



AMERICAN BAR ASSOCIATION

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TESTIMONY

OF

DENNIS B. DRAPKIN

ON BEHALF

OF THE

AMERICAN BAR ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS & MEANS

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Thank you, Mr. Chairman. My name is Dennis Drapkin. I am the Chair of the American Bar Association Section of Taxation. This testimony is presented on behalf of the American Bar Association (the "ABA").

The ABA is comprised of more than 400,000 members. The Section of Taxation includes 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" or "IRS"), 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.

I greatly appreciate the opportunity to appear before the Subcommittee on Oversight (the "Subcommittee") today. My testimony will focus on three key issues bearing on the administration of the tax laws: (i) the importance of adequate funding for the Internal Revenue Service, (ii) the need for a balance between enforcement and providing services to taxpayers, and (iii) the need to simplify the tax laws. I will also briefly address pending legislation relating to offers in compromise.

IRS Funding

The ABA has consistently supported full funding of the IRS to carry out its missions of taxpayer service and fair administration and enforcement of the tax laws. We note that the Administration's proposed 2007 Budget includes an increase in IRS funding as compared with the FY 2006 enacted level. We urge that Congress fund the Service at least at the level the Administration has proposed.

Adequate funding is central to the ability of the Service to provide America's taxpayers with top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all. Fulfilling this mission is possible only if the Service has the resources necessary to collect taxes owed efficiently and effectively without imposing undue burdens on taxpayers.

The Need for Balance Between Enforcement and Service

Achieving acceptable levels of compliance requires a balance of effective taxpayer service and vigorous enforcement. Effective front-end taxpayer service enhances voluntary compliance, thereby reducing the demands on enforcement down the road. Consistent fair and credible enforcement of the tax laws, in turn, encourages greater voluntary compliance.

Given the level of complexity of our tax laws, taxpayer service is a necessity. Taxpayers must be able to obtain accurate information on complicated tax law provisions affecting them. The Service fulfills this task in a number of ways, *e.g.*, telephonic call-in lines, walk-in information sites, print publications, and, increasingly, electronic communications. All these activities are vital to providing taxpayers with the information they need to fulfill their responsibilities and to obtain the benefits to which the law entitles them. In her 2005 Annual Report to Congress, the National Taxpayer Advocate underscored the need for adequate taxpayer services, and suggested a number of areas that could be improved. At the February 8, 2006 meeting of the IRS Oversight Board, the need for greater and more effective taxpayer service was stressed by many of the speakers.

The Service must also have adequate funding to perform its fundamental enforcement mission. In order for our voluntary tax system to work, taxpayers must believe that the laws will be enforced and those who cheat will be caught. To be effective, the Service's enforcement efforts must be broad-based in two senses. First, an enforcement presence must be apparent throughout the economy. A perception that the Service's enforcement efforts are too narrowly targeted leads to noncompliance in areas perceived to be out of the spotlight. Second, funding must be sufficient for all those in the Service whose primary mission is compliance, *i.e.*, auditing revenue agents, appeals officers, tax litigators, and revenue officers, to do their jobs. Neglect of any of these inevitably compromises the ability of the others to fulfill their compliance responsibilities.

In addition to supporting adequate service and enforcement, constant attention must be given to ongoing administration of the tax laws. The economic environment in which the tax law operates is constantly changing. The Treasury Department and the Service must address these changes through publication of clear and understandable guidance to taxpayers, through training of Service personnel, and through improvements to processing, audit, and controversy resolution techniques. Techniques and procedures for prompt and efficient resolution of recurring errors must be formulated and implemented, and longer term solutions to eliminate such errors through simplifying legislation or otherwise must be identified. Such solutions, in turn, are possible only when decision makers have accurate information concerning how the system is actually functioning. Thus, adequate funding for those who compile statistics of income and perform research on administration and compliance is also vital. There have been important initiatives at the Service aimed at improving audit currency and achieving better resource targeting in audits. These are worthwhile programs that should be encouraged and continued.

The Need for Simplification

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 demonstrated repeatedly 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. Reducing complexity must be a continuing priority of the Congress.

Making the tax system simpler is a legislative priority of the ABA. For 30 years, the ABA and the Section of Taxation have been on record urging tax law simplification, so that laws can be (1) easily understood and complied with by taxpayers, and (2) fairly and consistently administered and enforced by the IRS. We know that simplification is an issue the Subcommittee takes seriously, and we appreciate the efforts the Chairman and other Members of the Subcommittee have made over the past few years to focus attention on the need for simplification and to motivate Congress to enact important simplification legislation.

In this regard, we wish to acknowledge that in 2004 Congress enacted important simplification of the definition of a "child" under the Internal Revenue Code. After the new definition was adopted, issues were raised with respect to the allocation of dependency exemptions between custodial and noncustodial parents. On September 1, 2005, we wrote to the Chairman and Ranking Members of the House Committee on Ways & Means and the Senate Committee on Finance to suggest changes to the technical corrections originally introduced to address these issues. In the Gulf Opportunity Zone Act of 2005, Congress enacted technical corrections to resolve these issues adopting the approach suggested in our letter. We applaud the quick action of Congress in addressing these issues.

Questions have since been raised about other unintended consequences of the new definition of a child. We are studying these questions and the solutions that have been proposed, including the recent proposals by the Treasury, and we stand ready to work with you and your staff to address these questions. It is important, however, that the issues that have arisen with respect to simplifying the definition of a child not deter the Congress from pursuing additional simplification of other complex provisions of the Code.

As this recent experience indicates, simplification is not easy. The new issues regarding the definition of child, for example, illustrate the difficulties inherent in balancing simplification, on the one hand, against addressing a multitude of perceived inequities, on the other. In addition to requiring careful examination of possible unintended consequences, simplification frequently requires either foregoing revenue or making choices that benefit some taxpayers and adversely affect other taxpayers. But simplification is worth the cost. Simplification 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 understand how the law operates.

In recent years, the Section of Taxation has worked with the American Institute of Certified Public Accountants (“AICPA”) and the Tax Executives Institute (“TEI”) to identify simplification priorities and realistic simplification initiatives. Together with these other organizations, the Tax Section 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. There is a consensus for tax simplification, and we urge you to call on us and our colleagues in the AICPA and TEI to help you make it a reality.

We would like to take this opportunity emphasize a few simplification matters 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. The ABA recommends that the individual AMT be repealed. We recognize that replacement sources of revenue likely will 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.

Even if big-ticket simplification such as AMT repeal cannot be accomplished immediately, there are other important, but smaller scale, simplification proposals that can be adopted in the near term if appropriate legislative focus is applied. For example, we have called your attention in prior testimony 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. Perhaps even more important are the disincentives that occur when a taxpayer attempts to avail himself of benefits under several provisions and the combined phase-outs create marginal tax rates well in excess of what the section 1 tax table says the taxpayer’s marginal rate should be. We recognize the action taken by the Congress 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.

We also note that the President’s Advisory Panel on Tax Reform offered a number of separate recommendations in its November 2005 report that could promote significant simplification of the federal income tax, including repeal of the individual and corporate AMT.

The Panel also recommended a limited number of tax credits relating to family status; simplifying tax benefits for charitable donations, home ownership and health coverage; and restructuring numerous individual savings and retirement provisions. We commend the Panel for its focus on simplification. Its report has made numerous useful suggestions that merit further study and consideration.

We and others previously 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, and we have publicly applauded the prompt guidance they issued in response to Hurricane Katrina. The guidance process is, however, continuous, and the work of the IRS and Treasury 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.

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.

Offers in Compromise

Offers in compromise are an important collection tool that can provide taxpayers with a “fresh start” and foster long term compliance. The Tax Relief Act of 2005, S. 2020, proposes adding a 20-percent down payment requirement to lump-sum offers-in-compromise. It is apparently intended that the lump-sum down payment would be nonrefundable and retained by the Service if the offer is rejected. While the apparent objective of the proposed changes – to reduce the number of offers that are not made to the IRS in good faith – is laudable, we nevertheless have serious concerns about this proposal.

A successful offer-in-compromise program raises revenue both from the offer and by bringing taxpayers back into the system. Relatives and employers of the taxpayer are often the source of funds for offers in the current system. These parties will understandably be far less willing to commit non-refundable monies under the regime that would be created by the Senate bill. Because the 20-percent nonrefundable down payment requirement could dramatically reduce available outside funding for potential offers, there is a significant risk that the proposal could decrease the number of legitimate offers submitted, the number of offers accepted and the number of individuals reentering the tax system. The provision also marks a change in direction from the 1998 Taxpayer Bill of Rights. Accordingly, we recommend that the proposal not be adopted.

Mr. Chairman, thank you for the opportunity to appear before the Subcommittee today. I will be pleased to respond to any questions.