



# AMERICAN BAR ASSOCIATION

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**TESTIMONY**

**OF**

**KENNETH W. GIDEON**

**ON BEHALF**

**OF THE**

**AMERICAN BAR ASSOCIATION**

**BEFORE THE**

**SUBCOMMITTEE ON OVERSIGHT**

**OF THE**

**COMMITTEE ON WAYS & MEANS**

**April 14, 2005**

Thank you, Mr. Chairman. My name is Kenneth Gideon. I am Chair of the American Bar Association Section of Taxation. This testimony is presented on behalf of the American Bar Association.

The American Bar Association appreciates the opportunity to appear before the Subcommittee on Oversight (the “Subcommittee”) today to discuss the critical need for simplification of the federal tax laws. We know this is an issue the Subcommittee takes seriously, and we appreciate the efforts the Chairman and other Members of the Subcommittee have taken over the past few years to focus attention on the need for simplification – and to motivate Congress to enact important simplification legislation.

### **ABA Section of Taxation**

The ABA is comprised of more than 400,000 members and its Section of Taxation has more than 18,000 tax lawyers who work in law firms, corporations and other business entities, government, nonprofit organizations, academia, accounting firms and other multidisciplinary organizations.

Our members provide advice on every substantive and procedural area of the tax laws, and interact regularly with the Internal Revenue Service (the “Service”), the Treasury Department, and other government agencies and offices responsible for administering and enforcing the tax laws. Many of our members have served in staff and executive-level positions at the Service, the Treasury Department, the Tax Division of the Department of Justice, and Congressional tax-writing committees.

### **The Need for Simplification**

Making the tax system fairer, simpler and easier to administer is a legislative priority of the ABA. For nearly thirty years, the ABA and the Section of Taxation have been on record urging tax law simplification, a broad tax base and lower tax rates.

In recent years, the Section of Taxation has worked with our colleagues at the AICPA Tax Division and the Tax Executives Institute to identify simplification priorities and realistic simplification initiatives on which Congress can act. The Tax Section and our colleagues in our cooperating organizations will continue this important work. But it is important that Congress – in every tax bill – also join in the effort and actually enact viable simplification proposals. In this regard, we want to acknowledge that the Congress did just that last year in enacting important simplification in the definition of a “child” in the Internal Revenue Code. This definition affects many provisions of the Code. Your efforts last year made life a little easier for millions of taxpayers, and we thank you for it. But much more needs to be done.

We believe that complexity is at the root of many significant obstacles to efficient and effective administration of the tax laws. Indeed, the National Taxpayer Advocate and others have repeatedly demonstrated that complex tax law provisions make life harder for everyone. They cost taxpayers time in simply trying to understand what is required of them, and they make errors by taxpayers and the IRS a virtual certainty. Eliminating complexity where we can identify it and fix it must be a continuing priority of the Congress.

We understand that simplification is not easy. It frequently requires that either revenue be foregone or choices made such that some taxpayers benefit and some taxpayers suffer as a result of enacting simplification proposals. But simplification is worth the cost. It pays dividends in terms of easing the burden of compliance for all taxpayers, simplifying the task of taxpayer education and law enforcement for the IRS, and improving taxpayer morale by making it easier to appreciate that the law operates fairly for all taxpayers.

A substantial effort at identifying complex provisions that can be simplified has already been undertaken by the staff of the Joint Committee on Taxation in their comprehensive 2001 study on tax simplification. As the Joint Committee noted, complexity reduces taxpayers' perceptions of fairness of the federal tax system by creating disparate treatment of similarly situated taxpayers. Although perceptions – and their impact – are difficult to measure, the effects of complexity, we believe, contribute substantially to taxpayer perceptions that our tax laws are not fair.

While the Joint Committee's 2001 study provides a substantial number of simplification alternatives, we would like to emphasize a few requiring urgent attention. The dual tax system created by the Alternative Minimum Tax is one of the most serious complexity problems in the current Code. Each year, more and more middle-class Americans have to compute their taxes under two systems to determine which they must pay. The individual AMT is complex, leading to frequent errors. It results in indefensible policy outcomes such as a taxpayer prevailing in a lawsuit only to find that she owes the IRS more than she collected. In short, whatever policy justification may have existed for the individual AMT when it was enacted has long since disappeared.

The American Bar Association believes that the individual AMT should be repealed. We recognize that replacement sources of revenue will likely have to be identified to accomplish this – but the time has come to eliminate the complexity and burden of having a growing number of middle-class Americans each year compute individual taxes under two different systems.

The Tax Section also notes that the corporate alternative minimum tax creates complexity for corporate taxpayers that is in many ways akin to the problem for individuals. The Tax Section has written to Congressional leaders urging that the corporate AMT also be repealed. Again, we recognize that this may well require replacement revenues to be identified and substituted – but, as a matter of tax policy, making corporate taxpayers compute their taxes under two different systems creates major and wholly unnecessary complexity in our tax system. Our position on the corporate AMT represents the views of the Section of Taxation. This position has not been approved by the ABA House of Delegates or its Board of Governors and should, therefore, not be construed as representing the position of the American Bar Association.

Even if big ticket simplification such as AMT repeal cannot be accomplished immediately, there are a range of important, but smaller scale, simplification proposals that can be adopted if appropriate legislative focus is applied. We called your attention last year to the need to address the complexity arising from the numerous provisions such as educational benefits, the earned income tax credit, and retirement savings provisions that are phased out as a taxpayer's income increases. Because these provisions have typically not been coordinated, the phase out thresholds and ranges in such provisions vary widely – and often overlap.

The result is not merely mind-numbing complexity but often disappointed taxpayer expectations as the complicated calculations make it difficult for taxpayers to plan whether they will be able to utilize tax benefits subject to phase-outs. For example, a teacher contributes to an individual retirement account only to discover that she earned \$1500 too much last year to claim the deduction. Perhaps even more important are the disincentives created by combining phase-outs that occur when a taxpayer attempts to avail himself of benefits under several provisions. Such combination phase-outs can create marginal tax rates well in excess of what the section 1 tax table says that taxpayer's marginal rate should be. Again, we applaud the Congress for the limited but important action it has taken to address the phase-out problem in the context of personal exemptions and the overall limitation on itemized deductions. But much more can and should be done – and the time has come to do it.

Other useful simplification proposals such as elimination of provisions that have little current utility or current revenue impact, *i.e.*, "deadwood," should be considered. There has been progress: corporate taxpayers will be spared having to consider what might make a corporation "collapsible" because Congress

repealed the provision. Congress could also review whether the accumulated earnings tax provisions are needed and whether one set of anti-deferral rules could replace the multiple sets of rules we have now.

We strongly recommend, as we have in the past, that Congress seriously consider the many excellent simplification recommendations made by the Joint Committee in 2001. If, in every session, Congress would set itself the task of enacting legislation to address some of these problems, members could create momentum that, over time, could make a real difference, by improving the Code, easing taxpayer burdens, and making the tax laws far more administrable. We urge you to call on us and our colleagues in the AICPA and TEI. There is a consensus for simplification, and we are ready to roll up our sleeves and to help you make tax simplification a reality.

We and others recently testified before the IRS Oversight Board in support of Treasury and IRS efforts to achieve simplification through the regulatory process. Fundamental to this effort is the publication of prompt and clear administrative guidance dealing with new legislation as well as new developments in the way business is transacted. The Treasury and IRS deserve commendation for their efforts to publish guidance on the 2004 Act that was timely and answered important questions. But the guidance process is continuous, and its work is never done. Timely, clear guidance advances the goal of simplification by reducing ambiguity and uncertainty. We believe that a strong published guidance program constitutes one of the most important contributions the Treasury and IRS can make to simplification.

We also want to record our continuing support for IRS efforts to improve the examination process by improving its targeting and currency. Important practical simplification can also be achieved administratively by the creation of clear, accessible procedures for the resolution of recurring taxpayer errors. There are several such programs now, but more could be implemented. It is worth noting, however, that consistently recurring errors over a period of years are probably a strong signal to the Congress that the Code provision giving rise to such errors could probably be improved.

As always, Tax Section members stand ready to work with you and your staff members to achieve simplification. We commend you for what you have done, but it is vital that your efforts continue and that they succeed.