April 30, 2004

Hon. Amo Houghton
Chairman
Subcommittee on Oversight
Committee on Ways & Means
U.S. House of Representatives
Washington, DC  20515

RE:  Oversight Hearing on March 30, 2004

Dear Chairman Houghton:

Thank you for the opportunity to testify before the Subcommittee on Oversight on the critical need for tax simplification.  On behalf of the American Bar Association Section of Taxation, set forth below are our responses to the nine follow-up questions set forth in your letter of April 5, 2004.

(1)  Limited registration of paid tax return preparers. The National Taxpayer Advocate has recommended that Congress enact a program for registration, examination and certification for federal tax return preparers. The data underlying this recommendation suggests that errors on returns prepared with the assistance of paid preparers arise in inverse proportion to the level of education and training possessed.

The Section of Taxation believes that the subject of limited registration or certification of paid tax return preparers warrants serious consideration by Congress. Under present law, tax return preparers are not required to demonstrate any minimum competency level in taxation, nor are they required to maintain any minimum continuing education requirements in order to prepare federal income tax returns. Although tax return preparers are not subject to registration or qualification standards, they may be subjected to either civil or criminal penalties for falling below specific identified standards set forth in the Internal Revenue Code.

As the tax laws have become increasingly more complex, the percentage of taxpayers finding the necessity to rely on tax return preparers has materially increased. The result is that approximately 55% of all income tax returns are now submitted by tax return preparers. Unfortunately, the documentation submitted by the National Taxpayer Advocate underlying her recommendation supports the conclusions that errors on tax returns prepared with the assistance of paid tax return preparers rises in inverse proportion to the level of education and training possessed.

At present, the American Bar Association Section of Taxation has not adopted a formal position on the recommendations made by the National Taxpayer Advocate. Individual members of a task force created under the Committee on Standards of Tax Practice have prepared comments dated January 26, 2004, which have been submitted to the Internal Revenue Service setting forth their observations on the National Taxpayer Advocate preparer
licensing proposal. Although those comments have been reviewed by the leadership of the Section and have been submitted over the signature of the Chair of the Section of Taxation, they do not represent the policy of the American Bar Association. Those comments generally support a program for licensing tax return preparers and offer suggestions on ways to improve such a program if pursued further by Congress. The comment letter of the individual members of the Tax Section Committee Standards of Tax Practice may be found at [www.abanet.org/tax](http://www.abanet.org/tax).

It is readily evident that greater accuracy in return preparation can be obtained by developing minimum standards for tax return preparers that will assure a minimum level of competence and quality control. The increase in accuracy would ease administration, and reduce the enforcement burdens of the IRS. Unfortunately, these positive benefits must be weighed carefully against the question of whether the IRS has the available personnel resources and funding to be able to administer such a program. Although the Office of Professional Responsibility is charged with responsibility for oversight of tax professionals, it is already burdened by the need to allocate substantial resources to the administration of the examination for enrolled agents and actuaries.

It is believed that any consideration of this subject should include a recommendation for enhanced enforcement of the civil and criminal laws against unregulated paid tax return preparers and the enforcement of the disciplinary standards permitted by the Office of Professional Responsibility for those tax return preparers that are subject to Circular 230.

(2) **Sources of complexity.** The complexity of the tax law results from many decades of piecemeal provisions aimed at specific economic and social goals, without sufficient consideration to the overall scheme of the Internal Revenue Code and the integrity that is required to have an effective administrative process consistent with the voluntary collection system and reasonable enforcement of the tax laws. Congress is to be commended for periodically engaging in comprehensive reform as occurred in 1939, 1954 and 1986. There are many other reasons that exemplify the causes of complexity. In recent years, the requirement of revenue neutrality has had a significant impact. Once new legislation is enacted, the requirement of revenue neutrality frequently interferes with the process of modifying the tax laws to correct deficiencies in recently passed legislation when the changes would result in a reduction of tax liabilities and there is not a readily available offsetting revenue-producing counter-provision.

The Code is also replete with hyper technical, intricate packages of provisions aimed as catching every possible avenue of tax avoidance planning with respect to a particular targeted subject matter. While the effort is to set a reasonable standard for the average taxpayer, the effect is frequently to cause such an intricate maze of compliance requirements that the intended beneficiaries are the ones that lose the intended benefit.

Additional sources of complexity arise from the constant changes in the tax laws. It is difficult for taxpayers, practitioners, and even the IRS to keep up with the changes, such as those resulting from the frequent use of sunrise and sunset provisions whose purpose is to affect the revenue scoring of legislation.

Another source of complexity is the retention of deadwood provisions that are no longer relevant because of the passage of time or the enactment of other provisions which have substantively replaced those that have become deadwood. Other provisions may not be deadwood, but have lost their original purposes. A recent success was the elimination of section 341, the collapsible corporation provision. Other current examples might include the accumulated earnings tax (§ 531), the personal holding company tax (§ 541), and the sale restrictions on redemptions of stock in related corporations (§ 304).
My testimony illustrated the problems of complexity that result from the complex phase-out, phase-in provisions drafted to target a particular tax benefit to taxpayers within a specific range of income. While we recognize the policy decisions that might drive such phase-out and phase-in provisions, it is evident that the provisions are a prime source of tax complexity. A second illustrated case included the unification of the five different definitions of “child.” We earlier urged the Oversight Subcommittee to take steps to address this problem.

The Section of Taxation continues to draw attention to the 2001 Joint Committee on Taxation Report that presented a very comprehensive list of over 100 recommendations for simplification that warrant consideration by Congress. In my testimony on March 30, 2004, to the Oversight Subcommittee, I covered a number of these recommendations. The Tax Section, with its colleagues in the American Institute of Certified Public Accountants, and the Tax Executives Institute, have recommended specific examples for provisions that are in need of simplification, some of which have been addressed through legislation over the course of the last three years.

The Section of Taxation continues to commend your attention to earlier submissions of testimony by the Section of Taxation such as the report submitted by then Chair Stefan F. Tucker on the subject of the impact of complexity in the Tax Code on individual taxpayers and small businesses, dated May 25, 1999, with other joint submissions made with AICPA and TEI. (See www.abanet.org/tax/pubpolicy)

(3) Importance of Tax Simplification. The American Bar Association and its Section of Taxation have long been strong advocates for simplification of the Internal Revenue Code. This year, the Board of Governors of the American Bar Association reconfirmed federal tax simplification as one of its highest legislative priorities. Although many of our members may earn a living by assisting clients to understand and interpret complex tax provisions, or by representing clients in controversies with the IRS that arise due to differences in such interpretations, our members believe that it is in the best interest of a sound tax system that Congress take immediate and concrete steps to simplify the tax laws. It is clearly understood that an overhaul of sophisticated Internal Revenue Code provisions may alter or eliminate some practitioners’ chosen specialty of taxation practice. That is an inherent risk and characteristic of the selection of specialized tax practice. The betterment of the federal tax system and the availability of a fair and equitable set of tax laws for the benefit of the public at large is a paramount priority of the American Bar Association.

Complexity is a serious obstacle to efficient and effective administration of the tax laws. It interferes with a sound tax system at each stage. It leads to uncertainty in planning transactions. It creates problems when taxpayers are attempting to prepare and file their own tax returns. It increases taxpayers’ costs since the laws are so complex that more than half of all tax returns are prepared by paid tax return preparers. The ambiguity of the law causes questionable compliance that may result in audits, controversy with the IRS, and ultimately, litigation.

Complexity has materially reduced the taxpayer’s perception of fairness by creating disparate tax treatment of similarly situated taxpayers. Simplification reform is also essential since tax law complexity creates a myriad of opportunities for technical manipulation of the tax laws, clearly in ways that had never been contemplated by Congress. If Congress is not prepared to engage in a comprehensive reform of the tax laws, then it is strongly recommended that efforts be undertaken to chip away at complexity with a concerted, short and long-term plan of action.

(4) Tax information for tax preparers. The Tax Section appreciates that the IRS is in the process of launching a program that will permit tax return preparers to have additional access to information from the IRS that will assist them in better representing the interests of their clients. At the present, the Section of Taxation has not yet undertaken an analysis and review of the program. It will be prepared to recommend improvements in due course as appropriate.
Guidance. As indicated in the Tax Section testimony before the Oversight Subcommittee and before the IRS Oversight Board, the Tax Section is pleased that the Treasury Department and the Service have stepped up their efforts in recent years to work towards simplification through the regulatory process. The prompt issuance of guidance advances our goal of obtaining simplification by reducing ambiguity and uncertainty. The Tax Section is encouraged by the improvements that have occurred over the past few years. We strongly encourage the publication of formal revenue rulings and revenue procedures that will provide clarity and simplify ambiguous laws and regulations. It is important that adequate resources be made available to the development of such revenue rulings and procedures as they provide authority for tax practitioners that can be relied upon as having presidential value with the Internal Revenue Service and Treasury Department. In addition, we encourage the practice of issuing prompt public releases that will provide guidance as new tax legislation is enacted. The new practice of the IRS of updating its guidance priority plan quarterly is welcome, as such quarterly reports demonstrate where progress has been made and where work remains to be done.

The Section of Taxation has long been on record as supporting substantial increases in the budget and resources of the Internal Revenue Service to enable it to increase comprehensive guidance on the interpretation of the tax laws. The Tax Section is pleased that Donald Korb has been confirmed as new Chief Counsel of the Internal Revenue Service. We anticipate that he will move forward quickly to evaluate the allocation of available resources and the benefits of increasing resources within his area. His evaluation should include an analysis of the benefits of increasing resources in this area.

IRS budget. We have continually championed the need to provide the IRS with adequate resources to perform its mission. As we testified before the IRS Oversight Board earlier this year, we fear that the IRS will never have sufficient funding to properly address the many demands imposed on it by Congress until serious steps are taken to address complexity in the tax law. We also believe that the nature of the annual appropriations process hinders the ability of the IRS – or any other federal agency for that matter – to maintain a constant focus on its strategic plan. To the extent that Congress can take additional steps to provide multi-year budget planning so as to avoid the detrimental impact of stop and start programming, we believe that the IRS will be in a better position to properly and efficiently allocate its resources.

Finding the appropriate balance between service and enforcement is not an easy task, but it is one on which we believe both the IRS and this Subcommittee should remain focused. We believe that the task will become easier with simplification. As discussed above, complexity is at the root of several significant obstacles to efficient and effective administration of the tax laws.

Business Systems Modernization. Modernization of the technology infrastructure through which the IRS collects over $2 Trillion each year to fund the operations of the federal government is critical. Sound systems are necessary to ensure that (i) returns can be processed accurately and efficiently, (ii) calls to the IRS can be routed to knowledgeable employees who have the training and access to information to promptly and accurately answer questions, (iii) information returns and other documents can be appropriately matched to confirm compliance, and (iv) data can be mined to better focus enforcement efforts.

Office of Professional Responsibility. The Tax Section has been encouraged with the creation of the Office of Professional Responsibility in January of 2003 to enhance the oversight of tax professionals. The Section commends the Commissioner for his recent appointment of Cono Namorato as director of Professional Responsibility. The Office of Professional Responsibility has been shouldered with the responsibility for overseeing examinations for enrolled agents. The Office also has very broad authority under the existing and proposed provisions of Circular 230 to investigate compliance and apply discipline where warranted for those who are privileged to practice before the Internal Revenue Service. On February __, 2004, the Tax Section submitted comments on new Circular 230 proposals. These were supplemented by my oral testimony before the IRS on February 19, 2004. The comments are available for review at www.abanet.org/tax
The Tax Section encourages the Office to establish fair and equitable procedures to assure compliance with the Circular 230 regulations and to apply censure, suspension and disbarment from practice before the Internal Revenue Service for those tax practitioners who willfully engage in a pattern of conduct in violation of those rules. We are encouraged that funding and resources allocated to the Office have increased and anticipate that the Office will have a more significant role in the administration of the Internal Revenue Service.

(9) **State of the tax system.** We believe that much has been accomplished in the six years since enactment of the IRS Restructuring and Reform Act. It takes time to change the culture of an organization as large as the IRS, but we have seen many improvements in the way that the IRS goes about its business. However, much remains to be done. Some of this depends on the IRS, such as the continuation of business systems modernization and the development of reliable, up-to-date, cost effective means of measuring compliance. However, Congress also can do more to improve the state of the tax system. For example, while technology has enabled the IRS to manage some tasks more efficiently, thereby freeing up resources that can be applied in other areas, we believe that the ability of the IRS to do more with less will be vastly improved if Congress takes dramatic action to simplify the tax code.

The ABA Section of Taxation hopes that the foregoing observations are helpful to the Subcommittee. We would be pleased to meet with you or your staff to further discuss these views or any other matters.

Sincerely,

Richard A. Shaw
Chair, Section of Taxation