TAXING TIMES: THE CASE FOR IRS REFORM

HEARING

BEFORE THE

SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH, NATURAL RESOURCES, AND REGULATORY AFFAIRS

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

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WEDNESDAY, APRIL 3, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES, AND REGULATORY AFFAIRS,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Phoenix, AZ.

The subcommittee met, pursuant to notice, at 9:13 a.m., in the City Council Chambers, 200 West Jefferson, Phoenix, AZ, Hon. John Shadegg presiding.

Present: Representatives Shadegg and Salmon.

Staff president: Mildred Webber, staff director; Karen Barnes, professional staff member; David White, clerk; and Liza Mientus, minority professional staff member.

Mr. SHADEGG. Good morning. At this time, I would like to call to order this field hearing of the Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs.

My name is John Shadegg, I represent the Fourth Congressional District of Arizona.

I have a number of things to say here at the outset to begin this hearing. Let me start by thanking Chairman Clinger of the House Committee on Government Reform and Oversight for making this opportunity for a hearing available to me. And I would also like to thank Chairman David McIntosh, who is the subcommittee chairman, for making this opportunity possible, and his staff for their dedicated work to pull all of this together this hearing.

This is the 15th field hearing of the Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs. That is because the chairman, Mr. McIntosh, believes very strongly that it is important to get out into the field and to allow taxpayers and—in this case, taxpayers and ordinary citizens an opportunity to have input into the legislative process directly by speaking, without having to come to Washington.

There are a number of things I want to say. Let me start by saying it is not true that there are no other committee members here because they are all afraid of being audited. They are in fact tied up with other business. Congressman McIntosh himself had planned to be here, but regrettably, due to other circumstances could not be. We will be joined later by Congressman Matt Salmon as a part of this hearing.

Let me start by talking a little bit about this opportunity. I am pleased to be here in Phoenix. I am particularly pleased to conduct a congressional hearing in my own Congressional District and to allow the constituents of the Fourth Congressional District an op-

portunity to express their views and to participate in a forum so that they can have a voice in the regulatory reform debate going on in Washington.

As tax day is fast approaching, the Internal Revenue Code, our obligation to file our taxes, the copious forms we have to fill out, the regulations we must comply with, are obviously on our minds. During my campaign for the U.S. Congress and as a part of my tenure in Congress, I have consistently asked my constituents what issues they want me to address. And consistently, they have said to me that they are concerned about the tax burden imposed upon them by the Federal Government. They have said to me what they hope we will do in this Congress is to get Government off their backs so that they can build their businesses, create jobs and provide for their families.

Let me turn just for a moment and refer to the exhibits which you see behind you, because I think they are quite interesting. To my right, your left, is the joint resolution establishing the authority of the U.S. Congress to collect an income tax—to levy and collect an income tax. That was passed in 1909 and became the 16th amendment to the U.S. Constitution. On my left, your right, you will see the first Income Tax Code of the Nation. That is, by the way, the entire first Income Tax Code of the Nation. It consists of approximately 15 pages. By contrast, you will see in front of me all these volumes. They comprise approximately 8,600 pages of Tax Code which now govern your conduct and the payment of your taxes. That is quite a dramatic change between 1909 and 1996 where we sit in this particular circumstance.

What then is the purpose of this hearing? Well, let me start with one issue that is of great concern to me and has some bearing here, and that is that in 1992, as chairman of the "It's Time" anti-tax initiative, the proposition 108, we passed a constitutional amendment here in Arizona to require a two-thirds majority before taxes in the State could be raised yet again. I made a pledge that as a Member of the U.S. Congress, I would take that fight to the Federal Government, and I have done so. Early in my term, I urged House Speaker Newt Gingrich to schedule a vote on a tax limitation amendment. And as many of you know, that vote will occur this year just shortly less than 2 weeks from today. On tax day 1996, April 15, Monday, a week from this coming Monday, there will be a vote in the U.S. Congress on a tax limitation amendment, an amendment that follows the Arizona example, requiring a super majority by both the House and the Senate before taxes can be raised. Four out of the last five Federal tax increases have been passed with less than a two-thirds majority. This amendment, the tax limitation amendment, would make it somewhat more difficult for the Congress to raise your Federal taxes one more time.

But that is not the focus of this hearing, though it is a timely topic and one I hope you are all interested in. The focus of this hearing is tax regulations and penalties which are within the jurisdiction of this subcommittee of the Government Reform and Oversight Committee. Each year, Americans experience tremendous frustration as they spend countless hours and millions of dollars complying with tax regulations. According to Jack Faris, president of the National Federation of Independent Businesses, the IRS is

the agency that imposes the greatest burden on small business. The current Federal income tax system has become extraordinarily complex, costing taxpayers an estimated $75 billion a year to comply with.

In 1993, Money magazine invented an average income tax situation and asked 50 tax professionals to calculate the appropriate tax liability. Forty-one of those professional submitted returns—41 had different answers. The answers ranged from a low tax exposure of $31,846 to a high of $74,450, despite that the IRS itself asserted that the actual tax liability was $35,643. The preparers' fees for this exercise varied even more widely than the different tax liability, ranging from a low of $375 to a high of $3,600.

Half of all individual taxpayers pay a total of more than $7 billion a year to someone else to prepare their taxes. During the course of a tax year, they spend about 3 billion hours, an average of about 27 hours per year per taxpayer dealing with their tax affairs. That is the regulatory side of the issue of tax reform.

The other side, and what in part brought about this hearing, is an issue about the question of penalties. The IRS levies rather heavy penalties when it determines that a taxpayer has violated one of its regulations. It imposes on Americans a total of $3.5 billion a year in fines. These fines are often levied even if the mistake was unintentional. Indeed, under current tax law, taxpayers who accidentally underpay their taxes have to pay a 20 percent penalty in addition to the interest on the underpayment. One can certainly argue that this is too high a penalty to pay when considering the fact that the regulations are so complicated that it is easy to make an honest mistake.

For American families, filling out confusing tax forms has become an excessively burdensome task. The purpose of this hearing is to bring forward useful information on regulatory reform within the tax arena and to look at the issue of penalties.

Now as I mentioned, Congressman Matt Salmon, who could not be with us for the beginning of this hearing will join us later, and when he does, he may well want to make an opening statement.

But I want to express my appreciation to him for coming and being a part of this hearing today. Congressman Salmon serves on the House Small Business Committee, which is an oversight committee which is uniquely affected by the IRS tax policy because of its impact on small business. In addition, the Small Business Committee is the only other committee besides this one which has held oversight hearings on the IRS this session of Congress. When Congressman Salmon is able to join us later this morning, I will give him an opportunity to make an opening statement.

At this point, let me take care of a couple of housekeeping details. Congressman Clinger, the chairman of the Government Reform and Oversight Committee, has imposed a rule which requires that all witnesses before this committee be sworn in, and so when you come to the witness table here at the front, I will stand, ask you to hold up your right hand, I will hold mine up and administer the oath to you.

With regard to the way the hearing will be conducted, the rule in the U.S. House of Representatives is a 5-minute testimonial rule and a 5-minute questioning rule. That testimonial rule requires

that you present your testimony within the span of 5 minutes. Let me make clear a couple of things. First of all, I want to thank each of the witnesses for taking the time to appear here today and for preparing a written statement. Virtually all of you have prepared and submitted a written statement, some as lengthy as 27 pages. The custom in the U.S. Congress is that your written statement will appear in its entirety in the record of this hearing, to be reviewed by other members of the subcommittee and if they wish, by other members of the full committee. However, I would urge you to summarize your testimony rather than read it, and to present it in a way in which you are simply reflecting what has actually happened, the experience you have had and let the members of the panel and the members of the audience know precisely what has happened to you in kind of simple and straight-forward terms.

To my left, to your right, right in front of us here is David White. David will be holding up time cards that will allow you to know how much time is left in your statement. We refer to David as the enforcer of the committee and if you look at his size you can see why he aptly bears that title. [Laughter.]

Because we have relatively small panels and because we have relatively few Members of Congress—indeed, only myself and Congressman Salmon later on in the hearing—I can be somewhat flexible in allowing you to go beyond the rigid structures of a 5-minute time limit, though if you go far beyond that, I will have to let you know that you are going beyond it and ask you to summarize your testimony as quickly as you can.

With that, I believe we have covered all of the mechanical details with the exception of one. I want to just bring to your attention one final point. In this Nation, we devote roughly 24,000 employees to the enforcement of Federal laws. The Federal Bureau of Investigation has 24,000 employees. To enforce our border and ensure its security, the Border Patrol has roughly 5,800 employees. The Drug Enforcement Administration, charged with carrying on the Nation's war against drugs, has 6,700 employees. By contrast, we devote five times the largest of those numbers—that is, five times the number of employees of the FBI, are employed at the Internal Revenue Service, over 111,000 employees currently administer this Nation's Tax Code, whereas only 24,000 enforce our Federal laws.

It seems to me that tax simplification could at least hold the prospect of not having that number grow, and certainly would hope, to make it shrink.

With that, let me call forward the first panel. The first panel consists of Sybille Koberstein and Alma Davis. If you would come forward.

I should probably explain, Congressman Salmon had an early morning prior obligation, he will join us at about 10:30. So at that time, I will allow him to make a statement.

If you would, raise your right hand.

[Witnesses sworn.]

Mr. SHADEGG. Let the record show the witnesses answered in the affirmative.

Sybille, if you would begin. And again, let me urge you, your entire statement will appear in the record as written and submitted. If you want to summarize it, you may deviate from it, make the

salient points you want to make and if occasionally you will glance at David, you will have an idea of how much time—David White right here—you will have an idea how much time is remaining for your statement. Again, I can be somewhat flexible, I want you to be able to get your message across. We just cannot run significantly over the allotted 5 minutes.

STATEMENTS OF SYBILLE KOBERSTEIN, BUSINESS OWNER; AND ALMA DAVIS, BUSINESS OWNER

Ms. KOBERSTEIN. OK. Good morning, Congressman Shadegg and any other members of the committee here. I want to thank you for allowing this time for me to address you and to relate a brief history of our experiences as taxpayers, that we encountered with the IRS.

My husband and I operated and owned a manufacturing insulation building company and for many years it was a very profitable and large business that consumed most of my husband's time.

We had used, at that time, the services of an accountant and certified planning advisor from 1982 through mid-1986. We had relied heavily on his service, advice and recommendations for our personal and our business matters, as we both had limited experience in financial investment matters. He had prepared our 1983, 1984 and 1985 Federal tax returns. He also assisted with the preparation of financial records of our corporation and the preparation of the tax returns.

During 1984, we, upon the advice of our accountant, invested in Hi-Tek Cinema Productions, Ltd. Our decision to invest was based on his representations to us that Hi-Tek was a legitimate business opportunity and enterprise.

During this time, within a month later—this was in September—August-September—that we invested. The following month, in November, on Friday, November 30, 1984, my husband suffered a heart attack, was taken to the hospital where I met him. I stayed through the night and he continued to suffer major cardiac arrest, which left him in a coma by morning. He stayed in a coma until January 1985 and also remained in the hospital 4½ months thereafter.

At that time, simultaneously, I struggled to maintain the operations of our corporation and keep it functional. It was a challenge to try to fill his shoes since he was a very active CEO working about 15-plus hours a day. This meant holding business meetings in the hospital waiting room for me and taking phone calls until 11 at night. Eventually, it just became apparent to me that this was going to be too much and I could no longer maintain the demands of the business, provide for my family and physically care for the needs of my husband. Then I became involved in a huge sales transaction at the same time of our company that started early in 1985 and consummated in the spring of 1986. I also had to hire attorneys there to represent my husband and myself in a medical malpractice lawsuit at the same time.

During this crisis, neither my husband nor I had become aware of Hi-Tek's failure to properly conduct its partnership business until July 17, 1987, when we received a letter from one of the gen-

eral partners of Hi-Tek, informing us that the IRS had made some adjustments to the 1984, 1985 and 1986 K–1 schedules.

I had not paid much attention at the time, since so much else was going on in our life that seemed more important. And in August 1988, the IRS sent a letter regarding proposed adjustments to the 1984 partnership changes. Prior to this time, I had hired a new accountant that replaced the previous one. He had decided that we should—the new accountant, my husband and myself went to the IRS office to try to talk to them concerning the letters that we had received now. Prior to this time, we had never had any problems or dealings with the IRS that were adverse. We were prepared then to pay the tax due and the interest thereon on that portion, if we could agree upon having the penalties abated. We contended that the asserted penalties should be waived in their entirety for the reasons that we were not negligent or in disregard of the rules and regulations in the preparation and filing of these returns by our accountant. We had reasonable cause to and in good faith did rely on his services, advice and recommendations and he had filed the taxable years 1984, 1985 and 1986.

Since that meeting came to no avail, because the IRS was not willing to negotiate any deductions of any kind while we were there, our accountant advised us to hire a tax attorney. Consequently, we retained the services of an attorney, Yale Goldberg, to aid in this issue with the IRS. We could not believe that in the interim, after having made—going to the IRS office, making contact willingly, that they still consequently liened our home. I do not know if any of you have ever gone through that, but that is quite a process and it is on your record for 7 years thereafter, which was devastating to us as a small business and as a family.

He eventually did—Yale Goldberg did negotiate an abatement of three of the penalties that had been assessed. At the time, it was really impossible for us to believe that we needed to hire an accountant CPA, a tax attorney, just in order to communicate with the IRS, instead of being able to negotiate with them as a taxpayer directly. This caused additional stress for us at this time and large sums of money. And then it was not until February 19, 1992, that the check for nearly $80,000 paid as a cash bond for taxes that were yet to be assessed from the IRS with respect to this 1984 taxable year.

Mr. SHADEGG. Thank you very much. Alma Davis.

Mr. DAVIS. Thank you, Congressman Shadegg.

As stated, my name is Alma Davis, I live here in Mesa, AZ. I have lived here for the past 17 years, I have a wife and six children.

My story of entanglement with the IRS begins approximately September 1985. My partner and I had transferred some assets that we had in one particular construction business to another construction business for a minority interest. After a few months, it was discovered that this particular company had not been paying their withholding taxes. We held several meetings with the officers; they turned out to be acrimonious. It was discovered also that I had fallen in bed with a couple of unscrupulous partners. They had done this to two other companies.

Anyway, after several meetings and several discussions, it was decided that I would go ahead and have a secretary mail in a 941 and ask the officer to make a payment to the IRS of $10,000 for withholding taxes. The 941 was mailed, the deposit was never made. Anyway, in May 1986, I tendered my resignation just 9 months after I joined this company, and then the entanglement with the IRS begins.

I was lassoed. I contacted my cousin, who is a tax attorney, who said he would represent me for what he thought and I thought would be just a short period of time explaining what the details were. I was dead wrong. I had a lien filed against me for a quarter of a million dollars. I did not realize at the time but when you contest something with the IRS, it stops the statute of limitations and so this thing just continues to run forever. Basically, this lien was on me for several years. I lived what I consider a sub-human life for 8 years while the IRS battled this thing out.

My cousin finally turned me over to an attorney, Marlan Walker, who will testify at this hearing. He contacted me and said that there was a new program that the IRS had instituted called Compliance 2000. He felt that my criteria fell very favorably within this new program and that I would be able to get some tax relief and get this lien off me and get on with my life of raising my family.

After several attempts that Marlan made with the IRS, they rejected our offer in compromise I believe three or four times, wanting information that went clear back to 1981 and 1982, years before I even had joined in with this particular company. I think the second and final go-around, he asked one of the IRS agents who was handling this case, Mr. Gordon Toncheff, if he would meet himself, my wife and I at our home and he could see for himself our circumstances and that I was not hiding any huge sums of assets and whatever else he thought I might be sitting on.

The time for the appointment came, he did not show up. Marlan said I would like to have him get there and you meet him and then I will be there presently. I happened to slip out the back to my backyard and as I was walking in my backyard, I noticed a fellow was already in my backyard snooping around. He introduced himself as Mr. Toncheff from the IRS. He had parked down the street, hidden his car a few doors down or several doors down, admitted himself through my fence, which I consider trespassing, and he was just taking notes of everything he could possibly envision in my backyard.

I would just like to point out for the record, we live in a modest home, we live in a modest neighborhood. Six children in a three bedroom home is not what I consider extravagant. He wanted to see everything I possibly had back there. I had stuff from my father and my brothers I had in storage there. He practically got on his hands and knees to see under my garage doors of which I was readily willing to open. And to his chagrin, he found just a bunch of stuff we could not fit in the house, covered in dust nonetheless. Anyway, my wife slipped in the house quickly to call Marlan to see if he was en route, which he was. He got there, we had some further conversation.

Again, we offered another offer in compromise. This Mr. Toncheff rejected it again. Eventually, I believe it was the fifth time, after

several letters to—I believe Marlan sent them to our Senators and our Congressmen—anyway, we finally got some relief in 1994, about 8 years after this mess started.

I was unable to secure—I am a contractor by trade and I went down to get, from a reputable company, to get a new insurance policy for my company and the fellow ran a TRW on me and said do you realize you have a quarter of a million dollar tax lien on you? We are not going to touch you. That was somewhat disturbing to me.

I eventually got it taken care of and we are here to hopefully get some reform in this powerful agency that I feel has—they hold all the cards, have all the power and the common citizen cannot deal with them. It is virtually impossible for a common citizen to deal with them.

Thank you.

Mr. SHADEGG. Thank you.

Let me go back and get some further information, if I might, Ms. Koberstein. As I understand it, the essence of your experience was you were using a tax advisor—was that a CPA?

Ms. KOBERSTEIN. Yes, it was.

Mr. SHADEGG. OK. And on the advice of this CPA, you invested in what you thought would be a long-term productive investment?

Ms. KOBERSTEIN. Right.

Mr. SHADEGG. What year was that?

Ms. KOBERSTEIN. That was in roughly—it was like September-October in 1984 that he came up with that particular investment.

From time to time, he would recommend investments for us and we were in a bracket at the time to make some investments, which we did. And we followed his advice, he was a certified financial planner.

Mr. SHADEGG. And the essence of this matter is that sometime down the line, the IRS then later disallowed some deductions which you had made?

Ms. KOBERSTEIN. Right. We did not know anything about it until several years later, we received a letter from one of the general partners, I learned that he was, from that corporation that the IRS had been investigating them and had disallowed tax credits for the general partners and for all people who had invested therein. Then it was not until the next year the IRS contacted us and wrote us a letter saying that they were indeed investigating the disallowance of credits for them. But it really was not a bill yet, it was just kind of a notice.

I took it to the new accountant. We had some problems with our other accountant. I took it to our new CPA and he said well, this is really not a bill yet, you cannot pay anything off this, but I will start checking into it for you, which he did.

Mr. SHADEGG. So the initial contact was a letter advising you that they were investigating this company and might therefore disallow a deduction you had taken?

Ms. KOBERSTEIN. Right, uh-huh.

Mr. SHADEGG. Do you have any idea what your tax exposure initially would have been at that time?

Ms. KOBERSTEIN. Well, that was part of it, they really never put an amount to it. They wanted the initial, whatever allowance you

had received for tax credit in 1984, 1985 or 1986, to put that back in as ordinary income. They then were going to add on the penalties and interest upon the penalties and the amount, and by the time they really contacted us, years down the road, of course it was running still. We went to the office to try to solve it ourselves, and they really were not at all cordial. They were not interested in making any deals, they said they could not disallow anything, especially not the penalties, even though we were ready to pay the bill. And I tried to explain then, and I brought my husband with me to show them indeed what all we had been through with other pressures and problems and sickness, that we might not be paying as much attention to this matter. But we did have an accountant the whole time.

Mr. SHADEGG. So you first made—you got this notice. At some time later, you and your husband went, without legal counsel, to the IRS.

Ms. KOBERSTEIN. Just with our accountant.

Mr. SHADEGG. Just with your accountant. And made an offer to pay something at that point in time.

Ms. KOBERSTEIN. Right, to stop the interest, which did not take place then. And eventually when Yale Goldberg got onto the case and worked with them, they—he suggested to us that we did pay the amount as a bond to stop the interest from accruing.

Mr. SHADEGG. Was that bond the $80,000 figure you mentioned?

Ms. KOBERSTEIN. Yes, it was nearly $80,000. It was actually $75,000 and something. We also had a tax credit standing from the following year that they were holding and that was a little over $10,000.

Mr. SHADEGG. If I could ask you to pull the microphone a little bit closer, there are people in the back of the audience who would like to hear you and cannot.

Ms. KOBERSTEIN. OK.

Mr. SHADEGG. At what point did you seek legal counsel, how many years into this particular experience?

Ms. KOBERSTEIN. I believe that I contacted—we contacted the attorneys roughly 1990 or 1991.

Mr. SHADEGG. And the essence of your situation was that the IRS was asking for or demanding a penalty and your response was, look if we made an innocent mistake here, we made an innocent mistake. We are sorry about that, we will take care of the back tax, we will pay interest on it, but we do not feel we should pay a penalty.

Ms. KOBERSTEIN. Right. Yeah, I did have a long conversation with them and I tried to get them to explain to me why I should be penalized for something that I really did not do intentionally. The intent was just to make an investment on the advice of our accountant. And at the time, my husband was the one who had been dealing with him the most and now he could not speak or write and it really tied my hands in being able to know exactly what had taken place. This accountant had left the State and was no longer available. So I really was left kind of just in a lurch.

Mr. SHADEGG. But you made it clear to the IRS from that first meeting that you had been relying on expert advice.

Ms. KOBERSTEIN. Right. And I never tried to hide or become invisible, which really irritated me when they went ahead during that time after the contact and liened our home anyway. That was, they said, because I was unwilling to pay the full amount with the penalty and interest first and then they were willing to hear our side.

Mr. SHADEGG. Let me ask, when they placed the lien on your home, was that before or after you retained legal counsel?

Ms. KOBERSTEIN. That could have been before, shortly before.

Mr. SHADEGG. At that point, you felt you needed help.

Ms. KOBERSTEIN. Yes.

Mr. SHADEGG. And ultimately, with the aid of legal counsel and with the——

Ms. KOBERSTEIN. Many months into it.

Mr. SHADEGG [continuing]. Proof that you had been innocently relying on what you thought was sound advice.

Ms. KOBERSTEIN. Because of the special circumstances with my husband.

Mr. SHADEGG. The penalty itself was ultimately waived?

Ms. KOBERSTEIN. Yes, three of them were.

Mr. SHADEGG. OK. The interest continued to accrue and you did in fact pay the back tax.

Ms. KOBERSTEIN. Yes. That's why we paid the bond, to hopefully stop it at that point. They had not quite yet assessed the full amount they said and that would be coming within 2, 3 months yet.

Mr. SHADEGG. Did Mr. Goldberg advise you to go further with this appeal or was he satisfied with what you were able to ultimately get in terms of relief?

Ms. KOBERSTEIN. Unfortunately he said that interest is not normally abated from tax situations, so that was about where we could go with it.

Mr. SHADEGG. OK. Roughly—Mr. Goldberg is a talented attorney—do you have any idea what it cost you to fight this fight?

Ms. KOBERSTEIN. You know, offhand, I do not because it also involved having a CPA—having someone in his office do a lot of research and work, which we tried to do before. I did not bring those papers with me, but——

Mr. SHADEGG. Let me just ask one last question. And Mr. Davis concluded his testimony by saying that he felt it was impossible for him to deal, as a citizen, with the IRS once in this circumstance, that he had to ultimately get assistance. Is that your sense of it as well, is that how you felt?

Ms. KOBERSTEIN. Absolutely. I felt like you did not get anywhere as an individual taxpayer, that unless you brought legal counsel, they were not even going to talk to you. It takes legal counsel in order to write the letters and go above where you can talk to people in the IRS level, to get somebody's attention.

Mr. SHADEGG. I appreciate that.

I do not know if there is anything else you would like to add. You might want to introduce your husband, who is here.

Ms. KOBERSTEIN. Yes.

Mr. SHADEGG. And your two sons.

Ms. KOBERSTEIN. This is my husband over here, J.R. Koberstein, and our sons, Edward and Greg.

Mr. SHADEGG. Thank you very much.

Mr. Davis, I was fascinated by an aspect of your testimony, it probably fascinates most people. It is a little bit startling. Your written testimony and again your testimony today is that this IRS agent, having agreed to come to your house, in point of fact did not come to the front door and did not knock. The first time you saw him or met him or were confronted by him was in your backyard which he had already entered, is that correct?

Mr. DAVIS. Yes, that is correct.

Mr. SHADEGG. Did he—describe that exchange for me, if you would.

Mr. DAVIS. Well, as I recall, I went out in my backyard. I have a very large piece of property, it is an acre or a little over an acre and as I walked out back, I have some out-buildings back there and as I was out back I noticed that he was—this fellow was already in my backyard, already had come up a back driveway that I have a fence across and stuff, and had parked his car down—I do not live in a typical subdivision, there is quite a bit of space between our homes, but he had parked a few doors down and then had walked up and cut through my property.

Mr. SHADEGG. That would be like——

Mr. DAVIS. He was trespassing.

Mr. SHADEGG [continuing]. Several hundred yards away?

Mr. DAVIS. Yeah, yeah, at least 150–200 yards away. And of course, we had been anticipating this visit most of the morning and I thought that he would come to the front door and ring the bell like most common decent people do.

Mr. SHADEGG. Had you been cautioned or advised by your attorney that they might be interested in doing a surprise investigation?

Mr. DAVIS. No. I think I had asked Marlan, Marlan said we would like to set up a meeting out at your home so he can see firsthand where you live and what you have got and meet you firsthand and scope out—you know, see for himself what we were telling him.

Mr. SHADEGG. OK.

Mr. DAVIS. And I said well, I am a little bit nervous, is he going to come and, you know, go through every bedroom and the fridge and everything else? I mean, I had a little trepidation, not knowing—only having experience of distrust based upon my personal experience. And then when he did not come to the door and 9 o'clock came and went and I was out back, and lo and behold he was already there.

Mr. SHADEGG. Do you have any idea how long he had been there when you finally happened upon him?

Mr. DAVIS. I presume 5 minutes or so, you know. Anyway, I really do not know the length of time.

Mr. SHADEGG. At that point, you called your attorney and he came to your home?

Mr. DAVIS. Well, he was—my testimony reflected, he was already en route. My wife went and called him on his mobile telephone and he said I will get there as soon as I can. Then Marlan came and we had a conversation.

Mr. SHADEGG. I understand he is going to testify later, but was he at all surprised?

Mr. DAVIS. Oh, yeah, he was livid and I was livid. I mean frankly I was really torqued, I was bent out of shape because I felt like I had been jacked around so long and so far that, you know—I have come to the conclusion why people can get so frustrated with the Internal Revenue Service that they would do stupid things.

Mr. SHADEGG. I do not want to make more than there is, I guess in fact the IRS has the ability to do these so-called lifestyle audits but did this particular agent explain to you why he chose to come in the back way? Did he discuss that with you?

Mr. DAVIS. No. In fact, I had understood thoroughly earlier that morning that he would come to the door, meet us, we were to let him in, just treat him cordially and answer any questions he might have and then show him around.

Mr. SHADEGG. Let us go back for a moment. As I understand your written testimony and I believe you reaffirmed it here today, you joined this company by contributing assets or buying stock?

Mr. DAVIS. Yes. We had transferred—I transferred a few assets in for a minority position in this company.

Mr. SHADEGG. And as I understand your testimony, it is that after joining the company, you discovered that withholding taxes on employees already employed by the company had not been paid for a time period before you purchased your interest in the company, is that right?

Mr. DAVIS. That is correct.

Mr. SHADEGG. And then I guess that practice continued?

Mr. DAVIS. Right, it did.

Mr. SHADEGG. And you made an effort to protest that and to document your objections to it.

Mr. DAVIS. Absolutely.

Mr. SHADEGG. And that was, I take it, papered, I mean you developed a written record of that?

Mr. DAVIS. Yes, I know I did.

Mr. SHADEGG. Which was ultimately disclosed to the IRS?

Mr. DAVIS. Yes.

Mr. SHADEGG. How many years—well, nonetheless, you were in fact, because you were a part of the company, responsible for that?

Mr. DAVIS. Yes.

Mr. SHADEGG. Did the IRS go after other principals in this company for——

Mr. DAVIS. I have been told they have, but I do not have any way of——

Mr. SHADEGG. You do not know.

Did the IRS go after you—do you know, and maybe you do not—was a part of their effort to collect unpaid withholding taxes for activities before you bought your interest in the company?

Mr. DAVIS. Yes, they liened me for activities prior to my involvement.

Mr. SHADEGG. How much money all told was involved?

Mr. DAVIS. Well, the tax liens were $234,000 or $244,000.

Mr. SHADEGG. The tax lien. There was a lien imposed on your property also?

Mr. DAVIS. Yes.

Mr. SHADEGG. And do you have an estimate in your own mind or do you have the figures to establish how much of that was for the time period you were a principal of the company versus before?

Mr. DAVIS. Not exactly. I believe for the months preceding us, there was $30,000 or $40,000 without penalty and interest that was prior to my becoming involved with them.

Mr. SHADEGG. Are you able to break out for the committee the total amount of taxes due, the total amount of penalties imposed and the total interest that was collected?

Mr. DAVIS. I'm not prepared to do that, no. Actually, I have tried to close that chapter in my life and bury it as deeply as I can and just hold onto that lien release.

Mr. SHADEGG. I take it, it was your sense that there was a lack of fairness in all of this?

Mr. DAVIS. Absolutely. That would be an understatement.

Mr. SHADEGG. Did you have—you indicated that you felt ultimately you needed assistance in dealing with the IRS. Tell me what drove you to that conclusion and how you would like to have been treated differently, what efforts you used to try to get this resolved before getting assistance.

Mr. DAVIS. I guess once I got a first notice or a second notice, I happened to show it to my cousin and he kind of raised his eyebrows and said well, I will go ahead and answer this for you, because this is really a delicate matter, you have to handle this in just such a way or you will be lost. So he prepared a lengthy document and handled it for us, or handled it for me. And I did that just because I did not know where to start. So that is when I first contacted my cousin.

But after this proceeded for several years, he just washed his hands and said, Alma, I think you need to get somebody else, he said this is just too complicated for me.

Mr. SHADEGG. Ultimately you wound up getting other legal counsel?

Mr. DAVIS. Yes.

Mr. SHADEGG. OK. How many years did this entire experience span?

Mr. DAVIS. I believe it started getting nasty in 1986. When I say nasty, just you know, where—in 1986, I resigned in May 1986, and I think I got my first notice sometime shortly after that. Then it finally ended in March 1994 or April 1994.

Mr. SHADEGG. With regard to the inspection of your property, was it the IRS' position that if you had not been able to pay; that is, if you did not have the assets to pay, they could enter into a settlement with you, but if you did have the assets to pay, they could not? How did it come about that they wanted to physically inspect your property?

Mr. DAVIS. Well, my understanding was this new program called, I believe it is called Compliance 2000, was an effort put forth by the IRS to bring people that had fallen in these crevices of desperate trouble I guess with them, to bring them back into full participation and see if they could not resolve some type of settlement and get them back on track to where the liens were removed and they were living a normal U.S. citizen life. After we had gone back and forth several times with this offer in compromise that Marlan

had said would satisfy—as far as he was concerned, satisfy their requests—and they rejected it every time, that is when he said well, listen, I will just set up an appointment with this agent and have him come out and he can physically see you as a person, see your family, see where you live and see, you know, what he wants to see.

Mr. SHADEGG. And the agent did question you about various assets that were on your property, boats, cars?

Mr. DAVIS. Yes, absolutely, absolutely.

Mr. SHADEGG. And how many settlement offers did you go back—went back and forth?

Mr. DAVIS. Minimum—four or five. It took an incredible amount of time, effort and I cannot even begin to stress the emotional energy. It was bad on me, but my wife and family, I felt really suffered the biggest portion of this.

Mr. SHADEGG. Ultimately you were assessed and did agree to pay how much?

Mr. DAVIS. Yes, $17,659.

Mr. SHADEGG. That is all the questions, I have. I did hope that Congressman Salmon might make it here, because I believe, Mr. Davis, you are a constituent of his.

Mr. DAVIS. Yes.

Mr. SHADEGG. If you are going to be here any longer, we might at least have him chat with you when he comes or maybe have a chance to call you back in case he has any questions.

Other than that, if either of you have anything you would like to add, I simply want to express my appreciation for your taking the time and relating your stories. Thank you very much.

Mr. DAVIS. Thank you.

Mr. SHADEGG. I will now call the second panel and with it, we have significant expertise. First, Mr. Marlan Walker of Walker Ellsworth, P.L.C.; Mr. David Bosse of Walker Ellsworth, P.L.C.; Mr. Yale Goldberg, Frazer, Ryan, Goldberg & Hunter; and Mr. Mike Pietzsch, Polese, Pietzsch, Williams and Nolan. Gentlemen, if you would come forward.

If I could get you to hold up your right hand. As I indicated, Mr. Clinger does require testimony to be sworn.

[Witnesses sworn.]

Mr. SHADEGG. The record will reflect that all the witnesses answered in the affirmative.

Let me start by simply saying it is not lost on any of us here that this is tax season, it is an extremely busy time of the year, so I appreciate, gentlemen, your taking the time at this extremely busy time of the year out of your schedules to both prepare your written testimony, which I know took time, and to come here and testify today. I sincerely appreciate your efforts.

Let me add a couple of other points. First, on a personal note, Yale Goldberg and I have known each other for many, many years, when I was practicing at Triane Wernicke, he was I believe at Lewiston Roeka and became a friend back then. Our professional lives, paths crossed a couple of different times. Yale, I appreciate your efforts in being here.

Let me just kind of make one little personal insight. I called my own CPA yesterday to chat with him about a couple of issues and

I had just finished reading one of your testimony, and I do not know which one it is, but it was testimony which I am sure you will bring forward about the alternative minimum tax. And I thought as I read it, I thought well this is kind of crazy, the alternative minimum tax does not really ever affect individuals, it is a corporate tax concept. But the testimony had presented it in the individual context. Well, when I called my accountant and we were chatting about various things, he was aware of this hearing and he said oh, by the way, John, you need to be aware that there is a possibility in looking at your tax return for this year, that you will be required to pay an alternative minimum tax. I said that is not possible, I am an individual taxpayer, I am not a corporate taxpayer and that is a concept for corporations that do not pay enough money and the Government decides they have got to go back and get more. And he said no, John, as I have looked at this preliminarily, you may well have an exposure under the alternative minimum tax.

So I do not recall whose testimony it comes from, it will certainly come out here today, but I would very much appreciate your explaining to me exactly how it is that the Government can say well, we decided you did not pay enough tax, so we have got some more we are going to exact from you as a minimum. Maybe that will enlighten us all.

Again, I do appreciate in this busy tax season—and my accountant barely had time to talk to me yesterday—your taking the time to be here, gentlemen.

With that, let me start, Mr. Walker, with you.

STATEMENTS OF MARLAN WALKER, WALKER ELLSWORTH, P.L.C.; DAVID BOSSE, WALKER ELLSWORTH, P.L.C.; YALE GOLDBERG, FRAZER, RYAN, GOLDBERG & HUNTER, L.L.P.; AND MIKE PIETZSCH, POLESE, PIETZSCH, WILLIAMS AND NOLAN

Mr. WALKER. You want to start with me. OK.

First of all, I would like you to substitute, if you will—given the time constraints that we were operating under in preparing these outlines, I have prepared an amended outline which I would like substituted into the record.

Mr. SHADEGG. Sure.

Mr. WALKER. There are some technical changes which I think are important.

Mr. SHADEGG. Without objection, so ordered.

Mr. WALKER. Thank you.

I would like to just talk a little bit about Mr. Davis' case, who was up here. Mr. Davis—I know Mr. Davis because of the long period of time we worked together in trying to get an offer accepted by the IRS, but I can tell you that there are probably 100 other files that would have been able to give similar testimony to this committee.

When I first looked at this case—keep in mind, he was only involved in this company for 9 months. And when I first looked at the case, I came to the conclusion that he had done everything within his power to force that corporation to pay its withholding taxes, and that he was not a willful responsible person. In other

words, he had not acted willfully under the statute, 6672, and therefore should not be assessed. But we were faced with a very difficult dilemma.

He had already gone through the appellate division of the IRS, I could not open that back up, although I tried. What that left us with was the prospect of paying the tax, at least the tax as to one particular taxpayer for all quarters involved, and then making a claim for refund and taking him to Federal district court and suing. But Mr. Davis was not in a financial posture to do that, he simply could not afford to pursue that route. I did try to open it back up with the IRS; I got nowhere.

To this day, I think that this is an individual who is not a responsible person, because he did not act willfully under the statute, and yet he was assessed with a $250,000 tax liability, which reflected about $3 to $4 of interest and penalties for every dollar of tax owed. I went to bat for him.

When the new offer in compromise guidelines came out, I suggested to him that we do an offer in compromise to see if we could not get this resolved for a minimal amount. And we went through, as he indicated, numerous offers. I got jerked around like I have never been jerked around, even though this was supposed to be an offer program that was to get taxpayers such as him into compliance with the IRS and get the liens and levies lifted from him so that he was no longer burdened by this incredible Kafkaesque sort of procedure that he found himself involved in.

I just want to address two other things relating to him. One has to do with the way he was treated at his home. I had made an appointment with the revenue officer involved. The revenue officer was supposed to meet me at his house at the front door at a scheduled time, and he in fact did come early, parked down the street and snuck into the backyard. I was absolutely furious at this conduct. There was not a lot I could do about it because I still wanted to get the offer settled, and so I bit my tongue and tried to work with them and yet he rejected the offer anyway.

I finally made complaints to Congressmen and Senators, I was furious over this case, and got responses and finally the case got assigned to Kathy Ray, who was just a breath of fresh air to deal with after the original revenue officer, and we did get the case settled for significantly more than I thought he should have paid, but we needed the IRS off of his back.

Now I am running out of time, I suppose you can read my outline. At least, I hope you read the one that I have submitted in place of the one that is published. But I do want to point one other thing out. And that is that as a professional, I have found that the treatment that taxpayers get versus the treatment that is afforded to attorneys is remarkably different. Taxpayers who try to handle their own cases before the IRS are frequently not treated with respect and courtesy, particularly at the Collection Division. When attorneys or accountants get involved, particularly attorneys, the demeanor changes. I have got to say I am not treated generally with disrespect by the IRS, I generally have a pretty good working relationship, with certain exceptions. But I cannot say that that is the case with respect to most of my clients who have tried to deal with the IRS on their own. They simply cannot deal with the bu-

reaucracy and the compliance techniques that are used by these revenue officers to collect taxes.

Now I could go on and on. I have quite a bit to say about penalties and so on in my outline. I want to point out that generally when a client comes to me, I look at a tax liability that has been exacerbated by penalties and interest, which is frequently $4 or $5 to every dollar of tax that was originally owed. The number becomes so incredible that the taxpayer no longer feels any moral obligation to pay it. And I think that really undermines the collection obligation of the IRS. The IRS is trying to collect a debt which the taxpayer does not feel any obligation to pay.

I notice that I am out of time. The remainder of what I would like to say is in the outline, so I would refer you to that. Thank you.

Mr. SHADEGG. Thank you very much. Mr. David Bosse, please.

[The prepared statement of Mr. Walker follows:]

TAX AND TIMES : THE CASE OF IRS REFORM

Written Statement before the House Government Reform and Oversight Committee
Subcommittee on National Economic Growth, Natural Resources and Regulatory Affairs

Prepared by Marlan C. Walker, Esq. and David R. Bosse, Esq.
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The Effects of Excessive Penalties and Interest:

The Internal Revenue Code has currently in excess of one hundred fifty (150) separate civil penalties which may be imposed upon taxpayers for every conceivable mistake, mishap or misunderstanding. In practice, the Internal Revenue Service automatically penalizes virtually every mistake made by taxpayers no matter how innocent. The compounding of penalties and interest often increases the tax liability from 300-500%, thereby making it impossible for the typical taxpayer to pay his debt to the government and stay in the "system". Typically, the IRS assesses the tax, and then adds to the tax liability various penalties, and then assesses interest against the sum of the tax and penalties compounded on a daily basis. Further, the interest which is applied against the sum is imposed at a rate significantly in excess of what the taxpayer will or can receive as a return on his own investments.

Once the tax has been assessed, together with penalties and interest, the matter is referred to the Collection Division of the Internal Revenue Service. Collection procedures at the IRS are often so abusive and confrontational that a taxpayer must frequently resort to one of two strategies to survive: The first strategy is simply to withdraw from the system and go underground. This is not so much a strategy as it is a reaction to a problem which seems to have no solution to the average taxpayer who finds himself in debt to the IRS. The second strategy is

to hire competent counsel, at significant expense, to either represent the taxpayer before the IRS or to declare bankruptcy. There are several chapters of the bankruptcy code which can be invoked in order to protect taxpayers against the Internal Revenue Service, but few of them are palatable to an individual who simply wants to get current with the government and get on with his life. Income taxes can be discharged in bankruptcy provided that they are sufficiently old, but certain types of taxes cannot be discharged by bankruptcy which leaves the taxpayer with few alternatives. In today's modern world the middle and upper middle income class taxpayers are finding it easier to choose one of these two alternatives rather than pay tax assessments which are laden with excessive penalties and interest. This, then exacerbates the collection process. It hurts the federal fisc, makes the delinquent taxpayer unproductive and makes the Collection Division of IRS look ineffective in Congressional oversight committees.

In our experience, the combination of penalties together with the compound interest on both taxes and penalties, causes the tax debt to rapidly lose credibility to the average taxpayer. Once the tax debt becomes an unrealistic number, the taxpayer no longer feels a moral obligation to pay. We have had numerous cases in our office where the tax debt owned by the taxpayer is so large in relation to the original tax owed that the taxpayer simply cannot pay the debt under any scenario even if he were willing to do so. In many cases, the tax reflects $4.00 of penalties and interest for every $1.00 of tax liability. We are obviously aware of the many arguments that are made that interest merely makes the government whole on a present value basis. However, the interest that is imposed by the Internal Revenue Code is significantly higher than what most taxpayers receive as a return on investment, assuming that they have any return at all, and in most cases is higher than market rates. Further, regardless of economic justifications, the compounding

of interest and penalties, in our experience, undermines the collection process with the net result the government collects very little if anything in cases where there are large amounts of interest and penalties owed.

The collection process is further undermined by the lack practical business sense reflected by IRS personnel in working these cases. Generally, IRS personnel pursue an "all or nothing" collection philosophy. Although there is a procedure for Offers in Compromise, these procedures are generally not effective unless the taxpayer is completely bankrupt and can obtain a source of money to make the offer from a third party such as a relative. Further, as a result of recent changes in policy, we have found that the offer in compromise process is being lost as an effective procedure to pursue on behalf of most of our clients. The reason for this is that the IRS has recently established national standards for allowable expenses which are just absurd. For example, in Maricopa County, Arizona the national standard only permits a taxpayer a housing expense allowance of $1,085.00 which must cover not only mortgage or rent but in addition includes all utility payments. These national standards are used in calculating offers in compromise and installment agreements, thereby causing the amount which must be paid pursuant to these agreements to be artificially inflated.

Our experience also leads us to believe that the philosophy of the IRS regarding collections is flawed in other respects. The government apparently feels that a failure to collect the full amount of taxes owed, together with penalties and interest, sets a dangerous precedent for other taxpayers. Our experience leads us to believe otherwise. We have found that most taxpayers want to stay current with the government on their taxes. There are many reasons why

taxpayers have problems. We have encountered few clients who initially set out to cheat the government in any respect. We simply do not believe that the IRS philosophy regarding tax collection is supportable. Our experience with private business leads us to believe that businesses who use a business approach to collections, collect a far higher percentage of the debts owed to them and collect these accounts faster and with less administrative cost than the IRS Collection Division. Few of those companies, if any, adopt a strict "all or nothing" standard in the belief that this will encourage nondelinquent debtors to pay their bills. This flawed reasoning in philosophy by the IRS when coupled with the over-inflation of the original tax debt due to penalties and compound interest, increases noncompliance by taxpayers who are delinquent on their taxes.

Dealing with Overburdensome Regulations (Marlan Walker):

I began studying tax law in approximately 1975. Since that time the code and the regulations have doubled in size. Most of the increase has been regulatory. Many of those regulations are legislative, meaning that Congress has abdicated its responsibility to the IRS. I have attempted over the years to stay current in as many areas of taxation as possible. However, I am finding it increasing difficult to stay even topically aware of the many changes which are being made by the Internal Revenue Service through its countless regulatory projects. For example, I am one of the handful of tax attorneys in the Phoenix area who has a working knowledge of the regulations dealing with partnership allocations, Section 704(b) of the Code. I have spent hundreds, maybe thousands of hours dealing with these regulations and yet, I still find them difficult if not, in many cases, impossible to understand.

Although I could list the many regulatory projects of which I am aware I do not believe that this would be particularly helpful to this statement. I can assure you that there is more material than any one person or even a small army of people could review and understand in a lifetime. If I, as a tax lawyer who works in the tax area daily, cannot keep up with the extraordinary number of regulatory projects produced by the IRS on an annual basis, how can Congress expect the average taxpayer to understand the law?

I am finding that I practice tax law with a great deal of trepidation. I am constantly concerned that I am missing some arcane regulation which has direct bearing on the client's business activities. For example, I used to have the debt allocation rules of Section 752 memorized. The new regulations under Section 752 now require an understanding of the Section 704(b) and (c) Regulations. Those regulations are now over 100 pages long and very difficult to understand. More importantly, I am finding that my client's are unwilling to pay for the enormous amount of time that it takes to educate myself in this area. Obviously, if I am not paid I have little motivation to continue to stay current in this field of law. I am also aware that many of my colleagues feel as I do. If the tax system in this country is so complicated and arcane that tax professionals no longer want to continue in the profession, it is not difficult to predicate what will likely happen to the system.

This brings us full circle back to the penalty issue discussed above. We previously stated that taxpayers are penalized for virtually every mistake and every omission or misstep made with respect to the tax law. Yet the tax law is so complicated and so voluminous that it is virtually impossible for any person, including tax professionals, to have a working knowledge of more than

a few select areas of the tax code and regulations. We therefore submit that the system is inherently unfair. It is simply unfair to produce a tax structure which cannot be understood or applied by even sophisticated taxpayers and professionals let alone average taxpayers in calculating their tax liability and then penalize them for that failure.

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Mr. BOSSE. Yes, I am going to continue a little bit on Marlan's theme.

We do a lot of work in dealing with the Collection Division of the IRS, which seems to be the division that raises the most acrimony. And this is a situation usually where the tax has been found to be due and owing and we have assessments of penalties and interest, and as Marlan said, very, very frequently, we are running into $3, $4 and $5 of interest and penalties to every dollar of tax involved. Especially—this is obviously very true with cases involving older tax years. We had periods where interest was running between 18 and 20 percent, and that just compounds very rapidly and triples, quadruples and quintuples the amount that is due and owing.

I was going to talk specifically about a case that kind of exemplifies the situation we find ourselves in with the Collection Division. I was hired to represent a Phoenix business executive who owes—whose tax liability is approximately $47,000. The years are fairly new, the tax liability was $30,000, the interest and penalties are $17,000, now about $18,000 actually.

We filed what is commonly called an offer in compromise to reach some agreement with the IRS as to a number that was livable. We were prepared to go as high as $30,000 on the offer, which was a full pay on the tax. The IRS now applies—has come out within the last I guess it is 6 or 8 months, with national guidelines as to what they allow as living expenses. And this is done to compute what they feel the taxpayer can afford to pay either by way of an installment agreement, or by way of an offer in compromise. They take the taxpayer's gross salary of he and his wife if they both work—in this case it was both husband and wife. And they subtract certain living expense allowances and certain obligations of the taxpayer. They do not allow credit card debt, they allow for rent and/or living expenses, I should say; housing and utility expenses for I think a family of four in Maricopa County of approximately $1,050. And what all ends up happening is that it artificially inflates the taxpayer's ability to pay, both for an offer in compromise and for an installment agreement.

Our offer was turned down, based upon these computations. The taxpayer then is faced with a couple of choices—and remember, in his mind, he is offering a full pay on tax, he just wants a wipe off of interest and penalties. The taxpayer's choice is to basically file a Chapter 13 bankruptcy, which allows us to put the Government on a—the court will impose a 5-year installment pay plan through the bankruptcy court. And instead of the Government getting $30,000 up front, the Government is going to get $783 a month over 60 months. And under the bankruptcy law, it stops the running of interest. So it is a relief provision and it works very well. But from the Government fiscal perspective, it is an absolute disaster when you look at the time value of money. Where they could have had $30,000 in February 1996, they will now get $783 a month over the next 5 years—I know I am running out of time here—which is what is going to happen in this case.

The interesting thing is 10 years ago, 12 years, 15 years ago, I would have had a very, very difficult time convincing an upper middle income or an upper income taxpayer to engage in a Chapter 13 type filing. In today's world, believe you me, it takes about 10

minutes to convince someone, if the situation fits, that this is the way to go.

As a sequel to this case history, the taxpayer on May 18, the taxpayer got a 14-day notice from the IRS Automated Collection Division in Denver, saying please call us in 14 days. And this is routine because the offer has been denied. So the case is now back in Collections for collection. So the taxpayer—we had intended to call the IRS within that 14 day period. On the—the taxpayer two Fridays ago goes to his office and he is informed by his VP–Finance that the IRS has levied his salary and they are taking his salary. This levy was issued on the 24th day of March, 6 days after the 18th, which is the 14-day notice. The taxpayer luckily—we called the Automated Collection Division and explained to them a mistake had been made and for one of my few times in my life, they withdrew the levy. But just to add to the confusion, the taxpayer goes home that evening—30 seconds—the taxpayer goes home that evening and he gets in the mail a letter dated March 23d saying he has 7 days to call the IRS, not withstanding the fact that he has received a 14-day letter.

I think this points up what Marlan was saying. Our clients, our citizens, they cannot deal with this type of paperwork and this type of sort of cross dating without the benefit of counsel. It is impossible.

Thank you.

Mr. SHADEGG. I appreciate that.

Before we go to the next witness, let me just say, David, I think we are doing OK on time, so we can be a little bit more lenient. These guys bring us a great deal of expertise. I want to make sure we give them a chance to get their points across. And I will try to give you an opportunity in my questioning to make sure you have an opportunity to get your points across.

Let me make one other point on that. It is important, both to bring forward anecdotal information, but also to see if we cannot come forward with substantive reforms. And one of the things I want each of you to be thinking about is in the area of regulatory reform within the Tax Code, this massive increase we see in regulations here—I guess this is the actual Tax Code, right? These are the statutes. And then all we see here are the interpretations, the regulations and the interpretive opinions.

I am interested in suggestions you are able to bring to the committee of how we can do regulatory reform. I am also interested very much in how the offer in compromise process works and whether or not the penalty structure is productive, or as Mr. Bosse's testimony has suggested, whether we are really cutting off our nose to spite our face in terms of the Federal fisc, which is of grave concern to me.

With that, Mr. Pietzsch.

Mr. PIETZSCH. Thank you.

I have addressed a slightly different area in my brief and that is because the retirement system in this country, along with the health care system, is perhaps one of the most important domestic issues. And interestingly enough, it is very much focused on tax issues because of the fact that contributions to employer-sponsored

or employee-funded retirement arrangements are tax deductible, if made in a proper fashion.

You will recall that 20 years ago, Congress passed an act called the Employee Retirement Income Security Act.

Mr. SHADEGG. ERISA.

Mr. PIETZSCH. That was supposed to emphasize retirement income security. Interestingly enough, because of deficit-driven tax legislation in the 1980's and 1990's, the focus seems to have flipped. Instead of retirement income security, more and more statutes and especially regulations have focused on attempts to restrict funding of retirement arrangements, rather than promote the funding of retirement arrangement.

My interpretation and my belief is that, as a result of this overly complex, this excessive, this over-reaching regulatory environment, that retirement income security has actually been significantly diminished, not enhanced. There are in fact fewer retirement plans today, there has been a decline, a steady drop-off of retirement plans since—especially since the 1986 Tax Act and the subsequent regulations which were issued. And I think you can find a direct correlation between the drop-off in the number of retirement arrangements in this country and the excessive regulations that are issued with respect to retirement plans.

There seems to have been a growing tendency in the last decade and a half to micro-manage this area. And, by the way, my comments do not reflect solely on the retirement area. I think they are reflective of the tax system as a whole, or the entire regulatory structure. But again, the pension area happens to be an enormous portion of it. Many of the volumes you have on the table in front of you, you would find that a good deal of the verbiage deals with the retirement plan and other benefits areas.

This tendency to want to micro-manage has meant that there seems to be a regulatory policy to seek out and to absolutely preclude any abuse whatsoever, whether it is real or imagined abuse. In my experience of over 20 years of working in the retirement plan area, it is my impression that most employers are reasonable, most employers are making a real, bona fide effort to help their employees build retirement savings, but regulators seem to believe that every possible area of potential abuse has to be wiped out and that means regulations have to cover every conceivable issue that one could ever imagine.

Now, when you draft regulations in such a way as to attempt to preclude any possible abuse, what you do is create a hugely technical system that becomes—it is so complex, it is so technical, it is impossible even for most experts to interpret. You will find differences of opinion every day among Treasury and IRS officials as to the interpretation of very basic provisions of the retirement plan tax law. The incomprehensibility of the regulations is such that this produces tremendous cost for taxpayers, it produces confusion and inevitably it is going to result in noncompliance, because if the rules are overly technical and not even the experts can understand them, you are going to have lots of inadvertent, technical noncompliance.

The costs to this country are enormous. With approximately 900,000 retirement plans, there are literally millions and millions

of dollars in costs just required to attempt to comply with regulations. It has been estimated that over $100 billion in costs have been attributable solely to the need to update and in other manners, seek to comply with retirement plan rules just in the last 20 years. Imagine if that $100 billion-plus had been spent in actual retirement savings, had been devoted to enhancing worker security rather than spent in purely technical compliance.

I can give you a couple of specific examples. When the 1986 Tax Act was passed, IRS—the 1986 act was to become effective in 1989 for the most part with respect to pension plans and many, many other areas of tax law. The IRS issued regulations in tentative draft form in 1988 and 1989, they were supposed to have been effective in 1989, but they were not, because of the inability of Treasury to generate comprehensive regulations that in fact made sense.

Regulations were issued, withdrawn, reissued, withdrawn, in some cases as many as three or four times. It took a decade to finally release final regulations and in fact because of that fact, taxpayers were ultimately given extended time in which to amend their plans to comply with the 1986 act. But this creates confusion for everyone and certainly creates a climate in which there is, again, an enhanced opportunity for technical errors.

What happens if you make technical errors in this area and many, many other tax areas? You can become subject to penalties which can be very, very significant. In the pension area, for example, you can be subject to penalties amounting to as much as 10 or 15 percent of total plan assets in some cases. You can have a situation where a plan becomes disqualified and that means that all of the retirement assets that been accumulated become immediately subject to tax and penalties. One practitioner described that as something akin to dropping the atom bomb on a taxpayer, because we have such a horrific result.

Yes, the IRS—and I do applaud them for having implemented some programs in recent years to attempt to deal with some of these problem situations, but, as other testimony has indicated, those programs are not perfect. And in fact, you should not have to resort to going to those programs in the first place if the rules were more reasoning, more straight-forward, had more common sense built into them in the first place.

One of but thousands of examples I am sure is a case I read recently involving a pension plan that happened to have surplus pension assets. And because of some technical snafus in connection with the termination of the plan, the IRS ended up imposing penalties because the plan failed to put additional money into the plan. They also imposed penalties because the plan then had too much in the way of assets. So the taxpayer was subject to a double whammy. And that may seem absurd, that may seem bizarre, but these kinds of results occur.

The actuarial audit program that began in approximately 1989 involved over 20,000 pension plans nationwide, many of them here in Arizona. It tied up tremendous IRS resources, it tied up tremendous taxpayer resources. The IRS in effect created new rules after the fact and attempted to impose them retroactively and in doing so, used those new rules as a basis for audits and proposed disallowance of plans. Taxpayers had to fight literally for years, from

approximately 1989 until just this past year when taxpayers finally won this battle in the courts. But frankly, that was a program that did not need to occur in the first place. Again, an example of regulatory legislation, if you will, going beyond, in my opinion, the scope of what Congress ever intended.

Again, there are many, many good individuals, well-meaning individuals in the IRS, but I think there is a system in place that seems to allow, if not encourage, the issuance of regulations that are expensive to live with, overly complex, over-reaching and simply unnecessary.

Thank you.

Mr. SHADEGG. Thank you very much for your very informative testimony.

Mr. Goldberg.

Mr. GOLDBERG. Good morning, Congressman.

My name is Yale Goldberg. I am with a Phoenix law firm named Frazer, Ryan, Goldberg & Hunter, L.L.P. Prior to moving to Phoenix in 1977, I worked for the Tax Division of the Department of Justice. I am appearing today on my own behalf.

I applaud your and the committee's conscientiousness in setting up hearings like this and seeking the citizen input and other tax professional input in an effort to improve our tax administration system. I do not need to tell you that these are challenging times in more ways than one for the people in charge of our tax administration system. And I appreciate the opportunity to address your committee.

I have been asked to provide a few comments in the excessive penalty and over-burdensome regulation portion of your program. My message is simple and brief.

As you probably know, during 1987, at the urging of the then-Commissioner of Internal Revenue, who was Lawrence Gibbs, the Internal Revenue Service started a task force to study the issue of civil penalties. Up until that time, the perception even shared within the IRS was that the old system was too complex, too harsh and often resulted in multiple or stacked penalties emanating from the same transaction. As an example, in the case of a tax shelter, a typical tax shelter, it would not be uncommon for the IRS to assert an over-valuation penalty, a substantial under-statement penalty, a tax motivated interest penalty and a negligence penalty all on the same transaction.

The result of the IRS study and its recommendation to Congress was IMPACT. That stood for Improved Penalty and Compliance Tax Act. And IMPACT clearly did improve the situation in this area, but I feel that it failed to address two important points. One of these points is the automatic assertion of a failure to pay penalty even when a legally binding installment agreement is entered into between a taxpayer and the IRS. And I use this example. The example could pertain to a constituent of yours or a client of mine. We will take a married couple who for all years have conscientiously paid and filed their tax returns on time, fully paid them. But for 1 year, they had a tax liability of $30,000. Let us say they are both self-employed and because of family emergencies could not pay their taxes. Let us say it is the 1993 tax year. In a perfect

world, all the taxes would be paid but we know we are not there yet.

Typically, when the IRS confronts an unpaid tax liability like this, they want to get a detailed financial statement, given under penalties of perjury, showing all that the taxpayer can pay. And in the financial statement, as you heard earlier, there is living expenses that are allowable, though unfortunately brand new national guidelines have been set forth, and from my perspective they are not as realistic as they might be. So that is something that needs to be addressed. But importantly, as a result of the financial statement, the Internal Revenue Service and the taxpayer agree on an installment agreement. And the installment agreement reflects all that the taxpayer can pay. Ironically, Congressman, now there is a $42 fee for entering into an installment agreement, a so-called user's fee.

All of this sounds fairly efficient, and it is, but here is the kicker. Once the installment agreement starts and the underlying premise is that the taxpayer is paying all that they can per agreement with the IRS, there is a failure to pay penalty that kicks in. So the taxpayer is paying a pro rata portion of tax, interest on the tax that they owe and a failure to pay penalty. And the failure to pay penalty—it too is more complex than it might be. It is either .5 percent a month before a final notice has been issued or 1 percent a month. So that means for a 25-month period, the taxpayer is going to be paying basically 12 percent a year. That penalty stops when it gets up to 25 percent. So during this time, when the taxpayer enters into a binding installment, they are hit with this penalty. And I might add, there is an interesting interface between what Congress can do and the IRS, because this failure to pay penalty is in the Internal Revenue Code and it is a matter of how the IRS interprets it. So it is kind of a joint issue that should be addressed.

The other penalty issue that strikes me is the situation typical of the Koberstein situation. And that is, either in a tax shelter context or another context. And I will use the term, kind of a good faith dispute on underlying tax liability between the IRS and the taxpayer. And in my experience, sometimes penalties are just automatically asserted and sometimes they are only abated if the taxpayer agrees to the tax and it seems like that is an unfair bargaining chip for the Internal Revenue Service to use.

In closing, we do have a voluntary compliance/self-assessment system. And from my perspective, with a system like that, it behooves us to just want fairness and the appearance of fairness, and at times I think the IRS is conscientiously trying to do that. Maybe a last parting thought is it seems like the old school and the new school. And I think that the IRS is trying, with the mandates it is getting from Congress and from the GAO, to take a different approach; maybe some of the people who have been there longer, it is maybe more difficult for them to implement those new guidelines.

Thank you.

[The prepared statement of Mr. Goldberg follows:]

Yale Goldberg

TAXING TIMES: THE CASE FOR IRS REFORMS

EXCESSIVE PENALTIES AND OVERBURDENSOME REGULATIONS

In November 1987, the IRS Commissioner created a task force to determine how civil tax laws were being administered by the IRS. The task force determined, among other things, that there were numerous inconsistencies in how civil penalties were being assessed between regions, service centers and district offices. These inconsistencies were attributed to numerous factors including training and experience of the revenue agents and officers, and differences of IRS personnel attitudes towards non-compliant behavior, including an individual's personal experience with a similar situation, or an individual's belief about the purpose of the asserted penalties.

In response to the task force's conclusions, the IRS in February 1989 issued a report aimed to consolidate it's policy on penalty assessments in hopes of ensuring that all taxpayers would be uniformly treated by the penalty assessment process, and ensuring consistent administration of penalties in all functions of the IRS, all in search of encouraging voluntary compliance by taxpayers.

While the civil penalty assessment process has improved somewhat during the past years, I am of the opinion that two important areas relating to this process were overlooked by the task force. One of these areas concerns the assessment of penalties in situations where taxpayers enter into installment agreements with the IRS to begin satisfying their outstanding tax liabilities. The second area concerns the assessment of penalties in situations involving tax shelter assessment cases. In both instances, it has been my experience that the penalties are unduly and unfairly harsh and financially burdensome to taxpayers -- taxpayers who cannot afford to pay the tax portion of

their outstanding tax liabilities, let alone the huge penalties and accruing interest that are added to the tax portion assessment.

INSTALLMENT AGREEMENTS

One of the goals in allowing taxpayers to enter into installment agreements is to allow the IRS to collect the tax liabilities in full or to collect the maximum amount reasonable as quickly as possible. The amount to be paid under an installment agreement is measured by an analysis of a taxpayer's financial statements, taking into consideration the new reasonable allowable expenses as adopted by the IRS in September, 1995.

The concern that I have with respect to the penalty assessment process when combined with the installment agreement process is that penalties (failure to pay in particular) continue to accrue during the term of the installment agreement. Although interest is governed by law and is not abatable unless the tax portion of the tax liability is abated, penalties continue to accrue at the rates governed by law. In many instances, taxpayers enter into minimal amount payment installment agreements due to their inability to pay. As such, the amounts paid under the installment agreement in a majority of the instances do not equal the sum of the interest and penalty that continues to accrue on the overall tax liability. Although a taxpayer continues to make monthly payments under an installment agreement (in an amount that the taxpayer and the IRS acknowledge is the maximum he can pay), he may never be able to satisfy his outstanding tax liability because of the substantial penalty accruals.

I feel the task force could have looked into -- and made a recommendation on -- the stoppage or cessation of penalty accruals during the time that a taxpayer is paying under an installment agreement. This would allow the taxpayer to at least have the potential of satisfying

his or her outstanding liability at some time in the future. With the continued penalty accruals and interest accruals, the taxpayer paying under an installment agreement may never see the light at the end of the tunnel. This in turn could lead to frustration with the tax system and force taxpayers to become less compliant. I would suggest that the IRS or Congress consider suspending penalty accruals against taxpayers that are paying under an installment agreement in hopes of allowing taxpayers to satisfy their outstanding tax liabilities in full without having to pay forever under the installment agreement.

TAX SHELTER PENALTY ASSESSMENTS

I have represented numerous taxpayers who had invested in tax shelters in the late 1970's and early 1980's. As we now know, the IRS ultimately disallowed the vast majority of the tax shelter deductions taken by taxpayers who invested in these tax shelters, thereby resulting in large assessments of taxes, interest and penalties. In many instances, in view of TEFRA partnership provisions, the tax assessments related to tax years going back more than 10 years. When an assessment is finally made (sometimes more than 10 years after the tax year in question), the assessment will include the taxes, penalties and interest. In almost all cases that I have been involved with, the penalties and interest accruals were many times the amount of the tax portion of the assessment.

In one case, the taxpayer I represented had invested in a tax shelter during the early 1980's. He took a deduction on his 1982 return and paid the applicable taxes due on his timely filed return for that year. After an audit and disallowance of tax deductions -- more than 8 years later -- the IRS made an additional tax assessment of $15,500.00. In doing so, the IRS also assessed approximately $16,000.00 in penalties and $26,000.00 in interest accruals. For this same

taxpayer for tax year 1983, the IRS assessed an additional tax assessment of $14,200.00, together with an interest assessment of $20,400.00 and penalties totaling approximately $10,000.00. When the taxpayer retained me, he had already paid the assessments amount in full. We filed a claim for refund to request the refund of the penalties based on the applicable reasonable cause standard, but the request was denied. Without the necessary funds to proceed to litigation to pursue the refund of the penalties paid, the taxpayer was forced to drop the issue.

In another instance, a couple I represented also had tax shelter deductions disallowed by the IRS. A negligence penalty of $10,000.00 was assessed against them without affording them the opportunity to explain the basis for investing in the tax shelter or the basis of the deductions taken on their returns. After retaining me to request the abatement of penalties, we successfully convinced the IRS that the taxpayers were not negligent with their tax returns for the years at issue, and that they acted reasonably in investing in the tax shelters in question and taking the applicable deductions on their tax returns. Accordingly, the IRS agreed to abate the penalties and refund the penalties paid, along with the applicable accrued interest previously paid by the taxpayers.

As seen from the two foregoing cases, the IRS seemingly routinely imposed penalties against the referenced taxpayers. These taxpayers -- who were either inexperienced in these matters or did not have the ability to retain proper representation before the IRS -- proceeded to pay the penalties asserted, even though they probably had reasonable cause to have the penalties abated. We were successful in one case and unsuccessful -- primarily because of lack of funds to pursue the matter in court -- on the other case.

I feel that the task force could have taken the tax shelter penalty assessment scenario into consideration in 1987 when it was asked to review the civil tax penalty system. The automatic assessment of penalties against taxpayers involved in tax shelter audits only adds frustration -- both mental and financial -- to the taxpayers involved. My experience has been that the vast majority of these taxpayers acted reasonably when they invested in the shelters back in the early 1980s. To punish them with automatic penalty assessments many years later creates an extreme financial hardship to these taxpayers. Again, this hardship and frustration with the civil tax system could and probably does force many taxpayers to go "underground" as a result of not being able to pay their enormous tax bills. This type of automatic penalty assessment defeats the purpose of the having taxpayers become voluntarily tax compliant. Since one of the goals of the IRS is to collect from taxpayers the maximum outstanding possible, it appears to me that the abatement of these types of penalties would probably encourage taxpayers to pay their liabilities sooner, especially since they would have the comfort of knowing that they would eventually pay off their tax liabilities in full sooner without having to worry about the huge penalties being paid.

Mr. SHADEGG. Gentlemen, thank you very much.

Let me preface my remarks by saying our goal here is not just to look at whether or not the IRS is legislating through its regulations but whether or not the Congress is itself culpable.

I did meet before we began this process with several representatives of the IRS and chatted with them in my office. They were quite concerned about how this was going to go—actually in their offices. I met here in Phoenix with Mr. Mark Cox, who is the Southwest District Director, and Mr. Joseph Rumicombe—I cannot pronounce his name—he is the Assistant Southwest Director. Are those gentlemen here?

[No response.]

Mr. SHADEGG. At one point we thought they were going to be here.

I also met in my Washington office with Mr. Fred Murray, Special Counsel for Legislation and Mr. Dwayne Vincent, Legislative Affairs Division of the IRS. I tried to make it clear to them that my goal here was to produce substantive suggestions for improving the regulatory morass which surrounds our Tax Code. And as far as I was concerned, if they wanted a Congress bash, that was fine with me, I did not really intend an IRS bash, but our goal here is to find out areas where—forgetting who is responsible—we can make improvements. And if in the definitions the Congress has given to the IRS, there is ambiguity, that is something I can take back to this committee and we can deal with. If in fact there are evidences or instances where the regulations go beyond what it is that Congress appears to have written, that is an area that we can look at IRS' conduct and try to improve it.

But this is by no means intended to be a solely point-at-the-IRS exercise. This is an exercise which I would like to believe will lead to substantive reform.

With regard to that, let me go back first to Mr. Walker. You mentioned in your testimony the concept of responsible party. That goes to I believe the questioning I asked, which was whether or not, given the fact that your client joined this company after some of the tax liability had been accrued, he was nonetheless held responsible for that. I take it that is in fact the way the Code is written, and perhaps for good reason.

Mr. WALKER. Well, yes, if you—generally speaking, if you are an officer of the corporation and you have check-signing authority and payroll taxes are not paid, then you are within the definition of a responsible officer under section 6672. You have to willfully—there is a willful element to that as well.

I guess, you know, I understand the purpose for that statute and I think it has a salutary purpose. I think it is one that is beneficial generally. But I think in its application it ropes in people who are innocent and essentially ruins their lives. I have had I cannot tell you how many clients come in who were completely unaware of the tax liability of the corporation and who were roped in, in effect, as a responsible person and had an incredible tax lien placed on him and his property, in circumstances that were unfair.

I think that in that narrow area, that a great deal of—I think that Congress could solve the problem to a great extent by allowing responsible officers to petition the Tax Court and giving the Tax

Court jurisdiction over those issues. Right now, the Tax Court does not have jurisdiction over responsible officer penalties.

Mr. SHADEGG. So if someone wanted to establish they were not a responsible party——

Mr. WALKER. Right, they would be able to go to the Tax Court and have that established prior to paying the tax. As it now stands, the tax has to be paid and a claim for refund has to be made before you can obtain the jurisdiction in the U.S. Federal District Court.

Mr. SHADEGG. And I presume you have clients who cannot pay the tax.

Mr. WALKER. Simply cannot pay it. Although you do not have to pay the whole tax, in all fairness. All you have to pay is the tax for one employee for all quarters. It is a fairly technical area and there is a question of whether or not collection can take place during the period that you are pursuing a refund.

I would like to make one other point, totally off the subject.

Mr. SHADEGG. Sure.

Mr. WALKER. I would like to clarify the record in one respect, for the benefit of Mr. Bosse. He is listed as an associate of mine and that is not the case and I just want to make that clear for the record, that he is my partner.

Mr. SHADEGG. OK.

Well, I appreciate that, we want to respect those formalities, they have consequences.

Let me ask you a little bit about—you in your testimony indicated that oftentimes the interest and penalties run three to four times the actual tax due. We would all agree that somebody who fails to pay a tax obligation ought to have to pay interest on that. So let us talk about interest first. Does the IRS collect simple interest, does it collect compound interest, is it extraordinary or is it done in the same fashion as a normal business?

Mr. WALKER. It is compounded daily at what I consider to be a fairly high rate. Well, let me give you an example. The rate is higher than what I pay on my mortgage and that is without all the costs, the expenses that the mortgage company incurs in making that loan. I think it is high in the sense that it is more than what the average taxpayer can obtain as a return on his own investment. Now that is Congress' responsibility and that interest rate has been tinkered with from time to time over the last 15 years.

Mr. SHADEGG. Perhaps by Members of Congress who would like to increase the fisc so they can spend it on their pet projects?

Mr. WALKER. I do not know, to be honest with you. But I think that it is high and I think the way it compounds, it really stacks against the taxpayer to a point where, you know, he finally looks at the total debt—let us not call it the tax liability, let us call it the total debt—and just says this is impossible, I cannot deal with this, this is an incredible number, and because it is an incredible number, I feel no moral obligation to pay.

Mr. SHADEGG. I guess on the point on interest rates, I know in my own case, I have had experience where my accountant advised me I am better to go off and borrow that money at even an outrageous rate, you know, credit card rates or something close to it, which I would not otherwise borrow money for, at rates I would not

want to impose upon myself to buy a car, to avoid what would even be higher rates if I am not able to pay a tax obligation.

You talk about the issue of people opting out. Is that something you are seeing in greater numbers, people simply saying I cannot pay the tax, so——

Mr. WALKER. People bail out of the system, we get a lot of that. We see people—we encourage them to get back into the system, we try to use legal means to do that. But let us face it, if you are faced with a nondischargeable 100 percent penalty—let us take Mr. Davis' case for example. If we were not able to get an offer in compromise accepted, what would he be able to do? Nothing. He would have a quarter of a million dollar lien assessed against him and a revenue officer hounding him day and night. And that tax liability cannot be discharged in bankruptcy and it continues for 10 years.

Mr. SHADEGG. It sounds like Mr. Davis was at least hounded for a part of that time.

Mr. WALKER. For a good portion of that 10 years, yes.

Mr. SHADEGG. I want to go after the issue of penalties and discuss it with both you and Mr. Goldberg. What is the rationale behind the penalty and particularly what is its rationale for what would otherwise be either a negligent or unintentional failure to pay, or a negligent claiming of a deduction that was later disallowed, and are penalties also imposed upon someone who simply does not have the resources to pay a tax when it is due?

Mr. WALKER. The answer to the last question is yes. My experience is, and I think Mr. Goldberg will bear this out, is that penalties are assessed as a matter of course. If a tax is owed, a penalty is assessed. Now that is not to say we cannot get them abated occasionally. But they are assessed as a matter of course. I, myself have made mistakes on my tax returns and had Ogden contact me with a letter saying you owe additional taxes because you have forgotten whatever, and they automatically impose a penalty.

Mr. SHADEGG. And the penalty is in addition to the interest.

Mr. WALKER. That is correct.

Mr. SHADEGG. So they are at market or above market interest rates and then the penalties are imposed in addition.

Mr. WALKER. That is correct, and then there is interest on the penalty. So I mean, when you start looking at the growth of the tax debt, let us call it the debt to the government, it is just phenomenal.

Mr. SHADEGG. Let me just again try to clarify here, because I do not know the answer to this question—is it Congress telling the IRS to impose those penalties virtually automatically or is this a discretionary issue with the IRS? Who——

Mr. WALKER. This is Congress' primary responsibility.

Mr. SHADEGG. OK.

Mr. WALKER. Secondarily, it is the IRS in the interpretation of the law and what constitutes reasonable cause for having the penalty abated. And I will tell you honestly, it depends on who you call at the Ogden Service Center, what he has had for breakfast, whether or not he is going to abate that tax, because there is a lot of inconsistency in whether or not the penalty will be abated.

Let me just read one thing for you, Congressman, if I might. This is basically a paraphrase of the IRS handbook. It says "The IRS

stated policy is that a penalty is to be imposed only to enhance voluntary compliance. Even though a penalty may also accomplish other results; e.g., revenue raising, punishing the taxpayer and reimbursing the IRS for cost of enforcement, the decision to assert a penalty should be made solely on the basis of whether it does the best possible job of encouraging compliant behavior." According to the IRS, compliance is achieved when the taxpayer makes a diligent and continuing effort to meet the requirements of the law.

Now that paraphrases the IRS handbook. That is not what happens in practice, I can tell you. But frankly, this needs to be laid first at the feet of the Congress. I think Congress needs to address this issue and decide how it is going to penalize taxpayers for failures. Many failures are just honest mistakes, there is nothing intentional about them and I really question whether those honest mistakes are the kinds of behavior that Congress should attempt to penalize.

Mr. SHADEGG. Just to also clarify, both for an honest mistake, you pay interest and penalties and interest on the penalty, and for a simple inability to pay—I just do not have it, my grandmother got sick——

Mr. WALKER. Simple inability to pay, absolutely.

Mr. SHADEGG [continuing]. My grandmother got sick, I had to pay for her medical care bill, I could not pay my taxes. You get a penalty and interest and ultimately interest on the penalty.

Mr. WALKER. Section 6652(b) imposes a failure to pay penalty of 0.5 percent on the failure to pay the taxes unless the failure to pay is due to reasonable cause.

Mr. SHADEGG. Perhaps that has something to say for why the Nation would like at least a simpler Tax Code than one that seems more fair.

Let me though go to Mr. Pietzsch because I am interested in a point—Mr. Walker makes the point that sometimes it depends upon who you get at the Ogden Center whether you are going to owe the tax; yet, I heard in your testimony a point that kind of affects me. And I thought your testimony did a great job of exposing the problem with, as your term, micro-management, an entire regulatory structure where we regulate every conceivable human aspect of conduct, and we have written these regs to cover every single possible variation. This is a double-edged sword. On the one hand, we are a Nation of laws, we are a Nation where theoretically we write a set of laws and the laws are applied equally to everyone, not based on your position in the society or on your influence or any of those factors, but on the pure application of the law.

On the other hand, many of us have been arguing for regulatory reform, for change in the sense that we have created such a massive system in trying to write a law to cover every circumstance that we have decided that the Federal Government and the Congress and the bureaucrats, the army of bureaucrats and employees can better run every business. And indeed, I think in many instances you can argue the Tax Code, for example, dictates many business decisions which would be made differently but for the Tax Code.

I think your testimony suggested that ERISA and retirement plans are now governed more by a myriad of technical regulations

than by common sense, how can we take care of the retirement needs of employees of the company. How do we balance that?

Mr. PIETZSCH. You are absolutely right. The current Tax Code, as you have suggested, certainly was intended to influence policy, it was intended to influence taxpayer behavior. In many respects there is a carrot and stick philosophy in the Code and to a certain extent that is not unreasonable if you believe that the Tax Code should be an instrument of policymaking. I think unfortunately we have taken that position and carried it to its absolute worst possible extreme. And interestingly enough, the carrots have gotten smaller and smaller.

Mr. SHADEGG. And the sticks bigger and bigger?

Mr. PIETZSCH. Right, the stick is bigger and bigger. That seems to have been the trend over the last few decades.

The fact is that rules cannot be designed to govern every single nuance of one person's behavior. We cannot have completely sharp edges to every issue. You cannot have bright lines—by the way the term bright line was in vogue about the time of the 1986 act, I remember the regulators at the time discussing how they were going to create bright line tests to govern behavior throughout the pension system and many, many other tax areas. Theoretically you could have an objective formula, even if it took hundreds or thousands of pages, to make everything, quote, perfect. That just is not realistic. Common sense dictates that you cannot create one rule that is going to fit everyone and govern every circumstance. Nor are you going to find taxpayers who are in a position realistically to adhere to that one rigid micro-managed rule.

The other irony is that in its effort to micro-manage and create these bright line tests, sometimes you find Treasury going in a circle. There was a concept known as comparability back in the early 1980's that had to do with pension design that allowed different types of plans to exist as long as they were comparable. There was a lot of subjectivity to that test, but it worked—it worked. Treasury convinced Congress to change the rules in 1986, and you will find in the Congressional Record a lot of statements to the effect that the old rule was abusive. Interestingly enough, Treasury spent 10 years writing regulations under the 1986 act supposedly completely overturning the old rule. What you have ended up with looks just like the old rule. But now it is Treasury's product and presumably that makes it acceptable. You find many, many instances of this.

I think common sense should be the guiding principle. First of all, yes, I do believe the Tax Code should be simplified, it can be greatly simplified. And simplification does not have to mean unfairness. Simplification should mean, can mean greater fairness if it is done properly.

Second, Treasury I believe should be constrained to operate within the clear bounds, the clear guidance given by Congress. Treasury should not assume what Congress intended.

Third, I am concerned that Congress is often—and yes, Congress has some culpability in having passed so many laws and so frequent changes to those laws, but I often think that Congress is misled by some of the experts at Treasury. There has been a refreshing change in the past year or two in Congress because staff seems to now have a different, more positive attitude. But looking

back over much of the past few decades, I know of many, many instances where Congress acts on what would seem to be straightforward, relatively simple principles but instead there is a much broader agenda that lies behind all of that.

A good example is December 1994, the GATT bill, which would seem to have nothing to do with taxes, except there was a provision in the General Agreement on Tariffs and Trades legislation on pension plans, it was a revenue raiser. And that particular provision seemed innocuous on the surface. In reality though, once Treasury issued its regulations, many of the regulations or interpretations had nothing to do with the statute, you cannot find any supporting statutory change for these interpretations. They have the effect of actually taking away, literally confiscating a portion of the pension benefits earned by certain high earning taxpayers who were nearing retirement age, under certain circumstances.

I am aware of one company here in Phoenix where there was a down-sizing last year and a number of individuals had their pensions sharply reduced because of the operation of this GATT rule. Not because necessarily of the provision Congress adopted, but because of its interpretation by Treasury. And we are fighting that at the moment. As a matter of fact, Senator Kyl included a provision to correct that in the current—in the Balanced Budget Act.

The Balanced Budget Act, by the way, contains a number of important reforms and I would hope personally that those reforms are passed.

But the point is, yes, there are too many laws, they are changed too frequently, but the regulators also tend to leave common sense behind all too often in interpreting what laws there are.

Mr. SHADEGG. Great grist for lots of comment it seems to me. First of all, with regard to the Balanced Budget Act, I had intended to make a point in my opening remarks, I omitted it, thought I would put it in at some other point. Not many people in America probably are aware that the Balance Budget Act passed by the Congress and vetoed by the President contained a number of provisions along the line of a Taxpayers' Bill of Rights, a number of provisions that would have gone at some of these abuses, not comprehensively but would have made some significant steps in that direction. Regrettably with the veto of the Balanced Budget Act, so went those reforms.

There are two other so-called Taxpayer Bills of Rights that are before the Congress, but at the moment, given the climate, it appears like the prospects of getting those reforms in this Congress are not good, certainly getting a Balanced Budget Act which includes these specific provisions appears to be impossible at this time.

Your written testimony contains some interesting points I want to focus on. You refer to a torrent of regulations. Let me ask you, one of the common proposals is that Congress should review every regulation issued by an agency or every regulation which affects a certain number of people. Is that at least—is that practical? Or if that is not practical, is the task of Congress to write simply clearer laws when it legislates?

Mr. PIETZSCH. Well, I think certainly a good first step is to write clearer laws. Many of the—and again, this is my personal opinion,

but it is certainly shared by many, many practitioners—my opinion is that the laws themselves are needlessly complex, but having said that, the regulations do take liberties with those laws and go far beyond even the statutes themselves, sometimes creating literally hundreds of pages of text out of a single sentence or a single paragraph in the statute.

Mr. SHADEGG. So a single sentence here creates hundreds of pages here.

Mr. PIETZSCH. Yes, that is quite conceivable. And I would think that greater oversight on the part of Congress over regulation projects does make sense, perhaps regulations projects should be authorized in advance by Congress and that their scope be limited. Again, a lot of this though has to do with the underlying philosophy of wanting to—I believe you should encourage straight-forwardness, common sense and reasonableness as opposed to much more academic, theoretical posture. It would also help, frankly, if the regulations writers had more direct experience in real life and better understood what taxpayers had to cope with. Regulations projects do not very often invite hearings like this. I think a hearing like this is excellent, but you do not find very often the Treasury, before it issues regulations, holding open hearings like this to truly engage taxpayers.

Mr. SHADEGG. One of the concepts that is at the heart of regulatory reform, and for which the chairman of this subcommittee has been valiantly fighting, is the concept that regulations should undergo a cost-benefit analysis. Now I would have thought in not only the tax arena but in every other arena in which the Government enters in a regulatory fashion, that cost-benefit analysis of a regulation before it is issued would be, to use a term that is kind of not—maybe a little informal for this context, but appropriate—a no-brainer. That every American would say yeah, if you are going to regulate conduct, you ought to look at whether or not its costs exceed its benefit. And it seems to me that ought to be simple and straight-forward. You would be amazed at the resistance I have seen in the 104th Congress to the concept that regulations ought to undergo cost-benefit analysis. And it seems to me, even within the Tax Code, when we have heard numbers like have been used here today about the thousands of hours, the billions of dollars spent to comply with the Tax Code, cost-benefit analysis could certainly apply to the Tax Code, I take it.

Mr. PIETZSCH. I agree with you completely. I think that makes a great deal of sense.

Mr. SHADEGG. One last point. In the sharing equally of the blame between the IRS and the Congress, one of the points that my constituents who are in the business arena talked to me about, one that I am certain you feel, is the issue of well, what are we doing that is making this problem worse. And somebody in the literature I read recalled it as fine-tuning of the Tax Code. Your testimony makes the point, point-blankly said at least part of the blame must go to Congress, which since 1981 has passed 10 major tax laws. Now you think well, OK, that is a lot in that period, but maybe it is not too many. But you go on and make the point, resulting in 9,400 substantive changes in our Federal income tax law.

I mean, how can anyone comply with 9,400 substantive changes? The rule today is not the rule yesterday and will not be the rule tomorrow. How do we ask our Nation, how do we get a Nation to voluntarily comply with that kind of a system without throwing our hands up and quitting?

Mr. PIETZSCH. I agree with you. There used to be—if you look historically at the development of the Tax Code, there was at one point in time for an extended period of time, an unwritten rule that the Code would not be modified in any material way more than once approximately every 15 years. And that held true until essentially the 1970's, late 1970's and 1980's when suddenly the cap blew off.

Taxpayers have to—even the most intelligent taxpayer with the greatest resources at his disposal still must have time to analyze and absorb new statutes, particularly if the regulations are not timely that govern those provisions, and taxpayers gear up and then act in reliance on those rules. If those rules are changed frequently, the compliance becomes almost impossible.

Mr. SHADEGG. Well, in the last—within the last 3 years they have been changed retroactively, so people have been taxed retroactively, after the fact——

Mr. PIETZSCH. That is correct.

Mr. SHADEGG [continuing]. For conduct they engaged in. When they thought they were not engaging in a taxable transaction, the Government has gone back and said oh, yes, you were, and by the way, pay up, and imposed those requirements on essentially deceased people, the estates of those who are no longer with us were told you also have to pay up.

Mr. PIETZSCH. You are absolutely right.

Mr. SHADEGG. No wonder there is a level of frustration.

I do appreciate that. I guess I did say I was going to ask each of you for a substantive suggestion for reform. One that seems to at least appeal to me personally is the idea that we as a Congress say we are imposing some kind of a self-limitation rule that says we will not tamper with the Tax Code more than once a decade or once every 15 years, just to allow the people of America to understand the rules.

Mr. PIETZSCH. I agree.

Mr. SHADEGG. Some would argue that a two-thirds super majority requirement for future tax increases would have that effect. So maybe that is a new argument for that fight.

Mr. Bosse, let me talk with you just briefly about the issue of time value of money. As I understood your testimony—and I guess I would like you to summarize it again—what we have are rules in place that allow the Government to say no, we cannot take this much cash now, we can take smaller payments over a much longer period of time and the net effect is the Government loses money and the Congress loses money to spend on its programs and the IRS reduces its essential ability to collect timely payment and put the Nations' fisc more in order.

Mr. BOSSE. And also more importantly, it keeps the taxpayer under this situation for a much longer period of time than maybe he needs to be. Therefore, you know, it sort of raises the antagonism level between his government and himself, and that is some-

thing—at least when it is paid, it is over with, the lien is off and everybody goes home. And I think that is kind of important.

We see a lot of cases where this occurs and we do feel—these national guidelines have so changed the installment agreement offer in compromise area that it really undermined the offer in compromise program of a couple of years ago, which was a looser program and was bringing money in.

Mr. SHADEGG. So offer in compromise looked to you like common sense, a good idea to resolve these disputes and to get a timely resolution of them, not itself burdened by excessive detail?

Mr. BOSSE. Well, these guidelines—and by the way, the guidelines are their own guidelines. There is no congressional input, or at least there is no statute on these guidelines, none whatsoever. They are a figment of someone in Washington at Treasury or at the IRS—it may have resulted as a part of a GAO report of some kind.

Mr. SHADEGG. A good idea gone bad or a good idea not fully utilized?

Mr. BOSSE. Probably not a good idea to begin with—probably not a good idea to begin with.

Mr. SHADEGG. OK.

Mr. BOSSE. You know, national standards of what someone should spend for housing, I mean that gets a little bit over-bearing and over-reaching. And it hinders the ability to make the deal and get the case over with.

Mr. SHADEGG. I have had people say to me outside the context of a congressional hearing, that IRS agents have said to them, look, I would like to be able to structure this in a way which looks reasonable but regulations do not let me.

Mr. BOSSE. And that is correct, that is correct. I think the senior field agents that I have worked with, on their bigger cases, the big cases, where you have old tax and lots of interest and penalties, if they could cut deals in the field and collect the tax. If you had an offer of collecting the tax and close those cases out, I think everybody would be way ahead. We have a lot of left over cases from the 1980's with enormous amounts of interest and penalties. I have one, tax, interest and penalties of $7 million and we are dealing with a five-to-one ratio. In other words, there is $5 of interest and penalty for every dollar of tax.

Mr. SHADEGG. Tax, interest and penalty, $7 million; ratio is five-to-one?

Mr. BOSSE. Right.

Mr. SHADEGG. Ratio of tax owed——

Mr. BOSSE. Interest and penalty is $5, the tax is $1.

Mr. SHADEGG. Did I understand you to say earlier that with this current structure, you now have more and more clients willing to go into bankruptcy to deal with the issue?

Mr. BOSSE. The bankruptcy issue started I think a number of years ago and we thought with the new more generous—I should not say generous, but a more—an offer in compromise climate that was conducive to resolving these cases was in place a couple of years ago, and since September, that has been eroded basically by what I was commenting about the new guidelines. And that is this case here. This guy is going into Chapter 13 and that is what is going to happen, because he cannot pay them $2,000 a month. He

can pay them $750 for 60 months and that is what he is going to do.

Mr. SHADEGG. Would it be productive for the Congress to require an audit of the IRS practices, using common business collection practice standards to see whether or not we are doing as good a job of collecting moneys owed us as a large business in America?

Mr. BOSSE. I think there would be no question about it. I think that is the—the lack of the business approach is—I do not believe American Express and I do not believe MasterCharge and other types of credit collection that have these type of accounts approach it like the IRS does.

Mr. SHADEGG. Let me go back just a minute, Mr. Pietzsch, I got the impression in your testimony that the complexity of the regulations really is causing what concerns me and that is a destruction of small business in America and a promulgation of large business. When I was a kid growing up in Phoenix, there was a hardware store down the street owned by a man in the neighborhood. You could buy any kind of hardware there, there were various lumber companies in this town that were not corporately owned by out-of-State huge interests. It seems to me today you cannot buy hardware or lumber from anybody less than a corporation as large as Home Depot. And you can say that about the drugstore business or the grocery store business. The grocery store where we bought groceries when I was a kid was also just a corner grocery store, not owned by a mega-chain.

Are we creating, with our goal to have regulations that cover every aspect of human conduct, an atmosphere in which only the large can survive and the small cannot? And to go back to your point about ERISA, are there small businesses that are just simply dropping out and not having retirement plans for their employees rather than trying to sustain that burden?

Mr. PIETZSCH. Yes, to a large extent what you say is correct. I think the burden falls heaviest on small business. That is very, very clear. Certainly the per capita costs, as I mentioned in my report, of just basic compliance are higher by definition, and small business more and more frequently find it difficult to comply because they cannot afford to pay the lawyers, the accountants, the other third party consultants, to keep up with this constant flow of new paperwork and regulations. As a result again, many businesses have to cut back in some fashion. Either they do not comply, which is I think unfortunate, or they cut back on employee benefit programs, for example. My own father retired without a pension plan because his business had to cut that off a few years before his retirement. Many, many small businesses have been forced to collapse their retirement plans or come up with designs that are not as beneficial to employees because of the regulatory costs.

Mr. SHADEGG. In essence, a small business can drop out of the pension plan field and simply say we are going to allow our employees to cover their own retirement and/or Social Security. We are not going to go through the hassle of creating a retirement system.

Mr. PIETZSCH. That is right. But unfortunately, and that is the irony, the employers who are doing the most for their employees, or attempting to do the most for their employees, are the ones who

get punished the most, because they have to bear the regulatory costs. The employers who really do not care or who have already thrown in the towel and simply admitted that they cannot keep up any longer are now out of that stream, to some extent, although they have other tax issues to deal with.

But employers who are conscientious and trying to do the most for their employees are very often the ones who are punished the most because of the enormous costs.

Mr. SHADEGG. So excessive regulation has in fact a burden on society, for example, in this area where the Nation is concerned about taking care of those who are beyond their working years and yet living out the golden years of their life, we by over-regulation make it more and more difficult for their employers to have cared for them.

Mr. PIETZSCH. That is right. And again, it is particularly sad because these are employers and employees both who are trying to do something for themselves with their own dollars. They are not asking for subsidies, they are not asking for someone to do the job for them. They are trying to do the job themselves but they are being hindered in that effort.

Mr. SHADEGG. Micro-managed.

Mr. PIETZSCH. Yes.

Mr. SHADEGG. Mr. Goldberg, your testimony had some striking numbers in it about the size of penalties vis-a-vis the tax liability originally owed. Is it your belief that we have created a tax penalty structure which does not make sense?

Mr. GOLDBERG. It is, and I think that IMPACT started to change that, Congressman, so that that did simplify things. As an example, a penalty before IMPACT, there was a time when the negligence penalty was 5 percent of the tax involved and then 50 percent of the interest on that tax. That was an example of confused philosophy as to what penalties were all about. IMPACT stated that the overall philosophy ought to just be compliance with the system.

I wanted to mention something when you were saying about the audit of the Internal Revenue Service. In one sense, I think it is ongoing and more recently more than ever, and it seems like Congress relies on the GAO to do their indepth studies and their watchdog studies and my understanding is that maybe the most recent overall appropriations bill or one of the appropriations bill, when the IRS was cut back with the other agencies, they were obligated to spend $13 million on private collectors and I have seen some things and I think we are really going to see a lot of publicity when this starts being implemented in the field, but my understanding is that the GAO was so critical of IRS' efforts to collect taxes for the very reasons you have heard today; you know, the taxpayers just being so frustrated with the system and maybe feeling that they are treated unfairly, that Congress said you now are going to spend $13 million for private collectors, and bids are being solicited now. It will be very interesting to see how they do and whether they are as effective as some of the private companies are.

Mr. SHADEGG. We have a witness from GAO as a part of this hearing, so hopefully he will touch upon that issue.

Let us talk about the philosophy behind the penalties. Does it make sense, and if it does, is the current structure still nonetheless excessive, to impose a penalty in addition to interest and then to impose interest on the penalty for someone who simply cannot pay a tax obligation but has acknowledged it and wants to pay it?

Mr. GOLDBERG. I think so, Congressman, and I think it erodes the perception of fairness in the system. Interesting, when IMPACT was passed, they felt there were three areas of penalties, and so the penalties are grouped into three major areas. No. 1, accuracy related penalties. And we spoke mostly about that, so that if someone just misinterprets the rule, that's called an accuracy related penalty, that is 20 percent of the tax liability. The other, the second third area was failure to file penalties. And these become time sensitive, so the most common one is 5 percent a month on the underlying tax liability, maxing out at 25 percent and then a so-called failure to pay penalty which works two ways. There are two levels. Here is an example of being just too darned complex. It is .5 percent a month until a final notice has been sent out and then 1 percent after that, it maxes out at 25 percent. In other instances, when it gets to payroll taxes, it is time sensitive in a different way. If the payroll tax is deposited between one and 3 days late, maybe 5 percent, three and 15—there is a pretty short time—three and 15 days, 10 percent of that until it maxes out. So it is still a pretty complex system, it still needs some additional tinkering.

Mr. SHADEGG. Additional tinkering. It looks to me like we have had almost too much additional tinkering.

The other aspect of your testimony had to do with the automatic assessment of penalties. Is that an area where reform would be productive? What would we do there, how would you do it? There was an idea earlier that you could empower the Tax Court to decide whether or not this was a responsible party without having to first pay the tax. Is there some other way that you could go at the issue of whether or not a penalty ought to be automatically assessed, and is that abusive conduct by the IRS, is that a problem with the regs or is that a problem with the statute?

Mr. GOLDBERG. You know, there are some checks and balances. Generally all penalties are appealable to an office called Appeals, and so in the manual, revenue agents who assert the penalties are told to maintain IRS policy, which means to take a position adverse to the taxpayer, not considering litigating hazard. In Appeals which most cases can go to, appellate conferees are told to consider litigating hazards, to look at both sides of the issue. So that is one place to go.

Interestingly, as of April 1, there is another key development. This was experimented in the Denver District and it just was implemented nationally April 1. It allows the appeal of collection issues. And so you have heard today two errors, penalty as a collection issue. Much of Mike's testimony has been substantive and changes to the substantive Code, but heretofore collection matters, which is really why I think you get most of the inquiries into your office, there has not been an opportunity to appeal them. Now there will be an opportunity to appeal those. And then in Mr. Davis' case, that is really a special penalty, that is a so-called re-

sponsible person penalty and there I think expanding the jurisdiction and opportunity for a taxpayer to go to the Tax Court will be helpful.

But here is what else occurs to me. It is the IRS pushing the envelope that created the problem there because Marlan aptly put it out, Mr. Davis came in after the fact and should not have been asserted a liability. It was cases that the IRS kind of pushed the Government to take in two Supreme Court cases that said if you come in after the fact, more money comes in, that money could have been used to pay the prior taxes, you are on the hook. In my perspective, that is how that added, two Supreme Court cases, because of the IRS pushing the envelope and pushing—the statute really does not say, you know, when the willful failure had to occur. And in my mind, it was a very strained position where subsequent funds that come into the enterprise that are used for what ought to be current needs, are not used and under certain circumstances create a liability. So that is how that evolved, as very vigorous, maybe over-vigorous enforcement of the tax laws by the Service.

Mr. SHADEGG. Probably pushed by an aggressive Congress that has an insatiable appetite for money.

Gentlemen, I did ask that each of you be offered an opportunity to make a substantive, one specific substantive or a couple specific substantive suggestions. If you have any of those that you would like to offer at this time, I would appreciate it. We have kind of taken notes on some of the points you have made.

Mr. WALKER. I have one. If I could just address the regulatory problem for a second? One of the areas I specialize in is partnerships, partnership taxation. And just to give you an example of how far the regulations go, section 704(b), section 704(c) and section 752 are all related. The regulations under section 752, I used to have memorized, they were that short. I could spout them off in my sleep, I knew how to deal with them, I knew exactly what they were, they were just a couple of pages long. Now the combined regulations for those three sections are over 112 pages long. And it is not just that they are long, they are incredibly complex.

I am probably one of a handful of people in this town—and I am not trying to be vain here—but one of a few people in this city who understands the 704(b) regulations. And even then, I do not understand them that well. I have probably spent thousands of hours on these regulations. Now that gets me to my point.

The point is that Congress has, in many respects, abdicated its responsibility with respect to tax legislation by simply saying we want the tax to be thus and so. Now you, Treasury, go figure out how to implement it. And that is true with the passive loss regulations, with regulations throughout the partnership sections, and I can go on and on and on. We call these legislative regulations, where Congress just simply says it is too hard to figure out, we do not want to figure it out. You go figure it out. So the statute gets to be very short, the regulations get to be very, very long. And once they become legislative regulations, they have the force and effect of law.

In effect, I have viewed that as really an abdication of responsibility by Congress to Treasury, which should never have occurred. And my suggestion would be to cut out all legislative regulations.

Interpretative regulations, fine. Legislative regulations I do not think should be a part of the Code.

Mr. SHADEGG. So the Code would then—the IRS or Treasury would have the authority to issue a regulation interpreting the Code, as written by Congress, but not imposing or setting forth the terms under which a tax would be collected.

Mr. WALKER. That is correct. Legislative regulations really do have the force and effect of law and they really do reflect an abdication of responsibility to the Treasury Department to actually enact tax law that is imposed upon taxpayers.

Mr. SHADEGG. Some would argue that they represent an unconstitutional delegation of legislative authority.

Mr. WALKER. Well, whether they are unconstitutional or not, I do not know. I have to deal with them in a practical world and——

Mr. SHADEGG. I can assure you, some would argue that.

Mr. WALKER. I am sure they probably would.

Mr. SHADEGG. Some up in Montana are arguing I think that point right now. [Laughter.]

Any other suggestions, gentlemen?

Mr. GOLDBERG. I would urge you to do whatever you can in regard to Taxpayers Bill of Rights 2, because we do have Taxpayers Bill of Rights 1, and in my opinion it has been very effective. Recently, within the last 60 days, the Commissioner said that she feels that many of the provisions of Taxpayers Bill of Rights 2 have been implemented, but that merely was in a public announcement and I do not think that the meat of it is in.

As a specific example, tax liens—I mean that really wreaks havoc on a taxpayer. It is totally subjective when they can assert it, so it is strictly in the discretion of the revenue officer, but once they are asserted, it is statutory for getting them released and it is nearly impossible to get them released absent full payment. I think there is something in there on that. So I would urge you to try and do something on Taxpayers Bill of Rights 2. I think that it is back in the Ways and Means Committee, so even though it failed, perhaps something could be tacked onto it, I think that would be very helpful.

Mr. SHADEGG. It is back in the Ways and Means Committee. I am a co-sponsor and I think there is hope. The problem is in the balance of the 104th Congress, there probably is not much hope. Some of the most important provisions, of course, as I said earlier were included in the reconciliation, the so-called Balanced Budget Act, which was vetoed. Hopefully we can try to somehow work an agreement with the President where we still get some pieces of those through yet this Congress.

Mr. GOLDBERG. You know, I think this, the next best thing is that announcement by the Commissioner that many of the provisions will be implemented, as well in the beginning of March, two huge provisions of the employee/independent contractor area, these classification settlement guidelines and new training materials are indicative of an impact I think that Congress is having on the IRS, and so they are small steps in the right direction.

Mr. SHADEGG. There has clearly been a change in climate, in atmosphere, and notwithstanding the failure, and I know Congressman McIntosh's staff would agree with me, notwithstanding the

failure and the frustration of Congress to get through true regulatory reform; that is, cost-benefit analysis and risk assessment, in this Congress, we understand from the regulating community that there has been a salutary effect, that many Government agencies are acting with a great deal of caution that was not there perhaps 18 months ago or so. So that is hopeful.

Mr. Pietzsch.

Mr. PIETZSCH. Congressman, I certainly urge the passage of the Taxpayer Bill of Rights provisions, but in addition, the pension reform provisions that were incorporated in the Balanced Budget Act. Ironically, these provisions reflect, to a large extent, ones that were passed previously in prior tax acts that never became law. They have some bipartisan support, they are objective in nature and they do not represent new law, they really represent the rollback of some very onerous, over-extended provisions, to return to a somewhat simpler, saner structure. They will not resolve all problems, but they are very, very important. That package that was in the Balanced Budget Act, I would hope could be passed as separate legislation or incorporated into the Balanced Budget Act once again, if indeed that act passes.

And again, beyond that, I encourage your support of some kind of a super majority vote requirement to change tax laws substantively in the future. Certainly the less frequent the change, the less expansive the change and the more thoughtful the process, the better off all taxpayers will be.

Mr. SHADEGG. I want to thank you. Let me conclude by saying it seems to me that your testimony has been very, very helpful in highlighting some of these problems. You make a good point, Mr. Pietzsch. In point of fact, regulatory reform has been slightly partisan. Regulatory reform in this area is very much bipartisan. The Taxpayers Bill of Rights has substantial or very, very significant bipartisan support. It seems also that when you look at our Tax Code and its impact on our society and its unintended consequences—for example, in a Nation with a Social Security system which truly does not adequately protect the retirement interests of our citizens, for the Nation to be promulgating a system of regulations and laws governing individual retirement systems established by business to be so complex as to discourage people from taking that opportunity, is working counterproductively and in a Nation where small business has been at the heart of the production of growing jobs or the increase in jobs in our economy, to make life so complicated that it has become almost impossible for someone to start a new business is not a policy consequence we ought to be pursuing.

I appreciate your testimony. It occurred to me—one last point—as you were speaking, that perhaps one way to build political support for a super majority requirement would be for a Member of Congress, and I might do it myself, to tack onto that constitutional amendment a constitutional prohibition against any retroactive tax, which apparently does not currently exist.

Gentlemen, thank you very much.

Let me call forward our next panel. It does include several representatives of the Internal—two representatives of the Internal Revenue Service. As I mentioned, I did speak with both officials of

the IRS here in Arizona and in Washington. First, Mr. William Raby, of the Raby law office. Is it Raby or Raby?

Mr. RABY. Raby.

Mr. SHADEGG. OK. Mr. Natwar Gandhi, Associate Director of Tax Policy at the General Accounting Office; Ms. Leigh Cheatham, Deputy Director of the Arizona Department of Revenue, an old friend—a longstanding friend; Mr. Marshall Washburn, National Director, Specialty Taxes, Internal Revenue Service; and Ms. Judith Dunn, Associate General Counsel for Domestic Matters, I guess of the Internal Revenue Service.

Ladies and gentlemen, thank you very much, we appreciate you taking the time to be with us. I know it required all of you to take time out of your otherwise busy lives and obligations, some of you affected by tax season, some of you perhaps not as much affected by tax season.

Why do we not start, Mr. Raby, with you.

Oh, oh—one slight memory glitch on my part. We need to swear you in.

[Witnesses sworn.]

Mr. SHADEGG. The record will reflect that all of the witnesses answered in the affirmative. Now, thank you, David. Good to have committee staff around and I will thank all of the staff for their great assistance in a few minutes. But Mr. Raby, let us begin with you.

STATEMENTS OF WILLIAM RABY, CPA, THE RABY LAW OFFICE; NATWAR M. GANDHI, ASSOCIATE DIRECTOR OF TAX POLICY, U.S. GENERAL ACCOUNTING OFFICE; LEIGH CHEATHAM, DEPUTY DIRECTOR, ARIZONA DEPARTMENT OF REVENUE; JUDITH C. DUNN, ASSOCIATE GENERAL COUNSEL, INTERNAL REVENUE SERVICE; AND MARSHALL V. WASHBURN, NATIONAL DIRECTOR, SPECIALTY TAXES, INTERNAL REVENUE SERVICE

Mr. RABY. Mr. Chairman, thank you for requesting my testimony. I attached a brief bio sketch to the material that I provided and I am not going to go back over that. I think the bottom line of my professional life though is that I have spent over 40 years as a CPA, professor and an author working with the income tax system, working with the taxpayers who have to cope with it and working with the practitioners that try to help them. I want to caution, however, that I am not here as a spokesman for any organization with which I am affiliated. These thoughts are basically just my own.

My one-sentence message is that the problem of IRS reform is first and foremost a problem of reforming the income tax law itself. Congress, the IRS and the courts have together created a structure that really perplexes and ensnares most taxpayers, almost everybody at some point in their lives and many it ensnares every year as we go through it.

I have six points really to make in terms of what I would do about it. Many of these points have been made I noticed in the previous panel as well, so I will try to move quickly through them.

Probably the major point is to create a tax structure and then stop tinkering with the thing. Taxpayers and their advisors are

just like those of us who try to get around on a large metropolitan area freeway system. The system is complicated but most of us only have to get through certain parts of it, and the same parts repetitively. And so we learn it, we learn where to go, we learn where to get on, we learn where to get off. The problems we get into are when there is roadwork, detours and accidents.

By the same token, taxpayers like to be able to treat similar transactions in similar ways year after year. What fouls them up is when you cannot do this year's return based pretty much upon what you did last year.

Second—and this is not the most popular suggestion in the world—simplify the individual income tax by eliminating most income exclusions and most itemized deductions. Taxpayers should continue to be able to deduct the cost of producing income, they should be allowed to deduct charitable contributions. It is probably politically necessary that they still be able to deduct interest and taxes on their personal residences. But certainly we want to get rid of things like the alternative minimum tax, the passive activity loss rules, all the rest of the claptrap that is really a snare for the unwary, much of which was put in there to get rid of tax problems that do not exist any longer. The solution remains long after the problem is gone.

And probably most important of all, we need to get rid of the mind set that counts it as being worthwhile to complicate the tax law to whatever extent is necessary in order to eliminate any remote possibility that someone might be viewed as getting an unwarranted benefit. You get complaints from taxpayers who have been imposed upon in terms of collection activity and so forth, but on the other side, tax administrators and people who deal with even the structure of the tax law itself are constantly pummeled because somebody apparently got away with something and we need to close that loophole.

Such an approach, I would suggest, to the tax law is the equivalent of a high speed police chase in congested traffic over a minor traffic violation. You simply pay too much in terms of complexity for what you get in the way of equity.

The truth is that an individual income tax is no more inherently complex than is an individual consumption tax. It is as complex as it is—and you used my phrase, which is not original with me—it is as complex as it is because of this congressional penchant for fine-tuning. And the Treasury Department and IRS follow that lead and engage in the same type of fine-tuning. And fine-tuning is the enemy of simplicity. Attempting to achieve perfect equity is the enemy of simplicity. The perfect is usually in fact—and this should be clear to people in Congress—the perfect is always the enemy of the possible because you do not get things done if you hold out for the perfect solution.

The third suggestion may be one you have not heard before, and that is to simplify business income tax rules by going back to the spirit of the original 1954 Internal Revenue Code as it was enacted in 1954. This had been the first major change in the tax law after the 1939 Code, 15 years, as somebody pointed out.

Essentially, business is governed by a body of accounting principles which we call generally accepted accounting principles or

GAAP, in preparing financial statements. And what we really need is to have the tax law simply allow the reasonable use of GAAP as a way of arriving at business income. It probably will not be perfect, but it will fit what businesses have to do anyway and it is something that is capable of being audited using the private sector to determine what is a reasonable tax form. I have some details on that in my written material.

Fourth, we need——

Mr. SHADEGG. Can I interrupt you for a second? Those are generally accepted accounting principles, GAAP?

Mr. RABY. GAAP, right.

Mr. SHADEGG. OK.

Mr. RABY. The fourth point is to provide for easier access to financial justice when the IRS does overstep its bounds. Right now we have a section, section 7430, which even with the changes in the Taxpayer Bill of Rights No. 2, is not going to work very well. And I have some of the reasons set forth here, and suggest what some of the solutions might be.

Fifth, we need to change the law in terms of the approach to tax law interpretation. Clearly the IRS has to have an ability to put the burden of proof on the taxpayer when dealing with facts. On the other hand, there is no reason why any reasonable interpretation of the tax law should not be allowed to prevail unless Congress has clearly indicated to the contrary. And this gets into the regulation process a bit and I have some suggestions on that in the paper.

Finally, proceed to adopt some version of the consumption tax that is being debated right now, as an addition, not as a replacement to the total package of income, estate and gift taxes. Reduce the effective rates of tax even more than they are. There is a lot less perceived inequity, a lot less incentive to fine-tuning when you have tax rates of 15 or 20 percent than when you have tax rates, as we have had during much of my earning lifetime, as high as 70 percent. On the other hand, I think it is going to be impossible to simply kill the income tax and replace it entirely with something else. We are going to have needs for revenue and they are going to be almost inexorably demanding. But we can certainly reduce the irritant effect of the income tax, make it part of a package which will help the economy work better.

So the bottom line, the IRS can undoubtedly be reformed, but only if its job description gets rewritten. That means rewriting and it means simplifying the tax law.

Thank you.

[The prepared statement of Mr. Raby follows:]

THE PROBLEM OF THE IRS IS THE TAX LAW ITSELF

STATEMENT OF WILLIAM L. RABY

BEFORE
THE HOUSE GOVERNMENT REFORM AND OVERSIGHT COMMITTEE
SUBCOMMITTEE ON ECONOMIC GROWTH

April 3, 1996 Phoenix Field Hearing

TAXING TIMES: THE CASE FOR IRS REFORM

Mr. Chairman and members of the subcommittee, thank you for requesting my testimony. A brief bio sketch is attached, but the bottom line of my professional life is that I have spent over forty years as a CPA, professor, and author working with our income tax system, the taxpayers who have to cope with it, and the practitioners who try to aid them. I hasten to caution you, however, that I am not here as a spokesman for any organization with which I am affiliated.

My one-sentence message is that the problem of IRS reform is first and foremost a problem of reforming the income tax law itself. Congress, the IRS, and the courts have together created a structure that perplexes and ensnares most taxpayers at some point or another in their lives and provides an annual obstacle course year after year for many taxpayers.

What would I recommend doing about it? I have six points to make.

First, create a tax structure and then stop tinkering with the law. Taxpayers and their advisers are like motorists dealing with a complicated freeway system. The system may be complicated, but most people only traverse a part of it, they do so quite frequently, and they cover the same basic routes. Thus, they learn how to get to where they want to go. What fouls them up is road work, detours, and accidents. Taxpayers likewise tend to have similar transactions year after year. What fouls them up most is changing the rules of the game from one year to the next.

Second, simplify the individual income tax by eliminating most income exclusions and most itemized deductions. Taxpayers should continue to be able to deduct the costs of producing income. They should be allowed to deduct charitable contributions. It is probably politically necessary that they continue to be able to deduct interest and taxes on their personal residences. Get rid of the alternative minimum tax, the passive activity loss rules, and all the rest of the claptrap that is a snare for the unwary average taxpayer.

More important, get rid of the mind set that counts it worthwhile to complicate the tax law to whatever extent necessary in order to eliminate any remote possibility that someone might be viewed as getting an unwarranted benefit. Such an approach is the equivalent of a high speed police chase in congested traffic over a minor traffic violation. You pay too much for what you get!

The truth is that an individual income tax is no more inherently complex than is an individual consumption tax. Why, then, is it as complex as it is? The answer is the Congressional and administrative penchant for fine tuning. Fine tuning is the enemy of simplicity. Attempting to achieve perfect equity is the enemy of simplicity.

A stripped down income tax would actually be quite simple. Backed up with today's extensive withholding and information return capabilities, it could ultimately result in individual tax returns prepared by IRS computers and automatically audited by the computer system. It would include cutting the individual income tax rates so that the top tax bracket is somewhere in the neighborhood of 20%. Needed additional revenue could be generated by the consumption taxes discussed in the sixth point (below).

Third, simplify business income tax rules by going back to the spirit of the original 1954 Internal Revenue Code, as enacted in 1954. There is in existence a body of concepts called Generally Accepted Accounting Principles (GAAP) which businesses

follow in preparing financial statements for credit grantors, shareholders, and other third parties. Almost all of the complexity in taxing business income arises from differences between tax accounting concepts and GAAP. These differences are almost all timing differences, but keeping track of them enormously complicates tax reporting for businesses. Destroy the differences.

-Provide that, with one exception, business income is to be determined in accordance with GAAP, which is an accrual accounting concept. That exception? Very small businesses would be allowed to continue to use the cash receipts and disbursements method of accounting.

-Provide that the income tax returns of all but these very small businesses would have to be reviewed (not audited) by an accountant who would affirm that they were in accordance with GAAP and with the information being furnished to owners, managers, and third parties. Thus, much of the IRS audit function would be shifted to the accountants retained by the business itself. The IRS could focus more of its business audit emphasis on auditing the return preparers to catch, and punish, those few bad apples that will be found in almost any barrel. At the same time, treat as pass-through entities all businesses not publicly traded, just as partnerships and S corporations are treated now, and impose corporate tax on the publicly-traded businesses at rates of from 15% to 25%.

Fourth, provide for easier access to financial justice when the IRS does overstep its bounds. Present Internal Revenue Code Section 7430, which provides reimbursement of legal fees and expenses for taxpayers who prevail in a tax controversy, is actually a bit of a joke. It provides that the taxpayer may be awarded reasonable attorney fees (generally based upon $75 per hour (modified for changes in the cost of living)) and costs in two categories:

1. Administrative costs incurred after the earlier of the statutory notice of deficiency (90-day letter) or the date the taxpayer receives "notice of the decision of" the IRS appeals office, and

2. Litigation costs.

But the statistics indicate that section 7430 has accomplished very little. Robert T. Duffy, at 95 TNT 198-103 in Lexis, points out that "(d)uring the first ten years of its existence, roughly 1983 through 1992, awards of litigation costs under section 7430 averaged only about $220,000 per year and $6,300 per award." Elsewhere, in 48 Tax Lawyer 937 (Summer 1995), Duffy pointed out that "over the first four and one-half years of experience with awards of reasonable administration costs, the total amount of such awards was around $2,000." That is hardly suprising because almost all taxpayer administrative costs are incurred before the 90-day letter is issued.

The General Accounting Office reported (95 TNT 237-20 in Lexis) that during fiscal 1993 and 1994 combined, there were 43 attorneys fees awards of more than $10,000, aggregating $1.6 million, charged against the Internal Revenue Service. Of these, 26 were under section 7430, aggregating $1.1 million.

These trivial amounts are mute evidence that Section 7430 is, in fact, a cynical promise of equal access to tax justice for most taxpayers. The hurdles that must be cleared before a section 7430 award can be obtained help explain why there are so few awards and why they are for so little. The main obstacles involve the following:

-Establishing that the IRS position was not substantially justified (i.e., was unreasonable);

-Showing that the taxpayer's net worth did not exceed the section 7430(c)(4)(A) limits on the date the proceeding commenced;

-Showing that the taxpayer exhausted available administrative remedies within the IRS;

-Establishing the time spent by counsel and others on the parts of the controversy for which a section 7430 award is being sought, negativing IRS contentions that the time was excessive or related to issues other than those for which the taxpayer should be reimbursed, and establishing that the fees were actually paid and were in no wise contingent upon being reimbursed by the government; and

-Establishing, if possible, that the statutory $75 per hour (adjusted for cost of living increases) is not reasonable under the circumstances and a higher hourly rate should be allowed.

To make the promise of equal taxpayer access to justice a reality, I would urge that the Congress do the following to Section 7430:

1. Allow a taxpayer to recover actual expenditures incurred, including a reasonable allowance for income lost because of the tax controversy, in handling a tax controversy at any level in the IRS (as contrasted to allowing recovery now for almost no administrative proceedings) or in court;

2. Allow legal, CPA, and EA fees to be reimbursed based upon prevailing per diem fees in the taxpayer's community and without regard to whether paying the fee is or is not contingent upon success in obtaining recovery of the fee from IRS;

3. Allow recovery if the taxpayer prevails, in whole or in part, unless the IRS can establish that the tax controversy is the result of the taxpayer's failure to reasonably cooperate in establishing the facts involved in the controversy; and

5. Throughout a proceeding to recover fees and costs, put on the IRS the burden of going forward with evidence to show that the taxpayer is not entitled to the recovery claimed.

Fifth, change the approach to tax law interpretation. The burden of proof as to the facts will still normally have to be on the taxpayer for practical reasons. Why? The taxpayer creates or controls the evidence of what happened. However, a taxpayer's reasonable interpretation and application of the law should prevail as against the IRS interpretation and application of the law except in those specific instances where the Congress has directed the IRS to promulgate rules. When Congress provides such rule-making direction, those rules should only become effective after they have been submitted to the appropriate Congressional committee or subcommittee and ratified by it either through specific approval or failure to take any action.

Sixth, proceed to adopt some version of a consumption tax as an addition, and not as a total replacement, to the income, estate and gift taxes. This could be either along the lines of the business tax portions of the Armey or the Nunn-Domenici bills pending in Congress or be a state-administered national sales tax. Current discussions of the various flat and consumption tax proposals proceed on the assumption that their adoption would be coupled with elimination of the existing structure of income and transfer taxes. This is quite naive, in my opinion. I would suggest that, just as major changeovers in entity information processing usually involve running parallel systems for some period of time until the bugs are out of the new system, so, too, whatever flat or consumption tax, if any, that the Congress settles on should probably run parallel to the existing tax structure during a lengthy phase-in and transition period. In fact, it seems to me that given the changes taking place in the U.S. economy, as well as in the age-distribution of the U.S. population, a multi-source revenue system would have distinct advantages over the present system as a way to fund the government for an indefinite period into the future.

The dirty little secret in most discussions of tax change and tax reform is that no one really knows what the results will be of doing anything--or of doing nothing. Past projections of the effect of tax innovations like DISCs or IRAs have had almost no relationship to what actually occurred after their enactment. How the 1986 Tax Reform Act would affect the savings and loan and real estate industries was not adequately reflected in the analyses that were done at the time 86 TRA was being considered. I find it hard to believe that if they know that they do not know what the the effects will be, the responsible people in Congress will be willing to take the much greater gamble of completely scrapping the present system of raising tax revenue and switching over at once to an untried approach. It is not just that the new way of raising tax dollars may not raise the amounts estimated; rather it is the impact--the completely unpredictable and

potentially cataclysmic impact--of such a change on local, state, federal, and international business and financial relationships.

Conclusion

The IRS can undoubtedly be reformed, but only if its job description is rewritten. That means rewriting and simplifying the tax laws. That also means putting the taxpayer onto a level playing field when dealing with the IRS by both presuming that the taxpayers' reasonable interpretations of the law are correct and by allowing them to be fully reimbursed for their costs of successfully contesting IRS positions and proposed exactions.

Mr. SHADEGG. Thank you very much.

I normally would not comment at this point, but you brought up the issue of generally accepted accounting principles. Are you familiar with Charles Grogan, the actor?

Mr. RABY. Not offhand, no.

Mr. SHADEGG. Did you happen to see the movie, "Dave?"

Mr. RABY. I guess I did not. I am not that much of a motion picture——

Mr. SHADEGG. Let me just relate this story because I have always thought it would be fun to use it somehow. The movie "Dave" is about a man who happens to be an identical twin, by appearance, to the President and the President needs someone to stand in for him at some occasion and these Secret Service agents discover that this guy looks exactly like him. And the President I believe suffers a stroke or a heart attack and they bring this guy Dave in as a stand-in President. They brought him in thinking they would just be using him for an hour or so, it winds up the President has this stroke and this guy Dave becomes the President for a period of time. And he is manipulated by a Vice President who is going to try to take advantage of all this.

But one plot line in the movie has to do with Dave wants to effect a certain policy, he starts asserting himself as this stand-in President. He has had in private life, where he ran an employment agency, an accountant. His accountant happens to be played by Charles Grogan, who is a very, very funny actor. He wants to effect this policy, he is trying to do it, he cannot get anywhere. He calls his friend, Charles Grogan, his accountant, into the White House, the guy sneaks into the White House late at night, they spend an entire night trying to examine the Government's books and figure out how to pay for this program that Dave wants to advance.

Finally they work through it all night and they come up with a way to do it and there is a scene early morning hours, probably just after daylight in the morning, they are in the White House portico, the accountant Grogan is getting into his car leaving and he now of course understands that Dave is standing in for the President and the President has had this stroke and is debilitated but nobody is telling the truth to the public. And Grogan turns to Dave and says, "Dave, you have got to get out of here, nobody keeps their books like this." [Laughter.]

And it is true. I mean all businesses in America operate under the generally accepted accounting principles, but not the Federal Government.

So it is a great scene, I have often thought about using it at some point, maybe in a fundraiser talking about how bizarre the Federal Government operates.

With that, an expert on how the Federal Government operates might be someone from the General Accounting Office, Mr. Gandhi. And I understand you have an associate with you and your assistant, Mr. Wonzy.

Mr. GANDHI. That is right.

Mr. SHADEGG. Let me call on you at this time.

Mr. GANDHI. Thank you, sir. And I did see that movie, and in my life as an accountant, there are not many occasions when I was very proud of being an accountant, but that was it. [Laughter.]

Mr. Shadegg, we are pleased to be here today to discuss the results of our work done on the burden that taxpayers, both businesses and individuals, face in complying with the Federal Tax Code. Because of the congressional concerns about business taxpayer burden, we identified sources of such burden and examined the feasibility of obtaining reliable dollar estimates of business tax compliance costs. We have defined burden as the time taxpayers spend, monetary costs they incur, and frustrations they experience in complying with tax requirements. Currently, we are also reviewing alternative tax filing procedures. Although our work in this area is incomplete, we can share some preliminary information about individual tax burden issues.

Overall, we have three points to make. First, the complexity of the Tax Code compounded by the frequent changes made to it, is the driving force behind business tax compliance burden. Second, a reliable estimate of the overall cost of tax compliance would be costly and in itself a burdensome process to obtain. Finally, reducing the tax compliance burden will be a difficult undertaking because of the various policy tradeoffs that must be made, such as revenue and taxpayer equity.

Business officials and tax experts told us the Tax Code is complex, difficult to understand and in some cases incomprehensible. They also said the Code was burdensome because of the additional recordkeeping and calculation it requires. More specifically, businesses have difficulty because of numerous and unwieldy cross references and overly broad, imprecise and ambiguous language found in the Code.

Frequent legislative changes were also cited as problematic. For example, 1 year after the expansive Tax Reform Act of 1986, the Omnibus Reconciliation Act of 1987 changed about 50 provisions that potentially affected businesses. IRS itself faces the difficulty of maintaining a work force of auditors who fully understand all tax requirements.

Moving next, Mr. Chairman, to the overall cost to businesses of complying with the Tax Code. We did not identify a readily available, reliable estimate of such costs but there was a general consensus that compliance is burdensome and some businesses offered anecdotal examples of the costs. Developing a reliable estimate would require businesses to separate tax costs from other costs and also to respond accurately to tax burden questions. This kind of inquiry would be an expensive and burdensome process in itself.

Our final point, Mr. Chairman, deals with how difficult it would be to reduce the tax compliance burden due to policy tradeoffs such as revenue and taxpayer equity that would have to be made. One approach for simplifying the Tax Code would be to tackle particularly burdensome provisions individually. Business officials and tax experts identified several provisions that they perceived to be especially problematic. These included the alternative minimum tax, uniform capitalization, the foreign tax credit and pension and payroll provisions. Simplification of any of these provisions has the potential for reducing the compliance burden of many businesses.

Another approach that has been proposed is to completely overhaul the Tax Code by replacing the current income tax with some form of consumption tax. In considering such changes, legislators

need to raise several sometimes competing concerns. These include the revenue implications, the need to address equity and fairness and the desire to achieve social and economic goals.

The tension in achieving balance among these tradeoffs and at the same time making it easier for taxpayers to comply represents a significant challenge to Congress. On the individual side, almost 100 million U.S. taxpayers currently must file individual tax returns even though most have fully paid their taxes through the withholding system. To assist the Congress in identifying options for reducing taxpayer burden and IRS paper processing, we are studying return-free filing systems. While we are still finalizing the results, we can provide some preliminary information.

In countries where there is return-free filing, the most common system we identified was one that returned final withholding. Under this system, the withholder of income tax, say an employer, is to determine the taxpayer's liability and withhold the correct tax liability from taxpayer. Another type of return-free filing we call tax agency reconciliation depends entirely on information reporting and allows the agency, IRS, to calculate the taxes based on these information documents. The agency is to send the taxpayer either a refund or a bill, based on the tax liability and the amount of withholding. We identified 36 countries that use one of these two forms of return-free filing.

Given the extent of withholding and information reporting that exists under our current tax system, we estimated that about 18.5 million taxpayers whose income is derived from only one employer could be covered under a final withholding system. An estimated 51 million taxpayers could be covered under an agency reconciliation system.

We estimated that both taxpayers and IRS could save a great amount of time and millions of dollars in costs under either form of return-free filing. However, the employers would face substantial additional burdens and costs under the final withholding system and the tax preparation industry could be adversely affected under either system.

In summary, reducing the tax compliance burden will be a difficult undertaking because of the various policy tradeoffs that must be made such as revenue impact, taxpayer equity and shifting compliance obligation.

Mr. Chairman, this concludes my oral statement. I request that our written statement be made part of the record. We will be pleased to answer any questions that you have. Thank you, sir.

Mr. SHADEGG. And without objection, your full statement will be included as a part of the record.

Mr. Wonzy, did you intend to make a statement?

Mr. WONZY. No. I would just be here to assist in answering questions.

Mr. SHADEGG. Very well. Ms. Cheatham. Good to see you again.

[The prepared statement of Mr. Gandhi follows:]

TAX SYSTEM BURDEN

SUMMARY OF STATEMENT OF
NATWAR M. GANDHI
ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

As business and individual taxpayers strive to comply with federal, state, and local tax requirements, they expend time, incur costs, and experience frustrations. GAO refers to this time, cost, and frustration as taxpayer compliance burden. In this testimony GAO identified the sources of compliance burden identified by businesses and examined the feasibility of obtaining reliable dollar estimates of the compliance costs borne by businesses. GAO collected information on compliance burden from the management and tax staffs of selected businesses, tax accountants, tax lawyers, representatives of tax associations, and officials of the Internal Revenue Service. The focus of GAO's efforts was the federal tax system.

Several themes emerged from GAO's analysis. First, according to those GAO interviewed, the complexity of the Internal Revenue Code, compounded by the changes frequently made to the code, is the driving force behind federal business tax compliance burden. Second, a reliable estimate of the overall costs of business tax compliance would be costly and in itself burdensome on businesses to obtain.

GAO is currently studying the impact of two return-free filing alternatives used in other countries on reducing individuals' tax compliance burden. While these alternatives offer promise in individual burden reduction, employers, the tax preparation industry, and state tax systems may experience burden increases or be otherwise adversely affected and IRS' capacity to implement such systems may need further study. Reducing the tax compliance burden on businesses and on individuals will be a difficult undertaking because of the various policy trade-offs, such as revenue impact and taxpayer equity, that must be made.

Mr. Chairman, Representative Shadegg, and Members of the Subcommittee:

We are pleased to be here today to discuss with the Subcommittee the results of work done on the burden that business and individual taxpayers face in complying with federal tax requirements. Because of concerns about business taxpayer burden, we identified sources of compliance burden and examined the feasibility of obtaining reliable dollar estimates of the compliance costs borne by business taxpayers. We have defined burden as the time taxpayers spend, monetary costs they incur, and frustrations they experience in complying with tax requirements. Because individual taxpayers may also face compliance burdens, we are currently reviewing alternative tax filing procedures to identify possible benefits to taxpayers and challenges presented by such alternatives. Although that work is incomplete, we can share some information about individual tax burden issues.

To provide a perspective on business taxpayer burden, we collected information on compliance burden from the management and tax staffs of selected businesses, tax accountants, tax lawyers, representatives of tax associations, and officials of the Internal Revenue Service (IRS). The corporate businesses we met with varied by geographical location, size, and industry

type.[1]

There are several points we will discuss today. First, according to the businesses we interviewed, the complexity of the Internal Revenue Code, compounded by the frequent changes made to the code, is the driving force behind business tax compliance burden. Second, a reliable estimate of the overall costs of tax compliance would be costly and in itself burdensome on businesses to obtain. Finally, reducing the compliance burden on businesses and individual taxpayers will be a difficult undertaking because of the various policy trade-offs, such as revenue and taxpayer equity, that must be made.

While discussing with us the many issues associated with compliance burden, the business officials and tax experts also acknowledged the legitimate purposes and requirements of the tax system. They said that filing tax returns and paying taxes were all part of doing business. But most firmly believed there must be easier ways to achieve the goals of the federal tax system.

COMPLEXITY OF THE FEDERAL TAX CODE

Business officials and tax experts told us that, overall, the

[1]While the businesses we interviewed were selected to provide a range of perspectives, they were not selected to provide a statistically valid sample. As a result their input cannot be generalized to all businesses. Appendix I provides detailed information about the scope of our work and methodology.

federal tax code is complex, difficult to understand, and in some cases indecipherable. They also said it was burdensome to comply with the code because of the additional record-keeping and calculations that the code requires. More specifically, they said businesses have difficulty with the code because of numerous and unwieldy cross-references and overly broad, imprecise, and ambiguous language. Such language, they said, appears to be designed to cover every conceivable case but leads to much taxpayer confusion and frequent misinterpretation of the code.

Frequent legislative changes, including the effects of these changes on other sections of the code, were also cited as problematic. Respondents said that the frequent and large number of legislative changes make it difficult for businesses to keep current on provisions that apply to their specific situations. For example, 1 year after the expansive Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1987 changed about 50 provisions that potentially affected business tax compliance. Business officials and tax experts said it was their perception that these frequent changes were designed to fix loopholes or perceived abuses; yet, in making these changes, Congress appeared not to have considered the impact they have on other sections of the code.

These same parties expressed frustration about provisions with finite lives being left to expire but later reauthorized. These

are tax provisions that may contain sunset clauses to encourage future reevaluation. And while recognizing the value of these provisions, business officials and tax experts said informed business decisions are difficult to make without knowing a provision's fate. Each of these concerns about changes to the tax code added to the uncertainty businesses face in attempting to understand and comply with the tax code.

The tax code also can create the need to establish and maintain numerous and sometimes duplicate sets of financial records. For example, all of the 17 businesses we spoke with said depreciation requirements caused them to maintain detailed records solely for tax purposes. For a given set of assets, some companies need to produce one set of computations and records for the regular federal tax and two additional sets for the federal Alternative Minimum Tax (AMT).[2] Many businesses are also required to produce additional depreciation computations and records for state and local income and property tax purposes.

Complexities in the code can also result in the need to complete time-consuming calculations. Among these, respondents frequently mentioned the calculations associated with the uniform capitalization rules, the AMT, and other provisions that force

[2]The Omnibus Budget Reconciliation Act of 1993 repealed the adjusted current earning depreciation adjustment for AMT purposes, effective for property placed in service after 1993. Consequently, only one set of depreciation records will be required for such property for AMT purposes.

taxpayers to trace the many categories of interest expense and apply a separate tax treatment to each category.

Our respondents also indicated that the compliance burden imposed by the federal tax system was made greater by the interplay of state and local tax requirements that at times were inconsistent with each other as well as with the federal code. Among the problems cited by businesses were different definitions of wages, income, and certain deductions; different methods for calculating depreciation; and inconsistent requirements for payroll reporting and timing of deposits. While the focus of our discussions was on the federal tax burden, some of the business respondents said that the compliance burden associated with state and local tax requirements exceeded the burden of the federal system.

IRS' ADMINISTRATION OF THE TAX CODE

Some business officials and tax experts also cited IRS' administration of the federal tax code as contributing to business compliance burden, although to a lesser extent than the complexity of and frequent changes to the code. Of those who cited difficulties with IRS, problems identified were with the tax knowledge of IRS auditors, the clarity of IRS' correspondence and notices, and the amount of time IRS takes to issue regulations.

The complexity of the code has a direct impact on IRS' ability to administer the code. The volume and complexity of information in the code make it difficult for IRS to ensure that its tax auditors are knowledgeable about the tax code and that their knowledge is current. Some business officials and tax experts said that IRS auditors lack sufficient knowledge about federal tax requirements, and in their opinion this deficiency has caused IRS audits to take more time than they otherwise might. However, other respondents said that IRS auditors were reasonable to work with. IRS recognizes the difficulty of maintaining a workforce of auditors who fully understand all tax requirements. IRS is developing a program to encourage auditors to become industry specialists so that they can increase their understanding of industry environments, accounting practices, and tax issues.

IRS also encounters difficulties in communicating with taxpayers, in part due to the need to ensure technical accuracy while at the same time presenting information clearly and concisely. Business taxpayers and tax experts said that the complexity of the forms and publications and the lack of clarity of correspondence and notices resulted in frustrating and burdensome experiences for the taxpayers. They said that business compliance burden is increased as businesses attempt to understand and respond to those notices and letters. Our last detailed examinations of IRS notices, forms, and publications, in December 1994, revealed

continuing problems with these documents.[1] IRS has been making efforts to resolve some of those problems.

Respondents also identified difficulties in complying with the code because regulations were not always available from IRS in a timely manner. IRS officials said that the amount of time that passes before a final regulation is issued varies, but it can take several years or longer. According to the officials, the amount of time is a product of the complexity of the particular tax provision, the process of obtaining and analyzing public comment on proposed regulations, and the priority IRS assigns to issuing the regulation.

For many tax provisions businesses depend upon IRS regulations for guidance in complying with the code and correspondingly reducing their burden. Without timely regulations, according to some respondents, businesses must guess at the proper application of the law and then at times amend their decisions when the regulations are finally issued.

RELIABLE ESTIMATE OF OVERALL BUSINESS TAX COMPLIANCE COSTS WOULD BE DIFFICULT TO DEVELOP

Moving next, Mr. Chairman, to the overall cost to businesses of

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[1]Tax Administration: IRS Notices Can Be Improved (GAO/GGD-95-6, Dec. 7, 1994); Tax Administration: IRS Efforts To Improve Forms and Publications (GAO/GGD-95-34, Dec. 7, 1994).

complying with the tax code, we did not identify a readily available, reliable estimate of such costs. While there was a general consensus that compliance is burdensome and some businesses offered anecdotal examples of their costs, our discussions with businesses and review of available studies indicate that developing a reliable estimate would require that several practical and severe problems be overcome. These problems include working with a broad spectrum of businesses to accurately separate tax costs from other costs and obtaining accurate and consistent responses from businesses on tax burden questions. This kind of inquiry would be an expensive and burdensome process in itself.

In our interviews with business officials and tax experts, we found that business tax compliance strategies usually were not done in isolation from other business operations; few of their activities were done solely or even primarily for tax reasons. More often, tax considerations affected the timing or structure of a business action not whether the action would occur. For example, in acquiring a business equipment would consider tax implications in terms of whether to buy or lease the equipment.

Few of the businesses we spoke with could readily separate tax compliance costs from other costs of doing business. The integration of the tax compliance activities with other business activities makes it difficult and time-consuming to collect the

information necessary from businesses to generate reliable cost estimates. For example, businesses said it would be difficult to take payroll expenditures and isolate those associated with tax compliance.

Further, business respondents said that they do not routinely need, thus it does not make sense for them to collect, information on compliance costs. And, to separate tax compliance costs from other costs of doing business would be burdensome and of questionable usefulness to them.

A few business officials provided estimates of some compliance costs, such as legal fees, payroll management fees, and tax software expenditures, but expressed limited confidence in their ability to provide accurate, comprehensive cost data. In addition, those few businesses that said they could isolate some of their tax compliance costs indicated that even in their cases, it would be difficult to separate federal compliance costs from state and local compliance costs.

THE CHALLENGE OF REDUCING BUSINESS TAX COMPLIANCE BURDEN

While we did not identify existing reliable business tax burden cost estimates, there was consensus among the business respondents, tax experts, and the literature that tax compliance burden is significant and that it can be reduced. Although some

gains can be made by reducing administrative burden imposed by IRS, the greatest potential for reducing the compliance burden of business taxpayers is by dealing with the complexity of the tax code.

One approach to simplifying the tax code would be to tackle particularly burdensome provisions individually. The business officials and tax experts we talked with identified several provisions that they perceived to be especially problematic. These included the AMT, uniform capitalization, and pension and payroll provisions. In addition, others have identified the foreign tax credit as needing simplification. Simplification of any of these provisions has the potential for reducing the compliance burden of many businesses.

Another approach that has been proposed is to completely overhaul the tax code by replacing the current income tax with some form of consumption tax. In considering changes to the tax code, whether they be limited in nature or comprehensive, legislators need to weigh several sometimes competing concerns. These include the revenue implications of any change, the need to address equity and fairness, and the desire to achieve social and economic goals. The tension in achieving balance among these trade-offs and at the same time making it easier for taxpayers to comply presents a significant challenge to Congress.

REDUCING INDIVIDUAL TAX COMPLIANCE BURDEN FACES SIMILAR CHALLENGES

The tax system is burdensome for many individuals as well as for businesses. Almost 100 million American taxpayers currently must file individual tax returns, even though most have fully paid their taxes through the withholding system. To assist the Congress in identifying options for reducing taxpayer burden and IRS paper processing, we are in the process of studying return-free filing systems and the potential impact they would have on the federal income tax system.

While we are still finalizing our results, we can provide some preliminary information on (1) the two most common types of return-free filing used in other countries, (2) the number of individual American taxpayers that could be affected by these two types of return-free filing, and (3) some of the issues that would need to be addressed if these systems were to be considered.

In countries with return-free filing, the most common type of system we identified was one that we termed "final withholding." Under this system, the withholder of income taxes--for example an employer--is to determine the taxpayer's liability and withhold the correct tax liability from the taxpayer. With the final year-end payment to the taxpayer, the withholder is to make a final reconciliation of taxes and adjust the withholding for that

period to equal the year's taxes.

Another type of return-free filing--referred to as "tax agency reconciliation"--depends entirely on information reporting to the tax agency by employers and other payors and allows the tax agency to determine the taxpayer's taxes based on these information documents. The tax agency is to send the taxpayer either a refund or a tax bill based on the tax liability and the amount of withholding. We identified 36 countries that use one of these two forms of return-free filing--34 with final withholding and 2 with tax agency reconciliation.

Given the extent of withholding and information reporting that exists under our current tax system, we estimated that about 18.5 million American taxpayers whose incomes derive from only one employer could be covered under a final withholding system. An estimated 51 million taxpayers could be covered under an agency reconciliation system.

We estimated that taxpayers could save millions of hours in preparation time and millions of dollars in tax preparation costs under either the final withholding system or the tax agency reconciliation system. We also estimated that IRS would save about $45 million in processing costs under the final withholding system, and about $36 million under the tax agency reconciliation system, in processing and compliance costs. However, employers

would face substantial additional burden and costs under the final withholding system and the tax preparation industry could be adversely affected under either system.

Furthermore, several changes to the current tax system would be needed in order to implement either form of return-free filing. Under both systems, taxpayers would continue to provide information to IRS on their filing status and number of dependents. Employers would need to be authorized by law to compute and remit tax liabilities under final withholding and they would have to set up payroll procedures to do so.

Consideration would also need to be given to the impact of these systems on certain states where the state income tax is tied to the federal income tax return. For example, IRS would have to speed up the processing of information documents under the tax agency reconciliation system so that tax liabilities could be determined before April 15, which is also the tax filing deadline for some states. IRS' own 1987 study of return-free filing recognized this processing problem and recommended against a tax agency reconciliation return-free filing system for that reason. As IRS improves its information processing capabilities, return-free filing may become more feasible.

In summary, reducing the tax compliance burden on businesses and on many individuals will be a difficult undertaking because of

the various policy tradeoffs, such as revenue impact, taxpayer equity, and shifting compliance obligations, that must be made. However, continued evaluation of ways in which tax compliance burden can be reduced is an important contribution to improving our tax system.

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Mr. Chairman, Representative Shadegg, this concludes our prepared statement. We would be pleased to answer any questions.

METHODOLOGICAL APPROACH AND LIMITATIONS

Our approach for (1) identifying the sources of compliance burden for businesses and (2) determining the feasibility of obtaining reliable estimates of the compliance costs borne by businesses was to review and assess the literature on tax compliance burden to identify issues and to conduct in-depth interviews of businesses and tax experts to obtain their views on compliance burden.

We reviewed about 25 commonly recognized studies from the literature on compliance costs and tax simplification. These studies provided information on how businesses comply with tax laws, the areas they find more difficult to comply with, causes for some of the tax compliance burden experienced by businesses, and suggestions for reducing compliance burden.

We interviewed business officials and tax experts to obtain detailed information on actual taxpayer experiences in complying with federal, state, and local tax requirements and to determine if companies could collect reliable taxpayer compliance cost data. These included interviews with tax and management officials of 17 businesses, three panels of tax accountants from the American Institute of Certified Public Accountants (AICPA), and a panel of tax lawyers from the American Bar Association

(ABA) Tax Section. We also talked with representatives of tax associations and IRS officials to obtain their views on the reasons for tax compliance burden.

We selected the 17 businesses to include a variety of geographic regions, industry types, and sizes, rather than to construct a statistical sample of businesses. The 17 companies were headquartered in 6 states across the country--California, Georgia, Maryland, New York, Ohio, and Virginia. They included a wide variety of industry types, such as manufacturing, services, telecommunications, and retail operations. We chose to focus, for the most part, on medium-sized companies because, among other things, relatively little past research has focused on this subgroup. Our sample included, however, a few large corporations and some relatively small businesses. Most of the 17 businesses were judgmentally selected from public databases that list publicly traded and privately held corporations. Table 1 summarizes the characteristics of the 17 companies we interviewed.

Although our results do not necessarily represent the business community at large, the AICPA, or the ABA tax section, they provide qualitative information on actual experiences--good and bad--that the companies encountered while complying with federal, state, and local tax systems. Moreover, our results on the

sources of tax compliance burden are consistent with the information found in the literature we reviewed.

Table 1: Characteristics of businesses interviewed by GAO

Company information[a]		
Type of industry	Number of employees (rounded)	Number of states
Printing	3,000	11
Manufacturing - paper products	8,500	50
Manufacturing - heavy equipment	1,300	4
Restaurant operations	2,300	6
Media operations	30,000	14
Real estate operations	20,000	47
Restaurant operations	5,000	5
Information technology	4,000	20
Retail & wholesale operations	1,400	3
Contractor	100	N/A
Importer/exporter	3,000	35
Retail operations	1,000	26
Retail operations	4,000	30
Food processing	800	N/A
Automotive car operations	1,200	11
Information management	3,000	35
Distributor medical equipment	100	2

Note: N/A means not available.

[a]Company assets ranged in size from around $50 million to almost $4 billion. There were 7 companies with less than $100 million in assets; 5 companies with between $100 million and $250 million in assets; and 2 companies with more than $1 billion in assets.

The asset size was not available for three companies.

Ms. CHEATHAM. Thank you, good to see you.

I am here on behalf of the Arizona Department of Revenue. We certainly have a great relationship with the local IRS and as a matter of fact, this morning I was notified that the Department of Revenue and the District was awarded a national award for the projects which I have discussed. We have an inter-governmental award from the Public Employees Roundtable. It is on our Arizona DOR/Southwest District IRS Fed-State Program, which is in my remarks. We were the only award in the inter-governmental agreement, which is a Federal-State as well as two like government awards.

I would like to note that we have this excellent relationship, it has been very beneficial to this State. We obviously have the more common programs which are the sharing of data, and the offset by the State for the IRS indebtedness of our taxpayers, but we see our role with the IRS as more of a partnership, that we should be easing taxpayer burdens, we should be simplifying the taxpayers' relationships with the bureaucracies and to find efficiencies and economies in our efforts in the tax administration area.

In recent years, we have partnered a number of initiatives that have improved service for our taxpayers and made our operations more efficient and effective. For example, this is the third year where we have sat down with top level management as well as actually the working employees and done brain-storming and then putting these initiatives into effect. We do joint workshops. This is important for the tax practitioners and the taxpayers, and we have traveled the State, had training seminars for the practitioners and the taxpayers. We are now beginning to do a satellite link to try to basically put this out to people who do not want to travel to the central area.

We have an absolutely wonderful program which we initiated. We switch taxpayer inquiry calls between our agencies. Especially this time of year, if you have ever tried to get ahold of an IRS or a DOR agent, it can become quite frustrating. We cannot staff to peak, so what happens is someone calls into my agency, they have a question that also requires an IRS response. Under the old system, we gave them the number, they had to come back in redial and go through the queue at the IRS. The same thing would occur at the IRS. One of the initiatives we put into place is our agents would say Mr. Shadegg, would you like to talk to the IRS, you would say yes, we would say just a moment, we would flip a switch and you would be at the lead of the queue at the IRS.

Last April, for example, over 10,000 taxpayers were helped in this program and this is one of the programs that we were nominated and awarded the service of excellence program award.

We are currently implementing another innovative program which has been a tremendous help to the public who owes money to both of us, and that very frequently happens. It is a joint installment pay program. One of our employees, either an IRS or a DOR employee, goes out and contacts the indebted person and we sit down, we work through the agreement for both agencies. It has reduced the time to do the agreement by about 40 percent, and because of the fact that the same arrangements are made, we do not over-commit the taxpayer to repayment. We have gone to a zero de-

fault, which is just amazing. And we have a tremendous amount of support from the public on this.

Some of the other programs we have are the Internal Revenue Service tax forms, tax information on our bulletin board, and our tax fax. We are exchanging public assistance staff. As of next Monday, we will have people from the Department of Revenue at the IRS and vice versa, and these people will do a one-stop shopping, so people will walk into either area and be able to discuss their tax problems.

We have the joint training seminars, as I said, which we have done about 800 people last year and we are up to about 500 this year. We have drive-through operations where, in Phoenix, the IRS has the forms and the returns for both agencies and we do that in Tucson, so that someone can come in at the last minute, as happens, and file their tax return with both agencies.

We also do two national projects. One is the paper W–2 project where the IRS and the Social Security Administration cooperate with various States and we use the data that the Social Security Administration does on optical scanning and we match it to our local data. This has been very successful for Arizona. In the first year of the pilot, we were able to collect about $1 million against individuals and employers who chose not to voluntarily file with Arizona. Additionally, because we matched for the IRS, we were able to add them to the Service's tax rolls at the same time.

We also have a project where the Department of Revenue is going to be issuing Federal identification numbers for the employers on our combined application, which we have done for years with all other State agencies. It is a pilot. We believe that by having someone be able to walk into one location, get both Federal and State registrations, it will certainly assist them.

These are good examples of what is possible when the Service and State government can work together, more that obviously can and should be done. What we would like to suggest is that several things be considered by Congress.

First, there are bureaucratic constraints which prevent cooperation. Those need to be addressed. Most States will offset Federal tax obligations against the State tax refunds. In Arizona, we had about 10,244 offsets last year and that was about $2.8 million being paid to the IRS at no cost to the Federal Government. Currently 32 States do it; however, the IRS has no authority to reciprocate and to provide offsets for our obligations against Federal refunds. Currently, House Resolution 757 and Senate Resolution 1408 contain provisions that would allow reciprocal offsets. We and the IRS support this.

We also would like to have a bill that would allow the Fed-State relationships to be expanded. This includes the transfer of data. For example, right now it is pretty well paper. Paper is burdensome, we face a lot of other problems. We would like to be able to go to the easier and the broader methodology of going to computer—use the computer technology where they would basically link up the computers and in a highly confidential and instantaneous, very cost-effective manner ship that information back and forth. There are security provisions in place. It would not be something that would be a problem.

There is insufficient IRS funding and there is nothing the States can do to help that. We would like Congress to show support for that funding mechanism.

And finally, the Treasury has expressed its intention to take to Congress legislation that would authorize a broad range of cooperative projects such as we have done here in Arizona, but have a cost-reimbursement basis. Legislation is needed to permit it. We would encourage you to consider it. The activities that would be more effective would be the joint or simultaneously issued installment agreements, cooperative lien and levy programs, sharing or exchange of audit or collection activities and telefiling.

Legislation would only grant the authority to do business in a businesslike way and it does not require or mandate a specific action or program. The policy decisions would continue to be done as they are now. We would encourage your support of this legislation and want to reiterate that we do have an excellent relationship with the IRS here in Arizona.

[The prepared statement of Ms. Cheatham follows:]

TESTIMONY BEFORE THE CONGRESSIONAL COMMITTEE
ON GOVERNMENT REFORM AND OVERSIGHT
SUB-COMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES AND
REGULATORY AFFAIRS

PHOENIX, ARIZONA
APRIL 3, 1996

BY

LEIGH A. CHEATHAM, DEPUTY DIRECTOR
ARIZONA DEPARTMENT OF REVENUE

Thank you for this opportunity to comment on the relationship between the Arizona Department of Revenue and the Internal Revenue Service

Let me begin by noting that the Arizona Department of Revenue has an excellent relationship with the Service, and one which has been referenced as a model for other district/state relations. You may be aware of the more common programs, such as the IRS offset against state refunds and the data exchange of federal tax information so critical to state income tax programs. However, in recent years we have partnered a number of initiatives that have improved service for our taxpayers and made each of our operations more effective and efficient. For example, this is the third year of a very active Fed/State program which has resulted in over two dozen ideas that have been successfully implemented. These ideas range from such simple things as offering joint workshops and training seminars for tax practitioners and taxpayers to more complex programs such as switching taxpayer inquiry telephone calls between agencies.

Among the more innovative programs was one initiated two years ago to transfer calls between our taxpayer assistance areas. Often taxpayers call in to one agency to only find they really need to talk to the other agency or even to both agencies. Before this program, they had to place a call to the second agency and wait until a line was available to answer their questions. Now they are freely transferred by our agents to the front of the other agency's phone queue. As a result, they only have to wait in one phone queue for service, rather than two. Last April, at the peak of our phone season, over 10,000 taxpayers were helped in this program which became a model for the country. This program was so successful we expanded it to our tax practitioner hot lines and are now working to install a switch between our phone collections units.

We are currently implementing another innovative program which is a joint installment payment agreement. This program offers a plan wherein taxpayers who have money due both agencies are able to work out one "part pay plan" to jointly resolve these debts. In our pilot program, we found these agreements reduced the amount of time the combined staff spent on a agreement by 40% while all but eliminating defaults on the agreement caused by taxpayers over promising payments. This program avoids competition between the agencies and makes it simpler for the taxpayer to comply with his tax obligations. As with the phone switch, this program is gaining national interest.

Briefly, some of the simpler Fed/State projects include the following:

- Adding Internal Revenue Service tax form and tax information to the State Electronic Bulletin Board
- Exchanging public assistance staff during the final week of the filing season. Service and Department staff are placed in each office to assist the public. This program offers one "stop shopping" for people who need help at these critical times.
- Holding joint training seminars for tax practitioners. For example, last December we jointly:
  - held 9 practitioner seminars for over 800 attendees at various locations across the state and currently have 500 interested people signed up for withholding tax seminars.
  - Shared drive through for forms and returns. IRS handles both in Phoenix and DOR takes responsibility for both in Tucson.

At the national level we partner with the IRS on two withholding tax projects. In the "W2 Paper Project", the IRS and Social Security Administration are cooperating with various states to determine if data captured by the SSA in their optical scanning process can be used by the states in lieu of local data capture. If successful, this project could cut paper submittals by taxpayers in half while reducing the overall cost of government operations. As an additional benefit, in the first year of the pilot, Arizona used the project to assess over $ 1 million against individuals and employers who were non filers for Arizona state withholding purposes. Many of these were also federal tax non-filers and the DOR has been able to furnish this information to the Service, thereby enabling them to efficiently add them to the federal tax rolls as well.

In another related project, Arizona has volunteered to pilot a project to issue the Federal Identification Number (FEIN) with the state tax license numbers. We already have a combined application for all DOR administered taxes and the Department of Economic Security (DES) administered Unemployment Insurance Tax. That package already includes the federal application used to enroll in the SSA and IRS programs. In the pilot, DOR will issue the Federal ID number at the same time it completes all the state

registrations for the employer. This program will thus offer business taxpayers "one stop over the counter" convenience.

The above projects are good examples of what is possible when the Internal Revenue Service and state government can work together. There is, however, more that can and should be done. In order to expand this cooperative effort the states have suggested some changes to federal law which we would like this sub-committee to consider. The changes primarily address the bureaucratic constraints which prevent the cooperation that is necessary and desired. For example, as noted above,. states offset federal tax obligations against their state tax refunds. Last year in Arizona alone, 10,244 offsets resulted in almost $ 2.8 million being paid to the IRS at no cost to the federal government. In total 32 states currently do refunds offsets for the federal government. Unfortunately, the IRS has no statutory authority to reciprocate and provide offsets for state debts against federal refunds. Currently H.R. 757 and S 1408 contain provisions that would allow reciprocal offsets. The IRS has supported the change in the law and estimates it will generate another $8 million dollars for the federal government as additional states would join the program if the IRS was allowed to reciprocate.

This matter has been considered in open hearings by both the 103rd and 104th Congresses. To our knowledge no objections by either taxpayers or state governments were noted at that time or at any other time for this idea. As already noted other states would join in the program and offer offsets to the IRS if there was reciprocity. The IRS estimates it could collect an additional $8 million over 5 years, so this is a Win/Win situation for both federal and state programs.

This bill needs to be included as part of a larger tax package. There probably is no single more important action that would cement the Fed/State relationship and contribute to effective, efficient tax administration with minimal taxpayer burden. These provisions need to be passed and as soon as practical.

We mentioned the paper W2 project that is part of the STAWRS (Simplified Tax and Wage Reporting System) initiative. Currently the SSA and IRS. are offering this program at no costs to the states. They are concerned that without funding they will need to charge for this service in the future. Instead, the IRS. and states should be encouraged to exchange information freely when the prime beneficiary is reduced taxpayer burden.

In a related vein, there needs to be a mechanism to allow for easier and broader information sharing and exchange between our agencies and the ability to explore joint projects without the constraint of trying to segregate costs. Just as we are considering issuing federal ID numbers for the feds at no cost to them, they should, for example, be able to consider processing of combined returns. Both agencies have a need for much of the same information to register an employer or process a tax return. It makes sense to

encourage initiatives which take advantage of that commonalty to reduce taxpayer burden and improve the efficiency and effectiveness of both agencies. In order to do that we need your help in tearing down barriers to this cooperation.

States and the federal government have long exchanged taxpayer return information. The technology used to achieve this routine exercise is far behind the times. Too often an exchange is still on paper, at other times it is on a physical tape or cartridge. In either case the process is time consuming, costly and cumbersome. Technology now allows simpler cost effective , instantaneous and highly confidential exchanges through direct communications between computers.

The program has been studied and pilots have been completed. All the current security provisions are in place as are controls. The only hold up is there is insufficient IRS funding to implement the program. Anything Congress can do to show its support for a secured, automated federal-state exchange of information program would be most helpful.

The Treasury has also expressed its intention to take to Congress proposed legislation that would authorize a broad range of cooperative projects on a cost reimbursement basis. The legislation is needed to permit better sharing of taxpayer return information (from one taxing agency to another), more cooperative activities in the area of collecting delinquent accounts and cost sharing between states and the IRS.

The types of activities which could be more effectively undertaken under this legislation include:

- o joint or simultaneously issued installment agreements
- o cooperative lien and levy programs
- o sharing or exchange certain audit or collection activities in particular when one agency is working accounts that the other is not.
- o joint federal/state telefiling

The legislation merely grants the authority to do business in a businesslike way, and does not mandate or require a specific action or program. Such policy decisions would continue to be made as they are today on a case by case basis.

We would encourage your support of this legislation.

Mr. SHADEGG. Thank you very much. We appreciate that and I have a number of questions of my own about it and hopefully Congressman Salmon will as well.

Let me at this point welcome Congressman Salmon to the dias and again express my appreciation for him being here today. As I indicated earlier, he serves on the House Small Business Committee which has oversight responsibility over the IRS, and is the only other committee so far this Congress to hold oversight hearings with regard to the IRS.

With the extensive testimony we have had today about the impact of our Tax Code on small businesses, I think he brings unique expertise, and I appreciate him joining us.

I do not know, Congressman Salmon, if you would like to make an opening statement of any type?

Mr. SALMON. That would be fine.

Mr. SHADEGG. We are delighted to have you do that.

Mr. SALMON. Thanks, Congressman Shadegg.

Leigh, it is good to see you again. I worked a lot of long hours with Leigh on the committee dealing with our tax system in the Arizona State Senate and I think that the State has done a lot to simplify the Tax Code within the State of Arizona. I think that it is about time at the Federal level, we follow suit and do some of the same things.

Alma Davis, I understand that you testified earlier. I apologize for missing that. I look forward to meeting with you personally and talking about your story.

I have co-sponsored a piece of legislation with Congressman Jim Traficant. He is a Democrat, but this is a bipartisan issue. It is the issue of the Taxpayers Bill of Rights. We passed a similar measure in the State of Arizona, as you know, Leigh, a few years ago. And the concept is this. That right now under our Tax Code, at least with the IRS enforcing our Tax Code, you are guilty until proven innocent. That is wrong. And in every other aspect of the law in this country, you are innocent until proven guilty and the burden of proof is on the entity bringing charges. I am one of those that believes that we need to reverse that trend and rein in the powers of the IRS.

As we have talked about various aspects of the Tax Code as it applies and impacts small business, I find out time and time again part of it is the oppressive nature, the fact that the Government keeps wanting more and more. And I am sure Mr. Shadegg mentioned a couple of the things that he is doing. No. 1, on the two-thirds initiative, he was the father of "It's Time" here in Arizona, and he is spearheading the same efforts back in Washington, DC, with the support of our delegation obviously, to require that any time we raise taxes, it requires a two-thirds vote instead of a simple majority. And I think it is a step in the right direction.

You have seen Presidential candidates talk a lot about simplification and I think people out there are just as interested in simplification as they are in tax relief, maybe even more so with some. The fact that when you submit your taxes you have to almost have a rocket scientist, if you are in small business, put together your taxes for you because it has become so cumbersome and burdensome and difficult. The ideas that have been posed, like a flat tax,

where you could fill out your taxes on the back of a postcard, have appeal to a lot of people. And the idea put forth by Congressman Archer to repeal the 16th amendment and replace it with a national sales—get rid of income tax altogether and replace it with a national sales tax. These kinds of ideas have appeal and I believe will be going through the hearing process in the very short future to determine what is the best way for us to go.

But it is clear that there are some taxes that are on the books right now that make no sense. We corrected one in the small business arena, we passed a health care reform last week which gives a 50 percent deduction to small businesses on their health care coverage. Why should it be that large businesses enjoy tax deductibility for the premium coverage for their employees, but small businesses do not enjoy the same kind of benefit? It is discriminatory and it ought to end. We ought to give small businesses the same benefits as large businesses.

Another issue that has become very, very important to me is the issue of an estate tax. The fact that during a person's lifetime they will pay multiple taxes on their business and yet then when they die and leave the business on to their children, it is taxed at 54 percent. What is fair and equitable about that? I have friends who own a printing company, whose father just died a couple of years ago. And when he died, they were faced with the prospect of continuing the family business or meeting their tax liability and selling the business and losing everything that their father worked so hard for all of his life.

I think our current tax policies not only are not totally fair, but they are not equitable and we need to figure out something that is simple and easy and fair and equitable, and that is why it is such an honor and a privilege for me to be here today alongside my dear and trusted friend and colleague, Congressman John Shadegg.

Thank you.

Mr. SHADEGG. Thank you, Congressman Salmon.

Let me say for the record officially, I have to request that—or state that without objection, which means I guess Matt, if you do not object and I do not object, you will be allowed to serve, for purposes of today's hearing, as a member of this subcommittee. So I am not going to object and I assume you are not going to object, so for the record, you are officially a part of the subcommittee for today's hearing.

With that formality taken care of, let me—and I would not normally introduce an individual witness in this way, but I am pleased that we have someone with this level of expertise. Our next witness represents the IRS, probably has been sitting there listening with a very close ear to what has gone on today. She is the Associate Chief Counsel in the Office of Chief Counsel of the Internal Revenue Service. It says Domestic, so I assume you do not have to deal with foreign tax issues.

Ms. DUNN. That is right.

Mr. SHADEGG. Ms. Judith C. Dunn received her B.S. in accounting from the University of Scranton in Scranton, PA, in 1977. She received her J.D. from Harvard Law School in 1981. She clerked from 1981 to 1983 for Chief Judge Theodore Tanenwald of the U.S.

Tax Court, which means she knows more than Matt and I put together by a factor of 10 in this arena. Prior to joining Treasury, Ms. Dunn was a partner in the Washington, DC, offices of Robson Gray where she had been since 1983.

The IRS has put together for us a 27-page statement for the hearing today, we certainly appreciate that. We will urge you not to read it, but to rather summarize it, and welcome you here to the committee. Thank you. Ms. Dunn.

Ms. DUNN. Thank you. Good morning, Congressman Shadegg, Congressman Salmon. As you said, my name is Judy Dunn and I am the Associate Chief Counsel, Domestic, for the Internal Revenue Service. With me today is Marty Washburn, who is the National Director of the Office of Specialty Taxes at the IRS.

We appreciate the opportunity to be here with you today to discuss the role of the IRS in administering the Nation's tax system. I have submitted for the record a written statement that covers several topics dealing with the various aspects of tax administration. I have also included testimony that Commissioner Richardson has recently presented to Congress dealing with recent IRS efforts to improve service to taxpayers.

This morning, I would like to discuss with you how my colleagues and I who work as attorneys at the IRS are also working to improve the legal aspects of tax administration. I especially want to focus on the work that we are doing in developing regulations and other guidance that helps taxpayers interpret the Code.

In general, the lawyers who work for the IRS have two principal responsibilities. First, there is tax litigation. Our attorneys represent the IRS before the Tax Court and we provide advice and assistance to the Department of Justice who represents the IRS in other courts.

While tax litigation is probably what most people think of as the principal job of IRS lawyers, the point that needs to be emphasized is that there is really very little tax litigation. For example, in fiscal year 1994, there were over 1.4 million audits. All but 70,000 of those cases were resolved at the examination stage. And the vast majority of the controversies that went beyond the exam stage were settled by Appeals or counsel, so that there were fewer than 1,500 Tax Court decisions. This record, which has been relatively consistent over the years, reflects our philosophy of resolving cases at the earliest possible stage of the administrative process and avoiding litigation wherever possible.

The second major part of the work the lawyers do for the IRS is to provide the correct legal interpretation of the Code, both for taxpayers and other IRS employees. Sometimes this interpretation is reflected in regulations, rulings or other published guidance that applies to many taxpayers. Other times, the legal advice is used to resolve individual cases. For example, we will provide a private letter ruling to a taxpayer on the tax consequences of a proposed transaction. We also provide legal opinions known as technical advice memoranda to resolve disputes between taxpayers who are under examination and an IRS examining agent or Appeals officer.

Whatever the situation, our legal conclusions reflect our best judgment as to the proper interpretation of the Code in light of congressional intent. As you consider possible changes to the tax sys-

tem and the future role of the tax administrator, it is important to understand that the IRS mission is not to collect as much revenue as possible. Our mission is to collect the proper amount of revenue, the amount that Congress has said should be paid.

While our work in resolving individual cases is an important part of tax administration and provides a valuable service to many taxpayers, I want to focus now on our work in writing regulations and other guidance that applies to taxpayers generally. This is where I think we have the biggest impact on tax administration. I want to share with you some of the things that we are doing to improve the regulations process. In this regard, I would like to make three points.

First, the principal complaint we hear from taxpayers about our regulations, believe it or not, is not that we issue too many regulations but that it takes us too long to issue them. Taxpayers do not always like everything about the content of our regulations, but they rarely complain that there are too many. This was the conclusion that GAO reached in the 1994 report on the burden of Government regulations.

In its report, the GAO concluded that the IRS' problem is a lack of regulations and that it takes too long to issue them. Many groups of tax practitioners have echoed the GAO's view. I have included with my written testimony copies of letters from the Tax Executives Institute, the American Bar Association, the American Institute of Certified Public Accountants and the New York and the Florida State Bars, that have all gone on record in support of the need for IRS regulations to help taxpayers understand the law and to help businesses plan their transactions.

In order to understand why the IRS—why the public wants more IRS regulations, it is important to understand that IRS regulations generally do not impose new substantive requirements on taxpayers. Tax liability is imposed by the statutory rules of the Internal Revenue Code. IRS regulations are intended to help taxpayers interpret the statutory rules written by Congress. The regulations clarify, explain and demonstrate the proper application of the general language usually found in the Code.

The second point that I would like to make is that in developing regulations in recent years, we have placed a premium upon the issuance of simpler, more generalized rules rather than very lengthy, detailed, complex regulations. While we believe this approach is better for all taxpayers and for the Government, we think it is particularly helpful to small businesses that may not be able to afford sophisticated tax counsel. We also think it reduces the potential for mischief among those large taxpayers who may be looking for loopholes.

One of the prior panelists, I believe it was Mr. Walker, pointed out how lengthy the 704(b) regulations are. I agree with him on this. Those regulations were written a number of years ago at a time when we believed that the more detailed the regulations, the better. We have changed our approach. I believe the regulation Mr. Walker referred to should be rewritten. However, given the many recent changes to the Code, we have instead devoted our resources to providing guidance under sections where there currently is none.

Third, I would like to mention the importance of public input and participation in the regulations process. We publish our regulations in proposed form and we ask the public for comment. We also invite the public to participate in public hearings about the regulations. At the hearing, the public has the opportunity to express any concerns they have about the regulations, to suggest changes to the regulations and to explain business constraints facing the taxpayer.

Before coming to the Government, I spent 10 years as a tax attorney in private practice and during that time I submitted comments on a number of proposed regulations, but I never really knew what happened to the regulations, I never knew if anybody really read them.

When I came to the Government 5 years ago, I was struck by how much consideration the IRS does give to public comments. The attorneys who work in my office and at Treasury carefully consider each and every comment received on a proposed regulation. Before a regulation is finalized, senior officials at the IRS and Treasury are briefed on all significant public comments and on how the regulation drafters propose to address the issues raised in the comments. I can assure you that IRS regulations are routinely revised and improved as a result of public input.

Because we think public input is such an essential part of developing good regulation, we have taken a number of steps to make it easier for interested taxpayers to participate in the regulations process. Starting in 1992, we began publishing a list of guidance priorities that lets the public know what projects we intend to complete in the coming year. We ask for suggestions from the public about which items should be included, and we always get requests for more items than we can possibly produce. Our 1996 plan was released at the end of February.

Then in 1995, we began issuing a brief plain language summary of each new regulation. These summaries are intended to give average taxpayers and small businesses a glimpse of the regulation without them having to hire a tax lawyer or accountant just to learn if the regulation might apply to them.

In January of this year, we began putting all our new regulations together with the plain language summaries on the IRS Internet home page so that taxpayers could read them without ordering specialized tax services. I understand that during a 20-day period in February, there were over 2,500 hits that involved downloading our regulations.

And on Monday of this week, we began accepting comments on regulations through the same Internet home page where the regulations appear. Taxpayers can now give us their comments on regulations just by E-mailing us.

Finally, I want to say a few words about the regulatory reform measure that President Clinton signed into law just a few days ago. Because I have not yet had the opportunity to review the actual text of the law, I cannot speak to the precise impact that it will have upon the IRS regulations and the IRS regulations process. Nonetheless, I want to emphasize that the IRS and the Treasury Department are firmly committed to minimizing any burden that the tax laws place upon taxpayers, including small businesses. While we are still studying the precise provisions of the bill, I want

to assure you that we support the philosophy embodied in the new law and we intend to comply fully with the letter and the spirit of the new regulations.

This concludes my prepared remarks. Thank you.

Mr. SHADEGG. Thank you very much. Mr. Washburn, did you intend to make a statement?

Mr. WASHBURN. No.

[The prepared statement of Ms. Dunn follows:]

STATEMENT OF JUDITH C. DUNN
ASSOCIATE CHIEF COUNSEL (DOMESTIC)
INTERNAL REVENUE SERVICE

BEFORE THE NATIONAL ECONOMIC GROWTH, NATURAL RESOURCES AND
REGULATORY AFFAIRS SUBCOMMITTEE OF
THE GOVERNMENT REFORM AND OVERSIGHT COMMITTEE

April 3, 1996

Mr. Chairman and Distinguished Members of the Subcommittee:

Good morning. My name is Judith Dunn, and I am the Associate Chief Counsel (Domestic), within the IRS Office of Chief Counsel. The lawyers in my office write IRS regulations, provide private letter rulings to taxpayers on the tax consequences of particular transactions, and coordinate the IRS's position in litigation. I appreciate the opportunity to discuss with you the role of the IRS in administering the nation's tax system and the many recent steps that we have taken to improve the service that we provide to our customers, the American taxpayer.

My written statement covers four central topics:

- o The fundamental mission of the IRS;
- o The IRS regulations process and the importance of public input to that process;
- o Improvement in the resolution of tax controversies; and
- o Recent IRS action to improve tax administration and enhance customer service.

While my office is not directly involved in many of the IRS actions described in the final part of my statement, I am happy to share this information with you on behalf of Commissioner

Richardson. For your convenience and information, I have attached as exhibits copies of recent testimony that Commissioner Richardson has had the opportunity to provide to Congress.

I. The Mission of the IRS

First, I would like to discuss with you the fundamental mission of the IRS. Understanding the mission with which we have been charged facilitates an understanding of our role in improving the tax system, as well as the limitations of that role. The mission of the IRS is:

> [T]o collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

This philosophy is further reflected in our Statement of Principles of Internal Revenue Tax Administration, which reads as follows:

> The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.
>
> With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.
>
> At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue."

> The revenue is properly protected only when we ascertain and apply the true meaning of the statute.
>
> The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.
>
> Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

As is clear from this statement, the IRS is in the business of administering and enforcing the tax laws of the United States. We neither make the law nor establish the administration's position on tax policy issues.

In fulfilling its mission, the IRS must interpret the law as passed by Congress. The increasing complexity of the statutes reflects the increasing complexity of the American economy. Much of the burden that falls upon taxpayers thus results from the statute itself, rather than from the Service's efforts to administer the law. Consider, for example, how the tax code has grown along with the American economy over the last half century. In 1939, the tax code was 504 pages long. In 1954, the code had almost doubled, to 929 pages. The current code, by contrast, is over five times its 1939 length -- 2700 pages.

II. The Regulations Process and Recent Improvements

A. The Nature of IRS Regulations

Before describing the process for developing IRS regulations, I'd like to discuss the nature of IRS regulations. In general, the IRS issues regulations to interpret specific tax rules written by Congress and to help taxpayers better understand and meet their tax obligations. That is, our regulations generally do not impose new requirements or sanctions on taxpayers. Rather, they typically describe requirements and sanctions imposed by Congress and attempt to give taxpayers guidance on how to comply with them.

Because IRS regulations provide guidance to taxpayers, the IRS is often cited for not issuing regulations quickly enough rather than for issuing too many regulations. For example, after interviewing businesses about the burden of government regulations, the GAO concluded that the IRS's problem is a lack of regulations, not an excess. The GAO report stated:

> Of those [tax advisors and officials of the businesses interviewed] who cited difficulties with the IRS, problems identified were . . . the amount of time IRS takes to issue regulations. . . . For many tax provisions businesses depend upon IRS regulations for guidance in complying with the code and correspondingly reducing their burden. Without timely regulations, according to some respondents, businesses must guess at the proper application of the law and then at times amend their decisions when the regulations are finally issued.[1]

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[1] Tax System Burden: Tax Compliance Faced by Business Taxpayers (GAO/T-GGD-95-42, December 9, 1994).

Other groups have echoed the GAO's view. The New York State Bar Association ("NYSBA"), in a letter to Senator Robert Dole dated March 10, 1996, stated:

> Unlike some types of government regulation, taxpayers welcome interpretive tax regulations. Tax obligations are imposed by statutory rules. In many cases, the precise meaning or application of the statutes is unclear and interpretive guidance of the statutory rules is therefore necessary. With clarification of these rules, business taxpayers save time and expense in determining their tax obligations, and avoid time-consuming, expensive disputes on audits of their tax returns. Such guidance also reduces the opportunity for taxpayers to take aggressive positions minimally supported by the statute.

The NYSBA made these statements objecting to the passage of legislation that the NYSBA thought would hamper the Service's ability to issue regulations in a timely manner. Similar statements were made in 1995 during Congressional deliberations regarding a proposed moratorium on any new administrative regulations. Such groups as the Tax Executives Institute, the American Bar Association, the AICPA, the NYSBA, and the Florida Bar Association were critical of any action that would slow the flow of new IRS regulations. I would point out that previous administrations have given special treatment or exemptions to IRS regulations in deference to these same concerns.

We take seriously the public's need for IRS regulations, and we believe that public participation in the process results in

better, more useful regulations. I would like to discuss the regulations process with you now.

B. The Regulations Process

The IRS regulations process is a joint effort between the IRS, the Treasury Department, and the public to develop rules that are consistent with the legislative intent of the tax code and that are as easy to apply as possible. As with everything else, a regulation begins with an idea -- Treasury, IRS personnel, or taxpayers identify an area of confusion or uncertainty in the statute. Often, a regulations project is begun to address questions raised when Congress revises the tax code. Other times, a regulations project is begun to provide certainty to taxpayers and the IRS regarding the proper tax treatment of a new financial product or corporate transaction. Developing a regulation generally is a lengthy, time-consuming process, requiring extensive deliberations and analyses not only of the law as it applies to a new code section, product, or transaction, but also how the new regulation may affect existing provisions of the code, products, or transactions.

We recognize that the guidance we publish affects not only the taxpayers who may be engaged in the transactions described in a particular regulation, but also the universe of taxpayers as a whole. Our system depends on everyone paying their lawful share of the total tax burden, and we are ever mindful of the fact that relief to any one group may raise the perception of an increased

burden on others. Because of the crucial importance of considering the appropriate scope and possible ramifications of our regulations, the deliberative process can be a lengthy one.

During this developmental stage, we seek as much public input as possible, often through meetings with taxpayers, either individually, in ad hoc groups, or under the auspices of various professional and business associations. I do need to point out, however, that this exchange of information is not a two-way street. Once we begin working on a regulation project, the specific contents of any regulation are considered confidential information until the rule is filed with the Federal Register. This information cannot be disclosed except in limited circumstances and with the specific approval of senior IRS or Treasury officials. We have to be particularly careful not to disclose information that could affect market behavior or provide someone who received the information an unfair advantage relative to taxpayers generally.

Once the new regulations are drafted, reviewed, and approved by both the Commissioner and the Treasury Department, the document is then published in the Federal Register as a Notice of Proposed Rulemaking, or "NPRM." The NPRM represents only the Service's proposal for a new regulation -- it is not yet binding authority. Instead, the preamble to the regulation, which explains the intended purpose and operation of the regulation, invites the public to submit written comments about the proposal

to the Service. In addition, the NPRM (or a separate announcement published in the Federal Register) invites the public to attend a public hearing in the IRS National Office with representatives from the IRS and Treasury. At this hearing, the public has the opportunity to share with the drafters of the regulation any concerns they may have, suggestions for changes to the document, explanations or clarifications of the transaction or product involved, or any other information that the speaker would like to share.

Both the receipt of written comments and the opportunity for a public hearing are critical in ensuring that our regulations do in fact appropriately address the topic or issue. Just as importantly, the opportunity for public comment and hearing ensures that the government is aware of and properly understands the myriad of real world situations facing the taxpayers who will be affected by the regulations.

We carefully consider each and every comment received to ensure that we have in fact considered all possible ramifications of the new regulation, that the new regulation does in fact operate in the manner in which it was intended, and that it will reach the desired goal of clarifying the law in the manner that is the least burdensome for the government and for taxpayers alike. The drafters of the regulation both at IRS and at Treasury then work together to make revisions necessary in light of the public comments. As the revised regulations are reviewed

at the IRS and Treasury, senior level officials pay particular attention to the public comments. The IRS Chief Counsel, the Commissioner, and the Assistant Secretary for Tax Policy are briefed on significant public comments and on the proposed response to the comments.

Public comments suggesting improvements to the proposed regulation routinely result in revisions to the proposed rules. Upon completing these revisions, the final regulation (Treasury decision), which by then has been the subject of intense scrutiny by both the government and affected or interested taxpayers, is published in the Federal Register. The document containing the final regulations also includes a preamble which contains a summary of the significant public comments and the IRS's response to the comments.

C. Recent Improvements in the Regulations Process

The IRS and Treasury are continually striving to increase public participation in the regulations process. I'd like to share with you a few of the changes that we have implemented recently in an effort to improve the process.

At the top of this list is the publication of the annual list of guidance priorities that identifies our top projects for the year. We refer to this list as our "Guidance Priorities List." Each year, the IRS and the Treasury Department formulate this list of guidance priorities on the basis of input received from a wide range of outside groups, as well as suggestions from

within IRS and Treasury. I cannot emphasize enough how important this plan has been for the guidance process. Ever since we issued the first version in 1992, we have found the list to be extremely valuable both as an internal management agenda to make sure we focus our resources on the items that are most important to the system, and also as an avenue for systematic communication with outside stakeholders that helps us make more informed decisions about those priorities.

We also have made a number of changes specifically designed to increase the participation of small businesses in the regulations process. We recognize that we cannot expect small business owners to comply fully with the tax laws unless they first understand their tax obligations and then have the tools they need to satisfy their obligations quickly and cost-effectively. During the spring and summer of 1994, OMB's Office of Information and Regulatory Affairs and the Small Business Administration jointly sponsored a forum in Washington, D.C., on regulatory reform for small businesses. The IRS participated, along with five other federal agencies, in a series of workshops focusing on several small business industries, and we listened to the concerns of small business owners and their representatives. At the request of Commissioner Richardson, the IRS held a special series of workshops as part of that regulatory forum to focus specifically on IRS issues.

To participate in this regulatory forum, the Commissioner established a new IRS Office of Small Business Affairs. This office reports directly to the Commissioner and has responsibility for improving the services that our organization provides to small business. One role of this office is the coordination of all IRS efforts to increase access to the regulations process for small businesses and average taxpayers.

The small business owners we talked to asked for (i) simpler regulatory language, (ii) earlier involvement in what regulations say, and (iii) an easier way to access regulatory information. In response to the request for easier access to regulatory information, we recently implemented a procedure that should help all taxpayers, but which was particularly designed for small businesses without specialized legal counsel. Under this procedure, each new regulation is accompanied by a brief, one or two page description, in non-technical language, that sets forth the subject matter of the regulation, describes the taxpayers who may be subject to it, and instructs the reader on where to go for further information and how to provide comments to the IRS. These summaries are available to taxpayers through FedWorld, a government-sponsored electronic information service, available via the Internet. Our intent is to provide small businesses with a simple and inexpensive way of finding out what regulatory actions we are taking and how they can get involved in the process.

To facilitate involvement of small businesses in the regulatory process further, it was suggested in the SBA/OMB Forum on Regulatory Reform that we extend the comment period we normally provide for proposed regulations from 60 days to 90 days. We responded immediately by doing just that. In addition, we have begun placing the entire text of all new regulations and proposed regulations on the Internet. In a period of just 20 days in February of this year, our Web site had 2,683 "hits" involving the downloading of tax regulations. In addition, as of April 1, taxpayers can comment on proposed regulations by transmitting their comments directly to us electronically. This should prove much more convenient and inexpensive for taxpayers than the traditional mailing of paper copies.

In keeping with our focus on maximizing the public's input into the regulations process, we have considered holding public hearings on proposed regulations at places outside of Washington, D.C. Doing so would greatly enhance our interaction with taxpayers "beyond the beltway," and would make it easier for small businesses and individuals to attend and participate in these valuable sessions. Unfortunately, our current budgetary constraints have precluded us from implementing this proposal, but we hope to do so in the future.

One additional change that I want to mention is probably the most important of all, and is consistent with the small business community's request for simpler regulation language. To quote

from the statement issued with the release of the 1996 Guidance Priorities List, "we endeavor to provide clear and relatively simple rules that do not attempt to address every conceivable situation." Rather than very lengthy, detailed regulations, we strive to provide rules based on general principles that conscientious taxpayers and practitioners can understand and use. In the past, we found that the more precise and detailed we tried to be, the more we confused small businesses and encouraged sophisticated taxpayers and their advisors to look for ways in which the rules could be interpreted or combined to produce tax results that bore little or no relationship to the economics of the transactions from which they arose. Our simpler, more general approach provides understandable guidance to small businesses and forces sophisticated taxpayers and their advisors to focus on the purpose of the rules, and to determine whether the tax results they seek are consistent with the economics of their deals and the intent of Congress.

The President recently signed into law a new regulatory reform bill that requires us to undertake some additional analysis prior to issuing a regulation. The IRS fully supports the objectives of the bill -- minimizing the burden that regulations impose on the public. We intend to comply with the spirit and the letter of these new requirements.

D. Examples of Burden Reduction

I would like to provide you with a few examples of how IRS regulations serve the mutual benefit of taxpayers and the IRS. The first example concerns the determination of whether an unincorporated business should be taxed as a partnership or as a corporation. Currently, that determination is made under a complicated set of regulations based on old case law. For the well-advised, those rules are easily manipulated to achieve a desired result. At the same time, however, the rules are extremely complex and full of pitfalls for small entities without sophisticated tax counsel. Therefore, we have proposed a major initiative, to be implemented through the issuance of IRS regulations, that will allow unincorporated businesses simply to elect whether they want to be classified as a partnership or as a corporation. This new classification election, referred to as "check-the-box," will be quick, simple, and hassle-free, and will save resources for both taxpayers and the government.

Since we announced this idea in March 1995, we have received a multitude of letters of support from groups representing tens of thousands of small businesses. At a July 1995 public hearing, we heard testimony from many private sector witnesses who also expressed overwhelming support for the initiative. We hope to issue the new rules in proposed form in the very near future.

A second example of how we have used regulations to reduce taxpayer burden occurred in September 1995, when we announced perhaps the most significant change in the record keeping area in

years. Since 1962, the threshold for which businesses are required to have a receipt for a travel or entertainment expense had been $25. Effective October 1, 1995, we raised that threshold to $75. We know that, for small businesses in particular, the $25 threshold had been difficult. The new threshold should make record keeping a lot less burdensome for both employers and employees.

Finally, we have also recently completed some important regulatory housekeeping. As part of President Clinton's Regulatory Reform Initiative, we have conducted a page-by-page review of all of our existing regulations and, based on that review, have withdrawn more than 30 obsolete regulations, amounting to over 160 pages in the Code of Federal Regulations.

III. Improvements in the Resolution of Tax Controversies

The issuance of IRS regulations helps taxpayers voluntarily comply with the taw laws and also minimizes disputes between the IRS and taxpayers. Nonetheless, as with any human endeavor, disputes do and will continue to arise between the IRS and taxpayers as to the proper interpretation and application of the tax laws. In those cases in which disputes do arise, our goal is to resolve the matter as early in the administrative process as possible, with a view to turning to the courts only as a last resort. Our fundamental strategy for accomplishing this objective has involved expanding the role of the IRS Examination function in resolving cases and providing opportunities for

certain issues to be considered by Appeals even before the rest of the case is finished in Exam. I would like to share with you some of the changes that the IRS has made to facilitate the early resolution of taxpayer controversies.

A. Resolution at Exam Level

Resolution of tax controversies begins with the IRS Examination function, which has the initial authority to determine a taxpayer's correct tax liability. In audits, Exam has the authority both to make findings of fact, and to apply the law to those findings, in order to determine the correct tax liability. In other words, Exam's goal is not only to raise issues, but also to resolve them.

In fact, the overwhelming majority of tax controversies -- and potential controversies -- are resolved while a case is still in Exam. In fiscal year 1994, Exam audited approximately 1.4 million returns; all except 70,000 of these audits were resolved at the Exam stage. Even in the high-stakes world of the Coordinated Examination Program (or "CEP", a program that focuses on our largest corporate taxpayers), approximately 75 percent of all cases in fiscal year 1994 were fully resolved by agreement in Exam. This figure is up from less than 50 percent just a few years earlier (fiscal year 1991).

We think this increase in the number of agreed cases reflects the success of a number of recent initiatives in the CEP area. For example, Exam formally established the Accelerated

Issue Resolution Program in 1994. Under this program, once Exam makes a determination for a year under audit, the taxpayer can request that the same determination be applied to other tax years for which returns have been filed but which have not yet been audited. If Exam agrees to this approach, the taxpayer and the IRS will execute an agreement that resolves the issue for these other years. This saves time and money both for the taxpayer and the government.

Another recent improvement in our procedures for the early resolution of tax controversies has been providing Exam with limited settlement authority in specific circumstances. Historically, Exam had been restricted to resolving issues based strictly on the merits of the position, and had been prohibited from settling or compromising issues based on such factors as hazards of litigation (which is the role of the IRS Appeals function). The Commissioner has recently delegated additional authority to Exam, authorizing them to settle certain issues in CEP cases by applying the same settlement that Appeals has reached with the taxpayer for an earlier year. In addition, Exam may now use Appeals settlement guidelines to resolve certain coordinated issues in the Industry Specialization Program and International Field Assistance Specialization Program. Providing greater settlement authority to Exam means less time and expense for both the taxpayer and the IRS in determining a taxpayer's correct tax liability.

B. Resolution at Appeals Level

The IRS Appeals function was created in 1927 with the central mission of settling tax disputes without litigation, on a basis that is fair and impartial to both taxpayers and the government. Prior to development of the Exam settlement initiatives that I just described, Appeals was the only administrative function within the Service with authority to settle cases based on factors such as hazards of litigation.

Appeals has an outstanding record of reaching agreements with taxpayers. Over the years, Appeals has consistently settled 85 to 90 percent of its cases by agreement with taxpayers. In recent years, Appeals has built on this tradition by promoting a number of new initiatives that should further enhance its ability to settle tax disputes without litigation.

First, there is the early referral process. Under this procedure, a taxpayer whose return is under examination can request that Exam transfer developed, unagreed issues to Appeals while Exam continues to audit the remaining issues. When the crucial issues have been resolved, it is often much easier to resolve the remaining smaller issues. Early referral is also expected to save time by allowing Appeals to work on the referred issues while Exam continues to develop the remainder of the case.

Another important Appeals initiative centers on mediation of taxpayer disputes. On October 30, 1995, Appeals began a one-year test of mediation as an extension of the traditional Appeals

process. Mediation is a non-binding process in which a neutral third-party guides the settlement discussions of the parties and assists them in reaching their own negotiated settlement. Under the terms of the present test, the mediation process will be available in Appeals to our largest corporate taxpayers in certain limited circumstances. Despite the limited scope of this initial test, however, we think that mediation potentially represents a significant step forward in the efficient resolution of tax controversies. We are particularly hopeful that the procedures will work well for the settlement of intensely factual issues such as valuation of property and the determination of whether compensation paid to an employee is reasonable.

C. Resolution Through Litigation

Let me turn now to litigation as a process for resolving tax controversies. First, I want to put the current state of tax litigation in perspective -- both in terms of its purpose and also in terms of the amount of litigation that actually occurs.

It is important to understand what we are trying to accomplish in the cases that we do litigate. The dollars we may collect in the individual cases are not our principal concern. Rather, our goal in litigation is to establish positions that will have a positive impact on the system as a whole.

This approach to litigation has been explicit in Chief Counsel orders dating back at least to 1964. Our partner in tax litigation, the Tax Division of the Department of Justice, shares

this same approach. Former Assistant Attorney General (and later IRS Commissioner) Shirley Peterson told the Federal Bar in 1991 that Tax Division attorneys are directed to advocate "the interpretation which makes the maximum contribution to a sound, wise tax system, not only immediately but over the long run."[2]

We recognize, however, that litigation entails the expenditure of substantial resources by both taxpayers and the government. Accordingly, we actively pursue the pre-trial settlement of docketed cases where doing so would not prejudice the government's interest. Consistent with this philosophy, we also are taking steps to encourage small taxpayers to pursue administrative appeals within the IRS rather than going immediately to court. Unfortunately, taxpayers without tax counsel frequently see the courts as their first, rather than last resort.

Our current practices of pursuing pre-trial settlements and of encouraging taxpayers to seek non-judicial remedies have been remarkably successful in minimizing the total quantity of tax litigation, especially in view of the potential for controversy. For example:

- Over 200 million tax returns are filed each year.

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[2] Peterson, "The Development of Tax Policy Through Litigation," Federal Bar News and Journal, Vol. 38, No. 6, p. 334 (August 1991).

- As stated above, about 1.4 million of these returns are examined, and all but about 70,000 of these audits are resolved at the Exam stage.

- In recent years, somewhere between 25,000 and 30,000 Tax Court petitions and about 800 refund suits are filed each year.

- The vast majority of the lawsuits filed are settled before they are tried. Only about 1,500 cases are tried and decided each year.

- The universe of appellate litigation is even smaller, with only about 300-325 Tax Court and refund litigation appeals, of which only about 50 are government appeals. Only a handful of cases end up in the Supreme Court.

While we think this record demonstrates our sincere commitment to conserving the resources of taxpayers and the government alike by avoiding unnecessary litigation, we are prepared to do even more. The Civil Justice Reform Act, the Administrative Dispute Resolution Act, and Executive Order 12778 require that we litigate more efficiently when litigation is necessary, that we promote settlement whenever possible, and that we consider alternative methods of resolving controversies.

We think alternative dispute resolution techniques have the potential to reduce even further the already small volume of tax litigation and to resolve additional disputes more quickly and inexpensively than has been possible in the past. For example, the IRS has instituted the use of binding arbitration and of voluntary, non-binding mediation, in appropriate cases. In addition, we are considering use of court appointed experts to resolve factual (as opposed to legal) disputes.

IV. Recent IRS Actions to Improve Tax Administration and Enhance Customer Service

Finally, Commissioner Richardson has asked that I share with you a number of other areas in which the IRS has made significant strides in recent years in improving the administration of the tax system and enhancing the customer service that we provide to the American taxpayers.

A. Taxpayer Bill of Rights 2

During the last year, we had the opportunity to work with Congress on the Taxpayer Bill of Rights 2 (TBOR2). When last year's efforts to enact the TBOR2 legislation proved unsuccessful, we administratively adopted the TBOR2 proposals that did not require Congressional action.

In January 1996, we published Announcement 96-5, entitled "Administrative Actions to Enhance Taxpayer Rights," to identify the TBOR2 proposals that the IRS had either already adopted or could adopt administratively with no legislative action. The Announcement also included IRS regulatory and guidance projects that were similar in nature to the TBOR2 proposals developed by the Ways and Means Committee.

As a result of this approach, the IRS has been able to provide taxpayers with some of the benefits of TBOR2 in advance of the legislation's enactment. For example, the IRS has already taken steps to strengthen the role of the IRS Taxpayer Ombudsman. The IRS has limited the number of IRS officials who can overrule a Taxpayer Assistance Order ("TAO") to only the Commissioner, the

Deputy Commissioner, or the Ombudsman. The IRS also clarified that the Ombudsman may issue a TAO to direct the IRS to pay a refund to a taxpayer to relieve a severe financial hardship and to stop a collection action to ensure a review of whether the action is appropriate. The Ombudsman now also has greater power over the selection and evaluation of local Problem Resolution Officers. Finally, the Ombudsman is now required to prepare annual reports on the most serious taxpayer problems and suggest administrative and legislative solutions to those problems.

In addition, the IRS has underway two studies. One is on the unique problems faced by divorced and separated taxpayers under the current tax system. The other is on interest netting. To help us with these studies, we recently issued two Notices asking for public comment on issues that may arise in each of these situations.

The IRS also has issued guidance to Revenue Agents and Revenue Officers on new procedures to notify one spouse of actions taken against the other spouse to collect their joint taxes. On April 1, 1996, the IRS put into place procedures to give taxpayers the right to appeal liens, levies and seizures proposed by the IRS. And, we formalized our practice of requiring our Regional Counsel to review designated summonses and limiting designated summonses to CEP cases, except in unique circumstances.

B. Other Administrative Strides

Commissioner Richardson also would like for me to share with you some of the strides that the IRS has made in the last three years in making it easier for taxpayers to communicate with us. We recognize that taxpayers get frustrated when they call us and repeatedly get a busy signal. We are trying to answer taxpayer questions more quickly and more efficiently, and in the past three years have answered more telephone calls than ever before. We also have a growing number of taxpayers who visit or write us. For example, in 1993, we heard from taxpayers by phone, visits, or letters 73 million times. Last year, the number grew to 118 million.

We have expanded access to our TeleTax recorded information line, which offers taped information on 148 topics all day every day, and refund information 16 hours a day, Monday through Friday. Last year, we answered 61 million TeleTax calls, over twice the 30 million answered in fiscal year 1994. In fiscal year 1995, our assistors also answered 39 million calls, an increase of more than 3 million over the prior year. We were able to serve more taxpayers by increasing productivity, expanding our hours of service, and installing call routing equipment that allows us to better manage our telephone workload. This technology allows us, among other things, to route calls to available assistors, who may be in the next county, next state, or across the country. Taxpayers cannot tell the difference, but we hope that they are aware of the improved service that results.

Technology also is creating entirely new ways for taxpayers to get forms and information from us while reducing our postage and printing costs. Three years ago, taxpayers requesting a publication or form either had to call us to have the material mailed or they had to drop by one of our offices, their local post office, or library. Not today -- at least for many taxpayers. Taxpayers with access to a computer and a modem can get forms and information anytime, anywhere in the world from FedWorld, which I discussed earlier in connection with the availability of tax regulations on-line, or from our site on the World Wide Web. The IRS's new home page on the World Wide Web has been accessed more than 25 million times. Forms also are available on CD-ROM, and for the first time this year, through our automated "fax on demand" service.

The use of technology also has allowed us to reduce taxpayers' paperwork burden by reducing the amount of paper records they must store. We accomplished this by proposing procedures that would eliminate requirements that taxpayers keep paper records and allow an electronic imaging system to be used instead. Along with the various changes to the regulations process that I mentioned earlier, permitting the use of digital imaging should prove particularly beneficial to businesses, who will be required to store far fewer paper documents.

Of course, the one event that brings each taxpayer in direct contact with the IRS is the annual filing of the federal tax

return. Here too, we are making progress so that this annual ritual is as convenient (if not painless) as possible. Despite the ritual criticism of the current tax system, recent data suggests that we are indeed moving forward on this front. USA Today recently reported a poll that showed that 52 percent of American taxpayers describe preparing their personal income taxes as easy. The Associated Press also recently reported on a poll that found that 50 percent of taxpayers insist the system is not too complicated for them personally. Nearly 40 percent of individual filers now use the easiest tax forms and more than 70 percent claim the standard deduction.

Filing tax returns by telephone also reduces taxpayer burden This filing season, 23 million taxpayers can file their tax returns with a phone call that takes less than ten minutes. As of March 22, 1996, 2.5 million taxpayers have already used this option. Three years ago, TeleFile was a pilot, and just last year, when it was only available in 10 states, 680,000 returns were filed by telephone.

Beginning in fiscal year 1994, taxpayers have been able to file their tax returns from their home computers through a third party transmitter. As of March 22, 1996, about 102,000 taxpayers had used this filing method, a significant increase from the 1,000 that filed through this service last year. Also this year, taxpayers in 31 states can satisfy both their federal and state tax obligations with a single electronic transmission, an

increase from the 15 states in which joint electronic filing was available in fiscal year 1993. As of March 22, 1996, 2.7 million joint Fed/State returns have been filed -- more than double the 1.1 million filed last year.

Electronic filing offers advantages for both taxpayers and the IRS. Taxpayers file more accurate returns and get their refunds faster, and we receive more accurate information more quickly and eliminate the need for expensive paper processing. Through these and other innovations in electronic commerce, we hope to continue to make significant strides in making the tax filing season as convenient for taxpayers and as cost-effective for the government as possible.

V. Conclusion

As Justice Holmes once said, taxes are the price that we must pay for a civilized society. Justice Holmes never said, however, that paying taxes needs to be difficult or inconvenient for taxpayers. The IRS is actively pursuing a wide range of actions to ensure that, while taxes necessarily will remain a part of each of our lives, calculation and payment of those taxes will be as easy as possible.

Mr. SHADEGG. I very much appreciate your being here and putting your time in and your detailed testimony—as I said, 27 pages in length or something close to that.

Let me just start through a series of questions I have and since Congressman Salmon was just able to join us, maybe my questions will evoke some questions from him as well.

Mr. Raby, both you and Mr. Gandhi talked about stability in the Tax Code, and that is, your words were "create a structure and then stop tweaking it." Mr. Gandhi in his testimony, if I can find the page, I marked it, made a specific reference to the burden that is imposed upon taxpayers as a result of changes. He specifically says, "Frequent legislative changes, including the effects of these changes on other sections of the Code, were cited [and he is referring to a survey of businesses] as problematic." He gives one specific example. He says, he says "One year after the expansive Tax Reform Act of 1986, the Omnibus Budget Reconciliation Act of 1987 changed 50 provisions of the Tax Code potentially affecting business tax compliance."

It seems to me both of you would argue for stability and might indeed support the idea of returning to a policy under which, whether stated or required by law, the Congress stayed away from the Tax Code for at least a period of—we heard 15 years earlier was the practice—maybe a decade. Even 5 years, it seems to me would be a vast improvement over the current structure where Congress tampers with the Tax Code every year.

Maybe either one of you would like to comment on that.

Mr. RABY. I cannot agree more. I am not sure of the practicality of 15 years. You have to remember that the 15 years that was referred to really was the 1939 to 1954, 15 years. We have not had any 15 year period since 1954. The 1954 Code was being tweaked by 1956, for example. And many of the changes that get made when you have a major piece of legislation are the result of two things that happen. The 1981 and 1986 acts are both good examples. In the 1981 act, for example, we created something called safe harbor leasing for business. And there was such an outcry on the part of people who felt it was a tax giveaway program that in the 1982 act, we took it away, which certainly does not make for any confidence on the part of the business community in planning transactions based upon provisions that might raise subsequent hindsight and be withdrawn.

Every major tax piece of legislation requires innumerable technical corrections, and very often the technical corrections turn out to be somewhat more substantive than simply commas because the legislation is something that some of the people who are reacting to it do not feel too comfortable with. So the number 50 seems almost like it would be smaller than I would expect.

Mr. GANDHI. And I agree with Mr. Raby here, I think that is a consistent theme, that we heard from the business practitioners and experts that we talked with, is that they would like to have some kind of a tax law holiday where it would give them time to get used to what has been legislated and plan their business strategies.

Mr. SHADEGG. Another point I noticed in your testimony, Mr. Gandhi, in your written testimony at least, you referred to a num-

ber of businesses that you surveyed, all of whom said that the depreciation requirements of the Internal Revenue Code forced them to maintain detailed records solely for tax purposes. And you go on to say that some companies have to produce one set of computations and records for their regular Federal tax and two additional sets for the Federal alternative minimum tax, the alternative minimum tax that I referred to earlier and that, at least in my mind, I thought was a business tax until my accountant told me it may apply to me.

That is indeed a part of the burden of the Tax Code, which I gather from your testimony you say is in fact so complex it is difficult for you at GAO to estimate the cost of that burden of compliance.

Mr. GANDHI. Yes, sir, that is correct. And that is also true of the business community itself, that they would have a hard time comprehending. And many times, in the case of at least the alternative minimum tax, many times after doing the calculation, they discover that AMT does not apply to them. So even to find out whether or not it applies to you, you still have to make the calculation. So AMT, with a few other things, is consistently cited as among the most problematic part of the tax law, that businesses have to face.

Mr. SHADEGG. And apparently not just businesses, because as Mr. Raby referred to, it is claptrap, but it applies not just to businesses but also to individuals.

Mr. RABY. Absolutely. Individuals are affected, too. Individuals incidentally may own rental property, have depreciation and may have to calculate that depreciation several different ways, not quite the five ways that a business might have to, because of the ACE, the retained earnings adjustment that is part of the alternative minimum tax. But three ways or four ways. It has been a bonanza for software manufacturers. There are a number of not completely inexpensive software programs to help businessmen and individual taxpayers cope with this type of complexity.

Mr. SHADEGG. Ms. Cheatham, I would like to compliment you and the Arizona Department of Revenue. As I read your testimony and saw what I consider to be user-friendly problem-solving arrangements or ideas like outlined in your testimony, such as someone who calls in and says I have got this problem and they launch into it and the explanation reveals it is not a problem with the Arizona Department of Revenue, it is not a State tax issue, it is in fact a Federal tax issue—and to compliment the IRS also for working in an arrangement with you to make that a workable system. I do not know if this happens to Matt, but frequently my staff will get calls by someone who will raise a problem which they understand is a problem caused by Government, but they have not been able to discern that it in fact is perhaps caused by county government or State government or city government. And we then are in a position much like you are of having to refer them back and forth.

Let me ask you, since we are focused on both regulatory reform and on penalties, what is the—first of all, what is the penalty structure under State tax law? Does it mirror the Federal penalty structure? Do you exact the same kind of penalties, for example, for

a taxpayer who simply cannot pay a tax that is due, do you impose both interest and penalties and interest on the penalties?

Ms. CHEATHAM. Yes, Congressman Shadegg, we do mirror to some extent their penalties. However, we do not have the complexity, for one thing. And we have what we call penalty abatement review where a penalty can be, in essence, protested to the department and we are able to abate up to 80 percent of them. That is 80 percent of the cases that come before us. We find many times that it is not intentional, many times it is unintentional. A miscalculation, for example, on the income tax, it is very easy to do a mathematical error. Or to find out that the error you made on your Federal return impacted your State return. So we have been able to address those.

Mr. SHADEGG. Let me ask you a question about that. What if someone made an error on their Federal return, and the State return often just picks those numbers up and you pay your State tax based on a Federal return number. If you discover that is what the error was, an error in the Federal return caused an error on your State return, are you subject to both interest and penalties?

Ms. CHEATHAM. Yes, sir, you are. However, what normally happens is the taxpayer finds out and then they file an amended with us and then there is an adjustment that is made. The more complex the Federal code, obviously the more complex it is to calculate. Arizona has been dropping its tax rates but once again, you have to be able to calculate your taxable income.

One of the problems we most frequently hear from taxpayers is that it was not the issue calculating their Arizona State income taxes, they had to go through the Federal process to get to us. We, over the last 3 years, have cut our taxes about 23 percent and so what has happened is they are paying to the Feds and getting an Arizona State refund. What we have been trying to do is encourage people to calculate their taxes early, file with us and that perhaps helps pay the Federal taxes.

The biggest problem we have, once again, is the complexity of the codes. We recognize that we piggyback the Federal, the complexity of the Federal code flows through and that is one reason why we have tried to increase our relationship, to get to the point where you are not as uncomfortable dealing with the Feds and the State in the same phone call or contact. And when we talk to taxpayers, they are afraid of tax issues; they know it is money out of their pocket, they know that we have a lot of power and authority, so we have tried to make it more user friendly and to allow people an opportunity to protest, to give us the reasons. If it is a valid reason that meets the criteria, to go ahead and give that relief. So it is probably easier at the State level, obviously we have a legislature we can walk in the door as we have done every year and be able to propose things to simplify the process for our Arizona taxpayers. It is not that easy in Congress, we recognize that.

We are pretty lucky I think actually at the State level.

Mr. SHADEGG. Matt and I are both discovering exactly what you just said. It is not that easy in Congress.

Let me—since the State does piggyback on the Federal return in many respects, tax simplification and regulatory reform at the Fed-

eral level would have a beneficial effect on the Department of Revenue I assume.

Ms. CHEATHAM. Yes. I mean absolutely. The problems that people have with taxes, once again, they have to go through the Federal process to get to the State process. We have a simplified process here, it certainly is not anywhere near as complex for most people. And I think it would really help people—the average person, not the person who goes to an accountant, but what we find to be is the average citizen who is just trying to understand what in the world an alternative minimum tax is and why would they need it when they only have a payroll. So we try to walk in the door when we go out to our presentations and tell people the simplification that we have, encourage them to understand their Federal responsibilities, know that they flow through to the State and then when someone goes awry of the system—and that happens—to have them be able to come in and solve that problem in one source. Come to the Department and have an IRS response, as well as go to the IRS and be able to work with the State. And that is really what I think needs to be done, is to have the interflow of information and the one-stop shopping, as it were.

Mr. SHADEGG. Given the opportunity, would you have any suggestions for the members of this committee or Congressman Salmon and myself for regulatory reform within the Federal Tax Code?

Ms. CHEATHAM. We have some suggestions as to allowing some leeway so that the IRS can work with the States, and I think each State probably has a lot of suggestions that would help. I think the biggest problem we have is the interplay within the districts. Harold Scott, my director, and Mark Cox, the district director here, were both new and they came in with very fresh ideas. Harold had been in business and knew the problems of being in business. So we felt that two fresh minds walking in the door, they made tremendous innovations, and of course, we have been recognized nationally now for 2 years with these innovations.

And I think you need to have State input. I think they will have a lot of input into what can be simplified, what can be working from their perspectives. So I would do an outreach to the States.

Mr. SHADEGG. Great.

Ms. Dunn, thank you for your testimony. Let me ask you, you heard some description in the testimony earlier of the distinction between interpretive IRS regulations, meaning we the Congress write a sentence in here, it is not a model of complete clarity, somebody decides we do not quite know what that means, so IRS needs to clarify that by an interpretive regulation. And the other term I believe that was used was legislative, which would mean I assume we direct you in a general sentence or a general paragraph to impose a tax and leave the specifics of how that tax is to be imposed or maybe even when or under what circumstances it is to be imposed. Do you agree with that distinction? Are there two such categories?

Ms. DUNN. There are. I think the vast majority of the instances are interpretive regulations. The consolidated return regulations, for example, are an example that we look upon most often as the legislative regulations where Congress has said if you have got several corporations and you want to file one consolidated return, Con-

gress says file your tax return under the regulations prescribed by the IRS. So there is really no guidance in the Code that sets out how those calculations are to be done. I mean, when you get to the bottom line, the rate is the rate that applies to corporations, but how you combine and adjust for the various items that the various corporations have, how you take into account transactions between the corporations, that is left to IRS regulations.

Mr. SHADEGG. The earlier witness suggested abolition of the legislative variety. I think the premise was Congress ought to be writing the laws, the IRS should not. It seems to me the IRS could take the position that they would be just as happy if in fact they were not asked to issue any legislative regulations, it would take away some heat and put it back on myself and Matt's colleagues and my colleagues in the Congress. And that may be way too high a level question for you to answer, but does the IRS have a position? Are you able to express a position on that issue?

Ms. DUNN. I am not sure that the IRS has a position. I certainly think that in many cases we would be just as happy to have Congress write the rules.

Mr. SHADEGG. When you said in your statement these various bar associations had urged more regulations to help taxpayers, did they in fact assert more regulations or clearer regulations? Where did the term "more" come from? It is hard for me to imagine, though maybe lawyers would do this, asking the Government for an increase in that myriad of laws and maybe it is business-getting by lawyers, I do not know.

Ms. DUNN. Let me see if I can find a copy of the letters. I would like to——

Mr. RABY. While she is looking, could I comment, Congressman?

Mr. SHADEGG. Certainly.

Mr. RABY. I have been involved in a lot of submissions on behalf of the American Institute of CPAs over many years. Usually what we and our clients are looking for are what you would call safe harbors. You have a law which is, to some extent, not quite crystal clear in its application to the myriad of circumstances and transactions out there. As conservative accountants at least and many of the people in TEI are also, and many lawyers and CPAs do not operate that much differently. We like predictability and therefore we like a regulation which says, and preferably with an example that is on all fours with our situation, yes, we can do this. And so we urge them to keep on putting out such regulations. We want safe harbors, right.

Mr. SHADEGG. I guess Matt and I both went to the U.S. Congress to reduce the size of the Federal Government, to have it interfere in people's lives less. I would say when you talk about frequent changes in the Tax Code causing uncertainty, causing complication, and I will speak for Matt and then let him in his questioning clarify if I am wrong, I think both he and I have a bias in favor of a no vote on the premise that to the extent—kind of like following the admonition of the Hippocratic oath, first do no harm. And it seems to me whenever Congress tinkers with the Tax Code, it is almost always doing some additional harm. So I at least have a bias that a no vote as a beginning vote is probably a better idea than an aye vote.

And so hearing someone say boy there is a clamor for more regulations, when you explain it as we would like clarity, we would like a simple understanding of what is there, certainly I would agree with that. My constituents would like clarity.

Mr. RABY. Right.

Mr. SHADEGG. They are not necessarily screaming for you to double the number of volumes before us.

Ms. DUNN. If I could just clarify that point?

Mr. SHADEGG. Certainly.

Ms. DUNN. Exhibit C of my written testimony has the actual letters and what they were actually—what TEI said in its letter is, "It is critically important that this guidance be issued in as efficient and timely a manner as possible. Anything that impedes the process should be avoided."

The other letters say essentially the same thing, they were written in response to a proposed moratorium, I believe in 1994 or 1995 on regulations, and it was requested that IRS regulations be excluded from the proposed moratorium. So that was the context in which most of the letters were written in that are included in my testimony.

Mr. GANDHI. May I comment?

Mr. SHADEGG. Certainly.

Mr. GANDHI. Ms. Dunn has done us a favor by citing GAO first as to have more regulations there. Our point here was that what the business practitioners told us was that, and as Brother Raby just mentioned, is that they would like to have certainty. And the business does not stop, the returns have to be filed every year—just to take one example of section 482, one of the most contentious areas for which we would not blame Ms. Dunn here, since she concentrates in domestic area, but in 1986, Congress started the ball rolling in terms of clarifying and suggesting that there ought to be a proper apportionment of income. In 1988, Treasury provided a White Paper, in 1993, they provided proposed temporary regulations. It was only in 1994, I believe in July, that they came out with final regulations. So from 1986 to 1994, the intervening years—you know, there has to be some guidance and they were clamoring for guidance so that they would provide a proper framework in measuring their own tax liability.

Mr. SHADEGG. Now that you put it in the context of the regulatory moratorium, I understand the context. It seems to me at that time the IRS did want to be exempted from the regulatory moratorium, I am certain it is an institutional bias of every regulatory agency that they believe their regulations help people and provide guidance. It was not at all shocking to me to hear that the regulating community in America thought the moratorium, the regulatory moratorium proposed by this Congress and pushed by our committee and our subcommittee and by Congressman McIntosh, would evoke that kind of reaction and that some people in the business community would say yes, I am waiting for the regulation that gets me off the hook or gets me the safe harbor that I am looking for. Quite frankly, I have to tell you as I go door to door or make it to various gatherings of my constituents, I do not hear a clamor for more regulations. They thought the moratorium was an excellent idea. I personally think it is a good idea. I would like to

have seen us enact a moratorium, to have left it in place long enough to require a review or cost-benefit analysis of all regulations and risk assessment, because I think this is arguably insanity. But that is just my own perspective.

Congressman Salmon.

Mr. SALMON. I do have an observation, a perception and a question. And then once I get through with that, I think that a big part of why we are holding these hearings is so that individuals can come up and share their thoughts and feelings and give their comments, so we will make way for the folks out there that have been waiting so long and patiently.

First observation is I have long marveled at the fact that if you make a mistake, even if it is an honest mistake, on your filings, that you can be held liable for penalties and interest, but the reciprocal is not true. That if the IRS makes a mistake or the State tax entity makes a mistake and they withhold too much from you, that they are not subject to penalties and interest. And I think it is kind of an interesting way of doing business.

Observation, perception, and maybe Judith, you can help me on this. But I know Congressman Shadegg and I both have district offices and our staff folks here work with constituents who have problems. The four major areas, at least in mine—John, maybe yours is a little bit different—but the four major areas where we are helping people as their advocate to the Federal Government, are Social Security, veterans' services, the IRS, and the other area would probably be immigration. Those would be the four areas where my folks spend almost all their time helping constituents and sometimes they expect us to be their attorney for them. We end up not being able to meet a lot of the needs because it crosses the line of what we can actually do.

But I have a lot of folks come in, small business people, come in and express their concerns, their problems that they have been in the midst of and I think this one typifies a concern that I have. I had a small business come in and they had back payroll taxes that were due. And right now they are trying to work with their representative from the IRS to work out a payment schedule because they cannot pay it off in one lump sum. The mistakes happened over a period of years, they were legitimate, honest mistakes and now obviously they have to pay the interest and the penalties and it is just insurmountable for them. I have seen the same thing—I am only using this as an example, it is not an isolated example. But it appears to me that at least some within the IRS have the opinion that we will be better served to make them go bankrupt and get nothing out of it than to try to work with the person or with the small business so that they can repay what they owe, so that it is a win-win, so that we get the revenues at the Federal level and they are able to keep their business going so they have employees coming in the door and employees paying taxes and employees being productive members of society. The perception is that there are many that are enforcing the provisions that we have set forth in our Tax Code that have a counter-productive mentality of we are just going to be punitive, we are going to show these people you cannot mess with the IRS and if you do, boy we will put you out of business.

But in the business world where I come from, if you have a debtor that owes you money, you almost bend over backward to try to accommodate that individual so that they can pay you back, because making them—punishing them and making them a public spectacle is one thing, but being a bottom line kind of guy, I would rather get the money in the door. The perception is that there is a heavy hand and it is to be punitive instead of to collect the money.

Can you comment on that? And I know that you do not represent everybody in the IRS, but it seems to me that the focus is all wrong sometimes when they try to force somebody out of business or force them into bankruptcy, where in the real world or the business world, you would do just the opposite and try to make them be successful so they could pay back their debt.

Mr. WASHBURN. Mr. Salmon, of course, I cannot speak to the specific case, but I can tell you that the Service policy and the Service position would be exactly what you proposed. In fact, we have redoubled our efforts in recent years to encourage our people to entertain offers in compromise, to go for installment agreements; because we agree with you. What our objective is, is to get these taxpayers back into the system and to get them away from this burden that is hanging over their head.

The problem we have, of course, is our obligation, our responsibility to all American taxpayers to make sure that everybody—because the vast majority of American taxpayers do pay their tax and pay it timely—so we have to be careful that we are not so say generous or sensitive to one particular taxpayer that other taxpayers who are in the system and complying say well, gee, that is not fair. In fact, that is one of the reasons that offers in compromise are open for public scrutiny so that the public has a right to come in and make sure that we are not cutting a deal.

But we agree with you, the objective is not to put people out of business because then they stop paying taxes.

Mr. SALMON. Absolutely.

Mr. WASHBURN. We want to keep them in the system. And in fact, our offers in—the number of offers in compromise in the last couple of years has doubled because of these efforts.

Mr. SALMON. I am glad to hear that, I really am, because frankly it makes good business sense, it makes good sense from the point of actually collecting revenues, and I know that you have that fine line.

I used to work in risk management and if you look like you are a soft touch, then everybody is going to take advantage of you. I understand that as well. But I guess, you know, my concern was we get the money and get as much as we can when we can rather than get nothing by forcing somebody out of business. And that makes all the sense in the world, so Marty, is it?

Mr. WASHBURN. Right.

Mr. SALMON. I really appreciate your comments and I hope that is the direction we are headed.

I really think that Congressman Shadegg has been thorough in the questions. I know that the answer is found in the acronym KISS, keep it simple, stupid, and hopefully we can make that work for the Tax Code and policies as well.

Thank you.

Mr. SHADEGG. At this time, the constraints of time—first of all let me thank this panel, I appreciate your testimony very, very much, it has been very helpful. I know it took time for you to put it together and be here, but we appreciate it, I think it is useful and will be valuable to the members of the subcommittee. Thank you.

Time constraints are such that we are going to go to the next phase of this hearing where we allow citizens, constituents, to stand up and express themselves and to relate their own experiences. As I said in my opening statement, one of the things I do appreciate about the opportunity afforded to me by Chairman Clinger and by Subcommittee Chairman David McIntosh is the opportunity to allow my constituents to speak and to try to shape this policy in Washington, DC, without the burden of going to Washington.

But time constraints are going to require the professional staff of the subcommittee to leave, they have to catch an airplane. But before they depart, I want to thank a number of people. First of all, Mildred Webber, who is the staff director of the Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs. Mildred has been tremendously helpful through all of this. Karen Barnes, a professional staff member who is here with her also. By the way, they have been on a circuit. As I mentioned earlier, this is the 15th field hearing of this subcommittee, one of which was held yesterday in California and the day before that in the State of Washington. So they have been on an aggressive schedule of going around the Nation trying to get input into the debate on regulatory reform. Also, David White, our enforcer, and Liza Mientus, who is the minority staff and works for Congressman Collin Peterson, which is where they were yesterday in California holding a hearing on this.

I also want to thank my own staff in general, but particularly Dina Ellis for her very hard work in pulling all this together. And I want to conclude by thanking Ian McPherson, a tax attorney here in town who did not testify today, but who was instrumental in helping us identify each of the witnesses to come forward and pulling this altogether. Ian, I appreciate your efforts.

I do not know if she left yet, if she had not stepped out of the door, I would have acknowledged my wife, who has been here in the audience for a little while, but she apparently has left.

So with that, we move to the next phase and this is a phase at which each of the individual citizens who wants to testify before the committee and relate their own experiences gets a chance to do so. I am going to ask you each to stand at your seat and be sworn in and then we will call you one at a time to testify.

First of al, Mr. William, is it Roley? Phyliss Sears, Patti Hollstrom, Mike Doyle and Chuck Byers. Those are the individuals that I am aware of who requested to speak. Is there anyone else who wanted to speak briefly?

Yes, sir. Your name is?

Mr. HAYES. Ed Hayes.

Mr. SHADEGG. Say it again.

Mr. HAYES. Ed Hayes.

Mr. SHADEGG. OK. Anyone else?

[No response.]

Mr. SHADEGG. If you would each raise your right hand.

[Witnesses sworn.]

Mr. SHADEGG. Let the record reflect that each answered in the affirmative. We are going to go through these in the order in which they signed in. First, Mr. Roley. And there is a microphone that we brought to you, I believe.

Again, you are under the rough time constraint of about a 5-minute statement. We will keep our questions brief. Our goal is to hear from you here.

Oh, before we do this, we have one other gentleman that wants to speak. Did you hold your hand up and were you sworn in, Mr. Rod McMullin?

Mr. MCMULLIN. No.

Mr. SHADEGG. OK.

[Witness sworn.]

Mr. SHADEGG. And your name is Rod McMullin? Would you state your name please?

Mr. MCMULLIN. I am No. 5, there are four ahead of me.

Mr. SHADEGG. OK, but if you would just give your name for the record.

Mr. MCMULLIN. Rod McMullin.

Mr. SHADEGG. Thank you. OK, Mr. Roley.

STATEMENT OF WILLIAM H. ROLEY

Mr. ROLEY. My name is William Roley, I am a retired Marine, I have spent 23.5 years on active duty through three wars.

I have a problem with IRS that has lasted since 1982. I have tried many times to get it resolved and never can seem to come to a resolution.

I am very bitter, I think I have been discriminated against several times in many ways. Back in 1981, I invested about $600,000 in a coal mine in West Virginia. I was the president of the corporation, nominally speaking. The mine foreman was vice president. The mine failed. I know for a fact that nobody took any tax withholding money other than to keep the mine running, but they came along and assessed us for not paying withholding taxes, which is fine. My first complaint was that I told the IRS that the other officer of the company had assets in Ohio and why only come after me and let him off the hook, which they would never answer that, but they did let him off the hook, they never went after him and he died and then we lost that case there.

At the time that I went into that, I was living in California, was married with two children and in 1982, my then wife filed for divorce, the judge says do not bother anything, you cannot sell any property until the divorce is finalized. It was never finalized and she died then in 1985. I went down to get our joint property in my name, found out that she and our daughter had conspired and violated the judge's orders, falsified records, transferred all the property over to my wife who then put it in joint tenancy with our daughter and when she died, by marital law, all my property went to our daughter. And I have had to go back to the court over there

in California to try to recover it. By the time I got everything around to it and paid the attorneys, there was nothing left.

But I have tried to settle the thing here with IRS in Arizona and then I asked that it be sent back over to California where my CPA was, they sent it back over there and the CPA took it in and he went as far as he could and nothing happened, and so he recommended I get a tax attorney which I did, who was a former member of the IRS team in Laguna Niguel, and we have been fighting this ever since years and years back. We have made offers of compromise, they have refused them on several grounds, then they shifted from California—I finally got a letter from Ogden saying we are going to take all your property, we are going to file against your pension and everything else, and then I wrote back to them, they sent it up to California, northern California, got the same kind of letters from them. Then it went to Denver. Finally, my attorney out there wrote them a letter and said we are handling it right here in Laguna Niguel, please do not send it any place else, and then we got a letter from Laguna Niguel saying we are going to have an in-house inspection in California for you, see how you live. They set it for March 21st and I went over there for that. The IRS people did not show up and when they called, they said we have sent your records back over to Arizona. It has just been a mish-mash from the very start to the very end.

Also another factor which I think was involved in California, there is a law out there, the Hirsch case that says that in case of a divorce or anything else, the other party, the other spouse, has to pay half the debts of the one spouse, and I told the IRS why do they not go after—which is all my property, which is now in the name of my daughter and my wife's estate, but they say that does not happen.

But what I am saying is I have been discriminated against and I am trying to get this thing settled and they just will not seem to come up with any kind of a settlement for us. And I have got lots of other suggestions to make, if we have some more time privately or however you want to do it.

Mr. SHADEGG. Thank you very much. I appreciate your testimony. It is precisely that kind of unfortunate personal situation that we are trying to avoid.

Congressman Salmon, do you have any questions?

Mr. SALMON. No.

Mr. SHADEGG. Thank you very much, Mr. Roley.

Phyliss Sears.

Let me correct the record, I should have acknowledged this. Phyliss is in fact a member of the Paradise Valley City Council and therefore it the Honorable Phyliss Sears.

STATEMENT OF PHYLLIS SEARS

Ms. SEARS. Thank you. I am here speaking as a citizen, however. Mr. Chairman and Congressman Salmon, good to see you again.

I am here today to address the personal costs to the present tax system. My husband has often wished for the opportunity to be able to speak to someone who might have the power to effect a change. I wish he could be here today doing this, for he bears the

heaviest burden in preparing each year's tax. But he is at work in order to pay this year's tax. [Laughter.]

I am certain our ancestors had no idea of the consequences they were unleashing upon the citizens of this country when they passed the 16th amendment.

I would just like to address some of the consequences we have felt in our personal family. All year long, we collect records of daily activities. I carry my Day-Timer everywhere I go to record any costs, any expense that might be included on our taxes, have a little mileage record in my car, I have to record it by work for the Council, work for the business, work for charity or travel for charity. Then at the end of the year, my husband and I spend probably the better part of a month adding up all these columns, accumulating it all, I am sure just about everybody here does something similar. We spend evenings and weekends collecting this data. Even then the tax is not done, it has to go to an accountant to get done and the cost of that.

Each year at the end of the tax season, we end up with a little brown box of records that go to the garage and you have to keep those boxes of records for 7 years. If you have records related to a house, you may have to keep them back as much as 30 years to prove the basis of your house that you now have, and if we are moving we have to carry all those records with us, as you know.

I think probably the greatest burden of all this is the resentment we feel toward our own Government for inflicting this on us to prove that we do not owe you any more than we already pay. And I do not mean you, I mean the Government. The emotional burdens of this, one-twelfth of our free time goes to preparing this, and the emotional cost of this—the only family fights we have ever had have been around tax time. Our kids, when they lived at home, used to know it is tax time, get out of the house. Again, I resent the Federal Government inflicting this burden on us.

Think what could be done with that time though, the productive efforts that it could be put to or the volunteer efforts that it could be put to, even care of or love for the family or recreation and renewal of the spirit.

Last, my husband and I started a business and I add to this burden of personal taxes, the time that we spend on city, county and State tax added to all this effort, and all this for the privilege of paying the Government some perhaps 43 percent of our income, or even higher if we did not go through these efforts.

I would end by saying are we for Congressman Armey or Steve Forbes' flat tax? You betcha. Even if it means paying a few extra dollars, the emotional expense would be worth it.

Mr. SHADEGG. Phyliss, thank you for that delightful testimony and let me tell you that you have done a marvelous job of putting a human face on the facts I recited in my opening statement. I pointed out that individual taxpayers pay a total of about $7 billion per year to someone else to pay their taxes, you indicated you do the same thing, once you have kept all those records, you pass them on to an accountant. And they spend about 3 billion hours, the average individual taxpayer, altogether individual taxpayers spend about 3 billion hours, an average of about 27 hours per year just dealing with their taxes. You have done a marvelous job of

saying forget the numbers, here is the real experience. I thank you for that testimony.

Congressman Salmon.

Mr. SALMON. I just wanted to comment how you really assuaged my conscience because I just had a fight with my wife a couple of weeks ago about taxes.

I just wanted to make a comment when you were mentioning how you carry your Day-Timer everywhere to keep track of your expenses, whether it's city council related.

Ms. SEARS. Yes.

Mr. SALMON. Interesting side note, I know Congressman Shadegg is as in tune with this as I am if he has done his tax returns yet, but we can only claim, as a Member of Congress, a cap of $3,000 in expenses and it is actually costing me an additional $20 to $24, we are kind of still fine-tuning it to keep two homes.

Ms. SEARS. Sure.

Mr. SALMON. One in Washington and one here. But you know, we like to beat up on ourselves and there is a cap. We cannot claim any more than $3,000 in expenses even if we have $25,000 or $50,000.

Ms. SEARS. And if there were a number we could give to the emotional cost, that is the burden my husband complains of the most.

Thank you.

Mr. SHADEGG. Patti Hollstrom.

By the way, Brian McAnallen of my staff, who is sitting where Dave was, will have the time cards to give you at least some idea of where you are on time, so we do not run extraordinarily beyond the time allowed.

STATEMENT OF PATTI HOLLSTROM

Ms. HOLLSTROM. Thank you. It is nice to be here today.

Mr. SHADEGG. Thank you. Good to see you again.

Ms. HOLLSTROM. Thank you.

I am pleased to hear that the Taxpayers Bill of Rights will change the guilty until proven innocent to the American principle of innocent until proven guilty. However, I do not believe that reform of the IRS is possible and I look forward to the day when America has a national sales tax for its citizens rather than an Internal Revenue Service collecting and enforcing a progressive tax on its citizens. And as long as we have a bureau, which in addition to the people who spend $7 billion a year preparing their taxes, and a bureau that spends $7 billion a year on its own department with, as you said today, 111,000 people, we will not have a fair system or a growing national economy.

So I argue with your premise today. It is not reform of the IRS, it is replacement of the IRS. [Applause.]

Mr. SHADEGG. Thank you very much. For those of us who have been fighting for rather strong reform, indeed you might even call it radical reform of the Federal Government in this Congress, Members of the freshman class such as myself and Congressman Salmon, I think you have got it exactly right.

It is kind of a mystery to imagine that there are only roughly 24,000 employees of the FBI but 111,000 employees of the IRS. It makes you wonder if we could not at least improve upon that sys-

tem. President Clinton was fond of saying in his campaign for election, America can do better. I think this is one example of where America can indeed do better but is not.

Congressman Salmon.

Mr. SALMON. No questions.

Mr. SHADEGG. OK. Mike Doyle.

STATEMENT OF MIKE DOYLE

Mr. DOYLE. Thank you.

I would like to read into the record a passage from the "Death of Common Sense," a book that is currently I believe on the best seller's list.

Mr. SHADEGG. It is a great book and I saw that you were going to speak about it, I am very pleased you did. It goes to not only reg reform within the IRS, but reg reform—regulatory reform generally throughout the Federal Government.

Mr. DOYLE. Absolutely.

The passage that I would like to read is entitled, "How law replaced humanity."

> The tension between legal certainty in life's complexities was a primary concern of those who built our legal system. The Constitution is a model of flexible law that can evolve with changing times and unforeseen circumstances. This remarkable document gave us three branches of Government and a Bill of Rights built on vague principles like due process. How detailed the Constitution should be was a matter of importance to the drafters. Alexander Hamilton, for example, argued that the Bill of Rights was too specific. Enumerating any rights at all, he argued, would imply the absence of other rights. Today, we no longer remember that specificity is even an issue or that words can impose rigidity as well as offer clarity. What is known as the common law, which we inherited from England, still governs relations among citizens. For centuries before the rise of the modern State and all its statutes and rules, the common law dominated the legal landscape. Its principles still provide the framework of our legal system. Common law is the opposite of iron-clad rules that seek to predetermine results. Application of the common law always depends on the circumstances. The accident caused by swerving to avoid the child is excusable; falling asleep at the wheel is not. To most experts, the highest art of American lawmaking is precision. Only with precision can law achieve a scientific certainty. By the crafting of words, lawmakers will anticipate every situation, every exception. With obligations set forth precisely, everyone will know where they stand. Truth emerges as the crucible of the democratic process and legal experts use their logic to transform it into a detailed guide for action. The greater the specificity the more certain we are that we are providing a government of laws, not of men.

It seems that these kinds of hearings go on interminably. Where does it end? What happens after this and other hearings like it? How does this change anything? What recourse does the average citizen have, to whom can they turn if they haven't the resources for a lawyer? Why has the IRS been given police powers and search capability without a warrant? Can a citizen charge an IRS agent with blackmail, trespassing, illegal search and seizure? Can a citizen sue an IRS agent for harassment, or is the agent protected?

It would seem to me the easiest way to solve these gross oversteps of power by the IRS is to make the individual agent accountable and put the individual agent at peril for conduct outside normal due process.

Thank you.

Mr. SHADEGG. Congressman Salmon.

Mr. SALMON. I would just echo very strongly what has just been said. As to—I think what you are paraphrasing when you say how much do these hearings help, you cannot fight city hall, that is the

old adage. I think you can. I think that our founding fathers when they created this great Government created a mechanism whereby we could change things. Yes, it is entrenched; yes, it has been around for a long, long time; yes, it is very, very difficult to make change. Boy, do John Shadegg and I know that. The kinds of minimum change that we have been trying to make, minimum change, over the last year, you would think that the world had come to an end. And it is the very bare minimum reform that right now we are finding the American public is squeamish about.

But I still have confidence. I have confidence in the process, I have confidence in this country and I have confidence in the people of this country that we can turn it around. But we have got to make sure that we are involved. Thank you for being here.

Mr. SHADEGG. I would just echo the last point that Congressman Salmon made, and that is thank you for being here. I think you asked some very poignant questions, the one that hits the most directly to me is the one how long do these seemingly interminable hearings go on, what do they do. I would bet that Congressman Salmon shares my frustration at trying to accomplish something in this process that makes it possible for regulations to grow in a cancerous fashion like all of these before us and yet almost impossible for he and I do to anything to reverse that trend or to stop it. Indeed, in my own opening remarks, I talked about how if we were to succeed in this effort, we might hold the number of employees at IRS at 111,000, I did not dare suggest we might in fact shrink it. Though, as Ms. Hollstrom pointed out, perhaps our goal ought to be not to shrink it but to abolish it.

I think indeed we do see a frustration in the people of America with a Federal Government that seems to be teflon itself. That is, no matter how frustrated the people get, no matter how much they demand change, change does not occur. This year's experience. We put provisions of a Taxpayers Bill of Rights into a Balanced Budget Act and we cannot get it signed by the President. We have Americans across the Nation screaming for a balanced budget and we cannot get it passed. We have Americans across the Nation screaming for reform of a welfare system that not only is costly but does not really help the people it is designed to help. And we cannot get that accomplished.

It is indeed frustrating. I applaud you for taking the time to come and participate in the process.

Mr. DOYLE. Congressman Shadegg, there is one easy way to overcome a lot of these problems. Change the guy in the White House.

Mr. SHADEGG. Careful. [Applause.]

With that, let me call on Mr. Hayes, Ed Hayes. Mr. Hayes, if you would please come forward.

STATEMENT OF ED HAYES

Mr. HAYES. Thank you, Mr. Chairman, I appreciate you giving me an opportunity to talk here. I think, as some of these other people, I could probably go back over the last 14 or 15 years and tell you some real horror stories, personal horror stories, associated with the IRS and some tax liens and so forth that have been really unbelievable.

But I really do not want to spend that much time and do that. I want to divert that a little bit to a situation that I am in right now. I know I have talked to Brian numerous times about some of my personal things, but in addition to that, I will give you an example. Here about 2 years ago, I had some individuals come to me that asked me if they put money into starting a business, if I would be interested in putting it together and heading it up, and we agreed to do that. I pretty much put everything together, we started it very shortly after that. There were a group of guys that were involved in starting that that had left a local company here. In turn, the local company of course was not really crazy about us doing that and so their attempt to put us out of business, to make sure we did not succeed was to sue us. And we could get into the court, some of the problems associated with the court system in this idea of tort reform, but aside from that, their attempts, knowing that legally they could not stop us; monetarily they could.

What in essence has happened over the course of last year or so, you have got a choice, when people put lawsuits against you, you either pay attorneys or you pay taxes. In this particular case, you know, there are not many choices. So we end up paying attorneys. If you do not pay the attorneys, you lose by default, so you have no choice.

We are in a particular position right now where all of that has finally been settled. We have, you know, no doubt a tremendous debt associated with all of the penalties and fees and so forth with respect to the IRS. Currently we have—we have had at times as many as 10 employees, I think we are down now to about 5 and we are starting to build back up. The associated tax problem, my suspicion right now, and I do not see a way around it, I am pretty sure is probably going to do us in, probably will put us under.

I do not know that I have any particular solutions for it, it is one of those things that I do not know that there are any choices associated with it. But I strongly support, you know, the idea of changing the system to a national sales tax. The delivery system is already there. Over the course of many, many years, it seems like I have not brushed against anybody that has not been in serious trouble with the IRS. There is something wrong with our system where the majority of the citizens in this country have serious problems with that one area.

The national sales tax thing, we are all accustomed to paying a sales tax and so therefore, the delivery system is already set up. It is not burdensome on anyone. I think it has a lot of advantages.

The one last thing that I want to talk about, I think that has bothered me for years and years, and that is the concept, the ultimate lies that were put together years ago that corporations need and must pay taxes. Corporations do not pay taxes, people pay taxes. It is time to inform the people of this country that that is an absolute lie, that is just a means of being able to collect taxes. Because as a corporation, all I can do is push those taxes, those burdens back on my products and services that the people have to pay for. And so I think that is all I have to say, Mr. Chairman, but I appreciate your time.

Thank you.

Mr. SHADEGG. Congressman Salmon.

Mr. SALMON. I just agree with you completely. I think a lot of times we beat up on these big companies and we beat up on the corporations. We are paying all the taxes, it is—generally speaking, it is the middle class that is paying for everything going on in America right now. Let us make no bones about it. These companies that are taxed at high rates, they do not just pay it and take it out of the stockholders' or the shareholders' proceeds, it comes out of us, the consumers. We are paying everything.

Good comments, thank you.

Mr. SHADEGG. Mr. Hayes, I simply wanted to echo. I have long believed what you said, which is corporations do not pay taxes. Now lots of times you say that in America and people get all offended by it, but it is an ultimate reality. A corporate entity that gets imposed a tax, sometimes they can pull it out of a profit margin but by and large that is not the case. By and large, the only place they have to go to is individual citizens and so it is in fact I believe a matter of accurate analysis for the American people to understand that corporations do not pay taxes. Ultimately, we all as individuals foot that bill. Because whether it is in the price of a carton of milk or the price of the automobile, that burden gets passed on to us sooner or later.

And last, Mr. Rod McMullin. Mr. McMullin.

Oh, we have another gentleman?

Mr. JONES. Allen Jones.

Mr. SHADEGG. OK. We will hear from Mr. McMullin and then we will have to swear you in. Have we sworn you in, sir?

Mr. JONES. No.

Mr. SHADEGG. Well, we will swear you in next then.

STATEMENT OF ROD MCMULLIN

Mr. MCMULLIN. Congressman Shadegg and Congressman Salmon, I am Rod McMullin, just a citizen. I had no intention of making a statement here this morning or this afternoon now and I know time is short, but hearing the comments, then I started scribbling some notes.

To give you a little background on what my comments may be—and they will be very short—I have been doing our own income taxes since 1937 with the help of my wonderful wife who is sitting in the back of the room, except for 4 years when I received greetings from President Roosevelt in 1942, that he would appreciate my services in the U.S. Army, and there I joined and with a salary of $21 a month, I really did not have much concern about income tax. Then after qualifying for a commission after service in the United States, I was shipped to the European theater of operations for 3 years and income taxes were the least of my concern over there.

But, I have done—I said I have done the taxes with her help, except for one time, I had a CPA in 1952 do it and when the CPA helped me or did it and I received a penalty. And from that moment on, I got mad and sent to the Bureau of Documents, sent them 50 cents, which is all it was for the instructions on how to do income tax and I have been doing it ever since. I have been able to keep up with the changes because they are gradual over the

years. I just pity anybody trying to do their income tax now, starting now.

We talk about complications. Forbes magazine ran an article about 3 years ago pointing out that many of the complications were intentional, placed there by the staff of the Ways and Means Committee and then after they were put into practice, they left the service of the Ways and Means Committee and joined legal staffs and CPAs to interpret the complications that they had built into the tax. Now maybe this is true or it is not true, but they named names and named amounts. And many of those Ways and Means Committee people, the lowest salary as I remember it was $350,000 a year.

Well anyhow, to go on to a solution. Facetiously I would propose that every Member of Congress be required to do his own income tax just once, without any help. [Laughter.]

You immediately would get some action then. But I would say the same thing that has been said here time after time, simplify, simplify, simplify. In fact, get it so simple that even the IRS can understand it.

So a tax reduction is desirable, some people talk about that, but let us face it, Congress is talking about balancing the budget in 7 years and that means that it is 7 years before we put $1 against the deficit, which by that time is probably going to be $7 trillion.

So let us get to it and get it down and simplify it in some manner. Your closing remarks on the statement here said that IRS forms have become an excessively burdensome task. I would just say from my experience that this is an understatement. The IRS forms have become a horrible nightmare to anybody who does their own taxes.

Thank you.

Mr. SHADEGG. Thank you very much. I could not have said it better. And I think your suggestion that we Members of Congress be required to do our own taxes without help once would have the exact effect you suggest.

Mr. SALMON. But, John, I think that would violate the Constitution which states that that would be cruel and unusual punishment. [Laughter.]

Mr. SHADEGG. Yes, sir.

Mr. JONES. My name is Allen Jones. I formerly used to head the Arizona Small Business Committee.

Mr. SHADEGG. Would you hold your hand up, Mr. Jones, first?

[Witness sworn.]

STATEMENT OF ALLEN JONES

Mr. JONES. Thank you so very much.

Mr. SHADEGG. Would you spell your name for us for the record?

Mr. JONES. A-l-l-e-n, and the last name is Jones, J-o-n-e-s. I will just take about 30 seconds to give you a little of my background. As a matter of fact, Rod here was an antagonist of mine at one time because we worked on a program to put Salt River Project on the tax rolls and I sponsored it, by the time we got our second initiative out, he asked Governor Fannin for a Blue Ribbon Committee and they did joyously come upon the tax rolls. I worked on the repeal of the inventory tax which reversed the entire economy of

Arizona in 1 year. And we got rid of the household goods tax, Jim Dewitt and I stormed for the property equalization, we wrote a great share of that, found about $58 million in loopholes, people were scarcely even paying any taxes. So there are many problems that I have worked on here. I am going to stop right here because I have got about 20 pounds of newspaper clippings that proves what I said is right.

So here goes with what I found here. I worked in Louisiana, quite a number of years ago, for a thing called the Liberty Amendment and it was to repeal the Federal income tax and to get Government out of business. It was a very difficult sell. It was backed by Walt Disney and Knotts Berry Farm, John Wayne, and so on. John Wayne was starting to fight cancer at that time. Walt Disney died, Knotts died, much of the money that helped us to carry this died out. We did not quite make the 7 years getting two-thirds of the legislature to force the 16th amendment to stand repeal. We have continued to work on it for quite a number of years, I have. I have a book hopefully will be published within 3 to 4 months. Actually I will not go into the title of it here, it will be out. But there are many, many things that I found as problems.

I have investigated thoroughly, all the people I could talk to in the last months and I have just placed in John Shadegg's hands 280 petitions that I spent about 6 hours gathering and from it we found that the people do not want any form of a—and I found this on all kinds of personal interviews—of an actual flat tax. It is an erroneous tax, it is a tax that is filled with lies and errors and it can do more damage to us than where we sit now, and God knows this is bad enough.

We are working for full repeal of the Federal tax. Now people say it cannot be done. Simplicity itself. Suppose we take the simplicity out, we pass just a little over $7 billion, the figures vary depending on who you go to in the Department of Commerce and so on, but if you will take 7.3, Congressman, and if you will multiply those figures out, you are going to find out a very amazing thing. If you multiply it by 9, you are going to have $670 billion—$670 billion is more than we collected on the entire Internal Revenue for this entire year, much more.

Now you are going to take some other figures here that are important to you. They want to have a lot of these people that will have comfort and rest and so on in their old age. I have been paying on my Social Security for 62 years now and I found to my amazement—or 60 years I guess it is. And I found to my amazement that this year they had to tell me that $1,189 worth of my money was taxable. They have also destroyed my accounts and so on. There are a lot of people who are seniors who are not going to be able to survive with what is going on, and this includes putting in a tax like we are talking about.

The actual truth on what is wrong with this taxing system right now—by the way, I sent both of you gentlemen papers and I did not hear from either one of you, although I heard from Stump and a few others, covering this Reclaim America, which is what we are calling it here. We are associated with people in about 20 different States and they are using much of my material today.

But I have broken down thoroughly a research that was done on where ore goes to before it becomes an automobile. We find that before we are through—corporate tax you say they are not paying? Oh, yes, they are paying corporate tax, you bet they are and they are paying others too. By the time this is added on, there is an add on that goes through, we find out we are paying $20,000 for a car that cannot cost us over $12,500 and $14,500 maximum to build here, but is all piled on one on top of the other in the form of tax. We are paying a VAT tax and it is a bad VAT tax.

Actually this is what has kept us from competing with Japan. I have got to stop.

Mr. SHADEGG. If you can conclude in half a minute or so.

Mr. JONES. OK. Japan has a 20 percent tax, they take it off when it crosses the border. We do not put anything on them. We sent ours over there with a full fledged tax on it and no wonder we cannot do business over there.

So you take a look at the charts, and I have got the charts available for you and I will send it to both of you Congressmen again because I think it is important. It shows that we advanced a huge sum of $1.3 trillion in the offset of imports against exports and that happens to be way in excess of over 19,000 jobs in this State—I mean in the United States. In fact, it is going to approach before it is through over a million jobs.

I think it is important to know that these things can be done. I ask you to seek carefully the words in this resolution. I will tell you my final percents. And I will be glad to take questions if you like. The percents. On the first day out, it was 65 percent. I was sorely disappointed but I saw they had a couple of questions they wanted to ask, so I took the bill that was introduced March 8, and I laid it down so people could answer it and when they looked at it, they said yeah, I will sign this willingly. I got 100 percent the next day and 100 percent the next day and I run an average of 91 percent the other 3 days I tried for those 280 petitions that are signed already.

I have already talked to others and we believe that we can get millions upon millions of signatures on the basis of what is here and this is what the people want and they do not want anything else.

Mr. SHADEGG. Thank you very much. I appreciate your efforts and your input today in today's hearing.

Congressman Salmon.

Mr. JONES. I will be glad to answer any questions if you have them.

Mr. SALMON. Thank you, I appreciate it too.

Mr. JONES. Thank you.

Mr. SHADEGG. With that, I think we have concluded the hearing.

I do want to say that Senator John Kyl submitted a very well-written four page long statement in support of this hearing. Without objection I would ask that that be inserted in the record.

[The prepared statement of Senator Kyl follows:]

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Remarks of
Senator Jon Kyl (R-AZ)

before the
Subcommittee on National Economic Growth,
Natural Resources, and Regulatory Affairs
House Government Reform and Oversight Committee

April 3, 1996

Mr. Chairman, I want to thank you and the members of the Subcommittee for the attention you are giving today to the need for fundamental reform of our nation's tax system.

During the next two weeks, millions of Americans will file their income-tax returns. According to estimates by the Internal Revenue Service, individuals will have spent about 1.7 billion hours on tax-related paperwork by the time their returns are completed. Businesses will spend another 3.4 billion hours. The Tax Foundation estimates that the cost of compliance will approach $200 billion.

If that is not evidence that our Tax Code is one of the most inefficient and wasteful ever created, I do not know what is. Money and effort that could have been put to productive use solving problems in our communities, putting Americans to work, putting food on the table, or investing in the nation's future are instead devoted to convoluted paperwork.

It is no wonder that the American people are frustrated and angry, and that they are demanding radical change in the way their government taxes and spends. It is no wonder that tax reform has become one of the major issues of this year's presidential campaign.

Mr. Chairman, there are a number of proposals for comprehensive tax reform, some of which will be discussed at today's hearing. The House Majority Leader, Congressman Dick Armey, has proposed a flat tax. Versions of the flat tax have been suggested by Steve Forbes and Senator Phil Gramm. The Chairman of the Ways and Means Committee has recommended that the income tax be pulled out by its roots and replaced with a national sales tax. Senator Richard Lugar has proposed a sales tax, as well.

I want to focus here, though, on a change that should be made whether we move to a flat tax or sales tax or some alternative. Indeed, it is a change that should be made whether comprehensive tax reform succeeds or not. I am talking about a change that would require a two-thirds majority vote of the House and Senate to approve tax increases.

The Tax Limitation Amendment, which I introduced in the Senate with the support of 19 other Senators, will be the subject of a hearing in the Senate's Constitution Subcommittee on Tax Day, April 15. The House leadership has aptly scheduled a vote on the proposal in the full House of Representatives on Tax Day. One of the chief cosponsors of the amendment in the House is Congressman John Shadegg, a distinguished member of this panel today and someone who was instrumental in the effort to write a tax limit into Arizona's Constitution.

The two-thirds supermajority that we believe should be added to the U.S. Constitution was recommended by the National Commission on Economic Growth and Tax Reform, appointed by Senate Majority Leader Dole and Speaker Gingrich. The Commission, chaired by former HUD Secretary Jack Kemp, advocated a supermajority requirement in its recent report on how to achieve a simpler, single-rate tax to replace the existing maze of tax rates, deductions, exemptions, and credits that makes up the federal income tax as we know it today.

Here are the words of the Commission:

> "The roller-coaster ride of tax policy in the past few decades has fed citizens' cynicism about the possibility of real, long-term reform, while fueling frustration with Washington. The initial optimism inspired by the low rates of the 1986 Tax Reform Act soured into disillusionment and anger when taxes subsequently were hiked two times in less than seven years. The commission believes that a two-thirds super-majority vote of Congress will earn Americans' confidence in the longevity, predictability, and stability of any new tax system."

Mr. Chairman, in the 10 years since the last attempt at comprehensive tax reform, Congress and the President have made some 4,000 amendments to the Tax Code. Four thousand amendments. Without the protection of the Tax Limitation Amendment, taxpayers would be particularly vulnerable to tax rate increases, particularly if tax reform eliminates many of the tax deductions, exemptions, and credits in which they find refuge today.

The Tax Limitation Amendment will make it more difficult for Congress to raise taxes. It will also help restore confidence, stability, and predictability to the Tax Code.

Ideally, the Tax Limitation Amendment should be put into place after comprehensive tax reform is accomplished. That is because tax reform necessarily aims to broaden the tax base -- eliminating the maze of tax deductions, exemptions, and credits that make up the income tax as we know it today -- and then apply one low tax rate to whatever amount of income is left. Because base-broadening would be subject to a two-thirds majority vote under the amendment, some are concerned that it could make comprehensive tax reform more difficult to achieve.

I would note that the Tax Reform Act of 1986 would have met the two-thirds test. The tax reform bill passed the Senate by a vote of 74 to 23, well over the 67 votes that would be required had the Tax Limitation Amendment been in place at that time. The House passed the bill by a vote of 292 to 136, two votes more than would have been required under the supermajority amendment.

So tax reform is not necessarily a reason to oppose the Tax Limitation Amendment at this time. Moreover, it is important to begin the debate now on the proposed constitutional amendment, because it takes a long time to build the necessary support in Congress and to win ratification by the states.

Another criticism comes from those who believe that tax increases should remain readily available to Congress as a tool of fiscal policy.

Mr. Chairman, I want to make just a few points in response to that criticism. First, the Tax Limitation Amendment itself cuts no taxes; it only raises the bar on future tax increases. Many people, myself included, believe that taxes are already far too high. This amendment, in effect, says, "enough is enough." It makes Congress find a way to meet its obligations without taking more from the pockets of the American people.

Understand that the average family already pays more in taxes than it does on food, clothing, and shelter combined. According to the Tax Foundation, federal taxes amount to about 27 percent of the family's budget, and state and local taxes consume another 12 percent -- for a total of 39 percent. But spending on food, clothing, and shelter totals only about 28 percent of the family budget. Families have to find a way to pay for everything else they need -- for example, medical care, transportation, education, and an occasional vacation or dinner out -- out of the meager amount that is left.

So what the Tax Limitation Amendment says is that government already takes far too much from hard-working Americans and should take no more, unless there is a very broad and bipartisan consensus in Congress and around the country.

A second point, Mr. Chairman. There is no small irony in the fact that it will take a two-thirds majority vote of the House and Senate to overcome President Clinton's veto and enact the Balanced Budget Act with its tax relief provisions. By contrast, the President's record-setting tax increase in 1993 was enacted with only a simple majority -- and not even a majority of elected Senators, at that. Vice President Gore broke a tie vote of 50 to 50 to secure passage of the tax-increase bill in the Senate.

The Tax Limitation Amendment is based upon a simple premise -- that it ought to be at least as hard to raise people's taxes as it is to cut them. What we are attempting to do with this amendment is force members of Congress to think of tax increases, not as a first resort, but as a last resort.

A third point. The amendment will make it harder to raise taxes, to be sure. But perhaps even more important than that, it will force Congress to fundamentally reassess the way it goes about raising revenue. Remember, the amendment does not limit ***revenue*** to the Treasury; it merely precludes ***tax rate increases*** without a two-thirds majority vote.

Most of us would agree that lower tax rates stimulate the economy, resulting in more taxable income, more taxable transactions, and more revenue to the Treasury. The tax cuts of the early 1980s are a case in point. They spawned the longest peacetime economic expansion in our nation's history. Revenues to the Treasury increased as a result -- from $599.3 billion in FY81 to $990.7 billion in FY89, up about 65 percent.

High tax rates, on the other hand, discourage work, production, savings, and investment, so there is ultimately less economic activity to tax. That is precisely what Martin Feldstein, the former chairman of the President's Council of Economic Advisors,

found when he looked at the effect of President Clinton's 1993 tax increase. He found that taxpayers responded to the sharply higher marginal tax rates imposed by the Clinton tax bill by reducing their taxable incomes by nearly $25 billion. They did that by saving less, investing less, and creating fewer jobs. The economy eventually paid the price in terms of slower growth.

It is interesting to note that revenues as a percentage of Gross Domestic Product (GDP) have actually fluctuated around a relatively narrow band -- 18 percent to 20 percent of GDP -- for the last 40 years. Revenues amounted to about 19 percent of GDP when the top marginal income tax rate was in the 90 percent range in the 1950s. They amounted to just under 19 percent when the top marginal rate was in the 28 percent range in the 1980s. Why the consistency? Because tax rate changes have a greater effect on how well or how poorly the economy performs than on the amount of revenue that flows to the Treasury.

In other words, ***how*** Congress taxes is more important than ***how much*** it can tax. The key is whether tax policy fosters economic growth and opportunity, measured in terms of GDP, or results in a smaller and weaker economy. Nineteen percent of a larger GDP represents more revenue to the Treasury and is, therefore, preferable to 19 percent of a smaller GDP.

Mr. Chairman, requiring a supermajority vote for tax increases is not a new idea. It is an idea that has already been tested in a dozen states across the country. In 1992, an overwhelming majority of voters in my home state of Arizona -- 72 percent -- approved an amendment to the state's constitution requiring a two-thirds majority vote for tax increases. As I indicated before, Congressman John Shadegg was instrumental in securing passage of Arizona's tax limitation amendment before he came to the Congress.

There is a reason that the idea has been so popular in Arizona and other states. Tax limits work. According to a 1994 study by the Cato Institute, a family of four in states with tax and expenditure limits faced a state tax burden that was $650 lower, on average, five years after implementation than it would have been if state tax growth had not been slowed.

Mr. Chairman, the Tax Limitation Amendment will force Congress to be smarter about how it raises revenue. It will force Congress to look to economic growth to raise revenue, instead of simply increasing tax rates. It will protect taxpayers from additional tax increases.

I look forward to working with you on this important initiative.

Mr. SHADEGG. With that, let me simply conclude by again thanking all of you for staying and for paying attention to the hearing. Thank each of the witnesses who bothered to prepare and submit their testimony and thank Congressman Salmon for taking time out of his busy schedule to be here and participate and hear from these constituents.

With that, I declare this field hearing of the subcommittee adjourned. Thank you.

[Whereupon, at 1:10 p.m., the subcommittee was adjourned.]

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