Comments on Summary of Staff Discussion Draft on Reforming Tax Administration

Introduction: As part of its commitment to support a simple and equitable tax system, the Section, through the collective effort of its Committees, has produced both a series of white papers that address broad tax policy principles and comments that provide detailed options for tax reform. The latest such effort answers then-Chairman of the Senate Finance Committee Max Baucus’s request for comments on his tax reform staff discussion draft concerning tax administration. Many topical issues, such as return preparer regulation, a statutory right to review by the Office of Appeals, the Taxpayer Bill of Rights, and the current tax penalty structure, are addressed. Following is the Executive Summary of the report. As with all of the Section’s government submissions, these comments, dated June 25, 2014, are available on the website at http://www.americanbar.org/groups/taxation/policy.html. –Jesse Tsai, Staff Counsel

On November 20, 2013, then-Chairman Max Baucus of the U.S. Senate Committee on Finance released a staff discussion draft of proposed reforms to the administration of the tax laws (the “Discussion Draft”). These Comments address certain aspects of the Discussion Draft and respond to the request for comment on certain issues affecting tax administration practice and procedure.

The Discussion Draft includes provisions intended to simplify the tax filing process and expand electronic filing, address tax-related identify theft, and reduce the tax gap through enhancements to information reporting. The Section of Taxation of the American Bar Association (the “Section”) supports the goals underlying these proposals. We also note, however, that addressing those goals requires an adjustment to the funding provided to the Internal Revenue Service (the “Service”) through the annual appropriations process. As we recently wrote to Congress, the Section is gravely concerned that the recent trend of funding reductions for the Service have the authority to regulate all paid tax return preparers. In light of the recent decision to the contrary in Loving v. I.R.S., 742 F.3d 1013 (D.C. Cir. 2014), the Section strongly supports this proposal, with clarifications discussed below to ensure that the legislation adequately remedies the issues raised in the Loving decision.

The Discussion Draft requested comments on whether Congress should create a statutory right to review by the Office of Appeals (“Appeals”) prior to the issuance of a notice of deficiency. The Section supports this proposal because it would increase fairness for taxpayers, resolve cases more quickly and economically for both taxpayers and the government, and help ensure the independence of Appeals. In addition, the Section respectfully recommends that Congress provide a pre-assessment statutory right to review by Appeals of all penalties.

The Discussion Draft also requested comment on reforming the current tax penalty structure to ensure that penalties are used appropriately to effectively promote taxpayer compliance. We applaud Congress for its consideration of reform of the penalty regime. In a 2009 white paper, the Section encouraged Congress to address civil tax penalty reform. With the benefit of five years’ experience since that white paper was issued, we believe that the principles and recommendations set out in the white paper are still timely, and that penalty reform is more important than ever. We also recommend that:

• The Internal Revenue Code of 1986, as amended (the “Code”) be revised to allow taxpayers to assert a uniform reasonable cause and good faith defense with respect to most, if not all, penalties.

• In TEFRA partnership proceedings, courts be permitted to take ancillary jurisdiction over the “reasonable cause and good faith” defense of partners, rather than requiring those partners to litigate their penalty defenses in subsequent proceedings.

• Congress apply strict liability penalties in only the most narrow circumstances.

• Congress repeal the “disqualified tax adviser” provisions that effectively require taxpayers to obtain “second opinions” with respect to certain transactions in order to assert penalty defenses based on reasonable cause.

• Congress clarify the codified economic substance doctrine.

• Congress provide taxpayers with an opportunity for pre-assessment judicial review of most penalties.

Follow-up on Funding for the Internal Revenue Service

Introduction: In response to H.R. 5016, which proposes to decrease funding to the Internal Revenue Service to its lowest level in a decade, the Section reiterated its support of adequate funding for the Service. This was initially expressed in the Section’s February 10, 2014, letter to the House and Senate Appropriations Subcommittees on Financial Services and General Government. While the Section appreciates the tremendous difficulty Congress faces, such a dramatic reduction in funding impairs the Service’s ability to maintain sufficient personnel that is properly trained. This will inevitably harm taxpayers and inhibit the Service’s ability to administer tax laws and collect tax revenues. As with all of its government submissions, the Section’s July 21, 2014, follow-up letter regarding Service funding in light of H.R. 5016 is available on the website at http://www.americanbar.org/groups/taxation/policy.html.

--Jesse Tsai, Staff Counsel

Dear Chairmen Udall and Crenshaw, and Ranking Members Johanns and Serrano:

In light of the U.S. House of Representatives’ passage of H.R. 5016, The Financial Services and General Government Appropriations Act, which would fund the Internal Revenue Service (the “Service”) at significantly reduced levels compared to the government’s fiscal year 2014, I respectfully reiterate, on behalf of the American Bar Association, our support for ensuring that the Service receives adequate funding for fiscal year 2015. As indicated in our letter to you on February 10 of this year, the American Bar Association has consistently supported adequate funding for the Service to carry out its missions of taxpayer service and enforcement of federal tax laws.

We recognize the intense challenges that the Congress faces regarding the federal budget. While we appreciate the difficult task at hand, we would like to reiterate the importance of providing the Service with sufficient resources to perform its critical functions of providing taxpayer service and collecting taxes properly due. The proposed funding reduction in H.R. 5016 would reduce the Service’s funding to its lowest level in ten years. While the Service has made great strides in reducing costs, such as increasingly automating systems, we believe that reduced funding will negatively impact the Service’s ability to serve taxpayers and enforce the tax laws that Congress enacts.

We worry that by not adequately funding the Service, we are at risk that the following consequences might occur:

• A decrease in federal revenue. Every dollar devoted to tax enforcement yields a substantial increase in tax collections, and reducing funding in the Service’s tax enforcement efforts results in significantly lower tax collections.¹ Moreover, failure to collect taxes properly due undermines confidence in our voluntary compliance system, especially when honest and diligent taxpayers believe that other taxpayers are not paying their proper share.

• A lack of necessary Service personnel. In order to perform the Service’s critical functions, in the face of complex and constantly changing tax laws, a sufficient staff must be recruited and properly

¹ National Taxpayer Advocate, 2013 Annual report to Congress – Executive Summary, p. 21 (December 31, 2013).