September 26, 1997

Madame Chairman and Members of the Subcommittee:

My name is Pamela F. Olson and I am appearing before you today in my capacity as Vice-Chair (Committee Operations) of the American Bar Association Section of Taxation. This testimony is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing policy of the Association.

The Tax Section of the American Bar Association is comprised of approximately 25,000 tax lawyers located throughout the United States. It is the largest and broadest-based professional organization of tax lawyers in the country. On behalf of the Section, I would like to commend Chairman Johnson and the Members of the Subcommittee for their ongoing efforts in monitoring the state of the administration of our Nation's tax laws. The Subcommittee's oversight responsibility is extremely important to the confidence that the American people have in their tax system and in their Government, and we compliment you for the time and effort you have devoted to performing this critical function.

The Section appreciates the opportunity to testify before you today on legislative proposals concerning taxpayer rights. Our comments are divided into five parts:

First, I will offer some general comments on enacting additional taxpayer rights legislation.

Second, I will comment on some of the specific taxpayer rights proposals contained in Title III of H.R. 2292, a bill introduced by two distinguished Members of this Subcommittee - - Rep. Portman and Rep. Cardin. As explained below, the Section supports some of these proposals, but opposes, or has concerns about, others.

Third, I will comment on proposals to shift the burden of proof in Federal tax cases, such as that contained in H.R. 367, a bill introduced by Rep. Traficant. We believe that such a shift in the burden would have a significant adverse effect on tax administration and compliance. As such, we strongly oppose legislating a shift in the burden of proof.

Finally, I will describe several other provisions we believe should be included as part of any taxpayer rights legislative package. These provisions include: (1) requiring that 20 percent of the amount seized by
the Internal Revenue Service ("IRS" or "Service") pursuant to a levy from pension plans be withheld; (2) reducing estimated tax penalties when the tax liability is reduced; (3) permitting husband-and-wife offers in compromise to remain in effect as to a compliant spouse; (4) requiring that statutory notices of deficiency specify the date on which a Tax Court petition must be filed; (5) granting the IRS access to the U.S. Postal Service's National Change of Address database to determine a taxpayer's last known address; and (6) disclosing certain IRS tax policies. All of these proposals would serve to increase the fair administration of the tax laws and protect taxpayers.

I. Taxpayer Rights Legislation -- General Comments

The Section commends the Subcommittee for its interest in examining whether or not taxpayers have adequate rights and protections in their dealings with the IRS. As we have testified previously, we believe it is critical to foster a tax administration system that:

- applies the tax laws in a fair and evenhanded manner,
- aids taxpayers in fulfilling their obligations under the law,
- is sensitive to the impact that taxes and tax administration have on people's lives, and
- operates efficiently and effectively.

However, we also recognize that caution must be exercised in legislating additional changes that affect the administration of tax laws, especially to the extent those changes may result in Congress attempting to micro-manage the Service. Although we respect the critical role that the Congress plays in making sure that the tax system is functioning satisfactorily, we believe that, as with any large organization, the day-to-day management of the Service is best left to its executives and key employees. In this way, the oversight responsibilities and skills of the Legislative Branch are blended with the management and operational responsibilities and skills of the Executive Branch.

Moreover, we are concerned that Congress not require the IRS to administer any new procedures or programs without ensuring adequate appropriations. To do so could jeopardize the ability of the IRS to perform its necessary administrative and collection functions; delay needed modernization efforts; and impede, rather than enhance, taxpayer service. Therefore, we respectfully encourage this Subcommittee to take into account the cost to the Government -- and, ultimately, to taxpayers -- of imposing any new requirements on the IRS.

II. Taxpayer Rights Proposals Contained in H.R. 2292

As explained below, the Section supports the provisions in H.R. 2292 that relate to elimination of the interest differential, elimination of the "failure-to-pay" penalty during the period of an installment agreement, expansion of the jurisdiction of the Tax Court, and providing IRS matching grants to low-income clinics. In addition, we support the provision relating to the expansion of authority to award costs and certain fees, but have concerns about certain aspects of the provision. However, we oppose the provisions providing for civil damages for negligence in collection actions and a safe harbor for qualifications for installment agreements. We do not oppose the other taxpayer rights provisions in Title III of the bill, but have some concerns about the way some of those provisions currently are drafted.

A. Provisions We Generally Support

1. Elimination of Interest Rate Differential (Section 309).

Under present law, there is a differential between the overpayment rate charged, and the underpayment rate paid, by the Service. This differential can range from one to four-and-one-half percentage points. Section 309 of H.R. 2292 would eliminate the interest rate differential by creating one rate for both overpayments and underpayments and eliminating the "hot" and "GATT" interest rates contained in Section 6621(c) of the Internal Revenue Code of 1986, as amended ("Code"). The new rate that would be created would be based upon the Federal short-term rate, plus the number of percentage points the
Secretary of the Treasury estimates will result in the same net revenue to the Treasury as would have resulted without regard to the amendments made by the proposal.

We believe that providing the same interest rate for underpayments and overpayments is very desirable and is an appropriate step towards addressing the inequities created by the absence of global interest netting. However, notwithstanding our general support for the proposal, we are concerned about how the Treasury would determine the "revenue neutral" interest rate for a period. The proposal would require the Treasury to estimate the absolute and relative amounts of underpayments and overpayments it expects to receive for a given quarter, and the percentage of such underpayments and overpayments that would have been subject to "hot" and "GATT" interest rates under current law. While it is clear that the Treasury has historical information about absolute and relative amounts of underpayments and overpayments, it is not clear that the Treasury has adequate, if any, information about the percentage of such underpayments and overpayments that have been subject to "hot" and "GATT" interest rates. If this is the case, collecting or estimating this information on a prospective basis would be difficult and estimation of the "revenue neutral" rate would be subject to considerable judgment. Additionally, since the Treasury consistently receives more in deficiency interest than it pays, there might be a built-in bias to overestimate the required "revenue neutral" rate.

Therefore, if the proposal is included in legislation recommended by the Subcommittee, we respectively recommend that the tax-writing committees make clear that (1) the Secretary should base his or her estimate of the "revenue-neutral" interest rate on the most recent historical information regarding the absolute and relative amounts of underpayments and overpayments, and (2) that the percentage of such underpayments and overpayments that have been subject to "hot"/"GATT" interest rates should not be taken into account in determining the appropriate rate.

2. Elimination of Failure-to-Pay Penalty during Period of Installment Agreement (Section 310)
Section 310 of H.R. 2292 would amend Code Section 6651 to provide that the penalty for failure to pay would be disregarded for the period of time during which an installment agreement is in effect. We think this is a desirable and appropriate provision. In addition, we respectfully recommend that the Congress direct the Service to prominently describe the rights of taxpayers pursuant to this provision in the appropriate tax return instruction booklet(s). This directive could be accomplished through Report language.

3. Jurisdiction of the Tax Court (Section 314)
Section 314 of H.R. 2292 increases the ceiling from $10,000 to $25,000 per taxable period for cases that can be resolved under the Tax Court's Small Case Procedure. These procedures are often a very efficient and cost-effective way of dealing with taxpayers who are not represented by counsel. The current limit of $10,000 was established in 1984 and has been seriously eroded by inflation. We support increasing the ceiling.

Section 313 of H.R. 2292 would direct the Secretary of the Treasury to make grants to provide matching funds for the development, expansion or continuation of "qualified low-income taxpayer clinics." We strongly support the policy underlying this provision and respectfully recommend that the provision be included in any taxpayer rights legislative package. However, as suggested above, we believe it is essential for Congress to provide adequate appropriations for the program to ensure that the IRS will have sufficient funds to perform its collection and enforcement functions. Further, in order to ensure that taxpayers are made aware of the availability of pro bono representation by qualified low-income clinics, we respectfully recommend that Congress instruct the Secretary of the Treasury to develop methods for publicizing the clinics, including, but not limited to, posters and brochures displayed in taxpayer service offices and examination, appeals and district counsel office waiting rooms, and notices inserted in pre-and post- examination correspondence.
B. Provisions We Generally Oppose

1. Civil Damages for Negligence in Collection Actions (Section 303)

Section 303 of H.R. 2292 would authorize taxpayers to bring suits against the IRS for unauthorized collection activities and to seek damages of up to $100,000 in the case of negligent actions of IRS employees. Under current law, a taxpayer may bring suits for unauthorized collection only in the case of reckless or intentional actions of IRS employees. In such cases, a taxpayer may seek damages of up to $1 million.

While we endorse the goal of making the IRS more accountable for the actions of its employees, we believe the proposal goes too far. Our principal concern is that the lower standard of negligence may serve to impede tax administration, rather than to foster accountability. If the proposal were enacted, IRS employees might be deterred from taking appropriate collection action. In addition, the lower standard might encourage the filing of frivolous suits by taxpayers who seek to obstruct appropriate collection action. The present law standard of reckless or intentional action appropriately balances the need for IRS accountability with the need to fairly and efficiently collect taxes that are properly due.

2. Safe Harbor for Qualification for Installment Agreements (Section 311)

Section 311 of H.R. 2292 would require the IRS to enter into an installment agreement for the payment of tax if the following requirements were met: (1) the agreement was requested by a taxpayer; (2) the tax liability did not exceed $10,000; (3) the taxpayer filed the required tax returns; (4) the taxpayer paid the correct tax liabilities for the five preceding taxable years; and (5) the taxpayer has not previously entered into an installment agreement under the provision.

We respectfully submit that requiring the IRS to enter into installment agreements for liabilities of less than $10,000, without taking into consideration case-specific facts, would be ill-advised. Our principal concern is that the Service might be required to accept an installment agreement from a taxpayer even where the taxpayer is able to make an immediate payment of the entire tax liability or where the amount of the installment payments suggested by the taxpayer is unreasonably low. We believe that the availability and terms of an installment agreement should be related to a particular taxpayer's ability to pay. Thus, if it is determined that legislation on this issue is appropriate, we recommend that the Secretary be directed to enter into an installment agreement only when the agreement reasonably reflects the taxpayer's ability to make payments consistent with his or her reasonable living expenses.

Finally, because the Code generally defines "tax" to include penalties and interest, there is a question as to whether the $10,000 threshold amount referenced in the proposal relates only to the amount of tax due or whether it also includes penalties and interest. We suggest that this point should be clarified if this provision is included in a legislative package. We also believe that it would be appropriate to clarify that any time-sensitive underpayment penalties would not continue to accrue during the review process, but, instead, would again begin to run from the date of the notice of denial.

C. Provision Which We Support in Part and Oppose in Part - - Expansion of Authority to Award Costs and Fees (Section 302)

Section 302 of H.R. 2292 expands the ability of a taxpayer who substantially prevails in a controversy involving the Internal Revenue Service and/or the United States to receive an award of costs and fees. We support the parts of the provision that would allow the award of attorney fees at a higher rate when justified by the difficulty of the issues presented in the case or the local availability of tax expertise; the awarding of attorney fees when the individual representing the taxpayer has charged no more than a nominal fee; the increase of the net worth ceiling for individuals from $2 to $5 million; and the increase of the net worth of a business from $7 to $35 million.

We also support that part of the provision that would allow the award of reasonable administrative costs including attorneys fees incurred after the date the Service issues a proposed notice of tax deficiency (i.e.,
generally a 30-day letter and Revenue Agent's report), if the taxpayer substantially prevails and the position of the Service was not substantially justified. This approach was originally contained in the Senate version of the Technical and Miscellaneous Revenue Act of 1988 but was dropped by the Conference Committee in favor of the current law provisions. History now confirms that the effect of the Conference Committee action limiting awards of reasonable administrative costs to those costs incurred after the decision of the Office of Appeals or issuance of the statutory notice of deficiency effectively excludes substantially all administrative costs from the possibility of any reimbursement. As a correlative change, we recommend that Congress also amend the definition of "position of the United States" to delete the reference to the date of receipt of the decision of the Office of Appeals and to refer, instead, to the date of issuance of the first notice of proposed deficiency.

Finally, we are concerned with how to interpret the rule that the United States will not be considered to be "substantially justified" if it has not prevailed on the same issue in at least three circuit courts of appeal. In general, a taxpayer's costs and fees are not awarded against the United States if its position was substantially justified. As presently drafted, the provision could be read as requiring the United States to pay costs and fees in any case decided in favor of a taxpayer until the point that the United States' position has been accepted by three circuit courts of appeal. Such an interpretation would subject the United States to costs and fees in situations where, for example, it has prevailed in two circuit courts, but lost in one. We think this would be inadvisable. Such an interpretation may deter litigation in cases of first impression where guidance is crucial. We believe the appropriate rule is that if three circuit courts of appeals have ruled against the IRS and none of the cases are accepted for review by the United States Supreme Court, the IRS would be bound by these decisions. Accordingly, this language in the provision should be clarified.

D. Provisions We Do Not Oppose

We do not oppose the sections of H.R. 2292: requiring the IRS to disclose the reasons tax returns were selected for audit (section 304); directing the Joint Committee on Taxation to study the provisions in tax law regarding taxpayer confidentiality and access to tax return information (section 306); improving public access to IRS material under the Freedom of Information Act (section 307); directing the IRS to ensure that "offers-in-compromise" provide taxpayers with an adequate means to provide for basic living expenses (section 308); requiring that checks for the payment of taxes be made payable to the "Treasurer, United States of America" (section 312); requiring the IRS to establish a toll-free "hotline" for taxpayers to register complaints (section 315); improving the rights of taxpayers during IRS interviews (section 316); directing the IRS to establish procedures for alerting married taxpayers about their joint and several liabilities on all tax forms, publications and instructions (section 317); directing the Treasury and General Accounting Office ("GAO") to study the marriage penalty (section 320); and directing the GAO to report on the burdens of proofs for controversies (section 321). We also do not oppose the following provisions of the bill, but have concerns about the manner in which they currently are drafted.

1. Expansion of Authority to Issue Taxpayer Assistance Orders (Section 301)

The Taxpayer Bill of Rights 2 (Public Law 104-168) amended Code Section 7811 to provide the Taxpayer Advocate with broader authority to affirmatively take any action as permitted by law with respect to taxpayers who would otherwise suffer a "significant hardship" as a result of the manner in which the IRS is administering the tax laws. Treas. Reg. 301.7811-1(a)(4)(ii) defines the term "significant hardship" as "a serious privation caused or about to be caused to the taxpayer as the result of the particular manner in which the revenue laws are being administered by the IRS." The regulation further provides that mere economic or personal inconvenience to the taxpayer does not constitute significant hardship.

Section 301 of H.R. 2292 would further amend Section 7811 to identify four factors the Taxpayer Advocate should consider in determining whether a taxpayer is suffering significant hardship. These factors are: (1) whether the IRS employee to which such order would issue is following applicable
published guidance, including the Internal Revenue Manual; (2) whether there is an immediate threat of adverse action; (3) whether there has been a delay of more than 30 days in resolving taxpayer account problems; and (4) the prospect that the taxpayer will have to pay significant professional fees.

We are concerned that specifying four particular factors in the Code would create an implication that these are the only relevant factors or that these factors should be weighted more heavily than other considerations. Thus, although we have no problem with the Taxpayer Advocate taking into account any of the particular factors specified in the proposal, we do not believe that any amendment to the Code is necessary. Instead, we believe the Taxpayer Advocate should continue to take into account the particular situation of each taxpayer, including factors beyond the four set forth in the proposal.

2. Archival of Records to Internal Revenue Service (Section 305)

Section 305 of H.R. 2292 would require the Secretary of Treasury to disclose all IRS records to the Archivist of the United States, on request of the Archivist. Although we respect the Congressional interest in maintaining records of historical significance, we are concerned that the proposal, as currently drafted, does not adequately protect against the disclosure of confidential taxpayer information. We suggest that the provision not be enacted unless adequate safeguards are added to protect the integrity of confidential information so that taxpayers can be assured that personal information will remain private. We believe that failure to provide such safeguards would impede, rather than promote, taxpayer rights.

3. Procedures Relating to Extensions of Statute of Limitations by Agreement (Section 318)

Section 318 of H.R. 2292 would require the Service to notify a taxpayer of his or her right to refuse to extend the period of limitations, or to limit such extensions to particular issues, on each occasion where the Service requests the taxpayer to extend the statue of limitations. Although this provision appears to be beneficial to taxpayers, especially individuals and small businesses, we are concerned that, as currently drafted, it will be of little value from a taxpayer rights perspective because it ignores the practical ramifications that occur if the taxpayer fails to agree to an extension. In most cases, the Service will issue a notice of deficiency. The taxpayer then will be required either to (1) petition the Tax Court or (2) pay the tax and file a refund claim so that the issues in dispute can be referred to the IRS Appeals Office for settlement negotiations. Furthermore, the Service's current policy for entering into restricted consents to extend the statute of limitations, as set forth in the Internal Revenue Manual, is limited to situations involving no more than two issues where the examination is already complete and/or the case is already under the jurisdiction of the Office of Appeals.

Accordingly, we suggest that, if the provision is included in a legislative package, it be expanded to require the Service to provide an explanation of the ramifications of not agreeing to an extension. In addition, the Secretary should be required to issue regulations describing under what conditions the IRS will enter into restricted consents and those conditions should be explained to any taxpayer from whom a consent is sought.

4. Review of Penalty Administration (Section 319)

Section 319 of H.R. 2292 provides for a study and report by the Taxpayer Advocate reviewing the administration and implementation by the IRS of penalty reform recommendations made in the Omnibus Budget Reconciliation Act of 1989. Although we do not oppose the preparation of such a report, we believe that it should be prepared by the Secretary of Treasury and the General Accounting Office, rather than by the Taxpayer Advocate.

III. Comments on Legislative Proposals Shifting the Burden of Proof in Tax Cases

We understand that the Committee on Ways and Means may consider including in a taxpayer rights package a proposal similar to H.R. 367, a bill introduced by Rep. Traficant, to shift the burden of proof to the Secretary of the Treasury in all court proceedings involving Federal tax matters. Such a proposal would reverse the long-standing and well-established position under current law that, in general, the
burden of proof with respect to the correctness of the tax liability in question rests on the taxpayer. The general allocation of the burden of proof to taxpayers is consistent with our self-assessment system of tax administration, which relies on taxpayers to maintain the necessary records to accurately report their income and expenses.

We have serious concerns about legislating a change in the burden of proof and, therefore, respectfully encourage the Subcommittee to take no such action. Placing the burden of proof on the Government in tax litigation would require the Government to produce the business records, testimony or other evidence necessary to demonstrate the taxpayer's tax liability. This would place the Government at a fundamental disadvantage and likely would have at least three detrimental effects on tax administration. First, taxpayers might be inclined to be less forthright in preparing and filing their tax returns and, notwithstanding the potential for civil penalties (for which the Government would have the burden of proof), we believe that taxpayers would take more aggressive positions on their returns. Second, because taxpayers would have less incentive to volunteer the evidence supporting the positions reported on their returns, the Service would be forced to use its administrative summons power more frequently and intrusively during the audit process to gather the necessary information to support its determinations. This would be contrary to the objectives of taxpayer rights legislation. Finally, we believe that more taxpayers would litigate the Service's audit determinations, particularly in the Tax Court where prepayment of the contested amount is not required.

The potential adverse consequences of these effects on tax administration could be very dramatic. We would expect that the IRS no longer would be able to assure general compliance with the tax laws; that the high level of tax compliance in the United States would decrease, perhaps substantially; and that the revenues collected by the Federal Government from income and other taxes likely would correspondingly decrease, perhaps substantially. Further, additional litigation by taxpayers would require the expenditure of additional resources, increasing costs to the Government and, ultimately, to taxpayers in general. Thus, this single change in the law could significantly complicate the fiscal condition of the United States. Therefore, we strongly urge the Subcommittee not to include a burden shifting proposal in any taxpayer rights package.

IV. Additional Taxpayer Rights Legislative Proposals We Support

1. Withholding When IRS Seizes Funds From Pension Plan

Funds held in retirement plans are subject to levy by the IRS. Under Code Section 3405, certain distributions from retirement plans, including distributions resulting from an IRS levy, are subject to withholding in an amount equal to 20 percent of the distribution. However, in the case of a levy, the IRS does not allocate any of the funds paid in satisfaction of the 20-percent withholding requirement. As a result, the taxpayer can be subject to estimated tax penalties, failure to pay penalties, and interest. It is inequitable and onerous to subject taxpayers to these penalties and interest. Therefore, we recommend that Section 3405 be amended to require the IRS to set aside 20 percent of any funds in a retirement plan that are seized by levy.

2. Reduce Estimated Tax Penalty When Amount of Tax Due Is Reduced

Estimated tax payments are equivalent to withholding on an employee's wages. The estimated tax penalty, which is generally self-assessed by the taxpayer, is imposed where the taxpayer has underpaid estimated taxes. Technically, the estimated tax penalty represents an interest payment to the Government because, to the extent the estimated taxes are underpaid, the taxpayer has retained the use of money legally belonging to the Government. In situations where the taxpayer's tax liability is subsequently reduced, resulting in an overpayment of the estimated tax penalty, a taxpayer should be entitled to a reduction in the penalty. In this case, the overpayment represents interest payments on monies the taxpayer never owed the Government. Under present law, taxpayers cannot request a reduction in their estimated tax
penalty in this situation. We believe that this inequity in present law should be corrected through legislative action.

3. Revocation of Husband-and-Wife Offers in Compromise

Offers in compromise contain an agreement by the taxpayer to comply with the tax law for five years. If the taxpayer fails to comply, the compromise is invalidated. In the case of a husband and wife, the offer is invalidated as to both if either one fails to comply. This is true even if the parties are separated or divorced. We propose that, rather than automatically invalidating the offer as to both spouses, separate notices be sent to each taxpayer and if, within 60 days, the taxpayer demonstrates compliance, the compromise be preserved as to the compliant taxpayer.

4. Statutory Notice of Deficiency

Under Code Section 6213, the Tax Court has no discretion to accept petitions filed after the expiration of the applicable 90-day or 150-day period for filing petitions with the court. This leads to dismissals of many cases where taxpayers were confused as to the correct date, or cases where taxpayers relied on erroneous advice given by IRS officials as to the correct date. Therefore, we believe Section 6213(a) should be amended to require that the statutory notice specify the date on which the petition must be filed, with both parties bound by that determination of the date unless the taxpayer can prove the date is incorrect.

5. Communication With Taxpayers Last Known Address

The tax compliance system depends heavily on being able to communicate with taxpayers by mail, and taxpayers often are required to respond within a limited period of time. Too often, however, the system breaks down due to the use by the Service of an incorrect address. Therefore, we believe that the IRS should be granted statutory power to access the U.S. Postal Service's National Change of Address data base, and that the Code be amended to define the taxpayer's last known address in terms of all the facts and circumstances reasonably known to the IRS, including information in the U.S. Postal Service's database.

6. Disclosure of Service Tax Policies

Over the years, the IRS has greatly reduced the publication of Revenue Rulings and General Counsel Memoranda. The IRS should be required to disclose to a taxpayer, in any contested matter, any legal opinions from the Office of Chief Counsel that are relevant to the taxpayer's legal, as opposed to factual, issues. Such opinions should then be publicly disclosed, after deleting taxpayer identifying information, in the same manner as is currently done with private letter rulings and technical advice memoranda.

V. Conclusion

Thank you again for the opportunity to present our views today. We would be happy to work with the Subcommittee as it develops any legislative recommendations on taxpayer rights.

This concludes my prepared remarks. I would be pleased to answer any questions.