby allowing the Taxpayer Advocate to take action when deemed necessary to assure that taxpayers do not suffer unfairly. This recommendation is consistent with Congress' goal that the Taxpayer Advocate take a more assertive role on behalf of taxpayers when addressing the IRS' shortcomings.

*Increased Damages for IRS Negligence in Collection Actions and for Wrongful Liens*

Section 303 of the Bill includes a provision which would allow taxpayers to recover up to $100,000 for damages incurred as a result of the IRS' negligence in unauthorized collection actions. The AICPA supports this provision but believes that it, alone, is insufficient because it does not provide jurisdiction where the IRS has wrongfully filed tax liens. Accordingly, we recommend that this provision be amended to provide a cause of action against the IRS for wrongful liens and for federal tax liens filed in violation of the automatic stay provisions of the Bankruptcy Code (11 USC section 362).

*Offers in Compromise*

Section 308 of the Bill would require the IRS to develop and publish national and local allowance standards to ensure that taxpayers who enter into compromise

agreements have adequate means to provide for their basic living expenses. The AICPA supports this provision, but recommends the legislation be amended to reflect that revenue officers are encouraged, not just allowed, to use the discretion contained in the Internal Revenue Manual to permit variances from national and local standards when circumstances justify the variance. The standards should generally be followed but exceptions should be made if documented by the taxpayer or the IRS. In many cases, justifiable exceptions currently are not being allowed.

We also recommend that legislation provide that the standards should be updated and adjusted for inflation annually and that the standards be adjusted by moving the cost of food from a national to a local standard, by localizing the cost of housing by zip code rather than by county, and by taking into account the taxpayer's income and the size of the family in determining the housing standard.

In addition, we recommend that a study of the offer program be made to determine the reason for the declining acceptance rates, the increasing number of unprocessable offers, and other issues related to uniformity and fairness.

*Elimination of Interest Differential on Overpayments and Underpayments*

Section 309 of the Bill would eliminate the differential in interest rates for overpayments and underpayments in a revenue neutral manner. The AICPA supports this provision, with additional recommendations, as set forth later in our discussion of various issues concerning interest.

*Low Income Taxpayer Clinic*

To help low income taxpayers involved in tax controversies and to educate non-English speaking taxpayers about their rights and responsibilities under the tax law, section 313 of the Bill would allow the IRS to make grants for low income taxpayer clinics. The AICPA supports the funding of such clinics.

The proposal indicates that for any low income taxpayer clinic to qualify for a grant, however, it must "operate programs to inform individuals for whom English is a second language about their rights and responsibilities...." This mandate may not be reasonable—for example, in areas where there are few people for whom English is a second language. Thus, it is suggested this requirement be modified to indicate the need for these programs only as deemed appropriate.

*Review of Penalty Administration and Development of Recommendations*

Section 319 of the Bill would require the Taxpayer Advocate to review the administration and implementation of penalty reform recommendations made by Congress in 1989 and, by July 30, 1998, to provide an independent report to the House Committee on Ways and Means, the Senate Committee on Finance, and the Joint Committee on Taxation, containing legislative recommendations to simplify penalty administration and reduce taxpayer burden. The AICPA supports this provision; however, we believe the review and recommended legislation should also address all other penalty issues, particularly penalty assessment and abatement practices of the IRS.

The IRS assesses numerous penalties, thus requiring taxpayers to spend a great deal of time documenting reasonable cause for having the penalties abated. The process is both time consuming and expensive. Through reasonable cause and because of IRS errors, however, the IRS abates up to 50 percent of some types of proposed penalties. Unfortunately, taxpayers without representation are often unaware of the opportunities for abatement. It may be possible to achieve a more cost-effective and equitable outcome by establishing criteria for reducing assessments that are likely to be abated.

To reduce the burden on both the IRS and taxpayers, we recommend that the IRS establish safe harbor provisions for a variety of penalties which would automatically be deemed to be reasonable cause for abatement. This could be confined to late filing, late deposit, and certain information return related penalties. The object would be to concentrate on those penalties that are regularly assessed and abated. Safe harbor provisions could take the form of:

- No penalty assessments for an initial occurrence; however, the taxpayer would receive a notice that a reoccurrence will result in a penalty;
- Automatic non-assertion or abatement based on a record of a certain number of periods of compliance; or
- Voluntary attendance at some type of educational seminar on the issue in question, as the basis for non-assertion or abatement.

Use of the safe harbor approach would encourage and create a vested interest in compliance, since a good history of compliance could automatically result in relief. Additionally, the likelihood of future abatements would diminish if the taxpayer has a history of non-compliance. Furthermore, a system of automatic abatements would

reduce the time spent by the IRS and taxpayers on proposing assessments, initiating and handling correspondence, and subsequently abating a high percentage of penalties. The ability to abate a penalty for a reasonable cause other than those used for automatic abatements would exist; however, reasonable cause abatements requiring independent evaluation may be reduced.

*Cataloging Taxpayer Complaints of IRS Misconduct*

Section 315 of the Bill would require the IRS to establish procedures for cataloging and reviewing taxpayer complaints of misconduct by IRS employees. In addition, a toll-free telephone number would be established, for taxpayers to register their complaints.

The AICPA supports the development of procedures for cataloging and reviewing taxpayers' complaints of misconduct by IRS employees. The AICPA has reservations, however, about how such complaints should be registered with the IRS. We are concerned that establishing yet another toll-free telephone number, given the IRS' limited resources and its current inability to handle the volume of calls it receives on its taxpayer assistance toll-free lines, could drain resources and further erode the level of service provided. As an alternative, an electronic means of registering complaints might be considered to minimize the burden on the IRS. Further, a better approach might be to use existing avenues for registering complaints, such as the Problem Resolution Program or the IRS Inspection Service, that currently receive, handle, and catalog such complaints; however, the public should be made aware of the existence of such forums and of the procedures for filing complaints. Taxpayers should also receive a positive response, in some fashion, from the IRS indicating the resolution of their matter. Adequate safeguards should be added to protect taxpayers from reprisals when a complaint has been filed.

*Procedures Involving Taxpayer Contacts and Interviews*

Section 316 of the Bill would require that, before conducting an initial in-person interview relating to the determination of tax, IRS personnel must: (1) explain to the taxpayer the audit process and the taxpayer's rights under the process; (2) inquire as to whether the taxpayer is represented by an individual authorized to practice before the IRS; (3) explain that the taxpayer has the right to have the interview take place at a reasonable location, and that the location does not have to be the taxpayer's home; (4) state the reasons why the taxpayer's return was selected for examination; and (5) provide the taxpayer with a written explanation of the applicable burdens of proof on taxpayers and on the IRS. The section also would require that, before conducting an in-person interview relating to the collection of any tax, IRS personnel must explain to the taxpayer the collection process and the taxpayer's rights under the process. The AICPA supports these provisions.

a. Taxpayer Interviews.—The AICPA also recommends an additional provision concerning taxpayer interviews, to inform taxpayers of their rights to representation. IRC section 7521 specifically states that "if the taxpayer clearly states to an officer or employee of the IRS at any time during any interview...that the taxpayer wishes to consult with an attorney, certified public accountant, enrolled agent, enrolled actuary...such officer or employee shall suspend such interview regardless of whether the taxpayer may have answered one or more questions." We are aware of many instances where the IRS appeared to demand that a taxpayer personally appear at an initial examination meeting, and the taxpayer was not informed of the right to have a representative appear on his or her behalf. In most instances, an examination can be handled in its entirety by a representative. We believe stronger legislation is needed to ensure that taxpayers are notified of their rights under section 7521 and allowed appropriate representation.

b. Place of Examination.—Currently, IRC section 7605(a) provides that the "time and place of examination...shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances." Treas. Reg. section 301.7605–1 provides general criteria for the IRS to apply in determining whether a particular time and place for an examination are reasonable under the circumstances. The regulation also instructs that sound judgment should be exercised in applying these criteria and that there should be a balancing of the convenience of the taxpayer with the requirements of sound and efficient tax administration.

Unfortunately, the IRS placed unnecessary limitations on their field personnel through the Internal Revenue Manual. Parts 320:(1) and :(2) of IRM [4235], the Techniques Handbook for In-Depth Examinations, provide that the place of examination will be established consistent with the regulation and, with few exceptions, the examination of the records should be made at the taxpayer's place of business. This guidance also indicates that consideration should be given to conducting the examination at the IRS office or the representative's office only if the taxpayer's

place of business falls short in some respect relevant to conducting an examination. This often places an undue burden on small taxpayers with limited space. It also may result in a denial of a taxpayer's privacy if the taxpayer does not want others to know an audit is being conducted. Thus, the IRM guidelines are inappropriate in certain circumstances; the place of examination standard needs to be clarified legislatively. We recommend that IRC section 7605(a) be amended to state that the "time and place of examination...shall be such time and place as requested by the taxpayer and as are reasonable under the circumstances."

c. Notice of Examination.—The IRS initially contacts taxpayers either by telephone or letter to inform them of an upcoming examination. When the initial contact is made by telephone, it is followed by a letter to present the taxpayers' rights in written form. The process of allowing initial contacts to be made by telephone, however, creates many problems in ensuring taxpayers their rights. The revenue agent may request an appointment with taxpayers in initial calls. As previously noted, sometimes taxpayers believe they must personally be at the appointment and do not understand that they have a right to representation.

In order to protect the rights of taxpayers, we recommend that IRC section 7605 be amended to require that the initial notification of an examination be made in writing. This requirement should extend to all examinations. The rights accorded to taxpayers under IRC section 7521 (explanation of examination process, right to be represented, etc.) should attach when taxpayers receive a notice of examination.

*Studies of Reducing the "Marriage Penalty"*

Section 320 of the Bill would require Treasury and GAO to study of the feasibility of treating each individual separately for tax purposes, including recommendations for eliminating the marriage penalty, addressing community property issues, and reducing the burdens on divorced and separated taxpayers. The AICPA fully supports a legislative effort to mitigate or eliminate the "marriage penalty." The "marriage penalty" could be calculated as being equal to the difference between the tax calculated on the joint tax return as prepared and the amount of tax that would have resulted if the taxpayers' married filing combined taxable incomes were divided between each of the spouses, with tax calculated using the single tax rate tables. Another alternative is to just increase the tax bracket amounts for married returns or adjust the married filing jointly tax rate schedule, given the predominance of two-earner families at various income levels.

*Study of Burden of Proof*

Under section 321 of the Bill, the General Accounting Office would be required to prepare a report on the burdens of proof on taxpayers and on the IRS, and to comment on the impact of changes to those burdens. The AICPA does not agree with the proposals that have been made for shifting the burden of proof in civil tax matters. Accordingly, we could only support this provision in that it would provide information to Congress on the impact of such a change.

## III. Additional Recommendations by the AICPA

The AICPA recommends that any taxpayer rights legislation also address the following issues:

*Confidentiality in Tax Matters*

Historically, it has been the Internal Revenue Service's view that the primary source of factual data used to substantiate information appearing on the face of a return should be the taxpayer's original books and records. Recently, however, it has become more common for examining agents to seek, at the start of and during an examination, documents other than original books and records (such as engagement letters, management letters, representation letters, internal audit reports, and correspondence between the taxpayer and a tax advisor) that are not factually based but rather represent the taxpayers' thought process. Collateral source documentation (documents other than original books and records or other factually based documents) should not become part of a "fishing expedition," burdening a taxpayer and wasting resources.

Tax decisions developed by taxpayers or recommendations or tax advice from tax professionals may be based in part on private information and involve opinions and judgements, and even pure speculation as to the outcome of financial transactions and events over time. Taxpayers expect privacy and confidentiality in discussing tax matters internally or with their external advisors. Also, as a matter of public policy, a taxpayer has the right to expect all information regarding the taxpayer's tax mat-

ters will be accorded the same protection of privacy notwithstanding the professional classification of the representative.

Currently, IRC section 7602 authorizes the examination of books and records, the summoning of any person and the taking of testimony with respect to that which "may be relevant or material to the inquiry." However, current law does not distinguish between factual information necessary for a properly filed tax return and personal or proprietary information not necessary for proper administration of tax law. As previously mentioned, the result has been the periodic use of the broad summons authority by the IRS to probe for information not directly related to the tax return even when taxpayers are not suspected of wrongdoing.

The AICPA, together with the National Federation of Independent Business (NFIB) and the National Taxpayers Union (NTU), therefore, supports a legislative change to IRC section 7602. To maximize taxpayer protection, the proposal provides confidentiality protection to the taxpayer for nonfactual information such as thought processes and opinions, which includes advice sought from a tax professional. Under the proposal: (1) For all taxpayers, the IRS would have access to the factual information upon which a return is based (but not "thought processes, theories, analyses, opinions and mental impressions"); (2) If the IRS had a reasonable suspicion based on evidence that a taxpayer failed to fully report income, the Service would have broader authority to summon other factual information relevant to the taxpayer's income; and (3) If taxpayers become the subject of a criminal investigation, they would face the same broad summons authority available to the IRS today.

The purpose of this legislation is to facilitate the free flow of information and discussions by taxpayers, either internally or with their tax advisors. The legislation will not hinder the examination process, since it does not restrict the IRS' ability to obtain factual information upon which the tax return is based.

*Consistent Standards for Raising an Issue in an IRS Examination*

Treasury Department Circular No. 230, IRC section 6694, and professional ethics guidance of the AICPA and the American Bar Association ("ABA") provide that tax advisors may not recommend a position in a return that lacks a realistic possibility of being sustained on its merits. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

Although the AICPA and the ABA prefer not to assign mathematical probabilities to the realistic possibility standard, nevertheless, both professions subscribe to the standard. Unfortunately, the IRS has not chosen to instruct revenue agents to apply the same "realistic possibility" standard before raising issues in examinations.

For example, in a recent IRS examination, a revenue agent asserted in his Revenue Agent's Report ("RAR") that a taxpayer corporation must switch from the cash method of accounting to the accrual method of accounting based on an IRS Industry Specialization Paper for Health Care. Although the taxpayer was a personal service corporation (with no inventories) that is entitled by statute (IRC section 448) to be on the cash method of accounting, the revenue agent did not feel constrained from raising the method of accounting issue. When the taxpayer protested this issue to the Appeals Office, the Appeals officer consulted with the industry coordinator and dropped the issue. The taxpayer incurred the expense of protesting the revenue agent's adjustment to the Appeals Office even though there was no realistic possibility of the IRS prevailing on the issue.

As a matter of fairness and consistency, we recommend that the IRS require revenue agents to have concluded that there is at least a realistic possibility of success before proposing an adjustment against a taxpayer. One method of ensuring that a position contained in a RAR has a realistic possibility of success could be to require that each RAR be signed by an individual at the group manager or higher level, attesting to the fact that the proposed adjustments set forth therein meet the realistic possibility standard. Implementing a policy such as this would be consistent with tax administration principles for the IRS, set forth in Rev. Proc. 64–22, 1964–1 C.B. 689.

Rev. Proc. 64–22 provides, in part:

> The Service...has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

*Timely Case Resolution*

Currently, there is no incentive for the IRS to complete an examination within the statutory period (without regard to extension). Furthermore, taxpayers faced with the prospect of a notice of deficiency are, in essence, forced to grant extensions of the limitations period as a matter of course. This practice defeats the general purpose of a limitations period: finality.

Too frequently the Internal Revenue Service initiates an examination of a taxpayer's return when there is insufficient time remaining within the statue of limitations (without regard to extensions) to complete the examination and make a correct determination of the taxpayer's liability. In such a case, the IRS must either seek a consent to extend the statute of limitations or issue a statutory notice of deficiency. Ultimately, the choice falls upon the taxpayer; if the taxpayer extends the assessment period, a more accurate determination can be made; if the taxpayer fails to extend the assessment period, a notice of deficiency may be issued. In such a case, the notice of deficiency may be speculative or arbitrary, because the IRS failed to complete a thorough examination of the taxpayer's books and records.

In response to a notice of deficiency, a taxpayer has two options: file a petition for redetermination with the United States Tax Court or pay the deficiency. Either alternative can result in substantial expense to the taxpayer. Furthermore, a notice of deficiency receives a presumption of correctness before the Tax Court. As a result of the consequences of the issuance of a notice of deficiency, taxpayers generally are forced to agree to an extension of the limitations period.

In complicated audits, such as those involving large corporate returns, it may not be feasible for the IRS to complete an examination within the statutory period. Accordingly, in such cases, it may be reasonable for the government to request a consent to extend the statute. However, in audits of individual taxpayers, the government should complete its examination in the time prescribed by statute, without the need for extensions. Administrative or legislative changes should be made to provide a disincentive to the IRS for seeking extensions.

*Safeguard for Divorced or Separated Spouses and Married Persons in Community Property States*

Taxpayer Bill of Rights 2 ("TBOR2") provided for the disclosure of collection activities with respect to joint returns. However, we believe additional safeguards are needed to ensure the equal and fair treatment of spouses who are separated, divorced and/or have community property issues compounding their tax problems. The root of the collection problem is in the examination procedures that do not require both spouses be involved in an audit. We recommend legislation be enacted that would require, at the initiation of an examination, the absent spouse acknowledge by signature whether the other spouse may, or may not, represent the absent spouse (as well as procedures to deal with situations where a spouse refuses to sign such a statement or cannot be located). If both parties are aware of, or participate in the examination, then no one should be caught unaware of the liability and the resulting collection process.

*Interest Netting*

Currently, there is a differential between the interest rate a taxpayer pays on a deficiency and the interest rate the government pays to a taxpayer on an overpayment; the differential rate can vary from 1 percent to 4.5 percent. Situations often arise when a taxpayer is indebted to the government at the same time that the government is indebted to the taxpayer. Absent netting, a taxpayer who owes the government the same amount that the government owes the taxpayer would incur an interest obligation in favor of the government.

The Service's current policy with respect to interest netting is fundamentally unfair, both because of the manner in which the Service makes interest netting calculations and also because of the Service's inconsistent application of netting principles, resulting in similarly situated taxpayers receiving disparate treatment.

Interest provisions in the Code are intended to compensate the government or the taxpayer for the use of the money. (Rev. Proc. 60–17, 1960–2 C.B. 942) Interest applies only if there is an amount that is both due and unpaid. (See, e.g., IRC § 6601(a); and Avon Products, Inc. v. United States, 78–2 U.S.T.C. (CCH) ¶ 9821 (2d Cir. 1978).) To the extent there is a "mutuality of indebtedness" between the taxpayer and the government (i.e., to the extent the government and the taxpayer owe each other the same amount of money over the same period of time), there is no unpaid balance and, therefore, no amount on which interest should accrue.

The Service's current policy (See Treas. Reg. 301.6402–1.) of only netting outstanding overpayments against outstanding liabilities for both computational and

collection purposes is unfair to taxpayers that promptly pay contested amounts of tax and, therefore, have no "outstanding" liabilities. This is illustrated by the recent case of Northern States Power, in which the company's prompt payment of alleged deficiencies cost it $460,000 more in interest than it would have had to pay if it had delayed in making the payment. (See Northern States Power Co. v. United States, 73 F3d 764 (8th Cir. 1996), cert denied 117 S.Ct. 168.)

Finally, and of significant import, despite the Service's stated policies toward interest netting (i.e., that netting can legally occur when both deficiencies and overpayments are outstanding and unpaid, see, e.g., Notice 96–18), netting continues to be performed on an ad hoc basis. A revenue agent's decision to deny a taxpayer netting is supported and justified by language in the Eighth Circuit's opinion in Northern States Power, which states that such netting is discretionary. However, the Service's discretionary application of the law without any formal or enforced guidelines, policies or procedures is inherently unfair to taxpayers. The virtual absence of any clear legal standards for interest netting also is unacceptable from a systemic standpoint, because it affords the IRS unfettered power to convert a taxpayer from a creditor to a debtor, with the size of a potential interest debt quickly becoming astronomical.

Further, viewing comprehensive netting as entirely within the discretion of the Service interjects serious fairness concerns into the settlement process. The Service has used the netting issue as a bargaining chip in negotiations to extract concessions from taxpayers on issues under examination. This inappropriately distances negotiations from the merits of the underlying issues. It also has the inappropriate effect of using netting (or the absence of netting) as a tool to raise revenue, rather than as a means to compensate for the use of money.

The Service counters taxpayer criticism of unfairness with the argument that netting in all situations is not administratively feasible. While comprehensive interest netting raises concerns of administrative feasibility, more progress must be made in balancing these concerns with taxpayer fairness.

For these reasons, we recommend that Congress mandate that: (1) within 90 days, guidance be issued to implement comprehensive netting in all situations; and (2) as an interim measure, guidance be issued to require the Service to net comprehensively at the request of the taxpayer, provided the taxpayer furnishes the Service with relevant information and interest computations. We also recommend that the mandated guidance in this area be issued in the form of proposed regulations, so that all interested persons will have an opportunity to comment on the technical details.

By "comprehensive netting" we mean netting for all interest accruing after December 31, 1986 for all types of taxes and all years (open or closed) to the extent necessary to compute interest accurately for a refund or an assessment in an open year. The interim recommendation is similar to the elective approach previously recommended by the House Ways and Means Subcommittee on Oversight, as well as the approach of a draft revenue procedure submitted by the Compliance Subgroup of the Commissioner's Advisory Group at its January 1995 meeting.

As stated by House Committee on Ways and Means Chair Bill Archer in his letter to Treasury Secretary Rubin dated September 26, 1996: "In my view, Congress has given Treasury and the IRS both a clear mandate and clear authority to implement comprehensive procedures to net underpayments and overpayments before applying differential interest rates." Chairman Archer concluded that interest netting is a problem "Congress has long expected would be resolved administratively and I certainly hope that Treasury will reexamine its position on this issue." No further delays are acceptable. The time has come for the IRS to implement these procedures.

*Elimination of Interest Differential on Overpayments and Underpayments*

As noted earlier, section 309 of the Bill would eliminate the differential in interest rates for overpayments and underpayments in a revenue neutral manner. On a "going-forward" basis, the elimination of all interest rate differentials for purposes of determining interest on overpayments and underpayments effectively eliminates the economic detriment for some taxpayers who are both creditors and debtors during the same period of time. (However, it generally does not eliminate it for individuals who will be taxed on interest income and not be allowed a deduction for interest expense.) Although the proposal will increase the uniform interest rate to a level such that there will be no economic cost to the government due to its enactment, there is an inherent disincentive to establishing an exorbitant rate which encourages taxpayers to overpay their taxes.

With interest rate equalization, there is not an economic detriment for some taxpayers caused solely by the timing of payment and refunds (for interest periods

after date of enactment). In addition, the use of a single rate will ease the administrative burden of the IRS, encourage prompt payment of even partial deficiencies, and simplify the overall computation process. It is certainly a first step in the overall simplification process.

Given the recent court decisions in cases such as The May Department Stores Co. v. United States, 36 Fed. Cl. 680, 96–2 USTC ¶50,596 (Nov. 4, 1996) and Fluor Corporation and Affiliates v. United States, 97 TNT 162–9, however, the IRS should also take this opportunity to review the overall interest scheme and analyze the existing rules given the "use of money" principles long advocated by taxpayers and the courts. In addition, for interest accruing after 12/31/86 and before date of enactment, IRS should allow taxpayers to provide supportable interest computations which reflect interest netting to eliminate the economic detriment to such taxpayers currently resulting from the existing rate differential of up to 4½%.

*Detailed Interest Computations*

The AICPA is of the opinion that the IRS should provide interest computations, as a matter of course, to taxpayers when adjustments involving interest are made. Currently, a taxpayer only receives a notice showing the amount of tax and the interest due on such amount. IRC section 7522, which is applicable for notices mailed on or after January 1, 1990, requires that such notices describe the "basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice." At the present time, the starting date for the interest, the principal amount upon which such interest is based, and the rate charged on such amount are not provided to taxpayers as part of the notice procedure.

We believe the "basis for" description in the notice should apply to interest computations and should include interest rates and the dates for which the interest applied, the dates and amount of payments and credits, and the interest compounding method. With this information, taxpayers and practitioners will be able to verify the accuracy of interest computations and expeditiously resolve any discrepancies. We recognize that detailed interest computations could result in a burden to the IRS. Therefore, an exception could be made for de minimis interest amounts such as less than $50 or $100. If providing this information still would constitute a significant burden on the IRS, at a minimum, this information should be made available to taxpayers upon request and notice of the availability of the information should be communicated to taxpayers.

*Payroll Tax Collection*

The Taxpayer Bill of Rights 2 made a number of changes in the procedures under IRC section 6672 for the assessment against and collection of unpaid payroll taxes from owners, officers, and others known as "responsible persons." We recommend additional legislation be enacted to prohibit the IRS from attempting to collect the trust fund recovery penalty (also known as the 100 percent penalty) from any alleged responsible person during the pendency of any administrative proceeding or judicial action brought to contest the merits of the trust fund recovery penalty liability.

*Disclosure Changes (PIN/POA)*

IRS statistics indicate approximately 50 percent of all individual returns are prepared by paid preparers. We believe, especially because of the increasingly complex nature of the tax law, that taxpayers have a right to expect that the hiring of a preparer will avoid personal inconvenience and unnecessary loss of their own productive time in having their return accepted in the processing phases by the IRS. Our experience and IRS records show that the processing of notices during the return perfection and processing phase is a significant workload factor. Many practitioners and taxpayers, unaware of the strict enforcement of the disclosure rules, attempt to resolve these notices by having a preparer "do what the preparer is being paid to do"—i.e, prepare the return, solve any processing problems, and appropriately interact with the Service.

We believe changes in the disclosure rules would reduce taxpayer burden, reduce IRS correspondence in dealing with ineffective contacts by preparers without a power of attorney, and support the taxpayer's rights to be represented. Specifically, we recommend that third parties be allowed to discuss a notice and its related account with the IRS by use of a Personal Identification Number ("PIN") on the notices sent to taxpayers.

The use of a PIN was under active discussion between the AICPA Tax Practice and Procedures Committee and the IRS in the past, but we were unable to reach agreement with the Service regarding implementation of such a procedure.

The ability of a practitioner, parent, child, or neighbor to assist a taxpayer who does not understand, see well, hear well, etc., in handling his or her business affairs with the IRS immediately (i.e., a telephone reply or discussion), would reduce the time spent, frustration, and cost for the IRS, taxpayers, and preparers. Telephonic interaction with the IRS is the future of "one-stop" service and efficiency in a modern-day tax system. Two-way conversations between taxpayers, their representatives, and the IRS discussing notices, payments, penalties, errors, missing information, etc. must be distinguished from representing taxpayers before the Service and entering into binding agreements on their behalf, for which there is a need for a formal power of attorney.

*Consistency When Implementing IRS Policies*

Often, the IRS will institute policies designed to assist taxpayers or clarify the application of particular Code sections. However, when the Service institutes policies that impact taxpayers, it can be unfair when those policies are applied only to some taxpayers. In certain instances, the policies are designed to apply only to particular taxpayers, and those instances are not at issue. But, when a benefit is intended to apply to a taxpayer, and through ignorance or capriciousness, an agent fails to give the taxpayer the benefit of those policies, it is detrimental to both the taxpayer and tax administration. One such example is the IRS' inconsistent application of interest netting principles. Other examples exist. On June 3, 1996, the Assistant Commissioner (Examination) issued a memorandum to all regional compliance officers regarding overly broad Information Document Requests ("IDRs"). The memorandum was, in part, in response to complaints from taxpayers and practitioners about revenue agents initiating an examination and immediately requesting an array of documents, many of which prove to be irrelevant to the examination. The well-reasoned memorandum of the Assistant Commissioner (Examination) set forth a standard for issuing document requests: an IDR should be issued for specifically identified issues or specifically identified reasons. The memorandum made it clear that "kitchen sink" or "boxcar" IDRs are inappropriate.

The experience of many tax practitioners is that the guidance issued by National Office is sometimes disregarded and, in this instance, many agents are unaware of the memorandum. As a result, taxpayers continue to receive these overly broad, burdensome document requests. From the standpoint of an advocate, it is imprudent to bypass the revenue agent, and taxpayers thus frequently comply with these broad IDRs. As a general principle, the Service must strive to communicate its policies more uniformly throughout the organization. Policies should be meaningful, and there should be consequences when an agent or Appeals officer disregards a policy set forth by the National Office.

*Notification of Intention to Offset*

Current IRS procedures require that before any overpayment is refunded or credited to estimated tax, as requested by the taxpayer, there must be a review of a taxpayer's account for any balances due. If a balance due is showing for the taxpayer on another account or module, the overpayment will be offset and the remaining balance, if any, refunded or credited. The taxpayer is not given an opportunity to verify the correctness of the IRS data before this action is taken. We believe the IRS should provide taxpayers with notification of its intention to offset an overpayment from one account to a balance due on another account or module. We recognize the IRS' authority to credit amounts due the taxpayer to any other liability of the taxpayer, in accordance with IRC section 6402. However, the taxpayer should be notified of such credit application before the action is taken. In many instances, the balance due is erroneous or subsequently abated. Also, the credit application may have serious ramifications for the taxpayer, particularly an individual or a smaller business that cannot afford to engage a representative to deal with the IRS on such issues.

For example, a taxpayer may elect to apply an overpayment of income tax from one year to the next as an estimated tax payment. This overpayment is sufficient to cover the taxpayer's first quarter estimate for the subsequent year. The taxpayer, a sole proprietor, may have been assessed an employment tax penalty on a given quarter. The penalty is due to the fact that a proper liability breakdown was not included with the Form 941. Once this information is supplied by the taxpayer, the penalty will be abated.

Under the IRS' current system, the taxpayer's overpayment of income tax will be applied to the outstanding assessment for the employment tax penalty. The remaining amount applied to the first quarter estimated tax payment for the subsequent year may then be insufficient to cover the required quarterly payment and cause the taxpayer to be subject to an estimated tax penalty on the subsequent year. If

the employment tax penalty is subsequently abated, the amount credited to the account will then be refunded to the taxpayer from the employment tax account; the estimated tax penalty will not be abated automatically.

To remedy this and similar situations, we recommend that taxpayers be notified prior to the application of overpayments to balances due on other accounts or modules. There may be other actions in progress to rectify such accounts or significant mitigating factors under consideration by another area within the IRS. The application of such overpayments, without providing the taxpayer an opportunity to address the situation, is a denial of "due process" and may create unnecessary complications and frustrations for both the IRS and taxpayers.

*Protection from Retroactivity*

The Taxpayer Bill of Rights 2 ("TBOR2") provided relief from retroactive application of Treasury Department regulations by providing that temporary and proposed regulations must have an effective date no earlier than the date of publication in the Federal Register or the date on which any notice substantially describing the expected contents of such regulation is issued to the public, with some limitations. The revision also allowed Treasury to provide that taxpayers may elect to apply a temporary or proposed regulation retroactively from the date of publication of the regulation. However, to date, Treasury has not provided taxpayers with the option of retroactive application.

In addition, the changes by TBOR2 did not address the issue of proposed regulations that are not finalized in a timely manner. For example, many proposed regulations have existed for ten years or more and have yet to be finalized. Even with the TBOR2 changes, such changes would apply retroactively to the date the proposed regulations were first issued. We recommend a time limit of no more than eighteen months be added for the period between the date proposed regulations are issued and the date they are finalized, for purposes of retroactive application.

*Rounding*

We believe requiring the rounding of numbers on most tax returns would decrease the number of errors in tax return preparation and processing. It could greatly enhance efficiency in processing tax returns and does not affect the rights of individual taxpayers.

*Technical Advice in Employee Plans and Exempt Organizations*

Currently, if technical advice is sought with regard to an exempt organization, and the determination by the National Office is in favor of the Service as to a tax-related issue (i.e., liability for or amount of tax), Examination is bound by that determination; however, the taxpayer may take the issue to Appeals. If already in Appeals (or once appealed), Appeals may settle the issue, but must accept the underlying legal analysis of the National Office. In other words, Appeals could settle the issue based on litigation risks, but could not "give away" the issue. However, if technical advice is sought with regard to an exempt organization and a determination is made by the National Office that the entity does not qualify as an exempt organization (or has engaged in activity that should result in the termination of the entity's exempt status), both the Examination Division and Appeals Office of the Service are bound by this decision.

Generally, technical advice may be reviewed on appeal, and the IRS Appeals Office may settle an issue, regardless of technical advice. The reason for this is that Appeals specializes in, and is trained to look at factors other than the "Service's position" as to an issue. Appeals is intended to give the issue a "fresh look" and can make independent determinations. One important factor considered in Appeals is the risk of litigation. Generally, issues may be settled for some dollar value despite the fact that one (or both) of the parties believes that its position is correct. However, the unique rules established in the limited circumstances of EP/EO deny taxpayers a "fresh look" other than by a court, which necessarily involves the expenses of litigation. We recommend that the legislation address this issue.

*IRS "Test" Programs*

In an effort to enhance taxpayer service, the IRS has implemented several test programs or other programs that are limited to select groups of taxpayers. Generally, it is the intent of the Service to expand test programs to other groups of taxpayers. Unfortunately, expanding the scope of taxpayers who may avail themselves of some of these programs often takes years, if ever. Some of these programs are naturally suited to be expanded into other areas.

For example, in Fiscal Year 1996, the Service began a one-year test of mediation with certain types of cases in the Coordinated Examination Program. The Service

has now announced that the "test" will continue for another year. To the extent that mediation has been used, it has been an unmitigated success. Furthermore, there are other taxpayers and subject matters that would be particularly well suited to mediation—such as valuation cases—that could benefit from the expansion of the mediation program rather than continuation as a "test." Other programs that could be evaluated for expedited expansion include accelerated issue resolution, early referral, and the delegation of more settlement authority to the Examination Division.

*Allowing Taxpayers in "Small Cases" in Tax Court to be Represented by CPAs*

The vast majority of small cases in Tax Court are "pro se." In such instances, the taxpayers do not have the benefit of representation and the Tax Court, in trying to determine a just resolution of the tax controversy, does not have the benefit of having the facts and applicable tax authorities presented to it by an individual knowledgeable in the area.

The need for greater access to representation of taxpayers in the Tax Court apparently is recognized by the court itself, by permitting students enrolled in certain tax clinic programs to practice before the Tax Court. The need also is apparently recognized by the National Commission on Restructuring the Internal Revenue Service and the drafters of the H.R. 2292, based on the proposal to fund tax clinics where students may practice before the Tax Court.

To provide taxpayers with greater access to representation with respect to their controversies, it is recommended that legislation be enacted to allow all CPAs to be authorized for small case practice before the Tax Court.

VII. CONCLUSION

The AICPA appreciates the opportunity to offer comments at today's hearing and is willing to provide the Subcommittee with additional assistance and comments as requested. Thank you for your attention.

---

Chairman JOHNSON. Thank you, Mr. Mares.
Mr. Lane.

**STATEMENT OF JOSEPH F. LANE, ENROLLED AGENT, MENLO PARK, CALIFORNIA, AND CHAIRMAN, GOVERNMENT RELATIONS COMMITTEE, NATIONAL ASSOCIATION OF ENROLLED AGENTS**

Mr. LANE. Madam Chair, thank you for the invitation for the National Association of Enrolled Agents to appear before you today. We have submitted a rather extensive written testimony and I'll just go through the highlights in the interest of time.

Out of the 21 provisions in title III of H.R. 2292, we agree fully with 14 of them and we have listed those, so we will not bother to comment on them at this time. On the remaining provisions, we offer some suggestions and comments.

On the Freedom of Information Provision, section 307, we would like to see this section expanded to require that whenever taxpayers or their authorized representatives request copies of workpapers, history sheets and other administrative file contents from revenue offices or revenue agents that are assigned the case that the law require that that be turned over within 10 days.

We have a vast variety of activities in the IRS districts. We have some activities, some IRS districts that are turning information over when requested by these people, others requiring the people to go through a formal FOI process that is not the process.

In the offer in compromise area, we would like to see, we have reviewed testimony from the American Bar Association Tax Section Committee, which we understand is in the process of approval, and

another one which is endorsed by the Federal Bar of Illinois, which would permit or bar the IRS from using the Bureau of Labor Statistics averages for determining taxpayer expense allowances in the collection case determinations.

We think each taxpayer's case should be determined on the unique facts and circumstances of that taxpayer. One of the problems that has been caused by the use of these national standards and local standards, we believe, have been an increase in the number of bankruptcies filed in 1996 and continues to this day. And we believe Congress should implement a study to look at those bankruptcies. GAO should also do that. And we believe the law should be changed in that area.

Regarding taxpayer interviews, section 316, we think this section must include language that makes it clear beyond a doubt that the Service does not have the right to interview a taxpayer without a summons. That was made imminently clear in Taxpayer Bill of Rights 1. If the taxpayer does not want to appear before the IRS and wants his representative to do so, that should be the taxpayer's right and the taxpayer can be made to appear by IRS only through the issuance of a summons.

We think that there are ample examples in the current processing of cases in the Exam Division where they are abusing their summons authority by attempting to bypass illegally the powers of attorney that are in place to interview the taxpayer.

And, Mr. Portman, we provided your office with a case right on point on that that is occurring right now in—where they have illegally bypassed the representative and attempted to go to the taxpayer and issue a summons rather than requesting or honoring the taxpayer's request for a 30-day letter to be issued. This must stop. I mean we cannot allow the IRS to just flaunt the law and ignore provisions of the Taxpayer Bill of Rights that give the taxpayer right to counsel.

The evaluation of joint and several liability. I was stunned to sit here this morning and listen to Mr. Lubick's comments on this. I remember sitting in the Taxpayer Bill of Rights hearing in March 1995 where we talked about changing that to a proportionate share liability. We had that NGU professor here. He did an excellent job, 2 years to get a 50-page document analyzed. You know, maybe we ought to go out and contract with a law firm to give us an opinion on this law if the Treasury Department's Chief Counsel's Office can't do it in 2 years. It is just incomprehensible for me. He says he has been working on it since 1963. Thirty-four years is another matter.

Procedures relating to extensions of statutes, section 318. We don't have a problem with the procedural problems we have with the exam function. But we do believe there are severe problems right now with collection procedures for requesting statute extensions on collections cases and urge the Subcommittee to hold a hearing on this area. We believe there are abuses going on in this position.

We have situations today where the automated collection function in the IRS is asking people who filed a 1996 tax return in April and who are asking for an installment agreement, and let's say it is a $10,000 case, and they can only pay $55 a month, the

IRS manual today requires them to ask that taxpayer as a provision for giving and granting an installment agreement to sign a statute extension to extend the statute to 14½ years from now. That's outrageous. There is nothing to say that that statute is imminent. They have 9½ years left on the 10-year statute Congress gave them in 1990.

I don't think it was ever the intention of Congress to have IRS in the mortgage business with 20- and 30-year notes on taxpayers. If they can't collect it in 10 years, it is outrageous. That whole area ought to be looked at, whether or not they should even be continued to have the right to collect statute extensions in collection. They, after all, have the right to reduce their lien to a judgment if they think there is a sufficient reason to pursue the taxpayer.

A review of penalty administration. We would like to see the whole penalty structure reviewed. There are too many penalties for too many infractions, and you can't expect anybody to understand how they should work. And I think that we have seen ample evidence of that this week.

We have some additional comments. We support the Dunn-Tanner bill that was introduced today. We absolutely think that is a fundamental right of taxpayers not to have their own advisors used as witnesses against them. We believe another thing that needs to be changed in this statute is the unreasonable compensation statute needs to be amended. We have seen an abuse of process in the exam function where the unreasonable compensation statutes in small businesses are being used to target people that have paid themselves relatively attractive salaries. And I think the abuse on this is this generally occurs when you have a situation where the agents have spent a lot of time on a case and they have not been able to develop any issues because, quite frankly, companies that are this well off and can afford to pay the corporate shareholders very welfarely have their accounting act together, have afforded good tax advise, and have done things correctly.

So we would like to see the Code change which bars the IRS from raising the unreasonable compensation from corporate cases if the W–2 compensation is $1 million or less. It is only fair to put small business on the same plane you have large corporations, especially when we have situations today where we see average corporate executives earning 300 and 400 times the average salary in the corporation, and we have got one example quite publicized last year.

Disney paid somebody $90 million not to work for them. It is a phony tax issue that should be dropped. We also urge the Subcommittee to register all commercial tax preparers and level the playingfield. There is another problem we have where we have identified that the taxpayer who files a delinquent tax return and it is more than 3 years old, they do not get credit for their Social Security taxes, even though they are paid in. That needs to be changed. That is an unfair law.

We also believe that Congress ought to establish a principle that in no case will the penalties ever exceed 100 percent of the tax due for a given tax period. And the other thing is that the tax penalty should be used or scored for revenue estimation purposes.

The last thing we will leave you with is a suggestion that you may want to look at extending the time based on reasonable cause for people to file claims for refunds. We saw a case last year where an elderly man who had Alzheimer's paid an estimated tax payment of $7,000 instead of $700 and it was discovered by his daughter 3 or 4 years later and she filed a suit and the court was not able to grant relief in that area because they didn't have the statutory authority to do so. We would like to see that addressed. There should be a provision for reasonable cause for taxpayers that find themselves in these situations where they can go back and get refunds.

We will be happy to take any questions you may have on this topic. Thank you.

Chairman JOHNSON. Thank you, Mr. Lane. And thank you for your offer of the rural agents to work with the IRS to look at any backlog of problems there are right now——

Mr. LANE. We're very concerned.

Chairman JOHNSON [continuing]. And to ensure that we don't have more cases out there like those that testified in the Senate. We appreciate that. That was spirited action on your part.

[The prepared statement follows:]

**Statement of Joseph F. Lane, Enrolled Agent, Menlo Park, California, and Chairman, Government Relations Committee, National Association of Enrolled Agents**

Madame Chair and members of the Oversight Subcommittee, my name is Joseph F. Lane, EA. I am an Enrolled Agent engaged in private practice in Menlo Park, California. I am the Chairman of the Government Relations Committee of the National Association of Enrolled Agents and I am pleased to have this opportunity to present testimony on behalf of NAEA's more than 9,000 members on the taxpayer rights provisions of H.R. 2292.

Enrolled Agents are tax professionals licensed by the Department of the Treasury to represent taxpayers before the Internal Revenue Service. The Enrolled Agent designation was created by Congress and signed into law by President Chester Arthur in 1884 to ensure ethical and professional representation of claims brought to the Treasury Department. Members of NAEA ascribe to a Code of Ethics and Rules of Professional Conduct and adhere to annual Continuing Professional Education standards which exceed IRS requirements.

Today, Enrolled Agents represent taxpayers at all administrative levels of the IRS. Since we collectively work with millions of taxpayers and small businesses each year, Enrolled Agents are uniquely positioned to observe and comment on the average American taxpayer's views about the Internal Revenue Service.

Representatives of NAEA testified at five public hearings conducted by the National Commission on Restructuring the IRS and we submitted written testimony for the record for a sixth hearing. In addition, our National staff attended numerous informal meetings with Commission staffers and Commissioners. We praised the work done by the Commission in focusing on constructive ways of improving our tax administration system and making the IRS more responsive to taxpayer input. We support the Commission's recommendations which have been incorporated into the pending legislation as we believe the true bipartisan nature of the Commission's deliberations and the earnest give and take of the democratic process have produced a set of recommendations which are carefully woven together and interdependent upon each other to effect the change all agree is necessary in the way our tax administration system works. We urge the House to pass H.R. 2292, the Portman-Cardin bill, currently under consideration so restructuring can proceed as soon as possible.

One of the major focus areas of the Commission report was that the IRS must place more emphasis on respecting taxpayer rights in carrying out its compliance mission. Toward that goal, H.R. 2292 addresses several specific provisions for enhancement of taxpayer protection and rights and we are pleased to be able to comment on those today. In addition, we are including several additional suggestions in this crucial area for the Committee's consideration.

H.R. 2292 TITLE III PROVISIONS

We support the following provisions of the bill without exception:

- Expansion of Authority to Issue Taxpayer Assistance Orders (Section 301)
- Expansion of Authority to Award Costs and Certain Fees (Section 302)
- Civil Damages for Negligence in Collection Actions (Section 303)
- Disclosure of Criteria for Examination Selection (Section 304)
- Archival of Records of the Internal Revenue Service (Section 305)
- Tax Return Information (Section 306)
- Elimination of Interest Differential on Overpayments and Underpayment (Section 309)
- Elimination of Application of Failure to Pay Penalty During Period of Installment Agreement (Section 310)
- Safe Harbor for Qualification for Installment Agreement (Section 311)
- Payment of Taxes (Section 312)
- Low Income Taxpayer Clinics (Section 313)
- Jurisdiction of the Tax Court (Section 314)
- Cataloging Complaints (Section 315)
- Study of Burden of Proof (Section 321)

On the remaining provisions, we offer the following comments and suggestions:

*Freedom of Information (Section 307)*

We would like to see this section expanded to require that whenever taxpayers or their authorized representatives request copies of the work papers, history sheets and other administrative file contents from a Revenue Officer or Revenue Agent assigned to the taxpayer's case that the Service employee will comply with the request within 10 working days. We have encountered widespread variations among IRS districts regarding this question. In some they are following the National Office policy of releasing the requested data while others are requiring the taxpayer or the representative to file formal FOIA requests which greatly increase defense costs to the taxpayer. In addition, the items which should be released should be everything in the administrative file not specifically prohibited by statute.

*Offers in Compromise (Section 308)*

We believe the intent of this section was to make certain that taxpayers, seeking to compromise their tax liabilities, were insured they would be able to have adequate means for their normal living expenses but we do not believe the language of the bill adequately addresses the key issues. We believe the Service should be required to view each taxpayer's case facts on their own merits and not be authorized to employ national and local standards.

We have reviewed the legislative proposal drafted by the American Bar Association's Tax Section and another endorsed by the Federal Bar of Illinois and concur with the concept that the Service should be barred from using statistically generated average expenses in favor of considering the unique facts and circumstances of each taxpayer's case in making collection case resolution decisions, including offers in compromise.

We understand the Service's position that using the Bureau of Labor Statistics data provides a level playing field among all taxpayers. The Service maintains that the standards were developed to answer taxpayer and practitioner complaints about inconsistent treatment of taxpayers. We agree that if the result of the use of standards was consistent treatment it would be an acceptable result, but we are increasingly concerned about the lack of good judgment being exhibited in cases reported to us by our Members. Service employees, especially Revenue Officers, are compensated based on the complexity of their cases. When the National Office dictates that standard allowances be used then more often than not the standard amount becomes the final answer despite the fact that the Manual permits some deviation from the standards in exceptional cases with supervisory approval. This "checklist approach" leads to as many inequities as the prior system of evaluating each taxpayer on their actual expenses and has caused some new concerns to crop up, notably in the areas of bankruptcy and offers in compromise.

There has been a dramatic increase in the number of personal bankruptcies since January, 1996. The increase last year was in excess of 25% despite a very strong economy in almost every part of the country. In our opinion, many of these increased bankruptcies were the direct result of the IRS imposition, in October, 1995, of National and Local standard expense allowances for use in reaching Collection case determination decisions. In many instances, the imposition of these limits on what a taxpayer may claim as a necessary and reasonable monthly expense has benefitted the Service to the detriment of other unsecured creditors and, in some

cases, secured creditors who enjoyed lien priority to the IRS liens. This is especially true with respect to real estate holdings of taxpayers.

We do not believe this effect was ever intended by Congress when enacting the Federal Tax Lien statutes. These standards have a pervasive effect as they impact any case resolution decision relating to the ability of the taxpayer to secure an offer in compromise, an installment agreement, or a determination that the tax is currently not collectible.

In many geographical areas, the standard expense allowances for housing, utilities, property taxes, homeowners or renters insurance, association fees and property maintenance and repairs are absurdly low. As a consequence, many practitioners have been forced to recommend that their clients seek the protection of the bankruptcy court as there simply is no way to resolve the matter administratively within the IRS.

When we raised this issue with IRS National Office Collection officials last year, we were advised that their new policy had no impact they could discern on bankruptcies. We believe there is ample indication that there is a direct cause and effect and urge the Committee to investigate the problem.

*Procedures Involving Taxpayer Interviews (Section 316)*

We believe this section must include language that makes it clear beyond doubt that the Service does not have the right to interview the taxpayer without a summons. The first Taxpayer Bill of Rights made it clear that taxpayers had the right to counsel and did not have to appear along with their representatives. We have been fighting with the Service ever since then regarding this question. In fact, we would propose that taxpayers be given the ability to secure monetary sanctions against Service employees who bypass taxpayers' representatives with legal Powers of Attorney. This issue is significant enough that when we poll our Members we find that the overwhelming majority can cite specific instances where Service employees have gone around them and tried to contact the taxpayer directly in clear contravention of published internal IRS procedures and the law. It is such a pervasive problem that we have had to develop training materials for our Members on how to handle illegal bypasses. It is time to make those Service employees who flaunt the law to pay up personally for their transgressions.

*Evaluation of Joint and Several Liability (Section 317)*

We have no specific objection to this section but wish to comment that we are still in favor of the United States being brought into conformity with the rest of the industrial nations of the world in permitting proportionate share liability on jointly filed returns. We thought the Committee's hearing on this subject in March 1995, was very interesting and hoped that some substantive change would be in process by now on this issue which is the cause of so many problems between the IRS and taxpayers.

*Procedures Relating to Extensions of Statute of Limitations by Agreement (Section 318)*

We have no objection to the provision with respect to examination statute extensions but in our opinion, current IRS procedures for seeking collection statute extension approvals from taxpayers need a total overhaul. It should be an exceptional case where the Service is not able to collect the assessment within the ten years permitted by statute, this was their justification for seeking the extension from six years to ten in 1990. One would be reasonable to assume that requests for taxpayers to extend statutes were rare. In fact, the Collection Division Automated Collection Service (ACS) has begun requiring taxpayers who request installment agreements which can not fully pay their tax obligation within ten years to sign extensions on the collection statute now even though there may be as much as 9.5 years left on the statute! For example, a taxpayer filed a 1996 return on April 15, 1997 owing $10,000.00. The IRS review of the taxpayer's financial condition revealed an ability to pay installments of $55.00 per month. The taxpayer was requested to sign an extension until the year 2012! In a contrasting situation, taxpayers with no ability to pay monthly would have their cases reported as "currently not collectible" and suspended without being asked for the statute extension! We question if the current statute permitting extensions is still needed in light of the 10 years permitted to collect. After all, the Service always has the right to reduce its lien to a civil judgment if it feels additional time is warranted to effect collection.

Congress should examine the whole issue of permitting extension of Collection statutes and at the very least should consider establishing some dollar criteria threshold before a statute extension request could be made of a taxpayer. In the interim, we suggest that the Service be required to provide every taxpayer asked to

sign a statute extension with a publication specifically addressing the implications of signing or refusing to sign such requests. Additionally, we think Service requests for extension ought to be in writing and that the taxpayer should be provided with a 5 business day "cooling off" period to seek professional advice concerning the request for extension. Finally, in the event Service personnel coerce, mislead, or misinform taxpayers about the consequences of statute extensions, then taxpayers should have the right to revoke the extension and the original statute date should be reinstated even if that means the Service becomes effectively barred from further Collection efforts. These changes would go a long way towards making taxpayers feel the Service is adhering to both the spirit and the letter of the law.

*Review of Penalty Administration (Section 319)*

We have no objection to the Taxpayer Advocate studying the issue of penalty reform but the problem with penalties often originates here in Congress. The best example we can cite is the recently enacted practitioner penalty for failure to perform due diligence on earned income tax credit cases. We acknowledge there are several legitimate questions concerning if there should be an earned income credit and if IRS is the proper agency to handle it, but the way to solve it is not to penalize the income tax preparer who is relying on information provided by the client. The onus for accuracy belongs with the taxpayer. We offer some additional suggestions in the penalty arena below.

*Study of Treatment of All Taxpayers as Separate Filing Units (Section 320)*

We would have expected to see the issue of joint and several liability listed among the items studied under this section. If it was intended then we believe the wording of the section ought to spell it out.

ADDITIONAL TAXPAYER RIGHTS ISSUES

*Protecting a Taxpayer's Right to Confidentiality*

We would like to see the Committee recommend legislation protecting a taxpayer's right to confidentiality for any tax counsel and advice. It should be a basic right of taxpayers not to have their own advisors used as witnesses against them. We believe that the IRS has overly broad summons authority which permits it to inquire into a taxpayer's thought processes and the tax advice they received. This violates the taxpayer's reasonable expectation of privacy and confidentiality and goes beyond IRS needs for factual information to determine proper tax liability. Under current law, taxpayers can protect nonfactual information such as analyses, advice and opinions only if they have the financial resources necessary to obtain legal counsel. This practice results in unequal treatment of taxpayers based on their financial status or choice of tax professional.

We believe that the Committee should consider the following proposal to provide all taxpayers fair and equal treatment:

1. for all taxpayers, permit the IRS access to all factual information upon which a return is based;
2. if the IRS had a reasonable suspicion based on evidence that the taxpayer failed to fully report income, the Service would have authority to summon other factual information relevant to the taxpayer's income; and
3. if a taxpayer became the subject of a criminal investigation, the IRS could employ the same broad summons authority available today.

This proposal removes the conditions and ambiguities regarding whether a taxpayer may keep tax advice confidential by linking that protection to the taxpayer—rather than the identity of the tax advisor. Taxpayers remain fully obligated to report every dollar of income and prove every deduction, exemption, expense and credit claimed on the return. However, the IRS would not have access to nonfactual information—such as opinions, analyses, thoughts, theories and mental impressions of the taxpayer and his/her advisor—without the taxpayer's consent.

*Revise the Unreasonable Compensation Statute*

We recommend that Congress revise the Internal Revenue Code provisions concerning unreasonable compensation to include language which bars the IRS from raising this issue in cases where the Form W–2 compensation is $1,000,000.00 or less. We think it is nothing short of outrageous that small business owners who have worked for years to build their successful business enterprise should be subjected to second guessing by IRS Revenue Agents as to what should be their compensation. This is especially true in light of highly publicized reports where large corporation executives are being paid 300 or 400 times the average wage in their company and in one case where Disney paid one executive $90 million to leave! The

courts have held for taxpayers in most cases on this issue in recent years. This issue is usually raised only after the agents have spent a great deal of time looking at other issues and not been able to identify any problems since enterprises able to pay up to this level of compensation generally are well run, have excellent accounting systems in place, and can afford competent tax advice. It is time to stop harassing successful entrepreneurs with this phony tax issue!

*Register All Commercial Tax Return Preparers*

We would like to see the recommendations of the IRS Commissioner's Advisory Group regarding the registration of all commercial tax return preparers enacted into law. We believe that a fundamental taxpayer right is to be able to rely on the expertise of the individuals who assist in helping citizens meet their tax obligations. We have, for too long, had an uneven playing field where those tax professionals who have made the most significant commitment to their profession—Enrolled Agents, attorneys and Certified Public Accountants—are the most regulated. Only those professions require continuing professional education. Only those professions have developed standards of professional practice and published standards of professional ethics. The tax laws of this country are too complex to permit commercial firms to offer services to taxpayers without requiring they maintain a minimum level of technical proficiency and stand by their product in the event of error. Taxpayers deserve no less. We regulate barbers more than we regulate commercial tax preparers in this country and you can recover from a bad haircut in three weeks!

*Provide Full Credit for Social Security and Self-Employment Taxes Paid In*

Current procedures followed by the IRS and the Social Security Administration with respect to properly crediting the Social Security and Self-Employment taxes paid by delinquent taxpayers need to be corrected by statute. If a taxpayer fails to file a tax return for more than three years, even if there is a refund due and all taxes are paid in timely, the taxpayer is not credited by the SSA for the FICA and SE taxes paid in, yet the IRS insists on collecting these same taxes. If the government is paid the taxes it should credit the taxpayer's account—that is only fair.

*The Total Amount of Penalties Should Never Exceed 100% of the Tax*

As a general principle of fair and reasonable tax administration, we believe Congress should declare that the total amount of penalties asserted against taxpayers should never exceed the tax amount for the same period.

*Tax Penalties Should Not be Used for Revenue Raising*

We believe the current penalty statutes should be subject to a top down Congressional review. There are too many penalties for too many infractions and no one could reasonably expect taxpayers to comprehend their applicability. We think the current code's proliferation of penalties has accomplished nothing but to create taxpayer perceptions of a system run amok and acts like a hidden tax rate. This feeling is reinforced by the fact that various committees have taken to scoring penalties for revenue estimation purposes.

*The Number of Years to Claim Refunds Should be Lengthened*

We have all seen some recent tax law cases where ample reasonable cause existed to permit longer periods for taxpayers to claim refunds and the Courts found themselves bound by statute to deny the claims. We believe this is wrong and Congress should extend the right to refund claims for a period longer than three years.

SUMMARY

We thank the Committee for the invitation to share our Members' positions with you today. I will be happy to respond to your questions and comments about our views.

---

Mr. Kamman.
Mr. KAMMAN. Kamman.
Chairman JOHNSON. Sorry. Kamman.

**STATEMENT OF BOB KAMMAN, COUNSEL, TAXPAYER RIGHTS PROJECT, NATIONAL TAXPAYERS UNION, ALEXANDRIA, VIRGINIA; ACCOMPANIED BY AL CORS, JR., DIRECTOR, GOVERNMENT RELATIONS, NATIONAL TAXPAYERS UNION, ALEXANDRIA, VIRGINIA**

Mr. KAMMAN. Thank you Chairman Johnson, Members of the Subcommittee. My name is Bob Kamman, and I represent the 300,000 members of the National Taxpayers Union, who strongly support granting additional rights to and remedies for taxpayers. When Congress enacted taxpayer rights legislation in 1988 and again in 1996, it left something out. It should have made the statement requiring that when you grant a taxpayer right by statute, it should be liberally construed in favor of the taxpayer. That is not being done. And the result is that rights that are granted by statute are taken away by the regulations as IRS right to construe them.

I would like to focus on a couple of examples of this. One under section 7811, the Code section that authorizes taxpayer assistance orders, the definition of hardship that is contained in that section has become a burden that the taxpayer must meet in order to get entry to the Taxpayer Assistance Program.

One of the most important job skills of an IRS Problem Resolution Officer is to deny that hardship exists. We see evidence of this all the time. While there is no evidence that the first Taxpayer Bill of Rights intended for a strict definition of hardship to be applied, that is what is happening. For example, it is unlikely that any of the taxpayers who testified this week before the Senate Finance Committee could have convinced the IRS Taxpayer Advocate that they met the IRS standard for hardship.

The time has come for Congress to tell the IRS the meaning of hardship. Section 301 of H.R. 2292 accomplishes this objective. If an IRS employee is breaking IRS rules, then that is a hardship, and the Taxpayer Advocate should intervene. If a taxpayer is threatened with a levy despite good faith efforts to make payment arrangements or proof that the tax is not owed, then the Problem Resolution Officer should act instead of advising, "call us back when the levy is actually issued."

Having account problems with the IRS may just be stressful, but having to wait more than 1 month for an answer is a hardship. And being told by a tax professional that it will take 5 hours or $500 to convince the IRS of its mistake is a hardship regardless of the taxpayer's income or assets.

The second example of the need for regulatory relief is Code section 7430, which awards costs and certain fees to taxpayers who prevail in cases against the IRS. The current law allows payment of fees to CPAs and enrolled agents. This is not just an attorney fee statute. Fees are allowed in administrative proceedings only when administrative remedies are exhausted.

Section 302 of H.R. 2292 recognizes that the clock should start running for IRS liability for reimbursing fees after issuance of the 30-day letter. The 30-day letter generally follows the conclusion of an unagreed audit and invites the taxpayer to take the case to the Appeals Office. There is a problem with section 7430 in the regulations. The regulations state a request must be filed with the Inter-

nal Revenue Service personnel who have jurisdiction over the tax matter underlying the claim for the cost. This is somewhat like the New York Police Department requiring a victim of alleged abuse to file their claims for compensation with the arresting officer.

Under existing law, a taxpayer who is denied administrative expenses for cases settled at the administrative level must sue the IRS in Tax Court. Even if section 7030 is amended as proposed by H.R. 2292, the Nation's CPAs and EAs may have to advise their clients that having won their case, they will still have to hire a lawyer to win their fees.

We recommend that the fee approval process be assigned to the Taxpayer Advocate Office with input from the IRS personnel who handled the case. But if there is an independent Taxpayer Advocate, that position is where taxpayers should go for this remedy of having some of their fees paid in administrative and court proceedings.

Finally, maybe we should submit a bid on Mr. Lane's contract here regarding spouses. The tax problems of spouses who wind up paying the tax debts of their former husbands or wives, which has been pointed out earlier, is one of the most common complaints. There is another example this week, which is the former spouse who is paying the taxes on the income of the former spouse who has left town and is mostly a tax deadbeat, maybe a child support deadbeat also. We have made a proposal to remedy this. This isn't a perfect solution, but it didn't take a year to come up with it in a draft and review.

We believe that when the same tax debt is owed by two people, Congress should establish a priority for the IRS to follow in its collection efforts. Thousands of divorced single parents would welcome simply some breathing room so they can make their family, not their tax bill, their first priority. We propose, upon request by a qualifying former spouse, the statute of limitations for collection, along with all enforced collection action be suspended until the taxpayer's youngest child reaches 18. And during that period, the failure-to-pay penalty not be assessed.

The other spouse would continue to be targeted for collection action. To qualify for this relief, a former spouse would have to have a dependent child living at home and owe tax only on income received by the former spouse, disregarding community property rules.

We have made a number of other suggestions, comments and proposals regarding the taxpayer rights provisions of H.R. 2292 in our written statement. We look forward to working with the Subcommittee staff if they have questions or require assistance on any of these suggestions. Thank you.

[The prepared statement and attachment follow:]

**Statement of Bob Kamman, Counsel, Taxpayer Rights Project, National Taxpayers Union, Alexandria, VA**

Thank you for the opportunity to testify on reforms to improve taxpayer rights. I represent the 300,000 members of the National Taxpayers Union (NTU) who strongly support providing taxpayers with additional rights and protections during the tax audit and collection process. I am accompanied by Al Cors, Jr., who is Director of Government Relations of NTU. Although NTU's Executive Vice President David Keating could not be here today, he contributed substantially to our analysis and comments.

I am a lawyer in Phoenix, Arizona. My office address is 3031 W. Northern Avenue #150, Phoenix AZ 85051. I also write articles on tax topics; many of these have appeared in a membership newsletter published by NTU. I have also written on tax issues for The Wall Street Journal's opinion pages, and have been quoted concerning taxpayer rights in publications such as U.S. News and World Report, Reader's Digest, Money and Kiplinger's Personal Finance. I worked for the Internal Revenue Service, from 1973 through 1978, in various Taxpayer Service assignments.

Representative Johnson, we commend you for scheduling this hearing to examine taxpayer rights. Because the IRS has more power over more citizens than any other agency, it is especially important that Congress establish safeguards to protect the rights of taxpayers and to regularly maintain oversight of the tax collection power.

## FOCUS ON TAXPAYER REMEDIES

In the last decade, many proposals have been made about granting rights to taxpayers who must deal with the Internal Revenue Service. Some of these suggestions have been enacted into law. Today, the time has come for Congress to consider, not just the subject of taxpayer rights, but the need for taxpayer remedies. Americans do not yet have enough of the former, but what they lack most is the latter.

The taxpayer rights provisions of the Internal Revenue Code are like the civil rights provisions of the former Soviet Union's constitution. On paper, they tell a wonderful story. In practice, for many taxpayers there is no effective protection against government abuse.

The first question that taxpayers may ask about an IRS action is, "Can they do that?" But when the answer is "No," the next question has greater importance: "What can I do to stop it?" Too often, the answer is, "not much," or "nothing at all."

There are a number of practical ways to fix this lack of remedies. The legislative approach should recognize the need for "Taxpayer Triage"—categorizing and providing the appropriate level of assistance for each taxpayer problem.

Most complaints can be handled by the IRS itself, if there is a Taxpayer Advocate who is independent, effective and resourceful. Many more disputes with the IRS can be resolved by the professionals who deal with the tax law most, day to day—Certified Public Accountants (CPAs) and Enrolled Agents. The smallest number of cases, although perhaps the most important, will require the involvement of the legal profession.

Because of the government's fondness for acronyms, perhaps this program should be known as TRAUMA (Taxpayer Remedies Against Unfair Mistakes and Abuse).

## TRAUMA LEVEL ONE: THE TAXPAYER ADVOCATE

Today, one of the most important job skills of an IRS Problem Resolution Officer is knowing how to deny that a "hardship" exists for a taxpayer who has asked for help. There is no evidence that, when the first Taxpayer Bill of Rights was enacted in 1988, Congress intended the definition of "hardship" to be liberally construed in favor of the IRS and against taxpayer rights. Nevertheless, that is what happened, when the Regulations to Section 7811 were written.

To help prevent such narrow interpretations by the IRS, the following language should be added to this bill: "In any administrative or judicial proceeding, the taxpayer rights provisions of this Act and all other Taxpayer Bill of Rights legislation shall be liberally construed in favor of the taxpayer."

The time has come for Congress to tell the IRS the meaning of "hardship." Section 301 of HR 2292 accomplishes this objective. If an IRS employee is breaking IRS rules, then it is a hardship, and the Taxpayer Advocate should intervene. If a taxpayer is threatened with a levy despite good-faith efforts to make payment arrangements or proof that the tax is not owed, then the Problem Resolution Officer should act, instead of advising "call us back if a levy is actually issued."

Having an account problem with the IRS may just be stressful, but having to wait more than a month for an answer is a hardship. And being told by a tax professional that it will take five hours, or five hundred dollars, to convince the IRS of its mistake, is a hardship regardless of a taxpayer's income or assets.

That these are circumstances that create hardships for taxpayers should be obvious to anyone except a career IRS employee; and that is why we strongly believe that the Taxpayer Advocate should not be selected from those ranks. The Taxpayer Advocate must be free to function without concern for his career aspirations within the IRS. He should not have to worry about how other IRS managers view his involvement with their areas of responsibility. A presidential appointee, confirmed by the Senate, in the role of Taxpayer Advocate would be most likely to effect pro-taxpayer changes in the IRS and with Congress.

A more independent Advocate, however structured, would come to the job without the restrictive mission-oriented mentality that besets many career agency executives. He or she would be more receptive to the needs of taxpayers and to changing business-as-usual, and would be far more likely to recommend, to the Congress and to the IRS Board (as proposed in HR 2292), solutions to taxpayers' problems.

The National Commission on Restructuring the IRS (NCRIRS) recommended that candidates for Taxpayer Advocate "should have substantial experience representing taxpayers before the IRS or with taxpayer rights issues. If the Advocate is selected from the ranks of career IRS employees, the selection also should be a person with substantial experience assisting taxpayers or with taxpayer rights issues, and the job description should stipulate that it will be the employee's final position within the agency."

HR 2292 modifies the Commission's recommendations so that the Advocate could be an IRS employee, saying "An individual who, before being appointed as the Taxpayer Advocate, was an officer or employee of the Internal Revenue Service may be so appointed only if such individual agrees not to accept any employment with the Internal Revenue Service for at least 5 years after ceasing to be the Taxpayer Advocate." National Taxpayers Union does not oppose this modification.

The Commission's recommendation that the IRS Board should "have final authority over the hiring decision" of the Taxpayer Advocate will also help ensure the independence and clout needed to increase the effectiveness of this position.

## TRAUMA LEVEL TWO: TAXPAYER REPRESENTATIVES

Awarding attorney fees, when most taxpayer representatives are not licensed to practice law, is like writing health insurance policies that pay emergency-room physicians, when there are not enough paramedics to staff the ambulances. Current law—Internal Revenue Code Section 7430—allows payment of fees to CPAs and Enrolled Agents, in administrative proceedings, only when administrative remedies are exhausted. Section 302 of HR 2292 recognizes that the clock should start running, for IRS liability for reimbursing professional fees incurred by taxpayers, after issuance of the 30-day letter. This letter generally follows the conclusion of an unagreed audit, and invites the taxpayer to take the case to the Appeals Office.

What is wrong with this picture? While Congress may enact laws that permit the payment of such costs, the IRS writes the procedures for actually claiming the reimbursements. The Regulations provide, "A request. . . must be filed with the Internal Revenue Service personnel who have jurisdiction over the tax matter underlying the claim for the costs." This is somewhat like the New York Police Department requiring that victims of alleged abuse file their claims for compensation with the arresting officer.

Under existing law, a taxpayer who is denied administrative expenses for cases settled at the administrative level must sue the IRS in Tax Court. Even if Section 7430 is amended, as proposed by HR 2292, the nation's Certified Public Accountants and Enrolled Agents may have to advise their clients that, having won their case, they will have to hire a lawyer to win their fees.

If there were no IRS officer charged with protecting taxpayer rights with the maximum degree of independence and authority allowed by the system, there would be no solution to this problem. Fortunately, Congress has created, and now plans to enhance, the position of Taxpayer Advocate. One of the functions of that office should be to review and approve applications for Taxpayer Compensation Payments, from those who qualify for Section 7430 relief.

## TRAUMA LEVEL THREE: THE LEGAL PROFESSION AND COURTS

Taxpayers can suffer enormous financial damages even when they win. The 1996 Taxpayer Bill of Rights 2 legislation made several needed improvements in the law, especially the new requirement that the IRS prove it was "substantially justified" in pursuing a case. Nevertheless, the IRS still has the ability to crush taxpayers of modest means because they know such taxpayers often cannot afford representation to ensure their rights.

Because litigation expenses are paid, if at all, only after the taxpayer prevails, the IRS will continue to have the advantage over middle-class taxpayers. To the extent that IRS losses can be used as precedent by all litigants, the proposed changes to Section 7430, at the upper and lower ends of the income scale, will help all taxpayers. Low-income taxpayers will be better served by legal clinics, and high-income taxpayers whose assets exceed the current qualifying levels will have less incentive to accept unjust results simply to avoid the cost of resistance.

As the Commission noted in its report, "there historically has been a concern that expanding taxpayer rights to redress would be disruptive to collection efforts. Set-

ting aside the issue of whether it is appropriate that taxpayers should be provided rights only to the extent that it does not disrupt collection efforts, the Commission found no evidence that the rights to redress and collection of representation fees provided to the taxpayer under the Omnibus Taxpayer Bill of Rights and Taxpayer Bill of Rights 2 have caused disruption to IRS collection efforts. In addition, the costs of expanding taxpayers' redress have been vastly overestimated. For example, the cost of reimbursing representation fees was originally estimated to be over $100 million per year. The actual cost has been approximately $5 million per year."

It should be noted that Section 302 of HR 2292 creates a "safe harbor" for the awarding of fees as follows: "The position of the United States was not substantially justified if the United States has not prevailed on the same issue in at least 3 United States Courts of Appeal." Proponents of taxpayer rights would wonder if they had died and gone to Heaven if this language were actually enacted, because the NCRIRS recommendation was only that "if the IRS has lost a position in at least three United States Courts of Appeal .. . . subsequent taxpayers will be entitled to recover under section 7430 because the subsequent loss would serve to indicate that the position of the IRS was not substantially justified."

Lawyers in the Justice Department's Tax Division have rights too, so it may be unfair to require three wins by the IRS before a loss can be disputed. However, the Commission recommendation needs to be reworked also, since the IRS usually stops litigating when it has lost in three circuits. We believe the safe harbor should be a loss in one circuit without any offsetting win in any circuit. If the IRS wants another taxpayer "guinea pig" in another region, let it take the risk of paying the attorney fees if it loses yet again. Taxpayers should be able to rely on Tax Court decisions without fear of IRS lawsuits.

### SAFEGUARD THE RIGHT TO BE SELF-SUPPORTING

The 1988 Taxpayer Bill of Rights made the very necessary improvement of exempting a larger amount of a taxpayer's weekly salary from levy. But that law, as well as the Taxpayer Bill of Rights II passed last year, made little change in the amount of property exempt from seizure.

The 1996 law lifted the amounts from a paltry $1,650 for personal property to $2,000, and from $1,100 for equipment and property for a trade, business or profession to $1,250. Despite indexation of these amounts after 1997, they hardly add up to a significant change and are far from sufficient to allow a taxpayer to be self-supporting.

What self-employed plumber could maintain his self-employment with just $1,250 in tools, equipment and a truck? What computer programmer or author could do so? Very few, if any.

Who can provide the basic essentials of clothing and furnishings for a family with only a $2,500 exemption?

Here is another absurd contrast: O.J. Simpson could protect more assets from a wrongful death judgment than an overdue federal tax debt! You could say that while everyone knows death and taxes are certain, Congress believes that taxes are more important.

The bankruptcy laws provide far more protection than this. We would like to see the exemption amounts lifted, either to $10,000 or to the same protection level as the bankruptcy laws. Many taxpayers are forced into bankruptcy court by the IRS. Raising the exemption amounts might reduce tax-related bankruptcy filings, and would safeguard the right to be self-supporting. The current levels are ridiculously low.

We would also like to see a study of how many bankruptcies could be prevented by requiring IRS collection procedures to recognize the reality of bankruptcy as an easier way of dealing with many tax problems. Under current procedures, the IRS will refuse a $10,000 offer in compromise, even if the entire debt is dischargeable in bankruptcy. The IRS will also require higher monthly payments than a Chapter 13 plan might require. When the IRS forces a taxpayer to file bankruptcy, it not only diminishes the amount of revenue collected by the government, but it often reduces the amount that other creditors would otherwise collect from a debtor who wants to make payment arrangements in good faith.

### STOP EXPECTING DIVORCE-RELATED TAX PROBLEMS TO "JUST GO AWAY"

One of the most common complaints we hear comes from taxpayers whose former spouse has disappeared, at least from the IRS's radar screen. The IRS pursues the former marriage partner it finds first, usually looking no further than for the name and address it has in its computer. She is often a single parent, working to support a family with little or no help. Tax-debt deadbeats are often child-support dead-

beats, as well. The biggest mistake made by these targets of IRS collection and audit activity is that they filed a joint return.

Of course, in some audits, taxpayers can be relieved of a tax liability under the so-called "innocent spouse" rule. However, its provisions are so complicated that it should be known as the "lucky spouse" rule for the few people who can meet all of its tests.

In one case in Arizona, the IRS dunned Carol Bettencourt, even though she had been divorced for five years. Her former husband ran out on a court-ordered $60-a-month child support payment schedule. Carol never saw a dime from him, but she was expected to pay his tax debts. Carol turned to the IRS Problem Resolution Officer, who told her that since she had once filed joint returns, the only solution was to pay up.

But the Problem Resolution Officer failed to note that the IRS hadn't sent Carol's notice of tax deficiency to her last known address, which the tax law requires. Fortunately, with volunteer legal help, Carol got her tax refund, which had been withheld to pay her husband's tax debt. It is especially important to simplify and ease criteria that taxpayers must meet to qualify for protection as an "innocent spouse."

Taxpayer Bill of Rights II required that the Treasury Department study this issue and report to Congress by January, 1997. We are still waiting for that report. Why is it that the Treasury Department and IRS expect taxpayers to file on time, but that studies required by law are often extremely late? In Arizona, state judges are not paid if they fail to reach a decision on a pending matter within 90 days. If Congress impounded the paychecks of Treasury Department executives until required reports were delivered, perhaps these officials would find a way to turn in their homework on time.

The 1996 legislation also required that one party to a joint return be told what efforts are being made by IRS to collect from the other. "You satisfy the tax debt, and we'll satisfy your curiosity," seemed to be the remedy. What the law should require is, "You tell us where he is, where he works, and what he owns, and we'll go after him at least as vigorously as we are now pursuing you."

A divorcing spouse should also have the right to petition the IRS for a final determination of any outstanding or potential tax liabilities, under the "prompt assessment" procedures now available to deceased taxpayers (that is, their executors and personal representatives). This would provide some protection from a tax surprise, after a divorce is final.

Reportedly, the IRS computer system is unable to set up separate collection accounts when the two divorced spouses live in different IRS districts. If this is true, then it is not simply a question of the IRS trying to collect the joint tax liability from the spouse who is located first, but the spouse whose case is being aggressively pursued by one of the two districts. Or, a Revenue Officer may determine that another spouse lives in another district and refer his case to the other district for collection. Case closed, problem transferred. But a fair solution would still elude the unfortunate taxpayer.

In some cases when the same tax debt is owed by two people, Congress should establish a priority for the IRS to follow in its collection efforts. What thousands of divorced single parents would welcome is simply some "breathing room" so that they can make their family, not their tax bill, their first priority. There is a way to do this that will not cost the Treasury a dime, and may actually result in higher receipts.

In Attachment 1, we propose that, upon request by a qualifying former spouse, the statute of limitations for collection—along with all enforced collection action—be suspended until the taxpayer's youngest child reaches the age of 18; and during that period, the failure-to-pay penalty not be assessed. The other spouse would continue to be targeted for collection action. To qualify, a former spouse would (1) have a dependent child living at home; and (2) owe tax only on income received by the former spouse (disregarding community property rules).

This relief would not help every divorced person who unwisely filed a joint return; but it would certainly help all those who elected to use it. And I believe it would improve morale among IRS collection employees, who have as much regard for "family values" as anyone else.

### EMPLOYERS NEED REMEDIES TOO

If an employer does not report and deposit withheld income and Social Security taxes, then certain responsible officers can be held personally responsible for the taxes. Such assessments are commonly known as "one hundred percent penalty" cases, because the penalty on the individual equals all of the Trust Fund taxes that

the corporate employer did not pay IRS. While Taxpayer Bill of Rights II provided the IRS with additional abatement authority, this is still an area ripe for reform.

When the IRS seeks to collect these Trust Fund taxes, it often assesses liabilities on everyone in sight (including bookkeepers, accountants, bank officers, inactive directors, inactive or resigned corporate officers, and family members), whether or not they are truly a responsible officer. Inside the agency, this is called the shotgun penalty approach. A lot of innocent people get hurt.

Unfortunately, the burden of proof is on the taxpayer to prove that he or she was not responsible for the lack of payment. You might as well ask the taxpayer "When did you stop beating your spouse?" Proving a negative is a difficult proposition at best.

The burden should be on the IRS to prove the taxpayer was responsible.

Why can't the tax laws define the responsible parties as: 1) the chief executive officer; 2) the chief and senior financial officers; 3) those who serve on the board of directors and own a significant stake in a privately held corporation; and 4) other responsible parties, designated on a schedule that could be attached to the corporation's last quarterly 941 tax return of each year? The attached schedule would clearly state the serious responsibilities to remit Trust Fund taxes and require the signature of each named responsible person to indicate their knowledge of, and consent to, these rules.

If the IRS had the names and addresses of such persons in its computer, then these responsible persons could be immediately notified when a payment has been missed. It would allow these officers and other responsible persons to immediately investigate why these taxes have not been remitted on time, protecting the Treasury and innocent taxpayers.

### Protecting Confidentiality of Taxpayer Advice

Taxpayers often feel they are presumed guilty by the IRS and asked to prove their innocence. The reach of IRS authority even encompasses taxpayers' private thoughts, including what options they may have considered or tax advice they may have received, that have nothing to do with the information on the tax return.

NTU strongly supports legislation to limit the IRS's scope of authority to "factual information upon which the return is based" in routine audits, while providing for a progressively broadened scope of authority under appropriate circumstances. This would help ensure that all taxpayers are treated equally by the IRS. It can also save them money and give them a greater choice of tax advisors. Currently, taxpayers can protect non-factual information only if they can afford legal counsel.

Under such proposed legislation:

- The IRS will continue to have the authority to access all factual information upon which every tax return is based;
- When there is a reason to suspect that the taxpayer has failed to fully report income, the IRS will continue to have the authority to access all factual information exposing unreported income through more extensive investigations; and
- Should a taxpayer become the subject of a criminal inquiry, the IRS will continue to have the authority to conduct a full criminal investigation.

Curbing unwarranted intrusiveness into taxpayers' privacy will in no way curtail IRS authority to conduct a criminal investigation or gain access to all relevant facts when a taxpayer is suspected of underreporting income. In fact, by limiting the IRS in most cases to the factual information necessary to ensure compliance, taxpayer privacy legislation will enable the IRS to focus its resources more effectively on investigations and other tax compliance measures that stand a more realistic chance of success.

### Legal Aliens Also Deserve Greater Taxpayer Rights

HR 2292 should repeal the "alien tax clearance" procedures contained in Code Section 6851(d). This archaic and absurd statute requires, for example, that a taxpayer who is not a citizen but who has lived in the United States for twenty years, complying with all federal tax laws, to obtain written permission from the IRS to leave the country for a two-week vacation.

To the extent that this law is ignored—which is largely the case—it contributes to the lack of respect for enforcement provisions that do serve a worthwhile purpose. To the extent that it is enforced, it wastes IRS Taxpayer Service resources and imposes only on taxpayers who are dedicated to voluntary compliance.

### TAXPAYERS NEED A REMEDY FOR CARELESS IRS BEHAVIOR

There are many fine employees in the IRS who care about helping taxpayers to comply with the law and who care about respecting taxpayers' rights. But given the sheer number of employees and the billions of tax returns and documents that are received by the IRS each year, it is inevitable that mistakes will be made and that some employees will act out of line.

Although the Taxpayer Bill of Rights laws enacted in 1988 and 1996 offered important new protections for taxpayers, they maintained traditional protections for IRS employees—even those whose behavior the agency long ago should have disavowed.

The original Taxpayer Bill of Rights proposal would have allowed taxpayers to sue for damages if "any officer or employee of the Internal Revenue Service carelessly, recklessly or intentionally disregards any provision" of the tax laws. As the bill progressed through the Congress, the word "carelessly" was dropped from what became Section 7433 of the tax code.

In the 1986 Tax Reform Act, Congress substantially liberalized the definition of negligent actions by individual taxpayers. During the 1980s, tax preparers have also been subject to increasing penalties for not exercising due diligence. Yet incredibly, Congress refuses to require the IRS to exercise reasonable caution in using its vast array of enforcement powers. We believe Congress should require the IRS to practice due diligence in its enforcement actions in order to prevail in litigation where a taxpayer sues for damages. Congress should require that the IRS issue regulations defining a due diligence standard for actions by its employees. We expect that the IRS would include the procedures already outlined in the Internal Revenue Manual as much of the criteria to define this standard.

Taxpayers who have been financially harmed or devastated by IRS carelessness in ignoring a due diligence standard should have the right to sue and recover damages. We strongly support allowing taxpayers to recover damages for negligent actions by the IRS as proposed in Section 303. We also note that Section 7433 of the Internal Revenue Code is still flawed because it only applies to collection of a tax, not the determination of it.

Courts should also have the option of requiring damage awards, when based on the "reckless" or "intentional disregard" standards, to be paid by the employees who violated taxpayer rights, and not just by the agency that employed them.

Several years ago, Congressman Andy Jacobs introduced an amendment t make IRS employees personally liable for attorneys' fees paid by taxpayers who proved IRS agents acted arbitrarily and capriciously in pursuing the taxpayers. While this proposal may have gone too far, the concept is a good one—allowing such judgments, in egregious cases, would serve notice to IRS employees that their first duty is to protect taxpayers' rights.

Section 552(F) of the Federal Freedom of Information Act contains a standard that may be useful in drafting such a provision in the federal tax law. It says that "Whenever the court orders the production of any agency records improperly withheld from the complainant and assesses against the United States reasonable attorney fees and other litigation costs, and the court additionally issues a written finding that the circumstances surrounding the withholding raise questions whether agency personnel acted arbitrarily or capriciously with respect to the withholding, the Special Counsel shall promptly initiate a proceeding to determine whether disciplinary action is warranted against the officer or employee who was primarily responsible for the withholding."

### UNLOCKING THE COURTHOUSE DOOR

In the rare cases when the IRS goes out of control, federal law largely prevents the courts from allowing taxpayers to enforce their rights. The Federal Tort Claims Act allows the government to be sued in certain instances but specifically excludes "any claim arising in respect of the assessment or collection of any tax or custom duty." Of course, the 1988 Taxpayer Bill of Rights granted two very limited exceptions to that rule.

Another unnecessarily restrictive law is the Anti-Injunction Act, the law that locks the courthouse door when taxpayers try to assert their rights. It's past time to give them the keys.

Under Section 7421 of the Internal Revenue Code, no lawsuit can be brought by any person in any court for the purpose of restraining the assessment or collection of any tax, except in limited circumstances.

The case law around the Anti-Injunction Act indicates many problems in obtaining injunctions to restrain the collection of the tax. It is clear that injunctions will be granted where the failure to grant relief would result in irreparable damage to

the taxpayer. But an injunction will only be allowed where it is clear that under no circumstances would the government prevail (or that the taxpayer would not owe the tax). Otherwise only two remedies are available to the taxpayer: 1) pay the tax, file a claim for refund, and sue for recovery if the claim is rejected; or, 2) file a petition in Tax Court before assessment and within the short period of time allowed for filing such a petition.

NTU recommends that the Anti-Injunction Act should be amended to give taxpayers the ability to enforce their rights if necessary. Taxpayers should be allowed to file suit in a federal district court to enjoin the IRS from enforcement action because: 1) the deficiency assessment was made without knowledge of the taxpayer and without benefit of the appeal procedures provided by law; 2) there has been an improper or illegal assessment; 3) there has been an action in violation of the law or tax laws or regulations providing for procedural safeguards for taxpayers; 4) the IRS has made an unlawful determination that collection of the tax was in jeopardy; 5) the value of seized property is out of proportion to the amount of the liability if other collection remedies are available; or, 6) the IRS will not release the seized property upon an offer of payment of the U.S. interest in the property.

Then, there's the Declaratory Relief Act. This law says that citizens can file suit to get a court to declare their rights "except with respect to federal taxes."

In author David Burnham's excellent book, *A Law Unto Itself,* he quotes California tax attorney Montie Day and his views on these laws that prevent taxpayers from enforcing their rights. He says that allowing such limited lawsuits would make "the IRS more accountable and make the agency more likely to operate in a lawful fashion."

To illustrate this point, he said "assume you are under audit and somehow you learn that the revenue agent has decided the best way to investigate you is to break a window of your office, climb through it and examine your correspondence."

"You come into my office for advice, wanting the court to rule that the IRS agent can't conduct his audit in this way. We consider filing a suit for declaratory relief, but then we remember that the court does not have the authority to issue such a declaration of rights in tax matters because of that exception in the Declaratory Relief Act."

"Then we think his tax investigation by breaking into your office. This approach, of course, cannot be followed because the court is forbidden to even consider such requests under the Anti-Injunction Act."

As long as taxpayers are largely banned from suing to enforce their rights, taxpayers will continue to be at risk of financial ruin and emotional devastation from the IRS. It is completely unfair for the IRS to have all the powers and for taxpayers to have few rights that can only be enforced with great legal difficulty. We must ensure fair treatment of innocent taxpayers to continue respect for our Constitutional system of government.

## TAX COMPLEXITY INVITES ABUSE

Only weeks after the National Commission on Restructuring the IRS reported that "reducing taxpayer burdens by simplifying the tax laws and administration must start with the Congress and the President," one of the most insidiously complex tax bills ever conceived by Congress was signed into law by the President.

The fact that the nation has survived the greater part of a century, since the adoption of the 16th Amendment is unfortunately being accepted as evidence that no amount of absurdity can be a threat to democracy, even when contained in the tax form instructions that every law-abiding citizen is expected to understand.

Consider the language of the new Child Tax Credit, which provides in part:

"(2) Alternative credit amount.—For purposes of this subsection, the alternative credit amount is the amount of the credit which would be allowed under this section if the limitation under paragraph (3) were applied in lieu of the limitation under section 26.

(3) Limitation.—The limitation under this paragraph for any taxable year is the limitation under section 26 (without regard to this subsection)—

(A) increased by the taxpayer's social security taxes for such taxable year, and

(B) reduced by the sum of—

(i) the credits allowed under this part other than under subpart C or this section, and

(ii) the credit allowed under section 32 without regard to subsection (m) thereof."

The insidious aspect of this and other parts of the latest tax law is that they create the greatest degree of complexity for those who are least able to deal with it—the average American family, earning under the "phase-out" income limitations. If their incomes are high enough to meet the "Alternative Minimum Tax" criteria—

only $45,000 for married couples, they face even greater levels of complexity and possibly a loss in the value of the credit.

Federal judges don't sentence tax-crime defendants to read the Internal Revenue Code, because it would be cruel and unusual punishment. Law-abiding Americans should not be asked to wade through such gibberish, ironically labeled as "Taxpayer Relief."

CONCLUSION

The job of protecting taxpayer rights will never end. Much progress has been made, but more legal protections are necessary. We sincerely appreciate the efforts being made by members of this subcommittee to formulate legislation to better protect taxpayer rights.

**Attachment 1**

1] Section 6502 (relating to statute of limitations for collection action) is amended to add the following:

(c) Upon application by a qualifying former spouse with dependent child, the period for collection allowed by subsection (a) shall be suspended until the end of the tax year in which the taxpayer's qualifying child reaches the age of 18. During this suspended period, no enforced collection action (including refund offsets) shall be taken against the applicant. For purposes of this subsection,

i) a "qualifying former spouse with dependent child" is a taxpayer whose unpaid tax liability arises from a joint return, on which the unpaid balance of tax is attributable to income received by the other spouse (disregarding community property rules); and who has a qualifying child.

ii) a "qualifying child" is a child under the age of 18 for whom the taxpayer is allowed a deduction under section 151, and who is identified by name and Social Security Number at the time the taxpayer applies for suspension of collection action.

2] Section 6651(c) (relating to failure-to-pay penalty) is amended to add the following:

(4) The penalty for failure to pay tax under Section 6651(a)(2) shall not be assessed for any period of time that the period for collection is suspended under the provision of Section 6502(c).

Chairman JOHNSON. Thank you very much.

Mr. Harris.

## STATEMENT OF ROGER HARRIS, VICE CHAIRMAN, FEDERAL TAXATION COMMITTEE, NATIONAL SOCIETY OF ACCOUNTANTS; AND PADGETT BUSINESS SERVICES

Mr. HARRIS. First of all, let me begin by saying the National Society of Accountants is again pleased to offer testimony on H.R. 2292. We would like to commend the Subcommittee for holding this important session today. And we would also like to strongly endorse the legislation introduced by Representatives Portman and Cardin.

My name is Roger Harris. I am testifying today in my capacity as vice chairman of the National Society of Accountants, Federal Taxation Committee. I also represent Padgett Business Services, a firm which for over the last 30 years has provided accounting and financial services to small businesses.

The NSA's 17,000 member practitioners represent over 4 million individual and small businesses. And we think this gives us a unique perspective on taxpayer rights. In our view, the best way for government to foster and protect taxpayer rights is for the IRS to improve its level of customer service.

The service component of the IRS should be the primary engine that drives the agency. Taxpayers have a right to expect prompt and courteous treatment from the IRS. The vast majority of the taxpayers who attempt to comply with the rules and regulations should not feel like they are treated like the smaller group, who for whatever reason, are noncompliant.

For the sake of time, I will comment on a few parts of the taxpayer rights that we believe either need slight modification or we agree with strongly, beginning with the Taxpayer Advocate. We are very pleased to see the independence that this bill gives to the Taxpayer Advocate so that they may be free to offer suggestions without concerns about their future within the Service.

We also recognize the importance and the effectiveness of the Problem Resolution Officers, and this bill has addressed their ability to issue taxpayer assistance orders. Again, we commend the legislation for its expansion of what they now can do, but we would offer one additional suggestion. That is that when a small business is involved, that the definition or the examination of significant hardship should and must include the effect that the IRS procedures would have on the employees of that small business. I think to ignore the hardship that could be created on employees would certainly not be in the best interest of the government as a whole.

With regard to offers in compromise, again, the IRS has been asked to develop public schedules of national and local allowances. We have some concerns here in that the regional and local issues may not always be addressed properly, such as family size, health, whatever. What we think has to happen here is that the agents are directed under all circumstances to use these as guidelines only. They must have the directives issued to them to not issue these guidelines without consideration of factors that may exist in an individual taxpayer's situation. These guidelines cannot be expected to work for any and all taxpayers.

With regard to the performance awards, here we do not want this, I think, worthy goal to be interpreted improperly by the taxpaying public. And we have, in this case, offered a wording adjustment that customer service should be considered an important factor regarding any cash award to an IRS employee. Tax enforcement performance for employees engaged in enforcement work should be considered only one factor in determination of making a cash award.

With regard to penalty reform, again, we are very happy to see this area being looked at. We are particularly hopeful that the area that—one of the areas that will be looked at is the consideration of the due diligence penalty that could be assessed on preparers with regard to the earned income credit. We think this opens up a whole new area of concerns for preparers that they are being asked to go above and beyond their normal responsibilities with regard to the tax law.

And finally, as an addition to this bill, we continue to offer our suggestion that the IRS find other ways to track preparers other than their Social Security number. I find it extremely hard to believe in today's society that the only way preparers can be monitored is by placing their Social Security number on the tax return.

Many other agencies seem to have no difficulty tracking individuals without publishing their Social Security number on the statements or the credit cards that they carry around with them.

In conclusion, Madam Chair, again let us thank the Subcommittee for the opportunity to be here. And again, I would like to reemphasize our support for this legislation. We think that this legislation is the only thing that we have seen that offers not only the taxpayers, but the people at the Internal Revenue Service that come to work every day and try to do a good job the structural and the attitudinal changes necessary to make this a customer service organization. Thank you. And we look forward to any questions you may have.

[The prepared statement follows:]

**Statement of Roger Harris, Vice Chairman, Federal Taxation Committee, National Society of Accountants; and Padgett Business Services**

The National Society of Accountants (NSA) is pleased to testify on H.R. 2292, the Internal Revenue Service Restructuring and Reform Act of 1997. The legislation is the result of recommendations made by the National Commission on Restructuring the Internal Revenue Service. NSA commends Chairman Nancy L. Johnson and the other members of the Subcommittee on Oversight for holding this most important hearing on taxpayer rights. NSA strongly supports H.R. 2292, legislation introduced by Representatives Rob Portman and Benjamin Cardin. The legislation greatly elevates the prospects for modernization, improvement in agency efficiency, and enhancement of taxpayer services.

My name is Roger Harris. I am testifying today in my capacity as Vice-Chairman of the National Society's Federal Taxation Committee. I am the President of Padgett Business Services, a firm that has provided accounting and financial services to small service and retail businesses for over 30 years. Our 400 plus franchises prepare several hundred thousand tax returns each year, and provide taxpayer representation services to their clients.

The National Society of Accountants is well positioned to provide testimony to the Subcommittee on the issue of taxpayer rights, particularly in the context of the Commission's report and H.R. 2292. The National Society is an individual membership organization representing approximately 17,000 practicing accountants located throughout the United States. NSA members are, for the most, part either sole practitioners or partners in moderate-size public accounting firms who provide accounting, tax return preparation, representation before the Internal Revenue Service, tax planning, financial planning and managerial advisory services to an estimated four million individual and small business clients. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct. As our members serve a sizeable small business constituency, NSA is in a unique position to address those matters regarding taxpayer rights.

CUSTOMER SERVICE AND TAXPAYER RIGHTS

The best way for the government to foster and protect taxpayer rights is for the IRS to improve the level of customer service the agency provides the public. H.R. 2292 emphasizes the concept of customer service over compliance. This is at variance with the public's perception that the IRS' main mission is tax compliance, e.g. audits and collections. NSA agrees the service component of the IRS should be the primary engine which drives the agency. We believe that a customer service oriented mission will bring out the best in IRS employees. This is what the American public wants, and we believe IRS employees want as well.

By helping to inculcate a customer service oriented culture at the IRS, Congress would be taking a major step in protecting a taxpayer's rights when faced with an IRS audit or collection problem. In this connection, the practitioner community is an important stakeholder relative to customer service and taxpayer rights. A great number of taxpayers deal with the IRS through their tax practitioners. There are many opportunities for practitioners to experience IRS customer service at various levels, from telephone contacts through audits, collections, and appeals. Based on their repeated and varied contacts with the IRS, practitioners have a unique perspective on customer service.

There is a clear need for improvement in all aspects of IRS customer service. For example, from the public's perspective, the front line in IRS customer service is

what they experience when they speak with an IRS employee on the telephone. The quality of the IRS' telephone systems, as well as the manner in which the IRS employees conduct themselves on the telephone, has shown substantial improvement in recent years. Nevertheless, the IRS telephone system and customer relations process continue to cry out for further and dramatic improvement.

The proper training of IRS employees and providing them with technology are important keys to quality customer service. The Commission's report strives to portray IRS employees as competent, hard-working individuals who want nothing more than to deliver the highest quality in service to the public. In order to turn around the supertanker we call the IRS, there needs to be a change in the management structure of the IRS along the principles described above. This includes better training of IRS employees. They also need to be provided with more of the basic technology tools of the 1990s, tools which NSA's members often take for granted, e.g. more fax machines, copiers, and computers.

### Office of Taxpayer Advocate

The National Society of Accountants commends the sponsors of H.R. 2292 for providing certain meaningful enhancements in the office of Taxpayer Advocate. We view this provision as a critical component of improving taxpayer rights.

The legislation builds on the pro-taxpayer provisions found in the Taxpayer Bill of Rights II (TBOR2). TBOR2 established the office of Taxpayer Advocate within the Internal Revenue Service. It empowered the Advocate to resolve individual taxpayer problems, to analyze concerns about the nation's tax system, to propose legislative and administrative solutions to those problems and concerns, and to report to Congress on the operations of the Advocate's office. TBOR2 also gave the Advocate broad authority to take any warranted action permitted by law relative to taxpayers who would otherwise suffer a significant hardship as the result of IRS action.

In testimony earlier this year before the Restructuring Commission, NSA stated that the Taxpayer Advocate, to be successful in his or her position, must have an intimate knowledge of the functioning of the IRS. Since knowledge is gained from years of experience within the Service, we observed that in order to be truly the taxpayer's advocate, this individual at the same time must be willing to question, publicly as well as internally, the functioning of the very agency to which his or her career has been devoted.

NSA believes H.R. 2292 strikes the right balance in ensuring that the Taxpayer Advocate is successful. The legislation provides the Taxpayer Advocate be appointed by and report directly to the Commissioner of Internal Revenue, with the approval of the Internal Revenue Service Oversight Board. H.R. 2292 also provides that the Advocate have substantial experience representing taxpayers before the IRS or with taxpayer rights issues. If the Advocate is a person who previously has worked for a significant period of time for the IRS, he or she must agree not to accept any employment with the IRS for at least 5 years after ceasing to be the Taxpayer Advocate.

From a positive perspective, we believe H.R. 2292 is carefully crafted in that American taxpayers are not foreclosed from benefitting from the appointment of a Taxpayer Advocate who may happen to have the experience and insight of an IRS veteran. Ironically, the IRS veteran may in fact be the person best situated to "fill the shoes" of the Taxpayer Advocate. Requiring that any such person take an oath not to work for the IRS for at least 5 years after leaving the Advocate post evidences a critical step has been taken to help ensure that the Advocate is willing and able to report openly about potentially sensitive issues.

H.R. 2292 broadens the scope of the Taxpayer Advocate's annual report to identify areas of the tax law that impose significant compliance burdens on taxpayers or the IRS. The report also must identify—in conjunction with the IRS National Director of Appeals—the 10 most litigated issues for each category of taxpayers with recommendations for mitigating such disputes. In addition, the legislation makes certain improvements in the selection process, geographic allocation, and career opportunities of Problem Resolution Officers. The National Society strongly supports these improvements in the Taxpayer Advocate's position and authority. We also are particularly supportive of the requirement that the Advocate take steps to ensure local telephone numbers for the Problem Resolution Officer in each IRS district be published and made available to taxpayers.

### Expansion of the Authority to Issue Taxpayer Assistance Orders

In order for a Problem Resolution Officer (PRO) to issue a Taxpayer Assistance Order under current law, the PRO must determine whether the taxpayer is suffering or is about to suffer a significant hardship. If such hardship is determined to

exist, the PRO is to make a determination as to whether the IRS action warrants being changed. The Tax Regulations define a significant hardship as a serious deprivation caused or about to be caused to the taxpayer as a result of IRS administration of the tax law.

H.R. 2292 modifies the current application of the significant hardship test by requiring the Taxpayer Advocate to consider whether IRS employees followed applicable administrative guidance (including the Internal Revenue Manual), whether there is an immediate threat of adverse action, whether there has been a delay of more than 30 days in resolving the taxpayer account problem, and whether there is a prospect that the taxpayer will have to pay significant professional fees for representation. The National Society of Accountants supports all of these modifications.

However, we believe there is yet another consideration in cases involving small businesses. NSA recommends that in situations affecting small business, a determination be made as to whether a "significant hardship" will be imposed upon employees of the business who may be adversely affected by the IRS decision regarding the Taxpayer Assistance Order, e.g. losing their employment.

The National Society considers these modifications will change the landscape of Taxpayer Assistance Orders in a positive fashion. This in turn will help IRS enforcement activities in a constructive manner.

### Removal of Preparer's Social Security Number from Tax Returns

The practitioner community is becoming increasingly concerned about the requirement that a paid tax return preparer's Social Security number appear on returns he or she prepares. Revenue Ruling 79–243 states under Section 6109(a)(4) of the Internal Revenue Code, "any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, the preparer's employer, or both ...(and) that the identifying number of an individual shall be the individual's Social Security number." Revenue Ruling 78–317 gives some relief by stating that "an income tax return preparer is not required to sign and affix an identification number to the taxpayer's copy of a federal income tax return." The Social Security number need only be reflected on the tax return filed with the IRS. This kind of "fix" does not alleviate practitioners' frustrations.

In today's world of instant access to volumes of sensitive information about an individual, including even credit reports accessible over the Internet, practitioners are very concerned that their Social Security number could be the key to unauthorized release of their own financial information. Practitioners feel the requirement they include their Social Security number on returns violates their privacy, as it could provide a possibly unscrupulous taxpayer with the opportunity to access certain records that otherwise would not be available. Once the taxpayer leaves the practitioner's office, there is no guarantee that he or she will file the original tax return with the IRS, without first making copies of the original returns. There is always the possibility those copies could end up being misused. As part of the Subcommittee's deliberations on H.R. 2292, the National Society of Accountants suggests the Subcommittee review this requirement with the IRS and develop a separate system for identifying tax return preparers.

### Performance Awards

H.R. 2292 requires the IRS' establishment of a performance management system covering all IRS employees, with the exception of members of the IRS Governance Board, the Commissioner, and the Chief Counsel. As part of this performance management system, the bill generally provides the IRS with flexibility in granting awards to employees. However, the legislation provides that "A cash award...may not be based solely on tax enforcement results." While this particular sentence appears to be well intentioned, NSA believes it could be misconstrued to authorize IRS officials to make cash awards to employees "principally" on tax enforcement results. Further, tax enforcement "results" also could be misconstrued to indicate the fostering of quotas to qualify for awards.

In NSA's view, the criteria for cash awards should be redrafted to highlight the point that: "Customer service should be considered an important factor regarding any cash award to an IRS employee. Tax enforcement performance for employees engaged in enforcement work should be considered only one factor in a determination of making a cash award." This change in the bill's language would be consistent with the spirit of the IRS Restructuring Commission report, which is to encourage the IRS to place greater reliance on customer service and less on tax enforcement.

### Offers in Compromise

The legislation provides for the IRS to develop and publish schedules of national and local expense allowances to ensure taxpayers entering into an Offer in Compromise can provide for basic living expenses. While the National Society believes this provision attempts to address a real problem underlying the IRS collection process, we are concerned the provision (as currently drafted) does not give practical relief to taxpayers.

The National Society of Accountants' members are of the view the current allowable expense standards for Offers in Compromise and Installment Agreements are inconsistent with the real cost of living for families. Our members' concerns include the fact the expense standards do not adequately address issues such as family size, housing and utility allowances, and the cost of car ownership. Our members also are concerned that Revenue Officers are using the expense standards as strict rules rather than for general guidance.

IRS collection personnel must be given a clearer directive allowing them to make exceptions with respect to a taxpayer's expenses in an Offer in Compromise situation. This is particularly so when the taxpayer's health or his or her ability to generate income provides a reasonable basis for such exceptions. Further, Revenue Officers should be given the authority to take into account the possibility that the taxpayer may file bankruptcy when reviewing an Offer in Compromise, which is counterproductive.

In view of the systemic and recurring Offer in Compromise issues, a study of the program by an entity outside the government should be considered. An objective and realistic perspective on the subject would be helpful to both the government and the public.

### Safe Harbor for Installment Agreements

Section 6159 of the Internal Revenue Code requires the IRS to consider entering into an Installment Agreement with taxpayers to the extent such an agreement will facilitate the collection of the tax liability. However, Internal Revenue Manual Section 5331.1: (1) states the taxpayer does not have an absolute right to demand the IRS enter into an Installment Agreement with him. Once the Installment Agreement has been entered, current IRS procedures generally do not alter the conditions of an agreement unless the IRS determines the taxpayer's financial condition has significantly changed.

H.R. 2292 modifies Section 6159 by providing a safe harbor for taxpayers who do not owe the IRS more than $10,000 in tax liability. Under this provision of H.R. 2292, the safe harbor is available as long as the taxpayer has filed all tax returns during the prior five years and the taxpayer has not previously obtained an Installment Agreement under the safe harbor.

NSA supports a safe harbor measure. However, we believe the tax administration process would be better served if the safe harbor is made available to taxpayers on more than just a "once-in-a-lifetime" basis. Further, the safe harbor provision of H.R. 2292 should be modified to permit the rollover of a tax liability from a previous Installment Agreement as long as the total liability under the new safe harbor Installment Agreement does not exceed $10,000.

Because the Installment Agreement provision of the legislation is described as a safe harbor, the legislative report language should clarify that the provision does not in any way restrict other available collection settlement options, including other means of obtaining an Installment Agreement.

### Tax Penalty Reform

The National Society of Accountants is very supportive of the provision mandating a study by the Taxpayer Advocate on tax penalties. The legislation calls for the Advocate to review the administration and implementation of penalty reform recommendations made by Congress in 1989, including legislative and administrative recommendations to simplify penalty administration and to reduce taxpayer burden.

NSA believes tax penalty reform should become the next serious phase of IRS restructuring. A review of the full range of taxpayer and preparer penalties would be productive. Moreover, we strongly urge the bill be clarified so that the Advocate is required to review the extent to which the federal government relies on tax penalties for revenue raising purposes.

We recommend the penalty study also include a review of the new earned income tax credit due diligence requirement imposed on paid tax return preparers by the Taxpayer Relief Act of 1997. Under the new tax law, should a preparer fail to exercise "due diligence" in determining a taxpayer's eligibility for the earned income tax

credit, or with respect to the amount of the credit itself, the preparer is subject to a $100 penalty. The new law requires this penalty be imposed in addition to any other penalty of present law. Yet there is no guidance given for the regulations to be promulgated under the legislation.

It is our view the IRS will find the earned income tax credit due diligence penalty very difficult to administer. While the National Society of Accountants fully believes a preparer should ask the proper questions of a client about an individual's qualification for the credit, the practitioner should not be expected to become a "policeman" for the IRS on the issue. The standard for earned income tax credit reporting should be consistent with the standard for any reporting position.

Instead of imposing due diligence penalties of this kind on preparers, a preferable approach would be to make all tax return preparers subject to the regulations in Treasury Department Circular 230 enforced by the IRS Director of Practice. In this way, the full practitioner community would be subject to uniform requirements. We believe this is the best way to increase professionalism, encourage continuing education, assure more ethical behavior, and better enable the IRS to prevent unscrupulous tax preparers from operating.

PROBLEMS WITH INTEREST AND PENALTIES

The bill makes a number of positive changes in the law with respect to interest and penalties. First, the bill eliminates the differential in the interest rates for overpayments and underpayments "in a revenue neutral manner." Second, the bill tolls the application of the failure to file penalty while a taxpayer is making payments under an IRS Installment Agreement. NSA commends the bill sponsors for including these pro-taxpayer measures as part of the legislation.

LOW INCOME TAXPAYER CLINICS

Under the legislation, the IRS is permitted to make grants, i.e. to provide matching funds, for the development and expansion of low income taxpayer clinics. We strongly support this initiative. It is an important measure in ensuring all taxpayers are afforded the opportunity to obtain representation when faced with an IRS audit or collection matter.

The legislation requires clinics be made available to taxpayers whose income generally does not exceed the poverty level by 250 percent. NSA believes this income test may be too high and not properly targeted. In order to better utilize the scarce financial resources involved with this important program for the American public, it may be preferable to limit the availability of the clinics to taxpayers whose income generally does not exceed the poverty level by 125 percent.

OTHER PRO-TAXPAYER INITIATIVES

H.R. 2292 includes a number of positive provisions to enable taxpayers to recover certain costs and fees when they prevail and when the position of the IRS was not substantially justified. Other positive, pro-taxpayer provisions in the legislation include certain modifications with respect to the U.S. Tax Court's jurisdiction, and procedures for cataloguing and reviewing taxpayer complaints regarding the misconduct of IRS employees. NSA believes these are positive taxpayer protection measures and supports them.

CONCLUSION

The National Society of Accountants offers its assistance to the Subcommittee in any way requested. It would be our pleasure to help you achieve these mutual goals.

---

Chairman JOHNSON. Thank you, Mr. Harris.
Ms. Olson.

## STATEMENT OF NINA E. OLSON, EXECUTIVE DIRECTOR, THE COMMUNITY TAX LAW PROJECT, RICHMOND, VIRGINIA

Ms. NINA OLSON. My name is Nina Olson. I am the executive director of The Community Tax Law Project and I thank you for the opportunity to be here today. And first and foremost, I want to say

that I appreciate you inviting a representative of low-income taxpayers to be before your Subcommittee and I encourage you to hear from representatives of that group more often.

The Community Tax Law Project is a nonprofit organization in Richmond, Virginia. We were founded in 1992. Our goals are three. We represent low-income taxpayers who are Virginia residents. We educate taxpayers about their rights and responsibilities in the tax system. And we strive to increase public awareness about the problems of low-income taxpayers.

We achieve that through the operation of a pro bono panel of volunteer accountants, attorneys, and enrolled agents who live throughout and practice throughout Virginia. We provide them backup training and continuing education programs also. We provide in-house support and we publish a national newsletter of low-income taxation called "The Community Tax Law Report."

We also represent taxpayers before the Tax Court. And we have an agreement with the Tax Court whereby they insert letters about The Community Tax Law Project in trial calendar notices that are scheduled in Virginia. And unrepresented taxpayers can then contact us and see if they qualify for representation.

Now, it is my experience in the 22 years that I have practiced that I have never encountered a case such as what we have heard the last 3 days in the Senate Finance Committee hearings. I must say, though, that low-income taxpayers do have problems. They are afraid. They often will get notices that they find incomprehensible. They are not able to express their facts favorably or clearly in the way that the IRS can process them. They don't know the buzz words. They don't know to say I'm currently not collectible. Or I want to talk to a Problem Resolution Officer. They don't understand the burden of proof. They don't understand what they need to prove. They don't understand the process. And they don't understand the law.

So the solution to that is, in fact, a three-part thing. We need to provide them access to representation. We need to provide them education. And we need to make the IRS accountable to them.

Now, in one respect, the tax system is adversarial from day one. The government is proposing to take people's money and people don't like that. But if they feel that they have to give up their money, then they want to know that they were given fair treatment. And that is where we come in.

Again, low-income taxpayer clinics provide representation and they provide an advocate for the taxpayer. They also provide a reality check. If the result is unfavorable to the taxpayer, then at least they are hearing it from a party who has their interests at heart. We are not the government trying to collect their money. We are their advocates. We make the system work better because we settle cases or achieve the correct result a lot faster down the line. And we keep people in the system.

Our goal is to resolve problems at the earliest level, the appropriate level, so that you are not trying to adjudicate the merits of a case at the collections level just because the taxpayer hasn't understood the notices preceding it. And they end up in collections.

Now, student tax clinics began in the seventies. There are currently 14 student tax clinics at law schools and 2 student tax clin-

ics at accounting schools. Student tax clinics usually are run with a faculty member. And they have a cap of $10,000 per year, the concern being with students that you don't want to have too much of a liability at stake where students are involved. Most of the student clinics are means tested. The Community Tax Law Project places no cap on deficiency amounts.

We do means test, however. We represent taxpayers whose income is up to 250 percent of Federal poverty level. Now, for a family of four, 250 percent of Federal poverty level is $40,000. That may seem like a lot of money to you, but we're talking about four people here and we're talking about perhaps an intensive Tax Court case where if they went to an attorney they would be told you need to put down at least $10,000 and maybe $20,000 to get through the door. Two-hundred-fifty percent of Federal poverty level for a one-person family is just shy of $20,000.

Now, if that person had to litigate an innocent spouse case or just bring an innocent spouse refund request, we had a pro bono attorney who spent 25 hours on an innocent spouse refund request for a single taxpayer. Now, if that were just at $100 per hour, that is $2,500 and someone with $20,000 a year doesn't have $2,500 to spend on that.

Now, another thing we use is an asset test. We are not going to represent people who may have a quarter-of-a-million-dollar house and may be on a fixed income, but have a house that they could actually get some income from, some cash from to pay an attorney. So we look at qualification.

Chairman JOHNSON. Ms. Olson, I'm sorry, but the red light has gone on and if you could skip to the part of your testimony that pertains to recommendations to improve taxpayers' rights.

Ms. NINA OLSON. OK. I'll hit four. First, I think that, on the low-income taxpayer clinic program, you need to expand the definition so that it doesn't just include outreach to only people who have English as a second language. You should target traditionally low-income populations for education.

I think you also need to encourage the Service and require the Service to report back to you about their methods of publicizing the taxpayer clinics. We have serious problems about getting them to cooperate with us about that.

I think you need to address whether tax protester cases are going to be acceptable cases for these clinics to take up.

And you also need to address who will award these grants. Will the IRS award them or who precisely? And my concern there is if we take positions that the IRS doesn't like, will our funding be cut off the next year?

With regard to offers in compromise, I support the loosening of the national standards, but I must emphasize that you should also apply that to installment agreements. These standards are applicable in those situations and they affect low-income taxpayers much more.

Third, I think it should be made clear that there is no minimum amount for offers in compromise. In my district, they will not accept an offer of $500 or $1,000 because it doesn't cover the cost of processing them and that looks like if you can't afford it, you can't

get resolution. Whereas, someone who has more money can pay the fee and get resolution.

And that's it. Thank you.

[The prepared statement follows:]

**Statement of Nina E. Olson, Executive Director, the Community Tax Law Project, Richmond, Virginia**

Madame Chairwoman and Members of the Committee:

Thank you for providing me the opportunity to testify on the issue of taxpayer rights. I comment in my capacity as the Executive Director and staff attorney of The Community Tax Law Project. CTLP is a 501(c)(3) organization founded in 1992 for the purposes of (1) providing low income Virginia residents with pro bono legal representation in federal, state and local tax disputes; (2) educating low income individuals about their rights and responsibilities as U.S. taxpayers; and (3) increasing public awareness of and encouraging informed debate about policy and practice issues impacting on low income taxpayers.

CTLP accomplishes its goals in a variety of ways, including in-house legal representation and a pro bono referral panel of volunteer attorneys, accountants and enrolled agents. The Project provides back-up training and technical support for its volunteers and maintains a research library. Student interns from local law schools receive course credit for working at the clinic. It sponsors continuing legal education programs, including one in June, 1995, on the representation of low income newcomers. I frequently address groups of low income parents and workers about tax issues impacting on their families and their businesses. CTLP also publishes The Community Tax Law Report, a national newsletter about low income tax policy and practice.

BACKGROUND

My remarks today are tinted from my perspective as a Taxpayer Advocate, one who has daily contacts with all levels of the Internal Revenue Service on behalf of low income taxpayers. Perhaps even more important, I am the attorney who answers taxpayers' calls for assistance and screens cases for acceptance by the Project. I hear directly from low income taxpayers about their own efforts in resolving tax disputes and their treatment by IRS employees.

Let me unequivocally state that in my twenty-two years of tax practice I have found IRS employees to be as a rule considerate, helpful and genuinely interested in resolving disputes. Even in the most adversarial of situations some measure of decorum and mutual respect is present. However, and this is a big "however," the same cannot be said about unrepresented taxpayers' treatment, particularly at the collections level, and, specifically, with the automated collection sites.

It is my experience that unrepresented taxpayers, in particular low income taxpayers, receive inadequate assistance from IRS employees. This is so despite the well-intentioned efforts of many Service employees. The reasons for this discrepancy in treatment are legion, but foremost among them must simply be the fact that taxpayers feel frightened and threatened by the IRS' power as a creditor. In large part these feelings are encouraged by the Service's own notices, which state that they may seize your vehicle, levy on accounts, etc. While this fear may ultimately lead to taxpayer compliance, my point here is that it also creates in many taxpayers a "flight" response. Taxpayers already expect the worst and act in a manner that may bring "the worst" about. Nervous and anxious, the taxpayer is often unable to convey vital information that may enable the IRS to resolve the dispute.

Even when a taxpayer attempts to inform the Service about his or her position, the taxpayer may not know the right questions to ask, the right person to address them to, or the appropriate procedure for relief. Some IRS employees do not reach out to the taxpayer and attempt to elicit the necessary information. In dealings with the Collections division, taxpayers feel like quasi-criminals, rather than individuals who are attempting to arrange payment of their taxes.

Taxpayers receive incomprehensible notices from the Service. At the Project, we try to target our own publicity at a fifth-grade reading level. Imagine what a taxpayer may think who receives a five page letter from the IRS listing schedules of interest calculations and only on page 2 or 3 discovers the reason for a proposed adjustment to account. Even if the taxpayer does not ignore the notice, he often cannot understand the options open to him for protesting the notice. The taxpayer's failure to communicate generates a 90-day letter; his failure to file a Tax Court petition results in assessment; and an issue which should have been resolved through

correspondence ends up in collection, where a taxpayer's protests that "I don't owe this tax" fall on deaf ears.

District Counsel attorneys can only do so much for a pro se petitioner in the United States Tax Court. A taxpayer may be in Tax Court not because she has a winning side but because she can't afford to pay the tax. The petitioner may not provide enough facts for the district counsel attorney to determine the appropriate tax treatment of an item. Settlement attempts may be rebuffed by the taxpayer as a move to outsmart her. The IRS is perceived as an enemy and that perception precludes communication and cooperation.

TAXPAYER REPRESENTATION ISSUES

Section 313. LOW INCOME TAXPAYER CLINICS.

*The Need for Clinics:*

The problems described above make the case for passage of Section 313, which addresses seed money funding for low income taxpayer clinics. Taxpayers without access to representation will receive vastly different and less favorable results in the tax system than those who are represented by a tax professional. The tax professional acts as an advocate but also as a reality check. In fact, it may be that the most important service representatives provide is educating taxpayers about the tax system and their rights and responsibilities within that system.

Student tax clinics have been operating since the late 1970's. Today, there are approximately 14 law school clinics and 2 accounting school clinics. Student clinics are conducted under the guidance of a faculty member; representation is generally limited to taxpayers with $10,000 in tax liability or deficiency per year. Most, if not all, impose some sort of financial eligibility requirements for case acceptance. Some of the clinics maintain active relationships with the members of the private tax profession, arranging student mentor programs and even case referrals.

My own program, The Community Tax Law Project, limits its case acceptance to taxpayers whose income is at or below 250% of the federal poverty level. Representation is free of charge for taxpayers meeting Legal Services Corporation eligibility (i.e., 125% of federal poverty level). We charge a $25 one time administrative fee to taxpayers with income between 125% and 250% federal poverty level. Needless to say, no attorney accepting a pro bono referral may accept a fee from the client, even if the client's financial circumstances change for the better. We are careful to protect the integrity of our referrals and to ensure that our program cannot be used for the private inurement of individuals.

Our clients come from all over Virginia, including Chesapeake watermen, members of the Asian community in northern Virginia, workers and elderly individuals from Richmond, Roanoke, the Tidewater, and Harrisonburg. We have rural and urban clients. Our pro bono panel of over 135 tax professionals also covers the state. Thus, I am able to make client referrals to tax professionals in the general geographic area closest to the client.

Over the past year, The Community Tax Law Project handled in-house or through pro bono referral approximately 30 to 40 cases each month—almost 400 cases on an annual basis. Of the three Tax Court dockets held in Richmond and Roanoke, Virginia, each year, we formally or informally participate in nine to fifteen cases. These figures do not include the many phone calls I field each week that are strictly informational.

Perhaps the most common misperception is that low income taxpayers don't pay taxes so they can't have any tax problems. Our clients have cases involving complex issues, such as investment tax credits and depreciation deductions claimed by rural farmers; the taxable nature of severance pay received by a Navy pilot in combat status at the time of his retirement from service; and the taxable nature of a payment received in the settlement of a complicated suit alleging anti-trust violations as well as personal and reputation injuries. Other cases involve the responsible person penalty (IRC 6672) and employee classification issues. All of the taxpayers involved meet our income eligibility guidelines; their cases involve serious issues of law and fact.

The Earned Income Credit, administered through our tax system, may be the single most successful anti-poverty initiative today. Yet the EIC and related dependency exemptions and filing status determinations involve some of the most intricate and complicated sections of the Code. Many of our cases raise these very issues. We also see a fair number of "innocent spouse" cases, including one in which the ex-wife failed to report nonemployee compensation from an astrological 900-number helpline, a job her ex-husband, our client, never knew she held.

All of our clients in the above cases are struggling hard to make ends meet. In many cases, their returns were prepared by tax preparation services or by VITA programs. But who is there to help with the problems that arise after the return is filed?

*The Need for Funding:*

It would seem that low income tax clinics are an obvious solution to the problems described above. Yet universities are struggling to find funding for an enterprise that not only provides its students with valuable practical experience and instills in them a professional commitment to community involvement but also offers substantial assistance to taxpayers and the tax system. In its first year of operation, CTLP sent out over thirty grant applications to national, state and local foundations. All applauded our mission; all stated that tax representation did not fall within their funding priorities. CTLP currently operates on a $28,000 annual grant from the Virginia Law Foundation.

Seed money support would go a long way toward encouraging the charitable sector to recognize the need for tax representation and the relationship of tax to a whole slew of problems affecting low income individuals. As the tax system becomes an agent of social policy and the source of initiatives directed at encouraging taxpayers to work, attend higher education, or to save for retirement, those individuals who cannot afford professional advice will be increasingly left in the dust. This is a social policy matter and is rightfully the focus of private philanthropy.

But the federal government also has a stake in seeing that low income taxpayers have access to representation. Our tax system is a voluntary system, whereby taxpayers report their own tax obligations. Taxes truly are the "lifeblood" of our government and noncompliance with the tax system drains the public coffers and alienates compliant taxpayers. However, where a system is perceived as stacked against the taxpayer and where their legitimate complaints, questions and requests are handled brusquely, impolitely or incorrectly, taxpayer compliance will suffer. Representation ameliorates this situation by keeping the taxpayer within the tax system. Representatives not only protect the taxpayer's rights but also explain to him his responsibilities.

In short, it is in the government's interest to ensure that taxpayers are adequately represented, regardless of their income level. Despite initial misgivings about students and private sector attorneys engaging in protracted disputes and wasting government resources, IRS employees at all levels now recognize the contribution clinics make to the smooth administration of the tax law. Clinic representation speeds up the dispute process, clarifies the issues, and facilitates settlement where appropriate. Finally, clinic representation saves expense because it often leads to case resolution at the earliest, most appropriate level.

*Outreach and Education:*

I applaud the sponsors of this bill for emphasizing the need for outreach and education efforts in those communities where English is a second language. Newcomers to the United States from other countries often are completely unfamiliar with the concept of an income tax and have never had to file a tax return before. Members of such communities are highly entrepreneurial and may be unaware of self-employment tax rules. They may work as household employees and are not aware that their employers are not withholding social security tax on their behalf. They may fall into the hands of unscrupulous preparers who claim erroneous dependents or qualifying children for purposes of the Earned Income Credit.

I recommend to your Committee, however, that clinic outreach not be limited to those communities specifically but be expanded to include "traditionally low income populations." For example, CTLP is working on a program to train welfare-to-work program participants and their case workers throughout Virginia about basic tax issues, including dependency exemptions, the advanced earned income credit, self-employment issues, and dependent care credit. Many members of this population have never had a bank account before much less filed an income tax return. As a taxpayer advocate, I look at the number of people entering the workforce and see the problems three years down the line when the Service begins to issue notices about improperly filed (or nonfiled) returns. An ounce of prevention goes a long way.

Further, I encourage you to add a provision requiring the Secretary of the Treasury, or his delegate, to develop methods for publicizing the clinics, including, but not limited to, posters and brochures displayed in taxpayer service offices and examination, appeals and district counsel office waiting rooms, and notices inserted in pre- and post-examination correspondence. Currently, Internal Revenue Manual 6570 Chapter (17)48 provides for such publicity on behalf of student tax clinics. (See also IRM Exhibits (17)00–1 through –7 for examples of "stuffer" notices.) There are

no such provisions applicable to independent nonprofit clinics such as CTLP. To date the Service has not agreed to supply such publicity on CTLP's behalf, despite numerous requests over the last four years.

It is interesting to note that CTLP is handling 30–40 cases each month without any publicity from the Internal Revenue Service. The Community Tax Law Project originally requested such publicity in February, 1993, and we are still without any formal assistance from the Service. Most recently a pilot proposal to the National Appeals Office was met with opposition from Appeals on the ground that Appeals has a satisfactory case closing rate. I am advised that Appeals is in favor of pro bono representation but that they believe it should occur earlier in the dispute process. I concur with the idea of reaching taxpayers at the earliest level, but I do not view any of these methods as mutually exclusive. As the Service well knows, sometimes it takes several attempts to get a person's attention.

My concern here is for those taxpayers who drop out and never take their cases to Appeals because they do not have representatives. I am also concerned about the quality of case closings where taxpayers are unrepresented. We should try to reach these individuals along with taxpayers in exam or in collections.

There are many employees at all levels of the Service, from the Commissioner and Chief Counsel to Collections employees, who support the concept of pro bono representation. Student tax clinics and CTLP would not be as successful as they are today without the support of IRS employees. I view the clinic publicity boondoggle as another classic example of "not in my backyard" concerns. Thus, an unequivocal direction from Congress about the development of publicity measures for tax clinics, along with the imposition of a deadline for reporting back with such a plan, should overcome any footdragging on the Service's part.

Section 314. TAX COURT JURISDICTION.

As of June 1997, over 50% of the Tax Court's docket consisted of "small tax cases," i.e., cases in which the deficiency (including penalties) at issue is greater than $10,000 per year. The S-case docket affords taxpayers an opportunity to have their day in court without prepayment of the deficiency.

According to Chief Counsel's office, as of September 30, 1996, the Tax Court docket consisted of 30.2% of cases in the range of $10,000 to $100,000. It is difficult to project how many of those will elect the S-case docket. One significant drawback to S-case litigation is the lack of an appeal. $25,000 is a large enough sum to suggest to me that many taxpayers would not elect the S calendar thereby forgoing an avenue for appeal.

Because of this appellate path restraint I do not think there will be a flood of S-case petitions in this deficiency range. However, it is possible that more pro se taxpayers in this deficiency range will be inclined to bring S-case petitions where the cost of litigating a regular Tax Court case led them not to file under the existing rules. This observation only serves to emphasize the importance of providing funding for more clinical programs to assist in such representation.

Section 302. ATTORNEY FEES.

To date, I have not personally encountered a case in which I would request attorney fees. However, I feel that the system is fundamentally flawed if the Service can be punished for its "not substantially justified" positions in cases involving taxpayers with the ability to pay for representation, but the exact same behavior will go unpunished if the taxpayer is represented on a pro bono basis.

Section 7430 is modelled after the Equal Access to Justice Act, 28 U.S.C. § 2412. Under the EAJA, attorney fees are awarded to pro bono representatives. (See, e.g., Cornella v. Schweiker, 728 F.2d 978 (8th Cir. 1984).) There is a slight difference in wording between § 7430 and the EAJA, namely, the former statute defines "reasonable litigation costs" as "reasonable fees paid or incurred for the services of attorneys in connection with the court proceeding." IRC § 7430(c)(1)(B)(iii) (Italics added.) This language has been cited as grounds for denial of pro bono attorney fees in tax litigation. (See Gaskins v. Commissioner, 71 T.C.M. (CCH) 3165 (1996).)

It is interesting to note, however, that the Joint Committee's General Explanation of TEFRA 82 clearly states Congress' intentions in enacting § 7430 to cover the award of attorney fees to pro bono organizations: "[I]f an attorney is employed on behalf of the taxpayer by a third party such as a section 501(c)(3) organization, those attorney's fees may be recovered by the taxpayer even though the organization initially incurred the expense of retaining the counsel."

To me, then, this amendment to section § 7430 reflects Congress' willingness to provide all taxpayers with access to justice, as well as a desire to penalize the Internal Revenue Service when it takes positions not substantially justified in cases, regardless of the income level of the litigants.

EMPLOYEE ACCOUNTABILITY ISSUES

302(b). AWARD OF ADMINISTRATIVE COSTS INCURRED AFTER 30-DAY LETTER.

Most Appeals Officers are willing to reverse unreasonable positions advanced in the examination stage. However, I support the proposal for including administrative costs incurred after the issuance of the 30-day letter in attorney fees awards under Section 7430. Appeals officers serve as the dividing line between settlement and litigation. The Appeals officer is the first IRS employee in any tax dispute who can consider hazards and risks of litigation. For this reason I believe they should be held to the standard of taking positions that are supportable; if they do not, they do violence to the system, forcing the taxpayer and the government to further expense, either through litigation or the collections process. Appeals officers must be held accountable for meeting the high standards they profess. They have nothing to fear if they live up to such standards.

Section 303. CIVIL DAMAGES FOR NEGLIGENCE IN COLLECTION ACTIONS.

Although the vast majority of CTLP's calls involve collection actions, I cannot support the imposition of civil damages for negligence in collection actions. I am concerned that the undertrained, understaffed, and beleaguered employees in the IRS Collections Division will become even more demoralized. I fear that this provision may result in some truly outrageous actions being punished but that the overall level of service will decline even further as employees feel subject to allegations of negligence. It is much more effective to provide better training and support for first-level customer service employees so that they can feel some professionalism about their jobs than it is to make all employees the possible targets of irate taxpayer allegations.

Section 315. CATALOGING COMPLAINTS.

I support H.R. 2292's provisions requiring procedures for cataloging and reviewing taxpayer complaints about IRS employee misconduct and the establishment of a toll-free hotline for taxpayers to register such complaints. Such a system would lead to employee accountability without subjecting the employee to the demoralizing provisions described in Section 303, as outlined above.

Precisely because the tax system is the one federal agency with which Americans have the longest and most frequent contact, its employees must conduct themselves in a highly professional manner. To this end, they should be held accountable for their actions. A workable grievance system should provide taxpayers with the ability to report what they perceive as employee misconduct while respecting the rights of IRS employees and taking into consideration the negative public perception all tax collectors must face.

Even where complaints are not sustained, the information gleaned from the cataloging effort will provide tax administrators with concrete data of what taxpayers themselves perceive as abuses. This, in turn, can provide direction for publicity campaigns to inform the public about certain procedures or can lead to systemic change that can avoid the perceived problem.

COLLECTION ISSUES

Section 308. OFFERS-IN-COMPROMISE.

As a general proposition, low income individuals rarely qualify for offers-in-compromise. I have clients who, under the Service's own guidelines, have no net equity in assets nor any present value of their five-year income stream. Yet because they can offer only $500 to $1,000, often using funds loaned from family members, the Service will not accept the offer. It is in the Service's interest to sit back and wait for collection from possible future tax refund offsets rather than to accept an offer which will not even cover the cost of employee time expended in processing the offer.

While this may make economic sense, it has the unfortunate effect of saying to low income taxpayers that they cannot receive finality on an outstanding tax liability, despite years of continuing compliance, whereas someone with greater means can. This unintended consequence smacks a little bit too much like "buying" justice, and, I believe, reinforces the feeling among low income taxpayers that they are being abandoned by their government.

I recommend to this Committee that the Service be directed to accept valid, workable offers despite the quantitative cost to the system. An improved perception of equal treatment of all taxpayers will redound to the benefit of the Treasury.

Section 308 of this bill addresses the use of national and local allowances only within the offers-in-compromise program. I encourage this Committee to extend its coverage to the use of such allowances in installment payment arrangements. While the motivation behind the use of allowances—the avoidance of wild fluctuations be-

tween districts and the resulting forum shopping—is laudable in theory, in practice the results are impractical and ignore the reality of many people's lives.

For example, the national standard for food allowances increases depending on one's income level. It is well documented that citizens of the inner city often have the highest food prices—they do not have large supersaver grocery stores in their areas, and often shop at convenience stores with high mark-ups. This fact defies the "logic" of the national standards. Yet in one installment arrangement negotiation, the revenue officer refused to allow my client an extra bus trip fare in order to go shopping at a supersaver store. In short, she condemned him to spending less money on food than he was actually spending and denied him a valid expense that would have enabled him to keep his actual food costs within the national allowance. This posture is impossible to justify and again makes the tax agency appear to ignore the real needs of the rank-and-file taxpayer.

Section 310. ELIMINATION OF APPLICATION OF FAILURE TO PAY PENALTY DURING PERIOD OF INSTALLMENT AGREEMENT.

This provision will go a long way toward bringing people back into the system. I receive at least one call each week from someone complaining that despite the payments they are making under an installment plan, the balance never declines. They invariably state that they don't know how much longer they will keep up the payments, since they aren't getting ahead.

In the commercial sector, applying a failure to pay penalty while receiving payments and charging interest on a past debt would be called "usurious." The rationale for the failure to pay penalty is to punish the defaulted debtor for not paying the debt. If the taxpayer is making installment payments and, more importantly, is fulfilling the compliance conditions of the installment agreement, then that taxpayer should be encouraged to remain within the agreement and within the tax system. He or she should not continue to be financially penalized. The Treasury's interests could be protected by reinstatement of the penalty upon taxpayer default.

Section 311. SAFE HARBOR FOR QUALIFICATION FOR INSTALLMENT AGREEMENTS.

I view this provision as helpful and of very limited application. Many delinquent taxpayers are tardy for several years running. In such cases, it is my opinion that they should undergo close financial scrutiny prior to entering into or modifying installment plans. (As noted above, the standards used to evaluate one's financial needs should be revised for greater flexibility.) However, for the taxpayer who has remained compliant except for an isolated instance, usually attributable to some catastrophic event in the taxpayer's personal or professional life, this provision will encourage him to remedy his delinquency and will give him a sense that his government has his interests at heart.

### TAXPAYER INFORMATION AND EDUCATION

The Service simply must do a better job of advising the taxpaying public about tax procedures and about potential traps for the unwary. At the same time, the public must be made aware that the tax laws are not created by the Service, nor does the IRS itself receive the tax monies. Attempts to better educate and inform the taxpayer about such matters will go a long way toward reducing (not eliminating) animosity toward the IRS.

Section 316. PROCEDURES INVOLVING TAXPAYER INTERVIEWS.

Taxpayers need to understand the procedures relating to examination and collection of tax before the commencement of any interviews. It is not enough to simply insert a notice in an otherwise incomprehensible mailing. The IRS employee should also explain the process in understandable terms to the taxpayer. This description will not only help the taxpayer understand the process and his rights, but it will also serve to remind the IRS employee of the entire process and his own role within it.

This section should also state that an unrepresented taxpayer shall be advised of the availability of any organizations providing pro bono representation prior to the commencement of an interview. If the individual expresses a desire to contact such an organization, the interview should be rescheduled for a later time, unless the taxpayer consents to the continuation of the interview.

Section 304. DISCLOSURE OF CRITERIA FOR EXAMINATION SELECTION.

A large part of the current disaffection with the IRS is simply attributable to the lack of information about its activities, most notably the audit examination. Providing greater information about the criteria for audit, in a manner that will not disclose any items "detrimental to law enforcement," will help erode the aura of secrecy surrounding the Service. It will dispel myths about how returns are selected. Great-

er information will lighten the task of those of us in the private sector who defend the integrity of the IRS.

This information must be graphically as well as grammatically legible. It should be available in numerous languages, and it must be accompanied by an education outreach campaign involving IRS employees and private sector professionals. It is not enough for the criteria to be buried in a densely worded publication; the Service must make a good faith effort to publicize the information. Again, professional groups and tax clinics can be of assistance here; creative thinking and efforts are called for.

Section 317. EXPLANATION OF JOINT AND SEVERAL LIABILITY.

No problem bedevils the tax practitioner more than the consequences of joint and several liability for taxes on a joint return. Innocent spouse cases are some of the most frustrating and tragic I have personally encountered. It is my experience that many taxpayers look back with hindsight and say that had they but known they were signing on to a joint debt, they would not have filed a joint return.

Although I do not think that a well-publicized explanation of the consequences of joint and several liability will eradicate the innocent spouse problem in the most tragic of cases, for a large number of filers it will make them stop and think twice before signing joint returns. Furthermore, if such an explanation were included in notices from the examination or even the collections division, the taxpayer will be alerted to the need for attending the meeting himself or to the need for possible separate representation. Thus innocent spouse issues will be raised earlier in the dispute process.

Unfortunately, this proposal would be rendered meaningless in practice if a spouse does not receive notice of the IRS exam, appeals or collection action. It can only be fully effective if the Service has accurate and updated taxpayer addresses, which would be facilitated by granting the Service access to the postal service's address files. IRS employees must also be instructed to require consent from an absent spouse to representation by the present spouse prior to conducting an examination or other interview. This consent can be supplied on the existing Form 2848, Power of Attorney and Declaration of Representative. Alternatively, the Service could develop a separate form for consent which includes the joint and several liability explanation and on which the absent spouse acknowledges having received and reviewed said explanation prior to consenting to representation by the present spouse. This notification, along with information about the availability of pro bono representation, will protect many spouses.

CONCLUSION

In concluding my remarks, I wish to emphasize again the importance of providing taxpayers with information, assistance, and access to representation. Without these elements our voluntary tax system will fail. Further, the Internal Revenue Service must be adequately funded in all its operations in order meet its tax administration and enforcement responsibilities. New customer service initiatives, including low income taxpayer clinics, should not be excuses for underfunding other IRS functions.

H.R. 2292 goes a long way toward crafting a tax system that fulfills its revenue raising mission in a manner that respects the average citizen's person and property. The bill is posited on the assumption that taxpayers wish to comply with their tax obligations and enables them to do so with dignity. The low income individuals I represent ask no more than that.

Chairman JOHNSON. Thank you very much. I would now like to recognize my colleague from Texas, Congressman Johnson, who is a valued Member of the Ways and Means Committee, but not a formal Member of this Subcommittee. It is a pleasure to have you join us today.

Mr. JOHNSON OF TEXAS. Thank you, Madam Chairman. I would like to take the time to introduce Stephen Winn. He is the president and chief executive officer of Computer Language Research, Inc., and I bet one of my valued constituents from Dallas, the Dallas area. And I just wanted you to note that he is testifying on behalf of the Software Publishers Association, which has about 1,200

members on an issue that ought to interest every Member of the Subcommittee.

Chairman JOHNSON. Thank you. And welcome, Mr. Winn.

**STATEMENT OF STEPHEN T. WINN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COMPUTER LANGUAGE RESEARCH, INC., CARROLLTON, TEXAS; ON BEHALF OF SOFTWARE PUBLISHERS ASSOCIATION**

Mr. WINN. Madam Chairman and Members of the Subcommittee, thank you for that introduction. I know I will not be confused with Steve Wynn, owner of the Golden Nugget now. I am president of the Computer Language Research and am testifying today on behalf of the Software Publishers Association, representing 1,200 companies in my industry.

I would like to enter my prepared statement into the record and give our views on three important elements of the IRS restructuring debate. First, we are strong supporters of the electronic filing and believe that increased usage of electronic filing will occur if the IRS provides incentives to taxpayers and transmitters of electronic tax returns.

Second, the proposal to eliminate the differential between interest owed by the government and owed by the taxpayer with the taxpayer getting the lower rate is long overdue.

My third topic is one of extreme concern to my firm and all software publishers in general. To our dismay, the IRS is attempting to seize the single most important asset that we own, our intellectual property, through prolonged and ruinous litigation without compensation and without offering even basic trade secret protections.

First, let me give you a quick primer on software. It is created by a programmer who writes out instructions for the computer in a human readable form called source code. Source code is a recipe, if you will, for our products. Source code contains all of the trade secrets and know-how that sets one firm's products apart from another.

Once source code is developed by a programmer, it is then turned into machine readable or executable code. Executable code is what the computer understands. It is what we license to our customers in the form of CD–ROM disk. So source code is the recipe to the project. And the executable code is the actual product that we license to our customers. This brings us to the present problem.

The IRS has demanded access to the executable version of our software claiming that it is a book and record. Now, while we disagree with this interpretation, we nevertheless have complied with the government's demands and have granted access to the executable code in those instances where the IRS has agreed to protect our trade secrets.

Once the IRS has access to the executable code, they are on equal footing with the taxpayer. Now, it appears that the IRS wants more. They want source code or the recipe for our software. Mr. Brown testified that decisions are embodied in the software. This is not accurate. Software does not decide anything. The people who drive the software make decisions. In other words, the taxpayers. These decisions or inputs control what result is generated

by the software. And these discussions are fully disclosed to the IRS during the examination process.

No one disputes that a company's books and records are necessary both to prepare and audit its tax return. In order to audit the tax return, the IRS must be able to establish an audit trail that shows them how each number in the finished return flows back to the corporation's financial accounting systems.

Ordinarily, the audit trail is provided in the form of workpapers. All tax preparation software packages produce workpapers to facilitate mapping source data to the finished return.

The IRS would have us believe that numbers on the return are produced by a black box without support. Now, do you honestly believe any corporation would accept numbers that magically appear out of a black box with no support? Of course not, because how would they know whether or not they were paying too much tax? Corporations demand to know exactly how every number in the return is derived and how it ties back to their financial accounting systems. Our executable code gives them this information and that information is shared with the IRS during the examination process. So you might ask, so what, just give them the source code.

Well, one problem with this is the IRS is not willing to provide protections for our trade secret information. If they are going to look at the recipe, the basis for our competitive advantage in the market, then they have to be willing to keep it a secret. And they are not willing to do this. We are very pleased that Congressman Sam Johnson plans to introduce legislation to address this problem. The bill is quite modest and merely prevents the IRS from seizing third-party source code.

It permits the IRS to gain access to the executable code under conditions designed to minimize the risk of disclosure to a third party. Finally, it gives the IRS unfettered access to the software in any criminal proceeding. I strongly urge the Subcommittee to give Congressman Johnson's bill every consideration and to include it in any taxpayer rights legislation.

This concludes my statement, Madam Chair. I would be happy to take any questions.

[The prepared statement follows:]

**Statement of Stephen T. Winn, President and Chief Executive Officer, Computer Language Research, Inc., Carrollton, Texas; on behalf of Software Publishers Association**

Madam Chairwoman and members of the subcommittee:

My name is Stephen T. Winn and I am President and Chief Executive Officer of Computer Language Research, Incorporated, a tax return preparation software company headquartered in Carrollton, Texas. I am testifying today on behalf of the Software Publishers Association, the leading software trade association composed of 1200 companies, ranging from the largest and best known to many other, smaller firms. Thank you for giving the SPA and me the opportunity to give you our views on three important elements of the IRS restructuring debate.

First, we are strong supporters of electronic filing. Tax software publishers have been helping the Fortune 1000 corporations process and file their returns in electronic formats for many years. Further, millions of individuals are now using computers and our software to fill out their tax returns. The next logical step, of having those returns filed electronically, is only a relatively small step away. Providing incentives, including a longer time period for filing—which is logical given that it takes the IRS less time to process an electronic return—and financial incentives for transmitters, are both good ideas which would accelerate the movement away from paper-filing. The IRS study commission was correct in their view that electronic fil-

ing will be far more efficient, less prone to error, and cheaper over the long run than paper-based returns. Eliminating paper returns for millions of individual filers, and for thousands of small and medium sized businesses, will dramatically lower IRS error rates and enhance taxpayer—customer—faith in our tax collection process. Concrete steps beyond mere platitudes are called for and the Commission's recommendations are a good start.

Second, the proposal to eliminate the differential between interest owed the government and that owed the taxpayer—with the taxpayer getting the lower rate—is long overdue. Whatever revenue was raised from this artifice was too much. At the same time, I understand the problems of "revenue neutrality" and will leave suggestions for solving the controversial aspects of this proposal to others.

My third topic is one of extreme concern to my firm and other business software publishers. To our dismay and over our objections, the IRS, during audits of licensees of business software, is attempting to seize the software industry's single most important asset, its intellectual property, through prolonged and potentially ruinous litigation, without compensation, without offering even the most basic protections to the publisher. In my view, the IRS is on a wrong-headed crusade based on a fundamental misunderstanding of what software is and what it does.

First, let me give you a quick primer on software. It is created by a programmer, who writes out instructions for a computer in human-readable form called "source code." A corporate tax program, such as those published by my firm, may have 300,000 pages of source code, as well as notes the programmer makes as he proceeds, and comments from users who call in during the tax season with ideas and problems with the software.

The source code is then taken to a "compiler," which turns it into machine-readable, "executable" or "object code." When you buy software at your local computer store, it usually comes in the form of CD–ROM disks; this is executable code.

Source code is the crown jewel of any software company. It contains all the trade secrets, know-how, and tricks of the trade that set one firm's product apart from another firm's. We do not share our source code with anyone and we guard it by aggressively prosecuting any infringement of copyright, trademark, and trade secret laws.

This then brings us to the present problem. The IRS wants our software and is using the audits of our corporate customers to try and get it. In two cases now being litigated, as well as in at least another 5 cases about to begin the litigation process, the IRS has issued Information Document Requests (IDR's) and summonses for the software. In some instances, the IRS has issued "designated summonses" demanding that the taxpayer turn over the tax software. A designated summons is a powerful tool, in that it stops the running of the statute of limitations until lifted. Unfortunately for our customers, a standard software licensing agreement prohibits the licensee from giving it to anyone, including the IRS. In response, the IRS has issued summonses to the software publishers demanding the software. The most recent summons that CLR has received demands both the executable code—the CD–ROM disks—as well as the voluminous and highly sensitive source code versions of the software.

At CLR, which has been creating tax return software in one form or another for 30 years, our first thought was to find out what problems the IRS was having understanding our customers' tax returns so that we could help them find a solution. That is the way we have worked with the IRS since our inception and the IRS and the taxpayer had always come away satisfied. The IRS responded that they did not have a particular problem with the software but that the IRS National Office wants it anyway. Further, the IRS said that they have such broad powers under Section 7602 that they can take whatever they want on audit from either the taxpayer or from a third party software publisher. They then refused to negotiate with us further concerning a national accord which would allow the IRS to do its job while protecting our key asset.

The tax production software we publish is not customized or produced specifically for one company. It is merely a set of algorithms for calculating a return. The taxpayer must enter its financial data onto the return, usually relying on a general ledger software package for the financial numbers. No one disputes that a company's books and records are necessary both to prepare and audit the return. In order to audit that return, the IRS must be able to establish an audit trail that shows them how a number flows from the final tax return to the general ledger. Ordinarily, this audit trail is provided in the form of work papers. All tax preparation software packages produce work papers to facilitate this mapping of source data to the finished return. If a tax software program did not produce these reconciling work papers, no one would use our software because no one—not the taxpayer, who

has the highest interest in making sure his return is correct, or his auditors—could ascertain how a number on the return tied back to company's financial books.

The IRS is arguing that the software has somehow replaced the reconciling work papers so that the only way that they can track a number from general ledger to the final return is to access the software itself. This is simply not true, however. The fact is, in every instance of which we are aware, the taxpayer has been able to provide the IRS with an audit trail from final return to financial books without access to the software.

So if the taxpayer can demonstrate a clear audit trail from source data to the finished return, why does the IRS persist in demanding access to tax return production software?

We believe the IRS wants access to 3rd party software so that they can process alternative scenarios through the software. In other words, they want to use the software rather than examine it. They want to be able to improve the efficiency and effectiveness of their auditing process by confiscating software rather than using their own. (I should note here that CLR won a competitive bid two years ago to license an international tax program to the IRS at a cost of $2 million. We also trained 100 IRS examiners in the program just so they would have their own audit software). As much as we all appreciate the need for an efficient IRS, the SPA strongly believes that stealing software is not a proper reason to issue an IRS summons—especially a designated summons, which stops the running of the statute of limitations and makes our customers very unhappy.

We also think that the IRS is suspicious that a computer might be used to substitute for audit work papers that reconcile financial books to the tax return. Although I can understand that the IRS has to deal with some tough cases, this is really a little paranoid. If the computer software does not produce a reconciling work paper for a particular number, then it isn't going to do the Service any good to review the software because the support is simply not there. If the computer software does produce a reconciling work paper for a particular number, then all the taxpayer has to do is print it. The IRS doesn't need access to the software to obtain audit work papers.

We think that another more sinister motive is emerging. Rather than deal with specific audit issues pertaining to specific taxpayers, the IRS seems to be positioning itself to go on a fishing expedition to study all taxpayers that have used particular features in the software. If the IRS wins access to source code and programmer notes, can we expect a John Doe summons to follow requesting that we turn over information about who is using what feature in the software?

The SPA is also concerned that the next summons offensive will target the publishers of general ledger and accounting programs. It is those programs, after all, that generate the numbers that are used in the tax return. If, as the IRS claims, it cannot be expected to rely on numbers on a return produced by a computer, then the source of those numbers must also be suspect. And what about the company's network for collecting those numbers? The list of potential summons targets could easily go on and on and on.

What would the IRS get if they did win access to a publisher's source code?

They would get nothing usable by a field agent. Indeed, there are very few programmers with a tax background. The IRS would have to hire one of our competitors or someone capable of becoming a competitor to understand the source code. Only a part of the code deals with tax matters; the other part is instructions to the computer regarding the operating system, printing, what color the screens should be, etc. It is those hard-won tricks-of-the-trade that a competitor would find very interesting.

It is my understanding that no IRS audit of any taxpayer has to this day ever included the seizure and unrestricted use of third party tax compliance software by the IRS. Yet now the IRS would have us believe that it is impossible for it to perform an audit without such seizure and unrestricted use. The SPA believes such an assertion is without merit.

We are very pleased that Congressman Sam Johnson has introduced legislation to address this problem. The bill is quite modest and is not IRS-bashing by any means. It merely prevents the IRS from seizing third party, computer source code from a tax preparation or accounting program in examination. It also permits the IRS to gain access to the executable version of software under conditions designed to minimize the risk of disclosure to a third party. The bill would also clarify that courts have the power to protect a publisher's intellectual property rights in any IRS summons enforcement action. Finally, it gives the IRS unfettered access to the software in any criminal proceeding. I strongly urge this committee to give Congressman Johnson's bill every consideration and to include it in any taxpayer rights legislation that you pass.

This concludes my statement, Madam Chairwoman. I would be happy to answer any questions that you or the committee may have.

---

Chairman JOHNSON. Thank you. I assure you that Congresswoman Johnson will give Congressman Johnson's bill a consideration. First of all, I want to thank the panel for your input and for the specificness of your testimony. Your recommendations will be looked at very carefully.

This is a real opportunity for us. We now have a couple of years of closeup experience ourselves. This is our third year as a Subcommittee. With the Commission's indepth work, we are, in a sense, kind of uniquely situated to do some good work here. And we appreciate your input today and will look forward to working with you.

I did want to go back to something that a number of you brought up that I didn't get to pursue earlier just to make clear that it is very much on the table. This issue of how people are treated after divorce is a very big issue. And in my interest in moving on to this panel, I did not call on Mr. Lubick for his comments. But it should be noted for the record that, in April 1996, more than 1 year ago, in response to our Taxpayer Bill of Rights 2, the IRS did issue a manual, a manual of instructions to the field offices that modified their proceeding for dealing with cases involving a claim for relief based on the innocent spouse provisions.

In other words, they did respond. They did start the process. And that more than 1 year later well after the date that the report is due, we still have no report is indeed cause for concern. We will be moving ahead. I would like to ask—I was pleased that many of you do have comments on that issue and suggestions for us.

I agree, Mr. Lane, we did talk about prorated. I mean, there are some solutions here that we should be looking at. So I will invite your specific input on that as we move forward. But I also would like to know whether any of you are conscious of these new instructions in the panel and have they made any difference to your knowledge out there.

Ms. Olson, thank you very much for your comments in regard to this particular group of people that you work with and the focus on the importance of outreach through the proper vehicles and in the proper language when trying to service people who we see as low income, but do pay taxes.

Mr. LANE. I have a comment on that. One of the problems we are running into, as I understand it, from a number of comments to us in the last several months, the provisions of the Taxpayer Bill of Rights that were signed into law last year by the President specify that with respect to ex-spouses and with respect to people who may have also been asserted the trust fund recovery penalty, that the taxpayer has the right to request information as to what efforts are being taken in that regard.

We have had several Members come to us who have valid powers of attorney from the taxpayer. So according to the bill of rights that was passed in 1988, they should be able to stand in the shoes of the taxpayer and get any information the taxpayer would be entitled to have. The Service is now taking the position that because

they are not the taxpayer, they cannot get this information that the Taxpayer Bill of Rights 2 enables the taxpayer to get, and they are requiring the taxpayer themselves come in with the application to receive the information. That is ludicrous. And that should change.

Chairman JOHNSON. Thank you very much. Anyone else have any comment on how those regulations are affecting the practice?

Mr. KAMMAN. I think a journey of a thousand miles must start with a single step and this is a single step. I think what I heard earlier today is IRS pointing out, well, we don't want anybody to believe that what is in the manual is enforceable or actually anything close to being law. It would be nice if that were put in—whatever IRS is doing would be put in their publication one, the publication that goes to taxpayers who are subject to this kind of collection procedure. If the taxpayers don't know about it, maybe taxpayers with representatives know about it, but most taxpayers who are contacted by the Collection Division do not have representatives. They need to be told what their rights are, if they have any rights, or if there is even any administrative grace, tell them about it.

Mr. LANE. Could I raise a question on that?

Chairman JOHNSON. Yes.

Mr. LANE. One of the things that bothers us and has continued to bother us for years is we run into issues where we have got a case being worked in the field, the Internal Revenue manual has a specific comment about how that case should be handled, and we are told by the local office, well, that is only a guideline. We are not required to follow it. That doesn't have the force of law.

And we have raised this several times with a variety of Commissioners and a variety of administrations. And the question we have to ask is, You know, who runs the Internal Revenue Service? Does the Commissioner make the policy, and the national office promulgate that policy, then the field is required to follow it? I mean did God give Moses the Ten Commandments or the ten suggestions? What's the answer?

Chairman JOHNSON. So the issue of the standing in the manuals is a very——

Mr. LANE. Exactly. The manual says something. And we are training practitioners on how to represent their clients by relying on what the guidebook says. And then they run into a situation in the office where they are told, Well, we don't pay attention to the manual. It is only a guideline. Well, they can't have it both ways.

Chairman JOHNSON. Thank you for that point. I want to go to a point raised by Mr. Harris in his testimony. You think it is a good idea to require that any person, that Taxpayer Advocates take an oath not to work for the IRS for 5 years. This has struck me as a very two-edged sword.

You certainly want people who are experienced, who know the process, who know tax law and so on and so forth to be your Taxpayer Advocates. But if you don't—I mean, are you saying, then, after they are done being a Taxpayer Advocate they can never work in any other job in the IRS?

Mr. HARRIS. We made a suggestion to the Restructuring Commission about our concern about the independence of the Advocate. The Commission came up with this solution to that problem. I

think it is the best solution. You know, are there others out there that might work as well? But I think what we have to ensure upon is that the person who is charged with these very important roles of valuating the issues that are of concern in the Service is not still concerned about their future movement within that organization, because it would certainly potentially cause them to hesitate in an honest response.

I think this is a fair solution to the problem. We are prepared to support it. I understand that, you know, it could be a concern that no one would take the job, because at the end of their term, they have to go seek employment elsewhere. But hopefully they will do a good enough job and they will be there until they are ready to retire and can be independent for that length of time.

Chairman JOHNSON. I read that recommendation of the Commission with some concern, because in a way this is the right kind of person who should be heading the IRS. And after they have really been there for a while and seen what the problems are at the bottom, they might be the very best person to be Deputy Commissioner.

Mr. HARRIS. Maybe we should say except for Commissioner.

Mr. LANE. Can I comment on that? We included a comment in our governance submission for your hearing on the 16th specifically on this issue. What we suggest in our resolution, because we have the same concerns Roger has about not having a career IRS official be put in this position and be wondering about where he goes next after this job, and, as a result, he doesn't want to offend the powers that he's got to deal with.

We suggested that the law ought to be rewritten that prohibits the appointment of an IRS employee to this position in the first place. In other words, if it was a career executive and someone made the decision, the President made the decision to appoint that person to that Taxpayer Advocate's Office, they would have to resign from the government so they would be truly independent when they went into that slot.

I agree with you. I think that an excellent potential candidate for Commissioner and designee would be somebody who has performed well as a Taxpayer Advocate. And we would not want to see that person precluded because that technically is an area considered employment with the IRS.

Chairman JOHNSON. I do think this is a very difficult issue. And in the Taxpayer Bill of Rights 2, while we gave greater independence to the Taxpayer Advocates, we did not go as far as some would have liked us to go. And we didn't because there is a real concern about creating a confrontational relationship between the advocate system and the IRS system. If there is anything that sort of continuous improvement shows you out of every other sector of the economy, it's people working together to solve problems. That is really powerful. While you want the Advocate to be independent enough to provide an outside view or at least to report directly to us so that the Advocate doesn't have to go through all the bureaucracy, which isn't necessarily malicious or ill intended but slow, laborious and has other priorities; I'm not at all convinced, in my own mind, that the degree of independence that this report is seeking creates the strong independent Taxpayer Advocates.

One of the problems that you create, then, is what is the Advocate's need for next employment? How is this going to affect their service of constituents? Will they get particularly interested in one kind of case and be a good Advocate and then get employed by that sector? So you set up a whole different dynamic. I'm not so sure we aren't better off dealing with the dynamic we know, which is the need for independence, but the need for good information, trustworthy relationships, that is a very big issue here. Can you trust them? If the Advocate has their own next job in mind and may be making a public display of how much stuff they can reveal, I worry about this.

Mr. LANE. We share your concerns about this. I mean, we have switched positions on this. If you recall, when we testified in March 1995, we were vehement about not making the Advocate an independent individual, but keeping it in the career IRS executive corps. The problem is, with all the additional responsibilities and rights that you gave that Taxpayer Advocate, you created an untenable situation for a career executive to survive in.

A career executive that fully used all of the independence that you gave that position would find themselves crosswise with the Commissioner and Treasury often. And so you are putting this person in really an untenable position. He is going to try and want to go out into another job with the Service.

Chairman JOHNSON. This is a longer discussion. But surely if he saw that much abuse, he would put himself at odds. With the new board in mind, that is not so agency dependent, I think that that conflict would be seen much earlier. I think we have to look at the reforms as a whole. I personally think that the outside board bringing in the private sector and a more independent voice helps the Advocates to maintain their independence. I do hear what you are saying. As we go forward, anyone who wants to comment on this or call me and talk to me about it on the phone, my jury is really out. I am not at all convinced.

Because in the legislative area and in the executive branch, we have really made it impossible for us to get some of the quality people we need because we have now built so many parameters around service. One of the biggest barriers are the parameters that we have put in place in regard to what you can do after you leave your Cabinet position or your Deputy Assistant position or even your legislative position. I am sensitive on that issue.

Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman JOHNSON. Mr. Portman. Oh, Mr. Johnson, would you like to ask questions?

Mr. JOHNSON OF TEXAS. Thank you. Just one, if you don't mind. I would like to ask the question based on the fact that the IRS is opposing what you want to do; that is, protect your property rights.

Is there a difference between the head office here in Washington and the district office that you deal with directly? And could you explain real specifically why they don't need that source code?

Mr. WINN. All right. In 30 years of doing business, my company has helped—or our executable software has been used to prepare probably 50 million tax returns. Not one time, not one time in 30 years and 50 million tax returns have we ever been asked for

source code. And the reason for that is the software executable version is all you need to determine how the software functions.

The IRS has testified that they believe the software makes decisions. I guess that would mean it would have to assume a life form. Software does not make decisions. It is instructed by people who tell it what to do. All of the decisions that the people, namely the taxpayer, entered into that software are fully accessible by the IRS. All of the workpapers they need to determine how every single number in that tax return was generated are available and are produced by the taxpayer. So to come after third-party source code, which the taxpayer has never had access to, is overreaching, in my opinion, and the Software Publishing Association's opinion.

Mr. JOHNSON OF TEXAS. But is there a difference between the way the district people treat you and the offices in Washington?

Mr. WINN. Well, we have never had a problem with the IRS for 30 years. We always worked with them any time they had a question in the field about a tax return that they wanted us to help them with.

About a year ago, the national office seems to have changed that policy, and they now want access to source code, and it is unclear to us why they feel they have to have it. What is interesting is they have their own audit software, which we coincidentally license to them. And under that license they are not entitled to source code, and they have not asked for source code for that software package when they licensed it from us.

Mr. JOHNSON OF TEXAS. Thank you, sir.

Thank you, Madam Chairman.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN [presiding]. Thank you, Madam Chair, and thanks to all the witnesses. We have had a lot of good input today, and I know we are going to have a lot of followthrough. We can't get into all the details today, but let me just see how far we can get.

Pam Olson, Ms. Olson number one, thanks for the support of most of the taxpayer rights provisions. In fact, much of what you say even outside of the legislative recommendations, I think, is very helpful to us because of some of these other issues we will be dealing with. I am eagerly anticipating the full support of the bar for this legislation so you can actually help us get this through the process. I know you will support the vast majority of what we are doing, including the taxpayer rights section. I know that is coming.

Let me ask about one specific one, if I can get your input on it, because it is one that I think AICPA feels strongly about. I will ask Mr. Mares in a second about it. It has to do with whether practitioners who are able to practice before the IRS would be allowed to represent a taxpayer in the Tax Court's small case procedures? And as you know, we have some procedures in the bill to raise the caps on the so-called S calendar.

Assuming that CPAs, and enrolled agents for that matter, agree to abide by the Tax Court's rule of practice, how does the ABA feel about that proposal?

Ms. PAM OLSON. Well, it is not something on which we have any position, but it seems to me that it is something that the section would and should support. The Tax Court has a number of problems with S cases with taxpayers being unrepresented, and often-

times, as Ms. Olson number two indicated, the problem with taxpayers is that they don't believe the IRS, or they don't quite understand.

Mr. PORTMAN. Right.

Ms. PAM OLSON. And oftentimes, if you can put somebody in that situation to explain things to them, you can eliminate the dispute entirely and eliminate the need for a proceeding at all. So it seems to me that allowing that to happen is something that would be a good change and something we should support.

Mr. PORTMAN. OK. Thank you very much.

So much of what Ms. Olson number two said about taxpayers who are less than 125 percent of poverty would relate to many of those taxpayers, which is the same degree of confusion and lack of representation.

Ms. PAM OLSON. Yes, definitely.

Mr. PORTMAN. Mr. Mares, I again appreciate all the support AICPA has given this whole process. This is what it requires to make some of these changes, to get that kind of wholesale support. I also agree with your suggestions on the taxpayer rights front. A lot of them, as you know, we have heard during the Commission process. But the rubber hits the road now, and we actually have to come up with a Chairman's mark, and this Subcommittee is charged with doing that.

Is abiding by the Tax Court's rules a problem for your members?

Mr. MARES. No, not at all. As a matter of fact, we would expect that anyone admitted to practice before the Tax Court would be bound by their rules and regulations, so that is not a problem at all.

Mr. PORTMAN. OK. All right. Well, again, thanks. We have your testimony here on the other provisions, which we are all going to look at.

Joe Lane, you have given us a whole lot of information today, some of which we have had through the Commission, some of which is new. One thing I wanted to ask about but which you didn't get into was this whole issue of the IRS deemphasizing its program for intervening early when a business, particularly a small business, misses a payroll tax deposit. I have heard about this back home. I know it came up during the Commission's proceedings.

What are your views about this, and do you have any recommendations for improving the FTD Alert Program?

Mr. LANE. One of the reasons that the FTD Alert Program—and basically, for those who don't know what that is, I will just give you a little explanation. When companies are required to give a payroll tax deposit, and if they miss a payroll tax deposit and they haven't been showing up, the IRS hasn't heard from them, they send out an alert to the field that says there is some missed FTDs, and then hopefully they would get on top of that case faster so you didn't have two or three quarters' worth of payroll tax liability run up.

One of the problems is that that is a program that frequently slips back in terms of priority because they have got other inventory that has already been assessed and that is getting old or sitting out there, and they have got offers in compromise, or they have got other things to work on.

I have looked at that issue for years, both as a Collection Division Chief who had problems managing FTD alerts because of those other competing demands and also as a practitioner now for 18 years. And I think you could actually do a statutory—a statutory tweak on a couple of Code sections and establish a new procedure that might really help get that high-risk taxpayer that I would say typically is your person who just starts a business or is in the first couple of years of business, is not adequately capitalized, and they start to use the trust fund withholdings they withhold from their employees as operating capital. That is the typical scenario in these situations.

You have two Code sections, 7512 and 7215, which basically allow the IRS to put the taxpayer on a monthly filing requirement for 941 taxes instead of quarterly.

Now, in the past, the taxpayer is required under that provision to set up a separate bank account, make deposits into that bank account, and if they provide—if they don't follow that regime once they have been put on that process, then they have the ability—the IRS has the ability to actually prosecute these people criminally.

I would suggest that what might make an appropriate fix to that—those cases very rarely are worked, and you very rarely see that program emphasized because the Department of Justice hates working them. OK? So you wind up getting this disconnect where IRS tries to transfer this stuff up, and they send it back.

What I would suggest you do is have the IRS consider contracting, go out with a request for proposal, contract with one of the large payroll companies like an ADP or Paychecks or something like that nationwide, and have a contract that provides statutory authority for the IRS to take—identify a high-risk taxpayer and require that taxpayer to use that contract for the first 2 years of business, or if they have missed FTDs, the first time they miss the FTD or have a delinquent quarter from 941 taxes.

Mr. PORTMAN. Because the record with the ADPs of the world is that there aren't the delinquencies, even though it is quarterly, not monthly.

Mr. LANE. Well, I am not so much talking about—once you identified that person, then what you would do is require statutorily in the language that under that contract, what that employer would have to do is deposit the gross payroll each pay period with that payroll processing company, and then those people would take care of making the deposits on time and preparing the tax returns quarterly and filing that stuff.

The key thing is to get the taxpayer into a business environment where the tax returns are being paid and fully filed on time, and if he is on that process, probation, for example, for want of a better word, for 24 months or 36 months, then you have got a scenario where the guy comes out of that, he goes into keeping track on his own. He has already got his cash flow situation ironed out. He is used to dealing with that. He is used to paying his taxes on time. And that is the high-risk taxpayer. That is what causes all of those problems. It is a double problem for IRS because they have to pay the refunds out to employees even if they didn't get the money sent to them.

Mr. PORTMAN. Any other members of the panel who have comments on that, I would ask you to give them to us in written form. I know, Mike, you may have some thoughts on that as well, because I think at some point you might want to look into it in this legislation if there is a statutory fix, maybe a couple of tweaks, as you said.

I have one other thing for you, Joe. I got a letter from Diana Thompson, who is an enrolled agent back in my district, about this issue of the bypass procedure, and I think this is an important one for us to address. You know, is this prevalent of the IRS going to a taxpayer directly rather than going through the enrolled agent or another representative of the taxpayer? And if so, what should we do about it, either in the statutory language or report language?

Mr. LANE. It is so prevalent that we have had to develop training materials for our people, when we teach our national practices institute, on what they do when their power of attorney is illegally bypassed.

Mr. PORTMAN. It is covered in the Taxpayer Bill of Rights.

Mr. LANE. Absolutely.

Mr. PORTMAN. But do you think that needs to be clarified, or do you think it needs to be strengthened, or do you think there needs to just be an emphasis on adhering to current law?

Mr. LANE. I think there ought to be monetary sanctions against an employee who bypassed the power of attorney without following the IRS manual procedures.

There are provisions in there to bypass when the representative is being uncooperative.

Mr. PORTMAN. Yes.

Mr. LANE. And they are supposed to go and get a letter approved by their group manager. That letter is sent out to the practitioner giving them one last chance to cooperate. Then they go to—they have the right to go to the taxpayer.

They are not following that, and this emphasis on these economic reality audits, financial status auditing, is what is driving it. And the IRS is telling their agents to talk to the taxpayers, get—talk to the taxpayers directly.

The case with Brian Hughes is an egregious example of this.

Mr. PORTMAN. It seems like it.

Mr. LANE. This is happening every day.

Mr. PORTMAN. Again, any other comments that people have on the bypass, let us know. That is another issue we may want to take up in addition to what is already in the legislation.

Mr. Kamman, thank you.

David Keating, as you know, is on the Commission and gave us a lot of input for these 21 provisions. In fact, he was the author of many of them, and I appreciate your additional thoughts here. You would like us to go a lot further in some ways, and one that I am interested in is the TAOs.

We had a discussion, as you know, earlier with Mr. Brown where Mr. Brown and I were disagreeing over the requirement that is in the legislation that a violation of the rules of the IRS would be considered as part of hardship, and your point is that it is hardship. I guess another way to look at that is just to have that be a separate criteria. How do you feel about that; in other words, have

hardship be defined one way, maybe in a more precise way for taxpayer hardship, but also have a violation of internal rules as being another reason for a TAO to be issued?

Mr. KAMMAN. One, I think it is clear from the language of the proposed statute that these are factors to be considered. I don't think there is any way a reasonable person could read this and say that it is limiting the issuance of taxpayer assistance orders. Sometimes I wonder if the people from IRS are reasonable.

But if that is a concern, if that particular issue is a concern, then just add a line saying this should not be construed as limiting—as giving any legal limit in the manual. Even if the manual is wrong, the taxpayer should be entitled to have the enforcement agent follow it until the manual is fixed.

Mr. PORTMAN. OK. Well, I think that is something again we might want to talk to you about in terms of clarifying that language, either the way you suggest or perhaps pulling out the violation of a manual as one of the criteria.

Mr. Harris, again, I understand, has been a great supporter of this whole effort, and you have given us some input today with regard to the low-income taxpayer clinics which we will get into in a second.

Ms. Olson, you made the suggestion, I think, in your testimony that it be limited to taxpayers of 125 percent of the poverty level. I just wonder how you come up with that recommendation? And in your experience, are there a lot of taxpayers at that income level, and how often are there problems with the IRS?

Mr. HARRIS. I think our concern was the directing the resources to the people who need it the most. Obviously, the lower the income, the more difficulty they are going to have affording any kind of representation. You know, the flip side of it, of course, is that you would hope that most low-income taxpayers are in a relatively simple situation and should be able to resolve their disputes with the IRS without representation.

It concerns me that low-income, simple-filing taxpayers are having to use representation of any type to solve their disputes. I would hope that the system would be able to accommodate them easier. But it was really just an allocation of resources, trying to make sure that the people who needed the help the most got it as opposed to other people who maybe could afford it aren't taking away the limited resources.

Mr. PORTMAN. I would just suggest that based on the Taxpayer Relief Act of 1997, there will be more, not less, confusion because of the EITC and tax credit overlapping provisions.

One other question for you, if I might. You recommended that the IRS establish a new numbering system for tax preparers. And as you know, the Commission looked at the issue of registration, regulation, and so on. Do you support the registration of all preparers? In our Commission recommendations, in the legislation, we require regulation, but not registration.

Mr. HARRIS. I have no problem at all with the regulation, and I think to the extent that it can even accomplish this goal, I just don't see why all people who are going to be prepared to file a tax return can't send in a 1-page form with their name and address and be issued some form of number other than a Social Security

number to put on that tax return. We do it all the time with other people, and certainly I think anyone who prepares tax returns should be on a level field with regard to Circular 230. But I also think in return for that we should be able to be issued some reporting number outside of our Social Security number.

Mr. PORTMAN. OK. Any other comments, Mr. Mares, others, on the issue of registration versus certification?

Mr. MARES. Well, I think one of the issues that you can look at with registration is, instead of registration of every individual preparer, particularly for larger firms where you are talking about several individuals who may have the ultimate responsibility under Circular 230, whether or not there should be registration of firms. This could ease administration.

For example, in our practice—as a matter of fact, I was up here testifying on a day when some returns were due that had my Social Security number on them, and it took some time and effort to get those Social Security numbers changed.

Mr. PORTMAN. Ms. Olson number two, I appreciate the testimony on the support of the low-income provisions. Your suggestion that it be publicized more, the issue as to who controls funding, I think, are appropriate concerns for the Subcommittee to look at for the final legislation.

In terms of the overall issue of representation of low-income taxpayers, one of the issues we have run into is that there may be some State limitations, like State bar limitations, on representation. To your knowledge, nationally, Virginia included, of course, have you run into any of these concerns in developing clinics or setting up clinics? Is there a need for uniform rules in this area?

Ms. NINA OLSON. I think that each bar—State bar, the difference within them is whether you can be an independent 501(c)(3), or do you need to be a licensed legal aid society in representation?

The statutes for a licensed legal aid society are very—they vary from State to State. I know of two States where an organization ran into a problem with that. Connecticut is one. But I don't know that they are insurmountable, and I do think that that is a State issue. It deals with such—you know, such things as the bar regulating itself as an agency of the State and its members.

Mr. PORTMAN. So you don't see the need for national standards to be developed?

Ms. NINA OLSON. No, I don't.

Mr. PORTMAN. OK.

Mr. Winn, I know you have really answered the questions that I have through your conversations with Mr. Johnson and in our discussion prior to the hearing. I guess all I can say is this seems to me to be a legitimate problem on the face of it. Your proposal seems reasonable. Whether it fits into the taxpayer rights section or not, I am not sure.

One of the concerns we have had is the potential involvement of the Judiciary Committee because this may involve some issues that relate to its jurisdiction.

And I may be the one that should answer this question for you, but have you had an opportunity to look into that issue to see whether there are other jurisdictional problems with this kind of an approach outside of this Subcommittee?

Mr. WINN. No, I have not.

Mr. PORTMAN. OK. Well, that is something that I will have to look into. That is my job after all.

Thank you all very much for being here. I am going to adjourn the hearing now. I will be around. If you have an opportunity to stay around, I would like to talk to some of the panelists. This hearing is adjourned.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

**Statement of Mortimer M. Caplin, Caplin & Drysdale**

My name is Mortimer Caplin and I served as Commissioner of Internal Revenue from 1961 into 1964. For some 30 years I taught tax law at the University of Virginia Law School, and have represented clients on tax matters for over 40 years.

It would be unwise, as the IRS Restructuring Commission recommends, to put control of the Internal Revenue Service into the hands of an independent, mostly private-sector board of directors—comprised of seven business and professional executives, one IRS union representative and the Treasury Secretary or Deputy Secretary. Such extreme experimentation in virtually privatizing a basic government agency risks unhinging a tax system that finances our government and is crucial to our national commitment to balance the budget.

Legal and constitutional issues aside, board control on a part-time basis is no way to run the IRS. A business style corporate model just does not suit the administration of a large government agency which, with over 100,000 career employees, is called on year after year to collect $1.5 trillion in taxes, process 200 million tax returns and match 1.2 billion information returns. Indeed a General Accounting Office study concluded: "in practice, the board form of organization has not proven effective in providing stable leadership, [or] in insulating decisions from political pressures."

Raising taxes is not comparable to manufacturing widgets, selling toothpaste or marketing financial services. In fact, very few people like the product in the case of the IRS—one of the real reasons why the agency is such a familiar whipping boy.

The rare exception may have been Justice Oliver Wendell Holmes who said that he liked to pay taxes. To him, it was the price of civilization—the price we are called upon to pay for the privilege of being a member of this democratic society. And despite much grousing and groaning, Americans do a remarkably good and honorable job in meeting this obligation.

Unfortunately, there will always be those who do not meet their full tax responsibilities, thus shifting the costs of government onto the backs of others. To see that they do, and to assure fair treatment for everyone, the IRS must of necessity carry out its enforcement role—whether by examining tax returns, collection procedures or even criminal investigations and prosecutions.

Difficult and unpopular as these monitoring tasks are, no tax system will work without them—whether it be a flat tax, unlimited savings account ("USA") tax, national sales tax, value-added tax or any other form of consumption tax. Moreover, they are not the kind of tasks that typically concern corporate board rooms. Nor are they the focus of credit card companies or other financial institutions in their constant quest for new accounts and enhanced earnings-per-share.

The IRS is not a "for-profit," bottom-line business.

Like many other government agencies, it has had its share of management errors and poor judgment. And major changes are long overdue: improving education and services for taxpayers, better training for employees, modernizing computer networks, and greater efforts to simplify and streamline the entire tax process—notwithstanding the impenetrable constraints imposed by our unbelievably complex tax laws.

But only some changes are within IRS' own control; others, like budgetary restraints and legislative changes, are solely within the control of Congress. Tax returns unescapably mirror the tax law, and until Congress takes serious steps to eliminate complexities—preferences, exceptions, phaseouts and backdoor financing of social and economic goals—tax returns and tax administration cannot achieve simplicity.

## DISTORTED "VISION"

The proposed overhaul designed by the Restructuring Commission and its statutory offspring (H.R. 2292 and S. 1096) is deeply flawed. It would obscure the core focus of the IRS, blur the lines of authority and hamstring improved efficiency.

The Commission proclaims as a "guiding principle" that "taxpayer satisfaction must become paramount at the new IRS": its "key recommendations are all geared toward making the IRS more user friendly." Often found are the words "customer" and "customer service," terms hardly descriptive of the true relationship that exists between taxpayer and tax collector. Topping it all off, the pending legislation asserts with a straight face: "The job of the Internal Revenue Service is to operate as an efficient financial management organization."

Is this a portrayal of the real tax world?

One searches hard in the Commission's report for emphasis on citizens' responsibility to meet their tax obligations, on the importance of improving voluntary compliance and on the need for enforcement activities to assure that all are paying their way.

And what about the law enforcement assistance IRS provides to the Justice Department in combating organized crime, narcotics trafficking and money laundering? Hardly work for an "efficient financial management organization."

## PRIVATE SECTOR CONTROL

It seems very clear that the privately-controlled board will dominate IRS administration. Just about every major managerial decision will require its endorsement: selection and removal of the Commissioner; approval of top level appointments and promotions; review of strategic and operational plans; and—of key importance—approval of IRS budgets and allocation of resources. And to underscore the importance of its role, the proposed restructuring statute requires that the board's version of the IRS budget be sent directly to Congress "without revision."

To add to its powers, the board will have its own staff along with outside experts and consultants. One is reminded that when former Supreme Court Justice (and former UN Ambassador) Arthur J. Goldberg suggested a similar regime for ordinary business boards, he was excoriated by hordes of CEOs and board room brethren.

Power is like a magnet, and the wary and sensitive IRS management team will undoubtedly be looking in many directions to see who is truly calling the decision-making shots. All this is aggravated by the void in the proposed statute concerning the Commissioner's relationship and reporting responsibilities vis-a-vis the Secretary of the Treasury.

Senator Charles Grassley conceives of this new body as "a real board with real independence, authority, and teeth." And House Speaker Newt Gingrich wants it to be "a real management driven from the citizen level."

But yet, the seven private-sector board members—as "special government employees"—will still be able to keep their outside jobs and salaries, and still be allowed to represent private interests before any federal agency other than the IRS. Will this satisfy the public that the tax law is being administered in an impartial manner, free from any conflicts?

Of major concern is the proposed legislation's diminution of the Commissioner's role in tax law administration. No longer would the Commissioner be a Presidential appointee confirmed by the Senate. No longer would the Commissioner be actually in charge of administering and managing the agency. Instead, prior board approval would be required for each significant decision.

To leave no fissures in the oversight regime, the proposed statute also obliges the Commissioner to "convene" a separate Financial Management Group and to procure its advice on all major financial management issues.

And what of the Commissioner's many real and symbolic roles which are of such crucial importance to the sound operation of our tax system: the leader and chief administrator of this major governmental agency; the source of final administrative appeals, "the court of last resort;" the IRS' nexus with tens of thousand of tax professionals, lawyers and accountants, all of whom are so vital to enhancing nationwide voluntary compliance; and the IRS' chief communicator—in dealing with the Congress and the President, in coordinating with the Treasury in carrying out tax policy, and in negotiating with foreign officials for better cooperation and improved worldwide tax compliance?

The proposed legislation inordinately reduces the Commissioner's position and standing at all these levels, much to the detriment of the entire self-assessment system.

REJECT RISKY EXPERIMENT

The Commission's proposed administrative maze—coupled with endlessly overlapping oversight by the GAO and a long string of congressional committees and subcommittees—amounts to a radical governance plan.

Let us not make this risky attempt to separate the Treasury-IRS historic governmental ties, as the Commission would. Tax policy and tax administration are inextricably intertwined; and the intrusion of a part-time, business-dominated board—controlling the selection and removal of IRS Commissioners, as well as controlling IRS budgets and resource allocations—threatens the sensitive balance in the basic operation of our tax system.

Better that we first insist that Congress meet its fundamental responsibility for "simplifying the tax law wherever possible"—making it more understandable, easier to comply with, easier to reflect on a tax return, easier to administer. Frequent changes in the law, with mountains and mountains of added complexity, are at the very center of IRS difficulties and taxpayer frustration.

And let us give the Treasury the opportunity to refine and test its new initiatives, which call for strengthening Treasury's oversight role, providing the IRS with more flexible budgeting and management tools, making greater use of outside computer and management experts, and placing heightened emphasis on taxpayer education and service.

Already announced by the administration is the proposed formation of a new "watchdog entity," a citizen review panel to perform an explicit oversight role and to advise the Secretary of the Treasury on improving IRS' overall administration of the tax law. Included is the formation of 33 local review boards—to monitor the actions of each IRS district office and to coordinate their efforts with the work of the new national citizen review body.

With the recent congressional and public focus on some of IRS' failings, and with the publicized constructive steps now underway, the IRS should be given the chance to institute fundamental changes to serve the best interest of taxpayers and the nation at large.

*Portions of this testimony are taken from my Washington Post Op-Ed piece, September 23, 1997.*

**Unsworn Statement of George Christian**

Mr. Chairman, in commiseration with the uncounted thousands of Americans abused at the hands of the IRS, I thank you for this unprecedented opportunity to have my statement placed in the record. I voluntarily make this statement under penalty of perjury pursuant to 28 U.S.C. 1746. My wife and I also take this opportunity to commend you for the courage to hold these hearings in light of the tremendous fear that has been expressed here by taxpayers, IRS employees, and even you, our elected representatives. Although, we began this nightmare more than twelve (12) years ago with a tax attorney, we necessarily became pro se when our attorney David L. Snyder withdrew at the suggestion of the Special Trial Judge Peter J. Panuthos, and then sued us for approximately six (6) times the agreed upon fee while our case was still pending.

Given the admitted abuses by the IRS, the apology of IRS' Acting Commissioner Michael Dolan, for the first time in twelve (12) years, My wife and I have hope that someone in government will acknowledge that we have been targeted by the IRS under the "color of law," in deprivation of our civil and constitutional rights. Given the testimonies of fear and abuse expressed here by white Americans, I ask that you accept my statement that:

Our file was illegally re-opened and we became targets of the IRS only after it was discovered that we are African Americans.

Prior to the discovery that we were African Americans, our fully disclosed personal and business returns were examined and closed without question or deficiency. This strongly suggests that the same tax position taken by a white entrepreneur would have been accepted as filed. Furthermore, we can document that the IRS, against African American entrepreneurs, illegally and maliciously fabricated a 1983 "TEFRA" partnership in violation of 26 CFR 301.7701–1(c). The fabrication was facilitated by the IRS fraudulently changing the date on a 1984 Georgetowne Sound/Christian-Hall distribution agreement and then circulating that agreement to misrepresent partnership activity in 1983. This TEFRA partnership was fabricated for the purpose of circumventing the three (3) year Statute of Limitations, but more tragically, for the purpose of depriving vulnerable African American entrepreneurs of their right to pre-deprivation litigation in the Tax Court. Accordingly, no valid Statutory Notices of Deficiency were issued; consequently, forced collections were made and many African American families were destroyed or permanently damaged, without any opportunity to be heard.

** Here, it must be noted that the IRS lied about the existence of an abusive tax shelter. The fraudulent "Abusive Tax Shelter National Litigation Project" was conceived without the required Sec. 6700 penalty, and did not cover the disputed 1983 tax year. Therefore, because the IRS had little chance of succeeding in Tax Court, it then conspired with the Tax Court to deprive vulnerable African Americans of the rights afforded every other American Citizen. Under the color of law, the IRS then claimed that the partnership "failed to file a return"; thus, leaving open the limitations period forever. All of this occurred after the statutory three (3) year period for assessing these minorities had expired. **

I will not attempt to specify each of the many illegalities we have suffered. However, I must state emphatically that no legislation to reform the tax code, or to stop IRS abuses, will be effective unless Congress acknowledges that the United States Tax Court is necessarily an integral part of the illegal abuses suffered by the American people. When we discovered that the Tax Court and the IRS had illegally conceived a national litigation project in violation of specific Congressional guidelines pursuant to Sec. 6700 IRC and Rev. Proc. 84–84, we became prime targets not only of the IRS, but the Tax Court as well.

Arguably, any national tax litigation project may be found unconstitutional even though properly conceived under strict guidelines set by Congress. However, where those strict guidelines mandated by Congressional Act are intentionally violated, there can be no doubt as to the litigation project's *un*constitutionality. To support our position that the project was unconstitutional, we challenge this committee, the judicial committees, or any concerned entity, to examine our Tax Court case and determine the validity of this entire administrative and judicial process. We think you will find this process a total sham.

The intentionally obfuscated record will show that the Fourth Circuit Court of Appeals dismissed our appeal for reasons unrelated to the merits of the case, but on the technicality of filing the appeal late. However, the record will also show that we did not intentionally delay the appeals process, but were seeking to correct the "record on appeal" which was fraudulently edited to conceal an illegal, unconstitutional conspiracy by the IRS and the United States' Tax Court. Here it is very revealing to note that it took one and one-half (1) years before the 4th Circuit decided

our *pro se* appeal was late, and that the Court did not have jurisdiction to hear our allegations of fraud and constitutional violations. TO THIS DATE, NO ONE WITHIN THE GOVERNMENT HAS DENIED OUR ALLEGATION THAT THE TRIAL TRANSCRIPT HAS BEEN CRIMINALLY EDITED.

Special Trial Judge Peter J. Panuthos was removed from our case "for cause" after we alleged that he either directed the editing of our trial transcript or, at the very least, had personal knowledge of the fraudulent editing. In a mandamus appeal to the U.S. 4th Circuit Court of Appeals, seeking not to possess the original tapes but only unedited copies, we allege that ST Judge Panuthos took possession of the court reporter's audio tapes "recorded as the sole record" of our Tax Court trial for the purpose of concealing the criminal actions of the IRS attorneys Arnold Gould, Pamela S. Wilson, Rajiv Madan and himself. The 4th Circuit concluded that mandamus action was too extreme a measure and that I should seek my rights to the tapes in some unspecified manner. To date, we are still unable to verify the authenticity and accuracy of the trial transcript for which we paid more than Two Thousand Dollars ($2,000). The Judicial Conference of the United States, having jurisdiction over courts of the United States, recommends that any "court reporter's audio tapes recorded as the sole record" of the trial should be made available for sale. However, unreasonably, court reporter Ann Riley and Associates threatened to sue us when we merely insisted on our right to purchase copies of the original tapes. Why????

We specifically allege that ST Judge Peter J. Panuthos, IRS attorneys Arnold Gould, Pamela S. Wilson and Rajiv Madan, edited the testimony of IRS auditor Jacob Haas to conceal his testimony. Under oath he admitted that he audited us and issued deficiencies because he got a phone call from the IRS' New York District Counsel office making that request. He also admitted that because of that phone call he failed to inquire as to our profit motivation or to check the validity of our personal return.

We also allege that, IRS attorneys Arnold Gould, Pamela S. Wilson, Rajiv Madan, and ST Judge Peter J. Panuthos criminally conspired to conceal the editing of my personal un-rebutted testimony. My testimony, supported by evidence, was that the Georgetowne Maryland partnership was not a tax shelter and that my sole proprietorship Electronic Services was in fact profitable, as a direct result of the business activities of Georgetowne Sound. All of this was illegally affected to secure a "lead case" decision adverse to the many taxpayers fraudulently "herded" into this national tax litigation project conceived unconstitutionally in defiance of specific Congressionally mandated guidelines.

To support our assertion that there was a conspiracy to violate our rights, we direct the committee to the verifiable fact that ST Judge Panuthos, for the single purpose of hindering any subsequent effort to sue for redress in the Maryland Courts, refused to grant our right to designate Baltimore, Maryland as a place for trial. The designated place of trial was properly filed by our tax attorney pursuant to Tax Court Rule 140. We maintain that this deceitful opposition to Baltimore as the designated place of trial, was self serving and is an undoubted indication of the premeditated conspiracy to violate Internal Revenue Law. The trial transcript will show that we raised this issue and insisted that we have waived none of the rights afforded us had the trial been held in Baltimore, Maryland. We assert that the only reason for ST Judge Panuthos to refuse to follow this very basic Tax Court procedure was to provide a huge jurisdictional obstacle for us to file suit; thus, legal immunity for the IRS attorneys and himself.

There is no way for us to know how wide spread are these illegal conspiracies to violate taxpayers rights. We can only say that we are currently suffering because we are one of the "targets" familiar to Revenue Agent Jennifer Long as she bravely testified before this committee. After unsuccessfully seeking the services of one former IRS agent, now tax attorney, he responded with "so they just raped you." As he then quickly suggested that we forget it and file for bankruptcy, I could not help but feel that he was too familiar with the public "raping" by the IRS in the United States Tax Court.

As I was forced to defend my family pro se, because the IRS tactics include running up the cost of attorneys' fees through bogus delay due to "legitimate" case back load, and because my attorney withdrew at the suggestion of ST Judge Panuthos, I discovered a most disturbing fact. That is that tax attorneys cannot practice before the Tax Court without certification by the Treasury Department. What's wrong with this picture?? How many Americans are aware that the tax attorney, on whom they are so totally dependent, is himself dependent upon the "parent" agency of the IRS for his livelihood. Realistically, what chance is there that an average tax attorney for a mere fee of Five to Ten Thousand Dollars ($5000–$10,000) would risk his livelihood by exposing an illegal conspiracy of the IRS in the Tax Court? Answer this question in the context of the fear that is exhibited here by IRS employees who

come to this hearing so afraid of reprisal that they must conceal their identities before they testify to the United States Senate. It is a fact; taxpayers stand a better chance of winning in the District Courts rather than in the Tax Court. It is a disservice to the American people to call the United States Tax Court the "Peoples Court" when the reality is an average tax payer targeted by the IRS has no chance whatsoever to succeed.

Imagine going to the United States Tax Court and having the "Judge" rule that your former accountant, who prepared the disputed tax return is not allowed to testify, even though he is under subpoena to attend the trial. Or imagine that your present accountant is not allowed to testify because he was not the accountant of record for that one particular year. Imagine that the Judge excuses IRS officials from a subpoena because he deemed your case not significant enough to interrupt their busy schedules. Imagine also, that the expert witness report which you must have time to study for rebuttal is handed to you on the day of trial in violation of Tax Court Rule 143(f) and the Federal Rules Of Civil Procedure. Or imagine the charade as the Tax Court Judge pretends to admonish the IRS attorneys because they have failed to provide the perfunctory task of providing you with copies of your administrative files because the files just happen to be "missing." We were intended, targeted victims of all of these abuses and more.

Given the lawlessness of the IRS as exposed in the Senate Finance hearing, the profound timidity of the tax attorneys who, for all practical purposes are certified by the IRS, and the failure of the Tax Court to uphold the law, you have the problem before you. A taxing system that does not foster trust and volunteerism, but instead has betrayed and entrapped the American people. A system that provides the guilty with the unlimited funds to abuse their victims and provides judicial cover for those abuses in the United States Tax Court. You have your work cut out for you.

If you are truly responsive to the American people, I challenge you to publicly investigate our allegations. I ask that you restore our rights as American citizens and give public notice to the IRS, and the judiciary that the hideous "Black Codes" are forever banned.

Pursuant to 28 U.S.C. 1746, I state under penalty of perjury that the foregoing is true and correct.

Date: September 30, 1997

Signed:

GEORGE CHRISTIAN
*U.S. Citizen / Taxpayer*

Wallace M. Dillon, Jr.
110 Cottage Lane
Blauvelt, NY 10913

Reform Plan to Replace All Taxes with a Fee Based on a Trade Charge

October 2, 1997

A. L. Singleton, Chief of Staff
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Singleton;

A consumption-based plan is the only sensible reform currently proposed. Yet, it can be made better easily by expanding its base – currently restricted to retail sales – to a low, single-rate fee based on a 1% trade charge for all trade transactions ... with everyone participating – no exceptions – without pain or sacrifice for anyone.

What should government cost? If what we paid for government were limited to what is fair and adequate for the basic functions of government – to establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, secure the Blessings of Liberty to ourselves and our Posterity and, without interference, to protect our privacy and rights to property – no one could have a valid objection to that cost. The legitimate function of government is protection of the rights granted to it by The People, who remain subjects to no sovereign!

Life, liberty and property are worthless without government protection and there is an equitable way to pay for that protection.

What should each of us pay? We can divide the cost of providing protection so that everyone pays their fair share. All life's necessities and property are acquired through a trade; a price is paid for whatever is traded. If we divide total government expenses in a year by the total annual value of all trade, we would define the percentage of trade that would finance the cost of government for a year -- and if each trade paid that same percentage toward the support of government, we would all be paying our share, equitably and fairly – producing the revenue the government takes now with taxes, except we would no longer need those taxes.

That's exactly what the Freedom Fee will do when it becomes law and replaces all forms of taxation! It's a Trade Charge based on a small percentage of the total trade -- retail, wholesale, and commercial on all goods and services. Paid voluntarily – not taken by extortion and threat!

Annual trade in this country can be calculated fairly accurately by adding up all the checks paid in a year. In the banking industry, that simple sum is called "debits"... the total amount of checks cashed by the banks. Debits - representing the amount of Trade - according to the Federal Reserve Bulletin dated December 1994 were running about 360 trillion dollars a year and Federal Outlays cost us about 1.5 trillion dollars a year. To determine an equitable share of each trade we should pay to support the government for our protection, divide the $1.5 trillion cost of government by the $360 trillion volume of trade. That equitable share – the Freedom Fee – is just over 4 tenths of one percent to cover federal spending!

Now you can see that a fee based on 1% of Trade - the federal government's share - is not only adequate, **it's excessive!** That's why the Tax Freedom Project has a cap on the trade charge to prevent our fee payments from exceeding 110% of current tax revenues. It is a fair and equitable way to pay for government service. No one gets a free ride and no one gets gouged. It's a Freedom Fee – and everyone is a winner ... and protected. The Freedom Fee!

Competing reform plans, while well intentioned, only scratch the surface of a solution. Flat Tax reforms are fundamentally income-based tax plans, typically at a 15% - 20% rate, after allowing for certain exemptions. A flat tax offers the advantage of simplicity for individuals and reduced complexity for businesses. However, the Flat Tax would be paid in addition to state and local income taxes as well as all other federal, state, and local taxes, fees and surcharges.

Congressman Bill Archer . . .

Sales taxes, familiar mostly as the taxes we pay when purchasing certain goods and services for our own use, are taxes we pay in addition to other taxes and fees. Value-added taxes are based on a tax rate applied to a company's sales of goods and services - less the cost to produce them. VATs historically are assessed in addition to existing taxes. A VAT is a different way of camouflaging an income tax. It is a tax which is imposed on a firm's productivity and the gains from its enterprise. It punishes enterprise and producers -- it rewards parasites and encourages welfare.

The Freedom Fee - a 2% trade charge - will replace all other government revenue sources. In their place, we will pay a small percentage of every purchase to support Federal and our state and local governments. 1% to each is fair and adequate. All citizens will save money – individuals and businesses of all classes. Income will no longer be in the equation, nor shall it be of any concern of the government; the IRS can be eliminated. Our property and wealth shall be protected, and we shall regain our privacy.

The cleanest, and perhaps the only way to implement this reform is by way of federal and state constitutional amendments. (A draft of an amendment is available upon request.)

If anyone would oppose this plan you should ask them to explain why they would withhold its obvious benefits from us taxpayers, our nation's economy, and your constituents. Congressman Archer, your plan only needs to be expanded to complete this reformation!

Very truly yours,

Wallace M. Dillon, Jr.
Dir. Tax Reform
New York State Taxpayers Alliance

Enc. Abstract of Freedom Fee Plan

**Statement of Wallace M. Dillon, Jr., Blauvelt, NY**

**The 1% Freedom Fee for 1998**

WHAT SHOULD GOVERNMENT COST?

If what we paid for government were limited to what is fair and adequate for the basic functions of government—to establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare,[1] secure the Blessings of Liberty to ourselves and our Posterity, and without interference, to protect our privacy and rights to property—no one could have a valid objection to the cost. The legitimate function of government is protection!

*What should each of us pay?*

Life, liberty and property are worthless without government protection and there is an equitable way to pay for that protection.

We can divide the cost of providing protection so that everyone pays their fair share. All life and property are acquired through a trade; a price is paid for whatever is traded. If we divide total government expenses in a year by the total annual value of all trade, we would define the percentage of trade that would finance the cost of government for a year—and if each trade paid that same percentage toward the support of government, we would all be paying our share, equitably and fairly—producing the revenue the government takes now with taxes, except we would no longer need those taxes. That's exactly what the Freedom Fee will do when it becomes law and replaces all forms of taxation! It's a Trade Charge based on a small

[1] Take notice this says promote Welfare, not provide Welfare.

percentage [2] of the total trade retail, wholesale, and commercial on all goods and services.

Annual trade in this country can be calculated fairly accurately by adding up all the checks paid in a year. In the banking industry, that simple sum is called "debits.".. the total amount of checks cashed by the banks.[3]

Debits, according to the Federal Reserve Bulletin dated December 1994 are running about 360 trillion dollars a year and the cost of Federal Outlays are about 1.5 trillion dollars a year. Now divide the $1.5 trillion cost of government by the $360 trillion to determine the percentage each of us should pay to support the government in a fair and equitable way. That fair share is just over 4 tenths of one percent!

Now you can see that a tax based on 1% of Trade is not only adequate, it is too much! That's why there is a cap on it to prevent exceeding 110% of taxes. It is a fair and equitable way to pay for government service. No one gets a free ride and no one gets gouged. It's a Freedom Fee ... and everyone is a winner ... and protected. The Freedom Fee!

## TAX DEFINITIONS

*Value-Added Taxation (VAT) (Rep. Gibbons proposal)*

In a value-added tax, the tax base consists of the total value added by all firms. Stated less abstrusely, value added is measured simply by the total sales of a company's products or services less the cost of all its purchases from other firms subject to the tax.

It is usually calculated by applying its tax rate to a company's sales with a credit against its taxes for the taxes shown on the invoices for all its purchases.[4] Value-added taxes, usually 15%–20%—and usually added on *top* of other taxes—only affects goods, not services. This additional tax is passed along to consumers in the form of increased prices.

(Note—This is but a different way of camouflaging an income tax ... a tax which is imposed on our productivity and our *gains* from our enterprise. It punishes enterprise and producers—it rewards parasites and encourages welfare.)

*Sales Taxes*

Familiar mostly as the state and local taxes we pay on sales of selected goods and services at one or more stages of distribution. These taxes are paid in addition to all others taxes, fees and surcharges. For example:

- the tax may be levied on the sale of a commodity every time it changes hands. Such a tax is commonly called a turnover or transaction tax;
- or the tax may be levied on the sale of a commodity only upon its transfer of ownership at one particular time—thus, only the sale of manufacturers may be taxed when those sales represent completed products; only the sales of wholesalers may be taxed when goods pass into the hands of retailers; or only retail sales may be taxed as the goods pass into the hands of consumers.[5]

## TAX REFORM PROPOSALS

*The "Freedom Fee" (Based on a Trade Charge)*

The Freedom Fee replaces *all* other revenue sources. In their place, we pay a small percentage of *every* purchase to support our state and federal governments—1% to each is fair and adequate. The Freedom Fee is simple. All citizens will save money—individuals and businesses of all classes. Income will no longer be in the equation nor shall it be of any concern of government; the IRS can be eliminated. Our property and wealth will be protected, and we will regain our privacy.

The cleanest, and perhaps the only way to implement this reform is by way of Federal and State Constitutional Amendments. A draft of a State Freedom Fee Amendment is included along with a fuller description of the Freedom Fee Plan.

(The following proposals need further examination and definition)

---

[2] Studies show that 2% maximum would cover all Federal, State, and local revenue requirements. In our examples we will use 1% for the new state and local tax rates.

[3] What about cash purchases, goods and services bought with paper and coin money and not with checks? These purchases are sizeable, of course, but remember some checks are not purchases. When you write a check to get cash, or to transfer money from one account to another, that is not a purchase. You haven't traded anything and there should be no trade charge for government services. The two—the transfer checks and the cash purchases—could easily cancel each other out, so we will consider just the checks cashed, the debits.

[4] ...from Encyclopedia of Economics, by Douglas Greenwald, McGraw-Hill 1982

[5] ...Dictionary of Economics Sloan and Zurcher.

*National Sales Tax, Federal (Sen. Lugar proposal)*

This proposal would eliminate the federal income tax and abolish the IRS. States would collect, and forward to the government, a 17% national retail sales tax on goods and services. Purchase of homes and investment securities would be exempt. Annual federal tax returns would be eliminated. The National Sales Tax would be paid *in addition* to state and local income taxes as well as all other federal, state, and local taxes, fees, and surcharges.

*Consumption Taxes*

Tax base and rate are unclear—believed to replace FIT only—is collected in addition to all other federal, state, and local taxes.

*The "Flat Tax" (Rep. Dick Armey proposal)*

Fundamentally, a tax on income based on a 20%[6] flat rate after allowing for certain exemptions. It has the advantage of simplicity for individuals and reduced complexity for businesses. The Flat Tax would be paid *in addition* to state and local income taxes as well as all other federal, state, and local taxes, fees, and surcharges.

## Q&A

### ISN'T "TRADE CHARGE" A TAX?

A tax is what the government says you *have* to pay. A Trade Charge is what We the People, the voters, tell the government what we are *willing* to pay. The difference is—a Trade Charge is democratic, while taxes are dictatorial.

### IS 1% ENOUGH MONEY?

Actually, the 1% Trade Charge will generate too much revenue. That is why the Trade Charge is limited to 110% of all existing taxes. See Appendix A. [..need to develop explanation for Federal and State—each participating in a 1% Freedom Fee by way of their own Constitutional amendments.]

### HOW WILL THE 1% TRADE CHARGE AFFECT YOU?

You will be paying your state 1% instead of 20% (average state taxes). There is no charge on income. You pay the trade charge based only on what you spend. You will never have to pay property, sales, income, or any other state tax again. (The same rationale applies to Federal taxes. See Appendix B.)

### WHO WILL PAY THE 1% TRADE CHARGE?

Only the buyer pays. That means everyone who makes purchases for goods or services of any kind—wholesale, retail, money-market, loans, stocks, rents, leases, imports, investments, manufacturing, distribution, transportation, utilities,—pays the trade charge on everything purchased.

### WON'T I PAY TRADE CHARGE ON TOP OF TRADE CHARGE?

Taxes pyramid now! When you buy a loaf of bread you are paying the tax for the farmer, the miller, the baker, the storekeeper and everyone connected with producing and distributing that loaf. The difference is that now we pay about 20% more for hidden taxes. A dollar loaf of bread has about 20 cents tax in it. Under the Trade Charge, the rate is only 1%. The accumulated charges cannot be more than about 3% if everyone passes the Trade Charge along to the next person in line. Certainly the Trade Charge is better!

### HOW IS THE TRADE CHARGE COLLECTED?

The buyer pays it to the seller and the seller turns it in to the government. Stamps will be available for payment of Trade Charges for private purchases.

---

[6] ...after 3 years, the rate would drop to 17%.

CAN LEGISLATURES TAKE FUNDS FROM SCHOOLS, ROADS, ETC?

No. The 1% Trade Charge Initiative sets up 1998 as a base year. All government agencies that get money in 1998 must get money thereafter according to section 18 of the (State) Freedom Fee Initiative.

WILL THE 1% TRADE CHARGE REALLY SAVE ME MONEY?

You be the judge. Use the forms in Appendix C. One is for individuals, another for businesses. Fill in all your taxes. Don't forget the hidden taxes you pay for other people. Notice the difference!

**Consequences & Comments**

• If fully implemented in first year, the trade charge would produce a federal surplus approaching a trillion dollars.

With two-year implementation period, deficit spending could be eliminated within three years—and the national debt paid off in five years.

For every year implementation is delayed (while debating and testing other alternatives) at least a trillion dollars is lost—forever—not to mentioned the additional interest paid for maintaining the debt burden.

• Lobbying for tax breaks, loop holes and shelters has become a monstrous industry in itself, targeting every politician for special considerations and aborting the entire campaign finance and legislative processes.

• Milton Friedman agrees with me in identifying those who will be among the opponents to the Freedom Fee, and that's why "they" must be told what plan We the People want—not what "they" want/need to survive as a species. So—We design and they, our representatives support us . . . by implementing the People's plan!

• This is only plan where an individual's wealth can *grow*, even on a low, fixed income. Economy grows ... Savings grow.

• Only plan where increased spending in private sector also provides more revenue for supporting government operations, without pain or sacrifice, without pitting class against class. It destroys use of envy and divisiveness as tools to justify arbitrary social reforms and increasing taxes to increase government encroachment.

• Cuts compliance burden, direct and indirect by more than $ 700 billion according to Cost of Government Day 1997 studies.

• Eliminates IRS bureaucracy—a larger economy can absorb the "down-sized" in the producer sector, out of the parasitic burden.

• Eliminates many of the debates currently raging in Congress, and the media, about how, and where, and how much to change depressingly complex existing legislation. With passage of the Fair Tax, those issues and debates become either moot or irrelevant.

• I believe that it can be substantiated that most loss of jobs, and industry migration, can be traced to business "survivors" adjusting to the increased burden of government interference and regulation adding to cost of doing business. Stealing their profits is dangerous for their health. Let 'em fail, or succeed ... on their own!

**Benefits**

• Makes the funding of government equitable for all!
• You pay exactly your share of the cost of government—not a penny more nor less.
• Brings in adequate government revenue.
• Stops deficit spending.
• Make government affordable.
• Pays you a dividend if you vote.
• Disables government interference in the free marketplace.
• Prohibits new taxes.
• Simplifies government funding.
• Reduces cost of collecting funds.
• Eliminates IRS bureaucracy.
• Cuts compliance burden—direct and indirect.
• Self-regulating law.
• Only plan where wealth can grow—even on a fixed income.

• Restores opportunity ... most jobs are lost due to government interference in free market, increasing the cost of doing business.
• Only plan where increased spending in private sector automatically provides more revenue to support government functions.
• As economy grows, savings grow.
• Eliminates many of the heated debates about *how* and *where* and *how much* to change existing legislation. With enactment of Freedom Fee, they become either moot or irrelevant.
• Restores privacy. Government shall have no right—nor access—to information regarding our income and wealth ...how much, how we came by it, where we keep it, or what we do with it.

**It Will Eliminate All of the Following:**

Property Taxes
Income Taxes
Sales Taxes
Selective Sales Taxes
Gasoline Taxes
School Taxes
Vehicle Registration Fees
Gross Receipt Taxes
Corporation Taxes
Utility Taxes
Insurance Taxes
Tobacco & Alcohol Taxes
Severance Taxes
All License Fees
Building permit Fees
Driver's License Fees
Inheritance Taxes
Sewer Taxes
Street Taxes
Interest Taxes
Special Assessments
Bed Taxes
Toll Road and Bridge Fees
Government Parking Fees
Trash & Collection Fees
Park and Beach Fees
... among others

The following Charts, Tables, Examples of Comparative Outcomes, and References—integral parts of the Freedom Fee Proposal—were omitted due to space restrictions. However, to understand the benefits of this plan they are essential as references to data sources and for demonstrating, by example, how the Freedom Fee will operate.

The complete set of these references, charts, and worksheets are available for downloading on the Freedom Fee's Homepage on the Internet Web: http://www14.pair.com/samrigel/taxing.htm ...and a link may be found also on Liberty Matter's homepage: http://www.libertymatters.org

• Estimated Government Revenue Based on 2% Trade Charge
• Trade Charge Revenue by State
• Example: Trade Charge vs Income-based System for $6.50/hr wage earner
• Sample Worksheet for Reader—Trade Charge vs Income Tax
• Example: Trade Charge vs Income-based "Flat Tax"
• Sample Worksheet for Reader—Trade Charge vs "Flat Tax"
• Example: Trade Charge vs Sales Tax
• Example: Projected Trade Charge—a large manufacturer (Ford)

**Statement of the Price Waterhouse LLP, Interest Netting Coalition**

Price Waterhouse LLP, on behalf of a group of companies, appreciates the opportunity to respond to the Chair's request for comments on ways to strengthen taxpayer protections and rights in dealings with the IRS. We commend the Oversight Subcommittee for examining these issues in its review of recommendations by the National Commission on Restructuring the Internal Revenue Service, embodied in legislation (H.R. 2292) introduced by Reps. Rob Portman (R–OH) and Ben Cardin (D–MD). Our statement focuses on IRS policies regarding the netting of interest on tax overpayments and underpayments—an issue that goes to the heart of fair treatment of taxpayers and sound tax administration.

THE PROBLEM

The issue of interest netting became important after the Tax Reform Act of 1986, which imposed a higher rate of interest owed to the government on underpayments than on interest owed to taxpayers on overpayments. This rate differential has twice been increased for corporations, first by the Omnibus Budget Reconciliation Act of 1990 and again by 1994 GATT implementation legislation. The current interest rate differential for corporations is as large as 4.5 percent.

This differential penalizes taxpayers during periods of "mutual indebtedness"—i.e., where a taxpayer owes debit interest on a deficiency and at the same time is allowed credit interest on a separate overpayment. During these periods, taxpayers may owe interest to the government even though they have no net tax liability for that time. Given the large sums involved in determining corporate income tax liabilities and the difference between the overpayment and underpayment rates, the potential cost to taxpayers in these situations can be significant.

A simplified example helps to illustrate the impact of the interest rate differential on taxpayers. Assume that a taxpayer in 1996 is audited on its 1992 tax year and is found to have a $1 million overpayment, which the IRS refunds, plus interest at the overpayment rate, on June 30, 1996. Assume that the taxpayer in 1997 is audited on its 1993 tax year and is found to have a $1 million underpayment, which it pays, plus interest at the deficiency rate, on June 30, 1997. In this example, the period of mutual indebtedness is March 15, 1994 (the due date of the 1993 tax year return), through June 30, 1996 (when the 1992 tax year's overpayment was refunded). Although the taxpayer owes the IRS the same amount it is owed by the IRS during this period, the taxpayer is subject to an interest charge—i.e., the difference between the overpayment and underpayment rates.

IRS POSITION, CONSEQUENCES

For purposes of determining interest, the IRS currently will net underpayments and overpayments within a single tax year (referred to simply as "netting") and where taxpayers have outstanding underpayments and overpayments for different years (referred to as "offsetting"). However, in situations involving more than one tax year, the IRS takes the position that it will *not* perform netting for periods of mutual indebtedness where either the overpayment or underpayment already has been satisfied by refund or payment (referred to as "global interest netting").[1] In the example above, the IRS would not take into account the 1992 tax year overpayment for purposes of determining interest to be charged on the 1993 tax year deficiency. This is because the 1992 refund already has been paid at the time interest is determined for the 1993 tax year.

Perversely, the government's refusal to perform global netting creates a strong incentive for taxpayers to delay closing accounts. In the example above, the taxpayer could minimize the impact of the interest rate differential by waiting to close the 1992 tax year until the IRS's audit of the 1993 tax year was completed. By the same token, taxpayers have an incentive to delay payments of deficiencies as long as possible if there is a possibility of a subsequent determination that a separate tax overpayment might run concurrently with the underpayment. Thus, the IRS's current policies discourage prompt payment of deficiencies. Ironically, this can have a negative impact on the stream of federal revenues.

CONGRESSIONAL MANDATE, TREASURY RESPONSE

When it first enacted an interest rate differential, Congress recognized that taxpayers should not be subject to an interest cost during periods of mutual indebted-

[1] The IRS's position on global interest netting was the subject of litigation in *Northern States Power Co. v. United States*, 73 F. 3d 764 (8th Cir.), *cert. denied*, 117 S.Ct. 168 (1996).

ness. The Conference Report to the Tax Reform Act of 1986 called on the IRS to implement "the most comprehensive netting procedures that are consistent with sound administrative practice."[2] Congress repeated this call each time it subsequently increased the interest rate differential (i.e., in both the Omnibus Budget Reconciliation Act of 1990 and 1994 GATT implementation legislation). Congress in the "Taxpayer Bill of Rights II," enacted in 1996, expressed concern that the IRS had failed to implement comprehensive interest netting procedures and called on the Treasury Department to study and report on these issues.

In its April 1997 report back to Congress,[3] Treasury concludes that global interest netting would be consistent with the intent expressed by Congress. Treasury explains that the IRS has not adopted global netting procedures because of administrative difficulties involved and because of uncertainty over whether it has the statutory authority to perform such procedures. The report concludes that legislation authorizing global netting procedures would be "appropriate."[4]

In conjunction with the study, Treasury outlined a global netting proposal as part of a proposed "Taxpayer Bill of Rights 3" initiative unveiled by the Administration on April 14, 1997. Under the proposal, interest on income tax overpayments and underpayments would be equalized where a taxpayer reasonably identifies and establishes an overlapping period of mutual indebtedness to the extent of, and for the time of, the overlapping amount. As a result of revenue concerns, Treasury proposed a prospective effective date—netting would be allowed only for periods of mutual indebtedness occurring after the date of enactment.

The Price Waterhouse Interest Netting Coalition applauds the Treasury global netting proposal. We believe legislation is a prudent means of resolving more than ten years of dispute in this area and perhaps unanswerable questions over statutory authority to perform global netting. We also believe Treasury's recommended mechanism for implementing global netting—i.e., placing the burden on taxpayers to identify applicable periods of mutual indebtedness—strikes a reasoned balance between the needs of taxpayers and concerns over the IRS's ability to administer global netting procedures.

We do have concerns over some aspects of the Treasury proposal. Foremost, we believe global netting should be allowed for any post-1986 tax years that remain open under the applicable statute of limitation. Failure to apply global netting to past periods of mutual indebtedness would leave in place an impediment to efforts to close these years and "get current" on audit cycles. Moreover, retroactive application would be consistent with the stated intent of Congress when it enacted an interest rate differential. We also see no reason why the global netting proposal should be limited to income taxes. Global netting is equally appropriate, and just as administrable, with respect to excise and employment tax overpayments and underpayments.

### ACTION UNDER H.R. 2292

The Price Waterhouse Interest Netting Coalition believes the issue of global interest netting is plainly germane to the current legislative initiative to restructure the IRS and strengthen taxpayer protections in their dealings with the Service. Indeed, we note that section 309 of H.R. 2292 includes a proposal to eliminate the interest rate differential altogether, which would obviate, going forward, the need for global interest netting. We support this proposal. However, in the event that such a proposal is not adopted by the Ways and Means Committee, we strongly would urge members to consider authorizing global interest netting procedures along the lines of the Treasury proposal.

We have now reached a point where all sides—Congress, the Administration, and taxpayers—are united in the view that global interest netting is justified and administrable. We believe legislative action should be taken now. Taxpayers stand ready to continue working with Congress and Treasury to reach final resolution of this issue.

---

[2] H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., 1986–3 C.B. (Vol. 4) 785.

[3] Report to the Congress on Netting of Interest on Tax Overpayments and Underpayments, Department of the Treasury, Office of Tax Policy, April 1997.

[4] Id, at 2.

**Statement of the Securities Industry Association ("SIA")**

The Securities Industry Association ("SIA") appreciates the opportunity to submit written testimony on the recommendation of the National Committee on Restructuring the IRS.

The SIA brings together the shared interests of about 700 securities firms throughout North America to accomplish common goals. SIA members—including broker-dealers, investment banks, specialists, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. Many of these firms are small businesses that affiliate with entrepreneurs who provide financial planning and/or accounting services as well as stock brokerage services. In the United States, SIA members collectively account for approximately 90 percent, or $100 billion, of securities firms' revenues. They manage the accounts of more than 50 million investors directly and tens of millions of investments indirectly through corporate, thrift, and pension plans.

SIA commends Chairman Archer and all the members of the Committee for holding these extensive hearings on the recommendations of the National Commission on Restructuring the IRS. We also want to take this opportunity to commend the members of the Commission for a job well done.

The securities industry plays a very important role in the tax filing process providing taxpayers with information that enables them to file timely and accurate returns. We also provide the IRS with similar information that enhances the ability of the agency to administer the federal tax laws. We firmly believe that the tax filing process could be substantially improved by changing the current information return deadline, which would benefit both taxpayers and the IRS. We urge the Committee to thoroughly review the process and timetable for delivering information returns.

ROLE OF SECURITIES FIRMS IN TAX FILING PROCESS

The securities industry is a major filer of information returns, providing returns each year to 50 million investors. The firms in our industry pride themselves on their track records for accuracy and timeliness. Nevertheless, there are a number of factors that contribute to the need for payers to file amended and corrected returns after the original due date. Amended and corrected returns are a processing and compliance nightmare, which cost taxpayers, financial firms, and the Service a tremendous amount of money, time, and effort.

The most significant contributing factor is the tight time frame that information must be processed and provided to taxpayers. Even under optimal circumstances, it is difficult to meet the current deadlines. While payers have until January 31 to mail information returns to payees, most large firms must cease processing on or about January 15. This is necessary to ensure sufficient time to print, insert and mail millions of consolidated information reporting forms by the required mail date. Since this information is not available before year end, it does not leave a lot of time to review the integrity of the information being sent. If processing problems arise, and they frequently do, securities firms have little time to correct such problems, before they are required to provide amended and corrected returns.

Secondly, the financial information required to be reported is not only generated internally, it is collected from outside sources. The most significant outside information relates to the characterization of distributions from Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs). Income classifications (e.g., capital gain versus ordinary dividend) are normally not available from the companies themselves until the second week in January, leaving very little time to process. Moreover, these initial classifications/allocations are frequently wrong, causing mutual funds and securities firms alike to file amended returns with their shareholders and investors.

Classification information is not only limited to REITs and RICs, but extends to corporations as well. Corporations may also change the taxability of their distributions due to insufficient earnings and profits or other corporate actions (e.g., taxable mergers, exchanges, spinoffs and other reorganizations). Again, the securities industry is at the mercy of these companies to provide this tax reporting information during the first two weeks of January. If such firms fail to provide this information, corrected and amended returns must be sent to payees and the IRS.

Finally, the information that is provided from outside sources is provided on paper, and not in a uniform format. Once received, securities firms must take the information, format it, create computer readable files to analyze, and use the information in preparing Forms 1099. While the securities industry has worked with other industry groups and vendors to provide a standardized flow of information,

the result has been less than perfect. Consequently, this limitation adds further stress to a process that is already overburdened.

### NEED TO CHANGE INFORMATION RETURN DEADLINE

Beginning with the Revenue Act of 1962, payers have been required to provide information returns to the Service and payees. Since then, information reporting requirements have exploded in scope and complexity. Most recently, for example, the Tax Reform Act of 1997 required that capital gain distributions from RICs and REITs be classified for 1997 as either long term, mid-term, and unrecaptured Section 1250 capital gains. Obtaining this information from all RICs and REITs, and developing a means of effectively conveying this information to the investors, will be a tremendous challenge, since current 1099 Forms do not accommodate this type of information.

While reporting requirements have increased, so too have the number of taxpayers receiving the information. For example, the total number of mutual fund shareholder accounts increased from 24.6 million in 1983 to 151.0 million in 1996. In light of the ever increasing complexity of reporting, increasing numbers of investors, and time frames for providing information that are already inadequate, there is little doubt that if the deadline for providing returns is not extended, the trend towards amended and corrected returns will continue.

### RECOMMENDATION

Accordingly, the SIA recommends that Congress facilitate the flow of timely and accurate information returns to taxpayers and the Service by changing the mailing date of Forms 1099 to February 15 from January 31, and the filing due date to the Service from February 28 to April 15. This recommendation is consistent with the proposal contained in the National Commission on Restructuring the Internal Revenue Service. These changes in the mailing and filing dates would dramatically reduce the numbers of amended and corrected returns provided to taxpayers and the Service, since payers will have more time to ensure the integrity of the information provided. This reduction in corrected returns will enable taxpayers to file their tax returns correctly the first time, instead of having to file amended returns in order to "get it right." Similarly, such a reduction will minimize the number of IRS inquiries due to mismatched income amounts, as well as reduce the processing that multiple tax filings require of the IRS. In short, such a change will save taxpayers, financial firms and the Service, a great deal of time, money and confusion, and make the entire process more efficient.