Statement of Steven C. Salch

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Restructuring the Internal Revenue Service

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Co-Chairman Kerrey, Co-Chairman Portman and Members of the Commission:

My name is Steven C. Salch. I have practiced law in Houston, Texas for 29 years, representing taxpayers, in state and federal tax matters. I am appearing before you today in my capacity as the Chair of the American Bar Association's 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 position of the Association. Accompanying me is Ronald A. Pearlman, of Washington, D.C., Chair of our Government Relations Committee and both a former Chief of Staff of the Joint Committee on Taxation and Assistant Secretary of the Treasury. While many members of the Section have been involved or consulted in the course of preparing our testimony today, I would like to particularly acknowledge the contribution of Greg Jenner of Washington, D.C., the Vice-Chair of our Government Relations Committee, who has also been the contact person for our discussions with the Commission staff.

The Tax Section appreciates the opportunity to appear before you today. From the inception of your work, the Section has tried to offer its considerable experience and expertise to assist the Commission to achieve its statutory mission. Members of the Section have met with Commission staff on numerous occasions to provide their views on topics of interest to the staff. We hope that assistance has been helpful, and we are eager to provide whatever help we can give in the future.

I would like to compliment the staff you have assembled. The mandate of this Commission is overwhelming in its breadth, yet your staff has managed to approach fulfillment of that mission in an organized and systematic way. We have enjoyed working with them and look forward to continuing that relationship as they complete their report.

As you may know, the ABA Tax Section is comprised of approximately 25,000 tax lawyers. It is the largest and broadest-based professional organization of tax lawyers in the country. We advise individuals on personal tax issues. We work with thousands of small businesses, both new and long-standing. And, we represent this country's major multinational corporations both as in-house advisors and outside advisors. Many of the Section's members, including my colleagues who are with me today, have served on the staffs of Congressional tax-writing committees, the Treasury Department and the Internal Revenue Service, and the Tax Division of the Department of Justice. Virtually all of the living former Assistant Secretaries of the Treasury for Tax Policy, Commissioners of Internal Revenue, Chief Counsels of the Internal Revenue Service, and Chiefs of Staff of the Joint Committee on Taxation are members of the Section.

Conversely, the majority of our members, like me, have spent the entirety of their professional lives advising clients on tax matters and representing clients in administrative and judicial proceedings to
determine tax liability. This geographic and practice diversity allows us to offer comments on the Internal Revenue Service from a variety of viewpoints, and we welcome the opportunity to do so. As one of the largest "stakeholders" in the Internal Revenue Service, we have observed this Commission's work with interest, professional curiosity and, occasionally, a bit of anxiety. We are as familiar as anyone with how the Service operates, its good points and its bad. Our members are constantly interacting with the Service at all levels. We see where it works well and where it does not. For that reason, before we move to the issues you have asked us to address, we want to offer some comments about the Service, its past performance, and its role in our system of government.

PERFORMANCE OF THE INTERNAL REVENUE SERVICE

It is axiomatic that no one likes the tax collector. While most of us would agree that taxes are the price we pay for a free society, we nevertheless focus our distaste for having to pay that price on the person or agency charged with exacting it. That is human nature. It is much like being a dentist (with due respect to the dental profession): everyone wants healthy teeth but many of us cannot help being unhappy with the person who inflicts the occasional discomfort necessary for us to achieve that end.

Though we appreciate this norm of human nature, we in the Tax Section become concerned when that natural inclination to hate the tax collector goes beyond reasonable bounds. To state it another way, we believe the Service often gets a bum rap. In truth, the Service is the envy of every other tax collection agency in the world. It collects something like $1.4 trillion in taxes annually in an efficient manner and has virtually no impact on the lives of most Americans. Where and when it does have an impact, that impact is usually minor, most often a computer-generated letter. The vast majority of Americans never deal directly with the IRS, let alone face the dreaded audit that we all hear so much about.

Why then are we in this country so focused on an IRS that many believe is out of control? Why is there a Commission, the purpose of which is to restructure the IRS when it has not been established that such restructuring is required?

The responsibility for this situation can be shared by all of us. First, the country is in a period of tremendous cynicism about its government and institutions. As a result, it is quite natural to expect that the IRS, as the collector of revenue, would not be held in high esteem. But that is only part of the reason. Our prevailing cynicism only provides fertile ground in which the seeds of distrust can be planted.

We in the tax community have not done a good job of educating our customers -- the taxpayers -- about the job the Service does. Perhaps because of our role as advocates for taxpayers in a system with adversarial elements, we have a tendency to ignore the positive and focus on the negative. That tendency is one we must struggle to overcome, as I pointed out in my Tax Section Newsletter column last year. This does not mean turning a blind eye to problems. It does, however, mean that the problems are only one side of the story. We must pledge to do more, to work with the public and the Service to assure that a balanced picture is presented. In that regard, we are actively exploring with the Service ways we can assist them in the distribution and presentation of their excellent educational program on Understanding Taxation, including Internet distribution.

Another portion of the blame rests here on Capitol Hill. Many people today are upset at what they perceive to be a tax code that is beyond repair. While it is debatable whether their concern is fully justified, there is little question that the tax code is overly complex. Over the last fifteen years we have seen a seemingly endless stream of legislative amendments to the Internal Revenue Code of unprecedented volume and mind-boggling complexity. People take comfort from stability and consistency
and, conversely find constant tinkering with the tax law unsettling. Unfortunately, many people lay the blame for this complexity on the IRS instead of in Congress, where the law is written.

For over 20 years, the Tax Section has consistently expressed its concern that the complexity of the Internal Revenue Code adversely impacts voluntary compliance and offered suggestions for simplification. Studies commissioned by the Tax Section and the ABA Foundation confirm our intuition that complexity, both real and perceived, clearly impacts the administration of our tax laws in ways that create negative impressions about the IRS in the minds of taxpayers.

It also is unfortunate that too many individuals, for whatever reason, exploit these elements of human nature and perception that make the IRS an easy target for unjustified criticism. We have become extremely concerned in the last three years as criticism of the IRS has increased in volume and vehemence. Is it any wonder that the public questions the integrity of the Service when its elected officials and other newsmakers are constantly trying to tear it down with ad hominem attacks?

The media also holds some of the responsibility because it seizes on the sound bites without focusing on the merit of the message (or lack thereof) or without taking the extra time to explain the real background of the issue to its viewers, listeners, or readers. This focus on the relatively few horror stories emanating from the Service to the virtual exclusion of the many positive stories of Service successes creates the impression that these incidents, while real, are the norm rather than the exception.

Let me be clear. We are not apologists for the Service. The Service will be the first to tell you that the Section never hesitates to confront the Service, institutionally, with problems we perceive or challenge actions of the Service that we believe are wrong. The Service is not perfect and, thus, it will never be free from criticism. Many of those problems have been called to the attention of this Commission.

But based on the experience of our members, on the whole we believe the Service does a very good job with the tasks assigned to it by Congress. Its people are dedicated professionals who seek to do the best they can, sometimes with very limited resources and inadequate training, and under trying circumstances.

The prospects for improving the quality of the service provided by the IRS, institutionally and by individual IRS employees, will be impaired if it, and they, view themselves as an agency and workforce under siege. Indeed, in the present climate, I certainly can appreciate why someone looking for a job would be less than enthusiastic about employment by an agency that has become everyone's favorite target, with diminishing resources, at a compensation level that has become embarrassingly below what the private sector pays for the same skills. If the Service cannot attract talented staff and adequately train and support them, we all know that the prospects for improved service diminish. In that regard, we applaud House Ways and Means Committee Chairman Archer for his recent testimony in support of adequate funding of the IRS, even as we debate and study its future structure.

We are confident this Commission will avoid personal criticism in its own report. But we also urge you to stress that it is incumbent upon those who shape or frame public debate and opinion to stress the positive as they offer justified criticism, and, in all cases, to avoid the siren song of the cheap shot.

It is the people you hope to reach with your report to whom this message must be directed. Lack of respect for an institution such as the IRS is a natural outgrowth of constant emphasis on problems or criticism unbalanced by the stories of success and professional service. Work to build up instead of tear down, at the same time fixing the problems that do exist.

SIMPLIFICATION
The next topic we would like to address is simplification and the extent to which complexity affects the administration of the tax laws by the IRS. We congratulate this Commission for recognizing that complexity has a detrimental effect on the administration of the tax law. The ABA and the Tax Section have long been forceful advocates for simplification of the tax code. The ABA is on record calling for simplification of the tax law. In addition, the Tax Section has testified on numerous occasions in favor of simplification, supported the effort to simplify the Code in 1985 and 1986, and has offered recommendations for simplifying many areas of the Code.

Over the past two decades, the Code has become more and more complex, as Congress has sought to address difficult problems in a fair and equitable way and raise revenue without explicit rate increases. As the complexity of the Code has increased, so has the complexity of the regulations that the Treasury and Service have issued interpreting such legislation. Moreover, the sheer volume of changes, as Congress has sought to raise revenue to reduce budget deficits, has made learning and understanding these new provisions even more difficult for taxpayers, tax practitioners, and Service personnel alike.

Many of these changes have not affected the average taxpayer, either because the provisions were directed only toward business or because they were targeted to specific types of transactions or activities. In fact, for the average taxpayer, the complexity of the tax code has not increased significantly. Nevertheless, the perception of instability in the Code, that the Code is becoming more complicated for everyone, takes a tremendous toll on taxpayer confidence.

This country's tax system relies heavily on the willingness of its citizens to voluntarily comply with their tax obligations. If that willingness is undermined, the system will break down. The problem is compounded if the changes that are made are so complex that taxpayers and their advisors cannot keep up, and becomes even worse when the IRS itself does not have the ability to understand the law. As complexity increases, so does non-compliance, as the perception of unfairness increases and taxpayers become even more resistant to taking the steps necessary to comply. The downward spiral begins.

We do not claim to have all the answers. We do believe that it will be a challenge to devise an entirely simple tax system that effectively deals with a complex, global economy, even if the tax system is charged with doing nothing more than simply raising a stated amount of revenue on a broad base with one rate and no deductions or exemptions. It is crucial, however, that we try. To do so requires hard choices and a willingness to embrace issues that are often dull and without passionate political constituencies. Frankly, simplification is not "sexy."

A commitment to simplification also requires a change in focus on the part of Congress. For the past 15 years, Congress has devoted its efforts in the tax arena to rates, progressivity, and revenue raising for budget deficit purposes. We do not quarrel with these objectives, but we do argue that they have tended to crowd out simplification as a priority. We strongly suggest that these priorities be brought into better balance.

The point we would urge on this Commission and on Congress is that the best tool for avoiding complexity is awareness of the problem. You can design systems, make procedural changes, conduct analysis, and hold hearings. But they are window dressing unless there is a strong, broad, and lasting desire on the part of Members of Congress to avoid complexity that permeates the tax writing process. The leadership, the Chairs of the tax-writing committees, and the members thereof, must endorse simplification as a bedrock principle, and that principle must be communicated clearly to those people that work for them. Time must be taken, and effort must be made, to ensure that this goal remains paramount.
In addition, effort must be devoted to correcting past mistakes. The Code can be simplified in many ways, but only if the resources are devoted to that task. Stakeholder groups, such as the Tax Section, can assist in the process and we pledge to do all we can to help. But frankly, we cannot do it alone. The Congress and the Treasury have to care about such efforts but, to date, have really only paid lip service to the idea. Thus, we are delighted that Treasury now has demonstrated a willingness to seek simplification of the tax law. While we do not have full details of Treasury's views, we are encouraged by Treasury's announcement and stand ready to be a partner in their effort. There must be an ongoing commitment of resources to the effort from those that write and administer the law. The tax writing committees and Treasury must be charged with developing simplification initiatives on a regular and frequent basis.

There must also be a recognition that simplification requires trade-offs, not all of which can work to a taxpayer's advantage. Sometimes, simplification will require "rough justice" resulting in certain inequities, whereas a more finely tuned but more complex provision would be more fair. For example, in the personal interest area discussed below, limiting deductible interest for everyone to a set amount regardless of its use would be very simple but may raise the hackles of those people who benefit from the rules of current law.

In other situations, simplification can mean eliminating "traps for the unwary" or cutting through complexity in a manner that makes a provision that is already taxpayer-favorable even easier to satisfy and, thus, more likely to be utilized. In those instances, Treasury and the Congress must be willing to accept that result.

Simplification, like most other compromises, will only succeed if the benefits and burdens are shared among all the interested parties. Thus, taxpayers, the Congress, and the Treasury must be willing to accept this "rough justice" as fundamental element of a comprehensive simplification effort. To date, that consensus has been lacking.

1. Possible Areas for Simplification

We were asked by your staff to develop a list of areas in current law that are overly complex and that would benefit from simplification. In complying, we have not sought to develop specific proposals as to how these areas could be simplified. Some would be relatively easy, with only minor changes having far reaching effects. Others would require significant policy choices that are beyond our assignment today. We would be pleased, however, to work with the tax writing committees to develop specific proposals for these and other provisions.

Many of these provisions will sound familiar. They undoubtedly will be suggested by other commentators as prime candidates for simplification. That does not necessarily suggest a lack of such candidates or a lack of imagination on the part of the commentators. Instead, it reflects a consensus about the areas that can be simplified, and the relative need for simplification of that area, in terms of the level of complexity and its effect on the greatest number of taxpayers.

We have limited ourselves to provisions affecting individuals. This does not imply that there are no complex provisions that apply to business. To the contrary, we believe that the most complicated provisions are business provisions, including the provisions relating to taxation of foreign activities, and that these provisions must be dealt with at some point. Complexity in the business sector results in misallocation of productive resources that could be better utilized elsewhere. We have chosen to focus our testimony on individual provisions, however, because their complexity has the greatest impact on attitudes toward the tax laws and their administrator, the IRS.
We note Treasury's Simplification Proposal adopts at least two of these proposals: global interest netting; and simplification of the dependency exemption provisions. We urge the Commission to endorse those proposals in its Report.

**a. Phase-outs**

Since 1986, the use of phase-outs has risen significantly. The first such instance was the infamous phase-out of the 15 percent tax rate enacted as part of the 1986 Act, known as the "Bubble." It had the perverse effect of making taxpayers with less taxable income subject to higher marginal tax rates than taxpayers with higher taxable income.

Although the Bubble was eliminated in 1990, two new phase-outs were added, one for otherwise allowable itemized deductions ("Pease") and the other for otherwise allowable personal exemptions ("PEP"). In each case, the deduction or exemption is reduced or eliminated beginning at certain (and differing) income levels and at different rates.

The stated rationale for these phase-outs is to increase progressivity by increasing the tax burden of upper-income taxpayers. In reality, depending upon the level of itemized deductions and the number of personal exemptions claimed, they create a range of marginal rates that can apply to taxpayers with identical economic income. The stated goal could be achieved much more simply by raising tax rates. A similar observation can be made with respect to the so-called "marriage penalty" on two income-earner families.

**b. Earned Income Tax Credit**

A great deal of attention has been paid recently to the desirability of the earned income tax credit, its place in the tax system, its complexity and the evidence that it has been plagued by fraud. We are not here to offer any opinion as to whether the provision should be retained as part of the tax system. We believe that is a policy choice better left to policymakers. We do believe, however, that the EITC is overly complicated and could be greatly simplified.

Specifically, the credit has definitions of "eligible individual" and "qualifying child" that are very complicated. It also has varying age requirements, and sliding scale eligibility based on two amounts subject to phase-outs. Taking into account the probable demographics of the taxpayers likely to be eligible for the credit, we believe much can and should be done to make it simpler. We have met with your staff to discuss these issues.

**c. Definition of Dependent**

The tax code has numerous, overlapping definitions of dependent. In addition to the EITC, definitions of dependent apply for purposes of the personal exemption, determination of filing status, the child care credit, the standard deduction, and the "kiddie tax," to name a few. The justification for such competing definitions is questionable, to say the least. As was argued ably by Professor Deborah Schenk of New York University Law School, the definitions can and should be reconciled. The ABA is on record in supporting such simplification. [3]

**d. Personal Interest Deduction**

The Tax Reform Act of 1986 embodied a compromise in terms of rate reduction in exchange for base broadening. One of the latter measures generally eliminated the deductibility of non-business interest, but
retained the deductibility of home mortgage interest and investment interest not in excess of investment income. As a result, it is necessary to trace both the source of the interest (i.e., interest on debt secured by a home mortgage) and the use to which a loan is put (i.e., whether the interest is investment interest or personal interest) to determine whether the interest is deductible.

While limits on the deductibility of interest can be justified as a matter of tax policy, these rules impose a tremendous burden on millions of individual taxpayers if loan proceeds are used for different purposes. Moreover, taxpayers, in general, may perceive unfairness in permitting taxpayers with equity in their homes to deduct interest while other taxpayers lacking such equity but using a loan for the same purpose cannot.

Similarly, interest paid by most individual taxpayers on tax deficiencies is not deductible and is payable at a higher rate than the rate of interest paid to taxpayers on overpayments of tax. Congress has repeatedly pressed the Treasury to allow netting of interest in cases where both a deficiency and an overpayment, arising from different taxable years, co-exist. A report from Treasury on this matter was released Monday. While the details remain sketchy, this report is the first step toward resolution of the problem, either through elimination of the rate disparity or by mandating interest netting, at least in the most simple situations.

e. Individual Alternative Minimum Tax

The individual AMT can be characterized as a ticking time bomb. If left unchanged, the individual AMT will apply to an additional five million taxpayers in the next five years, most of whom were not the intended targets of the AMT. (4)

The first problem is the threshold for the AMT. Under current law, taxpayers are not subject to the AMT if their AMT income (i.e., income after all the adjustments required by the AMT) does not exceed $45,000 for married couples, $33,750 for single individuals, and $22,500 for married couples filing separately. Those thresholds were set in 1990 and are not indexed for inflation. Their worth in present value terms has eroded significantly since 1990 and will continue to erode unless increased and/or indexed for inflation.

Second, for purposes of computing AMT income, many itemized deductions that are available in computing the regular tax are disallowed. Included in this category are state and local income taxes, which often represent the second largest itemized deduction (after home mortgage interest) claimed by taxpayers. As the amount of these itemized deductions increases over time, the difference between the taxpayer's regular taxable income and their income for AMT purposes will grow. As a result, that taxpayer faces the increasing likelihood that she will be pulled into the AMT.

f. The Kiddie Tax

Under current law, the unearned income of a minor child under age 14 is taxed to the child at the parent's marginal tax rates. Enacted as part of the 1986 Act, this "kiddie tax" was intended reduce the tax advantage from shifting income from upper income parents to minor children in lower tax brackets. The provision has generally been successful in that regard.

Unfortunately, however, that success has come at the price of significant complexity, especially for children who have unearned income and income from part-time jobs. Different tax rates apply depending on the amount of income earned and whether that income is earned or unearned. This is often confusing
for families, and we believe the provision can be simplified without reintroducing the potential for abuse existing before 1986.

g. Tax Court Jurisdiction

Because the United States Tax Court has specialized, national jurisdiction, and is the only prepayment forum for litigation of federal income, estate, and gift tax cases, it is the predominant forum for the consideration of controversies involving those taxes. The Tax Court also is the forum of choice for the "little guy." Because of the compounding of interest and penalties and the time typically required for a tax dispute to move into the judicial system, for individuals of modest means, the ability to go to court without paying the tax is often essential. Couple that with the general attitude of the Tax Court toward informal exchange of information, rather than formal discovery, and the Tax Court's strong emphasis on stipulations of evidence, and the result is a forum that can be relatively low-cost for an individual taxpayer seeking resolution of a tax.

In addition, at the urging of the Section, in 1969 Congress enacted Code section 7463, creating an even less formal, small case docket in the Tax Court for income, estate, and gift tax cases. The original jurisdictional ceiling on S case status was a $1,500 maximum deficiency in any one year. In 1972, that was increased to $5,000 and, in 1984, the limit was further increased to $10,000. In return for streamlined procedures and the finality of the decision (i.e. no appeals), taxpayers gain access to court where such access might otherwise be prohibitively expensive or cumbersome. This is a classic example of the principle of compromise to obtain simplification.

The $10,000 jurisdictional ceiling has not changed since July, 1984. Since then, inflation has significantly eroded its utility, with the result that many individual taxpayers are compelled to pursue judicial resolution of their disputes with the Commissioner in "regular," more formal, and more costly Tax Court cases. We believe this jurisdictional limit should be increased to $50,000. In addition, the increased jurisdictional limit should be indexed annually for inflation. By doing so, many more individual taxpayers would become eligible to elect to have their tax cases adjudicated under the streamlined procedures Congress wisely has adopted.

h. Summary

As noted above, this list is intended to be exemplary rather than exhaustive. In truth, there are many ways in which the tax law can be simplified. Our purpose today is to highlight some of the most important areas. But, most importantly, we also wish to emphasize the importance of a change in focus among our tax writers and policymakers. In the recent past, their priorities have rested elsewhere. As a result, the tax code has become increasing complicated, often needlessly so. We urge them to shift that focus back to simplification.

2. Changes in the Tax Legislative Process

Your staff asked that we address possible changes to the tax legislative process that could be instituted to avoid future complexity. Prior to our appearance today, representatives of the Tax Section met with your staff to discuss informally what changes we thought would be effective. Our testimony today summarizes those thoughts.

a. Quantitative Analysis
We were asked by your staff to review and comment on the feasibility of a system that attempts to quantify the complexity of changes to the tax code. While the proposition has superficial appeal, we are highly skeptical that any such quantitative measure of complexity is worthwhile.

Complexity is a relative concept, and depends greatly on the context in which it is raised. A Code provision may rank high on a numerical complexity scale and still be the least complex it can be. That high numerical score tells little about the need for the provision, and the balance that must be struck between that need and the burden such a complicated provision will generate. Moreover, there may be alternatives that rank lower on the complexity index but that do a far less effective job.

In the end, we believe such numerical indices would themselves either become so complex, if all the relevant factors were included, that they would become suspect or would be so limited in their composition that they would become meaningless. There simply is no easy substitute for the hard-headed analysis that we believe is required if complexity is to be minimized and simplification is to be achieved.

b. Complexity Analysis

Notwithstanding our skepticism about quantitative analysis, however, we believe a qualitative analysis of the complexity of proposed tax changes is necessary. As we noted above, we believe the best way to reduce complexity is for Treasury and the Congress (both members and staff) to remain focused on the issue. No formulas, no easy answers, just rigorous analysis. The trick is how to do it.

We suggest that it may be useful to require a "complexity analysis" of every tax proposal to be considered in Congress. Such an analysis could accompany every provision in tax proposals by the Administration and in a Chairman's mark, as well as every amendment introduced by a member in committee or on the floor. In addition, in committee markups, the staff of the Joint Committee on Taxation and the Treasury Department's Office of Tax Policy could be called upon to provide their analysis of the complexity of provisions under discussion.

In preparing a complexity analysis, it would be useful to have a series of core questions to be used as focal points. Each of the core questions need not be addressed in each and every complexity analysis, however, because some may be irrelevant in particular cases and because of limited staff resources. The purpose is not to check off each and every question that may be relevant; rather, it is to focus members and staffs on complexity and alternatives. Finally, the staff of the Joint Committee on Taxation could be charged with preparing a complexity analysis for each provision in a tax bill. That analysis could be included in the report of the Committee reporting the bill.

We believe the process of preparing and writing a complexity analysis could cause Treasury and members and staff to focus on complex provisions and less complicated alternatives. Requiring the complexity analysis to be done as narrative could sharpen the analysis beyond what it otherwise would be and also facilitate the process of securing meaningful comments from other stakeholders. The change needed is really not one of process but of attitude. For too long, simplicity has been a step-child of the tax legislative process as Treasury and Congress have focused on other, more pressing objectives.

We do not seek to displace those other objectives. Rather, we submit that requiring the policymakers, lawmakers and their staffs to devote time and attention to analyze provisions for complexity and commit that analysis and their conclusions to writing may introduce a focus on complexity into the process and facilitate considered selection among alternatives. Perhaps, over time, the focus will come naturally.

c. Involvement of the IRS
It has been suggested that the IRS should become more involved in the drafting of tax legislation. Proponents of this view believe greater IRS involvement will mitigate against enactment of legislation that is difficult to administer.

In reality, the IRS is regularly involved in the drafting of tax legislation and has been for many years. Representatives of the IRS traditionally have participated in drafting session. Statutory language, as well as draft committee reports, are circulated as a matter of course to those involved on behalf of the Service. Therefore, urging IRS involvement in the process as a preventative to complexity accomplishes little in and of itself.

What could be useful on a case-by-case basis is involvement of the right IRS people in the process. For example, in particular areas of the tax law -- such as excise taxes -- virtually all of the administrative expertise is lodged at the Service, both in the National Office and in the field. Tapping into this wealth of experience might be highly productive. Similarly, calling on field agents with specialized audit experience to advise on significant changes in a particular tax area also might be useful. Finally, in certain instances, preparation of a prototype of the IRS form required to administer the proposed legislation could help all interested parties understand the compliance and administration burdens the proposed legislation would impose on taxpayers and the IRS.

Obtaining the participation of the right IRS personnel is not easy, however. It has been the experience of those in the Tax Section who have participated in the legislative process that it is difficult to identify who the right people are in an organization of 120,000 people. The resources are spread throughout the agency and no one within the agency has the ability to marshal those resources quickly. It does little good to have an expert in gasoline excise tax fraud if no one in the National Office knows of the expert's existence.

We urge that the Service be directed to develop an inventory of its human resources to which tax drafters can be referred. Sometimes, but not always, these resources will reside in the National Office. Other resources will reside in the field. A word of caution: these resources do not include the Commissioner's personal staff or representatives of the Legislative Affairs office. We are referring to the real experts, the people who have lived with the system and know it inside and out. Involving those people could have a beneficial impact.

3. Other Areas of Complexity Affecting Tax Administration

We also would like to address three other issues that may affect federal tax administration. These are the complexity of IRS regulations, administration of state income tax laws and the assignment to the Internal Revenue Service of certain "non-tax" functions.

a. Complexity of IRS Regulations

Just as the complexity of tax statutes cause difficulty for IRS administration, so do tax regulations. There are many instances in which complex regulations have added significantly to the burden of taxpayers and the IRS. Some of the regulations, such as the regulations under Code section 704(b), dealing with partnership allocations, approach the status of legend.

We encourage the Commission to call attention in its report to the need for simpler regulations. The IRS and Treasury should be encouraged to draft simpler and shorter regulations, using more general interpretive guidance, safe harbors, and de minimis rules. The Treasury Department should also be encouraged to propose legislative changes in situations where the complexity of regulations flows from
the complexity of statutory language. In this regard, we applaud the efforts of the Service to experiment with "plain language" guidance on its award-winning Internet site.

b. State Income Taxes

In recent years, state income taxes have played a much more prominent role in tax planning. My home state, Texas, is among the six states that do not impose a personal income tax. Tax rates in states that do impose such a tax range as high as 11 percent. Only two states lack some form of corporate income tax. Therefore, the consequences of owing state income taxes is far from trivial in many situations.

Dealing with differing tax laws is a very complicated process. This is especially true in the case of businesses with operations in multiple states, but can also be true for individuals as well. In addition, multiple tax laws create the need for multiple audits as each tax jurisdiction attempts to impose its version of the law on the taxpayer.

In an ideal world, we would have a single tax code applicable on a uniform basis, with a single collection and enforcement agency charged with administration of that tax law -- the tax equivalent of one-stop shopping. As you know, states are not required to conform their income taxes to the Federal system. However, short of that, increased cooperation between the states and the IRS would be beneficial and should be encouraged.

c. Non-Tax Functions

There has also been a fair amount of discussion over the years about the imposition on the IRS of certain "non-tax" functions. For example, the Service is required by statute to collect debts owed other federal agencies through the tax refund offset program, determine eligibility for veterans' benefits, child support enforcement, and collection of student loans. Critics, often with justification, argue that these functions go beyond the essential role of the Service, and that their imposition only lessens the ability of the Service to perform its key role: collection of taxes, while injecting additional pressures on taxpayers' voluntary compliance.

We are unwilling to say, as a blanket matter, that the Service should never be called upon to perform non-tax functions. Indeed, we can envision situations in which the Service is the ideal, if not the only, agency to perform those functions. For example, in the case of determining eligibility for veterans' benefits, it is merely a case of determining previous income levels through computer matching and then transmitting such data to the Department of Veterans Affairs. Computer matching requires little time or agency human resources, and would otherwise require expenditure of more government resources to accomplish the same purpose. Common sense argues for the Service to perform this function as long as it is provided with sufficient financial resources to do so without jeopardizing its ability to perform its primary role in tax administration.

As a standard, any proposal to assign to the IRS a new non-tax function should be greeted initially with skepticism. Just as in the case of complexity, a search for less intrusive alternatives should be conducted. Hard questions about the reasonableness of using the scarce resources of the Service and the impact on taxpayer compliance attitudes should be asked. Then, only after policymakers have satisfied themselves there is no better alternative, should the Service be assigned that task. Moreover, when the decision to assign that non-tax function is implemented legislatively, the legislative process must also provide for adequate, additional funding to the Service for the duration of the assignment so that the availability of sufficient resources for the Service to carry-out its core tax administration functions is not jeopardized.
We all are aware that the Service has been subject to considerable criticism of late as a result of apparent missteps in its computer modernization program. Modernization efforts have clearly had problems which we hope have been or are on their way to being rectified. As previously noted, some of the criticism of the Service has failed to acknowledge that there, indeed, are successes in the over-all effort of the Service to put technology in the hands of its attorneys and agents and increase the availability of information to them.

We do not claim any unique expertise in computer systems design, particularly design of systems of the magnitude involved in the high-end of the TSM effort. Nor do we claim to understand the government procurement system. What we do understand, however, is that modernization is as essential for the Service as it is for every other business today, in whatever form is finally approved and authorized. In common parlance, our tax return processing system is headed for a train wreck. There is simply no choice but to appropriate the funds necessary to update the IRS computer system before it crashes.

We are comforted by the apparent willingness of Treasury, working together with the Service, to make the tough decisions necessary to get the job done. The problem has been identified, and responsibility has been assigned. The task now is to move past the criticism and get on with the job. We urge members of Congress, both on the tax-writing committees and on the appropriations committees, to work closely with the Service to assure that the effort goes as smoothly as possible. Based on our own experience in modernization of the technology systems we use in our practices, we also caution all stakeholders to remember that no system roll-out ever is bug-free, nor is any new software system ever implemented without some problems. Thus, we hope that as this process moves forward people will keep the long-term objectives and over-all progress in focus, rather than taking a laser beam approach to each individual step in the process.

We also urge this Commission to do more than emphasize the failures of the past. Instead, this Commission should identify any deficiencies in planning or implementation procedures and management that contributed to past problems and seek solutions or additional process improvements that will mitigate future recurrences of the same problems.

The IRS computer system was designed in the 1950's and built in the 1960's. This system was never intended to last a human generation let alone 30 years. However, attempts by the IRS to modernize its systems in the 1970's and again in the early 1980's were rejected for various reasons. Waiting until the system was already horribly obsolete before even embarking on a modernization effort was clearly one of the root causes precipitating the current crisis. It is just as wrong to fault the Service for delays in initiating the modernization process that arose because its requests were rejected as it is right to fault the Service for failing to properly implement modernization once the approvals and necessary funding were granted.

No business can operate successfully for long if it handles long-term, multiple-year capital expenditure budgets on an ad hoc, annual basis. Yet, that essentially is what the current annual budget process compels the Service to try to do. Thus, we suggest that one aspect of the solution to mitigate future recurrences of modernization false-starts and waste is to adopt a multiple-year, capital budgeting process for the computer modernization of the Service. As surely as the sun rises, the Service will be required to update and replace its computers regularly. Indeed, prevailing cost of ownership models suggest that is the economically prudent course. However, the Service can only do this in a systematic way if it has a budget that it can rely upon. Modernization should not be allowed to languish for periods, only to have
Service try to play catch up. Recent experience offers ample proof that giant technology leaps to catch up amplify the risk and cost of problems encountered in the modernization process.

Systems modernization must be an institutionalized, ongoing process with predictable, forward-looking budgets. We often hear that government needs to be run more like a business. We agree. But saying so is not enough. Government agencies must be given the tools with which to do so. No business of the size of the IRS could hope to stay in business without budgeting in advance for computer modernization. Congress, with appropriate oversight, must allow the Service the freedom to do so.

1. Effect of Cutbacks on Agency Performance

We also wish to express our concern about the effect cutbacks in IRS funding for personnel, its human resources, have and will continue to have on the effectiveness of the agency. We are cognizant of the need to reduce government spending in this age of budget deficits. We also recognize that until the growth of entitlements spending is restrained or federal revenue increases faster than entitlement spending, the squeeze on the discretionary portion of the federal budget, including the IRS portion of the Treasury budget seems an inevitable, continuing consequence. We recognize that problem is beyond your scope. However, we feel compelled to point out that cutbacks in its human resources cannot be made by the IRS without adverse effects on its ability to carry out its Congressionally mandated missions.

We are particularly concerned about two aspects of such cutbacks: staff morale and the so-called "brain drain." We have touched upon the morale question previously in our discussion about criticism of the IRS. It is human nature for morale to decline if IRS personnel perceive that they are an agency under siege. This problem is only compounded when staff resources are cut, resulting in higher workloads and an inability to keep up with the tasks assigned. Computer modernization can only take up so much of the slack. In the end, capable human beings are necessary to make to system work and to interface with taxpayers and their representatives.

This leads us to our second concern: the effect of layoffs and buyouts on the Service. Over the last several years, in order to trim staff to meet budget cutbacks, the Service has undergone a series of Reductions In Force and buyouts of senior personnel. This has two effects. First, it reduces the number of experienced personnel working at the Service and adversely affects its institutional memory. We have found in our dealings with the Service that there is no substitute for an experienced IRS agent or appeals officer. The practical experience and wisdom gained from years of on-the-job training simply cannot be replaced, no matter how smart a person is. Therefore, it is penny wise and pound foolish to address budget concerns by providing incentives for experienced personnel to leave the Service.

The second effect these actions have is the barrier they create to hiring quality people. It is already difficult, given the government pay structure, to attract the highest caliber people when they can earn far more in the private sector. This difficulty is increased when prospective employees view their job security at the Service to be in doubt because of the potential for Reductions In Force and buyouts.

In addition, it is important that cutbacks not hamper functions that only the Service can perform. In particular, we call your attention to the Statistics of Income function. This operation produces vital information regarding the operation of our tax system, but is one of the first to be targeted when budgets are cut. It is very important that it be funded, and that it not be one of the "usual suspects" in every round of cutbacks. We also urge the Commission to recognize the importance of the Employee Plans function, and the need for its continued, adequate funding.

2. Need for Adequate Training and Education
A corollary to the detrimental effect of budget cutbacks generally is the effect of cuts in training and education of IRS personnel. The quality of the IRS workforce is directly tied to the availability of programs offering continuing training in the tax law. Training is essential if Service personnel are to have any hope of maintaining competence in the tax law necessary to provide taxpayer service and perform compliance functions, especially in light of the volume and frequency of changes in the tax law enacted by Congress.

The Tax Section has attempted to assist in this area by providing instructors for various IRS programs across the country and developing third-party programs for joint training, such as the National Institute of Trial Advocacy Tax Court Litigation Course at which I was an instructor last month. But we and our colleagues in the other professional organizations can only do so much pro bono training. Ultimately, Congress must provide funding that is adequate to ensure that IRS personnel receive all the training necessary to competently perform their jobs. This Commission can play a key role by strongly endorsing the necessity of an adequate training budget and the avoidance of past tendencies to slash that budget first when funding becomes tight.

However, even when the amounts budgeted for training appear, those funds may not be spent in the most cost-effective ways. Presently, training funds are dispersed throughout various district and regional offices rather than being centrally coordinated. As a result, Service personnel who needing particular training may not receive it while others may be receiving unneeded training. We urge this Commission to review how training funds are allocated by the Service and examine whether they are allocated in the most effective manner.

**TAX SERVICE FOR LOW-INCOME TAXPAYERS**

We recognize that a good deal of the stress of the tax system arises from the necessity to provide representation to taxpayers of limited means. As lawyers, this is part of our professional culture. The Section has worked with the Service, the Tax Court, state and local bar associations, and law schools for over 25 years to develop programs to disseminate information, provide tax advice, and, if necessary, pro bono or low-cost, competent legal counsel and representation to low-income taxpayers. At this time we have several active projects in this area.

Presently, funds are provided for return preparation through the TCE and VITA programs. State and local bars provide attorneys for radio, television, and telephone bank taxpayer assistance programs. While none of us will be satisfied until every taxpayer who seeks and needs tax advice to comply with her obligations obtains that advice, these activities are working relatively well.

Unfortunately, there is less, organized, help for lower-income taxpayers once they progress to the tax controversy stage. All too often low income taxpayers are faced with the difficult choice of foregoing their rights to contest the Service's position, muddling through a very complex system on their own, or relying on individuals who are not trained or admitted to practice before the courts.

The small case procedure in the Tax Court alleviates some of these problems. Additionally, the Section is actively supporting efforts to standardize and communicate information to assist law schools in establishing, administering, and operating tax clinics to assist low-income taxpayers with active disputes with the Internal Revenue Service. However, both the Tax Court and Chief Counsel have legitimate concerns about the propriety of their assisting in disseminating information about the availability of tax clinic or other pro bono programs to potentially eligible taxpayers. Finally, there are differing state law provisions that have a regulatory impact on the ability of the bar to establish and operate organized pro
bono programs for lower-income taxpayers, particularly those with family incomes above 110% of the federal poverty standard.

It would be very helpful to this ongoing process if the Congress would specifically acknowledge it is not improper for the Tax Court and the Chief Counsel to distribute information about available, approved clinical and pro bono programs to potentially eligible individuals. It also would be helpful if Congress would specifically authorize the Tax Court to promulgate standards for pro bono programs directed toward petitioners before the Court and acknowledge that such standards would control over any conflicting state laws.

We also urge this Commission to point out these problems in its report and encourage the Congress, the Tax Court, the Service and its Chief Counsel, and the private bar to continue to pursue solutions.

CONFIDENTIALITY OF TAXPAYER INFORMATION

We understand that various members of this Commission have, from time to time, raised questions about the extent to which confidentiality of taxpayer information should be maintained.

As you know, section 6103 of the Internal Revenue Code imposes strict limits on the disclosure of taxpayer information. In addition, penalties, including criminal penalties under section 7213, are imposed for unauthorized disclosure of information. We would strongly oppose any significant loosening of the standards under current law.

Our studies of compliance as well as our experience as tax lawyers and as students of the tax system demonstrate clearly that a taxpayer's belief and expectation that their tax returns are and will remain confidential are critical factors in their attitude about compliance and their perceptions about the fairness and integrity of the tax system. Taxpayers are discouraged from being as candid as the law requires when they believe anyone who asks can see their returns or copies of their return information. They also are discouraged from being compliant when their tax returns are demanded by third parties as surrogates for financial statements. Thus, we are concerned by the trend of increasing demand by third parties for copies of taxpayer's returns, in much the same manner that a social security number has become a de facto national identity indicator.

We also recognize, however, that there has been much discussion of outsourcing of certain IRS functions to the private sector, including data processing functions. These proposals raise the possibility that tax return information will regularly be placed in the hands of private contractors.

The Tax Section takes no position with respect to the use of private contractors to perform data processing functions currently done internally by the IRS. We do believe, however, that the same strict standards for disclosure and the same strict penalties for unauthorized disclosure should apply to such private contractors. Whether that application is achieved by statute, by contract, or both, we adamantly believe outsourcing should be instituted only if there is no significant risk of contravening the reasonable expectation of Americans have that their tax return information will be held in the strictest confidence and will not be used for purposes other than tax administration.

ORGANIZATIONAL STRUCTURE OF THE IRS

We would next like to address the question whether the organizational structure of the Internal Revenue Service should be altered in fundamental ways. Throughout the course of this Commission's work, rumors have circulated that you were considering several different models for management. These models
apparently differ widely, from the creation of a "board of directors" for the Service to breaking the Service apart and assigning its component functions to different agencies and departments. Most recently, the Treasury Department announced its own proposals for revision of the supervisory oversight of the IRS and additional private sector involvement in the Treasury's supervision of the IRS.

We will address each of these models. Our comments are shaped by our own convictions about the fundamental, functional elements that must be present for the tax system to operate properly. Those convictions are drawn, in part, from the history of the American experience with tax levies and administration and collection of taxes, as well as our collective experience with our tax system and the tax systems of other countries.

At the outset, we submit that unless and until the Government is prepared to operate only with the funds taxpayers either provide voluntarily or provide without any risk of audit challenge from the Government, it will be necessary to have some organization within or without Government that does more than merely receive payments into the Federal treasury. Similarly, unless and until tax statutes are so clearly and comprehensively written that they answer all conceivable interpretative questions there necessarily will have to be some organization that develops and promulgates forms for taxpayers to use in complying with the tax law, that issues interpretative guidance to taxpayers, and that is equipped and capable of providing specific advice and assistance to individual taxpayers to assist them in complying with their legal obligations. There must also be an entity to collect, maintain, and analyze information furnished by taxpayers or third parties for compliance and other purposes. Those other purposes include data compilations necessary to identify compliance problems and evaluate the feasibility and effect of proposed remedies.

Someone inside or outside Government must be empowered to enter into agreements with taxpayers fixing the treatment of specific income items or transactions or resolving disputes with taxpayers short of a final judgment of the Supreme Court. Three examples of this function are the private letter ruling process, the Advance Pricing Agreement Program, and the determination letter process with regard to employee plans. These functions play an increasingly important role in the efficient administration of the tax law and should be maintained as a fundamental element of any tax administration system.

There must be a policymaking organization as long as any tax system has exemptions, deductions, exclusions, and taxes some transactions differently than others, based on form or the nature of the assets, income, or activity involved. Some entity must also verify that taxpayers have, in fact, correctly determined their tax liabilities, represent the Government's interests in any dispute with a taxpayer regarding her due compliance, and collect sums legally determined to be due and owing.

There must also be some organization to protect the Government's interest and those of its citizens and businesses with respect to other governments that have, under principles of international law, the right to impose their taxes on the same income or transaction the United States also taxes and to cooperate with such other Governments in determining the measure of taxes that each is entitled to levy on such income or transactions.

Today these functions, and others like them, are performed by the IRS. Any proposal for restructuring the IRS thus necessarily involves an examination of which of these functions are best maintained within the IRS and what changes in the organizational, managerial, and oversight structures for the IRS are likely to improve the performance of the retained functions.

The Employee Plans function of the IRS is not aimed at the collection of revenue. Rather, its function is to administer the statutory mix of tax incentives and sanctions Congress has created to regulate the private
retirement plan system, ensuring those incentives are only allowed to private retirement plans that satisfy a long list of social policy standards. As long as the incentives for compliance with those social policy standards and the sanctions for non-compliance are tax-related, we believe it is appropriate that the tax administration organization of Government make the determinations of plan qualification or disqualification.

There are also certain core concepts about the IRS that must be treated as "givens" in formulating and evaluating restructuring proposals. Perhaps the most important is that the IRS must be as free from political influence and corruption as we are able to make it. This is more than an issue of integrity. Compliance with the voluntary self-assessment system that is the core of the federal tax system will erode rapidly if taxpayers perceive that taxpayers with the "right connections," political or otherwise, receive favored treatment or, conversely, that the wrath of the IRS can be visited discriminately on taxpayers because of their political views or other reasons unrelated to tax administration.

Most of us in this room are too young to vividly recall the investigations at the end of the Truman Administration that produced much of the present IRS structure. Happily, with relatively few exceptions, the corruption that those investigations unearthed has not been repeated. But that freedom from corruption is not something that just happens. It happens in part because of the structure of the IRS and in large measure because of the individual integrity of each IRS employee, from the Commissioner down. Thus, whatever the structure of the IRS, there must be careful attention to assure the IRS is insulated from political and economic coercion or corruption and that there are adequate checks and balances in place to assure that any attempts to induce the IRS to deviate from the straight path are promptly detected and crushed.

Another core principle is that, whatever the structure of the IRS, it must turn the same square corners in administration of the tax laws that taxpayers are expected to turn in complying with the tax laws. This is a corollary of the integrity principle. It also is the essence of the fairness principle. Fairness only happens because of a structure, management with the technical expertise to make the right decision, and communication to and training of IRS personnel to make this principle part of the institutional culture.

The third core principle is transparency and accessibility to the taxpayers and tax professionals. The philosophy and procedures of the IRS need to be publicly available. Individual taxpayers must have access to IRS decision-makers to seek redress of grievances about the IRS handling of their case. The Taxpayer Advocate's Office has a vital role to play, but only after the normal IRS procedures have been followed or clearly have been denied to the taxpayer.

Tax professionals can assist the IRS in identifying and resolving administrative problems if there are avenues for them to provide input. At present, these include the Commissioner's Advisory Group and similar focused groups, Regional Liaison meetings between tax professionals and Service Regional Commissioner's personnel, and district-level meetings between tax professionals and the district director's personnel. Each of the major stakeholder groups has at least one formal meeting a year with IRS National Office personnel to discuss matters of interest and concern. These interactions and exchanges of view are mutually beneficial and enhance tax administration when both sides are prepared and views are candidly exchanged. Thus, we urge that the IRS structure recognize and encourage continuation of these opportunities for tax professionals to provide comments, criticism and advice to, and share concerns with, the IRS at all levels of the organization.

Service and responsiveness are corollaries of the principle of accessibility. Our studies of compliance indicate that the vast majority of American taxpayers want to honestly satisfy their self-assessment responsibility. However, when they cannot obtain answers from the Service to questions, or the answers
they get are not clear or correct, taxpayers become frustrated and concerned. Thus, the IRS structure must provide taxpayer service and be responsive to taxpayer needs and concerns.

The fourth core principal is accountability. There must be a clear delineation of the management responsibility within the IRS and to whom the IRS management is accountable in the executive and legislative branches of Government. The delineation of management responsibility reinforces the principle of integrity. If someone is not in the management responsibility or oversight chain, he or she or it has no business interfering in the management of the IRS.

Accountability also turns on the question of performance standards, both for the agency as a whole and for individual agency employees. We submit that the IRS should be judged in part on the efficiency and accuracy of the service and advice it provides to taxpayers. Taxpayer service personnel within the IRS should be judged by a similar standard, commensurate with the resources provided to assist them in rendering service to taxpayers.

The IRS should also be held accountable for administering the tax law fairly and without abusing the considerable powers Congress has granted to it. IRS personnel involved with providing technical assistance to taxpayers and IRS field personnel should be evaluated based on the accuracy and promptness of the assistance provided, not on the basis of how many times they conceived of a rationale that would support a view perceived as favorable to the Government. IRS field personnel in the Examination function should not be evaluated on the basis of the dollars of additional tax revenue proposed. Rather, they should be evaluated on the basis of whether or not they proposed the correct result, under the law, as evidenced in part by the amount of their proposed adjustments that are ultimately determined to be correct through subsequent administrative or judicial review.

Oversight is a corollary of this principle. Oversight must be exercised continually. If oversight responsibility is not clearly delineated or is diffused it will not be effective. Moreover, oversight is only effective if the responsibility is continually exercised, rather than occurring only after a crisis.

How do the various restructuring proposals that have been reported stack up under this functional analysis and these core principles?

1. Board of Directors

It has been suggested by some that the Service would benefit from an independent "board of directors," somewhat analogous to the board of a publicly-traded company. The stated goal of this change would be to provide the Service with independent oversight and guidance from a body supposedly constituted from various fields of business. This body would be in addition to, and not in place of, the normal oversight functions of the Congress and the Administration.

Commissioners of the IRS frequently have relied on advisory groups comprised of stakeholder group representatives to provide much of the input that proponents of a board of directors suggest would come from such a board. Admittedly, since the Commissioner traditionally selects his or her Advisory Group members and ultimately controls their agendas, the degree to which the Commissioner's Advisory Group actually functions similarly to a board of directors depends on the Commissioner. Thus, we do not view the creation of such an independent board as troublesome in and of itself. Indeed, an effective Commissioner's Advisory Group, like many boards of directors in the private sector, could provide invaluable help to corporate management, including:

Access to resources;
Differing world views;

Reality checks;

Creativity, experience, and wisdom; and

Legitimacy.

No one would question that providing these resources to the Service might be a tremendous help. However, we must add a cautionary note. We believe such an arrangement must be carefully structured in order to assure it functions consistently with the core principles of integrity and fairness. Should such a body be created, its membership must be balanced to assure it provides the Service with the balance of views essential to success. We urge that there be no members from the public (government) sector so that the board is not subject to criticism as political. And, it must be made bipartisan in order that it not be a vehicle for ideological intrigue.

We also question how such a board would be layered into the existing structure. Should it have reporting responsibilities and, if so, to both the Administration and Congress, or only one? Should it have actual powers or only advisory or oversight responsibility? No existing agency, department or board provides an appropriate model. The closest analog we could identify is the Council on Environmental Quality, but even that body cannot be used as a model since it resides as part of the Executive Branch.

2. Independent Agency

Others have suggested that the IRS should be an independent agency removed entirely from the Department of the Treasury. The IRS would become a separately managed, independent body somewhat akin to the Social Security Administration or the Postal Service. This, supposedly, would remove the Service from the political arena, allowing it to perform its core functions without concern for politics.

In all candor, we are at somewhat of a loss to understand the benefits that would flow from this structure. Nor do we understand why Congress would want an IRS unresponsive to policymakers in the Administration and in Congress. The image of the IRS unconstrained by political forces is not something we believe to be in the Nation's best interests. It is contrary to the core principle of accountability.

Under the present structure, the IRS is answerable to both the President of the United States and to the Congress in its oversight and appropriations roles. While it may be perceived that an IRS answerable to the President creates the possibility of partisan tax administration, in general the opposite is true. As part of the Administration, the IRS is subject to the very same checks and balances that constrain other agencies. Safeguards currently in place are very effective in ensuring that the Service sticks to its responsibilities.

Now assume that such political constraints are removed. First, the President would no longer have responsibility for the IRS. Such responsibility would be lodged solely in the oversight function of Congress. Given the amount of "constituent" dissatisfaction that usually accompanies the tax collection function, does Congress really want that sole responsibility? Moreover, imagine a tax collection agency divorced from the tax policy function of the Administration that, presumably, would remain in the Treasury Department. Those functions coordinate well together currently because both are subject to the ultimate authority of the President through the Secretary of the Treasury. Remove the IRS from the chain
of command and you have the specter of dueling agencies, one independent of Administration control. We in the tax community would not welcome that situation.

In reality, the IRS is not comparable to the Social Security Administration or the Postal Service. It carries out a crucial but extremely sensitive mission, where every twist and turn is fraught with peril. Rather than suffering from being subject to the political process, on the whole it benefits. The benefit may not be apparent on a day-by-day basis but it is, nonetheless, very real. In our view, an agency performing the role that the IRS does should not be any less subject to the checks and balances applicable in today's world.

3. Dividing the Internal Revenue Service

Some commentators have urged that the IRS be abolished and that its various functions be divided among existing agencies and new agencies created specifically for such purpose. For example, one plan would assign the litigation function to the Department of Justice, the ruling and regulation writing function to the Treasury Department, and the tax collection and administration function to a new agency.

This is the model about which we are most concerned. While one should never say never, it is our strong belief that, absent compelling evidence to the contrary, dismembering the IRS and allocating its functions among various agencies would be a mistake for the tax system.

Having the tax collection functions under the same roof with the litigation and interpretive functions permits a degree of coordination and rationalization that would be lost if those functions were housed in separate agencies. While such coordination is absent on occasion, it remains the rule rather than the exception. It occurs constantly, both through formal interaction and, more importantly, through informal day-to-day contacts. Altering that dynamic, to one where one function knows it is not answerable for its decisions to another function, could result in policy chaos. It may be difficult to discern that such coordination takes place under present circumstances, but it is there as an invisible force. We would only recognize fully how much it is missed after it is eliminated. We strongly urge that this path not be taken.

Indeed, we urge that the coordination that occurs today be enhanced not weakened. For example, we recommend that greater consultation occur between National Office personnel and field staff. We also urge greater coordination between the litigation function of the Chief Counsel's office, particularly regarding appeals, and the rest of the Chief Counsel's office in order to avoid appeals that, even if successful, may be counterproductive in the long run.

In conclusion, we have not yet seen compelling evidence that the fundamental structure of the IRS should be altered. In actuality, the current system functions fairly well. While there are many opportunities to improve the present structure, it has not been demonstrated how the Service would be improved by implementing any of the changes being discussed.

4. Treasury Proposal

On March 17, Deputy Treasury Secretary Summers announced Treasury's view of how to establish a framework within which the IRS can best get its mission accomplished, conceding that changes were necessary. He stated the Treasury would focus on five critical areas: oversight, flexibility, budgeting, tax simplification, and leadership. We have previously discussed our views concerning budgeting and tax simplification. While we do not have full details of Treasury's views, we are encouraged that Treasury does intend to pursue what we hope will be meaningful simplification of the tax law and stand ready to work with Treasury and the IRS in that effort.
a. Institutionalize Oversight

The general thrust of Treasury's proposal to institutionalize oversight appears to be that Treasury in the future will be more involved with the IRS. From a strategic or resource development perspective this renewed interest by Treasury is welcome. However, we are constrained to add the precautionary admonition that politics and tax administration are like acid and water: a volatile and dangerous mix. Thus, Treasury involvement with the IRS must not compromise the core principles of integrity and fairness in tax administration.

The Treasury proposes to create, at the Treasury level what can best be called a Secretary's Advisory Group that is a somewhat expanded version of the existing Commissioner's Advisory Group. It is not yet clear how this new Advisory Group would interact with the Commissioner's Advisory Group or whether the new body would serve a different function entirely. Also, based on the experience of the Commissioner's Advisory Group we suggest that the universe of issues and stakeholders is sufficiently large that it frequently is not efficient to try to gather them all under one tent, as opposed to having focused groups or sub-groups with expertise matched to specific issues and concerns. Nevertheless, we welcome the opportunity, as tax professionals, for a more formalized opportunity to provide input to Treasury and the IRS concerning issues of mutual interest.

b. Increase Flexibility

Treasury announced it will propose legislation to improve flexibility and increase outsourcing of IRS functions. We are encouraged that in announcing this initiative Treasury restated its commitment to maintaining the independence and freedom of the IRS from political influence.

As we have observed previously, the corruption that permeated the IRS in the late 1940's and early 1950's was largely attributable to the fact that the Regional Collector positions (roughly comparable to the present district director positions) were political patronage posts. The transition of IRS executive personnel to Civil Service status and the imposition of the restraints of that system on politically-motivated personnel decisions were a part of the solution then-devised to prevent recurrence of the corruption.

Experience of the past 40 years demonstrates those solutions have been relatively successful in achieving their goal, albeit at the cost of making it difficult for IRS managers to remove personnel for meritorious reasons. Thus, we will carefully study Treasury's proposal when the details are made public to assure that the price of flexibility is, in fact, not increased exposure to political influence or other corruptive forces.

c. Leadership

Treasury's proposal regarding leadership echoes an announcement by Secretary Rubin that the next Commissioner would be an individual with management expertise, as opposed to technical tax expertise. Similar suggestions have been made from both bodies and both sides of the aisle in Congress.

We agree there is no divine or constitutional mandate that the head of the Nation's federal tax administration must personally have expertise in tax law. Nevertheless, as the Treasury proposal appears to acknowledge, that expertise necessarily must be present somewhere within the senior executive management of the IRS. That knowledge is critical to achieving fairness in tax administration and maintaining the integrity of the IRS. Thus, if the Commissioner is not a tax professional, someone else at a senior executive position, appointed by the President, with the advice and consent of the Congress must be.
That other person necessarily will be the primary technical resource, consulted on issues of tax administrative policy and when persons or agencies outside the IRS, within or without the Government, seek to influence or shape IRS tax administrative activity or decisions. That person also must be accessible to the public and tax professionals who perceive problems in tax administration, including decisions or actions proposed or taken at the field level or National Office technical level. For that access to be meaningful this individual must be empowered and charged with making decisions on matters of substantive tax administration raised from within or outside the IRS or presenting them fairly to the Commissioner for decision. This is a fundamental requirement of the checks and balances system that necessarily must be present to assure the IRS adheres to the core principles we have outlined in discharging the mission given it by Congress. A soundly run IRS that makes the wrong technical or substantive decisions is worse for the tax system than a poorly managed IRS that does things right.

CONCLUSION

Again, we thank the members of the Commission for this opportunity to appear today. We do not envy the job you have undertaken. Changing the IRS to make it better able to face the challenges of a sophisticated, 21st Century economy is a very significant challenge. We are pleased to have been asked to play a part, and offer our services to the Commission and its staff as you complete your task.

We urge you to keep in mind that there is much good in what the Service does and how it conducts its business. It does have problems -- some serious, some not so serious -- and it can and should be made better. But, overall, it has been successful at its mission. It needs to be built up and strengthened, not torn down or weakened.

Thank you very much.

1See ABA Resolutions 1976-1 and 1985-2; Conference on Simplification (ALI-ABA 1978).


3See ABA Resolution 1986-1.

4See Memorandum from Kenneth J. Kies, Chief of Staff, Joint Committee on Taxation, to John L. Buckley, Minority Chief Tax Counsel, House Committee on Ways and Means (September 13, 1996).

5We offer no opinion whether such an arrangement would be permissible as a matter of constitutional law.