EXPLORING THE DEVELOPMENT OF TAXPAYER BILL OF RIGHTS II LEGISLATION

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 24, 1995

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EXPLORING THE DEVELOPMENT OF TAXPAYER BILL OF RIGHTS II LEGISLATION

FRIDAY, MARCH 24, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to call, at 9:10 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 14, 1995
No. OV-4

CONTACT: (202) 225-7601

JOHNSON ANNOUNCES HEARING TO EXPLORE THE DEVELOPMENT OF TAXPAYER BILL OF RIGHTS II LEGISLATION

Congresswoman Nancy L. Johnson (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will conduct a hearing to explore the development of Taxpayer Bill of Rights II legislation during the 104th Congress. **The hearing will be held on Friday, March 24, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:00 a.m.**

This hearing will feature invited witnesses only. In view of the limited time available to hear witnesses, the Subcommittee will not be able to accommodate requests to testify other than from those who are invited. Those persons and organizations not scheduled for an oral appearance are welcome to submit written statements for the record of the hearing.

BACKGROUND:

The term "Taxpayer Bill of Rights" refers to legislation that combines numerous individual provisions to strengthen the rights of taxpayers in their dealings with the Internal Revenue Service (IRS). The original Taxpayer Bill of Rights (TBR) became law in 1988. It sought to create a more level playing field between taxpayers and the IRS by creating over one dozen procedural safeguards for taxpayers. For example, it gave taxpayers a legal right to sue the IRS for up to $100,000 in damages in order to redress reckless actions taken by IRS agents in collecting taxes. It gave taxpayers in financial difficulty the statutory right to pursue installment payments plans with the IRS. It also prohibited the IRS from evaluating collection agents based on their collection results and from imposing collection quotas on its agents. Finally, it gave taxpayers who prevail over the IRS in litigation the right to have the IRS reimburse part of their attorney fees in some circumstances.

The 1988 legislation was a step in the right direction, but the general consensus was that much more could be done to help taxpayers. The Oversight Subcommittee held two days of hearings in 1991 to explore legislation to build on the 1988 TBR and further improve taxpayer safeguards and rights in dealing with the IRS. This hearing activity led the Subcommittee to conclude that it would be desirable to pursue a Taxpayer Bill of Rights II (TBR2). The Subcommittee Members developed H.R 3838 as legislation to create the taxpayer safeguards that they had identified as being helpful to taxpayers. H.R 3838 was introduced in November, 1991. A modified version of H.R. 3838 was included in H.R. 11, the Revenue Act of 1992, which passed Congress in October 1992, but was vetoed by President Bush for reasons unrelated to the TBR2 provisions.

The TBR2 provisions in H.R. 11 contained over two dozen provisions to help taxpayers. For example, one provision would have expanded the power of the Taxpayer Ombudsman in the IRS to issue protective orders to help taxpayers who were being treated unfairly by the application of normal IRS procedures. It would have imposed on the IRS an obligation to take reasonable steps to corroborate information returns whose accuracy is

disputed by the taxpayer. It would have given the IRS the authority to waive the interest on late tax payments in cases where the taxpayer had a good reason for the late payment. (Under current law, the IRS has broad authority to waive penalties but not the interest on late tax payments.) It also would have required the IRS to give that taxpayer 30 days advance notice before it revoked an installment payment agreement that it previously had entered into with a taxpayer.

The need for a Taxpayer Bill of Rights II has not diminished since 1992. Taxpayers would benefit if their rights were strengthened in dealing with the IRS. A good starting point in exploring expansions of the Taxpayer Bill of Rights in the 104th Congress would be the provisions that passed Congress in 1992 as part of H.R. 11. In addition, other legislation has been introduced in the 104th Congress, which builds on the earlier TBR.

In announcing the hearing, Chairman Johnson said: "When the average taxpayer goes up against the IRS, it's like a contest between David and Goliath. We should investigate ways to safeguard the rights of taxpayers in these contests. Taxpayers have a duty to pay their lawful tax liability, but they should not be put at a disadvantage by procedural rules and IRS policies that make the David and Goliath contest any more one-sided than it often is."

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Monday, April 3, 1995 to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at GOPHER.HOUSE.GOV, under 'HOUSE COMMITTEE INFORMATION'.

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Chairman JOHNSON. Good morning, ladies and gentlemen. I welcome you to our hearing to explore the development of a Taxpayer Bill of Rights II in the 104th Congress.

The primary mission of the IRS is enforcing our Nation's tax laws and collecting taxes that are legally owed. They collect $1 trillion in taxes a year. They struggle with $150 billion that people don't voluntarily offer with an outmoded computer system and 114,000 employees. On the whole, they do an outstanding job, but as with any big organization that has to do something that not everybody thinks is fun, they have some hard times and can be heavy-handed.

In the past, we have written Taxpayer Bill of Rights legislation. In 1988, we adopted a dozen procedural safeguards for taxpayers. We allowed taxpayers to make installment payments under certain circumstances and also gave taxpayers who prevail over the IRS the right to have the IRS reimburse their attorneys' fees in certain circumstances.

In the early 1990's, we gave a lot of time and attention to trying to assure that the playing field between the Government and its people on tax issues was relatively level. Unfortunately, that legislation, while it was broadly supported by the committee and was included in H.R. 11, was in the end vetoed by President Bush for unrelated reasons.

We now return to the issue of a Taxpayer Bill of Rights, and it is my intention and that of my committee to consider the provisions that we looked at in the early 1990's and to listen to our colleagues and listen to the people out there to see what measures are appropriate at this time to assure that in this period when, frankly, the IRS is faced with enforcing a far more complex code than a few years ago and a higher level of willingness on the part of people to deceive and dissemble in regard to their tax obligations and, therefore, has required the Government to have a far more aggressive antifraud program, that in this setting we also deal with the problems that intrusion and the disparity between the resources of the Government and particularly small individual taxpayers is properly balanced and that citizens in America don't feel unnecessarily powerless and defenseless in the face of the Government. Yet the Government must have the tools and position it needs to assure compliance with our Tax Code and with the obligations each citizen assumes to support the services of Government.

I yield now to my colleague, Mr. Matsui, the ranking member of the Oversight Subcommittee.

Mr. MATSUI. Thank you very much, Chairwoman Johnson. I first of all want to thank you for holding these very, very valuable hearings. I think, obviously, the fact that you have taken such a strong leadership role in this will mean that we will undoubtedly this year have legislation prepared, and I really appreciate the fact that you are moving in that direction. So I want to thank you very personally.

Second, very briefly, I think you gave an important and strong statement about what these hearings and future legislation are all about. But I might just add that, as you stated, we want balance in the collection of revenues to the Federal Government. Certainly, the Internal Revenue Service, which has a great deal of power and

influence over American society, must understand that taxpayers do have some rights and remedies. And so the issue of balance is very critical.

At the same time, I would hope that the Service and its valuable employees understands that this is not meant to cast aspersions upon the Internal Revenue Service itself. There are many tools, for example, that the Service does not have that I am sure it would like to have. It cannot waive penalties when the Service, for whatever reason, is not able to process a taxpayer's claim. Oftentimes, liens are misfiled. The Service does not have the ability to lift those liens. And so there are many valuable tools that we need to give the Service in order to have the Service do its proper work.

So I would not want the Service to view this as a threat, but to view this as a process in which all of us are working together to provide the best service possible to the American taxpayer.

So, again, I want to thank you very much for holding these hearings, and I look forward to the witnesses and certainly the markup of the legislation when it becomes available.

Chairman JOHNSON. Would any other member of the committee care to make a comment?

[No response.]

Chairman JOHNSON. We are pleased to welcome the Honorable Senator Grassley of Iowa as our first witness.

Senator Grassley, you have done a lot of work in this area yourself. We are pleased to have you here this morning, and we look forward to working with you on legislation that we hope not only will be considered by the House and the Senate, but let me make this point at this time since I rarely have a chance to say this directly to an esteemed Member of the other body.

I would hope that as we move this legislation forward that it could go to the floor separately and independently and not part of a whole great big bill. I think it is important in this era of public discouragement, in a sense, with the Congress that we move bills succinctly and independently so people can see exactly what we are doing. In this case, it is so important that people see that we are trying to balance their rights against their Government's at the same time we preserve the power of their Government to do what is in the public interest. For them to be able to see that legislation and hear that debate I think is important, and I hope to move this as an independent bill forward. And I would hope that it would be able to have that same treatment in the Senate.

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Let me suggest to you that that rarely happens. It is a very legitimate request and one that I would not shy away from. The process in the Senate doesn't lend itself very often to that happening, and I am sure to the chagrin of Members of this very important body, who have the constitutional responsibility of initiating such legislation as tax legislation.

Well, I, too, thank you very much for your interest in this very important issue and an opportunity to be with you. Thank you very much for holding this hearing.

As many taxpayers are struggling in the midst of the current tax-filing season, then obviously the issue of taxpayers' rights takes on kind of a very special importance. Although most IRS employees provide very valuable and very responsible service, taxpayer abuse by the Government is, of course, an ongoing problem. So with this in mind, I am very happy to have joined Senator Pryor and others in reintroducing the Taxpayer Bill of Rights II in the Senate as S. 258. This is a very necessary legislation, and it happens to build upon the original Taxpayer Bill of Rights that we passed into law in 1988.

Now, for me, the long process of trying to ensure taxpayer protections began in the early 1980's. At that time I was a member and then chairman of the Finance Subcommittee on IRS oversight. We made some progress, but it was only the beginning. Senator Pryor helped continue the cause when he succeeded me as chairman in 1987. At that time, we took the initiative and he asked me to work with him in pushing for a Taxpayer Bill of Rights by expanding legislation I and others had introduced. It took nearly 2 years, but we ultimately succeeded in achieving this goal and the passage of the Taxpayer Bill of Rights.

We now have a 6-year record of implementing the legislation, and specifically as it regards the Taxpayer Bill of Rights. Great strides toward taxpayer protection were achieved through this important piece of legislation. Now, however, the Taxpayer Bill of Rights of 1988 was never then, nor now, expected to be the final chapter in the book of taxpayer protection. It was a very major step in the continuing process of stamping out taxpayer abuse, and that process still continues to this very day as we look into new and different ways to improve the current law.

In reviewing the record, it is clear that much more needs to be done. There is no question that breakdowns in implementing the law have occurred, and there are gaps in the law that need to be filled.

For instance, we believe that the current ombudsman position is too limited and too beholden to IRS insiders. Our legislation will turn the ombudsman into a more independent office of taxpayer advocacy. And the purpose of that office is to expand powers for that office to help taxpayers and for the office director to have direct control in the hiring and firing of problem resolution officers. Currently, these officers are too beholden to their respective district directors and tax collection officers.

Other important provisions include the abatement of interest with respect to unreasonable errors or delays by the IRS. We also create a cause of action against the IRS for wrongful liens. In addition, taxpayers would have a right to an installment agreement for liabilities of less than $10,000.

We were successful in passing a similar proposal through the Congress in 1992. However, the underlying legislation at that time, because it was attached to a proposal, was vetoed by former President Bush. So, of course, we are back again in this new Congress to attempt to do as well or even better than we did in 1992.

Since 1987, Senator Pryor and I have worked in a cooperative, bipartisan effort to further taxpayers' rights. As our roles change somewhat in this new Republican-controlled Congress, we hope to

continue our successful teamwork, and we hope to work closely with the House and the members of especially this subcommittee in our efforts to improve taxpayers' rights.

Beyond the introduction of this bill, Senator Pryor and I will be working on further improvements and even more pro-taxpayer proposals that will be offered at a later date. This is a truly bipartisan effort. Even President Clinton mentioned to me personally a few weeks ago that he supported our efforts. And we have had quite a few meetings with IRS and Treasury officials who understand that the problem exists and are making an effort to work out agreements.

So I urge my House colleagues to join us, along with Chairwoman Johnson, in the cause to help make the IRS more responsible and more accountable to the taxpayers of this country.

I thank you for this opportunity, Madam Chair, and I look forward to working with you and other members of this subcommittee as we continue this bipartisan effort.

Chairman JOHNSON. Thank you very much, Senator. The kinds of things that you suggest from your legislation are certainly the kinds of things we are interested in, and we look forward to working with you. It may be that if we work effectively not only in a bipartisan way in both Houses but in a bicameral way that we can also give greater visibility to this legislation on the floor.

One of the issues that we are struggling with is the issue of burden of proof, and I wondered whether you would be receptive to expanding the rights of victorious taxpayers to have their attorneys' fees reimbursed by the IRS by requiring the IRS to show that it was substantially justified in maintaining its position in order to deny a taxpayer's claim for attorneys' fees.

Senator GRASSLEY. Yes. The answer is yes, we are willing to consider that. We had it in the 1988 bill. We had to take it out before final passage, but it is something that we have considered before and we would be glad to look at it again.

Chairman JOHNSON. There are some other suggestions in legislation before the House to put the burden of proof in civil tax cases on the IRS. This would reverse current practice, which places the burden of proof on the taxpayer.

Are you looking at changes of that nature?

Senator GRASSLEY. Well, obviously, that is the ultimate of taxpayers' rights, and from that standpoint, that is always a consideration. But it is probably the most difficult one for us to deal with because, of course, the IRS will argue that that takes away the ultimate tool that they have to bring people to prove the amount of tax that is owed.

You will find—I am sure you know this when you ask the question—how very central that is to taxpayers' rights, and yet the strongest arguments from the IRS will come on that particular question.

Chairman JOHNSON. We will certainly be pursuing that with them and with others who testify. It is a difficult issue, but there are some other aspects of that same issue that could be addressed in ways that you suggested from your legislation as well as some of the ideas that have come before us.

I yield to my colleague, Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

Senator Grassley, I like the notion of not only a bipartisan agreement but also a bicameral agreement, as the chairwoman has just mentioned. Do you happen to have an idea of when the Finance Committee might be moving its legislation on this area?

Senator GRASSLEY. Yes.

Mr. MATSUI. Because coordination might be something we might have to work on.

Senator GRASSLEY. Well, obviously, we seldom move any tax legislation without it first coming from the House. We might do some things simultaneously with you. Sometimes we move things out of committee to the floor.

We will not be considering—well, first of all, I don't know whether—I have not heard the chairman say when he was going to consider tax legislation generally, but my guess is that we are going to be, through the first couple weeks of May, working on welfare reform. So it will be after that date.

After that date, this would not have the primary position in the committee. It would be the tax bill that comes from the House of Representatives.

We still have not considered in our own minds whether or not we do some of this legislation through reconciliation—by legislation, I mean tax legislation—or separately. We have to make those decisions.

The final judgment as it relates to this bill, I think at that point, contrary to what Chairwoman Johnson requested, it probably would be considered a part of the tax bill at that point.

Mr. MATSUI. Thank you. I look forward to working with you.

Senator GRASSLEY. You bet.

Chairman JOHNSON. The gentleman from Missouri.

Mr. HANCOCK. I just wanted to thank you, Senator Grassley, for the work you have done over the years in this area. I think that maybe we are approaching a time that we are going to get something accomplished.

Thank you very much.

Senator GRASSLEY. Thank you.

Chairman JOHNSON. Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman.

Senator, I think you will find that there is bipartisan support for moving on a Taxpayer Bill of Rights. We obviously want to make sure that where a taxpayer has been wronged there are remedies available.

It seems to me there is a different view as to what impact, financial impact on the agency, some of these proposals might have and whether IRS has sufficient budgetary support in order to carry out many of the requirements that we currently have in the code. I am wondering whether you have done any study in this area, or whether there is any information of which you know, that is available that would either support or not support the notion that some of these problems may be related to the support or lack of resources of the IRS.

Senator GRASSLEY. Well, we are looking into it, but I have to be very candid. It would be difficult to get a firm figure. We have a responsibility in passing this legislation to make sure that it

doesn't detract from the usual efforts and ongoing efforts of IRS. But, additionally, there were tremendous resources in the last budget season given to the IRS, so I think that we need to think in terms of those increases, plus other increases that are being asked in the current budget process, as some flexibility for us to not be concerned, at least that not to be the utmost concern that you present, with these additional resources that have come to the IRS.

Mr. CARDIN. And I agree. It would be useful if we had some independent analysis as to what impact these new requirements may have on IRS, and basically whether these are financial problems within the agency or something else.

Senator GRASSLEY. Well, we know this: that we will have a judgment given to us by the Commissioner and others in the Treasury Department on the costs, and they will have to be a consideration for us to have. But I still think we have to consider the resources that have already been given and are presently asked.

Thank you, Madam Chairwoman.

Chairman JOHNSON. Thank you. Mr. Portman.

Mr. PORTMAN. Thank you.

Senator, thanks for being here and for your good explanation of the bill. I have two quick questions. One is with regard to the taxpayer advocate. I don't have the actual language of your bill in front of me, and I was wondering: Does your legislation contemplate that the President would nominate and the Senate confirm as compared to the IRS Commissioner appointing the ombudsman?

Senator GRASSLEY. Not currently are we considering that much of a change, but the selection not being as important as the independence once it is set up; and, most importantly, the authority of the ombudsman over other people in the taxpayer resolution area, because there is a process set up that isn't so intimidating to taxpayers, a process to get questions answered very quickly, a process that gets around the usual bureaucracy, a process that works fairly well but would work much better if they were within the purview of the ombudsman, or as we call it, the taxpayer's advocate.

Mr. PORTMAN. Tax advocate. And you think that kind of independence would be practical without having a selection process that would be independent of the Commissioner?

Senator GRASSLEY. Yes. I don't believe—although we are giving consideration to other methods as you suggest, although I would say myself I haven't given attention to the question of the President making the choice. After considering those, still the most important view would be the independence of whoever is appointed.

Mr. PORTMAN. One other quick question, and this is a followup to Mrs. Johnson's question to you regarding shifting the burden of proof. Having been chairman of the subcommittee and followed this for years, I just wondered if we could probe a little further into your thinking on this issue. It is a very delicate issue, as you know, and one we will hear more about later, I think, in our further panels. But have you thought about any interim steps where perhaps the taxpayer would have the burden to come forward with some threshold amount of information, data, and so on that the taxpayer

would have and the IRS would not? And then at that point the burden might shift to the IRS to make its case?

Have you thought about those kinds of——

Senator GRASSLEY. We have not thought very deeply about it. We have thought that the chances of making any change whatsoever as opposed to the chance of getting other important pieces of the legislation through, we have thought that the latter has been more important. So we haven't gone into the alternatives. And part of our thought as well was that if we would get an adequate bill of taxpayers' rights, then that diminishes somewhat the changing of the burden of proof.

The burden of proof is something that can be justified a little easier, the extent to which there is less intimidation from the IRS.

Mr. PORTMAN. Thank you very much, Senator. Thanks for coming over.

Chairman JOHNSON. Thank you very much, Senator. It was a pleasure to have you, and we look forward to working with you. Thank you for joining us.

The Honorable Mr. Jacobs of Indiana, please proceed.

STATEMENT OF HON. ANDREW JACOBS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. JACOBS. Thank you, Ms. Chairwoman and members of the subcommittee.

About 15 years ago, Representative Crane offered an amendment in committee that provided for attorneys' fees to be paid by the U.S. Treasury to citizens who were brought to court unreasonably by the IRS or without sufficient reason to bring those citizens before the court. At that time I was a member of the committee, and I offered an amendment to Mr. Crane's amendment that would provide that if an agent or an employee of the IRS should cause a citizen to be brought into court and put to expense in an arbitrary or capricious manner—something more than negligence or bad judgment—that the court could order that employee, the one who did it, to pay all or some of the costs to the citizen who was brought into court.

My argument then was what my argument is now. What did the taxpayers do wrong? Why should the taxpayers pay for damage done by an individual at IRS in an arbitrary or capricious, not merely negligent, but arbitrary and capricious manner? For some reason or another, that provision was not adopted.

However, my mother always quoted that if at first you don't succeed, try, try again. In 1986, I offered it to the big so-called tax reform bill that was before the committee. I was told by the chairman that it was not in order until the miscellaneous section at the end of the bill, which happened to come after 3 weeks at about 3 a.m. in this room, as they say in Indiana, of a Sunday. And a lady from the Washington Post—I think her name was Swardson—called me up in Indiana and said, "Isn't it true that this provision passed at 3 o'clock in the morning on a voice vote?" And I said, "That is true, but hardly all of the truth." I said that I had been working on it for however many years then; I guess it has been 15 or 16 now. And while it was passed on a voice vote, it was also passed on a rollcall vote.

Representatives from the IRS were in the room and gave their opinion about the amendment. One of them said, well, it is not a problem because we have internal disciplinary arrangements, and I replied to that by saying so do the doctors and so do the lawyers, and that is precisely why most people have no faith in public institutions anymore, people judging themselves and their peers. Whereupon, it passed by a show of hands 10 to 3. It went on to pass the House.

By the way, this reporter also asked me, wouldn't this have a chilling effect—there is a concept in law that you didn't learn in law school, but have a chilling effect on the performance of duties? And I said I believe it would have a chilling effect on arbitrary and capricious action by any IRS employee.

So how did it come out on the front page of the Washington Post the next morning? Just as you would imagine. Jacobs admitted that it was passed at 3 o'clock in the morning on a voice vote and it would have a chilling effect on the performance of duties by people at the IRS.

Now, I want just to add at least this: I hear it said that this is an insult to the employees at the IRS. Nothing could be further from the truth. We pass murder laws. That is not an insult to the citizens of this country, because very few people commit murder. And I am here to testify that very few IRS agents act in an arbitrary and capricious manner. But I am equally here to say that no service is perfect, and obviously sometimes someplace—I know a couple of cases—such a thing does happen.

Now, when it passed in the most recent tax bill—it has passed the House, I suppose, three times now, and when it passed most recently, the committee wanted to add the words "or maliciously." And I acceded to that. That is fine, exactly what I had in mind, someone who doesn't like your necktie or how you look or something like that.

So it has passed the House, I believe, at least three times, only to die in the cave of the bones, sometimes called the other body, after the IRS went to work on them.

Now, as a former police officer, I know that any time something like this is done with respect to any department of Government, there are many honest apprehensions about the misapplication of it. However, the provision that passed most recently provided as follows: You could not bring an independent action against an IRS agent. It would have to be—it was in the provision—an ancillary proceeding to the actual case itself, which is to say that once the evidence was in and was found wanting, the court could then conduct an ancillary proceeding on motion of the respondent to determine whether there was arbitrary and capricious action. So it didn't cost very much more; it was right there; the judge had already heard the facts and so on. And the judge was not required necessarily to assess the entire cost of the defendant, but the entire cost or any part thereof in the best judgment of the court.

That is about it, except that I hope you give us another chance to try it again, run it up the hill again.

Chairman JOHNSON. Thank you, Mr. Jacobs. That history was very interesting.

It is true that now a taxpayer who has been the subject of arbitrary and capricious action by the IRS can collect attorneys' fees. Is that not true?

Mr. JACOBS. Yes, but they collect them from innocent people, the taxpayers of the United States, even including the respondent, theoretically.

Chairman JOHNSON. I appreciate that. This would for the first time, though, in any Federal agency make the individual Federal employee liable. There is no other parallel in any other agency that we reach to the individual employee.

Mr. JACOBS. Yes. You have to start somewhere, I guess would be my answer to that. I mean, take the exclusionary rule, which we have dealt with recently in the House. The 75-year-old exclusionary rule, evidence obtained unconstitutionally excluded from a case even if it would convict the right person for a heinous murder. It is an outrage to the American public.

I say I am a former police officer. I gather evidence. I present it in court or at least I testify in court. Yes, I would like the person to be convicted. I am a good citizen. I think he is guilty. I think he or she ought to be convicted and punished.

But if you take the boat out of my driveway, it is going to have a lot more effect on my conduct than whether the evidence I gathered in a case makes a conviction. I have always thought that we should not have the exclusionary rule. The discipline should be directly against the officer who is a rogue who gets out of line.

So if this is the place to start, I am happy to be the George Washington of it.

Chairman JOHNSON. Have you had any experience with the internal disciplinary process at the Department?

Mr. JACOBS. I am sorry?

Chairman JOHNSON. You mentioned that you have always been told that the Department had an internal process to deal with individual employees who abrogated this standard. Do you have any comment on their process or do you have any idea whether it works?

Mr. JACOBS. Inherently, it is unacceptable to a civilized people that people judge themselves. I mean, it is what you call inherently incredible that you could have faith in a system where people and peers judge themselves. It is always thought better—we have all heard of the independent counsel. That is exactly what I am talking about.

Chairman JOHNSON. I hear what you are saying when you say it is inherently without credibility but, nonetheless, I think we need to know how it works and whether it has worked, and we will try to get that information on the record.

Mr. JACOBS. There was a case out in the Northwest United States a number of years ago where it was so obvious that the IRS agents were being personal about the respondent. They didn't like the people; they thought they were too snotty or whatever. That culminated in the man's committing suicide, so that the woman would have the insurance money to pay the tax bill.

Don't misunderstand me. I am not anti-IRS. I am not anti-police. Will Rogers said, "It is a great country, but you can't live in it for nothing," when he talked about taxes. Some people are just knee-

jerk. That is wrong. I want the highways, I want the police protection, I want the national defense, but I don't want to pay a nickel in taxes because that is un-American. Well, that is also nuts.

So I don't take that position at all. But I just say in those tiny little instances where that happens, the person who did it should pay, not the innocent taxpayers. That is my reaction. And, apparently, that argument went over. It has passed the House three times.

Chairman JOHNSON. Thank you.

Mr. Matsui.

Mr. MATSUI. Thank you.

Andy, I will tell you, I understand what you are saying, but don't you believe that the administrative process—I mean, if an agent is found to have committed a malicious act, what about the administrative process? They could be fired. They could be disciplined. There is a whole wide variety of actions that can be taken against them.

If we emphasize that, do you think that would have the same kind of deterrent effect as the issue of liability? It would seem to me that the whole notion of creating individual responsibility really changes the whole concept of what we are trying to do here, because I do believe it could have some chilling effect on others. You know, then you are at kind of the burden of a court system, and we know how jury trials are. Sometimes they work, sometimes they don't. Sometimes it depends upon how slick a lawyer is. Perhaps you can——

Mr. JACOBS. I just don't think murder laws have a chilling effect on most of us who don't tend to commit murder, and I don't think that a rule against arbitrary, capricious, and malicious action is going to have much effect, chilling effect—that is the term—on the IRS agents.

At first, I think they made some useful suggestions, by the way, when they said, What if somebody, a disgruntled taxpayer, just filed a suit against us? This has gone through a metamorphosis through the years. We changed that to make it an ancillary proceeding to the actual case itself, and nobody has standing to bring action against those individual agents. We trimmed this thing down quite a bit over the years, but I think it is down to the point now where it accomplishes the forensic purpose that I have described.

You asked me do I have faith in internal tribunals for misconduct of one's peers and people. No, I don't, and I don't think most Americans do. Most Americans understand the concept of conflict of interest.

Mr. MATSUI. Thank you.

Chairman JOHNSON. Thank you.

Mr. Hancock.

Mr. HANCOCK. I have absolute, complete sympathy with where we are heading here. There is no question about it. But I do have a little bit of a problem. This is a major change in the principle of agency, where the agent of an employer is on their actions, you can always go against the employer, which is true in the private sector. As a small businessman, if I have got a serviceman out here and

he does certain things, if he is at my direction, then I am responsible.

Mr. JACOBS. That is the whole point, sir. It is not at the direction. It is ultra vires. It is something beyond. Only under the color authority—you didn't do anything wrong if one of your people goes out and rapes a woman.

Mr. HANCOCK. I will agree, as long as it is a criminal action.

Mr. JACOBS. But he couldn't have gotten in the house if he hadn't been your serviceman.

Mr. HANCOCK. Well, that is true, but what about if I send somebody out to collect a bill and they get carried away? I mean, no criminal charges of any kind, but they get carried away on how they collect the bill and violate the laws on how to collect a bill. I have to answer for that. In fact, if my employee is out there doing the job and that individual brings a suit against me, then I am going to have to defend that suit and defend the employee, and probably they would get a judgment against me, similar to what we have——

Mr. JACOBS. They probably won't win the suit if you didn't direct him to do the crime.

Mr. HANCOCK. Well, my point is, are we talking about the agent or are we talking about the steps through his supervision?

Mr. JACOBS. We are talking about whoever took sets on somebody because he didn't like him. It is a fact situation.

Mr. HANCOCK. Sure, OK.

Mr. JACOBS. Someone who just took sets on someone, didn't like his race, didn't like his necktie, didn't like the fact they both wanted to go out with the same woman, whatever. That is the kind of case we are talking about. I am not talking about just some casual, let's go after one guy because we hate the service. I am talking about a fact situation, where it is arbitrary, well defined in the law already, capricious, and malicious. Now, that is a pretty heavy load to prove, and I don't think there is a danger.

As far as the major change is concerned, the last time I heard, the majority in this Congress favored some major changes.

Mr. HANCOCK. Do you know about any specific cases where the Internal Revenue Service may have initiated something on this order as an effort to make an example of the taxpayer where it could be talked about to make other people nervous?

Mr. JACOBS. You say an example?

Mr. HANCOCK. Yes.

Mr. JACOBS. Well, I just cited one, the one out in the Northwest a few years ago. And there are others. There are others.

We had a guy out in Indianapolis, an agent, a few years ago, called up one of the largest builders in the United States. Nobody knew how he got the direct line, but he did, and he got hold of the president of the company. And he got a little snotty with him and went on and on and on and on and on. And this guy said, you are nuts, I file my income tax by the boxful, and talk to my accountant, this is the first I heard of it.

This young agent called back, I think six times over a period of time. The fellow should have had his phone changed, I guess. But he called back six times, and somewhere along the line, surely he

would know that this was an honorable person. I don't know whom he was after.

Now, you might say, well, that is negligence. But after six times, you might have taken the trouble to look up what you are doing and find out. That was sort of borderline. I don't say it did any great harm. I guess this fellow had better things to do than be yelled at over the phone by an IRS agent.

Mr. HANCOCK. Thank you.

Chairman JOHNSON. Mr. Cardin.

Mr. CARDIN. Well, Andy, I think all of us agree that in the type of cases you are referring to, the taxpayer should have full rights and that there should be action taken against the Federal employee who has treated a person in that manner.

I get lots of complaints in my office about all Federal agencies, including the IRS, and the overwhelming number, perhaps all, would not fall into the category that you are referring to, those extreme cases.

Shouldn't we be looking for some balance in trying to deal with the problems that taxpayers have with the IRS by supporting additional efforts to modernize the way that the IRS handles the tax compliance issue by providing the resources which they need to modernize their facilities?

Mr. JACOBS. Absolutely. Absolutely. But you can't modernize a bad heart, and that is all this is about.

Mr. CARDIN. Yes, I understand.

Mr. JACOBS. That occasional rogue who, under color of authority, does damage to American citizen, and the whole issue here is whether other Americans citizens who didn't do that at all should be forced to pay taxes to pay for that person's—pay the damage, or should the person, the rogue, pay the damage? It passed the House three times. You voted for it.

Mr. CARDIN. I agree with you. We are in agreement. But I just believe that, unfortunately, we are trying to put so many things into the one category, so many types of constituent problems with the IRS into the one category, and trying to deal with a bill to deal with that category, where a large amount of the frustration that my constituents have with IRS is due to that Congress has not made available the resources for the IRS to modernize.

Mr. JACOBS. I acknowledge right readily that this is not a panacea. This is not the complete link. This is to deal with one specific problem, which is nothing less than an outrage. What is it Solon said? That civilization is impossible until the unconcerned are as outraged as the victim. I am outraged if you are wronged in that arbitrary and malicious fashion. It doesn't have anything to do with mistakes of the IRS. God knows we all make those. This is where intentional, heinous behavior occurs. That is all I mean. It is just an element.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Mrs. Johnson.

Andy, a few questions, but first just a comment on what Mr. Cardin said. I agree that modernization would help. I think more important would be simplification of the Tax Code rather than modernization, because I think if people understood clearly what

their rights were on both sides, the taxpayer side and the IRS side, there would be fewer instances of the kind that you mention.

But let me probe this a little further, and I do consider you the George Washington of this effort, as you know, the father of personal responsibility here. Arbitrary and capricious is a standard you use, which is the Administrative Procedures Act standard for rulemaking, and it is a pretty well established standard. There are a lot of court cases on it which would provide some sort of a safe harbor.

You also mentioned malicious behavior was added; you indicated at one point that it was arbitrary and capricious and malicious.

Mr. JACOBS. I beg your pardon.

Mr. PORTMAN. Is it and or or?

Mr. JACOBS. It is a disjunctive. It is or.

Mr. PORTMAN. Otherwise, it would be quite narrow, I would think.

Mr. JACOBS. It would be self-contradictory, I agree, but it is a disjunctive.

Mr. PORTMAN. I think that an important point to make is that there is, with the conjunctive, even, a lot of case law out there and that the standard—certainly if arbitrary and capricious is well established, I think that is important to have a safe harbor so that people understand on the IRS side what behavior would go over the line.

The second question is, you talked about the ancillary proceedings. You indicated that that would affect standing. It would limit people's ability to bring suits. Would it also, Andy, help with the situation with a lot of these tax litigation matters that go on and on for months, even years, and I would think there would be a cloud hanging over the head of the IRS agent during that time period. Having ancillary proceedings, does that affect that situation at all?

Mr. JACOBS. Rob, it is hard for me to believe that during the case in chief much of the evidence of what I am talking about, if it existed at all, would not have been heard by the trier of the facts, the judge. So I think that my perception is that the ancillary proceeding could be conducted in fairly rapid order.

Mr. PORTMAN. Another question I have relates to the cost of the taxpayer's legal fees. It is my understanding that you are asking that there be a personal liability on the part of the agent to pay those costs.

Mr. JACOBS. All or some part, yes.

Mr. PORTMAN. All or some part? And that is within the discretion of the trier of fact, of the judge.

Have you thought about putting some sort of a cap on that, Andy, to limit that liability at some——

Mr. JACOBS. Well, it wouldn't bother me. Yes, I think that would be reasonable. In other words, if a respondent gets his brother-in-law and figures he is going to get his fee paid, and he said, well, we will just make a $1 million fee, absolutely, I think that would be very—I am glad you mention it. I think that would be very helpful.

Mr. PORTMAN. Well, I thank you very much for bringing this issue before us. I am new on the committee, as you know, and

haven't had a chance to explore it yet. I look forward to seeing the statutory language, and I appreciate your continuing to push the effort.

Mr. JACOBS. Thank you very much.

Mr. PORTMAN. Thank you, Madam Chairwoman.

Chairman JOHNSON. Mr. Zimmer, would you like to inquire?

Mr. ZIMMER. I have no questions. Thank you.

Mr. JACOBS. Thank you.

Chairman JOHNSON. Andy, thank you very much for your good testimony and for your long work in this area, your perseverance over many years.

Mr. JACOBS. Thank you, Mrs. Chairwoman.

Chairman JOHNSON. We have appreciated it.

Our last witness on the panel is not here. When he arrives, we will visit with him. We will insert his statement into the record.

I would like to call the first panel: Hon. Peggy Richardson, the Commissioner of the Internal Revenue Service; and with her, Lee Monks, the Taxpayer Ombudsman from the IRS; and Cynthia Beerbower, Deputy Assistant Secretary of the Department of Treasury.

Deputy Assistant Secretary Beerbower, we are pleased to have you. I think this is your first appearance before our committee, and we are pleased to have you represent the Department of Treasury for tax policy.

STATEMENT OF CYNTHIA G. BEERBOWER, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF TREASURY

Ms. BEERBOWER. Thank you very much, Madam Chair and members of the subcommittee.

Chairman JOHNSON. Nice to have you, Ms. Beerbower. Why don't you go ahead?

Ms. BEERBOWER. In response to the subcommittee's request, I am pleased to present the views of the Treasury Department on many of the important issues of taxpayer rights. The administration supports many of the ideas in the legislation that we will be discussing today. Treasury has worked with the Internal Revenue Service to develop a package of administrative changes, including certain regulatory simplification to help taxpayers reduce the burdens of compliance. We have also been meeting with congressional staff, and we have been working on legislative initiatives that build upon the original Taxpayer Bill of Rights.

Commissioner Richardson in her testimony will discuss some of the new ideas that have emerged from our dialog with staffs. I want you to know we remain strongly committed to reducing taxpayer burden and safeguarding taxpayer rights in dealing with the IRS.

Last year, the Treasury Department supported the passage of tax simplification and technical corrections. It contained numerous provisions from the Taxpayer Bill of Rights II that were originally contained in H.R. 11. Although H.R. 3419 passed in the House, the legislation was never taken up in the Senate.

In its fiscal year budget for 1996, the administration has stated that it continues to support revenue-neutral initiatives designed to

promote sensible, equitable administration of the Internal Revenue laws. We support simplification and technical corrections. In addition, the budget describes the administration's support of compliance and enforcement measures. We have stated we support the reinstatement of authority to share information on cash transaction reports, and to fund undercover operations. We are working on intermediate sanctions, modernizing and streamlining IRS operations, and compliance with diesel dyeing.

The administration has also actively supported and pursued administrative measures to ease taxpayer burdens. In fact, the day before yesterday, the IRS issued a notice that relieves taxpayers who made charitable contributions of $250 or more from the statutory requirement that they obtain written acknowledgment from the charities for their 1994 returns. The IRS provided this relief because we have been hearing from a number of people of the difficulties that they have had in securing this written acknowledgment.

I detailed in my written testimony many of these initiatives that we have taken in order to simplify and in order to respond to problems individual taxpayers have had with the compliance burden.

Today, you have asked for our views on three pieces of taxpayer rights legislation that have been introduced in the 104th Congress: H.R. 390, which was introduced by Representative Traficant; S. 258, which was introduced by Senators Pryor and Grassley; and H.R. 661, which was introduced by Representative Thornton. You have also asked that we respond to title V of H.R. 11, which was passed by both Houses of Congress in 1992, but vetoed by President Bush.

In preparing our testimony today, we have reviewed the prior testimony in this area by Treasury officials. It is interesting to note that over a long period of time and regardless of the political affiliation of the administration, the testimonies of Treasury officials have been essentially consistent. Treasury has always cautioned Congress that compliance with our tax laws depends upon the public's perception that the tax laws are fairly administered and that the IRS has the ability to catch and to prosecute violators.

Our tax system has as its foundation voluntary self-assessment and compliance. The IRS only audits 1 percent of all returns. It is because of the dependency of the entire tax system on this voluntary compliance that Treasury approaches the subject today with caution.

There are three prerequisites to a successful voluntary tax system. First, the system must be fair and must be perceived as being fair. Second, taxpayers must be treated with respect and dignity. The enforcement mechanism should not be more intrusive or burdensome than is necessary for sound tax administration. Third, the system must operate efficiently and at a reasonable cost. If we increase the governmental cost of tax collection without commensurately increasing the benefit to taxpayers, we have wasted the taxpayers' dollars.

With these criteria in mind, we believe that certain important provisions in the proposed legislation will be very useful and valuable. However, we have serious reservations about other proposals. Although these proposals are well intentioned, we believe that they

could significantly undermine fairness, respect, and efficiency, and ultimately erode voluntary compliance with our laws.

I would like to focus initially on H.R. 390. This bill contains three sections. Our comments on the second and third sections are included in the written testimony. I would like to highlight the first section of H.R. 390, because that section concerns us very much.

Those of you who are lawyers know that the general rule is that the burden of proof in a civil proceeding is on the party who is in control of the facts. By contrast, in a criminal proceeding, such as a proceeding for criminal—or civil—fraud, the burden shifts to the Government.

There is much case law and it is in our written testimony that details the development of this legal doctrine. It is probably best summed up in a 1975 ninth circuit case called *Rockwell* v. *Commissioner* that reaffirmed the Tax Court rules, imposing the burden of proof on the taxpayer. The ninth circuit said even if it were to decide the burden of proof issue in the first instance, the court would impose the burden on the taxpayer. The taxpayer knows the facts, and he can testify as to what his intent or his purpose was. The Commissioner, on the other hand, must rely on circumstantial evidence, and most of it has to come from taxpayer records. So it is not unfair, said the ninth circuit, to impose the burden on the taxpayer to pursue the facts.

Section 1 of H.R. 390 would change this longstanding and well-established legal doctrine. What it would do is place the burden of proof on the Government in all tax cases for all issues.

While this provision may be relatively simple and innocuous on its face, we believe that it will have enormous and far-reaching adverse effects on the tax system. We believe, in particular, that it will result in a significant reduction in the willingness of taxpayers to comply voluntarily with their tax obligations, and it would greatly encourage tax protesters.

It is difficult to grasp a change of this magnitude. However, in fiscal year 1994, the IRS examined—through regular examinations and information return program contacts—4 million taxpayers. A vast preponderance of these audits were conducted by correspondence. Under the new provision, a taxpayer receiving a letter can simply refuse to provide the requested information.

The IRS would then be forced to do a face-to-face audit of the taxpayer. But even then, the taxpayer can refuse to cooperate. If so, the IRS is forced to disprove the items on the taxpayer's return. This would often be impossible. It would require extensive investigation by the IRS, lengthy face-to-face interviews of persons other than the taxpayer, and often the need to summon information from third parties.

As a result, the simplest audit would become a costly nightmare if taxpayers refused to cooperate. Taxpayers can wait for the Service to come up with the proof, and if the IRS gives up or abandons the effort, the taxpayer would automatically win.

Consider a few real-world examples of tax compliance, facts that the IRS would have to prove: one, if a taxpayer claimed a child as a dependent and the IRS suspects that the child does not exist, the IRS would be forced to interview neighbors; two, if the taxpayer claimed that he or she supplied more than half of the support of

a dependent, the IRS would be forced to prove that someone else provided more than half of the support of that dependent; three, if a taxpayer claimed that a certain piece of art that it has given to charity was worth $1 million, the taxpayer could just wait, and the IRS would have to prove that that particular piece of art was worth less; four, if a taxpayer claimed a $200,000 mortgage interest deduction, the IRS would be forced to summon the bank and prove that the interest had been paid and that the principal amount of the mortgage exceeded the $1 million limit; five, if a taxpayer claimed to be over 65 or if he claimed to be blind, the IRS would have to summon records to prove to the contrary; six, if a taxpayer claims lavish entertainment expenses, the IRS would have to disprove the expenses or the business purpose of the event by summoning waiters and credit card receipts; and seven, if a taxpayer claimed that his gambling winnings were offset by gambling losses, the IRS would have to prove that that taxpayer did not have the gambling losses.

The results in the business arena would be equally bizarre. If a foreign-owned U.S. company reported no profits and the IRS claimed there should be intercompany pricing adjustments that would result in profits, the IRS would have the burden of proving that the U.S. company had overpaid its foreign affiliate. This contradicts with the rule today, under which the company has to prove that it did not overpay. If a taxpayer claimed exemption from the passive loss rules for real estate by claiming that he or she worked more than 500 hours in the activity during the year, the taxpayer would need to show nothing, and the IRS would have to somehow disprove that claim.

The change in the burden of proof would have significant implications in the tax shelter area. Many tax shelter cases turn on whether the taxpayer can establish that the transaction or the investment was entered into with the intention of making a profit or was solely entered into to manufacture tax deductions. We believe it is reasonable for the taxpayer to have the burden of proving his own business motive. To do otherwise would open the door to shelters ranging from complicated corporate financial transactions to wealthy taxpayers who buy ranches as vacation homes and deduct the cost of what in reality is their vacation.

The bill would be an obvious boon to tax protestors, who would claim all sorts of deductions to zero out their incomes. The IRS would spend endless hours having to disprove each item on the protestor's return. Protestors would no doubt become extremely creative in claiming deductions that would cause the maximum difficulty for the IRS to disprove.

In fact, when we were preparing our testimony, we thought that section 1 of H.R. 390 could be named the Tax Protestors Relief Act.

There also would be a significant impact on the IRS appeals process, which has to take into account the hazards of litigation in settling cases. With the burden of proof on the Government, the IRS would be placed in a no-win position. It would either have to try to settle more cases for reduced amounts or proceed to court. Most taxpayers would not want to settle. They would hold out for court proceedings where they can simply sit back and relax. This choice would have little to do with the merits of the case, and it

would have everything to do with the IRS' ability to find the necessary records to prove the taxpayer's deductions.

H.R. 390 would also compromise taxpayer privacy. It would cause audits to be much more time-consuming and burdensome. The Service would be forced to conduct more extensive and intrusive investigations of the taxpayer. And if the taxpayer did not cooperate, third parties, such as banks and credit card companies, would be required to furnish lots and lots of information to the IRS. These documents would be viewed by third parties as very burdensome.

The system would also operate less efficiently, and it would be less able to deliver quality services at a reasonable cost. The choice really is: Will increased funding be provided for the IRS in order to enable them to carry some of this burden? Or will the funding remain the same and there simply be a reduction in the audit activity?

Just consider the task of disproving the existence of a child. If I claim that I have a baby, how are you going to prove that I don't? The fact that my neighbors never saw one or the grandparents don't know about one does not prove that the child does not exist.

Chairman JOHNSON. Ms. Beerbower, I really appreciate the specificity of your testimony. It is very helpful to the committee. But if you could summarize parts of it and continue with other parts, I would appreciate it.

Ms. BEERBOWER. I will.

There are many more arguments against H.R. 390 detailed in our written testimony. We have commented, as I said, on the other two sections of H.R. 390, but the length of my discussion on the matter is really designed to reflect the importance we place on the burden of proof and the magnitude of the change that is embodied in H.R. 390.

In evaluating H.R. 390, we ask you to consider whether it is in the long-term best interest of taxpayers to force the IRS to administer and enforce the tax laws with this handicap.

Although Treasury has not formally estimated the cost of this proposal, its cost is very large, and the trust of law-abiding citizens who do comply with the tax laws would be eroded.

I would like to conclude with a few comments on the other pieces of legislation, the Taxpayer Bill of Rights legislation that you have asked us to comment on.

As I said, Treasury and the IRS worked closely with Members of Congress and their staffs in developing the 1988 Taxpayer Bill of Rights. We are continuing to meet with congressional staffs to develop new ideas. Commissioner Richardson will go into these new ideas, and I need not at this point.

The two versions of the Taxpayer Bill of Rights that are the focus of this hearing are similar in most respects. I want you to know that we support many of the provisions in their current form and have suggested minor modifications. We have been discussing these modifications with congressional staff.

At the current time we understand that there are roughly 40 sections in each bill, and we have major disagreements with only a small number of them. We are supportive of the great bulk of the

bill, and the detail of our support is outlined in the written testimony.

I think with the balance of my time I would like to focus on just a few areas where our disagreement is very strong.

The taxpayer advocate provisions that are contained in the Taxpayer Bill of Rights II will be dealt with in detail, not only by the ombudsman but by the Commissioner.

Under current law, as you know, the administration's tax initiatives are not presented to Congress until they are cleared by the executive branch, the Office of Tax Policy, and the Office of Management and Budget. This coordinated clearance process is an important part of the function that we serve. In the Taxpayer Bill of Rights provisions in H.R. 661 and H.R. 11, the ombudsman would not only be required to submit annual reports to Congress, but he would be asked to give legislative ideas to Congress without being reviewed by the Office of Tax Policy, the IRS, or OMB.

Now, we like to believe that the ombudsman is independent. We support his independence. We are pleased that there is no mandate that the President select him and that his selection be confirmed by the Senate. And we applaud the deletion of this provision. But we believe that the administration should speak with one voice on tax proposals.

The administration needs to take into account its own priorities, the views of the Secretary of the Treasury, the concerns of many agencies, and in the Office of Tax Policy, we do believe that we provide significant technical revenue estimating and policy input.

We also need the administrative input of the IRS. In short, we believe that to change the reporting responsibilities on tax legislation of the ombudsman would essentially deny the executive branch the right to present Congress with a balanced economic agenda and would certainly undercut the role of the Secretary of the Treasury as the spokesman on the administration's fiscal matters.

We work with the IRS. We want you to know that Treasury has taken quite an interest in the administration of tax returns. Both Mr. Samuels and I have asked to visit Service centers in the next few weeks to see what type of burden they deal with. Last year, I went out to California to meet with the agents, and I was very interested in a lot of the comments they made about the difficulties they face.

We work with the IRS on legislative ideas, but we have been somewhat frustrated by the lack of opportunity to present good-government, legislative solutions. In 1993, tax provisions were viewed as nongermane to budget reconciliation. In 1994, there were no tax provisions in the budget. And in this current budget, while we have set them forth, we think that this committee needs to make a special effort—and it has done and we applaud what it has done in technical corrections—to place what is probably less glamorous tax legislation on the agenda and fight for its enactment.

I would also like to comment on the provisions providing for installment agreements as a matter of right and for the suspension of penalties that are in the Taxpayer Bill of Rights. You need to remember that most law-abiding and fiscally responsible taxpayers pay their tax liabilities on time. These provisions would encourage them not to. We have several examples in the written testimony,

but one thing to consider is the difference in the rate of interest on payments to the Federal Government and the rate of interest on a credit card balance.

If this legislation goes through the way it is, I would certainly expect people in the private sector to give advice to anyone that has an outstanding credit card balance, that it is far more tax efficient to pay the credit card balance before you pay your taxes. This is because in many instances I think the rate right now on credit cards is about 15 percent, whereas the rate on payments to the Government is 8 percent. It is clearly in your interest to pay down your credit card balance before you pay your taxes.

If the rate of interest on amounts owed the Government is less than the return that you get on your investments, you also would have an incentive to make these investments instead of paying the Government. And making these installment agreements a matter of right we think would seriously undermine efforts to pay your tax on time.

My final comments really deal with retroactivity. In H.R. 661, section 903 generally would prohibit us from issuing retroactive regulations. There are a number of exceptions that are detailed. There was a very useful provision in H.R. 11 that was dropped in the current legislation. It would have allowed regulations issued within 12 months of enactment of a statute to relate back to the date of enactment. But the authority to issue regulations retroactive is a great concern for us. There have been a lot of studies done of situations when the Treasury has acted retroactively, and I am not aware of any study that has ever concluded that we have engaged in a pattern of misuse or irresponsibility with respect to our authority to act retroactively.

If we were prohibited from acting retroactively, we would establish a window in the period of time between when changes in statutes occur and when the regulations that detail the manner in which one complies with those statutes are issued. Taxpayers would basically race against the Treasury in order to get their transactions in that window. We see constantly the arbitrage opportunities that are created in the financial markets that rely on the slowness of the Government to act, and we need the power to continue to at least threaten to act in many instances retroactively to prevent this type of arbitrage from occurring.

Despite these concerns, and in conclusion, we remain committed to the Taxpayer Bill of Rights. We believe we can work with this committee and can make the provisions better. And we look forward to that.

This concludes my prepared remarks, although I will stay for questions until after the Commissioner and the ombudsman have divided. Thank you.

[The prepared statement follows:]

STATEMENT OF
CYNTHIA G. BEERBOWER
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Madam Chair and Members of the Subcommittee:

In response to the Subcommittee's request, I am pleased to present the views of the Department of the Treasury on the important issue of taxpayer rights. This Administration supports many of the ideas in the legislation we will be discussing today. Treasury has been working with the Internal Revenue Service (IRS) to develop a package of administrative changes, including certain regulatory simplification to help taxpayers reduce the burden of tax compliance. We also have been meeting with Congressional staff to develop legislative initiatives that build on the original Taxpayer Bill of Rights.

Commissioner Richardson, in her testimony, will discuss some suggestions that have emerged from these dialogues. We remain strongly committed to reducing taxpayer burden and safeguarding taxpayer rights in dealing with the IRS.

Last year, the Treasury Department supported the passage of The Tax Simplification and Technical Corrections Act of 1993, H.R. 3419, which contained numerous provisions of the Taxpayer Bill of Rights 2, as originally contained in H.R. 11. Although H.R. 3419 passed the House on May 17, 1994, the legislation was never taken up in the Senate. In its Fiscal Year 1996 Budget, the Administration stated that it continues to support revenue-neutral initiatives designed to promote sensible and equitable administration of the internal revenue laws, including simplification and technical corrections. In addition, the Budget describes the Administration's support of such compliance and enforcement measures as reinstatement of authority to share information on cash transaction reports within the law enforcement community and to fund undercover operations. In the Budget, we also state that we support and want to work with Congress on proposals involving intermediate sanctions, the modernization and streamlining of IRS operations, and compliance with diesel dyeing requirements.

The Administration also has actively pursued administrative measures to ease taxpayer burdens. For instance, just this week, the IRS issued a notice relieving taxpayers who made charitable contributions of $250 or more from the statutory requirement that they obtain adequate written acknowledgements from the charities before they file their 1994 returns. The IRS provided this relief because of difficulties taxpayers are experiencing in obtaining these acknowledgements. As another example, in 1993 the IRS issued a notice providing relief for individuals who want an automatic four-month extension to file their tax returns, but who are unable to pay by the original due date the amount of tax estimated to be due. Although such taxpayers would still be liable for interest and late-payment penalties, they are relieved of the late-filing penalty that otherwise would apply.

In addition, the Administration has taken numerous administrative measures to make it easier for small businesses to deal with the tax system. The Administration routinely issues regulations designed to minimize or eliminate burdensome recordkeeping requirements on small businesses. For example, the Administration recently issued regulations reducing the reporting requirements necessary to claim an ordinary loss deduction on the sale of small business stock, simplifying return preparation for taxpayers subject to the alternative minimum tax, and simplifying the calculations for determining the amount of depreciation deductions for small businesses. The Administration has also issued guidance designed to assist small businesses in complying with complicated tax provisions -- for example, by issuing a revenue procedure that will greatly assist the rapidly growing number of small businesses that elect to operate as limited liability companies.

Today, you have asked for our views on three pieces of taxpayer rights legislation that have been introduced in the 104th Congress: (1) H.R. 390, which was introduced by Representative Traficant and others on January 4, 1995; (2) S. 258, which was introduced by Senator Pryor, Senator Grassley and others on January 23, 1995; and (3) H.R. 661, which was introduced by Representative Thornton on January 24, 1995. Because S. 258 and H.R. 661 are the same, I will refer to H.R. 661. You have also asked that we review Title V of H.R. 11, which was passed by both Houses of Congress in the Revenue Act of 1992, but vetoed by President Bush.

In preparing our testimony, we have reviewed the prior testimony in this area by Treasury officials. It is interesting to note that over a long period of time and regardless of the political affiliation of the Administration at the time, the testimonies of Treasury officials have been consistent. Treasury always has cautioned Congress that compliance with our tax laws depends upon the public's perception that the tax laws are fairly administered and that the IRS has the ability to catch and prosecute violators. Our tax system has as its foundation voluntary self-assessment and compliance. The IRS currently audits only approximately 1 percent of all returns. Since we depend upon voluntary compliance, Treasury approaches this subject today with caution.

There are three prerequisites to a successful voluntary tax system. First, the system must be perceived as being fair. Fairness requires that similarly situated taxpayers be treated similarly. The success of our system, therefore, hinges on each of us believing that if we pay our share of taxes, others will do the same.

Second, taxpayers must be treated with respect and dignity. The enforcement mechanism should not be more intrusive or burdensome than is necessary for sound tax administration.

Third, the tax system must operate efficiently in a manner that provides quality services to taxpayers at a reasonable cost. If we increase the governmental costs of tax collection, without commensurately increasing the benefits to taxpayers, the taxpayers' dollars will be wasted.

With these criteria in mind, we believe that certain important provisions of the proposed legislation will be useful and valuable. However, we have serious reservations about some of the other proposals in the proposed legislation. Although these proposals are well-intentioned, we believe that they could significantly undermine fairness, respect and efficiency, and ultimately erode voluntary compliance with our laws.

I. H.R. 390

I would like to focus initially on H.R. 390. This bill contains three sections. The first section, about which we have major concerns, would place the burden of proof on all issues in all tax cases in court on the government.

S 1. Burden of Proof

Current law. The general rule in civil proceedings is that the burden of proof is on the party that has control of the facts. By contrast, in criminal and certain penalty proceedings (such as civil fraud), the burden shifts to the government.

In the tax context, the general civil rule is articulated well by the Ninth Circuit case of Rockwell v. Commissioner, 512 F.2d 882 (9th Cir. 1975). In this case, the U.S. Court of Appeals for the Ninth Circuit held clearly that the burden of proof rests with the taxpayer both to produce evidence that rebuts the Commissioner's determination and to persuade the court of the correctness of the taxpayer's position. This, the court said, is proper and does not deny the taxpayer his right to due process of law. The court said if it were to decide the issue in the first instance, it would establish and uphold this rule:

> "The taxpayer knows the facts . . . . He can . . . testify as to what his intent or purpose was. The Commissioner, on the other hand, must rely on circumstantial evidence, most of it coming from the taxpayer and the taxpayer's records . . . . It is not at all unfair, in such a case, to place on the taxpayer the burden of persuading the trier of fact. . . " Id. at p. 887.

Proposal. Section 1 of H.R. 390 would change this long-standing and well-established legal doctrine in the tax context. It would place the burden of proof on the government for all issues in all tax cases in court. Section 1 provides: "Notwithstanding any other provision of this title, in the case of any court proceeding, the burden of proof with respect to all issues shall be upon the Secretary."

Discussion. While this provision may appear to be relatively simple and innocuous on its face, we believe it will have enormous and far-reaching adverse effects on the tax system. In particular, we believe it will result in a significant reduction in the willingness of taxpayers to comply voluntarily with their tax obligations and would greatly encourage tax protestors.

It is difficult to grasp a change of this magnitude. However, in Fiscal Year 1994, the IRS examined (through regular examinations and information return program contacts) four million taxpayers. Most of these audits are conducted by correspondence. Under the new provision, a taxpayer receiving a letter could simply refuse to provide the requested information.

The IRS would then be forced to do a full face-to-face audit of the taxpayer. But even then, if the taxpayer refused to cooperate, the IRS would be forced to disprove the items shown on the return. This would often be impossible. It would require extensive investigation by the IRS, lengthy face-to-face interviews of persons other than the taxpayer, and often the need to summon information from third parties. As a result, the simplest audit would become a costly nightmare if the taxpayer refuses to cooperate. The taxpayer could wait for the IRS to come up with proof and, if the IRS abandons the effort, the taxpayer automatically "wins."

For example, (1) if a taxpayer claims a child as a dependent and the IRS suspects the child does not exist, the IRS would be forced to interview neighbors; (2) if a taxpayer claimed that he or she supplied more than half the support of a dependent, the IRS would be forced to prove that someone else provided more than half; (3) if a taxpayer claimed that art given to charity was worth $1,000,000; the taxpayer could just wait, and the IRS would have the burden of proving it was worth less; (4) if a taxpayer claimed a $200,000 mortgage interest deduction, the IRS would be forced to summon the bank to prove that the interest had been paid and that the principal amount of the mortgage exceeded the $1,000,000 limit; (5) if a taxpayer claimed to be over age 65 and/or blind, the IRS would have to summon records to prove the contrary; (6) if a taxpayer claimed lavish entertainment expenses, the IRS would have to attempt to disprove the expenses (or the business purpose of the event) by summoning waiters and credit card receipts; and (7) if a taxpayer claimed that his gambling winnings were offset by gambling losses, the IRS would somehow have to prove that he did not have the losses.

The results in the business arena would be equally bizarre. If a foreign-owned U.S. company reported no profits, and the IRS claimed there should be intercompany pricing adjustments that would result in profits, the IRS would have the burden of proving that the U.S. company had overpaid its foreign affiliate, rather than (as today) the U.S. company having to prove that it did not overpay. If a taxpayer claimed exemption from the "passive loss" rules for real estate because he or she worked more than 500 hours in the activity during the year, the taxpayer need show nothing, and the IRS would have to somenow disprove that claim.

The change in the burden of proof also would have significant implications in the tax shelter context. Many tax shelter cases turn on whether the taxpayer can establish that the transaction or investment was entered into with the intent to make a profit or instead was solely to manufacture tax deductions. We believe it is reasonable for the taxpayer to have the burden of proving its own business motives. To do otherwise would open the door to shelters ranging from complicated corporate financial transactions to wealthy taxpayers who buy ranches as vacation homes and then deduct the cost of what in reality is the cost of their vacation.

The bill would also be an obvious boon to tax protestors, who would claim all sorts of deductions to zero out their income. The IRS would spend endless hours having to disprove each item on the return. Protestors would no doubt become extremely creative in claiming deductions that would cause maximum difficulty on the part of the IRS to disprove.

There also would be a significant impact on the IRS Appeals Office, which is required to take into account the hazards of litigation in settling cases. With the burden of proof on the government, the IRS would be placed in the "no win" position of either having to settle more cases for reduced amounts or to proceed to court. This choice may have little to do with the merits of the case and everything to do with the IRS's ability to obtain the necessary records.

Section 1 of H.R. 390 also would compromise taxpayer privacy and cause audits to become much more time-consuming and burdensome. The Service would be forced to conduct more intensive and intrusive investigations of the taxpayer and, if the taxpayer did not cooperate, third parties such as banks and credit card companies would be required to provide information to the IRS. These document requests would be viewed as imposing new burdens on these third parties.

The system also would operate less efficiently and would be less able to deliver quality services at a reasonable cost. The provision either would require increased funding for the IRS or a reduction in audit activity. Consider the task of disproving the existence of a child. If I claim that I have a baby, how are you going to disprove that? The fact that my neighbors never saw one or the grandparents never heard about one does not prove that the child does not exist. Even the lack of a birth certificate does not prove it.

The IRS would have to spend more time developing and litigating cases, even though it would have less chance of winning them. Audit resources would be spread even more thinly, and the audit rate would decline further. More summonses would be issued and more efforts would have to be exerted attempting to obtain district court enforcement of them. Because the statute of limitation on assessments would remain unchanged, this dilution in audit resources would effectively immunize more and more deficiencies from assessments. The ultimate result would be that IRS audits would only be cost-effective if very large amounts of money were at stake, inviting taxpayers to disregard the rules and fostering disrespect for the system.

In evaluating section 1 of H.R. 390, we ask you to consider whether it really is in the long-term interest of the average taxpayer to force the Internal Revenue Service to administer and enforce the tax laws with this impediment? Because of the negative impact on fairness, privacy and efficiency, the answer to this question is clearly no.

Although Treasury has not formally estimated the cost of this proposal, it is almost certain to be very large. The trust of law-abiding citizens who do comply with the tax laws would be eroded.

Moreover, this provision is likely to result in significant increases in reporting and recordkeeping burdens on the public because the IRS will be forced to obtain more information concerning taxpayers from third parties to carry the burden of proof. Not only will this be extremely costly, but it directly conflicts with our goal of reducing reporting and recordkeeping burdens wherever possible.

In sum, this proposal could severely weaken, if not destroy, our voluntary compliance system as we know it today.

* * *

I would also like to comment briefly on the remaining two provisions in H.R. 390.

§ 2. Secretary of the Treasury Required to Specify, on Request, Regulations Implementing Specific Taxes

Current law. Under current law, the IRS provides taxpayers with an explanation of the bases for its proposed adjustments in its statutory notices and provides detailed citations to authorities in support of its position in field audits.

Proposal. Section 2 of H.R. 390 would obligate the Secretary to provide each person who was made liable for a tax, upon written request, with a written identification of the type of tax and regulations relating to the adjustment. This written identification would have to be provided within 14 days of the request.

Discussion. We agree taxpayers should be made aware of the basis for an adjustment. In fact, this information is routinely provided by the IRS and already is available on request of the taxpayer. However, we question whether forcing a response in all cases within 14 days, regardless of the posture of the case, that could consume significant resources, would result in a commensurate benefit to taxpayers.

§ 3. Increase in Limit on Recovery of Civil Damages for Unauthorized Collection Actions; Exclusion of Such Damages From Income

Current law. Under current law, if an officer or employee of the IRS recklessly or intentionally disregards a provision of the Internal Revenue Code or Treasury regulations, the affected taxpayer may sue the United States for the lesser of (i) $100,000 and (ii) direct economic damages plus costs.

Proposal. The bill would increase the damage cap to $1 million and exclude the damages from the taxpayer's income.

Discussion. We believe that the current statutory provision strikes a reasonable balance between safeguarding the interests of taxpayers and the IRS. We are concerned that increasing the damage cap to $1 million could significantly encourage lawsuits by tax protestors. Excluding damages from income also results in mismeasurement of a taxpayer's economic income and is an indirect way of raising the cap.

II. TAXPAYER BILL OF RIGHTS 2

The Treasury and the IRS worked closely with Members of Congress and their staffs in developing the 1988 Taxpayer Bill of Rights legislation, and we are continuing to meet with Congressional staffs to develop new ideas that will build upon the advances that already have been made. Commissioner Richardson, who will testify after me, will set forth some of the ideas that the IRS and Treasury are developing.

As a general policy matter, the Administration has and will support legislative and regulatory proposals for procedural changes that are well-defined and that improve the tax system, subject of course to budget neutrality requirements that must be satisfied.

We also caution against attempting to codify existing IRS practices and procedures. This may hamper the ability of the IRS to revise those rules to respond to changed circumstances and encourage a small segment of the taxpayer community to engage in unproductive litigation that consumes scarce IRS resources. The costs of the delays and litigation expenses generally must be borne ultimately by all taxpayers.

The remainder of my testimony comments on specific provisions of the "Taxpayer Bill of Rights Two" (TBOR 2) bills.

The two versions of TBOR 2 that are the focus of this hearing (H.R. 661 and H.R. 11) are very similar in most respects. We support many of the provisions in their current form or with minor modifications that we have been discussing with Congressional staffs. At the current time, we understand that there are roughly 40 sections in each of the current bills and we have major disagreements with only a small number of these provisions. We are supportive, for example, of proposals in each of these bills to (1) extend the interest-free period for payment of tax after notice and demand; (2) disclose collection activities against spouses who filed a joint return; (3) permit joint returns after separate returns without immediate full payment of tax; (4) include phone numbers on payee statements; (5) apply the failure-to-pay penalty evenly to regular and substitute returns; and (6) make reasonable efforts to notify taxpayers that have made payments the IRS cannot associate with any tax liability.

Commissioner Richardson will testify in more detail on some new ideas that have been suggested. I would like to focus the balance of my testimony on our points of disagreement with the bills.

Taxpayer Advocate

§ 101 of H.R. 661 and S. 258 (same in pertinent part as § 5001 of H.R. 11). Establishment of Position of Taxpayer Advocate within the IRS

Both H.R. 661 and H.R. 11 contain two sections that affect the office of the Taxpayer Ombudsman. I generally will defer on these provisions to Lee Monks, the current Ombudsman. However, there are two issues on which I would like to comment.

Current law. Under current law, the Administration's tax legislative initiatives are not presented to Congress until they are cleared by all pertinent executive offices and agencies, including the Office of Tax Policy, the Internal Revenue Service, and the Office of Management and Budget. The Ombudsman is appointed by the Commissioner.

Proposal. Section 101 of H.R. 661 and section 5001 of H.R. 11 require the Ombudsman (who would be renamed the Taxpayer Advocate) to submit an annual report to the tax-writing committees on the activities of his office. Each such report would have to contain recommendations for legislative solutions to problems encountered by taxpayers. These reports would not be permitted to be reviewed by officials of Treasury, IRS, or the Office of Management and Budget, including the Commissioner and the Assistant Secretary for Tax Policy, prior to being submitted to Congress.

Section 5001 of H.R. 11, unlike section 101 of H.R. 661, requires the Taxpayer Advocate to be appointed by the President and confirmed by the Senate.

Discussion. We believe that the Ombudsman (or Taxpayer Advocate) should be independent and free to discuss his views, and we are pleased that the current bill does not contain a mandate that he be chosen by the President and confirmed by the Senate. But we draw the line at submitting legislative proposals in the absence of review by other offices. We believe that the Administration should speak with one voice on tax legislative proposals, taking into account the priorities of the Administration, the views of the Secretary of the Treasury, the concerns of many agencies and the technical, revenue estimating and policy input of the Office of Tax Policy and administrative input of the IRS. In short, we believe this provision undercuts the right of the Executive branch to present to Congress a balanced fiscal and economic agenda and the role of the Secretary of the Treasury as the spokesman of the Administration's fiscal matters.

Installment Agreements

§ 202 of H.R. 661 and S. 258 (not in H.R. 11). Running of Failure-to-Pay Penalty Suspended during Period Installment Agreement is in Effect

Current law. Under current law, taxpayers generally must pay interest and a failure-to-pay penalty on taxes that are not paid on time. The failure-to-pay penalty applies during the period of time an installment agreement is in effect.

Proposal. The proposal would suspend the failure-to-pay penalty during the period of time an installment agreement is in effect, as long as the agreement was requested before the due date of the return.

Discussion. This proposal would have a serious negative impact on revenues and collections. Taxpayers who otherwise could pay taxes on time would be encouraged to pay in installments. Consider the interest arbitrage between the rate of interest on payments to the Federal government and the rate of interest for credit card borrowings. The government rate is only about half the credit card rate. Obviously, anyone with credit card balances should pay that first before paying tax. Also, if the rate of interest owed the government is less than the return taxpayers could earn by investing the delayed payments, taxpayers would have an incentive to borrow from the government by not paying tax on time. The consequences of the proposal would be exacerbated when combined with the proposal (section 201 of H.R. 661 and S. 258) permitting installment agreements as a matter of right.

Interest

§ 301 of H.R. 661 and S. 258 (modification of § 5201 of H.R. 11). Expansion of Authority to Abate Interest

Current law. Under current law, the IRS has the authority to abate interest assessed with respect to a tax deficiency or payment that is attributable to the error by, or delay of, an IRS employee performing a "ministerial" act.

Proposal. In the case of taxpayers with net worth and size exceeding certain thresholds (generally, $2 million for individuals and $7 million or 500 employees for businesses), the IRS would be authorized to refund or abate interest attributable to "unreasonable" IRS errors or delays, regardless of whether the error was attributable to a "ministerial" act. In the case of taxpayers with a net worth and size below the thresholds, the IRS would be obligated to abate the interest until the demand for payment was made. The counterpart to this proposal in H.R. 11 omits the net worth distinction and does not mandate abatement for any taxpayers.

Discussion. This broadening of the authority to abate interest in both H.R. 661 and H.R. 11 would encourage taxpayers to seek relief from interest assessments as a matter of course, imposing significant administrative and controversy-related costs on the IRS. These costs ultimately would be borne by all taxpayers. In addition the vagueness of the standard for abatement would lead to uneven application of the law.

Moreover, even during delays in the resolution of an issue, taxpayers have the use of government money. Since interest (unlike a penalty) is compensation for the use of money, the provision would represent an economic windfall to taxpayers in many cases.

The net worth distinction in H.R. 661 lacks a solid policy foundation as it is unrelated to the purpose of an interest charge, which is to account for the time value of money. When coupled with the mandatory abatement for "small" taxpayers, the proposal also would have a negative impact on tax revenues. We also believe that the net worth distinction would add significant administrative complexity.

Information Returns

§ 603 of H.R. 661 and S. 258 (modification of § 5503 of H.R. 11). Requirement to Conduct Reasonable Investigations of Information Returns

Current law. Deficiencies determined by the IRS generally are afforded a presumption of correctness.

Proposal. Section 603 of H.R. 661 would place the burden of proof on the IRS in all reasonable disputes concerning the accuracy of income reported on an information return filed by a third party, unless the IRS had conducted a reasonable investigation of the accuracy of the return. The proposal is more expansive than its counterpart in H.R. 11. Section 5503 of H.R. 11 is limited to disputes over information returns in court proceedings, does not apply unless the taxpayers cooperate, and requires the IRS to present "reasonable and probative information" concerning the deficiency, rather than to shoulder the burden of proof.

Discussion. We believe the H.R. 11 proposal strikes an acceptable balance between taxpayer and government burdens. The IRS already has updated its procedures to incorporate the substance of that proposal.

For many of the reasons discussed in our comments on section 1 of H.R. 390, we have very serious misgivings about the version of this proposal in H.R. 661. By shifting the burden of proof on income reported on information returns to the IRS, the H.R. 661 proposal could eviscerate the IRS's matching program by eliminating the presumption of correctness if the IRS failed to physically examine the return or otherwise conduct a "reasonable investigation" of the return's accuracy. Taxpayers, without presenting any supporting evidence, could force the IRS to investigate the accuracy of information returns before issuing notices of deficiency.

Any statutory change that prevents the IRS from asserting deficiencies on the basis of information returns could have devastating effects on the tax compliance system and profoundly increase the resource needs of the IRS. Computerized matching of information returns has had a significant positive impact on taxpayer compliance. This change would represent a significant step backwards.

Administrative Costs

§ 804 of H.R. 661 and S. 258 (not in H.R. 11). Authority for Court to Award Reasonable Administrative Costs

Current law. Under current law, a "prevailing party" in an administrative or judicial proceeding is entitled to reasonable litigation and administrative costs, including attorneys' fees. Positions of the IRS taken prior to issuance of an IRS Appeals decision or notice of deficiency are not taken into account.

Proposal. Although the drafting of the proposal is not entirely clear, its intent appears to be to permit taxpayers to recover costs in connection with IRS positions asserted prior to an IRS Appeals decision or notice of deficiency.

Discussion. Cost recoveries should be allowed only after the United States has adopted a litigating position. The position of the United States during the early stages of an investigation cannot be judged against the "substantial justification" standard used to determine if one is a prevailing party, because examining agents pursue fact-finding investigations that do not consider the hazards of litigation.

Relief from Retroactive Regulations

§ 903 of H.R. 661 and S. 258 (modification of § 5803 of H.R. 11). Relief from Retroactive Application of Treasury Regulations

Current law. A taxpayer may rely on Treasury regulations and revenue rulings that accord with the taxpayer's particular facts. In addition, penalties are abated for taxpayers who rely on other written guidance of the IRS. The Secretary may exercise its discretion to issue tax regulations prospectively or retroactively.

Proposal. With a few exceptions, section 903 of H.R. 661 and the corollary provision in H.R. 11, would prohibit final regulations from applying to a taxable period ending before the earlier of (1) the date related proposed regulations were filed with the Federal Register; or (2) a Notice was issued substantially describing the expected content of the regulations. Under both sections, regulations could apply to an earlier period (1) to prevent abuse of a statute, (2) to cure procedural defects in previously issued regulations, or (3) pursuant to an election by the taxpayer. The H.R. 11 version provides an additional very important exception. Under H.R. 11, regulations issued within 12 months of the date of enactment of a statute may relate back to that date. Both H.R. 661 and H.R. 11 would apply retroactively to invalidate regulations that already have been issued.

Discussion. Section 7805(b) of the Internal Revenue Code, in existence basically since 1921, confers broad authority on Treasury to authorize prospective effective dates for rulings, regulations and other types of guidance. It presumes that regulations can always be applied retroactively. However, in practice, Treasury rarely has applied guidance retroactively unless the taxpayers have wanted retroactive treatment. Most reviews, some of them rather extensive, by academics, bar associations and practitioners, have concluded that Treasury has acted responsibly and reasonably. We are not aware of comments suggesting a pattern of misuse or other emergency justifying the type of fundamental change contemplated by the proposal.

The ban would encourage aggressive return positions for transactions that occur in the "window" between the date of change in the statute and the date of issuance of regulations interpreting that change. Taxpayers would routinely litigate the new nonproductive question of whether a retroactive regulation was justified, because their transaction "abused" the statute. In addition, the exception for retroactive regulations to curb abuse of a statute would not cover regulations addressing judicial decisions or substantive defects in prior regulations. The absence of an exception in H.R. 661 for regulations issued within twelve months of the related statutory provision would inhibit the ability of Treasury to implement the operation of new legislation according to Congressional intent. Taxpayers would constantly "race" the Treasury to complete their questionable transactions before regulations could be issued.

Finally, the retroactive effective date of the proposal is, at best, counterproductive. By applying to regulations filed on or after January 5, 1993, the proposal in H.R. 661 would undercut legitimate taxpayer reliance on regulations issued on or after that date and before H.R. 661 was enacted.

* * *

This concludes my prepared remarks. I will remain to answer any questions that you have after the Commissioner's and the Ombudsman's statements. Thank you.

Chairman JOHNSON. Thank you, Ms. Beerbower. .
Ms. Richardson, welcome.

STATEMENT OF MARGARET MILNER RICHARDSON, COMMISSIONER, INTERNAL REVENUE SERVICE

Ms. RICHARDSON. Thank you, Madam Chairman and other distinguished members of this committee. I have a longer written statement which I would like to submit for the record and then summarize it, if I might.

I appreciate the opportunity to be able to testify today before this subcommittee on the possible development of a Taxpayer Bill of Rights II. The issue that we are discussing today, ensuring that the rights of American taxpayers are protected, is of the greatest importance to me, to the Internal Revenue Service, and to American taxpayers.

With me today is Lee Monks, the Taxpayer Ombudsman, who will speak to you from his perspective as a taxpayer advocate.

I want to begin today by assuring you that the Internal Revenue Service is committed to respecting the rights of all taxpayers. Although I believe that we have the best tax administration system in the world, that does not mean that we should not continue to improve it. Our tax system, with the rights afforded taxpayers under it, is the model to which other nations look both in planning their systems and in measuring their successes.

Since becoming Commissioner almost 2 years ago, I have had the opportunity to visit with many of our almost 115,000 employees. What has particularly impressed me has been their dedication to and concern for protecting taxpayers' rights and their commitment to reaching balanced, sensible solutions to the varied and often unique taxpayer situations with which they are confronted. The vast majority of our employees care very deeply about providing good customer service and about protecting taxpayers' rights.

I think we have long recognized that there is an interrelationship between taxpayer service and taxpayer rights. We understand that when we make it easier for taxpayers to meet their filing responsibilities, when we are helpful in assisting them with their questions, and when we more quickly respond to an account inquiry or problem, the more likely it is that they will feel respected and, in reality, have their rights respected.

Our commitment to providing good quality service to every taxpayer does run deep in our organization, and we are working very hard to break down the functional areas so that every employee, not just those who are officially assigned to the Taxpayer Service area, appreciates the importance we attach to taxpayer service and taxpayer rights.

But despite our progress, I believe that by working together we—Congress, the Treasury Department, and the IRS—really can still do more to enhance taxpayers' rights. There are, as Ms. Beerbower mentioned, significant areas of agreement about what provisions would further enhance taxpayers' rights, and I won't go into those. But we have detailed them in an appendix to my written testimony.

I would like to share with you today several new proposals that we believe will further enhance the rights of taxpayers. The first

proposal would assist the IRS in safeguarding each taxpayer's right to privacy. Protecting taxpayers' rights of privacy is a top priority for the Internal Revenue Service. I have repeatedly stated that we will not tolerate any violation by employees of taxpayers' rights of privacy. Taxpayers' confidence that their privacy rights will be honored and that their tax return information will be kept confidential is one of the foundations of our voluntary compliance system.

A basic tenet of our confidentiality and privacy policy is a prohibition against employee access to or use of tax return information, except when it is essential for that employee to perform his or her assigned function. Our proposal, which we hope you will support, provides specific criminal sanctions that would apply to employees who violate this policy.

Under another proposal we have made, the IRS would be required to abate a penalty assessed for the first time a taxpayer failed to make the required deposits of payroll taxes if: that failure occurred during the first quarter that wages were paid; the return was filed on time and appropriate payments were made; and the taxpayer completes an IRS-approved education program that addresses the filing and payment requirements. This relief is aimed typically at new small business employers.

Finally, we propose a requirement that we issue annual reminders to taxpayers with outstanding delinquent accounts that are not in an active collection status, which remind taxpayers about the status of their accounts, the continued accrual of interest and penalties, and the continued possibility of having their refunds offset to pay those outstanding amounts.

Madam Chairman, we would like to assist your subcommittee in making these proposals a reality. We would also like to work closely with the Treasury Department and the subcommittee as you all consider various proposals so that we can inform you about the provisions we believe would propose significant administrability issues. Some of the provisions raise issues that should be considered and balanced against the additional burden and appearance of inequity that they would cause.

One example is a provision to require income tax return instructions to contain information on installment agreements, extensions of time to pay, and offers in compromise. We believe that by promoting the availability of offers in compromise before returns are filed and taxes are due through references in the income tax instructions, there is a risk of undermining the confidence of the overwhelming majority of taxpayers who timely and fully pay their liabilities. It is issues of this nature, balancing the rights of taxpayers who do pay fully and on time against the rights of those who may make an offer to settle their liabilities for an amount significantly lower than the amount they owe, that are ones we hope the subcommittee will explore with us further as it considers the legislation.

We also hope to work with you to give you an appreciation of some of the resource issues presented by the proposals, as well as some of the technological constraints that make some of the proposals infeasible with our current systems.

In the interest of time, I only want to discuss a few of the administrative concerns we have with the proposals considered today,

but, again, outlined in my index are a number of concerns that we have about some of the proposals.

Although the taxpayer ombudsman is going to address the organization and responsibilities of his function and a proposal to expand its authority to issue taxpayer assistance orders, I wanted to share with you how the ombudsman and his organization have had a positive impact on the promotion of taxpayer rights within the IRS.

Not only does the ombudsman and his organization assist taxpayers individually through the Problem Resolution Program, he also provides recommendations to improve the quality of IRS programs and systems that benefit all taxpayers. Through these recommendations for systemic changes, the ombudsman has a much wider impact than if his only contribution were to address taxpayers' problems individually.

Currently, problem resolution officers in the Service centers and district offices report to the heads of these offices. This organizational structure provides a strong incentive for these field offices to deliver quality services to taxpayers and promptly resolve taxpayer problems. It also allows problems that occur at the local level to be resolved at the local level.

The current structure, by all accounts, is working well. There is a proposal in some of the legislation to remove problem resolution officers from the current management reporting lines and have them report to the ombudsman in Washington, D.C. Madam Chairman, I encourage the subcommittee and your staff to explore with the ombudsman and his staff the effect that such a change would have on their ability to help taxpayers. Any change should be carefully considered and not just done for the sake of change.

We are also concerned with provisions that generally give noncorporate taxpayers the automatic right to installment agreements once every 3 years and eliminate failure-to-pay penalties for taxpayers who request installment agreements by the due dates for payment of their taxes. Rather than enhancing taxpayers' rights, these automatic installment agreements, with no failure-to-pay penalties, would be unfair to the vast majority of taxpayers who do pay their taxes on time.

Another proposal would expand the IRS' authority to abate interest assessments by replacing the "error or delay in performing a ministerial act" standard for abatement with an "unreasonable error or delay" standard. It would also require the IRS to abate interest assessments against small businesses and most individuals in cases of "unreasonable error or delay," but only until the date that the demand for payment is made. The apparent justification for this proposal——

Chairman JOHNSON. Excuse me, Commissioner. Could you come a little closer to the microphone?

Ms. RICHARDSON. I am sorry.

Chairman JOHNSON. Gradually, I think we are all having more trouble hearing.

Ms. RICHARDSON. The apparent justification for this proposal—that a taxpayer who has an unpaid tax liability and is charged interest on that unpaid liability is somehow economically disadvan-

taged relative to a taxpayer who timely paid his or her liability without interest—is one with which we do not agree.

This broadening of the interest abatement standard would encourage taxpayers, particularly those with large liabilities, to seek routine relief from interest assessments, thereby imposing significant administrative costs, as well as controversy-related costs, on the IRS and the judicial system. These costs ultimately would be borne by all taxpayers.

Another proposal would require the IRS, prior to commencing an examination, to notify a taxpayer in writing of a planned examination and the examination procedures, with exceptions which apply for criminal investigations, collection jeopardy situations, national security needs, and confidential law enforcement. In many respects——

Chairman JOHNSON. Excuse me, Commissioner. You do have to practically have the microphone right in your face. Thank you.

Ms. RICHARDSON. In many respects, this provision is consistent with our current procedures. For example, we generally provide written notice and a copy of Publication 1, "Your Rights as a Taxpayer," prior to commencing an examination. This provision requiring advance notice, however, would undermine some compliance efforts, including roadside inspections of highway vehicles to ensure they are not evading Federal motor fuel excise taxes, compliance checks for currency transaction reporting, and unannounced visits to electronic return originators to determine whether they are complying with our procedures.

Our current document matching program is an efficient, cost-effective way to stop underreporting of income. We experience an overall compliance rate of over 95 percent in the areas for which we have information reporting. Under the document matching, we match information documents, such as forms 1099 received from third parties, against filed income tax returns. Underreported amounts become subject to correspondence audits.

I am greatly concerned about the provision in H.R. 661 and S. 258 that would shift the burden of proof to the IRS for income reported on information returns. Taxpayers, without presenting any supporting evidence, could force the IRS to investigate the accuracy of information returns before issuing notices of deficiency. We believe this proposal would render the IRS' matching program inoperable. Without this program, the IRS would need substantial additional resources to reach the same level of compliance with the tax laws that we have today.

An H.R. 11 proposal to reform the Service's information reporting procedures provided the same standards as those currently in the Internal Revenue Manual. The H.R. 11 proposal reflected the joint effort of the Service and Treasury, working with Congress, to respond to the concern underlying both that proposal and the H.R. 661 and S. 258 proposal. We believe that that proposal in H.R. 11 strikes a reasonable and appropriate balance between the rights and obligations of both taxpayers and the Government.

I would like now to turn to H.R. 390. H.R. 390 contains a provision that would shift the burden of proof to the IRS during any court proceedings. Madam Chairman, not only would that provision undermine the Federal income tax system, but also State tax sys-

tems that depend on Federal deficiency assessments, assessments which would simply evaporate if this provision were enacted.

The current burden of proof rules have been in place for well over a century and are closely woven into the fabric of our system of voluntary compliance. While proposals to shift the burden of proof to the Government have been advanced during this period, in each instance the proposals have been rejected. The reasons for rejection were well stated during a 1925 debate on a proposal that, like H.R. 390, would have placed the burden of proof on the Government. The quote went as follows:

> You might as well repeal the income tax law and pass the hat, because you will be practically saying to the taxpayer, How much do you want to contribute toward the support of the government? And in that case they would have to decide for themselves.

The Internal Revenue Code and the administrative policies of the IRS contain many procedures designed to foster the administrative settlement of civil tax disputes and result in the successful resolution of the vast majority of the civil disputes that arise under the tax laws. Not all disputes can be resolved administratively, however, and the code permits taxpayers dissatisfied with the outcome of these administrative proceedings to seek relief in court.

Throughout the history of tax litigation in this country, the taxpayer has been required to bear the burden of proof in tax disputes. This allocation of the burden of proof is in keeping with the common law traditions, is sensible and fair, and reflects some of the fundamental principles that underlie our system of taxation.

Generally, in civil tax litigation, the burden of proof is on the taxpayer. In those situations where liability is imposed for civil fraud or where there is alleged criminal liability, the burden of proof is on the Government—a situation that, for good reason, should continue.

But there are good reasons not to change the burden of proof in civil tax litigation. First, as I said, the current rules are consistent with the voluntary self-assessment system, which presumes that taxpayers, and not the Government, are best able to maintain and produce records to substantiate items on their tax returns.

Second, placing the litigation burden of proof on taxpayers promotes administrative resolution of tax cases. Knowledge of this ultimate burden provides an incentive for them to voluntarily produce information during an audit and subsequent administrative proceedings.

Third, taxpayers, like other claimants, should bear the burden of proving their claims in court. Under the common law, parties challenging administratively proper decisions of Government agencies are typically required to shoulder the burden of proof. The Internal Revenue Code and current administrative practices of the Internal Revenue Service ensure that taxpayers have many opportunities to seek resolution of tax disputes short of litigation.

Finally, considerations of fairness and efficiency require that taxpayers bear the burden of proof. The common law generally places the burden of proof on the party with the most ready access to the evidence necessary to adjudicate claims. This common law tradition is not only consistent with principles of fairness, it substantially

lessens the need for court-supervised and intrusive discovery during both administrative and court proceedings.

Also, it is unrealistic to expect that the Government has either the resources or the ability to prove that all taxpayer claims, no matter how outlandish, are false. I think that Ms. Beerbower touched on a number of the issues and concerns. I won't go into that here.

Chairman JOHNSON. She did. And I think if you could skip over those parts of your testimony——

Ms. RICHARDSON. Except to say that we believe that H.R. 390 would not serve in the best interests of sound tax administration and the American taxpayer. Taxpayers would be encouraged to keep or produce nothing about their tax affairs and require the Government to disprove every item on their return. Recordless taxpayers, including those who earn income from illegal sources, would be rewarded.

Passage of H.R. 390 would also necessitate additional information gathering by and reporting to the Government. Audits performed with the burden of proof on the Service would involve a much broader and more detailed inspection of the financial affairs of the taxpayer and third parties. Rather than simply choosing certain items on a taxpayer's return to review according to specific enforcement criteria, which we do today, the Service would, of necessity, need to challenge a greater number of items. The audits would be much more costly to the——

Chairman JOHNSON. Commissioner, if I may interrupt you for a minute. Since the Treasury did go into this in detail, I think if we could skip forward, since there is so much to cover this morning, I would appreciate it.

Ms. RICHARDSON. OK. Finally, I guess the final point we want to make is that court proceedings would also be burdened by the rule change because the only response the Government could make to shifting the burden would be to increase the amount of discovery in litigation.

We think that you will hear from a number of other sources also, Madam Chairman, who are interested in sound tax administration, that passage of H.R. 390 would in effect destroy our voluntary compliance system.

You also asked for our views as to how to best enhance taxpayer rights. In today's dynamic service-oriented business environment, taxpayers have come to expect prompt access to information and assistance with account inquiries and problems, the type of access and assistance they receive in the private sector. Unfortunately, however, as you know all too well, we simply cannot deliver this level of service with our 30-year-old technology. Only through modernization of our information systems will we be able to successfully meet the demands of taxpayers and provide taxpayer rights. Therefore, I am asking that this committee assist us in obtaining the tools we need to properly serve our customers by ensuring full and stable funding for our Tax Systems Modernization Program.

I would like to close with a simple yet, I think, very poignant illustration of the types of things that tax systems modernization would enable us to do for the cause of taxpayer rights. Earlier, we discussed concerns about a proposal to expand our authority to

abate interest assessments and to require us to abate interest assessments in certain cases. But what if we eliminate the need for these interest assessments in the first place without exposing the tax system to the problems presented by the interest abatement proposal?

Tax systems modernization holds the key to providing drastic reductions in the amount of interest assessed to taxpayers. When TSM is fully implemented with its online capabilities, our goal is to match information documents at the time a return is filed, not almost 2 years later, as is done today. That means that almost 2 years' worth of interest assessments could be eliminated for every taxpayer with an unpaid tax balance that is detected through our information document matching programs. TSM will also reduce errors, reduce the time it takes to begin and conduct examinations, speed up account problem resolution for taxpayers, and accelerate collection activities, thus providing further opportunities for reductions in the amount of interest assessments.

With TSM fully implemented, systemic improvements will be possible that would improve the efficiency of the Government, benefit all taxpayers, and result in significant interest assessment reductions.

We are already beginning to reap many of the benefits of TSM today, but we need your assistance to bring it to full and successful completion. Madam Chairman, I am committed to an IRS that expects no less than that all of its employees are advocates for taxpayers, while at the same time ensuring that taxpayers who are compliant with the tax laws are not disillusioned by those who use procedural loopholes to game the system.

I would like to thank you and your colleagues for the opportunity to provide our views in this important area, and we look forward to working with you on the proposals. I will be happy to answer questions after Mr. Monks testifies.

[The prepared statement and attachment follow:]

STATEMENT OF

MARGARET MILNER RICHARDSON
COMMISSIONER OF INTERNAL REVENUE

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS & MEANS

MARCH 24, 1995

Madame Chairman and Distinguished Members of the Subcommittee:

I appreciate the opportunity to testify today before this Subcommittee on the possible development of a Taxpayer Bill of Rights 2 (TBOR2) and on specific proposals in H.R. 11 from the 102nd Congress ("H.R. 11") and H.R. 390, H.R. 661, and S. 258 as introduced in this Congress. The issue we will be discussing today -- ensuring that the rights of American taxpayers are protected -- is of the greatest importance to me, the Internal Revenue Service, and American taxpayers. One of my most important responsibilities as Commissioner of Internal Revenue is to ensure that, in dealings with the IRS, taxpayers are treated fairly, courteously, and with respect and dignity.

With me today is Lee Monks, the Taxpayer Ombudsman. The position of Ombudsman was created by the Internal Revenue Service in 1979. Since that time, the Ombudsman has served taxpayers well and has made countless improvements in the ways that the IRS interacts with taxpayers. The Ombudsman has also successfully carried out the purposes of the Taxpayer Bill of Rights since its enactment in 1988. Mr. Monks will speak to you today from his perspective as an advocate for taxpayers.

I want to begin today by assuring you that the Internal Revenue Service is committed to respecting the rights of all taxpayers. I believe that we have the best tax administration system in the world, although that does not mean that we should not continue to improve it. Our tax system, with the rights afforded taxpayers under it, is the model to which other nations look both in planning their systems and in measuring their successes.

Since becoming Commissioner almost two years ago, I have had the opportunity to visit with many of our almost 115,000 employees. What has particularly impressed me has been their dedication to and concern for protecting taxpayers' rights and their commitment to reaching balanced, sensible solutions to the varied and often unique taxpayer situations with which they are confronted. Contrary to what is often, in my experience, a very distorted stereotype, the vast majority of our employees care very deeply about providing good customer service and protecting taxpayers' rights.

I realize that there will always be isolated instances in which individual IRS employees have made mistakes. I also realize that given the size of our organization, the volume of our business, and the number of contacts we have with taxpayers each year, the "giant" metaphors like the one in the Subcommittee's press release are simply irresistible. My hope, however, is that the overwhelming number of taxpayers who come in contact with us will come to know us as a genteel, Gulliver-like giant, rather than the Goliath referred to in the Subcommittee's press release.

TAXPAYER SERVICE AND TAXPAYER RIGHTS

In recent years, the Service has made great strides in focusing on customer service. We have long recognized the interrelationship of taxpayer service and taxpayer rights. The better we serve taxpayers -- the easier we make it for them to

meet their filing responsibilities, the more helpful we are in assisting them with their questions, and the more quickly we can respond to an account inquiry or problem -- the more likely it is that they will feel their rights have been respected. Our commitment to providing quality service to every taxpayer runs deep in our organization. By breaking down functional barriers of the past, we are trying to ensure that every employee -- not just those under the direction of the Assistant Commissioner (Taxpayer Services) -- appreciates the importance we attach to both taxpayer service and taxpayer rights.

Our strong commitment to customer service and taxpayer rights is also evidenced by our Compliance 2000 program. Our Compliance 2000 philosophy recognizes that taxpayers cannot comply with the tax laws unless they understand their rights and obligations under those laws. This recognition of our need to serve taxpayers on the front end through education and outreach is intended to ensure that they have every opportunity to comply. Through this approach, enforcement efforts are reserved for only those cases where education and outreach are not successful. As with our other taxpayer service endeavors, to the extent we are successful in reaching out to taxpayers under our Compliance 2000 program, the more likely they will appreciate our commitment to the cause of taxpayer rights.

COMMON GROUND AND NEW IDEAS

Despite the progress we have made in providing better customer service and enhancing taxpayers' rights, I believe that, by working together, we -- Congress, the Treasury Department, and the IRS -- can do still more to enhance taxpayers' rights. There are significant areas of agreement between the IRS and the H.R. 11, H.R. 661, and S. 258 sponsors about what provisions would further enhance taxpayers' rights. Proposals to extend the interest-free period for payment of tax after notice and demand from 10 to 21 days, permit disclosure of collection activities among spouses or former spouses who filed a joint return, permit joint return filings without full payment of tax after an initial filing of separate returns, and require information returns to include the telephone number of the payor's information contact, for example, all represent sound ideas that would help to make the tax system fairer and more administrable. (I have provided a more detailed discussion of these provisions and others in H.R. 661 and S. 258, in the attached Appendix.)

The Treasury Department and the IRS worked closely with Congress both toward the enactment of Taxpayer Bill of Rights legislation in 1988 and the development of the taxpayer protection provisions which were included in H.R. 11. In fact, many of the provisions in H.R. 11, H.R. 661, and S. 258 were suggested to Congress by the IRS. But I would like to share with you today several new proposals that we believe will further enhance the rights of taxpayers. The first proposal is one that addresses a concern that I have heard about in almost every meeting I have had with tax practitioners over the past two years. Under current law, taxpayers cannot have their representatives resolve issues presented in IRS notices without providing the IRS with written authorizations to disclose the taxpayers' return information to the representatives -- often a time consuming process that delays the resolution of the taxpayers' issues.

Our proposal would eliminate such delays. It represents a careful balance between the security of taxpayer data and the need to be responsive to taxpayers' desires for quick resolution of their cases. Our proposal would provide taxpayers with an alternative to the written consent requirement. Instead, we

propose that a unique identifying number be included on each IRS notice. A taxpayer could give that notice's unique identification number to its authorized representative, which would permit the representative to deal directly with the IRS without delay.

The second proposal would assist the IRS in safeguarding each taxpayer's right to privacy. I have made protecting taxpayers' rights of privacy a top priority for the IRS. I have repeatedly stated that the IRS will not tolerate any violation by employees of taxpayers' rights of privacy. Taxpayers' confidence that their privacy rights will be honored and that their tax return information will be kept confidential is one of the foundations of our voluntary compliance system. I have adopted more severe administrative sanctions, up to and including dismissal, for employees who violate our policy concerning confidentiality and privacy. A basic tenet of that policy is a prohibition against employee access to (or use of) tax return information, except to the extent essential for the employee to perform his or her assigned functions. Our second proposal, which I request you support, provides specific criminal sanctions that would apply to employees who violate this policy.

Under our third proposal, the IRS would be required to abate a penalty assessed for the first time a taxpayer failed to make required deposits of payroll taxes if: (1) the failure occured during the first quarter wages were paid; (2) the return was filed on time and appropriate payments were made; and (3) the taxpayer completes an IRS-approved education program that addresses filing and payment requirements. This relief is consistent with the Compliance 2000 philosophy that I outlined earlier and is aimed at new (typically small business) employers.

Finally, and consistent with our efforts to assist taxpayers in meeting their obligations, we propose a requirement that we issue annual reminders to taxpayers with outstanding delinquent accounts that are not in an active collection status (i.e., accounts for which we are no longer issuing collection notices and that we consider currently not collectible). These notices would remind taxpayers about the status of their accounts, the continued accrual of interest and penalties, and the continued possibility of having their refunds offset to pay the outstanding amounts.

Madame Chairman, I hope that these proposals for enhancing taxpayers' rights will be seriously considered by the Subcommittee. The IRS and the Treasury Department would like to assist the Subcommittee in making them a reality and in identifying appropriate offsets, as necessary, to ensure they are implemented in a deficit neutral manner.

AREAS OF CONCERN FOR TAX ADMINISTRATION

The IRS and the Treasury Department also would like to work closely with the Subcommittee as it considers H.R. 11, H.R. 661, S. 258, and H.R. 390 so that we can inform you about those provisions we believe would pose significant administrability issues. Some of the provisions raise issues that should be considered and balanced against the additional burden and appearance of inequity they could cause before the Subcommittee recommends legislation. One example is in section 5901 of H.R. 11 and section 1001 of H.R. 661 and S. 258. Those sections would require the income tax return instructions to contain information on installment agreements, extensions of time to pay, and offers in compromise.

Offers in compromise, for example, represent a delicate balance between the need to ensure that taxpayers are treated consistently and fairly and the need to ensure that the government will be able to collect at least a portion of an

insolvent (or close to insolvent) taxpayer's debt. By promoting the availability of offers in compromise before returns are filed and taxes are due through references in the income tax return instructions, there is a risk of undermining the confidence of the overwhelming majority of taxpayers who timely and fully pay their determined liabilities. Issues of this nature -- balancing the rights of taxpayers who pay fully and on time against the rights of those who may make an offer to settle their liabilities for an amount significantly lower than the amount that they owe -- are ones we hope the Subcommittee will explore with us further as it considers the legislation. We also hope to work with you to give you an appreciation of some of the resource issues presented by the proposals, as well as some of the technological constraints that make some of the proposals infeasible under our current systems.

In the interest of time, I will only discuss a few of our administrative concerns with the H.R. 11, H.R. 661, S. 258, and H.R. 390 proposals today. The Appendix to my testimony, however, outlines each of the provisions about which we have concerns. I would like to focus on the following proposals: (1) changing the Taxpayer Ombudsman's organization and responsibilities; (2) granting installment agreements as a matter of right to non-corporate taxpayers and eliminating failure-to-pay penalties for taxpayers that request an installment agreement by the due date for payment of their taxes; (3) expanding the IRS' authority to abate interest assessments and requiring the IRS to abate interest to certain taxpayers; (4) requiring the IRS to give advance notification of an examination; (5) shifting the burden of proof to the government in certain information report matching cases; and (6) shifting the burden of proof to the government in all tax matters. I will defer to the testimony of Cynthia Beerbower, Deputy Assistant Secretary (Tax Policy), on the importance of ensuring that the Treasury Department and the IRS retain the ability to issue retroactive regulations where appropriate in the interest of sound tax administration.

Taxpayer Ombudsman and Taxpayer Assistance Orders

While Lee Monks, the Taxpayer Ombudsman, will address the organization and responsibilities of the Taxpayer Ombudsman function and a proposal to expand its authority to issue Taxpayer Assistance Orders, I wanted to share with you how the Ombudsman and his organization have had a positive impact on the promotion of taxpayer rights within the IRS. Not only does the Ombudsman and his organization assist taxpayers individually through the problem resolution program, but the Ombudsman also provides recommendations to improve the quality of the IRS programs and systems that benefit all taxpayers. Through these recommendations for systemic changes, the Ombudsman has a much wider impact than if his only contribution were to address taxpayers' problems individually.

Currently, Problem Resolution Officers (PROs) in the Service Centers and District offices report to the heads of these offices. This organizational structure provides a strong incentive to these field offices to deliver quality services to taxpayers and promptly resolve taxpayer problems. It also allows problems that occur at the local level to be resolved at the local level. The current structure, by all accounts, is working well. Section 101 of H.R. 661 and S. 258, however, would remove PROs from the current management reporting lines and have them report to the Ombudsman in Washington, D.C. Madame Chairman, I encourage the Subcommittee to explore with the Ombudsman and his staff the effect that such a change would have on their ability to help taxpayers. Any change should be carefully considered and not be done just for the sake of change.

Installment Agreements and the Failure-to-Pay Penalty

H.R. 661 and S. 258 contain provisions that generally give non-corporate taxpayers the automatic right to installment agreements once every three years and eliminate failure-to-pay penalties for taxpayers who request installment agreements by the due dates for payment of their taxes. Rather than enhancing taxpayers' rights, this "automatic" installment agreement with no failure-to-pay penalties would be unfair to the vast majority of taxpayers who pay their taxes on time. Under the combined effects of these proposals: (1) all taxpayers would have every incentive not to timely pay and to borrow from the government at least once every three years at interest rates generally lower than prevailing market rates for unsecured debt; (2) the IRS would see a significant growth in its accounts receivable inventory (a topic of great concern to the IRS, Congress, and the GAO); (3) the IRS would have to shift substantial additional resources to intrusive, post-filing collection efforts; and (4) the revenue loss to the government would be substantial.

Abatement of Interest

Section 301 of H.R. 661 and S. 258 would expand the IRS' authority to abate interest assessments by replacing the "error or delay in performing a ministerial act" standard for abatement with an "unreasonable error or delay" standard. It would also require the IRS to abate interest assessments against small businesses and most individuals in cases of "unreasonable error or delay," but only until the date demand for payment is made. The apparent justification for this proposal -- that a taxpayer who has an unpaid tax liability and is charged interest on that unpaid liability is somehow economically disadvantaged relative to a taxpayer who timely paid its liability without interest -- is one with which we do not agree.

This broadening of the interest abatement standard would encourage taxpayers, particularly those with large liabilities, to seek routine relief from interest assessments, thereby imposing significant administrative costs, as well as controversy-related costs, on the IRS and the judicial system. These costs ultimately would be borne by all taxpayers. Additionally, the unreasonable error or delay standard is vague and, as such, would present significant challenges in ensuring consistent application of the law. Finally, "means testing" the requirement to abate interest by imposing a net worth requirement as the bill does is incompatible with the purpose of an interest charge and presents administrative complexity and additional burden on taxpayers if they are required to provide net worth data which would have to be verified.

Notification of Examination

Another section of H.R. 661 and S. 258 would require the IRS, prior to commencing an examination, to notify a taxpayer in writing of a planned examination and the examination procedures. Exceptions would apply for criminal investigations, collection jeopardy situations, national security needs, and confidential law enforcement or foreign counterintelligence activities. In many respects this provision is consistent with IRS' current procedures; for example, we generally provide written notice and a copy of Publication 1, "Your Rights as a Taxpayer," prior to commencing an examination. The provision requiring advance notice, however, would undermine some compliance efforts, including roadside inspections of highway vehicles to ensure they are not evading federal motor fuels excise taxes, compliance checks for currency transaction reporting, and unannounced visits to Electronic Return Originators to determine whether they are complying with IRS procedures.

Burden of Proof in Information Reporting Cases

Our current document matching program is an efficient, cost effective way to stop underreporting of income. We experience a overall compliance rate of over 95% in the areas for which we have information reporting. Under the document matching, we match information documents, such as Forms 1099 received from third parties, against filed income tax returns. Underreported amounts become subject to correspondence audits.

I am greatly concerned about the provision in H.R. 661 and S. 258 that would shift the burden of proof to the IRS for income reported on information returns. Taxpayers, without presenting any supporting evidence, could force the IRS to investigate the accuracy of information returns before issuing notices of deficiency. We believe this proposal would render the IRS' matching program inoperable. Without this program, the IRS would need substantial additional resources to reach the same level of compliance with the tax laws that we have today.

I believe that a proper balance is achieved under existing IRS standards, which were revised in 1993 to respond to the concern underlying this H.R. 661 and S. 258 provision. Under the revised standards found in the Internal Revenue Manual, if, in a court proceeding, a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return and the taxpayer has fully cooperated with the IRS, the government must present "reasonable and probative information" concerning this income in addition to presenting the information return. A fully cooperative taxpayer is one who provides, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within its control to the extent reasonably requested by the IRS.

An H.R. 11 proposal to reform the Service's information reporting procedures provided the same standards as those currently in the Internal Revenue Manual. The H.R. 11 proposal reflected the joint effort of the Service and Treasury working with Congress to respond to the concern underlying both that proposal and the H.R. 661 and S. 258 proposal. The H.R. 11 proposal is responsive to this concern. We believe that it strikes a reasonable and appropriate balance between the rights and obligations of both taxpayers and the government.

Burden of Proof

I would like to turn now to H.R. 390. H.R. 390 contains a provision that would shift the burden of proof to the IRS during any court proceeding. The bill provides:

> Notwithstanding any other provision of this title, in the case of any court proceeding, the burden of proof with respect to all issues shall be on the Secretary.

Madame Chairman, that provision alone would undermine the Federal income tax system. Not only would it undermine the Federal tax system, but also the state tax systems that depend on Federal deficiency assessments -- assessments which would simply evaporate if this provision were enacted.

The current burden of proof rules have been in place for well over a century and are closely woven into the fabric of our system of voluntary compliance. While proposals to shift the burden of proof to the government have been advanced during this period, in each instance, these proposals have been rejected. The reasons for rejection were briefly stated by a member of the Board of Tax Appeals (predecessor to the current U.S. Tax Court) during a 1925 debate on a proposal that, like H.R. 390, would have placed the burden of proof on the government:

> [Y]ou might as well repeal the income tax law and pass the hat, because you will be practically saying to the taxpayer, How much do you want to contribute toward the support of the government? [A]nd in that case they would have to decide for themselves.

The Internal Revenue Code and the administrative policies of the IRS contain many procedures designed to foster the administrative settlement of civil tax disputes. Indeed, these procedures result in the successful resolution of the vast majority of the civil disputes that arise under the tax laws. Not all disputes can be resolved administratively, however, and the Code permits taxpayers dissatisfied with the outcome of these administrative proceedings to seek relief in court.

Throughout the history of tax litigation in this country, the taxpayer has been required to bear the burden of proof in tax disputes. This allocation of the burden of proof is in keeping with common law traditions, is sensible and fair, and reflects some of the fundamental principles that underlie our system of taxation.

How the Current Rules Work

Generally, in civil tax litigation, the burden of proof is on the taxpayer. Thus, in cases in which the government questions the reporting of income or deductions or credits of a taxpayer and has made an administrative determination that additional tax is due under the law, and the taxpayer has exhausted his or her rights in the examination and administrative appeals processes, the taxpayer may go to court and ask the court to redetermine his or her liability. The burden is on the taxpayer to persuade the court that the determination made by the Commissioner of Internal Revenue is wrong and should be adjusted. Likewise, in those cases where the taxpayer contends that he or she has paid too much tax and wants the government to refund part or all of those payments, the burden is on the taxpayer. (In those situations where liability is imposed for civil fraud (the government seeks to impose the civil fraud penalty) or where there is alleged criminal liability (the government seeks to fine or incarcerate a person for violation of a criminal statute), the burden of proof is on the government -- a situation that for good reason should continue.)

Reasons to Leave the Current Rules in Place

There are good reasons not to change current law. First, the current rules are consistent with the voluntary self-assessment system, which presumes that taxpayers, and not the government, are best able to maintain and produce records that substantiate items on tax returns.

Second, placing the litigation burden of proof on taxpayers promotes administrative resolution of tax cases. Under the current system, taxpayers cannot prevail in court without marshalling and producing evidence in their favor. Knowledge of this ultimate burden provides an incentive for them voluntarily to produce information during audit and subsequent administrative proceedings. If this were not the case -- as it surely would not be if the government had the burden of producing all records necessary to challenge taxpayer assertions that they owe little or no tax -- taxpayers could "stonewall" auditors and examiners, playing a game of "catch me if you can."

Third, taxpayers, like other claimants, should bear the burden of proving their claims in court. Under the common law, parties challenging administratively proper determinations of government agencies are typically required to shoulder the burden of proof. The Code and current administrative practices of the

Internal Revenue Service ensure that taxpayers have many opportunities to seek resolution of tax disputes short of litigation. Disputes that end up in court do so only after a thorough consideration of the issues by the government (or taxpayer neglect of the administrative process).

Finally, considerations of fairness and efficiency require that taxpayers bear the burden of proof. Common law generally places the burden of proof on the party with most ready access to the evidence necessary to adjudicate claims. This common law tradition is not only consistent with principles of fairness, it substantially lessens the need for court-supervised and intrusive discovery during both administrative and court proceedings.

It is, moreover, unrealistic to expect that the government has either the resources or the ability to prove that all taxpayer claims -- no matter how outlandish -- are false. For example, a taxpayer claiming $50,000 for business supplies, could readily show that the deductions were proper simply by producing records of what was purchased, for what amount, and for what business purpose. It would be nearly impossible, however, for the Service to show that a claimed deduction was improper.

Many Internal Revenue Code sections contain provisions with very specific requirements for favorable tax treatment. If the government were required to prove that taxpayers do not meet the requirements for favorable tax treatment, aggressive taxpayers would be encouraged to take unsupported positions. In the end, the changes produced by H.R. 390 would reward aggressive taxpayers at the expense of compliant ones.

Passage of H.R. 390 Is Not in the Best Interest of Tax Administration or Taxpayers

I believe H.R. 390, if enacted, would not serve the best interests of sound tax administration and the American taxpayer. Shifting the burden of proof would undermine the record-keeping requirements of the Code. There would be little incentive for taxpayers to maintain records of their business and income producing activities. Rather, taxpayers would be encouraged to keep or produce nothing about their tax affairs and require the government to disprove every item on their return. Indeed, the absence of records would preclude a government challenge to virtually any taxpayer claim. "Recordless" taxpayers, including those who earn income from illegal sources, would be rewarded.

Passage of H.R. 390 also would necessitate additional information gathering by and reporting to the government. Audits performed with the burden of proof on the Service would involve a much broader and more detailed inspection of the financial affairs of the taxpayer and third parties. Rather than simply choosing certain items of the taxpayer's return to review according to specific enforcement criteria, the Service would of necessity need to challenge a greater number of items. The audits would be much more costly to taxpayers and the IRS because they would take longer and involve many more requests for information. They would also be more burdensome on third parties with whom the taxpayer has done business. Taxpayers would have no incentive to correct inadequacies in their records. Rather, the government would have to fill in the gaps by obtaining information from financial institutions, employers, employees, suppliers, contractors, etc., in order to "prove" that the taxpayer owed more taxes than reported. In summary, the Service's enforcement and collection activities would be infinitely more intrusive than they are today.

Additionally, not only would the government have to make extensive investigations of taxpayers, it would also be required to maintain extensive records about taxpayers. In order to carry its burden of proving that potential taxpayer claims were without

merit, the government would have to obtain and retain substantially more information about all taxpayers than is currently the case. All of this activity would entail invasion of personal privacy of the taxpayer on a level not found in the current system.

Finally, court proceedings would be burdened by the rule change. The only response the government could make to a shifting of the burden is to increase the amount of discovery it conducts in litigation. Taxpayers would have no incentive to turn over tax information voluntarily in such proceedings. Extensive, intrusive, and expensive, discovery battles would become more common, and court dockets would swell because of the discovery logjam.

A few examples will illustrate how the passage of H.R. 390 would substantially increase the costs of administering the tax system and burden the courts. In a routine dispute over depreciation deductions, the government would have to prove the cost of assets, the dates of acquisition, and previous allowances for depreciation in order to obtain a court ruling on the question. If the government could not obtain the taxpayer's records or the records it could obtain were inadequate to prove any of these items, the taxpayer, no matter how meritless the claim, would be entitled to prevail.

Also, if H.R. 390 were enacted, in every case in which a tax protestor claimed on its return that wages are not income, the government would have to come to court with the records to prove that the taxpayer had, in fact, been paid wages. In most cases, the government would have to obtain the records from the taxpayer's employer and require that one of the employer's bookkeepers or supervisors appear in court to authenticate records detailing wage payments and the fact of the protestor's employment.

In practical effect, passage of H.R. 390 would virtually immunize from challenge many of the itemized deductions claimed on Schedule A, would require the government to examine substantially more records to fend off claims, and would compel the government to engage in costly searches for corroboration of facts that unfortunately not all taxpayers would willingly acknowledge. In the end, passage of H.R. 390 would substantially increase the costs of administering the revenue system, substantially reduce the revenues the government should properly collect under the laws the Congress has enacted, and disadvantage honest taxpayers who keep proper records. Madame Chairman, I believe, as I think you will hear from a number of sources who are interested in sound tax administration, that passage of H.R. 390 would destroy our voluntary compliance system.

TAX SYSTEMS MODERNIZATION

You have asked for my views as to how best to enhance taxpayer rights. In today's dynamic, service-oriented, business environment, taxpayers have come to expect prompt access to information and assistance with account inquiries and problems -- the type of access and assistance they receive in the private sector. Unfortunately, however, the IRS simply cannot deliver this level of service with our 30 year old technology. Only through modernization of our technologies will we be able to successfully meet the demands of taxpayers and provide taxpayer rights. Therefore, I am asking that you assist us in obtaining the tools we need to properly serve our customers by ensuring full and stable funding of our Tax Systems Modernization (TSM) program.

I would like to close with a simple yet poignant illustration of the types of things that TSM will enable us to do for the cause of taxpayer rights. Earlier in my testimony, I

discussed several problems associated with section 301 of H.R. 661 and S. 258 -- a proposal to expand the IRS' authority to abate interest assessments and to require the IRS to abate interest assessments in certain cases. But what if we eliminate the need for these interest assessments in the first place without exposing the tax system to the problems presented by the interest abatement proposal?

TSM holds the key to providing drastic reductions in the amounts of interest assessed to taxpayers. When TSM is fully implemented with its on-line capabilities, our goal is to match information documents at the time a return is filed, not almost two years later as they are today. This means that almost 2 years worth of interest assessments could be eliminated for every taxpayer with an unpaid tax balance that is detected through our information document matching programs.

TSM will also reduce errors, reduce the time it takes to begin and conduct examinations, speed up account problem resolution for taxpayers, and accelerate collection activities, thus providing further opportunities for reductions in the amount of interest assessments.

With TSM fully implemented, systemic improvements would be possible that would improve the efficiency of the government, benefit all taxpayers, and result in significant interest assessment reductions. The IRS and taxpayers are already reaping many of the benefits of TSM today. It is a reality -- and we need your assistance to bring it to full and successful completion.

CONCLUSION

Madame Chairman, I am committed to an IRS that expects no less than that all its employees be taxpayer advocates while at the same time ensuring that taxpayers who are compliant with the tax laws are not disillusioned by those who use procedural loopholes to game the system. I would like to thank you and your colleagues for the opportunity to provide our views and comments in this important area and look forward to working with you to develop proposals that truly protect the rights of taxpayers and reduce their compliance burdens.

I would be happy to remain until after Lee Monks has finished his prepared statement to answer any questions you or the other Subcommittee members may have.

APPENDIX DISCUSSION OF H.R. 661 and S. 258 THE "TAXPAYER BILL OF RIGHTS 2"

This appendix provides a general discussion about the provisions of H.R. 661 and S. 258 (both cited as "Taxpayer Bill of Rights 2") and their effects on tax administration. This discussion is offered by the Internal Revenue Service to assist the Subcommittee as it explores the development of legislation that would provide additional safeguards for taxpayers' rights.

The discussion provided in this appendix is based on an important assumption that where the provisions of H.R. 661 and S. 258 overlap with provisions contained in H.R. 11 of the 102d Congress, the legislative history reflected in H. Rep. No. 1034, 102d Cong., 2d Sess. (1992) would be adopted as the legislative history to both H.R. 661 and S. 258.

The Subcommittee should note that the discussion of provisions contained in this appendix represents only the views of the Commissioner of Internal Revenue. Also, the staff of the Internal Revenue Service is continuing its analysis of the provisions and may have further technical comments to share with the Subcommittee staff in the future.

Nothing in the discussion of the provisions should be interpreted as constituting an official position of the Administration. The Administration would be pleased, however, to assist the Subcommittee with official positions, revenue estimates, and, where necessary, appropriate offsets to ensure deficit neutral implementation of any provisions of the bills that the Subcommittee decides to advance.

The following provisions would help to make the tax system fairer and more administrable:

§ 302. Extension of interest-free period for payment of tax after notice and demand. The current law's 10-day interest-free period upon notice and demand would be extended to 21 days for tax liabilities (including interest and penalties) of less than $100,000. The shorter 10-day period would continue to apply to amounts of $100,000 or more. Conforming changes would also be made to the failure-to-pay penalty.

§ 401. Disclosure of joint return collection activities. If the IRS has assessed a deficiency for a joint return, the IRS would have the discretionary authority, upon the written request of one of the spouses (or former spouses), to disclose whether the IRS had attempted to collect the assessed deficiency from the other spouse (or former spouse), the general nature of any such collection activities, and the amount of the deficiency collected from the other spouse (or former spouse). Although it is believed that such disclosure already is authorized under current law, this proposal would make explicit the IRS' disclosure authority in cases relating to separated or divorced spouses.

§ 402. Joint return may be made after separate returns without full payment of tax. Under current law, married taxpayers who file separate returns for a taxable year in which they are entitled to file a joint return may elect to file a joint return after the time for filing the original return has expired. The election to refile on a joint basis may be made only if the entire amount of tax shown as due on the joint return is paid in full by the time the joint return is filed. The bills would repeal this requirement.

§ 601. Phone number of person providing payee statements required to be shown on such statement. The bills would require that information returns include the telephone number of the payer's information contact, in addition to the currently required payer name and address.

§ 902. Treatment of substitute returns under section 6651. Under current law, if no return is filed by the taxpayer, the IRS may file a substitute return for the taxpayer. If the IRS files a substitute return for the taxpayer, the failure-to-pay penalty runs from ten days after the IRS sends the taxpayer a notice and demand for payment of the tax.

The bills would provide that the failure-to-pay penalty for substitute returns would apply in the same manner as for other returns. Thus, the penalty in each case would run from the due date of the return until the tax is paid.

If modified, the following provisions also would generally improve tax administration:

§ 203. Notification of reasons for termination or denial of installment agreement. Currently, the IRS is required to give a taxpayer 30-days notice before terminating an installment agreement due to a change in the taxpayer's financial condition. The bills would extend the 30-day installment agreement notification and explanation requirement to all cases in which the IRS may deny, alter, modify, or terminate an installment agreement (other than cases in which the IRS believes the collection of the tax to which the installment agreement relates is in jeopardy).

Through recently issued final regulations, the IRS already has adopted and implemented procedures requiring it to notify taxpayers 30 days prior to altering, modifying or terminating installment agreements, unless doing so would jeopardize collection.

Modifications necessary to facilitate tax administration: A notification requirement should not be imposed for denials of installment agreements, because this would permit taxpayers to stay collection during the notice period by merely requesting an installment agreement. During the 30-day period after notification of denial, a taxpayer that wished to evade collection enforcement actions could transfer assets to related persons, sell non-liquid assets and conceal its possession of the liquid asset proceeds, shift assets outside of the country, etc.

§ 204. Administrative Review of Denial of Request for, or Termination of, Installment Agreement. Under current law, the IRS is authorized to enter into written installment agreements with taxpayers to facilitate the collection of tax liabilities. In general, the IRS has the right to terminate (or in some instances, alter or modify) such agreements if the taxpayer provided inaccurate or incomplete information before the agreement was entered into, the taxpayer fails to make a timely payment of an installment or another tax liability, the taxpayer fails to provide the IRS with a requested update of financial condition, the IRS determines that the financial condition of the taxpayer has changed significantly, or the IRS believes collection of the

tax liability is in jeopardy. Except in cases where the collection of the tax liability is in jeopardy, regulations require the IRS to provide the taxpayer with a written notice that explains the IRS determination at least 30 days before altering, modifying or terminating the installment agreement.

The bills would permit a taxpayer whose request for an installment agreement is denied, or whose installment agreement is terminated, to seek an independent review of the decision.

Modifications necessary to facilitate tax administration: Denials of installment agreements should not be subject to appeal because this would permit taxpayers to stay collection during the notice period. See additional analysis and examples of concerns in section 203. The IRS has recently completed an eighteen-month pilot program for independent review of all collection activities (including enforcement actions) and is in the process of evaluating the pilot. The IRS would be happy to work with the Subcommittee to review the results of the pilot program. The Subcommittee may find such an approach helpful in evaluating the need for a statutory change in this area.

§ 501. Modifications to lien and levy provisions. To protect the priority of a tax lien, the IRS must file a notice of lien in the public record. Under current law, the IRS has discretion in filing such a notice, but once a notice is filed, the IRS may release it only if the notice was erroneously filed or if the underlying liability has been paid, bonded or become unenforceable. If a notice has been improvidently filed, it can not be released because release would extinguish the underlying lien. The IRS is authorized to return levied-upon property to a taxpayer only when the taxpayer has overpaid its liability for tax, interest, and penalty. In any event, certain property of a taxpayer is exempt from levy. The exempted property includes personal property with a value of up to $1,650 and books and tools necessary for the taxpayer's trade, business or profession with a value of up to $1,100.

Under the bills, the IRS would have the authority to withdraw a notice of federal tax lien if (1) the filing of the notice was premature or was not in accordance with the administrative procedures of the IRS; (2) the taxpayer has entered into an installment agreement for the payment of tax liability with respect to the tax on which the lien is imposed; (3) the withdrawal of the notice would facilitate the collection of the tax liability; or (4) the withdrawal of the notice would be in the best interest of the government and the taxpayer. If the taxpayer so requests in writing, the IRS would be required to notify credit reporting bureaus and financial institutions that the notice has been withdrawn. In addition, the IRS would be allowed to return levied-upon property to the taxpayer in the same four circumstances. Finally, the exemption amounts under the levy rules would be increased to $1,750 for personal property and $1,250 for books and tools. Both these amounts would be indexed for inflation.

Modifications necessary to facilitate tax administration: The IRS is concerned with only one of the four situations under which the IRS would be authorized to withdraw a notice of federal tax lien (i.e., the situation in which a taxpayer has entered into an installment agreement for the payment of tax liability with respect to the tax on which the lien is

imposed). Situations (1), (3), and (4) would give the Service the latitude to withdraw a notice of federal tax lien where taxpayers have entered into installment agreements, without the necessity of citing situation (2) as a candidate for potential relief. Citing situation (2) as a candidate for potential relief might permit less scrupulous taxpayers to enter into an installment agreement, convince the IRS to withdraw the notice of federal tax lien, and then default on the installment agreement after having disposed of assets that could be used to satisfy the liability.

§ 502. Offers-in-compromise. Under current law, the IRS may compromise any assessed tax if there is sufficient doubt about whether the tax is owed or is collectible. However, if the compromised amount is $500 or more, a written opinion of the Chief Counsel is required. Under the bills, the IRS would be authorized to compromise an assessed tax if doing so would be in the best interest of the government. A written supporting opinion of the Chief Counsel would be required only if the unpaid amount were $50,000 or more. The IRS would be required to subject these offers-in-compromise to continuing IRS quality review.

Modifications necessary to facilitate tax administration: Congressional concerns could be even better addressed by increasing the threshold for Chief Counsel review from $50,000 to $100,000. The IRS is concerned, however, that the proposed "best interest of the government" standard would be difficult to administer. The IRS now believes that its current interpretations of the existing standards for offer-in-compromise eligibility provide adequate flexibility to ensure that the program is fairly administered.

§ 702. Disclosure of certain information where more than 1 person subject to penalty. Under current law, the IRS may not disclose to a responsible person the IRS' efforts to collect unpaid trust fund taxes from other responsible persons who may be liable for the same tax. Under the bills, the IRS would be required to disclose to a person considered by the IRS to be a responsible person, if requested in writing by that person, the name of any other person the IRS has determined to be a responsible person with respect to the tax liability. The IRS also would be required to disclose whether it has attempted to collect this penalty from other responsible persons, the general nature of those collection activities, and the amount (if any) collected. Failure by the IRS to follow this provision does not absolve any individual of any liability for penalty.

Privacy-related modifications: To better protect taxpayers, the proposal should be modified to preclude recipients of the disclosed information from improperly re-disclosing it. Additionally, the statute or legislative history should clearly provide that if the IRS' determination as to whether a person is considered a responsible person is judicially overturned, the Service would not be considered to have violated the requirements of section 6103 of the Internal Revenue Code.

§ 703. Penalties Under Section 6672. Under current law, a "responsible person" is subject to a penalty equal to 100 percent of trust fund taxes that are not collected and paid to the IRS in a timely manner. The rules for determining

whether a person is a "responsible person" are the same for taxable and tax-exempt organizations. The IRS is not required to promptly notify taxpayers who fall behind in depositing trust fund taxes.

There are three components to the bills. First, the IRS would be required to take appropriate action to ensure that employees are aware of their responsibilities under the Federal tax depository system, the circumstances under which employees may be liable for the penalty, and the responsibility to promptly report failures in payments to the IRS. These actions would include printing warnings on payroll tax deposit coupon books and appropriate tax returns indicating that employees may be liable for this penalty, and developing a special information packet relating to this penalty.

Second, the section 6672 penalty would not apply to volunteer, unpaid members of any board of trustees or directors of a tax-exempt organization to the extent such members are solely serving in an honorary capacity and are not participating in the day-to-day or financial activities of the organization. This exception for unpaid volunteers would not apply if the volunteers had actual knowledge of the failure to pay or collect or if this proposal resulted in no person being held liable for the penalty.

Third, the IRS would be required, to the maximum extent practicable, to notify all persons who have failed to make timely deposits of trust fund taxes within 30 days after the return was filed reflecting such failure or after the date on which the IRS is first aware of such failure. If the person failing to make the deposit is not an individual, the IRS must notify the entity. The entity, in turn, would have 15 days from receipt of the IRS notice to notify all of its officers, general partners, trustees, or other managers. Failure of the IRS to provide notice under this proposal would not absolve any individual of any liability for a penalty.

> Modifications necessary to facilitate tax administration: These bills' provisions generally would complement IRS efforts to inform taxpayers about their responsibilities for trust fund taxes. However, the first part of the proposal raises some problems. As the IRS shifts both to alternative (non-paper) forms of making tax deposits and filing payroll tax returns, the use of the coupon booklets and forms to inform taxpayers about their responsibilities for trust fund taxes makes less sense. Fewer taxpayers will be using the coupon booklets and the forms in the future as these alternative payment and filing options grow. (The North America Free Trade Agreement, for example, requires use of electronic funds transfer for depository taxes. With this movement toward electronic payments, the use of paper coupons containing any written notification will substantially diminish or be eliminated.)
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> Additionally, the Service is concerned that with its current information systems, it could not meet the 30-day notification requirement. A 60-day notification requirement is more realistic. Future improvements in IRS information systems under Tax Systems Modernization would facilitate meeting a 30-day requirement.

§ 803. Failure to agree to extension not taken into account. Under current law, to qualify for an award of attorney's fees, the taxpayer must have exhausted the administrative remedies available within the IRS. The bills

provide that any failure to agree to an extension of the statute of limitations could not be taken into account in determining whether a taxpayer had exhausted administrative remedies for purposes of determining eligibility for an award of attorney's fees.

Modifications necessary to facilitate tax administration: This provision generally reflects current law. However, the provision should not apply to taxpayers who fail to fully respond to IRS requests for information on a timely basis.

§ 904. Required notice of certain payments. Under current law, if the IRS receives a payment without sufficient information to credit it to a taxpayer's account, the IRS may attempt to contact the taxpayer. If contact cannot be made, the IRS places the payment in an unidentified remittance file.

The IRS would be required by the bills to make reasonable efforts to notify, within 60 days of receipt, taxpayers that have made payments which the IRS cannot associate with any outstanding tax liability. Such a requirement is consistent with current IRS practices.

Modifications necessary to facilitate tax administration: While this requirement is reasonable and consistent with current IRS practices, a minor technical modification is necessary to accommodate situations in which a taxpayer will deposit an amount toward a liability that technically is yet to arise (e.g., an estimated tax payment toward a current year's liability that technically is not yet an "outstanding tax liability"). When a taxpayer makes such a deposit, with or without specific instructions, the IRS generally credits the deposit to the current year's liability. In such situations, a requirement to notify the taxpayer of application of the deposit to its current liability would be unnecessary and potentially burdensome to the taxpayer. Either the statute or the legislative history should make it clear that routine deposits toward future liabilities are not intended to be affected by the provision. Perhaps this could be accomplished by substituting "identifiable tax liability" for "outstanding tax liability" in the statutory language and legislative history.

§ 1001. Explanation of Certain Provisions. Under current law, the IRS may enter into installment agreements, accept offers in compromise, and extend the time for paying tax. The bills would require the IRS to take appropriate actions to ensure that taxpayers are aware of the availability of installment agreements, offers in compromise, and extensions of time to pay tax. The IRS would have to do so in both instructions for income tax returns and collection notices.

Modifications necessary to facilitate tax administration: The IRS already informs taxpayers of their right to enter into an installment agreement in both instructions to income tax returns and collection notices. Although the IRS has no objection to including information on offers in compromise and extensions of time to pay tax in collection notices, inclusion of this information on the instructions to tax returns could cause some taxpayers not to pay their determined liabilities, even where they have the ability to pay. In evaluating the desirability of this provision, adequate consideration must be given to the rights of the majority of taxpayers who make timely and full payment of their determined liabilities.

§ 1011. Pilot Program for Appeal of Enforcement Actions. Under current law, a taxpayer who disagrees with an IRS collection action generally may appeal to successively higher levels of management with Collection.

The bills would require the IRS to establish a one-year pilot program allowing taxpayers to appeal enforcement actions (including lien, levy, and seizure) to the Appeals Division. This would be permitted where the deficiency was assessed without the actual knowledge of the taxpayer, where the deficiency was assessed without an opportunity for administrative appeal, and in other appropriate cases. The IRS would have to report to the tax-writing committees on the effectiveness of the pilot program.

Modifications necessary to prevent duplication of efforts: The IRS has recently completed an eighteen-month pilot program for independent review of all collection activities (including enforcement actions) and is in the process of evaluating the pilot. It seems likely that this proposal was carried over from H.R. 11 (which was debated prior to completion of this pilot program), without recognition of the fact that the IRS had already completed its pilot program. The Subcommittee may find it helpful to discuss the results of the pilot program with the IRS before proceeding with a statutory change.

Other provisions that would either codify current IRS practices or assist taxpayers in ways that would not undermine the administrative process are highlighted below. For certain provisions, minor modifications are provided to ensure that the administrative process is not compromised.

§ 505. Safeguards relating to designated summons. In general, current law provides that if the IRS issues a "designated summons" to a corporation at least 60 days prior to the expiration of the statute of limitations for the assessment of tax, the statute of limitations is suspended either until a court determines that compliance is not required or until 120 days after the corporation complies with the summons pursuant to a court's determination.

Consistent with current IRS practices, the bills would provide that no designated summons could be issued with respect to a corporation's tax return unless the summons first was reviewed by the IRS Regional Counsel for the Region in which the examination of the corporation's return was being conducted. The IRS also would have to promptly notify in writing any corporation the return of which is in issue of any designated summons (or another summons, the litigation over which suspends the running of the assessment period under the designated summons procedure) issued to a third party.

§ 602. Civil Damages for Fraudulent Filing of Information Returns. Current federal law provides no cause of action to a taxpayer who is injured because a false or fraudulent information return has been filed with the IRS by another person asserting that the other person made payments to the taxpayer. It does, however, provide for criminal sanctions that apply to the intentional filing of false information returns.

The bills would provide that if a person willfully files a false or fraudulent information return, the affected person may bring a suit to recover damages from the person who filed the return. A $5,000 damage floor is provided.

Modifications: If this provision is advanced, the legislative history should provide that the outcome of the parties' civil litigation on the issue as to whether a person willfully filed a false or fraudulent information return should have no effect on an independent action taken by the government with respect to the payor for the intentional filing of a false information return.

§ 701. Preliminary notice requirement. Under current law, a "responsible person" is subject to a penalty equal to 100 percent of trust fund taxes that are not collected and paid to the government on a timely basis. If the IRS determines that an individual is a responsible person, he or she may appeal that determination administratively.

As is current practice, the bills would require the IRS to issue a notice to any individual the IRS had determined to be a responsible person with respect to unpaid trust fund taxes at least 60 days prior to issuing a notice and demand for the penalty. The statute of limitations for the assessment of the penalty would not expire before the date that is 90 days after the notice was mailed. The proposal would not apply if the Secretary determined that the collection of the penalty was in jeopardy.

§ 801. Motion for Disclosure of Information. Under current law, a taxpayer that successfully challenges a deficiency may recover attorney's fees and other administrative and litigation costs if the taxpayer qualifies as a "prevailing party". A taxpayer qualifies as a prevailing party if it (i) establishes that the position of the United States was not substantially justified; (ii) substantially prevails with respect to the amount in controversy or the most significant issue or set of issues presented; and (iii) meets certain net worth and (if the taxpayer is a business) size requirements.

The bills would provide that once a taxpayer had substantially prevailed in court, it could file a motion for the court to order the IRS to disclose all information and records in its possession with respect to the taxpayer's case.

§ 802. Increased limit on attorney fees. The maximum base rate for attorneys' fees would be increased from $75 to $110 per hour and would be indexed for inflation.

§ 905. Unauthorized Enticement of Information Disclosure. The Internal Revenue Code currently contains no provision prohibiting a tax professional from disclosing information about his or her clients to the IRS in exchange for forgiveness of the professional's tax liability.

The bills would create a civil cause of action if a government employee intentionally offers to compromise the tax liability of a professional tax advisor in exchange for information from that advisor about its client. The cause of action would permit the taxpayer to sue the government in district court without regard to the amount in controversy. Damages would equal the lesser of $500,000 or the sum of (i) actual economic damages sustained by the taxpayer as a proximate result of the information disclosure, and (ii) the costs of the action. The provision would not apply to information conveyed to a professional for the purpose of perpetrating a fraud or crime. The provision is not intended to apply to examination and collection activities of the IRS done in the ordinary course of its determination or collection of tax.

§ 1002. Improved Procedures for Notifying Service of Change of Address or Name. Generally, under current law, the IRS posts the new address of a taxpayer only when the taxpayer files a subsequent return or Change of Address form. If the taxpayer notifies the IRS of a new address on a return, this information is recorded on the IRS master file immediately. If the IRS is notified in other ways, the change of address information is recorded by the IRS only after it processes refunds and returns that show a balance due.

The bills would require the IRS to provide improved procedures for address changes and to institute procedures for timely updating all IRS records with change-of-address information provided by taxpayers. The proposal is generally consistent with the spirit of current IRS initiatives to improve IRS procedures regarding name and address change notification.

§ 1003. Rights and Responsibilities of Divorced Individuals. Although the IRS provides information on the rights and responsibilities of divorced individuals, this subject is not discussed in Publication 1, "Your Rights As a Taxpayer." The bills would require the IRS to include a section on the rights and responsibilities of divorced individuals in Publication 1.

> Modifications: This type of information is not generally consistent with the other information discussed in Publication 1 and there may be better ways of communicating these rights and responsibilities to divorced individuals. It may be more helpful to taxpayers, for example, to include a cross-reference in Publication 1 to our Publication 504, "Divorced or Separated Individuals."

§ 1012. Study on Taxpayers With Special Needs. The bills would require the IRS to conduct a study of ways to assist needy persons in complying with the tax laws. These persons would consist of the elderly, physically impaired, foreign-language speaking, and other taxpayers with special needs.

This proposal is generally consistent with the substantial efforts exerted by the Service in reaching out to needy groups to assist them in understanding and carrying out their obligations under the Federal tax laws. Examples of these initiatives include (i) the Volunteer Income Tax Assistance (VITA) program for low income, disabled and non-English speaking individuals; (ii) the Tax Counseling for the Elderly (TCE) program; (iii) videotaped instructions for completing returns in English and Spanish; (iv) materials in Braille and large print forms and instructions for the seeing-impaired; and (v) telephone assistance for the hearing-impaired.

§ 1013. Reports on Taxpayer Rights Education Programs. The bills would require the IRS to report to the tax-writing committees on the scope and content of its taxpayer rights education program.

§ 1014. Biennial Reports on Misconduct of IRS Employees. The bills would require the IRS to report to the tax-writing committees on employee misconduct cases.

To some extent, this reporting requirement duplicates other efforts. The IRS is already required by the Inspector General Act to report information on Inspection's investigative activities, including employee misconduct, to the Treasury Department Inspector General every six months. The Inspector General prepares a semiannual report to the Congress. The report includes summary information,

statistics, and descriptions of significant investigative activities within the Department. The report is sent to the Senate Governmental Affairs and Finance Committees and the House Government Reform & Oversight and Ways & Means Committees. These reports are available to the public.

Modification: The provision should be clarified to provide that it is not intended to require information, by employee name, on complaints, allegations, and investigations. Without such clarification, the provision would have the potential to invade the privacy of employees. Irreparable harm could be done to an employee's reputation if allegations against the employee were later proved unfounded or frivolous.

§ 1015. Study of Notices of Deficiency. The bills would require the GAO to study the effectiveness of IRS efforts to notify taxpayers about tax deficiencies.

§ 1016. Notice and Form Accuracy Study. The bills would require the GAO to conduct annual studies of the accuracy of the 25 most commonly used IRS forms, notices and publications.

In their current form, the following provisions would pose serious administrative problems.

§ 101. Establishment of position of taxpayer advocate within IRS. Under current law, the Taxpayer Ombudsman is appointed by and reports to the Commissioner. The Ombudsman's responsibilities are to bring the viewpoint of the taxpayer to IRS' policy and planning formulation. In addition, the Ombudsman oversees the operation of two programs to assist taxpayers. The first is the Taxpayer Assistance Order Program, under which the Ombudsman is authorized to issue a Taxpayer Assistance Order ("TAO") to assist taxpayers who otherwise would suffer significant hardship as a result of the manner in which the IRS is administering the tax laws. A TAO can require the IRS to release property of the taxpayer levied upon by the IRS or to cease action or refrain from taking action against the taxpayer. The second Ombudsman program is the Problem Resolution Program (PRP), which deals with cases in which IRS systems do not properly or timely handle the taxpayer's case or inquiry. Under this program, taxpayers receive special attention until their issue has been resolved.

Under the bill, the Ombudsman's title would be changed to the Taxpayer Advocate. As under current law, the Taxpayer Advocate would head an office in the IRS that reported directly to the Commissioner and would have responsibility for all aspects of the PRP Program, including Taxpayer Assistance Orders. Instead of reporting to the head of office, which is the current IRS practice, IRS employees in the field participating in the problem resolution program would report directly to the Taxpayer Advocate. In addition to the currently mandated annual report on taxpayer services prepared by the Ombudsman and Taxpayer Services, the Taxpayer Advocate would issue two reports each year to the tax-writing committees on past activities and future objectives of the office. The reports would include legislative recommendations. The IRS would be required to establish procedures requiring a formal response to all recommendations submitted to the Commissioner by the Taxpayer Advocate.

The Office of the Ombudsman has successfully carried out the directives of the Taxpayer Bill of Rights 1. Requiring field personnel to report directly to the Taxpayer Advocate would undermine grassroots accountability of the Ombudsman.

A procedural modification under which TAO decisions of the problem resolution officers could be appealed only to the Ombudsman (rather than to the District Directors as under current IRS procedures) could address Congressional concerns over the independence of the Ombudsman.

§ 102. Expansion of authority to issue taxpayer assistance orders. Taxpayer Assistance Orders under current law include the power to release taxpayer property levied upon by the IRS and to require the IRS "to cease any action, or refrain from taking any action" against a taxpayer that will otherwise suffer "significant hardship" as a result of the manner in which the IRS is administering the tax laws. A TAO may be modified or rescinded by the Ombudsman, a district director, a service center director, a compliance center director, a regional director of appeals or any of their superiors.

Under the bills, the authority to issue TAOs would be expanded to permit the IRS to affirmatively "take any action" with respect to taxpayers who otherwise would suffer a significant hardship as a result of the manner in which the IRS is administering the tax laws. The persons who could modify or rescind a TAO would be narrowed to consist only of the Taxpayer Advocate, the Commissioner, or a superior of the Taxpayer Advocate or the Commissioner. The provision would clarify that the Taxpayer Advocate could not determine the substantive tax treatment of any item.

The bills would also authorize TAOs for taxpayer "hardship," rather than "significant hardship." Eliminating the "significant hardship" requirement is troubling in that it would make the special relief provided by TAOs effectively available to all taxpayers other than the very small group of taxpayers for whom the timely payment of tax does not pose any hardship. This TAO expansion could present significant revenue consequences. Also, given resource constraints, the significant increase in the number of applications for TAOs that could be expected to result from expansion of the TAO standard could seriously undermine the Service's ability to serve those taxpayers whose needs are most pressing.

Other portions of this provision that expand the Ombudsman's TAO authority are also unnecessary. By delegation order, the Commissioner already has expanded the Ombudsman's TAO authority. This expanded authority includes the authority to take those affirmative actions, in addition to the current authority to cause the IRS to cease any actions, that appear to be the focus of Congress' concern (e.g., to issue TAOs to abate assessments, expedite refunds, and stay collection activity).

Finally, the bills' provision narrowing the number of individuals who could modify or rescind a TAO to only the Taxpayer Advocate or his delegate, the Commissioner, or a superior of the Taxpayer Advocate or the Commissioner is generally consistent with one of the Service's preferred alternatives to section 101 of the bills (i.e., ensuring that problem resolution officer's decisions on TAOs are appealable only to the Taxpayer Advocate). The Service's suggested statutory language here, however, would (1) clarify that, for purposes of section 7811 (concerning TAOs), "Taxpayer Advocate" includes those individuals that are part of the Office of Taxpayer Advocate and all problem resolution officers, and (2) limit those individuals that could modify or rescind a TAO to only the Taxpayer Advocate (as defined above) or the Commissioner.

§ 201. Taxpayer's right to installment agreement. Under current IRS procedures, an individual who owes less than $10,000 of income tax and can pay within a short time period generally will be granted an installment agreement for the payment of that tax upon request without providing financial information to the IRS. The request will not be granted, however, if the taxpayer has delinquencies other than those that are the subject of the request. For other situations, case resolution depends on the taxpayer's financial condition. In all taxpayer interviews, the IRS first looks for sources of full payment.

Under the bills, non-corporate taxpayers would have an automatic right to an installment payment of income tax liabilities if (1) they request an installment agreement, (2) their tax liability is less than $10,000, and (3) they timely paid tax liabilities for the 3 preceding taxable years.

Permitting taxpayers to enter into installment agreements as a matter of right would undermine a major tenet of our system -- that taxes should be paid on time. It would provide a windfall to taxpayers with liquid assets in excess of those needed to pay taxes and result in substantial revenue losses. The IRS' accounts receivable inventory would balloon and substantial resources would have to be reassigned to intrusive, after-the-fact enforcement efforts.

§ 202. Running of Failure-to-Pay Penalty Suspended. Under current law, taxpayers pay both interest and a failure-to-pay penalty on amounts paid after the due date for payment of taxes. Therefore, amounts paid under an installment agreement are subject to both interest and the failure-to-pay penalty.

For any taxpayer that enters into an installment agreement that is requested on or before the return due date, the bills would provide that the failure-to-pay penalty is suspended during the period the agreement is in effect.

This proposal would have a severe negative effect on both revenues and collections. Taxpayers who otherwise could pay taxes on time would be encouraged to pay in installments, because the interest owed the government would be less than either the return taxpayers could earn by investing the delayed payments or the general market lending rates for unsecured borrowings.

§ 301. Expansion of authority to abate interest. Under current law, the IRS has the authority to abate interest assessed with respect to a deficiency or payment that is attributable to the error by or delay of an IRS employee performing a "ministerial" act.

The bills would replace the "error or delay in performing a ministerial act" criteria for the abatement of interest by the IRS with a "unreasonable error or delay" criteria. Therefore, the bills would authorize the IRS to refund or abate interest attributable to "unreasonable" IRS errors or delays, in cases in which a taxpayer's net worth or size exceeded applicable thresholds (generally a $2 million threshold for individuals and a $7 million or 500 employee threshold for businesses or organizations). For taxpayers for which net worth or size do not exceed applicable thresholds, the IRS would be required to refund or abate interest attributable to unreasonable IRS errors or delays, but only until the date demand for payment is made.

The broadening of the standard would encourage taxpayers, particularly large taxpayers with large amounts of interest at stake, to seek relief from interest assessments as a matter of course, thereby imposing significant administrative costs, as well as controversy-related costs, on the IRS. These costs ultimately would be borne by all taxpayers. Moreover, even during delays in the resolution of an issue, taxpayers do have the use of government money on which they could earn interest. Since interest (unlike a penalty) is compensation for the use of money, the provision would represent an economic windfall to taxpayers in many cases. Additionally, "means testing" the authority to abate by imposing a net worth requirement is incompatible with the purpose of the interest charge. It also is unnecessary, as the taxpayer will receive all interest paid if the taxpayer is found to owe no tax.

The vague "unreasonable error or delay" standard for abating interest also would present significant challenges in ensuring consistent application of the law. This could undermine taxpayer confidence in the fairness of the tax system. Furthermore, because net worth is not an item that is currently reported to the IRS, the net worth requirement could not be administered without great difficulty for the IRS and taxpayers.

The expansion of authority to abate interest also is unnecessary, because the cycles for tax audits (i.e., the time from initial taxpayer contact to resolution of the audits) are very reasonable. For example, the cycle times for office (i.e., generally correspondence) and revenue agent (i.e., generally person-to-person) audits of Form 1040 are 225 days and 364 days, respectively. The cycle time for revenue agent audits of Form 1120 (other than for large corporate taxpayers in the Coordinated Examination Program) is 371 days. Within these cycle times, 120 days is "built-in," because it is represented by the time necessary for 30-day and 90-day letters. The Service cannot significantly shorten the time it takes to select a taxpayer for an audit, because of systems limitations in its current matching programs.

§ 503. Notification of examination. In general, the IRS notifies taxpayers in writing prior to commencing an examination and encloses a copy of Publication 1, "Your Rights as a Taxpayer," with the notice.

The bills would provide that, prior to commencing any examination, the IRS would be required to notify the taxpayer in writing of the examination and examination procedures. These requirements would not have to be followed if (i) the examination was in connection with a criminal investigation, (ii) the collection of the tax was in jeopardy, (iii) the requirements were inconsistent with national security needs, or (iv) the requirements would interfere with the effective conduct of a confidential law enforcement or foreign counterintelligence activity.

In many respects this provision is consistent with IRS' current procedures; for example, we generally provide written notice and a copy of Publication 1, "Your Rights as a Taxpayer," prior to commencing an examination. The provision requiring advance notice, however, would undermine some compliance efforts, including roadside inspections of highway vehicles to ensure they are not evading federal motor fuels excise taxes, compliance checks for currency transaction reporting, and unannounced visits to Electronic Return Originators to determine whether they are complying with IRS procedures.

§ 504. Increase in limit on recovery of civil damages for unauthorized collection actions. Current law provides that if an officer or employee of the IRS recklessly or intentionally disregards a provision of the Internal Revenue Code or Treasury regulations, the affected taxpayer may sue the United States for the lesser of (i) $100,000 or (ii) direct economic damages plus costs.

The bills would increase from $100,000 to $1,000,000 the damage cap for reckless or intentional disregard of the law by IRS employees. Increasing this cap would encourage lawsuits, consume IRS resources, and disproportionately benefit large taxpayers.

§ 603. Requirement to conduct reasonable investigations of information returns. Under current law, deficiencies determined by the IRS generally are afforded a presumption of correctness.

The bills would provide that if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return filed with the IRS by a third party, the IRS, when making a determination of a deficiency based on such information return, shall have the burden of proof with respect to such determination unless the IRS has conducted a reasonable investigation to corroborate the accuracy of the information return.

Shifting the burden of proof on income reported on information returns to the IRS would render the IRS' matching program inoperable. Taxpayers, without presenting any supporting evidence, could force the IRS to investigate the accuracy of information returns before issuing notices of deficiency. Without the IRS document matching program, the IRS would need substantial additional resources to reach the same level of compliance with the tax laws that is achieved today.

A proper balance is achieved under existing standards. The IRS presumption of correctness does not outweigh credible evidence presented by the taxpayer. To prevail, the IRS must counter the taxpayer's evidence with credible evidence establishing the accuracy of the return. Any law change that prevents the IRS from asserting deficiencies on the basis of information returns could have devastating effects on the tax compliance system and profoundly increase the resource needs of the Service. The biggest component of the tax gap is unreported income. The only practicable way to reduce that component is through computerized matching of information returns. Legislation of this nature would undermine that process and result in substantial revenue loss.

IRS Internal Revenue Manual procedures have already been updated to track a H.R. 11 provision that strikes an acceptable balance between taxpayer and Government burdens. Under the H.R. 11 provision, if a taxpayer, in a court proceeding, asserts a reasonable dispute with respect to any item of income reported on an information return filed by a third party and the taxpayer has fully cooperated with the IRS, the Government, in presenting evidence of the deficiency based on the information return, must present "reasonable and probative information" concerning the deficiency in addition to the information return. In order to fully cooperate, the taxpayer must provide, within a reasonable period of time, access to and inspection of, all witnesses, information, and documents within its control to the extent reasonably requested by the IRS.

§ 804. Authority for Court to Award Reasonable Administrative Costs. Under current law, a "prevailing party" in an administrative or judicial proceeding is entitled to reasonable costs.

Though the intent of the bills' provision is not clear, it appears to provide that administrative costs could be awarded from the first action by the IRS (instead of from the Appeals office decision or notice of deficiency as under current law). Cost recoveries, however, should only be allowed after the U.S. has adopted a litigating position. The position of the U.S. during the early administrative stages cannot be judged against the "substantial justification" standard used to determine if one is a prevailing party because examining agents pursue fact-finding investigations that do not consider the hazards of litigation.

§ 901. Required Content of Certain Notices. Under current law, tax deficiency and similar notices are required to "describe the basis for, and identify" the amounts of tax, interest, additions to tax, and penalties. An inadequate description does not invalidate the notice. The bills would require that tax deficiency and similar notices instead "set forth the adjustments which are the basis for, and identify" the amounts of tax, interest, additions to tax and penalties.

The IRS already provides details of adjustments which are the basis for proposed tax assessments in notices of proposed adjustments and statutory notices of deficiency issued by the examination function. Further, the IRS is engaged in a significant ongoing effort to clarify its notices to taxpayers in a manner that is compatible with its computer capabilities. Without modernization of IRS tax systems, however, it is not practical to provide details of adjustments and related interest, additions to tax, and penalty amounts on computer-generated notices. Only with full implementation of Tax Systems Modernization would such additional disclosures be feasible.

§ 903. Relief from retroactive application of Treasury Department regulations. Under current law, a taxpayer may rely on Treasury regulations and revenue rulings that accord with the taxpayer's particular facts. In addition, penalties are abated for taxpayers who rely on other written guidance of the IRS. The Secretary may exercise his discretion to issue tax regulations prospectively or retroactively.

The bills would generally ban the issuance of retroactive Treasury regulations. Such an unnecessary limitation would encourage aggressive taxpayer behavior and cause serious administrative problems. The New York State Bar Association and American Bar Association are of the view that, on balance, Treasury has exercised its discretion under current law intelligently and responsibly. Thus, there is no pattern of misuse or other emergency justifying the type of fundamental change contemplated by the proposal.

The prohibition would encourage aggressive return positions in the "window" between the date of change in the statute and the date of issuance of regulations interpreting that change. In addition, the exception for retroactive

regulations to curb abuse of a statute would not cover regulations addressing judicial decisions or substantive defects in prior regulations. The absence of an exception for regulations issued within twelve months of the related statutory provision (as provided in H.R. 11) would encourage the issuance of vague proposed regulations or notices that provide less guidance to taxpayers.

Additionally, the retroactive effective date of the proposal is counterproductive. By applying to regulations filed on or after January 5, 1993, the proposal would undercut legitimate reliance on regulations issued after that date.

March 24, 1995

Chairman JOHNSON. Thank you very much, Commissioner.

We do have four more panels today, and so I want to remind you that your entire statements will be entered in the record and are available to us.

Mr. Monks, if you could direct your comments in such a way that they don't reiterate comments of your colleagues, I would appreciate it.

STATEMENT OF LEE R. MONKS, TAXPAYER OMBUDSMAN, INTERNAL REVENUE SERVICE

Mr. MONKS. Thank you. Madam Chairman, distinguished members of the subcommittee, I am pleased to be here to comment briefly on the Taxpayer Bill of Rights II proposals and to respond to any questions you might have.

As the executive within the IRS with responsibility for administering the Problem Resolution Program on a day-to-day basis, I am in a most unique position. Although I don't have direct responsibility for day-to-day field tax administration programs, I am vitally concerned with how those programs are being administered and how they affect individual and business taxpayers.

One of my primary responsibilities is to ensure that the perspective of taxpayers is considered as decisions are being made and new programs are being implemented within the IRS. In addition, in my role as head of the Problem Resolution Program, I work with our field offices to provide assistance to over 400,000 taxpayers annually who experience problems when normal IRS processes or channels do not seem to work. Perhaps, most importantly, I am also responsible for the Taxpayer Assistance Order Program which was statutorily established by the first Taxpayer Bill of Rights to assist taxpayers who are experiencing significant hardship. On an annual basis, problem resolution works about 33,000 of these cases, more commonly referred to as ATAOs.

In the operation of these programs, a primary goal of PRP, problem resolution, is to identify IRS systems which may be contributing to taxpayer problems. We then work with those segments of the organization that have "ownership" of the process to suggest and make improvements designed to reduce problems of a similar nature in the future.

From an organizational perspective, I report directly to the Commissioner and, therefore, have been provided with a great deal of latitude and independence in accomplishing the mission of PRP. I provide functional direction, guidance, and support to the field problem resolution officers located in every IRS region, district, and service center. Since the vast majority of PRP casework is accomplished in our field offices, it is critical that PRP employees also receive strong support from their local head of office and appropriate functional management.

Today, I would like to share my thoughts on one particular area of the Bill of Rights which I understand is of concern to the Congress, and that is the independence of field problem resolution officers. Although we in the IRS feel that the PRP program is working well as it is currently constructed, and that both the Taxpayer Ombudsman and the field PRO's have been afforded the independence

necessary to accomplish our mission, I realize that many in Congress may not fully share that view.

Based on previously stated concerns in this area, I have given this matter a great deal of thought and would like to propose some specific changes that might alleviate some of your concerns. I must stress that these are my views and suggestions and are not presented as those of the administration, the Treasury Department, or the Commissioner.

First, concerning the Taxpayer Assistance Order Program, current procedures provide that a director, upon appeal, may overturn a taxpayer assistance order and deny relief to a taxpayer claiming significant hardship, based on the facts and circumstances of the particular case. I would propose that taxpayer assistance orders can only be appealed to the Taxpayer Ombudsman. This would address some of the concerns regarding problem resolution officer decisions on hardship cases being overturned by their directors. It would also strengthen the independence of field problem resolution officers regarding decisions relating to taxpayer assistance orders.

Second, concerning the reporting relationship of field problem resolution officers, I am strongly in favor of retaining the current reporting structure to the head of office for district and service center PRO's for a number of reasons. I would suggest the elevation of taxpayer assistance order appeals to the Taxpayer Ombudsman would address most, if not all, of those concerns. A further proposal would be to either designate the Taxpayer Ombudsman as the selecting official for all field problem resolution officer positions or ensure that the ombudsman has significant input into both their selection and annual appraisal. These actions would further enhance the relationship and accountability that currently exists between field problem resolution officers and the Taxpayer Ombudsman while also retaining the high level of support that problem resolution officers receive from their directors.

Field problem resolution officers have expressed their concerns, both to me and to their congressional representatives, regarding the impact of no longer reporting to the local head of office. They feel this could change the positive relationships they have established with their directors and other staff members and possibly impact on their ability to influence decisions and assist taxpayers on ATAO cases. I share that concern. The vast majority of these cases are handled in our field offices on an informal basis. This is due primarily to the positive working relationships established by our problem resolution officers with their functional counterparts. Any change to the current reporting structure could have an impact on those relationships with perhaps unintended consequences. I am of the firm belief that the current reporting structure, with the modifications I have proposed, is in the best interests of continuing our high level of support and assistance to taxpayers. Having said that, we are certainly willing to engage in additional discussions with the committee on this issue.

Earlier, the Commissioner in her remarks indicated I would comment on the proposal to change the ATAO process from taxpayers experiencing significant hardship to the more general standard of experiencing hardship. Problem resolution has already made a distinction in the categories of cases handled by the program. As I

mentioned earlier, we handle over 400,000 PRP cases annually. The general standards on these cases are: Subsequent contact by the taxpayer on the same issue; any contact that indicates the taxpayer has not received a response from the IRS by the date promised; any contact that indicates established systems have failed to resolve the taxpayer's problem; or where it is in the best interest of the taxpayer or the IRS that the case be worked by PRP.

ATAO cases, on the other hand, both have a high standard, significant hardship, and are afforded a higher priority as a result. The essence of the ATAO program is speed and individual attention. Substantially expanding the volume of cases by changing the criteria for an ATAO would inevitably diminish the level of attention and high priority these cases now receive. With over 150,000 ATAO's processed since the establishment of the program in 1989, my view is that the proposed changes would actually hurt those who are in most need of the immediate attention the program provides. Those cases not meeting the higher standard of significant hardship can still be included and receive attention as a regular PRP case.

In conclusion, I fully realize that despite the best efforts of the many hard-working, capable individuals in the Problem Resolution Program, we are not able to resolve every problem in the most timely and efficient manner. There are probably also instances where the program has failed to work as expected. I would certainly invite and encourage you to bring those situations to my attention in order that they may be examined and hopefully contribute to our continuing efforts to improve our services.

I would be glad to answer any questions you may have at this time.

[The prepared statement follows:]

STATEMENT OF

LEE R. MONKS
TAXPAYER OMBUDSMAN
INTERNAL REVENUE SERVICE

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS & MEANS

MARCH 24, 1995

Madame Chairman and Distinguished Members of the Sub-Committee:

I'm pleased to be here today to make some brief comments relating to the Taxpayer Bill of Rights 2 proposals and to answer any questions you may have.

As the executive within the IRS with responsibility for administering the Problem Resolution Program (PRP) on a day-to-day basis, I am in a most unique position. Although I do not have direct responsibility for day-to-day field tax administration programs, I am vitally concerned with how those programs are being administered and how they may be affecting individual and business taxpayers. One of my primary responsibilities is to ensure that the perspective of taxpayers is considered as decisions are being made and new programs are being implemented. In addition, in my role as head of the Problem Resolution Program, I work with our many field offices to provide assistance to over 400,000 taxpayers annually who have experienced problems when normal IRS processes or channels don't seem to work. Perhaps, most importantly, I am also responsible for the Taxpayer Assistance Order program which was statutorily established by the first Taxpayer Bill of Rights to assist taxpayers who are experiencing significant hardship. On an annual basis PRP works about 33,000 of these cases, more commonly referred to as ATAOs.

In the operation of both of these programs, a primary goal of PRP is to identify IRS systems which may be, inadvertently or otherwise, contributing to taxpayer problems. We then work with those segments of the organization that have "ownership" of the process to suggest and make improvements designed to reduce problems of a similar nature for taxpayers in the future.

From an organizational perspective, I report directly to the Commissioner and Deputy Commissioner and have therefore been provided with a great deal of latitude and independence in accomplishing the mission of PRP. I provide functional direction, guidance and support to the field Problem Resolution Officers (PROs) located in every IRS region, district and service center. Since the vast majority of PRP casework is accomplished in our field offices, it is critical that PRP employees also receive strong support from their local head of office and appropriate functional management.

I have previously shared my views on the Taxpayer Bill of Rights 2 with the committee in writing and recently testified before the committee on IRS efforts to reduce taxpayer burden. Today, I would like to share my thoughts on one particular area of the Bill of Rights which I understand is of concern to the Congress and that is the independence of field PROs. Although we in the IRS feel that the PRP program is working well as it is currently constructed, and that both the Taxpayer Ombudsman and field PROs have been afforded the independence necessary to accomplish our mission, I realize that the Congress may not fully share that view.

Based on previously stated congressional concerns in this area, I have given this matter a great deal of thought and would like to propose some specific changes that might alleviate your concerns. I must stress that these are my views and suggestions and are not presented as those of the Administration, the Treasury Department or the Commissioner.

First, concerning the TAO program, current procedures provide that a director, upon appeal, may overturn a TAO and deny relief to a taxpayer claiming significant hardship, based on the facts and circumstances of the particular case. I would propose that TAOs can only be appealed to the Taxpayer Ombudsman. This would address concerns about PRO decisions on hardship cases being overturned by directors. It would also strengthen the independence of field PROs regarding decisions relating to TAOs.

Second, concerning the reporting relationship of field PROs, I am strongly in favor of retaining the current reporting structure to the head of office for district and service center PROs for a number of reasons which I will cover in just a minute. I would suggest, however, that if there are concerns about the independence of field PROs in the current reporting alignment, the elevation of TAO appeals to the Taxpayer Ombudsman would address most if not all of those concerns. A further proposal would be to either designate the Taxpayer Ombudsman as the selecting official for all field PRO positions or ensure that the Ombudsman has significant input into both their selection and annual appraisal. These actions would further enhance the relationships and accountability that currently exists between field PROs and the Taxpayer Ombudsman while retaining the high level of support that PROs currently receive from their directors.

Field PROs have expressed their concerns, both to me and to their congressional representatives, regarding the impact of no longer reporting to the local head of office. They feel this could change the positive relationship they currently have with their directors and other staff members and possibly impact on their ability to influence decisions and assist taxpayers on ATAO cases. I share that concern. The vast majority of ATAOs are handled in our field offices on an informal basis. This is due primarily to the positive working relationships established by the PROs with their functional counterparts. Any change to the current reporting structure could have an impact on those relationships with perhaps unintended consequences. I am of the firm belief that the current reporting structure, with the modifications I have proposed, is in the best interests of continuing our high level of assistance to taxpayers. We are certainly willing to engage in additional discussion on this issue.

Earlier, the Commissioner, in her remarks, indicated that I would comment on the proposal to change the standard for ATAOs from a taxpayer experiencing significant hardship to the more general standard of experiencing hardship. PRP has already made a distinction in the categories of cases handled by the program. As I mentioned earlier, we handle over 400,000 PRP cases annually. The general standards for these cases are:

- subsequent contact by the taxpayer on the same issue (allowing time to resolve the initial inquiry);
- any contact that indicates the taxpayer has not received a response from IRS by the date promised;
- any contact that indicates established systems have failed to resolve the taxpayer's problem; or
- where it is in the best interest of the taxpayer or the Service that the case be worked in PRP.

ATAO cases, on the other hand, both have a higher standard (significant hardship) and are afforded a higher priority as a result. The essence of the ATAO program is speed and individual attention. Substantially expanding the volume of cases handled in the ATAO program would inevitably diminish the level of attention and high priority these cases now receive. With over 150,000 ATAOs processed since the establishment of the program in 1989, my view is that the proposed change would actually hurt those who are in most need of the immediate attention the program provides. Those cases not meeting the higher standard of significant hardship can still be included and receive attention as a regular PRP case.

In conclusion, I fully realize that despite the best efforts of the many hard-working capable individuals in PRP, we are not able to resolve every problem in the most timely and efficient manner. There are probably also instances where the program has failed to work as expected. I would invite and encourage you to bring those situations to my attention in order that they may be examined and hopefully contribute to our continuing efforts to improve our services.

I would be glad to answer any question you may have.

Chairman JOHNSON. Thank you, Mr. Monks. I will ask a couple of questions and then move on. If we need to come back, we will.

You mentioned at the beginning of your testimony that these were your thoughts and not those of the Treasury, I believe you said. I just wondered if your testimony had gone through the review process of the IRS and the Treasury as testimony traditionally does.

Mr. MONKS. My testimony was shared, but these are my comments.

Ms. BEERBOWER. Treasury did not receive a copy of his testimony in advance.

Chairman JOHNSON. Thank you. Ms. Beerbower, to shift gears just ever so slightly on you, one of the things that is of great concern to me is the whole matter of regulations and when they get written. And from the point of view of taxpayer compliance, I have come to feel this is a very important matter. Could you update us on how many regulations the Treasury and IRS are currently working, what your backlog is? Is the backlog decreasing or increasing? What is the general time lag between when Congress passes a tax law and regulations are written?

Ms. BEERBOWER. Yes, certainly. The IRS and Treasury have announced the 1995 business plan that has on it, I think, about 165—when I last counted it—regulatory projects. Now, these projects are on that plan because all of us, the IRS and the Treasury, are committed to finishing them before December 31.

Last year, I can't remember what our success rate was, but we try very hard to keep track of it. It might have been 85 percent, as I recall, that we completed.

The regulations are of varying degrees of difficulty. Some of them are very easy to write and very easy to issue. Others, such as the regulations that we have issued on contingent debt and synthetic securities and the accrual of income on certain financial products, are very difficult to write. They do take more time, and the lag is obviously greater depending upon the difficulty of the regulation. So it is very hard to say. In some instances, like section 385 in the code, the distinctions between stock and debt, there have never been satisfactory regulations issued.

Chairman JOHNSON. So what is the number of years that is the traditional gap between the passage of a major tax bill and the writing of the regulations?

Ms. BEERBOWER. It would be very hard to say. The OBRA regulations on the conduit provisions, on most of the areas in which significant guidance was needed, were provided last year. So within a year, we attempted to provide at least proposed regulations for most of those statutory provisions. But I think some will take longer.

Chairman JOHNSON. Could you get back to us with precise information on this matter of the gap between when a law is passed, when guidances are issued, and when regulations are adopted and finalized?

Ms. BEERBOWER. Certainly.

Chairman JOHNSON. Thank you.

Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

Mr. Monks, maybe I didn't hear you because I went out for a moment, but did you talk about the abatement of interest issue?

Mr. MONKS. No, I did not.

Mr. MATSUI. What is your position on that?

Mr. MONKS. We have looked at that for quite a period of time, and we believe that there are some instances where abatement of interest may be appropriate.

Mr. MATSUI. So you would favor, then, perhaps something to make changes there to give the IRS and Treasury or both the authority to make changes—or to abate interest, should it become necessary?

Mr. MONKS. I think that it should be looked at on a case-by-case basis. We should take into account the circumstances of the situation.

Mr. MATSUI. In other words, you do favor——

Mr. MONKS. I generally would be in favor of looking at it further.

Mr. MATSUI. What about getting the Service and/or the Treasury Department to lift liens?

Mr. MONKS. I certainly think that there are circumstances where that should be the case, yes.

Mr. MATSUI. Did you speak to that issue in your testimony?

Mr. MONKS. No, I did not.

Mr. MATSUI. I guess the question I want to ask is: How independent are you? How many people do you have working for you, directly under you? Field office, everything.

Mr. MONKS. Directly under me, I have a relatively small staff in the headquarters office, about 25 employees. The field problem resolution officers do not work directly for me. They work for either the regional commissioner, the Service center director, or the local district director.

Mr. MATSUI. Yes. You know, when I was on the city council in Sacramento, we had a situation where we had a city manager form of government, and the elected officials hired the city manager, and the city manager ran the government and basically gave us policy input. And we decided that we needed a little more independence, and we hired a budget analyst, but we didn't give the budget analyst anything but an office. In fact, he had to go out and get his own telephone and all this stuff, and we gave him a little budget. And he failed miserably. I mean, it was the worst situation in the world, and this guy destroyed his career, essentially. He had to move out of Sacramento.

Do you feel you are understaffed? Can you handle your work? Because you have, what, I don't know how many hundreds of thousands of taxpayers you have to handle. I would imagine you receive thousands of telephone calls an hour during the tax season. Is that correct? How do you handle that?

Mr. MONKS. Most of the inquiries go into our field offices. We have about 400——

Mr. MATSUI. But you don't run those offices, though. You don't have any control over those.

Mr. MONKS. I don't run those offices, but I do have a lot of contact with them. They get field direction and guidance from the ombudsman's office. We meet with them——

Mr. MATSUI. But we need an ombudsman, then, because, I mean, the field office is under the direction and control of the Department, right? So, I mean, that is great that they make those calls to them, but what is your function? Do you do the big picture stuff? Do you do the small picture stuff? If an individual taxpayer contacted one of your 25 employees, how do you handle that?

Mr. MONKS. Some of the taxpayer inquiries do come into our office. We work with individual field offices on specific cases. We get information from them. We assist them where they are running into difficulty. So there is a lot of coordination.

Mr. MATSUI. Let me ask, how long have you had this job?

Mr. MONKS. Two years.

Mr. MATSUI. What are your big accomplishments?

Mr. MONKS. We have, I think, made a number of recommendations. One specific project that we worked on in the headquarters office dealt with how to effect improving the processes on changing and updating our master file on taxpayer addresses.

Mr. MATSUI. Was it implemented?

Mr. MONKS. A number of the recommendations have been implemented. We are in the process of monitoring those recommendations to ensure that we do have greater capability in that area.

We are also——

Mr. MATSUI. I guess the question I am going to ask is—well, and you can't answer it, but do you perform a valuable function given your staffing levels and given what you are up against? And if you do, well, then, I don't know how you define it, but if you don't, are you even relevant? And if you need more staffing, then we need to know that. But then that creates—you know, do you have a parallel system? And I don't quite know how you deal with it, but you are kind of in a hybrid position. Who do you represent? Who do you work for? Congress or the executive branch or the IRS or Treasury Department? All these things are a little confusing to me, and I guess when this office was created, those things were thought through. But now that you have been in for 2 years, I would like to kind of pursue this further with you beyond this hearing, obviously.

So that is all I have for you, but I am going to follow up, I guess, with your office to find out exactly what you do.

Mr. MONKS. Certainly.

Mr. MATSUI. Let me ask Ms. Beerbower a question. You indicated—and I tend to agree with you on the burden of proof issue. I think if you really want a system of voluntary compliance, you almost have to put the burden of proof on civil matters on the taxpayer. And so I do tend to agree in a rather strong way with both Commissioner Richardson and you.

The abatement of interest issue, though, I can understand if I got a notice saying that I owe $3,000 but then there was no effort to collect, I will remember that. I will remember even if it is 5 years later. And if I get hit with the $3,000 plus interest, that is my problem and I have to deal with it. But I am not at all sure all taxpayers are in that situation. I can imagine some taxpayers perhaps who live day to day, week to week, month to month, being in a situation where if they got a notice for $1,500 that they owe, they might put it aside, and if there is no collection because, let us say,

the files got lost and 5 years later all of a sudden they are hit with this $1,500 plus interest, they may not be in a position to deal with it.

I don't know how you deal with a situation like that. It just seems to me there is an equitable issue that has to be dealt with, not for me or somebody who perhaps hires a CPA, has an accountant, you know, has the ability and the structure in order to remember those things and think, hey, I might be able to get away with it. But really, you know, if I don't, I am in trouble. But there may be some people that are not in that position. How do you deal with them? Do you make them pay and do you make them sell their house? How is this done?

I think what Mr. Monks says is correct. Maybe you do need a little authority to pick up those cases that are hardship cases.

Ms. BEERBOWER. I think it is a difficult question. As you suggest, it differs case by case, and the individual circumstances of the taxpayer and the facts behind it are critical to one's judgment of whether the relief is necessary or desirable.

I think in situations like that, it is hard to legislate.

Mr. MATSUI. Well, see, I would suggest, I mean, perhaps we give you the authority and you promulgate with the IRS and the ombudsman regulations that would give you some discretion in order to make those judgments. I just don't think it is fair to certain taxpayers, particularly if somebody quits from the IRS, quits their job, and then that file gets misplaced in some cabinet. I don't think that is fair to that taxpayer who may not have quite the background or perhaps the infrastructure to remember those things.

I would imagine there are quite a few of those folks.

Ms. BEERBOWER. I think we would certainly consider the possibility of perhaps publishing standards.

Mr. MATSUI. But you don't have the authority to do anything right now, though; is that correct?

Ms. BEERBOWER. Well, right now what we are doing is working with the staffs on the Taxpayer Bill of Rights, deciding where we need additional authority.

Mr. MATSUI. I am not talking about the staff. I am talking about you don't have the—in other words, there must be taxpayers out there that are in that position.

Ms. BEERBOWER. Yes.

Mr. MATSUI. Now, how do you deal with them? You make them pay, right?

Ms. BEERBOWER. At the moment, I'd defer to the Commissioner on that.

Ms. RICHARDSON. I think that is correct, Mr. Matsui. But also, one of our proposals which would address some of your concerns is to send an annual reminder notice to taxpayers that they do have an outstanding obligation. We are doing this now, but also it is included in the legislation.

Mr. MATSUI. See, in that situation, that is fine. If you were making an attempt to collect, then obviously the taxpayer has the obligation—I don't care what level the income or background of that taxpayer is. The taxpayer owes the money. But there have to be situations where maybe a notice was sent, but then no collection

effort was made for 3 or 4 years, and in that situation, the equity may shift or perhaps the burden of proof should shift in that case.

Why should then the Service put a person in a position where they may have to sell their house in order to collect that back payment plus the interest? It would seem to me you would want the authority to protect those taxpayers. And if we gave you that authority, you can promulgate regulations to deal with the hardship cases, but don't let me get away with it or people in my position get away with it.

I don't understand why you don't want that authority. It would seem to me—I just think that you can't resist all of these provisions. There are some, like the burden of proof, that I think are a problem and that would create tremendous problems for all of you if, in fact, we shifted the burden of proof. We would really no longer have a system of voluntary compliance. But in some cases, it would seem to me that you would want some authority in order to make the proper decision and protect the taxpayer for decisions that are not good.

Ms. BEERBOWER. I think we are certainly willing to consider that. You know, we do work out installment agreements, other types of payment plans for people not able to pay. I would want to study the facts, but I would strongly doubt that the house is taken before——

Mr. MATSUI. Well, let's take somebody making $30,000 a year with 3 kids or 4 kids, a couple of them trying to get through college and they are working part-time. But essentially that person is basically making it month to month, and there are a lot of people like that, I know, in my district and throughout the United States. That person gets hit for $800. You don't collect or attempt to collect for 5 years. That $800 becomes $1,800, you know—I don't know what the interest would be. But that person may not then be in a position to go out and even borrow, and so they would probably have to find some way to put their equity on the line in that house in which they may have $10,000 worth of equity. Then they are going to have a further problem meeting those monthly payments.

It seems to me that there are a lot of people that could be put in that position.

Ms. BEERBOWER. I would certainly consider it.

Mr. MATSUI. I will finish with this comment. I just hope that when you look at these things that you use some discretion, because if you just oppose everything, we may do something that might be bad for you. And we want to work with you. We want some flexibility on your part so that we can come up with a smart decision.

Ms. BEERBOWER. Well, as I was describing in the 40-some-odd provisions that are being discussed now at the staff level, there is major disagreement on only 6. There is massive agreement and modification going on with respect to the balance. I certainly don't want to suggest that we oppose all of the provisions.

Mr. MATSUI. I understand, but this abatement of interest issue seems to me one that you should—I mean, it would seem to me you would want that authority and then you can promulgate regulations and protect yourself but also protect some taxpayers. That is just an example.

Thank you.

Chairman JOHNSON. I would just like to follow up on the report issue so that we may focus on one issue at a time.

Mr. Monks, I know you do provide reports to the Commissioner and that those reports cite problems, operational problems, statutory problems, and make suggestions. In the past, the Treasury has not opposed the provision of these reports to the Congress, and, in fact, we have received in the last 2 years very good reports from Mr. Monks at the request of my honored and esteemed and beloved predecessor, Congressman Pickle of Texas.

But it is my understanding that the Treasury now opposes the provision of those reports to Congress. Is that true?

Ms. BEERBOWER. Honestly, I do not believe we have seen a report from the ombudsman. They are not sent to us. We do regularly communicate with the Commissioner, and the Commissioner will have suggestions that are given to us, and we work on those suggestions to develop legislation where it is appropriate or to embody the suggestion in regulatory projects.

Chairman JOHNSON. Your testimony suggests on page 10 that you oppose the provision of these reports to the committee.

Ms. BEERBOWER. We oppose the provision of legislative tax from proposals going directly from the ombudsman to the committee without the review that is institutional in the Office of Tax Policy—the revenue estimating, the balancing, the input, the conflicts with other provisions—and without filtering that through the Secretary of the Treasury and ultimately the President in order to speak with one voice on tax legislation.

Chairman JOHNSON. I appreciate your concern with the Treasury having a single voice. I hope you will think this over and discuss it with us in the days ahead, because I think there is some merit, frankly, to that discussion going on publicly, to the ombudsman having the responsibility to report things as he sees it to us, and our having the responsibility to work with you and listen. I think certainly the Nation does need one voice on tax policy.

But particularly in today's world, it is important that some of those controversies be discussed and the resolution be a matter of public process. And so I hope you will work with us to reconsider that position on your part.

Second, I do want to mention just to both Treasury and the IRS, I want to raise the issue of the fact that under section 7430, the taxpayer must not only prevail over the IRS on the merits of his case, but he also has to show that the IRS was not substantially justified in maintaining its position against the taxpayer.

We talked earlier in terms of burden of proof, and Treasury gave excellent testimony on how hard it would be for Treasury to prove certain things. It strikes me that it would be very hard for the taxpayer to prove that the IRS was not substantially justified.

What would be your position on switching the burden of proof to the IRS to show that it was substantially justified in maintaining its position in order to defeat a victorious taxpayer's application for attorneys' fees? Now, this is somebody who has challenged the IRS, he has won; it has been adjudicated that, in fact, his case was the better case. Why should he then have to go on to prove that the

IRS was not substantially justified when in this case the IRS has the information and he does not?

Ms. RICHARDSON. Madam Chairman, if I might, I would like to introduce Stuart Brown, who is our chief counsel. I think he is prepared to address that issue.

Chairman JOHNSON. Thank you.

Mr. BROWN. Thank you. Madam Chairman, let me say first that the provision you are describing is our current operating practice; in other words, when our attorneys are involved in a case which leads to a request for attorneys' fees and we decide to oppose the request, our guidance to our attorneys is that they must be prepared to prove the Government's position was substantially justified.

Now, I understand that is not required by statute at the moment, but that is, in fact, the way we operate at the present time. We haven't really considered whether it would be appropriate to enact that into legislation, but we certainly would be willing to discuss that further with you.

Chairman JOHNSON. All right. So you would not have any objection to us clarifying that, in fact, it was the IRS' responsibility.

Mr. BROWN. It is our current practice. I don't think I am prepared to state a legislative recommendation, but I can tell you that is——

Chairman JOHNSON. I think you need to think about that because that is——

Mr. BROWN. We would be happy to work with you on it.

Chairman JOHNSON. That will be of interest to us.

Mr. BROWN. Sure.

Chairman JOHNSON. As you are keenly aware, this month the House passed the Attorney Accountability Act. This bill encourages the settlement of litigation by imposing attorneys' fees on a party which rejects a settlement offer in cases where the court later awards the party less than the amount of the earlier settlement offer.

What would be the IRS' position regarding adopting a similar approach for taxpayer disputes for the IRS?

Mr. BROWN. We would be very careful before we went in that direction for tax litigation, and I guess there are a couple of reasons why. I think you have to remember that attorneys' fees are the tail and not the dog. Our main objective in any tax controversy is to resolve it at the earliest possible level, hopefully, when the questions are first asked by the agent; if not then, through the administrative appeals process; and if not then, in court, in a docketed status. But even though we resolve about 30,000 tax court cases a year, only about 1,000 to 1,500 are actually tried. The others are settled in the process leading up to the trial. And we are concerned that changes that would shift that balance would provide significantly more burden both to us and to the tax court if we do anything that confuses the situation or encourages additional litigation.

Beyond that, if Congress felt that it was appropriate to provide more liberal rules for attorneys' fees, our suggestion would be to make the rules as clear as possible. If you feel it is appropriate that the Government should spend more money to support tax-

payers who want to litigate cases against the Government, the only recommendation I would have is that we should find rules that make that process not interfere with the basic process of resolving the issue on the merits; and, secondly, that in itself, it should not become a major controversy and a source of continuing litigation. But let's just find some rules that are fairly simple and straightforward, and we can go forward from there.

Mr. CARDIN. Would the gentlelady yield on that point?

Chairman JOHNSON. I would be happy to.

Mr. CARDIN. I think this is a very important discussion because many of the cases that you are referring to have implications far beyond the specific case that may be under active consideration, and the IRS position and, indeed, the taxpayer's position may very well be influenced by the impact it has on other cases that are pending. And if we just look at the counsel fees related to a settlement offer and the cost after a settlement offer and the amount of dollars involved, it may not really reflect the importance of that litigation either to the taxpayer or to the IRS.

Mr. BROWN. That is absolutely true. We emphasize over and over again that the reason that we litigate particular cases is not only to collect the proper amount of tax from that taxpayer, but much more importantly, to make sure the rules are clarified and the law is understood and followed by everyone.

So the 1,000 or 1,500 cases that are actually tried to decision in tax court every year are an infinitesimal percentage of the total revenue we collect. The importance of those cases comes from the rules they establish for other taxpayers.

Mr. CARDIN. And, in fact, if you reach settlement you may not even have a clear understanding as to how it impacts on other taxpayers of similar nature if there is a settlement that is not clear as to the effect of it.

Mr. BROWN. I would agree with that. I think that this provision, as I understand this provision, has been available to the Federal Civil Procedure for a fairly long time, and it is only infrequently used in civil litigation generally.

Mr. CARDIN. I would like some time on a different subject.

Chairman JOHNSON. You will have some time.

Mr. Hancock.

Mr. HANCOCK. Thank you, very much. I recognize that this question about the burden of proof is a very, very complicated issue. I just was wondering if there is a way to come up with some type of language which breaks down the responsibility for the burden of proof rather than just saying the burden is entirely on the Internal Revenue Service or it is entirely the individual.

For instance in the cases that Ms. Beerbower mentioned, it is pretty obvious that if you claim a dependent, the burden of proof should be upon the claimant, not on Internal Revenue to prove whether you have the children or whether you do not.

The only trouble is once you start that method or start trying to itemize, especially with our complicated tax law, I am afraid you get into trouble. But it is something we might consider.

One of the things that concerns me is that compliance costs in our system is extremely expensive. There is a lot of money spent

just to comply that could better be spent for better purposes than complying with the tax law.

What about the cases where Internal Revenue obviously makes a mistake. For instance, an individual files the proper papers and everything, and Internal Revenue, in its own system, has the papers, but they get lost. And they end up saying, oh, yes, we are going to send this person a notice of deficiency. We will not give them a name, nobody that they can correspond with, and we are going to send them a little notice that says, you owe us $4,500, a general penalty.

Then that taxpayer has to hire a CPA, or uses his regular CPA or his attorney, whoever the taxpayer is, and files a power of attorney. A month later he still cannot get an answer. He starts trying to make telephone calls, and finds out Internal Revenue says, we will not talk to you on the telephone, we have to do it by correspondence.

Six months later after the individual or the company is out several hundred dollars in fees, Internal Revenue says, ah ha, we found the paper, it was here all the time.

Now, should not there be some way that that taxpayer could be reimbursed for the expenses they have incurred when Internal Revenue had the papers properly filed, the entire 6 or 8 months that they were trying to collect or say that there was a deficiency?

I mean should not the taxpayer have some type of reimbursement other than being able to take his $500 worth of additional attorney fees, or the CPA fees off of his next year's income tax?

Mr. BROWN. Mr. Hancock, if I understand the situation you are describing, I do not think it happens all that often, but it probably happens some times.

Mr. HANCOCK. Yes, it happens some times.

Mr. BROWN. And that when it does happen, I am told that we have some discretion to allow for small amounts to be paid to compensate taxpayers who are in that situation, under section 7430 in current law, as long as they have gotten to court.

Mr. HANCOCK. Well, what if you have a situation though where you cannot even get anybody to agree it ever happened. It happened but nobody says, well, we do not know, everything is OK.

Mr. BROWN. That is a much harder case for us because then we have two different people telling us two different stories.

Mr. HANCOCK. But you are telling me that there is a remedy for this type of situation.

Mr. BROWN. I was not completely aware of it until just now, but I am told that it happens on a fairly regular basis, we do allow small claims like that to be paid when taxpayers can convince us that it really was our fault that something got lost.

Mr. HANCOCK. Can you cite for me the code section that allows that?

Mr. BROWN. I can provide that to you later.

[The following was subsequently received:]

SERVICE'S AUTHORITY TO REIMBURSE TAXPAYERS

Question. At the hearing, Representative Hancock posed the following factual situation and question. A taxpayer files the proper papers, presumably for a correspondence audit, and the Service makes an obvious mistake and loses them. The Service does not provide any person that can resolve the matter and issues a Notice of Defi-

ciency. After the notice, the taxpayer hires an accountant or attorney, who files a power of attorney and tries to convince the Service of its error. Finally, the Service admits its error. The question posed by Representative Hancock was whether the Service could "reimburse" the taxpayer for the expenses.

Answer. As both the Commissioner and the Chief Counsel stated at the hearing, the present formulation of I.R.C. § 7430 allows the Service to reimburse the administrative costs described. Section 7430(a)(1) and (c)(2) address the situation where, after the issuance of a notice of deficiency as described here, costs are incurred. That statute provides for the allowance of reasonable administrative costs where the position of the Service in the notice of deficiency was not substantially justified. Clear administrative errors resulting in an unwarranted notice are obviously not justified. Reasonable accountant or other representative's costs are included in the allowable award amounts. I.R.C. § 7430(c)(1)(B)(iii) and (3). The Service can allow these costs without the taxpayer going to court or the court can require the Service to pay them. I.R.C. § 7430(f) (1) and (2).

The Service has promulgated regulations providing for taxpayer applications for administrative costs after resolution of the merits of the tax liability. Treasury Regulation § 1.7430–2 provides for the filing of the claim with the office that resolved the merits of the tax, or with the district director if the office is not known. The contents of the claim and the procedures for resolving the claim are clearly set forth in the regulations. Treasury Regulation § 1.7430–2(c)(3). These claims are normally handled by the Appeals division administratively following internal procedures published in Internal Revenue Manual (IRM) 8465.

Ms. RICHARDSON. And I think, Mr. Hancock, just to make clear, I think that that provision, as Mr. Brown said, is applicable once a case gets into court. We would certainly be willing to work with you and the staff to try to come up with something that might be equitable through the administrative process.

I think the problem is being able to define a standard that would be workable.

Mr. HANCOCK. Well, naturally they can go ahead and deduct their accounting fees or what have you, but they ought to get the full amount, not just the taxable amount of that deduction. That would make it a little bit more palatable.

Thank you.

Chairman JOHNSON. Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman.

Mr. Monks, I am trying to get a better understanding as to how your office operates and I understand that you handle different types of cases, some that are more involved than others.

I would like to concentrate on the TAO's, taxpayer assistance orders. If I understand your written testimony, you receive approximately 33,000 requests a year where the taxpayer has alleged significant hardship. And you have received since the inception of the TAO's about 150,000 requests.

Could you give me some indication of how many of those have led to your intervention and actually issuing taxpayer assistance orders?

Mr. MONKS. The application for a taxpayer assistance order is filed either by a taxpayer representative or by a Service employee when a taxpayer comes to them with a situation that appears to be a case of significant hardship.

We process all of those cases and in approximately 80 percent of the cases have found a form of relief of some sort for the taxpayer.

There are some cases where a——

Mr. CARDIN. A form of relief——

Mr. MONKS. Full relief or partial relief of the circumstances that created the hardship.

Mr. CARDIN. Without the need of formal——

Mr. MONKS. Without the need for the formal issuance of a taxpayer assistance order.

Mr. CARDIN. In those 80 percent of the cases, have you satisfied the taxpayer or you have satisfied yourself that the issue is resolved?

Mr. MONKS. I think both. In the vast majority of the cases, hardship is found and a change is made in favor of the taxpayer.

In some cases, we may not find that significant hardship exists, but it may meet the other criteria for a PRP case and we work that case and try to resolve the issue that led to the taxpayer coming to us.

Mr. CARDIN. And what difference is that from the 400,000 that you handled through the normal routine?

Mr. MONKS. The 400,000 cases refer to our problem resolution type cases. Those cases generally come to our attention as a result of a taxpayer having to contact us a second time on the same issue. Perhaps there has been a system breakdown, perhaps there has been a response promised to the taxpayer that was not made timely. Again, practitioners and Service employees have been trained to recognize those situations and refer those situations to problem resolution.

So we can look at the system that created the problem and try to determine what caused the problem.

Mr. CARDIN. So your 80 percent are screened through informal methods of resolving the problem; what happens to the other 20 percent?

Mr. MONKS. Let me go back. Those are the applications for taxpayer assistance orders.

In some cases the relief cannot be provided and we advise the taxpayer of the action that has been taken to research their account and let them know what the situation is. There are other situations where the relief is denied because it is barred by a statute or it is not the appropriate action to take.

Generally, when a case comes in, we discuss it with the function involved. For example, it may involve a collection issue. We discuss the issue with the taxpayer, and with the collection function and determine the most appropriate course of action to take.

Mr. CARDIN. How many cases actually end up where you have to issue an order?

Mr. MONKS. Not very many. In calendar year 1993 we issued 65 taxpayer assistance orders, and in calendar year 1994 we issued only 12. But again, generally these cases are discussed with the function involved and resolution is reached informally. Let me cite an example involving a collection issue.

We may reach a determination mutually that the case could be resolved better. The taxpayer's hardship can be relieved by granting an installment agreement instead of perhaps a levy on that particular account at that point in time.

So, in many cases, the resolution is reached informally without the need for the filing of a taxpayer assistance order.

Mr. CARDIN. And only 12 cases in 1994 you were unable to resolve the issue with the IRS then?

Mr. MONKS. And the taxpayer assistance order was subsequently issued.

Mr. CARDIN. Well, either you are very, very efficient, or there is not much independence from the agency. You could draw one of two conclusions from that.

Mr. MONKS. Well, what I would like to believe is that the problem resolution officers have been very effective in making their case, because again, on 80 percent of these cases we do provide relief to the taxpayers.

Mr. CARDIN. What standards do you use to issue an order? When will you issue an order?

Mr. MONKS. We would issue an order if we felt that the taxpayer presented a compelling case, we had presented our arguments to the function involved and they did not agree with us, and we felt strongly about the position that we were taking.

We would issue a taxpayer assistance order if we felt that that was the correct procedure to take and that there were no other ways to relieve that hardship.

Mr. CARDIN. And that happens in 12 cases out of 33,000 a year?

Mr. MONKS. That was the case for 1994.

Mr. CARDIN. Thank you.

Chairman JOHNSON. Mr. Monks, I would like to request a copy of the TAO's issued by the ombudsman for my safe, and a summary of the orders that were issued that would be available to the committee.

Mr. MONKS. The orders were issued by problem resolution officers in our field offices, but I can provide that.

Chairman JOHNSON. If you would provide an edited version for the members and then provide the cases, themselves, for the safe, I would appreciate it.

Mr. MONKS. Yes.

Chairman JOHNSON. Thank you.

[The following was subsequently received:]

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAXPAYER OMBUDSMAN

April 26, 1995

The Honorable Nancy L. Johnson
Chairman, Subcommittee on Oversight
Committee on Ways and Means
1135 Longworth House Office Building
Washington, DC 20515

Dear Madame Chairman:

At the hearings you conducted on March 24, 1995, you requested that I provide you with copies and edited versions of all Taxpayer Assistance Orders (ATAOs) issued during 1994. At that time, I informed you that there had been twelve (12) TAOs issued during 1994. When gathering the information, it was discovered that one of the TAOs had been incorrectly coded; therefore eleven (11) TAO were issued during 1994. Enclosed are copies of the 11 TAO files and a synopsis of the 11 files with identifying information deleted.

If you have any questions, please contact me or a member of your staff may contact my Executive Assistant, Tom Tiffany. We may both be reached at 202 622-6100.

Sincerely,

Lee R. Monks

Enclosures

TAXPAYER ASSISTANCE ORDERS (TAOs)

1. Case #1

This taxpayer is 73 years old and in poor health. She did not file a tax return for tax year 1991. Based on information reported to I. R. S., we prepared a tax return for her under Internal Revenue Code Section 6020(b) showing social security income of $8,578,00, dividend income of $15.00, interest income $1,711.00, and gross distributions from pension funds of $18,539.00 and $2,009.00. The tax due based on this unreported income is $2,501.00, plus penalties and interest from April 15, 1992. The taxpayer was very upset when she received the proposed tax assessment. She contacted her local office with a Form 911, Application for Taxpayer Assistance Order. I.R.S. did not locate any prior year liabilities. The Problem Resolution Officer (PRO) decided that the taxpayer's situation warranted relief. The PRO set up a meeting with the Examination Division to request the additional tax not be assessed due the taxpayer's age, poor health, and financial situation. Examination insisted the tax must be assessed. The PRO determined that a TAO would be necessary. A TAO was issued, Examination did not contest and the tax was not assessed.

2. Case #2

This taxpayer is 72 years old. She had major surgery three times, 1991, 1992, and 1993. Her only recreation and enjoyment is playing bingo. Her bingo winnings were reported to I.R.S. and additional tax was assessed for tax years 1990 and 1992 by Examination Division. Additional tax was proposed for tax year 1991 by Examination Division. The taxpayer contacted her local office with a Form 911, Application for Taxpayer Assistance Order, because she did not have the ability to pay the additional tax assessed and the tax proposed to be assessed. The taxpayer met with the Problem Resolution Officer (PRO) and gave her an affidavit stating that she spent any bingo winnings on additional bingo games and on auto expenses, etc. to travel to the Indian Reservations where the bingo games were held. She can no longer attend the bingo games as she is elderly, in poor health, and her sister-in-law, who drove her to the bingo games, is now deceased. The taxpayer owns no property and her only income is social security. The PRO determined that relief was warranted. A TAO was issued and the tax for 1991 was not assessed. The tax for 1990 and 1992 was determined to be currently not collectable and will not be pursued.

3. Case #3

This taxpayer owed a joint tax liability for tax year 1982 with her former husband. The taxpayers divorced in 1985 and the taxpayer wife was awarded the personal residence in the divorce settlement. Notice of Federal Tax Lien (NFTL) was filed for the 1982 joint liability, however, the divesting of the taxpayer husband's interest in the personal residence was never recorded. Therefore, the full lien attached to the personal residence. When the Service began seizure action for payment of the taxes due, the taxpayer wife filed a Form 911, Application for Taxpayer Assistance Order (ATAO). The District Office Problem Resolution Officer issued a TAO to settle the matter. The TAO instructed the taxpayer wife to full pay her portion of the 1982 joint tax liability ($17, 233.39), which she did on March 30, 1994 and the NFTL on the personal residence was discharged on July 7, 1994.

4. Case #4

The taxpayer is a clothing business, delinquent on quarterly returns and payment of Federal Tax Deposits and prior taxes. The Revenue Officer has attempted to work with the taxpayer and set up payment plans but the taxpayer has repeatedly not complied. The Revenue Officer was going to seize the business. A TAO was issued to stop the seizure. After review by the District Director, the TAO was rescinded.

5. Case #5

This taxpayer is the mother of new born twins and a 4 year old child. She is single and currently is unemployed and receives only Aid to Families with Dependant Children (AFDC). Her telephone is about to be disconnected and she needs to buy food for herself and her children. Her income tax refund from a prior year is to be offset to a tax liability of her ex-husband. A TAO was issued to provide the taxpayer her refund to purchase food and pay her phone bill.

6. Case #6

This taxpayer is homeless, in desperate need of refund. Currently staying at local motels, one day at a time. There is an outstanding balance due from a prior year. Issued a TAO to provide taxpayer refund and bypass balance due.

7. Case #7

These taxpayers are in need of their refund due to imminent foreclosure because they are 3 months in arrears on the mortgage payments. Their car was stolen with no insurance and recovered with a blown engine. A prior balance due is shown (debtor master file DMF) for child support owed by son who has used father's SSN. Child support enforcement agency verified that this taxpayer does not owe the child support. A TAO was issued to provide a manual refund and bypass erroneous liability.

8. Case #8

This taxpayer suffers from severe depression and has threatened suicide on several occasions. He is responding to psychotherapy and medication. A Revenue Officer set up a wage levy agreement of $543.00 per month which the taxpayer cannot afford. A TAO was issued to reduce the wage levy to $125.00 every pay period ($250.00 per month) so that the taxpayer can afford to continue medical care.

9. Case #9

This taxpayer was a non-filer. Tax returns for 1988, 1989, 1990, 1991, and 1992 were secured with current tax and accruals due in excess of $6,000.00. The taxpayer is 84 years old (as of October 1993). She made an Offer in Compromise which was rejected. She paid $700.00 with the offer. Almost simultaneous to the offer rejection, the Revenue Officer filed a levy on her wages (she was still employed at this time). Because the taxpayer was not given her appeal rights or an appropriate time to respond to the offer rejection, she filed a Form 911, Application for Taxpayer Assistance Order (ATAO). Based on the taxpayers health, age and doubt as to collectability, a TAO was issued to release the wage levy.

10. Case #10

The taxpayers are principals of a Sub-chapter S Corporation with a personal tax liability for tax year 1992 in excess of $39,000.00. They entered into an installment agreement with the Andover Service Center of $1,300.00 per month. The taxpayers requested that no Notice of Federal Tax Lien (NFTL) be filed as they planned to use personal assets as collateral for a loan to pay the taxes. It was evident that the taxpayers had not made adequate estimated tax payments or withholding allowances for the tax resulting from the reported $224,411.00 adjusted gross income

(AGI) shown on their 1992 tax return. Therefore, Collection denied the request and advised the taxpayers that the NFTL would be filed. A TAO was issued to delay the filing of the NFTL until February 4, 1994. The taxpayers agreed to an immediate payment of at least $5,000.00, agreement to a very short term installment agreement, and to furnish I.R.S. with complete financial information (both personal and corporate).

11. Case #11

These taxpayers desperately need their refund which is being offset to the Department of Education for a student loan which the taxpayers claim was repaid in 1984. The husband is currently unemployed and they need the refund to avoid foreclosure on home, continuance of health insurance, and to avoid utilities being disconnected. The taxpayers have a disabled child who needs to be on an electrically powered feeding apparatus 18 hours per day. A TAO was issued to provide refund and bypass Debtor Master File offset.

Mr. Zimmer.

Mr. ZIMMER. Thank you very much, Madam Chairman.

Commissioner Richardson, there was a problem that has been brought to my attention by a police detective who lives in my district. He pointed out that because the mailing label on the forms 1040 include the taxpayer's Social Security number, there is a real possibility of fraud being committed on the part of people who see that label in the mail.

I will not describe the kind of fraud that he said was possible in public, but you can imagine, I suppose. And because he is involved in prosecuting this sort of fraud, he believed that it was foolish for the IRS to include this ordinarily confidential information on a document which is seen by so many people.

Can you explain why the Social Security number is made available in this way?

Ms. RICHARDSON. Mr. Zimmer, we are also concerned about it, and in fact, have been trying to take steps to address it. I think a number of tax packages did not have the Social Security number on the outside this year.

I just became aware this morning of your specific question. I would like to get you the information about what we have done to address it, not just this year, but what we are doing longer term to eliminate that because we are very concerned about it. It is an issue that has been raised.

I think a lot of the problem about addressing it has been a technological one, because of the way our processing systems work. But I will let you know specifically. And we certainly concur with his concerns about fraud. I feel like I know a lot about that subject right now.

Mr. ZIMMER. It is your intention to eliminate this practice?

Ms. RICHARDSON. Absolutely.

Mr. ZIMMER. Can you give us an idea of how soon that will be done?

Ms. RICHARDSON. I will get you the specific information of how we are doing it. Some of it was done this year actually.

Mr. ZIMMER. Thank you very much.

Ms. RICHARDSON. Okay, thank you.

[The following was subsequently received:]

SOCIAL SECURITY NUMBERS [SSN'S] ON LABELS

IRS has received comments from taxpayers concerning the SSNs used on mailing labels for the tax packages. It is our experience that returns filed without the preprinted IRS label contain a high percentage of errors in the entry of the SSN, such as transposed characters and other mistakes. Such errors cause both the IRS and taxpayers unnecessary delays in processing these returns and in issuing any refunds that may be due.

IRS appreciates the privacy concern and is advising taxpayers that IRS mailing labels contain SSN's only when necessary and that the practice conforms to the requirements of the Privacy Act. Nevertheless, because of the privacy concerns raised by taxpayers, we are currently exploring and implementing, where possible, methods to hide or camouflage the SSN whenever technology and production costs permit.

Currently, the SSN is not visible on the outside cover of over 22 million individual tax package postcards, over 7 million individual tax packages and 18 million form 1040ES tax packages. The outside of the tax product contains the taxpayer's name and address and the complete mailing label with the SSN is inside the tax product.

For tax year 1995, the individual tax package postcard program (with the SSN concealed) will be expanded by 10 million. IRS plans to continue to expand the con-

cept of concealing the SSN for all tax packages. However, there are two concerns. First, the production cost of the tax packages will increase. The second concern is with the printing industry capacity for this technology (inkjet image) and the critical paper shortage.

IRS will continue to bid all individual tax package production contracts with the specification for concealing the SSN. And, as long as price increases are reasonable and production capacity exists, IRS will conceal the SSN on all 1995 Individual Tax Packages.

Note: For Tax Year 1994 there were approximately 80 million individual tax packages with the SSN displayed on the outside label.

Mr. ZIMMER. Next, I would like to bring up an issue related to taxpayer compliance. I suppose either the Commissioner or Ms. Beerbower can respond to this. Does the IRS recognize the concept of an accountant-client privilege?

Ms. RICHARDSON. Actually, no, we do not. I will let my lawyer answer that.

Mr. BROWN. No, we do not.

Ms. RICHARDSON. But, no, we do not.

Mr. ZIMMER. So that means that the IRS can request all the documents that are in an accountant's possession, including those given to the CPA by his client, and it would also mean, I suppose, that the IRS could force an accountant to testify against his client?

Mr. BROWN. Yes; that is correct.

Mr. ZIMMER. Now, if the client went for professional advice to a tax attorney, instead, that information would be privileged?

Mr. BROWN. I think it depends on the situation. Give me a minute. I think the answer is that the tax system is not unique in this respect. And we follow the rules that apply in Federal litigation generally, and so, to the extent there is an attorney-client privilege recognized generally in Federal litigation, we would respect that as part of the tax administration process as well.

To the extent that that differs from the privilege that is recognized for accountants, we also follow that difference.

Mr. ZIMMER. Now, does this not have an impact on the ability of people to get their tax advice, their tax planning consultation with a professional of their choice? The exact same information, the exact same services, in many cases, are provided, yet, in one case the communications are protected, and the other case they are not.

Now, I understand the general principal and I understand the attorney-client privilege is more universally recognized, but can you explain the public policy grounding for this position on your part?

Mr. BROWN. I can explain our position only to the extent of saying that we have followed the general principles that apply across-the-board in other Federal litigation.

And, second, we have a principle that we try to stay out of the disputes between the lawyers and accountants over who has the market for providing tax advice. This comes up in a number of contexts over time, including the question of what can accountants do in litigation, particularly in Tax Court. The question of privilege is another aspect of it.

And we generally try not to get put in the middle of those disputes.

Mr. ZIMMER. But your neutrality, in effect, has an impact on taxpayers and the policy, as it exists, would encourage taxpayers to go to tax lawyers rather than accountants.

Mr. BROWN. Let me be clear on this. The attorney-client privilege we recognize is no greater than the attorney-client privilege that we recognize generally.

So, for example, to the extent that you went to an attorney to prepare your return, the information you gave to the attorney for that purpose would not necessarily be privileged.

Mr. ZIMMER. I understand that.

Mr. BROWN. But I think in fairness to your question, there are some differences in the rules. And those rules might benefit attorneys relative to accountants in certain situations. I don't doubt that.

Mr. ZIMMER. Thank you very much.

Thank you, Madam Chairman.

Chairman JOHNSON. I would like to raise the issue of the problems involved in joint and several liability. And Mr. Monks, this surely must touch on many of the problems that you get, but Commissioner Richardson may also have some comment.

Where there is joint and several liability among two or more taxpayers, problems often arise as to which taxpayer is actually morally obliged to pay the debt.

In case of a missing spouse, under current law the incentive for the IRS is to go to the spouse that is quickest and easiest to find. That is often the divorced wife who stayed in the home.

There is no incentive at all for the IRS to find, to locate the other party that may simply be difficult to locate only because they don't bother to respond to IRS letters.

Sometimes this results in tremendous penalties building up and liabilities. Should the IRS be required to at least attempt to locate all jointly liable taxpayers, should they be required by law to try and collect from both taxpayers?

You must see a lot of these cases. I ask this because I see these cases in my district office. I think every Member of Congress does. And there are terrible inequities that occur in these situations.

Have you made any recommendations, Mr. Monks, as to how to deal with them? Is the IRS developing any new policy as to how to deal more equitably in these situations of joint and several, especially when there is often clear evidence of who actually is liable?

Mr. MONKS. We do receive a number of cases of that nature, and, generally, what we try to focus on is that individual taxpayer's specific circumstances. We try to look at their situation and to provide the most appropriate relief.

Chairman JOHNSON. When you say, look at their situation, do you mean looking at their ability to pay?

Mr. MONKS. No, no.

Chairman JOHNSON. Do you mean looking at——

Mr. MONKS. We look at their situation of hardship and what has led to that hardship. And we try to investigate the facts behind that situation. We may end up, as a result, communicating with other IRS offices about that case and what action is being taken.

But you are absolutely correct. A number of situations do come to a problem resolution officer specifically citing those kinds of concerns. I currently have a group in one of our regional offices taking a look at this specific issue. We have had a number of recommendations that have come in from various field offices and

what we are trying to do is to put that together and develop a comprehensive package that we can submit to the Commissioner. It will have more specific recommendations on what the Service might be able to do in this particular area.

It is of concern to us. It represents a major portion of the problems that do come into problem resolution and it is a very difficult situation for us to deal with.

Chairman JOHNSON. Commissioner, do you care to comment?

Ms. RICHARDSON. Yes, Madam Chairman. I think that we clearly should be looking at both taxpayers. In a situation where parties are jointly liable, we should be making equal efforts to try and find both parties. And, clearly, the one who has the best source of leviable income is probably the one we should look at first.

I think this is a good opportunity to mention something that we have begun implementing this year. It is what we call our early intervention program, we are trying to get to people much sooner than we once did. And that, I am hopeful, will address some of the problem.

But it also, I think, is an opportunity to make another commercial for improving our technology. To the extent that we can have up to date records, up to date information, including addresses, and can make on-line changes to that kind of information, we will be in a much better position to locate both of the parties and assure that they discharge their joint liability promptly.

Chairman JOHNSON. I would ask you to accelerate your working groups' focus on this issue. I think this is something that is very important to address because it does touch so many families. Most of them at a time in their lives when they have very, very meager resources.

I also want to put in the record that my office has had excellent success in referring people to your problem resolution officers.

Ms. RICHARDSON. Thank you.

Chairman JOHNSON. And that has been a real Godsend in these cases, both in terms of their timely response, and the fairness of their management of these problems.

So I know that you are making efforts. I just think we need to clean this up and if you could help us on that, the taxpayer bill of rights might be a very good place to attack that.

One last question that I would like to put on the record and then I would be happy to yield to my colleague, Mr. Cardin, if he has additional questions.

Under current law, taxpayers can't appeal collection decisions. And sometimes their first knowledge that there has been a problem is the notice of a lien on their property. Now, this can have catastrophic effects especially if you are a small businessman and you depend on regular revolving loans to fund new orders, and things like that.

And once that lien gets on, they are very hard to remove and it costs money to remove them. There is no notice of deficiency. I really think this issue is very important from the point of view of the taxpayers. It also goes to the resolution of these problematical cases that Mr. Monks office deals with.

People are not satisfied that they never hear back about what did happen in a timely fashion. On that issue of responsiveness, could you comment?

Mr. MONKS. On the issue of the collection appeals matter?

Chairman JOHNSON. Well, and should there be a formal IRS collection appeals process?

Mr. MONKS. We have just concluded a fairly lengthy test of a collection appeals process and a number of recommendations have been made to the Commissioner.

Ms. RICHARDSON. Well, they have not yet been made. They are in the process of being made.

Mr. MONKS. They are in the process of being made.

Ms. RICHARDSON. We hope to be able to make some decisions on that program within the next month or month and a half.

Chairman JOHNSON. I think this also would be a very appropriate focus of a taxpayer bill of rights because there are snarls that are causing real hardship.

Ms. RICHARDSON. It is clearly an area we have addressed in the last 18 months. We have done a test and we are in the process of evaluating it. We will be getting those recommendations in the next month or so and making a decision.

We will be happy to share those conclusions with you.

Chairman JOHNSON. I hope you also will consider allowing taxpayers to seek injunctive relief if they haven't had notice. So that they can stop a process that is destructive to them if they feel they have not been a part of resolving it.

I look forward to hearing from you on those issues, and I yield to Mr. Cardin.

[The following was subsequently received:]

IRS WILL SHARE CONCLUSIONS ABOUT COLLECTION APPEALS TEST AT LATER DATE

Commissioner Richardson is in the process of reviewing the report of the Collection Appeals Test and is considering recommendations. We will share our conclusions with Chairwoman Johnson as soon as they are available.

Mr. CARDIN. Thank you. Just for the record, I would ask the IRS and the Treasury to give us some ideas or thoughts on how we could expand the opportunity under the taxpayer bill of rights.

I think the taxpayer bill of rights is going to move legislation in this area. There seems to be strong bipartisan support for the legislation. But, perhaps this is also an opportunity to move forward in two other areas which you have both mentioned and which are important to taxpayers.

That is modernization, as well as tax simplification. I would be curious as to whether you would have some recommendations—I am not asking you to respond now, but to think this over and respond if you would later—as to some specific provisions that we may be able to include in the taxpayer bill of rights legislation to focus in on procedures to simplify the Tax Code with regards to common complaints by taxpayers, as well as providing the wherewithal to modernize the capacity of the IRS.

And if you could get back to us on that I would appreciate it.

But the second point, if I might, following up on Mr. Zimmer's point, I think it would be useful for us to know when we could expect Social Security numbers to no longer be on mailing labels. So

if you could get back to us with the specific date on which that practice would be terminated, I think that would be helpful for us.

[The following was subsequently received:]

DATE FOR REMOVAL OF SOCIAL SECURITY NUMBERS FROM MAILING LABELS

The IRS will be able to conceal the SSN on all 1995 Individual Tax Packages as long as price increases are reasonable and production capacity exists.

Chairman JOHNSON. I thank the panel for your participation this morning, your good testimony, and for your agreement on a lot of the things we are trying to do. We did not spend much time on the areas in which we are in agreement that we can move forward and I thank you for that agreement.

We will be submitting some additional questions for the record. We just do not have time to get to them today. And we will look forward to your answers on that, and we will look forward to your follow-up on some of the things that you are working on that we believe will fit into our work.

Thank you very much.

Ms. RICHARDSON. Thank you, Madam Chairman.

Chairman JOHNSON. The next panel will come forward, Jeff Jaeger of the Rutherford Hill Winery, from Napa Valley, Calif.; Georganne Howden, Houston, Tex.; Richard Beck, professor of law, New York Law School.

And we will start with Mr. Jaeger.

STATEMENT OF JEFF JAEGER, MANAGING GENERAL PARTNER, RUTHERFORD HILL WINERY, NAPA VALLEY, CALIF.

Mr. JAEGER. Madam Chairman and members of the subcommittee, my name is Jeff Jaeger, and I am here to talk about some IRS tactics used on my family's business that I consider to be extremely unfair treatment that makes honest taxpayers angry at government and those who created the system.

My company, Rutherford Hill Winery, is in the fine wine business in California's Napa Valley. We consider ourselves a small business, and although it may sound glamorous, it is very hard to make a profit in it.

The profits become simply impossible when we must spend $85,000 in attorney's fees to beat an insupportable IRS tax assessment, then are denied the recovery of $70,000 of those tax fees in court.

We have been audited by the IRS before several times. We have never lost a dime to the IRS when we have been audited because our tax accounting systems are sound.

In our recent tax court case, the IRS conceded every single item that they had assessed against us, but we still lost big money on the attorney's fees because of the coercive and deceptive practices of the IRS.

The main tax issue in our tax case was about our single pool LIFO (Last-in-first-out) inventory valuation method. It is the same method we had used from our beginning, 15 years earlier; the same method used by many of our competitors, including our sister winery, that cleared an IRS audit the same year with an identical LIFO situation; and a method that reflects income as well as any

other inventory or valuation method there is for our type of business.

According to tax law, the choice of the LIFO method is a taxpayer's. The IRS agent assigned to our case liked other pooling methods and wanted to force her choice on us.

Her approach was not only novel, but it created serious disagreement even within the IRS. However, she was allowed to send us the equivalency of a deficiency assessment notice. In saying this, I recognize that the Internal Revenue Code gives the Commission broad authority to change a taxpayer's accounting method if it does not clearly reflect income.

But the Code does not permit the Commissioner to order a change simply because an IRS agent thinks that a different method might reflect income more clearly. That, however, is exactly what the IRS was trying to do here.

Partway into our preparation of the tax court case, two issues unrelated to the LIFO issue were conceded to us by the IRS but not before we spent serious money getting ready to defend them.

It has now become clear that the IRS never intended to litigate our case at all. The agent on our case and her IRS cohorts were trying to force a different inventory valuation method on us, one that was neither accurate nor practical.

The agents were using the IRS's current protective shield against recourse to try and intimidate us into submission, even with an unwinable tax case, knowing it would cost us dearly to defend ourselves.

This is government gamesmanship at its worst. It was the agent's hope and the hope of her cohorts to pick on a few wineries, get them to concede, and then use those concessions, as they would use a tax court case, to coerce other wineries to change their methods to those preferred by the agents.

It is only natural that the IRS would not want to pick on too many wineries at once for fear that the wineries could join together and better defend themselves. Instead the agent used the old "divide and conquer" technique even without a legally supportable test case.

The fact we know now is that the IRS would not, in fact, could not possibly have gone to trial with our case. That does not mean that we knew of their intentions earlier. We had to assume there would be trial and we had to prepare for it. That preparation was extensive and expensive. We now feel like someone who had been held up by a man with an unloaded gun. Not only were we robbed, we were deceived as well.

Our case may sound as though we were an unlucky taxpayer singled out as a guinea pig by the IRS in its efforts to create government-favored retroactive tax law. While the practice of allowing the IRS to get pro-government court opinions, after the fact, is always unfair to tax planners, that is not what happened to us and not why I am here today.

The IRS was far more sneaky than that in our case. For us, the IRS proposed a tax adjustment that it could not possibly substantiate. Its proposed changes were so seriously flawed that it knew it could not dare to go trial.

Knowing there would be no trial, the IRS attorneys made no real trial preparations, but kept up a pretense that they were ready for trial.

The sole reason the IRS attorney kept the case alive was their hope we might concede enough to give the IRS an appearance of victory which it could then use to coerce concessions from other taxpayers.

Because present law makes the recovery of attorney's fees virtually impossible in tax court cases, no matter how ridiculous the Service's case, IRS agents and attorneys had no fear of proceeding with their "mission impossible" case against us. They faced no prospect of losing money, no consequent exposure of the bureaucratic bungling and chicanery, no risk at all in proceeding with their extortion plan against us, because in the end they would be accountable to no one. It was a no-lose proposition for them; it was a no-win proposition for us.

With the law, the way it is written now, we decided that pursuing an appeal to get our attorney's fees would likely be throwing good money after bad. It is never easy to get an appellate court to reverse a tax court decision and when the tax court reads the law to say that the position of the IRS is substantially justified in virtually all instances, no matter how far-fetched, and unfounded the IRS' legal theory may be, then the taxpayer stands no chance at all of getting reimbursement for attorney's fees. We thought it better to bring the case here, to this committee, in the hope that Congress would be more inclined to see that justice is done for the taxpayer when the IRS proceeds in bad faith.

Currently the Congress is searching for a way of dealing with the unfairness of the American legal system, where winners must now shoulder their own legal expenses, even though they win their case. To extend that search for fairness to legal actions involving the Government is only logical and just. The opinion in our tax court case denying us attorney's fees is not only another nail in the coffin of justice, but it is also a masterpiece of bureaucratic double talk.

The Service was well served, but justice surely was not. On behalf of businesses nationwide, my hope is for a change that would award attorney's fees to a petitioner in tax court any time the IRS answers the petition, reaches no settlement with the taxpayer, then fails to take the case to trial.

Furthermore, I hope Congress will seriously consider establishing a presumption, if not a rule, that attorneys' fees will be awarded to a taxpayer any time that taxpayer wins his tax court case.

Thank you.

Chairman JOHNSON. Thank you for your excellent testimony. It is sobering.

Ms. Howden.

STATEMENT OF GEORGANNE HOWDEN, HOUSTON, TEX.

Ms. HOWDEN. Thank you. Chairman Johnson, thank you for having me here. I feel my story is kind of simple. In 1985, I was divorced after 21 years of marriage. I was a high school graduate and married early and had kids early and never worked outside the home.

I never saw or signed a tax form. My husband made the money and he did not think it was my business to know what money he made or how he dealt with it.

In 1985, I filed for divorce and I got a job in retail. In 1986, in December of 1986, I got a notice from the IRS of some tax due and it was $600 or $400. It was in the hundreds of dollars.

I asked my attorney about it. At that point I wrote a letter to the IRS stating that I was in the process of divorce, that I was still in the family home, what his address was, the attorney's and mine.

My divorce was final in 1987. In that divorce my house was awarded to me. It was filed in the district court clerk's office. My attorney told me to file it in the property records and the tax records in Harris County. I also sent a certified copy of my divorce decree that stated the house was mine, to my mortgage company.

That was in September 1987. In January 1988 I went with my divorce lawyer down to the IRS because during my divorce I became aware of tax liabilities. I went down to the IRS and met with an agent there. And showed my divorce decree and she asked that I try to borrow money on the equity in my home. I went to three banks to do it, and it was kind of a bad time in Texas right then.

And with my lack of job history I was unable to do that. I also filled out the forms necessary, giving all my financial information. I was awarded this status of uncollectible.

At that time, the decision I made was because I had a son at home, 11 years old, and he wanted to stay in the house he had grown up in. And so we decided to try to make it there.

So a month at a time we stayed in the house, and because the only thing I had gotten from my divorce of any value was my home—I was unable to collect on the other things that were awarded—I thought, well, I'm putting a lot of money in the house, but I can get it out when I sell it, you know.

So I planned to keep it until he graduated from high school and then, at that time, sell my house—4 years passed. The only thing that happened that I got notification from, from the IRS, in those 4 years, was in 1991.

That was the first year of 3 years that I received notice that my $1,000 refund on my income tax was being applied to another person's Social Security number. And I assumed it was my husband's.

So I thought, well, that is fair. I am uncollectible, they can have my refund. In December 1991, I received a call on my answering machine from the problems resolution officer in Austin, Tex., which is our capital.

And it scared me to death. So I talked to a friend and he recommended a tax counselor, who is accredited with the IRS and he was a retired IRS officer of 30 years or something.

So I went down and hired him because I couldn't afford an attorney to counsel me. We had a series of meetings going over my problem.

And what we came up with during those months was I could either get an attorney and go to court, or I could sell my house. But the problem that came up when he talked to the IRS in Austin was they were going to take the house for the taxes from my marriage, but also my ex-husband had not filed any taxes in the years I had been divorced.

And they decided that somehow they figured out he owed $100,000 in income tax, and the IRS was going to take this stance. They said that the house was still his. And if they took that stance, it would take every bit of the equity, plus some, but then I would also end up owing about $15,000 in capital gains tax. So it was a lose-lose kind of deal for me.

In July 1992, I came home from work and found this seizure notice on the front door of my house. I had decided to sell my house after talking with my tax consultant, and see if the IRS would not be reasonable about his taxes.

So I had a for sale sign out and the seizure notice on the front door which does not do much to sell your house. And that was a shock. I had had no notice of this.

The next month I was in Austin and I decided to go and see the tax collection group manager who was handling this case. I happened to be in town, and I thought what do I have to lose?

So I went to see him and to discuss my problem with him. It was not very long after I arrived I found out that my case had turned into a personality issue not a principal issue.

And that my ex-husband had made him very angry. He said because my house records were not filed, my divorce records were not filed in the Harris County clerk's record, that he considered the house still joint property.

When I said, I would like to sell the house, because I knew I could gain more money that way in a forced sale. He said, you sell it, we are glad you do that, we will get more money.

He told me a lot of information about my ex-husband I did not know and said he would deny ever telling me that. He discussed his personal problems, but at the end of the conversation—and I listened like a lot of women do hoping to get some compassion—he said, you are going to lose it all and you just start all over again, and your capital gains you can pay out over time.

I was really in a no-win situation and though I am shaky, I am OK about all this today. In August 1992, the Republican Convention was being held in Houston, Tex., and I was fortunate to run into Donna Steele of Congressman's Archer's office.

And when she heard my case she was interested in looking into it and taking action for me. We started a long series of written communications. I was shocked that the IRS was so casual in their response to Congressman Archer. And it certainly made me realize I would have been wasting my money if I could have gotten an attorney, if they would not pay any attention to Congressman Archer.

The IRS held the position that the IRS was not a notified creditor, that they did not know about my divorce. And, in fact, I had gone in, personally, and showed them my divorce decree and it was filed everywhere that it was required in Houston.

In December 1992, the district director wrote and said he would take the proceeds of any voluntary or forced sale of my house for my ex-husband's $100,000 in current taxes, plus the amount of the 1992 taxes still owed from my marriage.

All through this process I was kept uninformed. I was never informed of any negotiation with my ex-husband toward the community debt from 1992. It felt real familiar, similar to my marriage.

November 1993, I got a call from an IRS office, saying that if I would pay all of the 1992 taxes, which was approximately $20,000 plus pay $10,000 additional they would release my husband's taxes off my home.

The problem I had with this was that I did not have any resources to come up with this kind of money because I could not sell my house because it was seized. So it was kind of a circular problem.

I, at that point, called my ex-husband—we do not communicate—in order to ask him if he would be willing—I had a judgment of unpaid child support for $50,000—and I asked him if he would be willing to buy that from me. That was my focus of the phone call.

At that point, he told me that a few months earlier he had made a settlement with the IRS. My ex-husband has a master's degree in engineering and he works for an engineering company. He has a home in Houston, a farm outside of town, cars, trucks, and an airplane.

He made a settlement with the IRS that they said he owed $99,286 so they asked him to pay $150 a month. And he thought it was a little foolish that I was having this trouble, that I could not resolve it. He sent me a copy of that.

I notified Congressman Archer about that discovery and think that that was probably the spark to the tinder. Congressman Archer wrote a very strong letter to the IRS and sent me the answer. Once again, I was amazed. They did not bother to answer most of his questions.

But they did say that out of respect to him they would release me from my tax liens if I would pay $17,600. So that is $15,000 in interest, and $3,500 in the 1982 tax that was due.

This was signed by the district counsel, the problem resolution officer, and the chief of the collection division. Two weeks later, I wrote the district counsel requesting a closure. I received no answer. That was December.

I was struggling with how to come up with the money and in March 1994, Mr. Archer suggested that I call the local Houston problem resolution officer, and try to set up a meeting. I got immediate response from them.

How I had managed to come up with money was that I sold my $50,000 child support judgment to an attorney for $17,500. I had a meeting with the IRS on March 28, 1994, and I was told I had a right to offer and compromise.

I filled out the papers. At the meeting 2 days later I was told I had no right to offer and compromise. That I had to pay the $17,500.

I paid the $17,500 and the 1982 taxes and I was told that I would receive a release of my home within a few days. This was March and I hoped to be able to sell my house during the summer when the sales are better. I was able to maintain my house until my son went to college, but after that it became very difficult to make ends meet.

And my credit rating was not the best. I am a real slow payer sometimes. I had to wait 5 months for that discharge. It came in August.

I lost the window of opportunity for sale for that year. Because I am in sales I do a little better over Christmas, so my house is on the market today. The problem resolution officer in Houston said that I could apply for a refund of some of the penalties and interest which I did do under her direction and her assistance. And she also included a letter of her struggle for the 5 months to get my house released.

For 5 months I received no answer. I resubmitted the letter. I got a call from the IRS that said I need to reapply on a different form but there was not really any reason to because they never refund.

I do plan to go forward with this. And without the intervention of Congressman Archer I would have a very, very sad story to tell here today. And I have found out that I am not the only person who has had this problem. And I do hope that I will be heard for not only myself but for others.

The system really did not work for me. Thank you.

Chairman JOHNSON. Thank you, Ms. Howden.

Mr. Beck.

STATEMENT OF RICHARD C.E. BECK, PROFESSOR OF LAW, NEW YORK LAW SCHOOL, NEW YORK, N.Y.

Mr. BECK. Madam Chairman and distinguished members, I am Richard Beck and I teach tax law at New York Law School. I appreciate very much the opportunity to be here and speak.

I have studied the problem of spousal tax liability for many years. I have written articles about it. I have worked with the American Bar Association about it, and I can tell you that the testimony you have just heard here is not an unusual case at all. It is very common for women to get stuck with their ex-husband's tax bills.

I have not been able to find out exactly how common it is because the IRS tells me they do not keep statistics. I once estimated that there are at least 10,000 cases a year in which collections were made from the wrong spouse. I think I was off by an order of magnitude. I now think there are probably from 50,000 to 100,000 cases a year.

To try to keep things short here, I disagree with some of the testimony that we heard earlier. I do not think that the answer to these problems is to improve the procedures for relief. I think the better approach is to cut the Gordian Knot completely, and end all spousal liability.

There is no reason in my opinion and in the opinion of the American Bar Association, ever, for one spouse to be liable for the taxes on income earned by the other spouse.

It should just be ended. I would like to point out that no other country in the world imposes this sort of liability. We are alone here in both kinds of liability that were suffered by Ms. Howden. Both joint and several liability for joint returns and community property liability for one-half of the other spouse's income are both virtually unknown in other countries.

Taking the easiest one first, the *Poe* v. *Seaborn* community property liability, there are many community property countries in the world. Not one of them uses family property law to impute income for tax purposes from one spouse to another, not a single one.

Canada had the same problem. They have a community property province in Quebec, and a gentleman there tried to do what Seaborn did here some 28 years before, and the Supreme Court of Canada came to the opposite conclusion. Spouses cannot split their income, each spouse is liable solely for the tax on his or her own earnings. I think that is the rule that we should have; we should repeal *Poe* v. *Seaborn*.

As for joint and several liability on joint returns, that rule dates from 1938 and there never was any good reason for it. The only reason the Treasury gave when it asked Congress for the rule after it lost in court, in 1935, was that it could not tell on a joint return whose income was whose, and therefore both had to be jointly liable for the full amount.

Now, that problem does not exist. In almost all cases it is very easy to determine whose income is whose. We have rules for that. And there were rules for that in 1935 when the Cole decision was made.

And even worse, at the very time that the IRS was saying it could not make these determinations it was, in fact, arguing that charitable contributions on joint returns should be limited by the separate income of each spouse on a joint return. In other words, the IRS knew full well how to separate the husband's income from the wife's income on a joint return when it was good for the government.

I would urge you to consider enacting the American Bar Association's proposal to end spousal tax liability. We have been considering these issues now for seven years in the ABA Tax Section. It is true that the innocent spouse rules could be improved in many ways, but we finally concluded that there is no principled place to draw a line.

The innocent spouse rules have been amended twice. They still do not work. The IRS now has the authority to ignore the husband and pursue the wife, even if the husband is readily available and has the money to pay. As long as the IRS has this authority, I think we can expect unfairness.

The law itself is unfair, not just the way it is administered. I would urge you to adopt the American Bar Association's proposal which is very, very simple. It does not affect tax rates. It does not affect joint returns. It does not affect any other issue except the apportionment of liability. And the only times when it would be necessary to make an apportionment is when there is a disputed deficiency for an unpaid tax.

In other words, everything would go on as it does now, except in a case when the IRS asks a spouse to pay a deficiency. That spouse should always have the right to say, I want to be assessed strictly on my own income.

I think it should be a fundamental right of all taxpayers to be taxed solely on their own incomes. Thank you very much.

[The prepared statement follows:]

STATEMENT OF PROFESSOR RICHARD C.E. BECK

In Support of Repeal of Spousal Joint and Several Liability for Income Taxes under IRC § 6013(d) and under *Poe v. Seaborn*

I. Joint Returns. Section 6013(d) requires joint and several liability of the spouses if they elect to file jointly. More than 98% of married taxpayers file jointly each year, because filing separately usually results in a higher tax. The incentive is all but irresistible, and joint filing has aptly been called "mandatory in fact." Thus virtually all married taxpayers are subject to joint return liability.

The statute itself is gender-neutral, but it appears that the vast majority of collections from the "wrong" (or non-earning) spouse are from women. The figure would be over 90% if the litigated innocent spouse cases reflect the general percentage of all collections.

This liability is aberrational when compared to tax systems in other countries,[1] even those which also provide valuable tax benefits to married persons filing jointly.[2] No other OECD country taxes wives for their husbands' income as a general rule, much less women who are separated or divorced.[3] Under U.S. law, by contrast, thousands of separated and divorced women each year are taxed for no other reason than that they were married at the time their ex-husbands earned income.

The rule of joint return liability was first enacted in 1938. Until then, filing jointly (which had been allowed since 1918) did not entail joint and separate liability of the spouses, despite the government's insistence to the contrary. See *Cole v. Comm'r*, 81 F.2d 485 (CA-9, 1935), *rev'g* 29 B.T.A. 602 (1933).

In *Cole*, the Ninth Circuit held that a taxpayer's cardinal right to be taxed only on his own income was unchanged by joint filing, and rejected the government's argument that administrative necessity requires joint and several liability, at least where the respective separate incomes of the spouses are ascertainable. The government argued that because joint returns do not explicitly set forth the respective separate incomes and deductions of the spouses, it would be unable to determine the separate amounts for which each spouse should be liable.

This purported "administrative necessity" was the only reason put forth in the committee reports when Congress overruled *Cole* by enacting the predecessor of Section 6013(d) in 1938. Yet the argument is palpably insufficient. There is ordinarily no difficulty in determining each spouse's net income on a joint return. The audit process almost necessarily reveals the source of any asserted deficiency.[4] Moreover, such determinations are in fact sometimes required under

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[1] For example, no marital liability for income taxes is imposed in any form in Canada, Australia, Japan, Italy, Spain, Sweden, or the United Kingdom.

[2] Cf. Germany, which provides for income-splitting computed as under U.S. law, but without joint and several liability, and Belgium, which has a still more generous system of income-splitting.

[3] In France, joint liability is imposed in principle, but wives who are no longer living with their husbands at the time of enforcement proceedings are nearly always excused. Also, unlike U.S. law, in France the tax authorities must exhaust all possibilities of collecting from the husband before turning to the wife. In the U.K., husbands were formerly liable for tax on their wives' income, but wives were never liable for their husbands' taxes. This system was abolished in 1990 in favor of completely separate liability for both spouses.

[4] There was no such difficulty in the *Cole* litigation either; the Bureau of Internal Revenue had simply assessed the husband by mistake, and negligently let the statute of limitations run as to the wife. In case of doubt, the IRS can always assess both spouses, and let the taxpayers

current law in order to limit the amount of each spouse's separate losses which may be carried forward or back to offset his or her share of income in a joint return year, and in order to calculate the amount of each spouse's separate right to a refund from a joint return.[5] The method used is to calculate each spouses's separate net income as if he or she had filed separately. There are adequate rules under current law for apportioning personal deductions and dependent exemptions for this purpose.[6] Over 2,000,000 separate returns are filed each year by married persons, with no apparent difficulty.

Adequate reasons for imposing joint and several liability have never been provided. There is no evidence that couples ordinarily share all their property to such an extent that they should be presumed indifferent to the incidence of tax liability. And even if such sharing were the norm, it could not justify joint liability after termination of the economic unity of the family by divorce.[7] Contrary to widely held belief, joint return liability was not enacted as the "price one must pay" for lower tax rates on joint returns. The favorable tax rates for joint returns computed by income-splitting were not introduced until 1948, some 10 years after enactment of joint return liability.[8] Moreover, the right of spouses to offset deductions and losses against each other's income and gains had been available to taxpayers from 1918 until 1938 without the "price" of joint and several liability. Joint returns were introduced in 1918, apparently for the sole purpose of convenience both for taxpayers and for the government, without any thought of special rates or privileges for married persons.

The quid-pro-quo justification for joint return liability is as weak logically as it is historically. The size of the benefits of joint filing (if any) bears no relation to the joint return

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prove the sources of their income, as the *Cole* court pointed out.

[5] See Rev. Ruls. 80-6,7,8; 1980-1 C.B. 296 ("separate tax method of allocation" applied to refunds; and for losses see Rev. Rul. 60-216, 1960-1 C.B. 126; Rev. Rul. 65-140, 1965-1 C.B. 127; and Rev. Rul. 75-368, 1975-2 C.B. 480.

Similar rules were in effect at the time of the *Cole* litigation, as well as other regulations (later invalidated) which required the same determination of the separate net incomes of the spouses for the purpose of limiting each spouse's charitable contributions and capital losses on joint returns. The Treasury has apparently never experienced any difficulty administering these rules. They all worked to the Treasury's advantage, however. The government's litigating position in *Cole* was thus at best uninformed, and was possibly in bad faith.

[6] The current rules are as follows: Business income and deductions are allocated to the owner(s) of the business. Investment income from community property and jointly owned property is divided equally between the spouses, even if one spouse actually receives all the income. Items of personal deduction (such as medical expenses) which are paid out of community or jointly owned funds are ordinarily divided equally between the spouses, but items paid out of separately owned property are normally deductible only by the payor spouse, even if the payment is for a joint obligation. (The limitations as to such items, such as the 7.5% floor on medical expenses, are separately applied to each spouse.) If the taxpayer can prove that the funds used were his own, however, he will be entitled to the entire deduction even when payments are made out of a joint account.

[7] Application of Section 6013(d) liability against separated and divorced women seems to be an unintended consequence of the original enactment of the general rule of joint return liability. Not one of the half-dozen cases litigated before its enactment in 1938 involved separation or divorce. The IRS seems to have developed its aggressive position in this area in the 1960's, during the post-war explosion in divorce rates. This social development could not have been foreseen in 1938.

[8] Income-splitting was not enacted as compensation for assuming joint return liability, but for the entirely different purpose of equalizing the tax burden between the common law states and the community property states, where income-splitting was already allowed on separate returns under the doctrine of *Poe v. Seaborn*, 282 U.S. 101 (1930).

liability assumed, which may be unlimited in amount. The benefit explanation cannot justify joint liability for an amount greater than the tax saving from filing jointly.

Finally, the "benefits" usually inure to the husband, while the liability almost always is borne by the wife. Joint return liability is not only unfair in principle, it is highly discriminatory against women in fact.

Innocent Spouse Rules. Congress enacted the "innocent spouse" rules under Section 6013(e) in 1971 in order to mitigate the harsh effects of joint return liability. Under these rules, a wife may be relieved of liability for tax items of the husband only if they are "grossly erroneous";[9] they cause a "substantial understatement;"[10] the wife did not know, and had no reason to know of the substantial understatement caused by such items ("innocence");[11] and taking into account all the facts and circumstances, it would be inequitable to hold the wife liable for the understatement ("equity").[12] The wife has the burden of proof as to all the elements for relief.

The relief rules are unsatisfactory in two respects. First, they limit relief in many deserving cases due to the arbitrary restrictions to "grossly erroneous" items and to "substantial understatements," and second, they are vague and unpredictable due to the nature of the "innocence" and "equity" requirements. There is a large body of case law interpreting the innocence requirement,[13] but the decisions are in conflict,[14] and the outcomes are largely

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[9] An item of omitted income is "grossly erroneous" per se. Erroneous claims of deduction, credit, or basis may also qualify for relief, but such items must in addition be "without foundation in fact or law." This phrase has severely limited relief for such items. Mere disallowance of a deduction does not qualify. There is no relief for simple nonpayment of tax where the return is correct; relief is in effect limited to items of negligence and fraud. There is no obvious reason for these limitations, and they have the somewhat bizarre effect of putting the wife in a better position if the husband misreports than if he reports honestly.

[10] There are dollar limitations under Section 6013(e)(3) and (4) restricting relief to items exceeding $500, and in the case of erroneous claims of deduction, credit, or basis, the item must in addition exceed 10% of the wife's pre-assessment year income if $20,000 or less, or 25% if her income exceeds $20,000. For these purposes, if the wife has remarried, her current husband's income must be included in the floor whether or not they file jointly.

[11] Factors which have been used by the courts as indicating that the wife had "reason to know" include lavish or unusual expenditures, involvement in the family budget or the husband's business, and higher education or business experience. The courts have not applied these factors consistently.

The cases are split as to whether the wife has a duty to review the return. Compare e.g. the recent tax shelter decisions in *Cohen*, 54 T.C.M. 944 (1987) and *Shapiro*, 51 T.C.M. 818 (1986)(taxpayers lost) with *Hinds*, 56 T.C.M. 104 (1988) and *Killian*, 53 T.C.M. 1438 (1987)(taxpayers won).

The wife has sometimes been held to have "reason to know" if she is aware of the existence of the underlying transaction, even if she knows nothing of its tax consequences or how the husband reported it. This doctrine that "ignorance of the law is no excuse" is without foundation in the statute.

[12] The principal factor considered under the equity test is whether the wife benefitted from the item over and above ordinary support. The courts have been extremely inconsistent as to what this means. Note, too, that because all elements for relief must be met, the wife may lose even if she did not benefit at all, if she is found to have had reason to know of the item.

[13] There are over 400 reported decisions under Section 6013(e), and the confusion grows ever greater. A considerable simplification would result if the relief rules could be repealed together with joint return liability.

unpredictable.[15]

The arbitrary limitations could be adequately reformed by amending the statute to omit the dollar limitations and the requirement, in effect, of negligence or fraud on the part of the husband. But there is no way to amend the innocence and equity tests, because they are essentially misconceived.[16]

The "innocence" test is at the heart of the relief rules.[17] But this test is illogical and inappropriate as a basis for relief. Ordinarily a reason to know (or due diligence) test is applied in the context of assessing whether a person who is in a position to prevent foreseeable harm to others has breached his duty of care. But the wife has no duty to certify the accuracy of her husband's tax items, except as created by the innocent spouse rules. Women generally do know that they have any such duty of certification,[18] and do not act as if they did. In countless instances, the wife simply signs the return as an accommodation to her husband.[19] And if she refuses, she may risk her marriage.

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[14] A particularly glaring conflict is presented by the "ignorance of the law is no excuse" doctrine. This doctrine seems to have been selectively applied only against women who are still married at the time of trial.

[15] At least as to the stated grounds of decision. It appears that many of the inconsistencies in the reported decisions can be accounted for by supposing that unconscious preferences of the judges have been at work. It appears that divorced women who had been housewives or who fulfilled traditional roles of dutiful dependency have fared better in the Tax Court than independent and educated women. Higher education and business experience have no obvious relevance to whether the wife had reason to know of the husband's understatement, but they are routinely treated as factors unfavorable to the wife.

[16] The reason for most of the defects in 6013(e) is that the rules were narrowly drafted to track the *ad hoc* reasoning used by the Sixth Circuit to nullify joint and several liability in a spectacularly unfair case. In *Scudder v. Comm'r*, 405 F.2d 222 (1968), *rev'g* 48 T.C. 36 (1967), the husband had embezzled large sums from a business owned by the wife and her sisters, without their knowledge. The IRS pursued her for taxes (including the 50% fraud penalty) on the embezzlements, and won in the Tax Court. The Sixth Circuit simply refused to apply the law, and exonerated the wife on the ground that she could not have intended to file jointly as to these fraudulent items, where she did not know of them, and did not benefit from them.

The Sixth Circuit's ingenious approach allowed it to do justice in the case at bar at a time when no statutory relief at all was available. But the relief was crafted to fit unusual facts, and it was inappropriate for Congress to use this narrow *ad hoc* device as the basis for general statutory reform.

[17] The importance of the innocence test is perhaps due to an intuitive perception that joint return liability is itself simply unfair. To the extent that the liability can be rationalized as somehow due to the wife's own fault, liability can be imposed in a manner less troubling to the conscience.

[18] It appears that very few taxpayers are, or have any reason to be aware of this assumption of liability. There is no warning on the Form 1040. Nor does it appear that preparers or divorce lawyers generally take this liability into account. Even if a wife is aware of this "duty," the penalty for breaching it is unfair. If a professional return preparer or an IRS agent fails to use due diligence, he does not become liable for the tax deficiency he could reasonably have been expected to discover on someone else's return. And yet such persons have both tax expertise and awareness of their professional duties, upon which the IRS does reasonably rely.

[19] When the duty of due diligence is pushed as far as it was in *Bokum*, it in effect requires the wife to seek a second professional opinion in all cases.

Such a requirement is not only unrealistic and unreasonable, it also defeats the original purpose of joint filing, which was to provide convenience to both the taxpayer and the government. It is unreasonable to expect both spouses to duplicate the effort of preparing the return, particularly if only one has income, or any complexity to his tax affairs.

In short, it makes no real difference at all to the government's interests whether the wife is innocent or not, nor whether she makes any effort at due diligence when she is "put on notice." For that reason, there is no underlying purpose or principle to guide the courts in weighing the variety of factors used to determine degrees of "innocence."

Under these circumstances, it is not surprising that the various legal "tests" have in large part degenerated into a global subjective one of whether the woman and her plight can move the judge to sympathy. It is obvious that taxation should not depend on such subjective criteria, and for that reason the innocent spouse rules cannot provide the remedy for the unjust effects of joint return liability.

Effects of Repeal of 6013(d). In order to institute a regime of elective separate liability for married persons, no other changes will be required. The current rate structure and system of filing statuses can remain unchanged, and the benefits of income-splitting for joint filers can be preserved. The separate liability of each spouse will be calculated according to the "separate tax formula" cited above. First each spouse's tax is calculated as if he or she filed separately, and then the ratio of wife's separate tax to the sum of both separate taxes is applied to the total joint tax due. In this way the benefit of the income-splitting rate structure is preserved, but the wife is liable only for the portion of the joint tax which is due to her separate income.[20] The formula is thus:

sep. liability = (sep. tax / both sep. taxes) x joint tax

Calculation of the wife's separate tax liability in the first instance will not require any changes in current law.

II. Abuse Potential. There would appear to be no abuse potential in repeal of joint return liability. Whatever abuse potential might arise from repeal of joint return liability would appear to exist already under current law. A couple planning to avoid the husband's taxes while leaving the wife with property not subject to tax can simply file separately. If there were any abuse potential here, it would already be exploited.

If joint return liability is repealed, the IRS may be expected to rely upon transferee liability under Section 6901 as a substitute. Although transferee liability will not apply in many cases where Section 6013(d) currently does apply, transferee liability should be adequate to police any potential abuses. Establishment of transferee liability for taxes depends upon state law of fraudulent conveyance, or federal bankruptcy law, where applicable. This will usually require the IRS to prove that the husband was insolvent at the time of a transfer of property to the wife, or that he became insolvent as a result of the transfer, and that the property was transferred without adequate or fair consideration. Where there is inadequate consideration for the transfer, it is presumptively fraud and there is no need to prove actual fraudulent intent on the part of either the debtor or the transferee.[21] Transferee liability can therefore apply under current law even if the wife is an innocent spouse within the meaning of IRC 6013(e).[22] Even if adequate

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[20] This calculation will not increase the complexity or difficulty of preparing returns, because it will only be employed on audit in cases where there is a deficiency which is contested by the wife.

[21] See e.g. *Mysse v. Comm'r*, 57 T.C. 680 (1972)(transfer of $10,000 C.D. to wife without consideration set aside where embezzler husband was insolvent at time of transfer because unassessed tax liability of over $115,000 from unreported income exceeded his total assets of $46,429. (Montana law)).

[22] In *Mysse*, the wife was held to be an innocent spouse with respect to IRC 6013(e) because she had no actual or constructive knowledge of the embezzlements, and received no significant benefit beyond ordinary support. She was nevertheless liable as a transferee for her husband's

consideration supports the transfer, however, if the wife is aware of or participates in her husband's fraud on his creditors, the transfer may still be set aside as fraudulent.[23]

Transferee liability cannot apply unless the husband is insolvent and unable to pay at the time of attempted collection, as well as at the time of the transfer. Thus if the IRS is restricted to exclusive reliance on transferee liability because joint return liability is unavailable, that will automatically have the desirable effect of forcing the IRS to exhaust all remedies against the husband before proceeding against the wife. In addition, transferee liability is limited to the amount of the transfer, and therefore (unlike liability under Section 6013(d)) the wife's liability cannot exceed the amount by which she was benefitted.

Finally, under transferee liability the wife is not at any unfair disadvantage compared with other transferees. All transferees are treated alike under Section 6901, without regard to marital status. By contrast, 6013(d) applies only to spouses. Children, parents, and even an adulterous girlfriend may receive gifts out of the husband's untaxed income, even with actual knowledge of his tax cheating, without incurring any liability (provided that the husband is solvent). Wives alone incur a liability in this situation.

I do not claim that transferee liability will be a complete substitute for joint return liability. Some situations will inevitably arise where the IRS will not be able to recover property of the wife which is in part derived from untaxed income of the husband. It seems unlikely, however, that such situations will arise frequently or will present a problem serious enough to require a remedy in anticipation, and none is suggested here.

It is well to remember that every other modern country manages to collect its taxes without reliance on joint and several liability.

III. Community Property Liability. A wife who resides in a community property jurisdiction is subjected to liability for one-half of her husband's taxes under the doctrine of *Poe v. Seaborn*, 282 U.S. 101 (1930), which construed family property law in the community property states to create a separate liability of each spouse for one-half of the tax on the income of the other on the theory that all earnings during marriage inure to the marital community, and are therefore owned by and taxable to each spouse in equal amounts. This form of liability does not depend upon filing a joint return, and results automatically from residence in a community property jurisdiction.

The *Seaborn* decision was very questionable when decided. Under community property law generally the wife has no right to spend or otherwise dispose of any part of her husband's earnings.[24] Her "ownership" rights to such income arise only upon dissolution of the marital community by divorce or death, and then only to such income that the husband has not already spent.

The *Seaborn* decision arose in the context of rates rather than liability, because the wife was willing and eager to accept liability in order to reduce her husband's taxes through income-splitting. The question was whether the wife had the right to report half of her husband's income on her separate return, rather than whether she had the duty to do so. It was not long before the IRS seized upon the decision to construct such a duty, however, and the result was a number of very harsh decisions requiring divorced women to pay half of their ex-husbands' taxes in

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taxes to the extent of the transfer.

[23] See e.g. *Wilkey v. Wax*, 225 N.E. 2d 813 (App.Ct.Ill. 1967) and *U.S. v. Alaska*, 661 F. Supp. 727 (N.D.Ill. 1987).

[24] This is still true even under the modern dual-management community property regimes. See Smith, *The Partnership Theory of Marriage: A Borrowed Solution Fails*, 68 Texas L.Rev. 689 (1990).

situations where they had received no benefit from his earnings.[25] A woman cannot protect herself from this form of liability even by filing separately, unless she first dissolves the community of property.

Apparently, no other income tax system in the world today except the U.S. imputes earned income from one spouse to the other on the ground of community property law,[26] including Spain, France, and Mexico, from which our state community property laws derive. In Canada, a situation arose which was identical to that in *Seaborn*, and the Canadian Supreme Court reached the opposite conclusion interpreting Quebec community property law. Because the husband had the absolute right to dispose of his earned income as he pleased, he must be taxed on it despite the wife's contingent rights under the community property regime.[27]

Still more surprising is the fact that at least two community property states, Arizona and California, reserve the right for state income tax purposes to tax either the earner for the full amount, or the community property owner for one-half. Thus the federal tax system defers to state matrimonial property law where the state's own tax law does not.[28]

Relief Under Section 66. There are relief provisions under IRC 66, first enacted in 1980, for the innocent spouse which provide limited relief from community property liability analogous in many respects to relief under IRC 6013(e).[29] The rules are far too restrictive, and have often failed to prevent obviously unfair results. Nearly all petitioners for relief under Section 66 have lost. It is revealing to note that when Section 66 was enacted, its revenue cost was estimated to be "negligible."

Section 66(c) (enacted in 1984) contains the same requirements of "innocence" and "equity" which are criticized above in connection with Section 6013(e). The innocence test is nearly impossible to meet under Section 66, because if the wife knows her husband was employed, she loses. Two other provisions allow relief without proof of innocence, but they

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[25] See *U.S. v. Mitchell*, 91 S.Ct. 1763 (1971). The Supreme Court noted the harshness of the result, but said the law was clear and the only remedy was legislative action similar to the newly enacted Section 6013(e). Enactment of Section 66 was nine years in coming, and probably would not have protected the wife in *Mitchell* any event.

The *Seaborn* briefs did not anticipate that the government might someday use the rule as a sword against non-earning wives. The anti-taxpayer use of the rule seems wholly unintended.

[26] Countries which ignore their community property law for purposes of taxing earned income include Canada, Germany, Belgium, the Netherlands, Sweden, and Italy, as well as France, Spain and Mexico.

[27] See *F.Sura v. M.N.R.*, 62 D.T.C. 1005 (1957)(Quebec taxpayer not permitted to split his income with his wife through community property law; *Seaborn* rule rejected)

[28] If it had been thought necessary to respect the matrimonial property law of the community property states for purposes of taxing earned income, the result should probably have been as it was generally in Europe in the early part of the century: mandatory joint returns with the husband primarily responsible for payment as sole administrator of the community property. See generally Dulude, *Taxation of the Spouses: A Comparison of Canadian, American, British, French, and Swedish Law*, 23 Osgood Hall L.J. 67 (1985). This would have been a far more realistic interpretation of community property law than the *Seaborn* decision, which imputed half of the husband's earned income to the wife. Also, it would not have created the intolerable disparities in the level of tax burden between the states which arose in consequence.

[29] Before enactment of the relief provisions, at least one court refused to apply the rule of *Seaborn* to avoid the "horrendous" result that the wife was "stripped clean" by the IRS though she had received none of his income. In *Bagur v. U.S.*, 603 F. 2d. 491 (1979), Judge Wisdom remanded the consolidated appeals to the Tax Court to determine whether the wives had suffered the equivalent of theft losses of their share of the community income.

suffer other shortcomings. None of the Section 66 provisions provides any relief for items other than omissions of income. Section 66(a) provides relief only if the couple lived apart at all times during the calendar year, and none of the earned income in question was transferred between them. Even one day of cohabitation during the year, or payments of support which are not *de minimis*, will preclude relief.

Section 66(b)(enacted in 1984) provides that the benefits of community property law may be disallowed to any taxpayer if he acts as if solely entitled to the community income, and fails to notify his spouse of the nature and amount of such income before the due date for the taxable year. The "benefit" here is the husband's relief of liability for one half of his earnings. This provision may be defeated if the husband notifies the wife of her liability, even if he gives her nothing.

Repeal of *Seaborn*. There is no doubt that Congress has the authority to overrule *Seaborn*, and it has already done so in many limited contexts.[30] The *Seaborn* rule has never been applied at all for purposes of the payroll taxes (social security and hospital insurance) and for the tax on self-employment income. Also, in 1976, Congress in effect repealed the *Seaborn* rule for couples one or both of whom are nonresident aliens.

The *Seaborn* rule now provides no benefit to taxpayers, and is advantageous only to the government.[31] This is a ironic in view of the fact that the *Seaborn* doctrine arose as a device to benefit residents of community property jurisdictions. This benefit was jealously guarded by representatives of such jurisdictions when repeal was attempted in 1940 (by means of proposed mandatory joint returns, without joint and several liability) in order to equalize the tax burden among the states. But since the 1948 introduction of income-splitting on joint returns for all married persons, the *Seaborn* rule no longer provides any advantage to taxpayers, and there should be no opposition to its repeal from the community property states.[32]

III. Effect on the Tax System. Neither repeal of Section 6013(d) nor repeal of the *Seaborn* rule need have any effect upon current tax rates nor filing statuses, and none is recommended here. These proposals for separate tax liability are put forward on their own merits for the sake of fairness and simplicity.

Revenue Cost. The IRS keeps no statistics on the frequency or amounts of collection from the non-earning spouse. It is therefore difficult to estimate the revenue loss from repeal of

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[30] Many sections of the Code contain provisions which are to be applied "without regard to community property laws." Among these are Section 32(c)(2)(B)(i) [earned income credit]; Section 402(e)(4)(G) [lump-sum benefits]; Section 408(g) [individual retirement accounts]; Section 414(d)(4)(A) [limitation on cash method of accounting]; Section 457(d)(7) [deferred compensation plans of state and local governments]; Section 911(b)(2)(C) [foreign earned income]; Section 4980(d)(4)(A) [excess distributions from qualified plans], and, of course, Section 6013(e)(5) [innocent spouse rule] and Section 66 itself.

[31] Except for a husband who may escape tax on half of his income. Note that this is a complete escape, since the wife has no right to contribution from him for her payment of his taxes, as she does in the case of joint return liability.

[32] Repeal of *Seaborn* would of course have no effect on community property law itself, and no recommendation is made here as to any issue of state family property law.

Note that even after repeal of *Seaborn*, women subject to community property law will remain under a tax disadvantage, because the husband's community half interest in her earnings is a property interest within the meaning of Section 6321 and subject to levy even for his antenuptial tax debts. Thus one-half of the wife's earnings may be levied upon to pay *all* husband's taxes even where she has no personal liability for them under *Seaborn*. See, e.g. *Medaris v. U.S.*, 884 F.2d 832 (CA-5, 1989).

6013(d) or *Seaborn*. It is probable that the loss (if any) will not be large, because often the husband is available to pay, and the wife is taxed only because her assets are more easily accessible to levy. In such cases, there may be an added cost of collection, but no revenue loss. In other cases, transferee liability would apply. In some instances, the Treasury will even profit from repeal.[33] In the community property states, some husbands report only half their income and force the government to collect the remaining half from an absent wife. Repeal of *Seaborn* would end this practice. Some revenue loss is probably inevitable, however.[34] But it must be borne because the government's revenue needs cannot justify taxing the wrong taxpayer in amounts bearing no relation to ability to pay.

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[33] For example, under current law a wife may actually escape tax on her *own* earnings by achieving innocent spouse status under Section 6013(e). This seems to have occurred in *Price v. U.S.*, 887 F.2d 959 (CA-9, 1989).

[34] The expected revenue loss should not estimated by simply writing off all potential assessments under Section 6013(d), because many such assessments are unrealistic or illusory. The IRS often assesses huge deficiencies on insolvent taxpayers (typically, but not limited to narcotics dealers and embezzlers) where it is obvious that the deficiency cannot be collected from either spouse. See, e.g. *Ratana v. U.S.*, 662 F.2d 220 (CA-4, 1981).

Chairman JOHNSON. Mr. Beck, do I understand you to say that everything the IRS did in the *Howden* case was legal? It was legal for them to ignore that she owned the house, and legal for them to ignore that he did not?

Mr. BECK. I do not know the details of that aspect of it. I cannot speak to that part of it.

Chairman JOHNSON. But the IRS does not have the right to ignore legal documents governing property ownership, do they?

Mr. BECK. That is correct. If they had some——

Chairman JOHNSON. But they do have the right or they do not have the right?

Mr. BECK. No; they do not have the right. I do not know the facts of what went on in this case.

Chairman JOHNSON. Right. I appreciate that you do not know the facts, but the law does not give them the right to ignore legal ownership, does it?

Mr. BECK. It does not. But even if the house belonged entirely to Ms. Howden, if she had a personal liability under *Poe* v. *Seaborn* to pay half of her ex-husband's taxes, that is a personal liability of hers and her own separate property can be levied upon to pay it.

So, again, I do not know the facts, but even the fact that it is entirely her house does not answer the question. Joint and several liability and *Poe* v. *Seaborn* liabilities are personal liabilities of the taxpayer that can be satisfied out of the separate property of the taxpayer, not necessarily out of joint property.

Chairman JOHNSON. Thank you.

Mr. Jeager, your testimony was very vivid and we will certainly review it and see what we can do about the IRS operating under startingly different assumptions in some cases than in others. I appreciate your taking the time to be here with us today and to go through your experience with us.

Mr. JEAGER. Thank you, Madam Chairman.

Chairman JOHNSON. You indicated in your testimony that the IRS never intended to actually take your case to Tax Court. What makes you think the Service did not intend to litigate?

Mr. JEAGER. Well, firstly the IRS used information from our filed tax returns in determining our deficiency notice. And when we had a chance to review their information the numbers they used in their computations were incorrect, and did not reflect the accurate numbers that we had on a similar tax return that we had in our possession.

On several occasions we invited the IRS to sit down with us, to correct their misinformation and they never responded. We were trying to give them the precise numbers, and they were unwilling to take the time to review their information with us.

We could not understand why they would not meet with us and had to assume they were only trying to drag us along until we would settle. And never really having the data that they needed to win in that court case.

Second, to further illustrate this fact, only a few weeks before trial one of our attorneys was having a discussion with the lead agent for the IRS who advised us for the first time that work papers, and I quote, "There were several serious computational er-

rors," in their work papers of the agent who did the audit of our business.

If the IRS was serious about going to trial and knew it had the burden of proof, it surely would have revised its computational errors before bringing the matter to the court, and to our knowledge, no such corrections were ever prepared.

Third, they were to file with the court, on a certain date, their expert witnesses with no witnesses being designated. With none available and inaccurate information it became increasingly obvious to us that they had never intended to try the case.

Chairman JOHNSON. To gain attorney's fees you would have had to prove that the IRS was not substantially justified in bringing their case. How hard would it have been to prove this? How much access would you have had to those figures?

Mr. JEAGER. It is extremely difficult. As the lawyers explained it to me the Tax Court—I am sorry, could you repeat the question?

Chairman JOHNSON. Under current law in order to get attorney's fees, which you would like to do and anybody in their right mind would want to do under these circumstances, you would have to prove that the IRS was not substantially justified in bringing the case.

How difficult would it be to prove this?

Mr. JEAGER. Well, it is extremely difficult. It is extremely difficult, Madam Chairman. As the lawyers explained it to me, the Tax Court says that no matter how marginal of the IRS' chances of success may be in bringing a case before the Tax Court, and no matter how burdensome and expensive it may be for the taxpayer to defend itself, the IRS' position is still substantially justified.

If that is the hurdle that a winning taxpayer has to clear to get its attorney's fees reimbursed then the taxpayer is almost going to win in its motion for litigation costs.

Chairman JOHNSON. Thank you very much, Mr. Jeager.

I am going to yield to my colleague, Mr. Cardin, and come back.

Mr. CARDIN. Thank you, Madam Chairman.

Let me thank all three of you for your testimony.

Mr. Jeager, your case is certainly one that disturbs all of us, that you had to go through the type of litigation costs in a case that, from your testimony, was rather straightforward and a practice that was long standing within the industry, which had not previously been challenged, and where there was no indication of any justification for the challenge.

I am having a hard time though understanding what happened in your case and why you were unable to successfully recover your costs, including counsel fees.

The Tax Court, you made a request to the Tax Court for costs and were denied because you could not establish that the Federal Government was not substantially justified in the position?

Mr. JEAGER. That is correct. That is accurate. I mean it is our opinion that no matter how small of an opportunity that the IRS has to extract money from the taxpayer, so to speak, they are substantially justified. And that substantially justified to us is unreasonable.

I think the true definition of substantially justified needs to be addressed.

Mr. CARDIN. Well, the legislation that has been filed in this Congress takes a different approach and I would like to get your views as to whether you think that would be effective or not.

It does two basic things. It first allows you to get information about your case from the IRS in order to be able to help the court in determining whether there was substantial justification in the Government's position.

And second, the legislation increases the dollar amount of the counsel fees which you can be awarded. I believe those are the two changes that are in the Taxpayer Bill of Rights II.

Do you believe that would help you in being able to recover your fees?

Mr. JEAGER. Well, you know, yes, I believe it would help. I mean I honestly think I would like to take it a further step. I think the law should require that the IRS take reasonable—and I use that word very hardly here, and very succinctly—because reasonable positions, they need to take reasonable positions before the tax court and it should be defined in a common sense fashion.

I mean as IRS legal theory that has a marginal chance of success and it is not reasonable and the law should so hold. I further think that when the IRS concedes a case, in its entirety, prior to trial the law should treat that the same as if the IRS had gone to trial and lost.

And I believe that in both those situations, the winning taxpayer should be reimbursed for their attorney's fees. The spirit of the current Congress is that government keeps its commitments with the American people and lives by the same standards and reasonableness and fair play that are supposed to be at the heart of our legal system.

I believe that that was the first law you passed shortly after this Congress convened. I want to make clear that I am not here solely to ask that businesses like mine get back some of the money they have expended on attorney's fees. That certainly would be fair, but there is another, larger good to be served by making the IRS act in a more reasonable manner.

The sure prospect of having to pay a winning taxpayer's litigation costs would incentivize the Service to pick and choose its cases more reasonably and responsibly, and the American people would be better served by having the IRS use its resources in that more efficient and effective manner.

Mr. CARDIN. Mr. Jeager, I am very sympathetic to your problem and think that we need to change the system so that in your type of case, you are able to recover your costs.

Mr. JEAGER. And my fellow wineries, as well, my fellow businesses that are in the same predicament that I am.

Mr. CARDIN. Right. I understand that. Let me compliment you on the product you produce. It is a very good product.

Mr. JEAGER. Thank you on behalf of the wine industry.

Mr. CARDIN. The concern I have is that the standard passed by the Congress would appear to be a rather generous standard to the taxpayer, would appear to be. So, because it requires the government to substantially justify its position. If I understand the IRS position today, they are willing to assume the burden of that proof,

where they would have to come forward and prove that their position was substantially justified.

That appears to be a pretty strong standard that the Government must meet. It is certainly different from the frivolous lawsuit standards which we use in typical lawsuits for the litigant to be able to recover costs.

So I am somewhat puzzled as to why the Tax Courts are imposing such a burden on the taxpayers, when Congress has already spoken to provide a mechanism for the taxpayers to be able to recover costs against the Government. That is what we intended in the Taxpayer Bill of Rights I.

I understand your position, and we certainly need to take a look at this to make sure that people who are put in a wronged position by the government are able to recover their costs.

Mr. Beck, I understand your position very well. In particular, it is troublesome in cases where spouses are no longer living together or living in a less than harmonious circumstance.

Are you concerned at all if we eliminate all joint liability that where a husband and wife are living together, that they may be able to concoct some form of property ownership that the government may not be able to get at in an effort to try and avoid tax liability, because one spouse earns the income, and using a joint-type of an ownership of certain properties in order to avoid paying their taxes?

Mr. BECK. I have devoted a lot of thought to that and so has the ABA and we all concluded that there is very little abuse potential in this for various reasons.

First is that under current law you can do all this anyway by just filing separately. You can avoid joint liability by just filing separately. It usually costs a little more in taxes, which is why people file jointly.

But if you could avoid taxes on any scale that was significant, people would be doing it right and left, because it does not cost all that much extra to file married filing separately.

That is the easy answer. The longer answer is that——

Mr. CARDIN. You have not seen any significant abuse by married taxpayers filing separately so that they can avoid joint liability, and then filing——

No. I do not think so.

And then you also have transferee liability that applies. If one spouse makes himself judgment proof by giving property to the other spouse, or to anyone else for that matter——

Mr. CARDIN. A little more difficult to establish though. Your first argument was very good; your second one I am not so sure transfers.

Mr. BECK. True. It will not apply in every case and there are hurdles. The IRS would have to show insolvency and you are quite right, it is not automatic. It is not a complete substitute.

Mr. CARDIN. But you convinced me on your first point. The first point was a good point. I am finished, thank you.

Chairman JOHNSON. I want to quickly run down a series of questions, Ms. Howden, since we do not have your testimony in writing. They are easy and it will not take long. We do have this vote coming up and we will adjourn between panels and go vote.

But as I understand it the deficiency asserted by the IRS related to your 1982 joint tax return. Did you sign that return?

Ms. HOWDEN. No, I did not.

Chairman JOHNSON. Did you qualify for the innocent spouse protections under the law.

Ms. HOWDEN. I was told that I did not because I was able to enjoy his income.

Chairman JOHNSON. Did the IRS ever attempt to contact you during the process of assessing the deficiency on your 1982 return?

Ms. HOWDEN. No, no.

Chairman JOHNSON. When did you first learn that the IRS had filed a lien against your house for the 1982 deficiency?

Ms. HOWDEN. When I found the seizure notice on the front door.

Chairman JOHNSON. So that was in what year?

Ms. HOWDEN. That was 1992.

Chairman JOHNSON. Did the IRS inform of any efforts it was taking to collect the taxes due on the 1982 return from your former husband?

Ms. HOWDEN. No, they did not. And when I asked for that information they said it was privileged. That they could not disclose what they were doing with him.

Chairman JOHNSON. I understand that your former spouse was permitted by the IRS to enter into an installment payment plan with the IRS. How much was he asked to pay, do you know that?

Ms. HOWDEN. He was asked to pay $150 a month on a $99,000 judgment or debt owing. He pays $150 a month.

Chairman JOHNSON. That is $150 a month on a $99,000 debt. Do you have any rough idea what his income is?

Ms. HOWDEN. I do not know. I imagine close to $100,000, I would think.

Chairman JOHNSON. Does he not own a couple of houses and an airplane?

Ms. HOWDEN. Yes. They seized one airplane but he has another one.

Chairman JOHNSON. But they settled for $150 a month on a $99,000 debt. Were you given the same opportunity?

Ms. HOWDEN. No, Ma'am.

Chairman JOHNSON. So you had to come up with how much did you say on how much debt?

Ms. HOWDEN. That was $17,500.

Chairman JOHNSON. On a $17,500 debt. In cases where a joint return has been filed, do you think the IRS should be required to give both parties who signed the return the opportunity to participate in the appeals process before the assessment, when the joint return is made final?

Ms. HOWDEN. I absolutely do. And on every occasion I told them I was willing to take responsibility for our joint debt.

Chairman JOHNSON. I will tell you, I have been in elective office almost 19 years now, and we have dealt with a lot of these cases in my office. And many of them arouse outrage. I have never heard such an outrageous story as yours today. I have never seen the IRS literally torment a single parent, struggling to support a child, for as many years as they have tormented you.

And believe me this case will drive one section of the Taxpayer Bill of Rights, with Mr. Beck's ultimate assistance.

And Mr. Jeager, I hope that small businessmen in America, when we get done writing a Taxpayer Bill of Rights, will be far more secure and far safer from the kind of attack that was launched against you and your business.

And if Mr. Hancock would like to make any comment or ask any questions, I would be happy to yield to him.

Mr. HANCOCK. Thank you, Madam Chairman.

About the only thing that I would say is that this has been building for the past 50 years, and it is going to come to a head one of these days.

And I am glad to see that we are holding a hearing and finally recognizing that, yes, we do have a problem. That IRS has a specific problem. There are people out there that will try to defraud. But this situation of rogue agents going after somebody and not exercising any judgment must be addressed. Otherwise, we will have more and more situations where people say, look, if they are not going to be fair, then I am not going to even attempt to pay my fair share.

This situation of Mr. Jeager. In your particular situation, you could afford the $80,000. I mean you are going to be able to stay in business.

There are a lot of small companies that would go out of business under these same circumstances. In fact, that has happened.

There has to be a balancing act, and I am glad to see that we are finally getting around to it. I would recommend a book to you, "The Good and Evil of Taxation." Pick it up and read it and that will tell you exactly what we have got to accomplish.

Thank you.

Chairman JOHNSON. Just as our system depends on the great majority of Americans, paying the amount of tax that they owe voluntarily, and fairly accurately, our system of problem resolution has to start from the assumption that the vast majority of people who have tax problems are not trying to defraud the Government.

Certainly some are and we have the capability to go after fraud where fraud exists. But the number of innocent Americans that become the victims of our tax system has simply got to be reduced. We made some efforts to do that in the 1988 law, we made some efforts to fix some things in 1992, and we are going to work hard to pass an aggressive law that protects the little guy in this round.

And I thank you very much for your testimony this morning, and as we work our way through the process we will keep you informed by our final drafts. And I hope by the end of it, you will see that democracy, in fact, works.

Thank you.

And we will convene the next panel in 10 minutes.

[Recess.]

Chairman JOHNSON. The committee will reconvene. We are in the process of a recommit vote, and I think the other committee members probably decided we were not going to reconvene until after the recommit vote. At least I am guessing that that is what they concluded, since none of them are back.

So as much as I hate to proceed, I think if we do not we are going to run into all kinds of other problems with afternoon planes.

So, my understanding that because of the delay you are interested in foregoing your comments, because we do have your testimony and we really are interested in what you have to say.

But some of the things that have come up, you have heard the issues that we are raising, and I would like to see if you have further comments on those issues. I am particularly interested in your comments on the preceding panel and the difficulty of joint and several liability, but also on electronic filing, and the modernization program. You have some expertise that goes beyond the narrow purview of this committee.

So if you would each make some comments on the issues that have been raised this morning, and also on these other issues I would be interested.

Commissioner Goldberg, would you start, please?

STATEMENT OF FRED T. GOLDBERG, PARTNER, SKADDEN, ARPS, SLATE, MEAGHER, & FLOM (FORMER COMMISSIONER, INTERNAL REVENUE SERVICE)

Mr. GOLDBERG. Sure. Thank you very much, Madam Chairman. It is a pleasure to be here this morning. With respect to tax systems modernization, my belief is that that is the single most important step that can be taken to enhance the rights and safeguards for the taxpayers of this country.

I think the tax system imposes an intolerable burden and I believe that modernization is the necessary step, the necessary predicate to relieve that burden. I think the problems we are seeing in the filing season this year would be largely remedied if tax systems modernization were in place.

I think you would have a world where you could both address those few taxpayers who engage in fraudulent activity without unduly and unfairly burdening the vast majority of citizens who are attempting to pay their fair share.

With respect to attorney's fees, I think the provisions in 988, the Contract With America ought to be applied to tax cases. I believe the government should be held to that liability. In effect, a strict liability standard comparable to that in 988. I also believe that the scope of 7430 should be broadened substantially.

I do not criticize——

Chairman JOHNSON. What do you mean by that?

Mr. GOLDBERG. I think that the IRS has been criticized for the limited awarding of attorney's fees. I do not believe that that is an IRS problem. I believe it is a statutory problem. And 7430 is drafted, it is simply a lot less than meets the eye.

For example, I would make attorney's fees available to all taxpayers. I would shift the burden of proof to the government in cases where taxpayers prevail. I would relax the definition of substantially prevailed and I think that the underlying assumptions of 988 apply with even greater force to the Internal Revenue Service.

There are lots of other issues that have come up. It is inappropriate to monopolize the time, and I turn it over to my colleague.

The one other issue I do want to comment on very briefly is the shifting of burden of proof to the government in tax cases. I think

that that is the gap between good intentions and disastrous consequence in that legislation is as striking as any proposal under consideration.

If that proposal were enacted it would be the worst of all possible worlds. It would result in a substantial loss of revenue from those who are bound and determined to cheat. And I think it would lead to an IRS that would be terribly intrusive.

For all of the honest taxpayers out there I think it is a very well-intentioned idea, but it is the siren song.

Chairman JOHNSON. Could you comment, lastly though, on this issue of whether or not a spouse should be liable for——

Mr. GOLDBERG. Yes. I think the current law has problems but I think the lesson is beware of unintended consequences. That with the best intentions in addressing that issue, and I do encourage you to address that issue, if you have, for example, a situation where a spouse works to put his or her mate through college and graduate school and earns all of the income, and that mate is responsible for filing returns, doesn't file a return.

Then subsequently gets divorced and thanks to his or her education is making a great deal of money. And the other spouse who earned that earlier income is supporting the kids on $15,000 a year. Under the rule you were talking about, it would be that spouse who had educated his or her mate, who had cared for the children who would be stuck with the liability. I do not think that is fair.

So my only advice is to be careful as you address that issue to be sure you do not create other unintended inequities.

I think the case you heard this morning is extraordinarily sympathetic.

[The prepared statement follows:]

Statement of
Fred T. Goldberg, Jr.
Before the
Subcommittee on Oversight
House Committee on Ways and Means

March 24, 1995

Madam Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify before you today on ways to enhance taxpayer rights and safeguards. Properly defined, this objective embodies the most important challenge facing tax administration. I applaud your interest, concern and ongoing oversight in this area.

While I am appearing today solely in my individual capacity, and not on behalf of any client or organization, I have had the privilege of addressing this issue from other perspectives: as IRS Chief Counsel, IRS Commissioner, and Assistant Secretary for Tax Policy. I also have perspectives on this issue as a private practitioner, taxpayer, and citizen. These different vantage points have shaped my views on how best to maintain and enhance taxpayer rights and safeguards. In particular, they have convinced me that all participants in the tax system -- the Federal government, Treasury and the IRS, taxpayers, tax practitioners and citizens -- share the same overriding objective of enhancing taxpayer rights and safeguards. Moreover, I am convinced that all parties can agree in large measure on the best avenues to achieve their common goal.

A. Preliminary Comments. Before turning to the specific questions you raised in the hearing announcement and in your invitation to appear before this Subcommittee, I would like to offer one general observation. So much of what we do in our public and private lives is about setting priorities and making choices. The same applies to the issue you are addressing today. The list of "things" that could be explored to enhance taxpayer rights and safeguards is truly endless. Any effort to consider (or do) them all would be futile and counterproductive. The challenge is to identify the "vital few" and assure that they are pursued vigorously and successfully.

In my opinion, there are two steps that must be taken to enhance taxpayer rights and safeguards. They both embody the same objectives as an item in the Contract With America: the "Job Creation and Wage Enhancement Act" provisions that focus on reducing the regulatory burden on our citizens. In the context of the tax system, the most important single step that can be taken is to achieve a dramatic reduction in the administrative and compliance burdens placed on taxpayers. The importance of this effort cannot be overstated: an intrusive, unresponsive and unworkable tax system is imposing an unacceptable burden on our citizens, and is a primary cause for the widespread distrust of government.

The two steps I recommend are:

1. *Tax Systems Modernization ("TSM").* Fully fund Tax Systems Modernization ("TSM") (including the funds requested in the Administration's Budget Request for FY 1996), and provide the constructive oversight necessary to assure its timely and successful implementation. The IRS is running on outmoded computers and stone age information systems. As a result, taxpayers waste hundreds of millions of hours and dollars each year in their dealings with the IRS. Issues that should never arise take months to resolve. Issues that should be resolved in a phone call require years of correspondence. Taxpayers must deal with numerous IRS employees to resolve the simplest of matters, when only one contact should suffice. A taxpayer needing a copy of his or her tax return to apply for a loan or a scholarship should be able to get a copy from the IRS in days; it now takes an average of several months, and millions of taxpayer requests for copies of their returns are never filled.

TSM can be and has been described in many ways. My own preference is for the framework embodied in the notions of burden reduction and "one stop service." Taxpayers ought to be able to resolve most IRS matters by dealing with one individual, most often through a single phone call. Based on my various experiences in government and the private sector, I am confident that TSM, properly designed and implemented, will save taxpayers hundreds of millions of dollars and hours each year. As a result, full funding of TSM, coupled with constructive oversight, is the single most important action that this Congress can take to enhance taxpayer rights and safeguards.

I recognize that TSM, standing alone, will not be sufficient. I should also emphasize that it will only succeed if the IRS is committed to a vision built around reducing the burden on taxpayers. Finally, I acknowledge that many mistakes are certain to occur along the way in an endeavor of this magnitude. Having said as much, the fact remains that TSM is the one essential step that must be taken. If that effort is delayed, or is not successful, there is nothing that this Subcommittee or any one else can do to rescue our citizens from an intrusive, burdensome and overreaching system of tax administration.[1]

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[1] As I've indicated, the IRS has made mistakes in pursuing TSM, and will make more mistakes as it goes down the road. That's reality, and to be expected. All in all, the IRS is doing a fabulous job. While it should be encouraged and supported in its efforts to do better, there is no turning back. If anything, the pace should be accelerated.

In this regard, I should acknowledge recent GAO criticism of the IRS modernization effort. In my opinion, the GAO commentary is simply wrong. It displays a stunning lack of perspective. It ignores reality and is often misleading. I believe it can be fairly characterized as destructive and counterproductive. I realize that these are harsh words. Unfortunately, I believe

(continued...)

2. *Tax Simplification*. Pursue tax simplification -- relentlessly and creatively. We are crushing our citizens, as well as our business, charitable and religious institutions with laws, regulations and procedures that are burdensome, duplicative, frequently unworkable, and often counterproductive. Simplification is another essential step that must be taken to enhance taxpayer rights and safeguards.

I acknowledge the common wisdom: when Congress threatens to simplify the tax law, most taxpayers and practitioners decide it's time to duck. That pattern must change. While fundamental reform may be the only way to achieve the kind of dramatic simplification that is called for, major steps can be taken within the confines of the current system. In particular, "think outside the box" -- recognize that any tax system is a grotesque necessity, not an end in itself; abandon the pathological quest for theoretical purity. Skip cosmetic surgery; excise whole tumors. When given the choice, simplify in a way that "loses" a little revenue -- increased receipts from improved compliance and reduced administrative costs will far off-set the "estimated" loss. Don't bother trying to simplify in a way that "raises" revenue -- it simply replaces one form of tax with another; it's just not worth the effort. Beware of "loophole closers": for the most part, they amount to surgery on the capillaries of a patient that's expiring from ruptured arteries. If truth be told, the revenue that most "loophole closers" generate goes to line the pockets of lawyers, accountants, investment bankers and other intermediaries.

B. Comments on Specific Proposals. Various measures previously considered by Congress (*e.g.*, H.R. 3838, as proposed and as modified for inclusion in H.R. 11), and measures introduced in recent months (*e.g.*, H.R. 390, H.R. 661, and S. 258), contain numerous proposals that are intended to enhance taxpayer rights and safeguards. I will limit my comments to the following broad areas: (1) the burden of proof; (2) attorneys' fees; and (3) a suggested framework for considering myriad specific provisions.

1. *Suggested Changes in Rules Governing the Burden of Proof*. From time to time, and for many years, it has been suggested that the IRS should bear the burden of proof in tax litigation. Boiled down to its essence, the appeal of this Siren song is obvious: in a democracy, it's simply wrong to put the burden of proof on a citizen in his or her dealings with the government. Framed this way, I'm certainly tempted to agree.

Unfortunately, I am convinced that shifting the burden of proof in tax cases would be the surest and most direct route to the worst of all possible worlds. It would be an enormous windfall to the few taxpayers who

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[1](...continued)
they are accurate. I recommend that this Subcommittee, and other affected Congressional committees, consider restructuring or terminating GAO's responsibility in this arena and pursue other oversight avenues that will help assure that TSM is carried out successfully.

are bound and determined to cheat the system; it would impose an intolerable burden on the vast majority of honest taxpayers who do their best to comply with the law.

For better *and for* worse, our system relies on self-assessment by taxpayers. The system functions because taxpayers are expected to maintain adequate records and to report properly their items of income, deduction, credits and the like. Changing the burden of proof would have two consequences:

First, it would reduce voluntary compliance. While most citizens would continue to try to pay their fair share, there would be some who would take advantage of the new framework to understate their liability and leave it to the government to prove a different result. While I am convinced that most taxpayers are fundamentally honest, and that the decline in voluntary compliance would be small in percentage terms, the revenue loss and the gradual erosion in the perceived fairness of our system would be sizeable. To put this in perspective, a decline of only 1% in voluntary compliance would cause an annual revenue loss of more than $10 billion. While estimates of this sort are highly speculative, my personal view is that the annual revenue loss ultimately would exceed this amount.

Second, largely in response to the foregoing, the IRS would be compelled to alter its approach to enforcement. Most of us believe that the IRS is far too intrusive today, and that tax administration is far too cumbersome, contentious and burdensome. Well, as the saying goes, "you ain't seen nothin' yet." Change the burden of proof and IRS tactics of today will seem like child's play. ***Of necessity***, the IRS would be forced to resort to far more aggressive techniques in auditing taxpayers and developing cases. Summonses, including third party summonses, would become routine. Expanded record-keeping requirements and increased litigation over discovery issues would be standard fare. In addition, the number of revenue agents and audits of taxpayers would likely increase dramatically. In the world of tax administration, it's hard to imagine a more well-intentioned idea that would have more undesirable consequences.

Having said as much, I do believe there are several areas where the burden of proof question could be addressed by Congress. The first involves a clarification included in H.R. 11 in response to the Tax Court's decision in Portillo v. Commissioner, 58 TCM 1386 (1990), *rev'd in part and aff'd in part*, 982 F.2d 1128 (1991). Section 5503 of H.R. 11 would have required the IRS to provide additional probative evidence in addition to the copy of an information return in litigation regarding the inclusion of additional income reflected on that return. Because taxpayers are faced with the need to "prove a negative" in unreported income cases involving information returns, I believe a change along these lines is warranted. At the same time, however, I should note that this provision reflects current IRS administrative practice and is therefore likely to have little practical impact except in rare and unusual circumstances.

A second area where the burden of proof should be shifted involves attorneys' fees. As noted below, I believe that the award of attorneys' fees to taxpayers should be automatic in certain circumstances. Under the current regime, Section 7430 requires a taxpayer who has substantially prevailed to prove that the government's position was "not substantially justified." Once the government has lost, I think it appropriate to require the government to prove that it's position was substantially justified.

2. *Attorneys' Fees.* As a citizen, and as an attorney, I believe that provisions contained in the Contract With America's "Common Sense Legal Reforms Act" are long overdue. I congratulate you and your colleagues for your timely action. My one observation is that the original proposals have already been diluted needlessly in some respects; hopefully, they will sail through the Senate during the coming months without taking on any more water.

The rationale underlying H.R. 988 is even more compelling in tax cases. I am confident that the government does not engage in "strike suits" for the purpose of extracting settlements from taxpayers. On the other hand, the practical effect can be the same. Moreover, the government lacks the same kind of settlement incentives that are present in the private sector because there are no market pressures requiring a rational allocation of resources. Finally, the government occasionally insists on litigating a case to "make" or "clarify" the law without regard to its risk of losing. While such action may be appropriate, there is no reason why a prevailing taxpayer should be required to foot the bill. Accordingly, I recommend that costs and expenses should be imposed on the government under circumstances similar to those identified in H.R. 988 (tailored to meet various procedural considerations unique to tax controversies).

I recognize that consistency would impose a corresponding liability on taxpayers. While that approach might be warranted, I urge the Subcommittee to address that question in light of the other sanctions imposed on taxpayers under current law (*e.g.*, the Section 6662(b)(2) substantial understatement penalty, the Section 6662(b)(3) and (b)(5) valuation misstatement penalties, the Section 6662(b)(4) pension liabilities overstatement penalty, the Section 6621(a)(2)(B) excess interest charge on taxpayers, the Section 6621(c) penalty interest provision applicable to large corporations, and the Section 6673 sanctions where a taxpayer's litigating position is "frivolous").[2] Stated differently, if a parallel regime governing attorneys' fees is desired,

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[2] My personal view, unsupported by any particular logic, is that taxpayers should be permitted to spend their time and money litigating against the government in tax matters despite the odds -- without liability for attorneys' fees. While I recognize that this has the practical effect of imposing costs on all other taxpayers, there is something quintessentially American about challenging the government "just to make a point" (perhaps, about the unintended consequences of the law or the absurdity of the government's own rules).

these other sanctions should be revisited and modified. Under no circumstances, however, would I make taxpayers involved in small case litigation (so-called "S" Cases) subject to liability for attorneys fees.

I also recommend that the provisions of Section 7430 be broadened and relaxed in several respects (*e.g.*, as noted above, shift the burden of proof to the government; make the award of attorneys' fees under Section 7430 available to all taxpayers; delete the limitations contained in subparagraphs (b)(1), (b)(3) and (b)(4); relax the "substantially prevailed" standard). The IRS has done a reasonable job of administering Section 7430 as drafted. The problem is that the statute, as drafted, is too narrow.

Finally, while it does not relate directly to the awarding of attorneys' fees, I would like to comment on costs incurred by taxpayers arising out of the so-called Taxpayer Compliance Measurement Program (TCMP). While such examinations are wholly appropriate in that they seek to determine the taxpayer's proper tax liability, they also purport to serve other objectives relating to tax administration.[3] The ordeal that taxpayers must endure to survive a TCMP audit defies description. If this program is continued, I believe that taxpayers should be entitled to recover reasonable costs incurred in the process.[4]

3. *Framework for Considering Other Proposals.* I suggest that the Contract With America, and Phil Howard's recent book, The Death of Common Sense: How Law is Suffocating America (1994) serve as a starting point for considering myriad other proposals to enhance taxpayer rights and safeguards. I also recommend Bayless Manning's remarkably prescient article, "Hyperlexis: Our National Disease," 71 Northwestern University Law Review 767 (1977), as well as Gordon Henderson's "Controlling Hyperlexis--The Most Important 'Law And . . . . .'," 43 Tax Lawyer 177 (Fall 1989).

The Contract, Mr. Howard's book, and the articles by Mssrs. Manning and Henderson make a simple and compelling case. We can't legislate common sense or good judgement. We cannot enact laws to right every wrong. While such efforts may be well-intentioned, they do more harm than good.

The same applies to tax administration and to legislation designed to enhance taxpayer rights and safeguards. Legislation that is intended to mandate common sense, or to right every wrong, is sure to fail. There are simply too many areas where common sense is required, and where its application to specific circumstances cannot be adequately anticipated. Likewise, there are too many "wrongs" that cannot be "righted" by legisla-

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[3] As noted above, this same concept provides an additional rationale for requiring the government to pay attorneys' fees.

[4] In the spirit of full disclosure, I should acknowledge my oft-stated view that TCMP has outlived its usefulness and should be restructured or abandoned.

tion. The law of unintended consequences has far too wide a reach.

The best of legislative intentions often pave the road to more litigation, greater taxpayer burdens, increased uncertainty, and counterproductive side effects. In all too many cases, legislation of this type is a futile effort to treat symptoms, while ignoring causes. If Congress concludes that there are areas where the Service consistently displays a lack of common sense, the better approach is to use the oversight process.

The primary focus of legislation -- *and administrative actions* -- should be to ***remove barriers*** to the exercise of common sense. I am convinced that taxpayers' rights are violated most often in cases where "the rules" prevent (or are perceived as preventing) fair play and the exercise of good judgement.

Finally, I would like to return briefly to the point I made at the outset regarding choices and priorities, and reference the Contract With America's attack on unfunded mandates. Every measure you enact entails a choice, and sets a priority. Every measure you enact imposes a "mandate" on the IRS. If you require the IRS to take any action, it means the IRS will not do something else, or will do something else less well.

With these observations in mind, I have the following comments on various proposals that may be considered by this Subcommittee as it deliberates in the months ahead. They are not intended as an exhaustive list; rather they are intended to illustrate the difference between attempting to legislate common sense and empowering the exercise of good judgement. Because I am more familiar with H.R. 11 as approved by Congress in 1992, my references are to provisions of that bill. By and large, my comments are equally applicable to taxpayer rights legislation introduced since that time.

Proposal	Comments
Restructure the Ombudsman position, and limit authority of senior officials	This is an effort to legislate common sense by imposing rigid lines of authority and reporting chains. It would accomplish little good, could cause much harm, and would be a barrier to the exercise of good judgement.
Installment Agreement Changes: automatic right, mandatory 30-day notice, mandatory "independent administrative review"	Once again, an effort to legislate common sense by imposing rigid rules. Proposals would accomplish little good, would cause much harm (including a substantial increase in noncompliance and lost revenue), would impose needless administrative costs and prompt needless litigation, and would be a barrier to the exercise of common sense. The IRS is doing a far better job in administering Offers in Compromise and Installment Agreements (thanks in large measure to the work of this Subcommittee). The primary challenges are to achieve greater consistency (there are still pockets of resistance to change) and to continue refining standards (not every taxpayer can be expected to win the lottery or inherit a million dollars). Legislation is not the way to assure progress on these fronts. On the other hand, it is clearly appropriate to suspend the failure to pay penalty during pendency of an installment agreement.
Preclude the issuance of retroactive regulations	In very rare and unusual circumstances, retroactive regulations may be justified. While Congress may wish to legislate guidelines limiting their use, I believe that the government has generally (though not always) exercised its retroactive authority with proper care. A more effective avenue may be ongoing oversight to assure that Treasury and IRS use good judgement. It is also worth noting a related problem: the rush to judgement. While I would not recommend a legislative solution at this time, I am concerned that a preoccupation with "protecting the revenue" leads to IRS rules and regulations with immediate effective dates that are not well thought out from a policy or implementation perspective. While nominally prospective, these pronouncements can be every bit as pernicious as facially retroactive rules.

Interest abatement	I am of two minds on this issue. The arguments against abatement authority are: interest is simply a charge for the use of money; it is a mechanical computation and abatement is inappropriate. Moreover, abatement authority would spawn substantial new litigation over standards that would be extremely difficult to apply in practice. The argument in favor of abatement focuses on IRS-caused delays, and the additional cost that those delays impose on taxpayers. I think this debate misses several points. First, many taxpayers do not see themselves as "borrowers" -- as the result of an honest mistake, a financially strapped family is faced not only with an unanticipated tax bill, but an enormous interest charge as well. Second, the tax law imposes numerous "finance" charges in addition to interest (*e.g.*, failure to file and failure to pay penalties). Third, deficiency interest rates do not reflect the government's cost of funds; they purport to reflect taxpayer borrowing costs. On balance, I think that the interest abatement proposals under consideration will accomplish less than hoped (*c.f.*, attorneys' fees under Section 7430), and will cause far more administrative difficulties than imagined. As a first step, I think that the better approach would be to do a better job of clarifying objectives, and explore various mechanical changes (*e.g.*, lower rates under certain circumstances) to achieve those ends. If it's not possible to make the mechanics work properly in that context, I would recommend abatement authority that is broader than currently proposed: permit the IRS to take all factors into account (*e.g.*, hardship, nature of the adjustment, taxpayer's prior compliance history, role of outside advisors, etc.). It may also be appropriate to limit the abatement authority to amounts above the government's cost of funds.

Following are other examples of provisions that give taxpayers or the IRS more latitude to exercise common sense:

- Sections 5301 and 5302 of H.R. 11 (relating to joint returns) -- provides taxpayers with greater latitude to exercise common sense
- Sections 5401 and 5402 of H.R. 11 (modifications to lien and levy and offer-in-compromise provisions) -- provide the IRS with greater authority to exercise common sense

Following are examples of provisions that I believe are futile or counterproductive efforts to legislate common sense:

- Sections 5604(a) and (c) of H.R. 11 (relating to the Section 6672 penalty for failure to collect and pay over tax) -- the goals and the approach are both laudable, but the mechanical rules are likely to create more problems than they solve

- Section 5801 of HR. 11 (required content of certain notices) -- notice clarity, like beauty, is in the eyes of the beholder; more to the point, neither can be legislated. (And, moving from the sublime to the ridiculous, the legislative history provides that IRS failure to comply with the statute has no consequences.)

- See, also, Sections 5901 and 5902 if H.R. 11.

C. Conclusion. Perhaps the best way to summarize my views is to urge you to heed the teachings of the Contract With America: set priorities -- don't try to enact laws to solve all the ills that afflict tax administration; focus on reducing the burden that the tax laws and tax administration place on taxpayers and citizens; don't try to legislate common sense -- empower the exercise of good judgement; be sensitive to unfunded mandates, even on the IRS.

Chairman JOHNSON. Thank you.
Mr. Gibbs.

STATEMENT OF LAWRENCE B. GIBBS, PARTNER, MILLER & CHEVALIER (FORMER COMMISSIONER, INTERNAL REVENUE SERVICE)

Mr. GIBBS. As usual, I find myself in agreement, Madam Chairman, with another former commissioner. So I will not repeat what Fred said. I will simply comment on another area that was discussed this morning, and that is the issue about the ombudsmen or the taxpayer advocate.

Frankly this is one where my prior public statements have been sympathetic toward the IRS. I think I understand what you are trying to do, and I would like to make what I hope might be a constructive suggestion.

Chairman JOHNSON. Go ahead.

Mr. GIBBS. I think the biggest concern that I have, and I heard it somewhat this morning, is the attempt to legislate good sense or common sense for these kinds of rules. The problem this creates, when you think you are legislating good sense, is that it gets you into some of the issues that deal with the organization and management of the IRS, and it tends to take on a micromanagement flavor.

On the other hand, with respect to some of the questions you have asked today, the things you have gotten into, the issues with respect to the ombudsmen reports, and similar types of things, I am wondering whether you could not accomplish the same thing by letting the American public know that this is going to be an issue, and asking the IRS and Treasury to give you a report by a certain date on each of the items.

And hold hearings and have an ongoing type of dialog to see why you cannot get the information you want. If there are management concerns with what you are suggesting, in terms of line authority of the ombudsmen or the taxpayer advocate over all of the IRS field organization, get into that to explore it.

But I would urge that in the context of the changes you propose, and in light of everything else that is happening at IRS, you should do that on more of an oversight type of basis, rather than trying to simply legislate the answers.

[The prepared statement follows:]

TESTIMONY OF LAWRENCE B. GIBBS

BEFORE THE SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

REGARDING EXPLORATION OF THE DEVELOPMENT OF

TAXPAYER BILL OF RIGHTS II LEGISLATION

MARCH 24, 1995

Madam Chairwoman, I am pleased to be here today to testify regarding the Subcommittee's exploration of the development of Taxpayer Bill of Rights II legislation. I was the Commissioner of Internal Revenue at the time the original Taxpayer Bill of Rights was passed in 1988. Although I did not initially support all of the provisions in the 1988 legislation, when it became clear that the Congress intended to pass the legislation, I worked with members of the tax writing committees in Congress and their staffs in the development of the 1988 legislation, and I oversaw the initial activities by the IRS to carry out the provisions after enactment. After leaving the IRS in 1989, I have continued to take an interest in the subsequent Taxpayer Bill of Rights proposals including correspondence with members of Congress and discussions with their staffs about various provisions in those proposals. Some of my comments today have been adapted from, and therefore are similar to, my prior communications.

During my tenure as Commissioner I worked with your predecessor in attempting to assure that the IRS met its obligations to fully and fairly collect the proper amount of tax owed to the Federal government. In addition, I have represented taxpayers in dealing with the IRS before and after serving as Commissioner. I therefore recognize, as I know you do, the difficulties that the IRS faces in collecting the amount of tax properly owed and at the same time doing so in a fair, even-handed and professional manner.

I take seriously the importance of balancing the authority needed by the IRS to discharge its obligations with the rights of individual taxpayers in their dealings with the IRS. You well know, and I recognize, that the balancing of such authority needed by the IRS with the rights of individual taxpayers is often as difficult as it is important. This is particularly true at the present time in light of the government's need for revenue, the complexity of our Federal tax laws, and the increasing lack of confidence and respect of our citizenry in governmental authority.

In view of these competing considerations, I have considered carefully many of the provisions in the subsequent Taxpayer Bill of Rights proposals. Some of the provisions may be helpful, but I have substantial concerns about the impact of other provisions on our Federal tax system. There are three provisions that I feel so strongly about for the reasons indicated below that I urge you not to include them in any legislation that you may subsequently consider.

1. **Shifting the Burden of Proof.** H.R. 390 would change the law to provide that in any Federal tax proceeding the burden of proof with respect to all issues would be upon the IRS. As indicated in the excellent summary prepared by the Staff of the Joint Committee on Taxation for this hearing, under present law the taxpayer generally has the burden of proof in all civil Federal tax proceedings. Therefore, the change proposed by H.R. 390, if

enacted, would shift the burden of proof from the taxpayer to the government. I oppose this change because I believe it is misguided, is likely to result in increased noncompliance with our tax laws, and is likely to mislead innocent taxpayers.

The policy behind this change is misguided because, I believe, there is a failure to understand how our Federal income tax system operates. In many countries, the tax collector initially decides how much tax to assess against a taxpayer, and then the taxpayer has the burden of proving that the tax collector is wrong. In the United States, taxpayers initially decide how much tax to pay and assess themselves by filing their Federal income tax returns. On the basis of taxpayers' self-assessments, the IRS each year pays refunds that average about $1,000 each to approximately 85 million taxpayers, for a total annual cost to the government of around $85 billion.

This is particularly significant when one considers that for most taxpayers the chances are less than 100 to 1 that the taxpayer's return will be audited. Further, if a taxpayer is audited, it also is significant that the taxpayer, and not the IRS, generally has all of the records and personal knowledge of the facts surrounding the transactions and activities reflected in the tax return. In light of all this, our present system is predicated on the assumption that because a taxpayer initially prepared and filed the return based on the taxpayer's information and knowledge (and often received a substantial refund based on the return as filed), it is fair to ask the taxpayer to bear the burden of proving that the return is correct if the IRS subsequently disagrees.

In short, under our present system, the taxpayer is presumed to have correctly prepared and filed the return, and for 85 million taxpayers--almost 75 percent of all taxpayers--the IRS relies on this assumption to pay substantial refunds without any questions asked. For these reasons, it is totally inappropriate to suggest, as some have stated, that a taxpayer is "presumed guilty" until "proven innocent" under the present system.

If the Congress passes the proposal in H.R. 390, I believe that some taxpayers may be led to understate their tax and overstate their refunds. Last Wednesday's Wall Street Journal discussed a recent survey which suggests that five percent of our taxpayers cheat on their taxes, and twelve percent would do so if they thought they would not be caught. Similar studies suggest that, apart from cheating, many taxpayers are more inclined to take aggressive positions on their tax returns if they believe that they are less likely to ultimately have to pay any additional tax. If Congress passes legislation shifting the burden of proof and taxpayers become less compliant because of their belief that the IRS will not be able to prove the lack of compliance, not only will our government's tax revenues decrease but also in such event the tax burden on compliant taxpayers will increase.

Finally, taxpayers who subsequently litigate with the IRS and do not properly prepare their cases under the mistaken belief that the shift in the burden of proof means that IRS must "prove everything" may be surprised and upset when they are confronted with discovery demands by the IRS and ultimately by an adverse decision by the court. All of us who have been involved in litigation understand that in today's climate of substantial discovery, it is likely to be difficult for a taxpayer to use burden of proof as a substantial sword or shield. Taxpayers representing themselves before the IRS and the courts, however, may be misled into believing that they do not have to produce information and arguments justifying the amount of their income and deductions if the government is required to bear the burden of proof. For these taxpayers, any new legislation shifting the burden of proof ultimately may be seen as a cruel hoax.

Because of the inherent fairness of our present system, the risk of potentially substantial losses of revenue if the burden of proof is shifted, and the confusion and uncertainty of pro se taxpayers about the implications of the shift, I oppose and would urge you to reject this legislative proposal.

2. Retroactivity of Treasury Regulations. Presently, Treasury and IRS officials have discretion about the extent to which regulations can be promulgated retroactively. Under Section 5803 of H.R. 11, proposed and temporary regulations could not be applied retroactively to periods preceding the date of publication unless Congress so provided or unless necessary to "prevent abuse of the statute to which the regulation relates" or "correct a procedural defect in the issuance of any prior regulation."

As a former Commissioner and as a practitioner, I support the notion that regulations should be issued promptly after legislation is enacted in order to provide affected parties with appropriate guidance and also to avoid the problems that retroactivity creates. However, because of the volume and complexity of tax legislation so frequently passed by Congress over the last thirty years, in my experience it has been increasingly difficult (maybe impossible) for the Treasury Department and the IRS to issue regulations as promptly as desirable and needed. Further, it is my experience that, under our government of checks and balances, it often is easier for taxpayers and their representatives to block or defer the issuance of regulations than it is for the Treasury and IRS to issue them timely, particularly those regulations that are perceived to affect the interests of taxpayers adversely.

Tax policymakers and administrators must deal with the delicate and difficult decision as to whether and to what extent a regulation should be retroactive or prospective. They must deal with a variety of different situations in which retroactivity, rather than prospectivity, is called for or required. I do not believe that the exceptions in the proposal to permit retroactivity are sufficient to cover the myriad of situations and conditions in which the issues arise. Indeed, in light of these circumstances, I seriously doubt the wisdom of attempting to prescribe in advance when regulations should be promulgated retroactively or prospectively. I believe that flexibility to respond to the exigencies of the particular situation is critically important, and that such flexibility is fundamentally what is included in the present provisions of Section 7805(b) of the Internal Revenue Code.

In balancing the needs of the IRS with the rights of taxpayers, I believe that the present flexibility should be continued. Courts have fashioned numerous remedies to permit taxpayers to overturn or circumvent regulations in appropriate circumstances. Over the last thirty years the courts consistently have demonstrated a willingness to uphold taxpayers' actions despite contrary provisions of the regulations when a court determines that the taxpayer has substantially complied with his or her tax obligations or that the IRS has abused its discretion in formulating or administering its regulations. Therefore, I urge you to reject this proposal.

3. Political Appointment of Ombudsman. Presently, there is a Taxpayer Ombudsman on the staff of the Commissioner of Internal Revenue who is appointed by the Commissioner and who oversees the Problem Resolution Program (PRP) of the IRS. Section 5001 of H.R. 11 would replace the Ombudsman with a "Taxpayer Advocate" who would be appointed by the President and confirmed by the Senate and who would supervise all of the PRP personnel. As a former Commissioner and a practitioner, I have worked directly with the Ombudsman and PRP representatives, and I enthusiastically support their goals and activities. My experience suggests that the role and importance of the Ombudsman and the PRP programs are increasing. I believe that among the keys to continued

effectiveness of these programs is the need to institutionalize the attitudes and objectives of the Ombudsman and PRP throughout the policies, procedures and personnel of all of the functions of the IRS.

In my opinion, the proposal in H.R. 11 would do just the opposite. By creating a new office headed by an independent Presidential Appointee and given a statutorily mandated independent function, the proposal separates PRP. In any large organization, once a program is separated, it becomes almost impossible to institutionalize the attitudes and objectives of the program. If the present proposal is enacted to statutorily mandate the Presidential appointment of a Taxpayer Advocate to whom the PRP program will be responsible, I believe that the detriments resulting from such change will more than offset any intended benefits.

Further, I am concerned that the rigidity and difficulty of amending statutory provisions will stifle the activities of the Ombudsman and PRP. At a time when the business, organization, and activities of the IRS are undergoing substantial and continuing change, I believe that the Ombudsman and PRP must have the flexibility to make changes in organization, activities and functions that will not be permitted by the proposed statutory provisions in H.R. 11. In light of the difficulty that Congress has had in passing technical corrections bills in recent years, I do not believe that there is sufficient flexibility in the Congressional tax legislative process to be able to accommodate the need for changes in the statutory provisions that future events affecting IRS in general, and the Ombudsman and PRP in particular, may require.

I am particularly concerned that the changes proposed may politicize the Ombudsman and thereby render the Ombudsman less effective in leading and managing PRP. As you may know, the Ombudsman presently is involved personally on a daily basis in numerous audit, collection and other enforcement activities affecting specific taxpayers. Often taxpayers or their representatives request the involvement of the Ombudsman. History has taught all of us about the dangers inherent in the involvement of political appointees in such activities on a day-to-day basis at the request of taxpayers. I therefore oppose and urge you to reject this proposal.

Thank you for inviting me to testify. I will be happy to answer any questions.

Chairman JOHNSON. That is a very interesting comment. It is particularly interesting because the one thing the Congress has been really outstandingly bad at is oversight.

And then we come in with either extraordinary penalties or micro-managing the administrative structure and then we wonder why government costs more, and it is more burdensome and more tangled. But that is a thought that I will take to heart and think through.

Mr. GIBBS. Ms. Johnson, this is my second time to attend one of your hearings. I worked closely with your predecessor, and I must tell you that in terms of the quality of the hearing that was the last hearing you had with the IRS and the quality of the hearing today, you ask good, hard, tough questions. So do the other members. That is the tradition here. And I would simply tell you that I think that with the quality of the staffs that you have, and under your leadership, I think something like that could really work with the IRS.

Chairman JOHNSON. Thank you.

I do think that the Congress, as the rest of the world—but certainly government policymaking is entering a new era. I think when you have to make change in the way this society has had to make change, when you look at the change in authority from the CEO, the guy at the machine in the factory and that is true in every other sector.

But we are going to have to make that power shift in government, too. We are going to have to make the power shift from the central power to the people on the line who are dealing with the constituents. But if we are going to have any quality, we are going to have to figure out how to oversee that and in the public sector we have never been very good at that.

One of the issues that the preceding panel brought up was the catastrophic level of victimization of some people in the current system.

And all of our regulatory reform is coming from bureaucrats in EPA who will not be rational. I mean I have dealt with them and they are in every agency. And it is unfortunate because there are lots and lots and lots of folks in all those agencies who are doing a wonderful job and are thinking through the implications of the law and the circumstances of a particular case.

And it is, in a sense, the irrational one or the hard-nosed one, the one who does not give a damn anymore that gives the bureaucracy a bad name and sometimes results in the wrong kind of legal change.

So if we can do a better job of oversight and we are going to try it very soon, so that we can see what is that tangle down there that needs to be released and can it be released through that current structure.

But I thank you. I am very proud of this committee. We have been preoccupied with other things, but I think we have never had a stronger oversight committee in terms of the quality of the members and the breadth of their knowledge.

And I am looking forward to doing a far better job of oversight not only for members' knowledge, but for the public's knowledge. I appreciate your comment, thank you.

Mr. GIBBS. I think your comments, and those of the other members as well, about the ombudsman program are correct. My instinct is that it is working. What you are trying to do is to make it work better, and I understand that.

One comment to you though is that, as the Congress is beginning to look at putting things back to the local level and to the States, I am concerned because this proposal, in effect, attempts to address the problems by bringing more power and centralization into the taxpayer advocate here in Washington, D.C.

Chairman JOHNSON. Right, exactly, I understand that. I hear your comment and it is well taken.

Mr. GIBBS. Another thing that I would comment about: I thought Mr. Monks this morning said something that is very significant in the IRS culture and organization when he said, "let me sit on the selecting committees and let me review folks and their pay and promotion."

If you start building the advocate or ombudsman into pay and promotion, then there is a way of doing the matrix management. I think that will work and pick up the same benefits you see of having him involved in the field.

Chairman JOHNSON. I thought that was a very good comment. I thought the other point of his testimony that we actually did not pursue in questioning, but that was very significant is the issue of relationships within the office. How do you deal with this difficult problem and are you going to make people adversaries out there on the front line?

And how are you going to lead them as a team cooperating on tough problems that clearly are not ones that we are all proud of.

Mr. GIBBS. Yes, Madam.

Chairman JOHNSON. Mr. Alexander.

STATEMENT OF DONALD C. ALEXANDER, PARTNER, AKIN, GUMP, STRAUSS, HAUER, & FELD, L.L.P. (FORMER COMMISSIONER, INTERNAL REVENUE SERVICE)

Mr. ALEXANDER. In view of the passage of time and in view of the fact that I agree almost completely with——

Chairman JOHNSON. We are all right. You do not have to rush. We have time.

Mr. ALEXANDER. I agree completely with almost all of what Commissioner Goldberg said, and I agree with what Commissioner Gibbs said about oversight.

When I was commissioner during those tranquil days of Watergate we badly needed oversight. We needed it in the Ways and Means Committee, the best committee to give it to us. And we did not get enough of it.

I was delighted with the hearing this morning, Madam Chairman. I am delighted to hear you say that you intend to followup and have further and searching oversight hearings like this one.

IRS badly needs to have an updated computer system. I agree with what Fred Goldberg said and I agree with what he said about, please do not pass any measure which would shift the burden of proof on all issues, in all tax cases, to the IRS.

The system can stand much, but it cannot stand that.

[The prepared statement follows:]

TESTIMONY OF DONALD C. ALEXANDER
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
MARCH 24, 1995

INTRODUCTION

Our system of income and employment taxes imposed on a very wide base of individuals and corporations depends not only upon withholding, information reporting and reasonable but effective enforcement by the Internal Revenue Service but also upon the public's willingness to comply. The last factor does not lend itself readily to analysis, but I think that significant to the public's willingness to comply is a basic belief that the tax system is reasonably fair and is soundly administered. Unfortunately, the mind-boggling complexity of current law, much enacted largely in an effort to seek exact statutory fairness, threatens acceptance of the system and, therefore, compliance with it.

Another important element, as I see it, is how the public views tax administration. Now, no one likes to pay taxes, and no tax collector is likely to win a popularity contest. (I am continually surprised about how two former tax collectors in North Dakota were elected to the Senate.) But the job of the Internal Revenue Service is to try to make sure that all taxpayers pay the taxes due from them. This means filing all required returns, accurately reporting income and determining tax, and paying the tax due. Now there is bound to be some slippage in a system like ours, and there certainly is. If IRS' estimates of the tax gap (roughly the excess of what is actually due from legal-sector taxpayers over what is paid) are reasonably accurate, and I think they are probably low, then our budget would be almost in balance if we could close the tax gap completely and collect a reasonable part of what the illegal sector owes. Of course, this won't happen. But we need to narrow the tax gap if we can, and surely we shouldn't permit it to widen. Not only would widening the gap increase the deficit but it would also send the wrong signal to our many compliant taxpayers: Why should they pay if their neighbors don't?

The IRS is a large organization, as it must be. It should be larger. It badly needs a new computer system but in the meantime it does the best it can with the aging, inadequate system that it has. It has the vast responsibility of trying to make the system work and, like other human organizations, it is not perfect. Some of its many people at times come on too strong with taxpayers, at times are arbitrary, at times are forgetful, and at times are too lenient. I have great respect for the present Commissioner and she is doing an excellent job in trying to reconcile IRS' duty to assist taxpayers and be reasonable toward them and IRS' duty to cope with tax avoidance and evasion and collect overdue and unpaid taxes. By the way, I think it ironic that while IRS is being beat around the head and shoulders (not without some reason) for being overzealous in collecting revenues, the job of collecting child support payments is being pushed on the IRS. If IRS does such a bad job in collecting taxes, why give it an additional nontax task?

H.R. 390

This measure, proposed by Mr. Traficant, would place the burden of proof on the Internal Revenue Service on all issues in all tax cases. In my judgment, this is unwarranted and ill-advised. Within a short time it would do great damage to our broad-based income tax system. Without large increases in staffing--which I don't believe will occur--the Internal Revenue Service would be overwhelmed in its efforts to require compliance with the tax laws. Taxpayers (and there are some) who don't want to meet their obligations to their country and to their fellow

citizens would soon overlook income and make exaggerated claims to deductions and credits on their returns. The Internal Revenue Service, called on to prove in all matters and all cases that the taxpayer's reporting was wrong, would simply be unable to satisfy this burden. How can the IRS prove a negative without demanding and reviewing all records relating to a taxpayer? It would be unrealistic to believe that the many honest taxpayers who attempt to meet their tax burdens in full would not soon realize that others were beating the system and getting away with it. The tax gap would increase substantially, and compliance with the system would have a commensurate decrease. The deficit would correspondingly increase.

If Congress perceives that current law is not sufficient to rein in overzealous IRS agents, the way to meet the problem is to review and strengthen section 7430 of the Code, which calls for the United States to pay taxpayer's costs in defending against IRS actions which were not substantially justified. One must remember that IRS agents are "real people" too; they don't leave the human race when they sign on with IRS.

TAXPAYER BILL OF RIGHTS

The following represents my preliminary comments on Taxpayer Bill of Rights 2 (T2) as contained in H.R. 661 and S. 258.

My general comment about T2 is that, as a general rule, it is inadvisable to try to micromanage the Internal Revenue Service through legislation. Although the exercise of oversight responsibilities does consume valuable Congressional time, and I realize how little time Members actually have, I recommend that there be more oversight on how the Internal Revenue Service fulfills its vast responsibilities and less direction in the statute on exactly what the Internal Revenue Service must do and must not do.

1. *Taxpayer Advocate.* Let's give the current Ombudsman provision a chance to work. I think it is working reasonably well, but this can be tested, and should be tested, at Oversight hearings. A statutory taxpayer advocate of the kind envisioned would, I think, create as many problems as it would solve. In trying to balance rights of taxpayers against effective and economical administration of the tax laws, I think this drastic step is not needed at this time.

2. *Installment Agreements.*

A. Installment agreements should be fostered, not discouraged, and I believe the recent step in imposing a $43 charge for installment agreements was ill-advised and should be rescinded. If for some reason any charge of this kind must be made, it should be limited to amounts of unpaid taxes exceeding, at least, $50,000. I do not think that the authority to issue taxpayer assistance orders under IRC § 7811 should be extended to eliminate the current limitation to a "significant" hardship. In a broad sense, all Internal Revenue actions which seek to separate a taxpayer from money create "hardships", for all of us are better off with our money than without it. Surely this should not be the sole test.

B. T2 would provide an automatic right on the part of an individual taxpayer to cause the Service to enter into an installment agreement if the unpaid tax in questions is less than $10,000 and if the taxpayer "has paid any tax liability for the three preceding taxable years". If I understand this provision, I think it goes much too far. However, T2 is correct in suspending the failure to pay penalty while an installment agreement is pending, and I do not take exception to its proposal for 30-days notice by IRS if an agreement is denied or terminated. The exception for cases in which collection of tax is in jeopardy should meet IRS' administrative needs. In my judgment, any gain by

providing an administrative appeals structure is outweighed by additional costs.

3. *Interest*. T2 would extend the provisions permitting abatement of interest, and would extend the interest-free period for payment of tax after notice of demand from 10 days to 21 days. I am concerned about these provisions, particularly that calling for mandatory abatement for small taxpayers. Small taxpayers deserve to be treated exceptionally reasonably and fairly, but I don't think this should extend to interest-free loans from the Federal government to those who haven't paid their taxes. While some of the changes seem worthy, I suggest you move cautiously here to preserve equity while forestalling another rash of lawsuits.

4. *Joint Returns*. These provisions are all right with me in principle. As to technical issues, I believe that the American Bar Association will comment.

5. *Collection Activities*. This is the most sensitive area, as I see it. The Internal Revenue Service has been heavily criticized for not being an efficient bill collector, and recently some have wanted to privatize collection of taxes. Perhaps on the basis of obsolete information about how private bill collectors go about their jobs when they are paid a percentage of the amount collected, I think that if collection of taxes were privatized, within a very few years taxpayers would be beseeching Congress to give the job back to the IRS. In the past the IRS has not been fully consistent in its collection stance either from time to time or from one locality to another. Some districts have been hard-line and some have taken a much softer approach. Surely the IRS should strive to prescribe uniform and reasonable rules and apply such rules uniformly throughout the country. But curtailing IRS powers to collect taxes means, to me at least, that less taxes will be collected and more will be written off. Again, we have a balancing problem.

My specific comments are as follows:

(a) *Withdrawal of Lien Notices*; Why not? (But we need administrable standards.)

(b) *Return of Levied Property*; Why not?

(c) *Increasing Exemption Levels*; Why not?

(d) *Expanding Authority to Accept Offers in Compromise*; Clearly $500 is too low, but $50,000 may be high. Given possible integrity and other problems, I would settle for $30,000. We can always increase the ceiling further if needed.

(e) *Notice Before Examination*; Is this really needed? What happens if the notice is defective?

(f) *Limits on Recovery of Civil Damages*; $200,000 would be plenty. Raising the level to $1 million would encourage bounty-hunting by contingent-fee lawyers whose practice will soon be diminished, I hope, by the enactment of long-needed legal reform.

(g) *Review of Designated Summons*; I think this should be left to the IRS; is this legislation really needed?

6. *Information Returns*. While I think that taxpayers receiving information returns should be provided with access to those issuing returns in order to clear up questions, this proposal raises questions which, at this very preliminary stage, I am unable to evaluate. What effect would an incorrect telephone number have on the information return? On balance, I would strongly encourage

the IRS to seek to provide taxpayers with what they need, but I would hesitate to put it in the law until further consideration. Moreover, I would extend the effective date until 1996.

7. *Civil Damages for Fraudulent Information Returns;* Why not?

8. *Requiring IRS to Make "Reasonable Examination" of Information Returns;* Given the enormous volume of information returns, I think this goes too far.

9. *Section 6672 Penalty.* The exception for jeopardy situations makes the proposed requirement of preliminary notice rules of somewhat less concern, but on balance, I question whether it is needed.

10. *Warnings and Notification Requirements.* If my understanding is correct that taxpayers may not use the lack of warnings to escape the 6672 penalty otherwise due from them, then I don't object to the warning provisions. However, I have substantial doubt about whether the notification requirements are administrable, and I recommend they be dropped. Both of these issues are better handled without legislation.

11. *Litigation Costs and Fees.* I would increase the cap as recommended but omit the other changes.

12. *Other Provisions.*

(a) *Required Content of Notices.* Provided the proposed change doesn't give rise to wholesale invalidation of notices, it seems all right.

(b) *Substitute Returns.* Seems fine.

(c) *Retroactivity of Regulations.* Although I certainly don't agree with Treasury and IRS all the time about their substantive pronouncements or, in a very few cases, about their respect for the rule that sound tax administration calls for fairness and leniency in selecting the effective dates of regulations, I don't think that the proposed changes are a good idea. Let's caution the administrators to turn square corners with the public, but in this situation, as in many others, it is better to leave the law where it is. Through oversight hearings and correspondence Congress can see to it that the administrators try to do their jobs correctly. I am particularly concerned about the proposed effective date of this provision: Eliminating retroactivity of regulations would be implemented retroactively.

(d) *Required Notice of Payments.* How about 90 days?

(e) *Unauthorized Enticement of Information.* Unless I am missing something, this seems all right.

13. *Form Modifications.* Let's leave this to the administrators and ask them at oversight hearings and otherwise what they are doing to make sure that taxpayers are fully informed.

14. *Studies and Reports.* Same comments as above. Besides, I don't think a law is needed for Congress to communicate with the General Accounting Office about Congressional needs and priorities.

Chairman JOHNSON. Thank you.
Mr. Cohen.

STATEMENT OF SHELDON S. COHEN, PARTNER, MORGAN, LEWIS & BOCKIUS (FORMER COMMISSIONER, INTERNAL REVENUE SERVICE)

Mr. SHELDON COHEN. Thank you, Madam Chairman. I would associate myself with just about everything that my colleagues have said on the taxpayer advocate, I think it is important. The commissioner goes around the country saying, "I am the only political appointee in this system." I think that is important. I think that is useful. I think it breeds confidence.

As to the innocent spouse, joint liability, I was there. The case that gave rise to innocent spouse came up when I was there and I proposed that legislation.

I think that what has been proposed to you is more far reaching than has been discussed here. And I think you need to go into that in a lot more detail before you dive into a pool where there may be some fish that you do not want to be in the pool with.

As to attorneys' fees, I have not personally had a problem. But I would agree that if the government goes down in blazing defeat that is the appropriate time for it to justify itself.

On equity jurisdiction, I once said before the Appropriations Committee when one of the members put the question to me, should I have equity jurisdiction? I said, yes, I have absolute confidence in my own judgment. I said, but on the other hand, I do not have confidence necessarily in those who might replace me. So maybe you had better not give it to me either.

So you have to be very careful about giving equity—do you want the Revenue Service to respond to a sad story? It may, it may and it may do it in a way that you do not like and then your oversight is going to be all over them.

So I would think long and hard about too much equity jurisdiction. Giving me equity is to do a dis-equity to everybody else. Because they have complied with the law.

[The prepared statement follows:]

TESTIMONY OF SHELDON S. COHEN
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON OVERSIGHT
MARCH 24, 1995

Madam Chairman and Members of the Subcommittee on Oversight:

My name is Sheldon S. Cohen. I am a partner in the law firm of Morgan, Lewis & Bockius in the D.C. office. I am delighted to appear before your Subcommittee today to give you my personal views on a possible expansion of the **Taxpayer Bill of Rights.**

The Congress has visited this area -- of protecting the rights of taxpayers from real or perceived ills -- since the original Taxpayer Bill of Rights became law in 1988. Several members of this House and of the Senate have from time-to-time suggested changes to further expand the rights of individual taxpayers during audit or collection activities. H.R. 11 was included in the Revenue Act of 1992 but was vetoed by President Bush and thus never became law.

I would like to discuss a few of the provisions of H.R. 11 which I believe should be modified and one new idea which has been raised recently which would require the government to bear the burden of proof in all tax situations.

I would remind the Committee that I served in the Internal Revenue Service on several different occasions. During the period 1952-1956, I served as a legislative draftsperson during the drafting of the 1954 Code and Regulations. In the period January 1964 through January 1969, I served as Chief Counsel for one year and Commissioner of the Internal Revenue Service for four years. I have also served as a Trustee of the National Academy of Public Administration and have served as a panel member of several studies for the administrative aspects of the Internal Revenue Service. I also served as Co-Chair of a study of the collection and privacy portions of the Internal Revenue Code for the Administrative Conference of the U.S. (The changes recommended by that group, co-chaired by Justice Scalia, were adopted by the Congress in 1976.)

The object of the **Taxpayer Bill of Rights** is salutary. Every taxpayer, in dealing with his government, should be treated fairly and courteously. There is no excuse for overbearing or harsh behavior on the part of any government official in dealing with any taxpayer. Most IRS employees do their jobs fairly. When I was Commissioner, I emphasized this -- that the good taxpayers deserve it and those that try to game the system will be confounded by fair treatment.

Nevertheless, as you can understand, the job of tax collection is tough and trying. There are many occasions where either or both the taxpayer and the IRS employee's nerves will be frayed, and they will annoy each other. Because an IRS employee occasionally annoys a taxpayer is no reason to give that taxpayer rights any better than any other taxpayer. To treat one taxpayer in a beneficial manner more favorably than another is to prefer one taxpayer over the other. This is unfair and creates hardship for other taxpayers.

Thus, I do not favor the waiving of interest as provided in H.R. 11 for "any assessment of a deficiency attributable in whole or in part to any error or delay by an officer or employee of the IRS..." may be abated. It is hard for me to see why a taxpayer should pay no interest even if the IRS unreasonably delays performing a managerial or ministerial act. The taxpayer had use of the money and could have had it in an interest-bearing account. Thus, I would use a fair interest rate. If you charge no interest, you benefit one taxpayer over the other.

I am troubled by the creation of a new Presidential appointee to serve as Taxpayer Advocate. Since the 1952 Reorganization of the IRS there has only been one Presidential appointee in the IRS, the Commissioner of the Internal Revenue.[1/] Prior to 1952 there were numerous Presidential appointees and each was appointed with the recommendation of the

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1/ The Chief Counsel is technically an Assistant General Counsel of Treasury assigned as Chief Counsel of IRS.

usual political sources. This lead to problems in the 1950s and lead to the so-called "Blue Ribbon" System we have now. If the Congress wishes to have a Taxpayer Advocate, this can be done, but there would appear to be no necessity to set up a position of such high rank which might become enmeshed in politics. I have enough confidence in this Committee's action over the years to believe it can properly monitor the role of the Taxpayer Advocate.

The Congress has from time-to-time criticized the IRS for its failure to collect all the taxes due. At other times the Congress has criticized the IRS for acting too harshly in collecting the taxes which are due. You must remember we are talking about taxes which are due or overdue and what is really necessary is determining whether the taxpayer has the capacity to pay more quickly or more slowly. Reasonable people may well disagree on these points. Reasonable notice by the government as to the change of an installment agreement may be required but not too much. Please remember the situation is very fluid and delay may cause failure to collect. That burdens the taxpayers who comply.

In regard to the provision regarding possible personal liability by an IRS employee, the House has earlier proposed such a provision. The Senate did not. The Bill as passed had no such provision. I would hope that you would go along with the Senate version again. Otherwise, you will inhibit IRS employees from acting on their best judgment on the threat of possible personal liability. The liability may not be real, but it will inhibit reasonable action out of fear. This will not be constructive for the administration of the tax laws. Likewise, it will not benefit the taxpayer as the law already gives him/her a right of reimbursement against the government.

In regard to retroactive regulations, taxpayers like them when they are favorable but violently disagree with them when they may be tighter than they want. The interpretive regulation is different from the legislative regulation. Assume the Congress passes a new provision and the Treasury issues a notice of rule making a year later -- then waits a year to complete the final regulation. The interpretive regulations merely interpret the law; it should be effective from the date of enactment assuming the courts find it to be a reasonable

interpretation. In most instances where the regulation takes a sharp departure from a prior position of the IRS, the regulations are prospective only. Likewise, most legislative regulations are prospective.

There are problems when a notice has been issued and the regulations are finalized years later. In such cases, then taxpayers often complain that they are harmed by the retroactivity of the regulation. How about the majority of taxpayers who go along with the Treasury's proposed position -- Are they harmed if you had a rule of no retroactivity. I think the compliant taxpayer would be hurt. He has followed the rule the Treasury suggested as right, but the person who pushes the edges gets the benefit of delay. I would not go for such a rule. Regulation can be fair even when applied retroactively. I don't think you can write a statute which gets it exactly right. There is too much judgment involved.

The area of the erroneous 1099, K-1 or the like is troubling. It would be good to work out a system to test these; however, it seems difficult to me to allow any taxpayer to contest the correctness of a 1099 by bringing in other taxpayers. Some system of allowing a taxpayer to prove to the IRS that the information return is in error should be allowed. I am not sure this is a prevalent problem. Certainly, the filing of a fraudulent 1099, K-1 or the like is now subject to penalty under the criminal sector of the law. I'm not sure you need more.

Another item should be raised. Some people have suggested it is inappropriate to have the taxpayer bear the burden of proof in a tax case. They assert that the government shall bear the burden of proof in all tax matters. This suggestion, while sounding nice, is quite illogical. In our self-assessment system, the taxpayer has the records and makes a self-assessment; that is, he asserts his position on his return. If the government disagrees with that position, it asserts a deficiency which the taxpayer can litigate in the courts. Historically, the first right to litigate was by way of refund. That is the

taxpayer was required to pay the tax and sue for a refund. The taxpayer, being the moving party, therefore bore the burden of proof. Next with the introduction of The Board of Tax Appeal and later the Tax Court, the taxpayer was allowed to litigate before paying, but the burden of proof stayed with the taxpayer. Thus since the inception of the first income tax in 1862 (proposed by President Lincoln), the burden has been on the taxpayer.

Now I can tell you as a litigating lawyer in private practice, I would love it if the government always had the burden of proof. But that is not fair nor is it practical. If you enact such a rule, it will dramatically effect the efficiency of the system and will result in lower collections. Think of a system where the taxpayer has all the records and the government has to prove the case. If the government has access to the records, it will demand them all (more than it really needs) just to protect itself. That would be costly and ineffective on both taxpayers and the government. On the other hand, perhaps this rule would deny to the government the records altogether. Then the tax system would be a shambles.

Although I have a personal interest in making it tough for the government (after all, I represent taxpayers now), I do not believe a change in the burden of proof would help the system in terms of fairness or effectiveness.

I have not discussed all the provisions of H.R. 11. If you would like my views on any specific provisions I have not covered, I would be pleased to address them.

Chairman JOHNSON. Well, thank you, Mr. Cohen. I think that is a very wise comment to make to us at this point. And I think every member, when they are first elected to Congress, one of the reasons I am opposed to term limits is that it is hard to understand this issue of equitable implementation nationwide.

And what fell on one of my constituents is clearly it outrageously inequitable. I could see, over time, clearly was better than the inequities that would result if we gave too much latitude in the implementation and the enforcement of tax law.

On the other hand, I do think this issue of what happens in some of these postdivorce situations is serious enough and the inequities that are resulting are serious enough that we need better guidance.

Mr. SHELDON COHEN. Oh, yes. I do not dispute that. I just say that——

Chairman JOHNSON. I would be happy to have your comments on the other side, because I think the recommendation to simply repeal this always has unintended consequences. So if you want to give us your thoughts on that particular issue, feel free to follow-on and do that. And that goes for all of you.

Thank you very much for your written testimony which we have reviewed, at least some of us have already reviewed, and it will be helpful to us as we move forward.

Thank you.

And after this vote there will be then one more vote with no time lag to speak of. So it will probably be about 15 minutes before the members are able to assemble for the final panel. I apologize for the delay.

[Recess.]

Chairman JOHNSON. My apologies for the delay but business is done around here in this kind of fractured manner all the time.

I am going to, in turning to the next panel, ask Mr. Lane to go first on behalf of the National Association of Enrolled Agents. We appreciate your testimony, Mr. Lane, and we know you have to catch a plane. So we will hear from you first and then the others in succession.

I do appreciate, very much, the panel members patience and the fact that you are all still here.

Mr. Lane.

STATEMENT OF JOSEPH F. LANE, ON BEHALF OF THE NATIONAL ASSOCIATION OF ENROLLED AGENTS

Mr. LANE. Thank you, Madam Chairman.

We have submitted written testimony and I am sure the committee has heard a lot today and I would be happy to submit my written testimony and just provide some additional comments rather than to go through all of it, if you would prefer?

Chairman JOHNSON. For all of you, your entire statement will be included in the record, that is our tradition. But we try to limit the opening statements to five minutes, and usually you are better off summarizing, particularly at this point, because you have heard the rest of the testimony, and giving us your thoughts on those other discussions.

Mr. LANE. Ok. Basically with respect to the tax ombudsmen issue, we think that the political culture within the Service would

not really allow a political appointee to effectively work as well as the current problem resolution function does.

And I think if the concern of the Congress is that they are not getting accurate information and they are not getting the types of reporting that they would like to have, then probably the best thing to do would be to address that issue much along the lines that Commissioner Gibbs suggested, that by having open hearings each year, for example, on the number of ATAO's that were issued and the interventions that problem resolution did provide for taxpayers.

But as taxpayer representatives, we feel that PRP functions fairly well and has been able to stop the enforcement divisions in their tracks when we need to have them stopped and most of the time it works.

I think the inclination of having a separate bureaucracy set up outside of the Service that the practitioners would have to deal with just provides another level of interface which I do not think really helps the taxpayers.

Now, we agree on the installment agreement provisions with one exception. We would like to see the bill amended to provide the right to an installment agreement to taxpayers that have even been delinquent in the last 3 years.

Chairman JOHNSON. Excuse me, I did not understand. The right to?

Mr. LANE. The bill proposes a right to an installment agreement.

Chairman JOHNSON. Yes, the installment agreement.

Mr. LANE. But the language in the bill says that the taxpayers had to have paid all the taxes, at least one out of the last three years, on time. There are a lot of people who, because of the withholding tables—for example, a couple that worked for minimum wage, if they both were claiming married and two they would be under-withheld when they file that joint return. And they need an installment agreement to catch up on last year's taxes.

The fact that that is just an accident of the way the tables work I think it unnecessarily penalizes those people to deny them the right to an installment agreement, and subject them to the additional late payment penalty.

Whereas if they had an installment agreement privilege they would not be charged, as the bill now proposes, with the late payment penalty.

So we would like to see that changed.

We agree with Professor Beck's proposals on the joint and several liability. I think that needs to be addressed. Clearly, that comes back to haunt a lot of us, especially out in community property states. We've got significant problems when IRS is trying to go after a new spouse's earnings on that to pay off prior liabilities. That really does complicate things.

On the collection activities, we agree with the ability now to withdraw an erroneously or prematurely filed lien. And we would also like to see additional restrictions put on Service employees who are employed in the automated collection sites, the ACS sites, or their replacement sites, the new taxpayer service sites, from being able to put liens on accounts without some better managerial review than they currently are subjecting them to.

One of the problems we have is we have these people who are trained very, very superficially on the impact that a tax lien has on a taxpayer's credit ratings. And they file these liens. And by the time the case gets to the field, the lien is already on file and it really complicates the ability of the taxpayer and the tax practitioner to be able to resolve that case using commercially available credit resources.

So it forces these people into very much more expensive installment agreements with the Service. And it is not to anybody's benefit to do that. It runs your accounts receivable inventory up and it hurts the taxpayer.

We would like to see the third party recordkeeping requirements extended to enrolled agents, just as CPAs and attorneys now have it.

One of the other concerns that we have is about H.R. 390. We think that is really a mistake. That legislation, which on the surface, appears to be mom and apple pie, really ought to be titled, the Tax Evasion Enabling Act of 1995. I mean it really complicates the process for the Service to administratively resolve these things.

What it does is this. It takes the burden off the taxpayer who files the tax return to provide the documentation, and puts that burden on every other taxpayer they did business with during the year. Because instead of having the intrusion between the taxpayer who filed the tax return and the Service auditing him, the intrusion now involves every other taxpayer that the Service has to involve to document the audited taxpayer's expenses or income. It really is not a fair process.

We have some additional suggestions for improvement and areas of concern. We think that any Taxpayer Bill of Rights ought to address the fears that the Service stirs up with taxpayers when they announce new programs.

There are a couple of changes that they recently announced that obviously are causing a lot of people concern. In the collection function, they have implemented user fees on people that require installment agreements.

As we heard in testimony at the rulemaking hearing, in January at IRS, if you had a taxpayer who worked for minimum wage, this user fee that they are now charging to let this guy have an installment agreement is 2 days pay.

That is an outrage. These are the people who can least afford to pay. When you consider the tax, the interest, and the penalties that they are paying, the interest and penalty charges, in total, would be usurious under state law, anywhere in this country. The only reason they are not is because the Federal Government is charging them.

But to tack on an additional $43 user fee is outrageous and we think that ought to be taken back.

The other program that is stirring a lot of concern up lately, with practitioners and taxpayers alike, is this new announcement that they are going to be pursuing the economic reality, or lifestyle audit. And that has got a lot of people concerned about why IRS needs access to all of their financial data and whether or not they are going to be using credit reports.

Obviously they are concerned about the abuse potential that exists. The practitioners are concerned because one of the key elements——

Chairman JOHNSON. Lifetime audits——

Mr. LANE. Lifestyle audits. In other words, what the Service is going to be looking at is the economic reality of that taxpayer. What they have said in their publications is that they are no longer auditing the tax returns, they are going to audit the taxpayer.

In other words, if you have got $30,000 on your return, how do you have a $400,000 house? Those types of questions. And all of their auditors are going through training right now on that topic. They are going through a 32-hour training course this month and last month.

The concern in the practitioner community—and I think it will probably be voiced by other people on this panel today—is that one of the key elements of the 1988 Taxpayer Bill of Rights Act was the absolute right of taxpayers to have representation and the right of those representatives to stand in the shoes of the taxpayers.

The way that these economic reality audits are being constructed, the advice the Service is giving to their auditors is that when it comes to lifestyle questions, the representatives are really not equipped to answer it and a taxpayer has to be present at the audit.

So that is going to stir up that whole issue we thought we finally had buried years ago. I think everybody probably will reflect the same concern.

Those types of announcements and programs that get introduced get people stirred up. I think that the key element of all of these Taxpayer Bill of Rights proposals ought to be that the Enforcement Divisions of the Service are able to do their job with the least amount of impact and adverse harm on taxpayers that they come in contact with.

That ought to be the over-arching goal of all of these proposals and changes.

I would be happy to take any questions you may have.

[The prepared statement follows:]

TESTIMONY OF JOSEPH F. LANE
NATIONAL ASSOCIATION OF ENROLLED AGENTS

Madam Chair Johnson, Ranking Member Matsui, members of the Subcommittee on Oversight, thank you for the privilege of testifying today. My name is Joseph F. Lane and I am an Enrolled Agent engaged in private practice in Menlo Park, California. Prior to commencing private practice fifteen years ago, I served with the Internal Revenue Service for almost ten years. While with the Service, I served at the District Office, Regional Office, and National Office levels and was the Collection Division Chief for the State of Hawaii, the Taxpayer Service Division Chief for the State of Connecticut, and the Resources Management Assistant Division Chief for the Manhattan District. I am here to testify on behalf of the National Association of Enrolled Agents (NAEA).

NAEA appreciates the opportunity to testify on behalf of its approximately 9,000 Enrolled Agent members and to speak for the individual and business taxpayers whom we represent. Enrolled Agents are professional individuals whose primary expertise is in the field of taxation and taxpayer representation. As the Committee members well know, the Enrolled Agent profession was created by an Act of Congress in 1884 to provide for competent and ethical representation of claimants before the Treasury. We are proud to say we have been diligently fulfilling this role for the American taxpayer for the past 111 years.

Enrolled Agents establish their expertise in taxation and taxpayer representation by either passing the Internal Revenue Service's comprehensive two-day examination on federal taxation or by serving as an IRS employee in an appropriate job classification for at least five years. NAEA members maintain their expertise by completing at least 30 hours of continuing professional education each year. Our members work with more than four million (4,000,000) individual and business taxpayers annually.

It is in our role as the voice for our members and for the general taxpaying public that NAEA submits this testimony on a proposed Taxpayer Bill of Rights 2.

Our testimony is prepared following the outline of the major titles of H.R. 661 for ease of reference and is as follows:

Title I - Taxpayer Advocate

We have reviewed the proposal for the establishment of the Office of the Taxpayer Advocate within the Service and have several concerns about this suggestion. We do not see a clear benefit from replacing the current Taxpayer Ombudsman position with the new Taxpayer Advocate position.

It is our feeling as taxpayer representatives that the Problem Resolution function as currently organized serves the taxpaying public well, is responsive to taxpayer complaints, and is endowed with sufficient ability to effect changes in the direction of action proposed by the enforcement divisions. It is not clear from the proposed language in the Bill if this Taxpayer Advocate would be a political appointee, although the mention that he or she would be compensated at the same level as the Chief Counsel would seem to indicate that this individual would not be a career Service executive.

We believe the organizational culture of IRS would severely inhibit the effectiveness of any political appointee placed in charge of a Service-wide network of career civil servants such as the Problem Resolution function. It would be far preferable to maintain the current structure, which, at least, has the benefit of wide-spread support within the Service and work to improve the reporting mechanisms back to the Congress if that is of concern. With respect to the Annual Reports due the Committee, we feel the Bill's approach is in error when it does not permit the Commissioner's staff to review and comment. If the Congress believes that it is not getting accurate information from the Commissioner, it has the ability to ask the GAO to study the question or verify the data. We question the advisability of requiring an employee of the Commissioner to prepare

"secret" reports to the Congress without coordination within the agency. Any proposal which sets up the Taxpayer Advocate function to be viewed as adversarial to the rest of the Service will be counterproductive to the Bill's intent.

Title II - Modifications to Installment Agreement Provisions

We agree with the proposed changes in the installment agreement section of the Bill with the exception that we believe that the right to an installment agreement ought to be extended to all taxpayers, even those who may have been delinquent in the past three years. Many installment agreement taxpayers are married couples earning minimum wages who discover to their dismay that the withholding tables leave them under withheld when they combine their wages for tax reporting purposes on their joint return. Many of these people have had installment agreements each year to finish paying off their prior year's liability. The fact that they have had taxes due each of the prior three years should not bar them from having the right to an installment agreement, especially since the only really practical way of collecting from these people is by installment agreement. Since this is the case, why make these people subject to the additional penalty charges which will accrue on their account?

We support the proposal to suspend the running of the failure to pay penalty during the period of the installment agreement. This gives real incentive to taxpayers to stay current with their installments, provides very real relief from the "crushing" accumulation of interest and penalties and restores the taxpayer involved to the ranks of compliant taxpayers sooner. The only change we would like to see is that this penalty relief be extended to those taxpayers in notice status after assessment and not just those taxpayers who request an installment agreement on or before the due date of the return. As currently drafted, the Bill provides an advantage to the taxpayers who have professional tax practitioners prepare their returns. They will be advised to request an installment agreement when they file. Those taxpayers who prepare their own returns or who may not be able to afford professional assistance would find out too late that this relief provision was available. This would place taxpayers least able to afford it at a disadvantage.

We also support the proposals which establish a notice requirement and a review process in the event the Service decides not to extend an installment agreement to the taxpayer. We urge the Congress to define what constitutes jeopardy situations wherein the Service can disregard the notice requirements required by the Bill. In our experience, what Service employees define as jeopardy situations often fail to meet any objective understanding of the term, in any judicial sense of the word.

Title III - Interest

We agree with the proposed modifications to the law governing interest due and applaud the extension of the interest free period for payment of tax after notice and demand is given. The ten day provision has long been unreasonable. We would like to see the period extended to thirty days. We would also like to see special provisions for extension of the interest free period beyond the thirty days if it can be demonstrated that the taxpayer had no knowledge of the assessment ever being made and had not received notice and demand.

Title IV - Joint Returns

We endorse the proposal to permit disclosure of collection activity data to the joint parties of the assessment. This is a change which has long been overdue in terms of equity to taxpayers and in terms of permitting the Service to defend its actions on cases.

Title V - Collection Activities

The proposals to permit withdrawal of prematurely or erroneously filed Notices of Federal Tax Lien are excellent. In addition, we would like to see restrictions on the ability of Service employees in the Automated Collection Sites or the replacement Taxpayer Service Centers to file Notices of Federal Tax Lien without proper managerial reviews for appropriateness and suitability. All too often, liens filed by ACS prevent taxpayers and their representatives from utilizing commercial credit sources to retire tax debts thereby necessitating more expensive installment agreements with the Service, a situation from which neither the Service nor the taxpayer derive any benefit.

The increased levy exemption amounts are too low, in our opinion. The amount of personal effects exempt from levy ought to be $2,500.00 with additional annual adjustments as proposed for indexing inflation. The tools of the trade exemption ought also to be $2,500.00, with future indexing. In addition, a business vehicle such as a truck or specially adapted vehicle ought to be allowed to be excluded up to the levy exemption amount. The Service currently maintains that the levy exemptions do not apply to motor vehicles, regardless of their manner of use.

We agree with the modification requiring District Counsel review on Offers in Compromise over $50,000.00. The prior threshold amount of $500.00 was absurdly low and contributed to a backlog in processing cases efficiently.

We agree with the provisions which would increase the limit on recovery of civil damages for unauthorized collection actions.

We would like to see the definition of third party record keepers extended to Enrolled Agents for purposes of the administrative summons provisions.

We would note that under Circular 230, Enrolled Agents have the same professional rights and responsibilities with respect to their practicing before the IRS as do attorneys and certified public accountants.

As I mentioned earlier, an individual does not become an Enrolled Agent without first demonstrating special competency in tax matters. This may be achieved by working for the IRS as a tax specialist for a minimum of five years or by passing a rigorous examination. This demonstration of competency is similar to that imposed on attorneys and certified public accountants. Furthermore, Enrolled Agents are required to maintain their competency through 30 hours of continuing professional education each year. Again, this parallels the continuing education requirements for certified public accountants and attorneys.

Finally, Circular 230 requires persons maintaining records for others to assist the IRS in the agency's efforts to conduct legitimate and effective investigations. Under Section 10.23 of Circular 230, Enrolled Agents, as well as attorneys and certified public accountants, may not unreasonably delay the prompt disposition of a matter before the IRS. Also, to the extent a client of an Enrolled Agent, attorney, or CPA has knowledge that a client has violated the revenue laws of the United States, that professional is required to promptly advise the client of the omission.

This revision would provide fair protection to taxpayers and to their representatives without causing undue restrictions on the Service.

The imposition of Counsel review in the case of corporate summons issuances is a good change, as is the requirement of notice to the corporation of summons issuances to other persons in connection with the corporate audit.

Title VI - Information Returns

The proposal to establish civil damages for fraudulent filing of information returns is long overdue and should be enacted. We have seen many innocent people, both taxpayers and government employees damaged by these fraudulent filings. It is important to insure that these violators are prosecuted to the full extent of the law. Of course, our support for this new provision goes hand in hand with the inclusion of the new proposed subsection which requires the Service to conduct reasonable investigations of information return disputes.

Title VII - Modifications to Penalty for Failure to Collect and Pay Over Tax

The proposed changes relating to proper notification are good changes. We have all seen cases where no prior notice was provided to taxpayers before assessment and taxpayers were ill-equipped to defend themselves years later due to unavailability of records.

We would like to see additional language in the statute providing exactly when the statutory period for assessing the Trust Fund Recovery Penalty commences and expires. For many years, there was common agreement between the Service and the practitioner community that the period for assessment was three years from the presumptive filing date of the employment tax returns from which the liability arose. The Service in recent litigation has tried to make the case that the Trust Fund Recovery Penalty does not arise from any particular employment tax return and therefore is not subject to the three year rule but rather that there is an "open" statute of limitations. Despite a decades long record of representing in court after court and case after case that the three year statute of limitations rule applied to Trust Fund Recovery Penalty cases, the Service is now contending that the Trust Fund Recovery Penalty is a "separate and distinct" liability from the employment tax liability of the employer entity. Taking this position means that there is no Internal Revenue Code Section 6501 (a) limitation period trigger. The Service is maintaining that since Congress never specified that Section 6501(a) or any other statute of limitations should govern Section 6672 assessments, there is no statute on these assessments. We do not believe this was the original intent of Congress and neither did the Service for many years. We urge Congress to put this flagrant ruse to an end immediately by stating in this Taxpayer Bill of Rights legislation that the Trust Fund Recovery Penalty assessments are subject to the statute of limitations provisions and requirements of IRC Section 6501(a).

We support the proposal to permit disclosure of information to other persons assessed the same Trust Fund Recovery Penalty concerning the status of IRS efforts to collect from fellow assessees. We believe that this change will insure a more even-handed collection effort by the Service - which in the past has tended to pursue the easily available parties disproportionately.

Title VIII - Awarding of Costs and Certain Fees

We support the proposed modifications for motions for disclosure of information and for the increase in attorney's fees.

Title IX - Other Provisions

The proposal to grant relief from retroactive application of Treasury Department regulations is acceptable provided that the section providing the taxpayers with the right to elect retroactive application is also approved. This would permit taxpayers to avail themselves of beneficial rulings.

We also support the requirement to notify taxpayers of payments which the Service cannot identify and associate properly with their account.

The new provisions for civil damages for unauthorized enticement of information disclosure appear to be acceptable.

Title X - Form Modifications; Studies

We particularly note the importance of the Congressional oversight of IRS employee misconduct. We urge that the Service be required to report to the Committee on an annual rather than a biennial basis. In addition, we urge that the Privacy Act be amended to permit reports back to taxpayers and their representatives regarding specific allegations of employee misconduct brought to the Service by taxpayers or their representatives once the Service has reached a final determination and personnel actions have been taken. This process insures taxpayers and the practitioner community that the Service follows through on allegations of employee misconduct and subjects employees to disciplinary actions when deemed warranted.

Comments on H.R. 390 : "Burden of Proof"

We have reviewed the provisions of H.R. 390 and find that the proposed changes with respect to shifting the burden of proof in civil cases from the taxpayer to the Secretary are much too radical. If Congress is seriously giving this proposal consideration we believe all taxpayers have serious cause for concern about the stability of our taxation system. **If we only represented tax evaders we would whole-heartedly endorse this proposal!** But we represent millions of compliant taxpayers who diligently maintain their books and records, compile their annual tax return data and self-assess themselves. These taxpayers are the rock-solid base of our entire voluntary compliance system. It is for these taxpayers that we register our concern about the proposed changes sought in H.R. 390.

If this change is adopted, the Congress shifts the burden for proving any one taxpayer's income or deductions not only from that individual taxpayer to the Service but also to every other taxpayer and business entity the individual being audited transacted business with in any given tax year. The record keeping requirements would far exceed anything imaginable under our current system and would cost all taxpayers far in excess of the amount they now expend. Aside from the essential unfairness of expecting everyone else the taxpayer deals with to assist the Service in making proper tax determinations, we also feel that the basis of our system assumes that taxpayers will have records to support the self-assessments they file. They are, afterall, the ones who had the income and the expenses and are best in the position to establish, at the least cost and time, what those items were.

We believe the Internal Revenue Code, as presently structured, provides manifold safeguards for taxpayers to administratively proceed through the Service and Courts to arrive at correct tax determinations. The Congress should be very wary of changing procedures as fundamentally as those proposed in H.R. 390 because the consequences on taxpayer compliance with such drastic change cannot be accurately predicted or measured.

Additional Suggestions for Improvement

We are encouraged by the prompt attention shown to the issue of Taxpayer Rights by the 104th Congress. Many of the areas addressed in the proposed legislation were addressed in H.R. 11 and deserve to be brought back on the table now. We have provided our frank opinions on these issues and made suggestions where we felt the proposed legislation needed additional emphasis.

Whenever we are addressing the issue of taxpayer rights, we think it appropriate to point out that the really serious matters regarding taxpayer interface with the Service occur at the enforcement Division level. Taxpayer concerns run highest when forced to deal with the reality of being audited or owing taxes. We believe any effective, worthwhile Taxpayer Bill of Rights will address concerns about how these Divisions carry out their responsibilities while at the same time inflicting the least possible harm on the taxpayers involved.

By way of illustrating taxpayer fears we feel should be addressed by any Taxpayer Bill of Rights, we offer the following procedures or policies the Service recently embarked upon or announced which have heightened concerns among taxpayers about their vulnerability in dealing with Service employees. For example:

- The Collection Division is in the process of developing new procedures to be employed when evaluating the taxpayer's ability to pay delinquent taxes. These new procedures, which concentrate on determining what are necessary monthly expenses and what constitutes reasonable amounts for those expenses, are an attempt to satisfy GAO criticisms about the Service being "too lenient" when determining taxes are currently not collectible. The new approach basically relies on Bureau of Labor Statistics data about family expenditures to set standard expense levels for taxpayers. We believe this process would be acceptable if the taxpayers could not document their true level of expenditures and the Service relied on the BLS data as a base. We disagree about using these statistics when taxpayers have ample documentation about their family expenditures to offer in their stead.

- The Collection Division has recently implemented a "user fee" charge on taxpayers who require installment agreements to pay off their delinquent taxes. We opposed this "user fee" in our testimony before the Service's committee on the proposed rule making and oppose it again here in our testimony. We think user fees ought to be prohibited for installment agreements. Taxpayers who need to pay on installment already pay interest and late payment penalty charges which would be considered usury under most state laws. To heap on them yet another charge for the cost of servicing their account is an outrage. To put it in perspective for the Committee, if the taxpayer is working for the minimum wage, the user fee is approximately two days pay!

- The Examination Division has recently announced the commencement of "economic reality" audits whereby the taxpayers, not the tax returns, will be audited. This interest in the taxpayer's lifestyle has aroused a great deal of concern among taxpayers. Taxpayers are fearful of their every financial transaction being scrutinized by the Service, apprehensive about their credit files and other financial data being subject to Service review on a wholesale basis, and frankly concerned about Service employees abusing the right to inquire into their financial records. We cannot fault the Service for seeking to make its audits more productive or for its effort to search out undeclared income - after all that is the primary mission of the organization and as taxpayers we support them. But, at the same time, we have grave concerns about the potential misuse of this confidential taxpayer data and concerns about who in the Service gets to decide in what circumstance the expansion of an audit into questions of lifestyle is appropriate. We also would like to see a requirement that the taxpayer be informed at the onset that the audit will delve into lifestyle issues.

- There is a great deal of speculation among the practitioner community that one of the primary motivations of the Service in choosing to 'audit" the lifestyles of taxpayers is that it provides a way to bypass the practitioner and get directly to the taxpayer thereby defeating one of the primary provisions of the Taxpayer Bill of Rights - the right of the taxpayer to secure representation and the right of the representative to "stand in the shoes" of the taxpayer. The IRS training manuals

for economic reality auditing provide guidelines for auditors that suggest that only the taxpayer is able to respond to "lifestyle" issues and therefore their presence at the audit should be required. This viewpoint obviously has taxpayers and their representatives concerned about IRS intentions for these cases.

Again, the members of NAEA thank you for this opportunity to present their views to the Subcommittee on these important issues. We offer our assistance to provide any additiional information raised by these comments or other areas of concern.

Chairman JOHNSON. Are there questions of Mr. Lane since he has to leave?

[No response.]

Mr. LANE. Actually I will have to leave probably sometime during this panel but I do not have to run right now. I will be here probably about another 40 minutes.

Chairman JOHNSON. Well, I will give the members a chance. Your comments have been very helpful and have gone to a lot of things that have been raised.

Mr. LANE. Thank you.

Mr. PORTMAN. Thank you Madam Chairman. First of all, Mr. Lane, I appreciate your testimony. You have seen it from both sides based on your brief bio at the beginning of your statement and therefore, your statement has particular credibility.

Now, just on the burden of proof for a moment, are you saying flat out, the burden of proof should not be shifted in any of these civil cases, and that there is nothing we can do short of an entire shift to address some of the concerns that have been raised earlier?

Mr. LANE. I think the burden of proof properly rests with the government when you have a criminal prosecution. But in a civil matter, common law and I am sure the bar, will lecture us in detail on what the common law is on this, but I mean the statements we have heard already today from the commissioners and from the IRS—it has always been the case that the person with the information should be able to document it.

We have a voluntary assessment system and the easiest and most effective way of auditing those tax returns is to go to the taxpayer who prepared them. Not to shift that burden to the backs of every other taxpayer in the country. We said in our testimony if we only represented tax evaders we would be wholeheartedly in support of this bill. But we represent millions of people out there who, every year, diligently keep track of their records and account for their income and expenses, and prepare tax returns and self-assess themselves.

To shift the burden on those poor people, the 82 or 83 percent of the population that complies, to be able to make cases against the 5, or 10, or 15 percent of the people that do not comply is really onerous. The cost to those people to maintain the records needed to answer all these IRS summonses would be just an outrage.

There is one other thing in my testimony that I did not cover. That is one of the changes that we would like to see included in this bill. Recently with respect to the 100-percent penalty or the trust fund recovery penalty, the Service for decades has maintained that there was a 3-year statute of limitations on the assessments for that penalty. They had 3 years from the presumptive date of filing of the employment tax returns from which that assessment arose, or that liability arose.

They recently have started to take the position that because Congress did not specify that section 6501(a) was the controlling statute of limitations on that 6672 assessment, that they had an open assessment and they had no rule they had to follow.

They have not done that for decades. They have taken the opposite position. We have always taken that position and I think we

should have it mandated, in law, that they will follow 6501(a) for purposes of making that trust fund recovery penalty assessment.

This is only just. I do not know where this ruse has come from lately, but it is an absurd position to take after they have taken this other opposite track for 30 years.

Mr. PORTMAN. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you. Thank you for your testimony. It was really very helpful.

Mr. LANE. Thank you.

Chairman JOHNSON. I did not realize you had served in Connecticut, too.

Mr. LANE. Thank you.

Chairman JOHNSON. Let's start with Mr. Cohen.

STATEMENT OF N. JEROLD COHEN, CHAIR-ELECT, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

Mr. JEROLD COHEN. Thank you, Madam Chairman. The tax section, of course, has 25,000 members and it is the largest and broadest based group of tax lawyers in the country. I would like, on behalf of the section, as you begin your period of leadership of this subcommittee, to congratulate you and extend to you our commitment to work with this very important subcommittee in the improvement of the U.S. tax system.

We think that this subcommittee's oversight functions are often more important in improving the tax system than the enactment of specific legislation. And in that regard I would like to mention three items that are not contained in the legislative proposals and should not be. But that we would commend to the oversight subcommittee to watch.

The first is the Service's field service advice program. That is a program for advice between attorneys in the national office and the field concerning specific taxpayer audits.

Our concern is that the taxpayers have no input into the factual information coming back to the national office, no way to find out what has come out of that, and no ability to challenge positions being taken.

We are in a dialog with the IRS concerning that, but we do think it is something that the subcommittee should be aware of.

The next is third-party information access. A potentially very attractive source of information for the IRS, especially in cross-border transfer pricing cases, is access to information of third parties who have nothing to do with the audit that is under examination.

These taxpayers are merely in the same business and may even be competitors of the taxpayer under audit. Now, that information may be very important to the IRS but the inquiries, often with summonses, raise real questions of confidentiality, especially when you are after proprietary information from competitors.

That often also can impose a very strong burden of data collection on the third party. So we think this subcommittee should be aware of those inquiries by the Service.

And, finally, we too are concerned about the new user fees on installment agreements. Those fees really should have a limit on them as to the amount of tax involved, and the income of the per-

son seeking the installment agreement. Low-income taxpayers should not be subjected to those user fees.

Now, none of those do we think we need legislation on, but we do think they come within this subcommittee's purview. The comments we filed today on the bill of rights are very detailed on the H.R. 661 and I will not go over those.

I would like to mention two provisions only. Now, the first is section 903 concerning retroactive regulations. It would put further limitations on the Treasury in enacting regulations that have retroactive effective dates.

We think that the Treasury has been very responsive to the need to balance fairness with the need for uniformity and clarity of the tax laws. We are afraid that this would slow down the regulatory process and, thus, we do not support that provision.

The next provision on which I would like to comment is not one that we do not support. It is the 100-percent penalty provisions, section 701 through 703. We do support most of those, but we would like to suggest that there is a real problem that could be handled legislatively here.

That is the right of a taxpayer who has paid the 100-percent penalty, as a responsible officer, to seek contribution from others who are also responsible. That right is not available in many States. They do not afford it for a Federal penalty and we think that the taxpayer fairness requires that taxpayers who have paid that penalty be able to seek contributions from others who are equally responsible for it, and perhaps even more responsible for it.

Finally, Madam Chairman, I would like to mention another matter that is very closely related to taxpayer rights, and on which we are very concerned. And that is the proposal in H.R. 390 to shift the burden of proof.

We think that the current law shifts the burden of proof in the appropriate circumstances. It does shift the burden to the Government in the case, for example, of civil fraud, contrary to what I saw in Mr. Traficant's statement, it shifts it when new matters are raised by the commissioner before the tax court. But to shift it wholesale, we think, would place a tremendous burden on the Government, and it would result in very intrusive audits and would have severe financial consequences for the FISC.

So we believe this single change in the law would have a very significant and very adverse effect on our system.

Thank you, Madam Chairman, for allowing me to represent the section before you today.

[The prepared statement follows:]

TESTIMONY OF N. JEROLD COHEN
ON BEHALF OF THE AMERICAN BAR ASSOCIATION

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

March 24, 1995

Madame Chairman and Members of the Subcommittee:

My name is N. Jerold Cohen. I am the Chair-Elect of the American Bar Association's Section of Taxation. The views I will express today are presented on behalf of the Section of Taxation. Unless otherwise noted, they have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be constructed as representing the position of the Association.

The Tax Section of the American Bar Association is comprised of approximately 25,000 tax lawyers located throughout the United States. As you begin your period of leadership of this very important Subcommittee, we extend to you our congratulations and our commitment to work with you, the other Members of the Subcommittee, and the Subcommittee staff in your efforts to further improve the U.S. tax system.

We appreciate the opportunity to appear before the Subcommittee today to comment on legislative interest in a second taxpayer bill of rights. Our comments are divided into three parts: first, I will offer some general comments on taxpayer rights legislation; second, I will comment on H.R. 661, the Taxpayer Bill of Rights 2, introduced in the House by Congressman Thornton; and, third, I will discuss a related matter of interest and concern to our members.

I. **Taxpayer Rights Legislation - General Comments**

Permit me to begin by reemphasizing the Tax Section's strong support for the ongoing work of the Oversight Subcommittee in monitoring the state of U.S. tax administration, including the effectiveness and efficiency of the Internal Revenue Service ("Service"). In our view, the Subcommittee's oversight activities often are more important in improving the functioning of the tax system than the enactment of specific legislation. Subcommittee hearings, such as today's, provide the American people an important forum for the discussion of perceived problems with tax administration and, thus, serve as a constructive mechanism for helping the Service properly carry out its mission.

We have a very strong interest as an organization of tax professionals in fostering a tax administration system that:

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

Notwithstanding our view that perhaps the greatest value of this Subcommittee's activities is its public oversight function, we recognize that there are issues of tax administration that cannot be solved merely by talk or administrative action but, rather, require a legislative

resolution. Occasionally, when we raise an administrative issue with the Service, we are told that restrictive legislation or a lack of legislative authority precludes the Service from correcting the problem. In such cases, we will bring the issue to the Subcommittee's attention, and, if appropriate, propose or support the Treasury Department's proposal of specific remedial legislation.

Inevitably there will be instances when we, as tax practitioners, and the Service or Treasury will disagree on a tax administration issue. There also may be legislative initiatives put before you that appear to be very popular with the public but which we believe, if enacted, would damage the tax system by seriously impeding the Service's ability to perform its tax administration obligations. In such cases, in spite of a proposal's public popularity, we will express our opposition.

One of the possible consequences of consideration of further taxpayer rights legislation is the danger that the Congress will attempt to micro-manage the Service. However, micro-management of the Internal Revenue Service by the Congress, in our opinion, is a mistake. As our country's "Board of Directors," the Congress plays a central role in making sure that the tax system is functioning satisfactorily. But as with any large organization, the day-to-day management of the Internal Revenue Service is best left to its officers and key employees.

As I indicated, we think that one of the values of a public discussion of taxpayer rights is the opportunity to identify issues that do not necessarily require a legislative response, but are of sufficient importance that the Subcommittee may wish to encourage a more in-depth analysis by the Service, the Treasury Department, the Subcommittee staff, the staff of the Joint Committee on Taxation or the General Accounting Office. There are four such areas that I would like to mention briefly today.

- **Field Service Advice** - The first matter involves what is known as "field service advice." During the past two years, the Service has adopted procedures governing communications between field and National Office personnel with respect to issues that arise in the audits of specific taxpayers. Although generally the Tax Section recognizes the importance of, and supports efforts to facilitate, interaction between Service field personnel and their lawyers in the National Office, the lack of any taxpayer involvement in the National Office's consideration of taxpayer-specific issues brought to its attention in the field service process and the lack of any ability to challenge positions taken by National Office personnel troubles us. We have expressed our concerns in a July 14, 1994, written submission to the Service, and we hope that the Service will take our comments and those of other interested organizations into account as these procedures are refined. Field service advice is a very sensitive area from the taxpayer's perspective, and it may merit future review by the Subcommittee.

- **Third-party information** - The second matter relates to the Internal Revenue

Service's access to so-called "third-party information." The Service apparently is of the view, perhaps properly, that it needs factual information in addition to that which it can obtain from the taxpayer under audit or from public sources in order to administer a system of arm's length transfer pricing. A potentially attractive source of additional information is third parties engaged in the same or a similar business to that of the taxpayer under audit. However, these third parties may have absolutely no relationship to the matter at issue and often are competitors of the taxpayer under examination. Under such circumstances, an inquiry from the Service into the third party's business affairs, using the Service's administrative summons authority, raises very important issues regarding the confidentiality of third-party information, particularly proprietary information. It also potentially imposes a significant data collection burden on the third party in connection with a matter with which it is not concerned. Because of the sensitivity of this audit technique, the Subcommittee might consider examining the relevant policy issues.

- **Advance rulings process** - A third area that may merit possible review by the Subcommittee is the Service's advance rulings process. Two developments relating to the Service's rulings program are of concern. First, the number of published revenue rulings, revenue procedures, and other advice of general applicability has gone down dramatically over the past 10-15 years.[1/] Second, access by individual taxpayers to advance rulings on specific transactions appears also to have decreased as the Service has expanded the number of areas in which it will not rule.

  Service rulings, both published rulings of general applicability and those that are taxpayer specific, are an important part of a properly functioning self-assessment system. If taxpayers are expected to file accurate returns that correctly apply the law, then the Internal Revenue Service must be given the resources - and it must devote those resources - to provide the necessary advance guidance. Otherwise, not only will taxpayers be frustrated by the lack of guidance, but we also are convinced that in some cases they will be reluctant to undertake desirable business transactions because of the uncertain tax results. In other instances, we fear that compliance levels will decrease.

[1/] This comment excludes an analysis of the issuance of regulations.

- **Installment Agreement User Fees** - On December 26, 1994, the Service issued proposed regulations (PS-39-94) that would impose user fees on taxpayers who enter into installment agreements for paying their tax liabilities. Under the proposed regulations, the fee for entering into a new installment agreement would be $43.00, and the fee for restructuring or reinstating an existing agreement would be $24.00.

  Although the dollar amounts of these user fees might appear minimal to most taxpayers, we are very concerned that they will impose a financial burden on low income taxpayers. We find it particularly troublesome that these fees could be imposed on low income taxpayers who by entering into payment agreements with the Service are attempting to meet their obligations to the Federal Government. Moreover, as a practical matter, requiring payment of a user fee for the privilege of entering into an installment agreement by persons with scarce resources will have the effect in many cases of merely reducing the amount of tax that the Service ultimately would receive. For these reasons, the Section recommends that the Subcommittee urge the Service to exempt low income taxpayers from the proposed installment agreement user fees. If the Subcommittee concludes that legislation is necessary to accomplish this objective, we would strongly support such legislation.

II. Taxpayer Bill of Rights 2 (H.R. 661)

Now, I would like to turn to the second part of our statement, which contains our specific comments on H.R. 661, the Taxpayer Bill of Rights 2.[2/] I will refer only to selected portions of the bill. A more detailed analysis has been provided to the Subcommittee staff.

A. Taxpayer Advocate

Section 101 of H.R. 661[3/] provides for the appointment of a senior Service official to be known as the Taxpayer Advocate, who would report directly to the Commissioner of Internal Revenue ("Commissioner").

Previously, our members opposed the provisions relating to the establishment of a Presidentially-appointed Taxpayer Advocate, for two principal reasons. First, they were concerned about the danger of improper influence within the Internal Revenue Service by a political appointee and second, they thought that, as a Service official, the Taxpayer Advocate should be accountable to the Commissioner. We are very pleased that H.R. 661 has abandoned the prior proposed

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[2/] The bill also has been introduced in the Senate by Senator Pryor as S. 258.

[3/] Unless otherwise indicated, section references are to H.R. 661.

structure and has made it clear that the Taxpayer Advocate will report to the Commissioner.[1/]

Notwithstanding the changes that have been made in Section 101, we continue to oppose its enactment. It would appear that the provision essentially codifies the present Service position of Taxpayer Ombudsman. In response to prior Congressional oversight activities relating to taxpayer service, the Service has put a taxpayer service management structure in place that seems to be working. If the Subcommittee has specific concerns about that structure, we suggest that these concerns be brought to the attention of the Commissioner and perhaps the Secretary. We do not think a legislatively-mandated management structure is desirable.

As more fully discussed below, we also oppose the provisions relating to Congressional reports and Taxpayer Service Orders.

- Congressional reports - We do not think that the Commissioner or the Treasury Department should be precluded from reviewing and commenting on the Taxpayer Advocate's reports prior to the time that they are transmitted to the Congress. A contemporary review and comment process should result in higher quality reports from the Taxpayer Advocate and more timely and complete commentaries from the Commissioner and Treasury.

- Taxpayer Assistance Orders - We think that it would be inappropriate to prevent the Commissioner from delegating to other senior Service officials the right to modify or rescind Taxpayer Assistance Orders issued by the Taxpayer Advocate. The Service is a very large organization and each year deals with millions of taxpayers in District and sub-District offices throughout the United States and in offices located in a number of foreign countries. It is impossible for the Commissioner to deal on a regular basis with matters involving individual taxpayers, in connection with Taxpayer Assistance Orders or otherwise. Furthermore, because the Commissioner is the Chief Executive Officer of the Internal Revenue Service, with responsibility for all of the management challenges facing the organization, such involvement clearly is not the best use of her time. She must be able to delegate authority to field personnel and should be empowered to do so in the Taxpayer Assistance Order context.

  We also wish to express our strong disagreement with the implication contained in Section 102 that a superior of the Commissioner (presumably the Secretary or Deputy Secretary of the Treasury or the President or Vice President of the United States) would have

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[1/] We also presume that the Taxpayer Advocate will be appointed by the Commissioner, although Section 101 does not so state.

the authority to become involved in taxpayer-specific matters pending before the Service. In the past, interference by people outside the Agency in matters involving specific taxpayers has created trouble in the tax system. We do not think it is advisable to alter the practice that the Commissioner's superiors have followed over the past 20 years of strictly avoiding any such involvement.

B. **Elimination of joint and several liability (American Bar Association recommendation)**

Under present law, married taxpayers are liable for their spouses' federal income taxes when they file joint returns. In community property jurisdictions, each spouse is liable for tax on one-half of the other spouse's earned income, even if they file separate returns. We recommend that for reasons of fairness and simplicity, both rules be repealed.

In many families today, both spouses work and follow separate business career paths. One spouse may have little or no direct knowledge of the business earnings and expenses of the other spouse. Even in the case of a family in which only one spouse works outside the home, that spouse may have little or no knowledge of the business affairs of the other spouse. Yet, in both situations, the spouse who did not earn the income can be liable for income taxes on the other spouse's income, even years after the couple has separated or divorced.

In most other developed countries, the trend is toward elimination or moderation of joint liability rules holding one spouse liable for the other's taxes. We think that the United States also should eliminate joint income tax liability and, therefore, we recommend that married persons be taxed only on their own individual income, without liability for tax on the income of their spouses, even when they file joint returns or reside in a community property jurisdiction.[5/]

C. **Designated Summons**

As a preface to our comments on the proposals relating to the designated summons procedure contained in Section 505, we wish to note our view that this relatively new procedure, which accords the Service an extraordinary audit tool, should continue to be considered by the Congress as in the experimental stage. We think its future will depend upon how the designated summons process is administered by the Service, and we encourage the Subcommittee to monitor this enforcement area.

Proposed Section 505 would require Regional Counsel to "review" the issuance of every designated summons. We oppose this requirement. Review by the Deputy Regional Counsel already is an administrative requirement, and we see no need to make such a requirement statutory. Such high level internal review has been effective in limiting multiple examinations of taxpayer books and records under Section

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[5/] In recognition of the sometimes harsh effects of joint liability, Congress enacted the "innocent spouse" provisions of Sections 6013(e) and 66. These rules are restrictive and ambiguous; they are among the most frequently litigated rules in the Internal Revenue Code. Repeal of joint liability would permit repeal of the innocent spouse provisions, resulting in a significant simplification of the tax system.

7605(b) without statutory specificity regarding the identity of the reviewer and should be just as effective in the case of a designated summons. Moreover, the existence of such a statutory requirement easily can lead to litigation regarding whether any "review" occurred in the particular case, and regarding what constitutes an adequate review.

The Service apparently believes that the use of a designated summons serves as an important method to obtain necessary information at the examination level. Under present law, however, the Service can use this method to extend the statute of limitations with respect to a taxpayer that has fully cooperated with the Service during the examination. Although this extraordinary compliance tool was designed to give the Service an additional means to deal with taxpayers who have resisted disclosure of necessary information, procedural fairness to all taxpayers is necessary to eliminate the potential for abuse outside this narrow context. Accordingly, the Subcommittee may wish to consider the following revisions to the statute to ensure the use of the designated summons as originally intended by Congress:

a. Provide that the taxpayer may, within 10 days of receiving a designated summons, file a petition in a District Court or the Tax Court seeking to quash or modify the summons, or seeking a court determination that the statute of limitations should not be suspended. In the event such an action is filed, the statute of limitations would remain suspended unless and until the court determined the existence of one or more of the following circumstances: (i) the Service had not previously requested in writing the information sought in the summons, (ii) the previous information request was not timely, or (iii) the person summoned did not have sufficient time to respond to the previous information request before the designated summons was issued. In order to quash or modify the summons, the taxpayer also would have to establish to the court's satisfaction that the person summoned had not failed to comply substantially with the previous information request. This right of judicial review would discourage the Service from issuing a designated summons in a case in which the taxpayer has cooperated in good faith during the examination and would allow an impartial court to decide whether the Service was attempting to misuse its designated summons authority.

b. Provide that the Service must identify the specific issue(s) and Code section(s) to which the designated summons relates, and that the statute of limitations may be suspended only with respect to the identified issue(s). This provision would ensure that the Service is using the designated summons to obtain only the information that it needs to develop a specific issue and would preserve the relevancy of the statute of limitations as an element of fairness in practical tax administration.

c. In lieu of the current requirement that the designated summons be issued at least 60 days before the date the statute of limitations is set to expire, provide that the designated summons must be issued at least 120 days before the date the statute of limitations is set to expire. This provision would protect the taxpayer against attempts by the Service

to extend the statute of limitations at the very last minute.

D. **100 Percent Penalty Provisions - Right of Contribution**

The American Bar Association previously has recommended legislation permitting a responsible person who has made payment of the 100 percent penalty to the Service to initiate a third-party action seeking contribution from the other responsible persons (Tax Section Recommendation 1981-6, 34 Tax Law. 1409 (1981)). We restate that recommendation today and, on behalf of the ABA, we strongly urge the Subcommittee to include a right of contribution in any legislation reported by the Subcommittee.

Too often the Service is satisfied with collecting the 100 percent penalty in the easiest situations. As a result, more culpable persons often escape liability. Unfortunately, state law does not always provide a remedy. Even states that permit joint tortfeasors to obtain contribution from one another do not permit a right of contribution in Section 6672 cases. These states believe that this is a federal matter and defer to the uniform rule in the Federal courts against contribution by other responsible persons.

The Federal rule against contribution is premised on the common law rule prohibiting wrongdoers from seeking contribution from one another. That common law rule has ceased to be the rule in many jurisdictions, and there is no reason to continue this rule in the case of a Section 6672 penalty. Moreover, we believe that the most effective way to assure that the Service will maximize its administrative collection efforts against all responsible persons is for each potentially liable person to know that contribution can be compelled. We would expect that, under these circumstances, more responsible persons will agree among themselves to contribute all that is necessary to satisfy the entire liability without the need for litigation.

We understand that there has been a reluctance to enact legislation granting a right of contribution because of the concern that it might lead to wealthier and more culpable people seeking contribution from less responsible persons. In our experience, it is more often true that the less responsible people suffer from the absence of a right of contribution. More importantly, however, if contribution were based on the culpability of a person regarding his or her control over the disbursement of available corporate funds, there would be no reason for any such person to be shielded from liability. However, additional protection might be provided by permitting someone in a contribution proceeding who is found not responsible to recover attorney's fees from the person(s) found responsible.

The Tax Section's 1981 Recommendation proposed granting the responsible party a right of contribution by cross-claim or third-party action in any litigation with the Internal Revenue Service regarding the 100 percent penalty, as well as the right to bring a third-party action against the other responsible persons in an independent judicial proceeding. The Association of the Bar of the City of New York Committee on Personal Income Tax also has proposed the enactment of a right of contribution ("New York City Bar Proposal"). The New York City Bar Proposal would require an action for contribution be brought in a separate lawsuit (rather than by cross-claim or third-party action in litigation with the Service) so that the Treasury's ability to collect the 100 percent penalty would not be obstructed by the action for

contribution. Although judicial economy might be fostered by having the contribution issue resolved in the same civil matter as the refund suit over the penalty, we think there is merit to avoiding any new procedure that might delay the Government's ability to obtain a judgment against the multiple responsible persons. Therefore, if the Subcommittee were to prefer the New York City Bar's recommendation of a separate proceeding, we would support that decision.

E. **Attorney's Fees**

The changes proposed in H.R. 661, in our opinion, are appropriate, and we support them. However, we think that there are other far more important changes that should be considered by the Subcommittee.

1. The Subcommittee should consider raising the ceilings on the net worth limitation and on the restriction of number of employees in order to make Section 7430 available to a broader range of individuals and small businesses.

2. The Subcommittee should consider whether taxpayers involved in declaratory judgment tax proceedings, as provided for in the Internal Revenue Code, should be eligible for awards.

3. The Subcommittee should consider whether any dollar limit on attorney's fees is necessary or appropriate. The law already requires that such fees must be reasonable. This reasonableness test could be amplified so as to be applied in light of prevailing levels of attorney's fees for work of similar nature in the geographical area in which the services are rendered. A fixed dollar limit on attorney's fees in any such proceeding also could be imposed.

F. **Retroactive Regulations**

The Tax Section urges the Subcommittee to reject the proposed amendment to Section 7805(b) contained in Section 903. The rules applicable to the effective dates of tax regulations should not be changed without a careful study of what the Service and Treasury have done in the past in establishing regulation effective dates, a determination of how the APA impacts on the promulgation of tax regulations generally, and a determination of the impact of any change on the administration of the law. We believe that a provision similar to Section 903 cannot be justified at least without a clear showing that the abusive cases of retroactivity, if any, are the norm rather than the exception.

In our view, a blanket restriction on retroactivity is unwarranted. Given the limited available resources, the Service and Treasury need a reasonable period of time to issue regulations. If regulations are timely issued, they should apply to all taxpayers similarly situated. If there are abuses resulting from the use of retroactive effective dates, it may be preferable to limit the period of time following enactment during which the Treasury could promulgate a retroactive regulation. Certainly the Congress has the ability to take such action on a case-by-case basis

as part of the consideration of specific pieces of proposed tax legislation.

Just as both Houses of Congress have recognized the unique status of tax regulations in the current consideration of proposals relating to a regulatory moratorium and changes in the regulatory process, we think the Subcommittee must consider very carefully any proposed change in Section 7805(b).

III. **Proposed Shift in Burden of Proof (H.R. 390)**

Finally, I would like to discuss another matter that we think is of extreme importance to future tax administration, namely, the proposal in H.R. 390 to shift the burden of proof in tax cases.

H.R. 390, 104th Cong., 1st Sess. (1995), would amend the Internal Revenue Code to place the burden of proof on the Secretary of the Treasury in all court proceedings involving tax matters.

The general allocation of the burden of proof to the taxpayer is consistent with our self-assessment system of tax administration, which relies on the taxpayer to maintain the necessary records to report accurately his or her income and expenses on a tax return at the end of the year. Accurate records, of course, are critical to resolving tax controversies, whether during the audit and administrative appeals processes before the Internal Revenue Service or in the courts. Because the taxpayer generates and is responsible for maintaining his or her business and other tax records, the taxpayer is in the best position to prove the amount of his or her income. Thus, the allocation of the burden of proof to the taxpayer ensures that taxpayers maintain accurate records and promotes the efficient administration of the tax system and the resolution of tax controversies.

Placing the burden of proof on the Government in tax litigation would require the Government to produce the business records, testimony or other evidence necessary to demonstrate the taxpayer's tax liability. This would place the Government at a fundamental disadvantage and likely would have three distinct effects on tax administration: (1) taxpayers might be inclined to be less forthright in preparing and filing their tax returns and may take more aggressive positions on their returns; (2) the Service would be forced to use its administrative summons power more frequently and intrusively during the audit process to gather the necessary information to support its determinations; more taxpayers would litigate the Service's audit determinations.

The potential consequences of these effects on tax administration could be very dramatic. We would expect that the Internal Revenue Service no longer would be able to assure general compliance with the tax laws, the high level of tax compliance in the United States would decrease -- perhaps substantially -- and the revenues collected by the Federal Government from income and other taxes likely would correspondingly decrease, perhaps substantially. In a nutshell, this single change in the law could further significantly complicate the fiscal condition of the United States.

Madame Chairman, permit me to thank you again for including the Tax Section in this important Subcommittee hearing. This concludes my prepared remarks. I would be pleased to answer any questions.

Chairman JOHNSON. Thank you and thank you for your testimony.

Ms. Walker, chair of the Tax Executive Committee at the American Institute of Certified Public Accountants, would you begin?

STATEMENT OF DEBORAH WALKER, CHAIR, TAX EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Ms. WALKER. Thank you, Madam Chairman, for the opportunity to offer recommendations for improving the Federal tax administration process.

I am Deborah Walker, chair of the Tax Executive Committee of the American Institute of Certified Public Accountants. We have 320,000 members. And it is our national professional organization of CPAs.

Let me just summarize some of this in view of the late hour and what we have heard prior to this.

Turning to the taxpayer ombudsmen issues, we see no need to disturb the reporting structure and risk hindering their ability to function effectively within the district. In fact, we think the quality of service provided by this group ranks among the highest in the Internal Revenue Service.

There are two things that we think would significantly help and I know we have heard a lot of concerns about that today. But we think that perhaps the biggest issue is training.

Too often training gets written out of the budget either in the budget process here or when it gets down to the IRS.

And resources that should go to training, resources that could help some of the issues that end up in problem resolution, could help with IRS agents more adequately trained in procedures and the basics of tax law.

The other important thing is that the Taxpayer Ombudsman should report to Congress on a periodic basis the activities of their office, the problem resolution office and the ombudsmen office. Also a response from the IRS on those activities is important. The response could detail what has been done to correct the problems noted. That may get away from the micromanagement that Congress needs to avoid.

Let me turn now to interest. We believe that the statute should be changed to provide that the Secretary must abate interest or refund interest attributable to unreasonable IRS errors and delays. The problem is, as we define it, that the ministerial act limitation is subject to interpretation and is interpreted far too narrowly.

We are concerned, by adding a managerial standard, that we are really just compounding the problem we already have which is we cannot define what a ministerial act is or a managerial standard. And it should basically be, if it is an IRS error or delay, that interest should be abated.

The last issue there is that interest may be abated. Of course, that has been interpreted to does not have to be abated. And therefore, we think that the may should changed to must be abated.

We also believe that there should be a reasonable extension of the 10-day interest free period to a 21-day period. However, we do

not support any dollar limitations with respect to that increased interest-free period.

Another piece of the interest problem is the differential between the interest rate owed to taxpayers on overpayments and the interest rate owed to the government. Congress included specific guidance for the Secretary to implement comprehensive crediting procedures. And those procedures have not been implemented. They are no longer on the business plan for 1995.

We think they need to be on that business plan and there needs to be some guidance for the crediting procedures.

Finally, we think that notwithstanding that we can make a lot of money checking IRS computations, we believe that interest computations should be disclosed to the taxpayers, the rates that are used, the dates that the rates apply, and when the payments and credits were made to various accounts.

Without that information it is virtually impossible for a taxpayer to determine whether the interest charges are correct, and it seems that certainly where interest charges are more than a diminimus amount of say, $50 or $100, it would not be too difficult to simply print the calculations out and supply them to the taxpayer so that they can check the calculations and the facts that were used in generating the calculations.

Turning to the examination procedures, we believe that stronger legislation is needed to ensure that the taxpayer is notified of his rights and allowed to representation. We have far too many instances where the IRS implies to the taxpayers that they must appear personally before the Internal Revenue Service and that a preparer cannot represent them or that they are not aware that a taxpayer can represent them.

So, we think it is important that when there is an examination, taxpayers be notified in writing. It is important that they be aware of the fact that they could be represented for this.

And finally, let me turn to the burden of proof issues. The AICPA cannot support the broad proposal contained in H.R. 390 which shifts the burden of proof to the government in any court proceeding.

With a voluntary tax system there is absolutely no way that the people who are signing under penalties of perjury should not have the burden of proof for supporting the numbers they are signing to. With that provision enacted, the IRS will have a very hard time, and as practitioners we will have a very hard time advising our clients.

The way that I look at it, and perhaps I have not thought long enough about it, but it seems to me that in almost every case you could simply get to court and tie things up forever, which is not going to be a good use of anybody's resources.

Having made that broad statement I do need to point out that there are certain instances, some of which Jerry mentioned—fraud—where the burden of proof should be on the government. And one area that we think is very important is information returns. The burden of proof should be on the government. The IRS needs to search information returns before they impose the burden on the taxpayers, since information returns are prepared by somebody else.

With that, let me close and say as the AICPA we are pleased to be able to help you and work toward the same thing that everyone wants, which is an efficient and effective tax administration system.

Thank you.

[The prepared statement follows:]

TESTIMONY OF DEBORAH WALKER
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Thank you, Madame Chairman, for the opportunity to offer recommendations for improving the federal tax administration process. I am Deborah Walker, Chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA). The AICPA is the national professional organization of CPAs, with over 320,000 members. Many of our members are tax practitioners who are highly concerned with the Internal Revenue Service's standards of accuracy, timeliness, fairness, and consistency and how those standards are applied to taxpayers and practitioners. We also recognize the need for the IRS to administer the system on an efficient and effective basis. It is imperative, therefore, that any changes balance those sometimes competing needs.

ADMINISTRATION IMPROVEMENTS

1. The Taxpayer Ombudsman and Problem Resolution Officers

We believe that the Taxpayer Ombudsman and the Problem Resolution Officers (PRO) have done an outstanding job. The quality of service provided by this group ranks among the highest in the Internal Revenue Service. We see no need to disturb the PRO's reporting structure and risk hindering their ability to function effectively within their District by placing them in a position as "outsiders" to other District personnel. There are definite advantages to having the source of problem identification and correction *within* the IRS.

The Taxpayer Ombudsman and the Problem Resolution Officers are more effective because of their ability to investigate the problems, analyze the reasons for them, report them to the appropriate executives, and monitor solutions. The Taxpayer Ombudsman has brought to the Commissioner's attention identified problems and legislative corrections. We believe that there exists an opportunity to enhance the program by:

- Statutory protection of training funds,
- Adequate funding of the Internal Revenue Service,
- Expansion of statutory authority under section 7811,
- Elevation of the Taxpayer Ombudsman position, and
- Statutory provision for an administrative appeal of Collection Division's actions within the IRS.

Many of the current problems of the IRS stem first from an excessive workload in the Collection Division and insufficient training of personnel in the realities of the business world. Additionally, the lack of emphasis on maintaining a current workload in the Examination Division has resulted in unnecessary hardships for those taxpayers who become involved in disagreements with the IRS.

We have consistently emphasized, in our prior testimony to the Congress, the need for improvement in the personnel recruiting and training programs of the IRS. IRS training programs are sometimes inadequately funded when resources are needed to maintain other programs. It is our belief, based on considerable experience, that many of the problems brought to the PROs are a result of IRS employees who are inadequately trained in IRS procedures and the basics of the tax law.

Further, we believe that the Taxpayer Ombudsman position should be elevated within the IRS organization. In order to accomplish this, we believe the Taxpayer Ombudsman must be a peer of the Deputy Commissioner or Chief Counsel.

We believe that the Problems Resolution Program operation would be strengthened by establishing a plan whereby the Taxpayer Ombudsman reports to the Congress on a periodic basis regarding:

- initiatives that the Taxpayer Ombudsman's office has taken,
- recommendations flowing in from the field,
- the inventory of open items on which no action has been taken,
- the inventory of items on which changes have been made and whether or not those changes resolve the underlying problem,

- recommended changes that have not been implemented with the reasons for not doing so, and the IRS official who made the final decision on each recommended change,
- Taxpayer Assistance Orders which were not honored by the IRS in a timely manner, and
- recommended legislative changes to mitigate problems taxpayers incur in dealing with the IRS.

We recommend that periodic reports be submitted directly to the Congress, without the perceived undue influence regarding prior review or comment from the Commissioner, the Secretary of the Treasury, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget. Additionally, we recommend a formal response to all of the Taxpayer Ombudsman's recommendations be submitted to the Congress by the Commissioner.

Further, we believe that expansion of the Taxpayer Ombudsman's statutory authority under section 7811 is essential to maintaining an efficient tax administration. Section 7811 authorizes the Taxpayer Ombudsman to issue a Taxpayer Assistance Order if the Taxpayer Ombudsman determines the taxpayer is suffering or about to suffer a significant hardship. Taxpayer Assistance Orders require certain actions such as the release of taxpayer property levied upon by the IRS, and may require the IRS to cease any action, or refrain from taking any action as a result of the manner in which the internal revenue laws are being administered. The Code, regulations and other administrative guidance set forth a standard of hardship requiring that the basis for seeking relief is "undue" or "significant" hardship. Therefore, we recommend the elimination of the qualifiers "undue", "significant", etc. thereby providing broader authority for the Taxpayer Ombudsman to take action so taxpayers do not unfairly suffer.

2. Awarding of Costs and Certain Fees

Under current law, as set forth in section 7430, administrative costs may be recovered from the IRS only if incurred on or after the earlier of (1) receipt of the final decision of Appeals or (2) receipt of the statutory notice of deficiency. However, generally no administrative costs are incurred after this period and thus, section 7430 is not effectively carrying out the intent of Congress. Further, the taxpayer is required to demonstrate that the IRS position was not "substantially justified."

We support legislation which would amend section 7430 to provide that any person who substantially prevails in an administrative proceeding can recover reasonable administrative costs if such costs are incurred after the earlier of (1) the date of the first notice of proposed deficiency that allows the person an opportunity for administrative review with Appeals or (2) the date of the notice of deficiency described in section 6212. To protect the government, the amendment to section 7430 could provide that administrative costs will not be recovered if the government can show that its position was substantially justified.

3. Notification of Intention to Offset

We believe the IRS should provide taxpayers with notification of its intention to offset a balance due on one account or module with a refund on another. We recognize the IRS's authority to credit amounts due the taxpayer to any other liability of the taxpayer in accordance with IRC section 6402. However, in such cases, the taxpayer is not notified of such credit application until after the action is taken. In many instances, the balance due is erroneously assessed or subsequently abated. Also, the credit application may have serious ramifications for the taxpayer, particularly an individual or a smaller business that cannot afford to engage a representative to deal with the IRS on such issues.

For example, a taxpayer may elect to apply an overpayment of income tax from one year to the next as an estimated tax payment. This overpayment is sufficient to cover the taxpayer's first quarter estimate for the subsequent year. The taxpayer, a sole proprietor, may have been assessed an employment tax penalty on a given quarter. The penalty is due to the fact that a proper liability breakdown was not included with the Form 941. Once this information is supplied by the taxpayer, the penalty will be abated.

Under the IRS's current system, the taxpayer's overpayment of income tax will be applied to the outstanding employment tax assessment. The amount applied to the first quarter of the subsequent tax year as an estimated tax payment may be insufficient to cover the liability and the taxpayer is subject to an estimated tax penalty on the subsequent year. If the employment tax penalty is subsequently abated, the amount credited against such assessment will be refunded to the taxpayer from the employment tax account. However, the estimated tax penalty will not be abated automatically.

The taxpayer should be notified prior to the application of overpayments to other balances of such taxpayer. There may be other actions in progress to rectify such accounts or significant mitigating factors under consideration by another area within the IRS. The application of such overpayments, without providing the taxpayer an opportunity to address the situation, is a denial of "due process" and may create unnecessary complications and frustrations for both the IRS and taxpayers.

4. Protection from Retroactivity — Prospective Effective Dates for Treasury Regulations

We urge the Subcommittee to consider legislation that would provide protection for taxpayers who make "good faith" efforts to comply with the tax laws during the period between enactment of the law and issuance of clear guidelines and final regulations. The AICPA supports the qualifications for protection from retroactivity as set forth in S. 258, *Taxpayer Bill of Rights 2*, introduced January 23, 1995. Such reforms would recognize taxpayers' needs for early guidance in complex areas of the tax law, while at the same time stimulate the IRS and the Treasury to accelerate issuance of such guidance.

5. Rounding

The AICPA believes requiring the rounding of numbers on most tax returns would decrease the number of errors in tax return preparation and administration. It could greatly enhance efficiency in processing tax returns and does not affect the rights of individual taxpayers. We strongly encourage the Congress to pass legislation requiring the rounding of numbers on most tax returns.

6. Disclosure Changes

IRS statistics indicate approximately 50 percent of all returns are prepared by commercial preparers. We believe, especially because of the complex nature of the law, that taxpayers have a right to expect that the hiring of a preparer will avoid personal inconvenience and unnecessary loss of their own productive time in having their return accepted in the processing phases by the IRS. Our experience and IRS records show the processing of notices during the return perfection and processing phase is a significant workload factor. Many practitioners and taxpayers, unaware of the strict enforcement of the disclosure rules, attempt to resolve these notices by having the preparer "do what the preparer is being paid to do" — prepare the return, solve compliance problems, and appropriately interface with the Service.

We believe changes in the disclosure rules would reduce taxpayer burden, reduce IRS correspondence in dealing with abortive contacts by preparers without a power of attorney, and support the taxpayer's right to be represented. Specifically, we suggest section 6103 be amended to allow for taxpayer representatives to request and receive a taxpayer identification number on the telephone without a power of attorney being filed and to allow IRS personnel to contact a preparer who has signed the return, or accept contacts by such a preparer on behalf of the taxpayer who has received a notice from the IRS with respect to that return. This would reduce the cost of tax administration for the IRS, taxpayers, and preparers. Such communications would be allowed solely for the purpose of perfecting or processing the return for a limited period (e.g., twelve or eighteen months) after the due date of the return or the date the return is filed.

INTEREST

7. Abatement of Interest for Unreasonable IRS Delays

Section 6404(e)(1) provides "...the Secretary *may* (emphasis added) abate" interest on "any deficiency in whole or in part to [due to] any error or delay by an officer or employee of the IRS (acting in his official capacity) in performing a ministerial act."

The ministerial act requirement too narrowly limits the possibility of relief to the taxpayer with the result that the IRS will not abate interest even if it is the IRS's fault. To add a managerial standard only further complicates the statute by providing another unclear standard for interest abatement. Further, IRS rejection of a taxpayer request to abate interest is consistently denied by the courts because section 6404(e)(1) provides no requirement for abatement.

We believe that the statute must be changed to provide that the Secretary must abate or refund interest attributable to unreasonable IRS errors and delays. The ministerial act limitation should be deleted from the statute, and courts should use "unreasonable error or delay" as the appropriate standard of review.

8. Netting of Overpayments and Underpayments for the Calculation of Interest

In 1986, Congress enacted a differential between the interest owed to taxpayers on overpayments and the interest owed to the government on underpayments. Recognizing the inequity created, Congress included specific guidance that "the Secretary should implement the most comprehensive crediting procedures under section 6402 that are consistent with sound administrative practice..." However, the IRS has not responded to Congress's guidance which appeared in the legislative history to the 1986 Tax Reform Act, the 1990 Omnibus Budget Reconciliation Act, and the 1994 General Agreement on Tariffs and Trade. Consequently, we urge Congress to pass legislation requiring "comprehensive crediting procedures under section 6402."

9. Extension of Interest-Free Period for Payment of Tax After Notice and Demand

Taxpayers generally must pay interest on late payments of tax. However, a ten day interest-free period is provided for taxpayers who pay the tax due within ten days of the date of the notice and demand for payment. Oftentimes, the taxpayer does not even receive the notice and demand until after the ten days have expired. Even if the taxpayer received the notice and demand on the date of the notice, ten days often is not adequate time for the taxpayer to gather data for a response, mail a response, and for the IRS to receive it, open it, and route it to the correct area. Therefore, we believe a reasonable extension of the ten day interest-free period to a twenty-one day period should be legislated. We do not support any dollar limitations on this increased interest-free period as is currently proposed in S. 258, *Taxpayer Bill of Rights 2*.

10. Detailed Interest Computations

We believe the IRS should provide interest computations, as a matter of course, to taxpayers when adjustments involving interest are made. Currently the taxpayer only receives a notice showing the amount of tax and the interest due on such amount. IRC section 7522, which is applicable for notices mailed on or after January 1, 1990, requires that such notices describe the "basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice." At the present time, the starting date for the interest, the principal amount upon which such interest is based and the rate charged on such amount are not provided to the taxpayer as a part of the notice procedure.

We believe the " basis for" description in the notice should apply to interest computations and should include interest rates and the dates for which the interest applied, the dates and amounts of payments and credits and the interest compounding method. With this information, taxpayers and practitioners

will be able to verify the accuracy of interest computations and expeditiously resolve any discrepancies. We recognize that detailed interest computations could result in a burden to the IRS. Therefore, an exception could be made for de minimis interest amounts such as $50 or $100.

COLLECTION IMPROVEMENTS

11. Application for Extension of Time to Pay (Form 2911) and Installment Agreements

The IRS's Consolidated Penalty Handbook stresses that the purpose of penalties is to "encourage compliant conduct." We support legislative and administrative efforts that the IRS no longer assert the failure to pay penalty when an installment agreement is in effect. We suggest the following expansion of the Taxpayer Ombudsman's recommendation:

> When there has been an application for extension of time to pay or a request for an installment agreement which is made in good faith, in proper form, and evidences a reasonable basis for the application, then the penalty should not be applied, beginning on the date of said application until denial or the termination of the extension or installment agreement, whichever occurs later.

12. Taxpayer Rights Review — Administrative Appeal of Collection Actions

We recommend the creation of an administrative appeal of collection actions (including liens, levies, installment agreements and seizure actions) to resolve issues on matters not related to the determination of tax. This procedure could be an additional function of the Appeals Division and should apply to actions where the deficiency was assessed without the taxpayer's actual knowledge or without an opportunity for an administrative appeal.

13. Expansion of Authority to Release Liens

The IRS currently may only withdraw a filed notice of lien if the notice was erroneously filed or if the lien has been paid, bonded, or became unenforceable. In many instances, taxpayers suffer severe hardships when a lien is filed against them. It is especially difficult for small business owners to carry on business because creditors are unwilling to do business with the taxpayer because of the IRS lien. We recommend expansion of the Secretary's authority to issue a certificate of release of lien and expansion of the IRS's authority to return levied property to a taxpayer when the taxpayer has overpaid their liability if it is determined that:

- filing of the notice was premature or not in accordance with IRS administrative procedures,
- the taxpayer has entered into an installment agreement to satisfy the tax liability,
- withdrawal of the lien will facilitate collection of the liability, or
- withdrawal of the lien would be in the best interests of the taxpayer and the Government.

Further, at the taxpayer's request, the IRS should be required to make reasonable efforts to give notice of the release of lien to the taxpayer's creditors and to credit reporting agencies.

14. Increase Levy Exemption Amount

We support legislation to increase the exemption amounts for property exempt from levy and the indexing of that amount for inflation. In addition, the exemptions permitted to an employee whose salary is levied upon by the IRS should include premiums on health benefits, life, or disability insurance. Thus, a wage earner would be protected from losing his or her health benefits coverage as a result of the IRS's levy. Also, there appears to be an inequity in the statute in that the statutory exemptions do not apply to wages which are direct deposited into a bank account.

15. Damages for Wrongful Liens

We support legislation for a cause of action against the IRS for wrongful liens. Additionally, we would like to have included a similar cause of action on liens in violation of the automatic stay provisions in bankruptcy proceedings.

16. Offers-in-Compromise

We support legislation which would eliminate the requirement of an opinion of Counsel in an instance where taxes are being compromised based upon doubt as to collectibility. Absent this change, we support legislation for a significant increase in the amount requiring a written opinion of Counsel for an offer-in-compromise.

17. Information Return Reporting

Where the taxpayer asserts a nonfrivolous dispute with respect to any item of income reported to the IRS on an information return, then the IRS — not the taxpayer — should bear the burden of proof in any deficiency or refund proceeding absent a showing that the IRS conducted a reasonable investigation of the facts and physically examined the taxpayer's return.

18. Payroll Tax Collection

The procedure for assessment against and collection of unpaid payroll taxes from the owners, officers, directors and/or anyone with the authority and control over payroll funds, "responsible party," helps ensure that "trust" funds are paid when due. However, the "fairness" of collecting all the tax from only one party when many may be involved is questionable. The statute actually permits the IRS to collect the full amount from each party; however, the administration has stated that it does not collect more than the actual liability. Because no party is allowed to know what has been assessed and collected from each of the other responsible parties and how any payment was applied, procedures should be established to show how, and from whom, the IRS has collected the tax and whether civil recovery from others is possible in a post-collection context.

Since collection efforts are directed against the person residing in the area of the IRS office assigned the case rather than against the person most liable for the failure to pay the taxes, or the person who actually benefitted from the failure to pay the taxes, such efforts are often unfair. We urge you to consider changes in this section of the law that would require an equal and fair pursuit of collection from all parties involved. We believe the law should require the IRS to disclose the "uncollected balance" (by tax period) remaining on the assessment to any party from whom it is attempting collection, as well as the identities of other parties against whom the assessment is made or to be made.

Further, we support a requirement that the IRS issue a preliminary notice which will give the taxpayer the right to an administrative appeals hearing for the failure to collect and pay trust fund taxes, or attempt to evade or defeat such taxes provided in section 6672. Also, we support legislative efforts to prevent the IRS from collecting more than 100% of the trust fund taxes owed. We believe legislation should be enacted to prohibit the IRS from attempting to collect the 100% penalty from any alleged responsible persons during the pendency of any administrative proceeding or judicial action brought to contest the merits of a 100% penalty liability.

19. Safeguard for Divorced or Separated Spouses and Married Persons in Community Property States

We believe additional reforms are needed to ensure the equal and fair treatment of spouses who are separated, divorced and/or have community property issues compounding their tax problems. We are especially concerned with the collection procedures applicable in these situations. Often, a

divorced spouse is not aware that a liability has been created in an examination process where the other party was the party examined, as in a situation where one taxpayer has a Schedule C, *Profit or Loss from Business (Sole Proprietor)*. Yet, after the assessment is made, the IRS will attempt to collect the tax from either party. If the taxpayers are divorced or separated and now live in different regions, or even different districts, the IRS tends to only make collection efforts against the spouse living in the area of the IRS office assigned the collection case, even though the distant spouse may have more funds available to pay the bill (and maybe even be the source of the liability).

The root of this problem is in the examination procedures that do not require both spouses to be involved in an audit. We support legislative procedures that require, at the initiation of an examination, the absent spouse to acknowledge by signature whether the other spouse may, or may not, represent the absent spouse. If both parties are aware of, or participate in, the examination, then no one should be caught unaware of the liability and the resulting collection process. Additionally, legislation may be required to ensure that disclosure laws are changed to provide adequate information to the divorced spouse in community property states.

EXAMINATION IMPROVEMENTS

20. Taxpayer Interviews

Section 7521 specifically states that "if the taxpayer clearly states to an officer or employee of the IRS at any time during any interview ...that the taxpayer wishes to consult with an attorney, certified public accountant, enrolled agent, enrolled actuary, ...such officer or employee shall suspend such interview regardless of whether the taxpayer may have answered one or more questions." The AICPA is aware of many instances where the IRS appeared to demand that a taxpayer personally appear alone at the initial examination meeting and the taxpayer was not informed of the right to have a representative appear on his or her behalf. In most instances, an examination can be completely handled by a representative and we believe stronger legislation is needed to ensure the taxpayer is notified of his or her rights and allowed that representation.

21. Place of Examination

We believe that section 7605(a) should be amended to say that the "time and place of examination...shall be such time and place as requested by the taxpayer and as are reasonable under the circumstances." Currently, section 7605(a) provides that the "time and place of examination...shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances." Treasury Reg. section 301.7605-1 provides general criteria for the IRS to apply in determining whether a particular time and place for an examination are reasonable under the circumstances. The regulation also instructs that sound judgment should be exercised in applying these criteria and that there should be a balancing of convenience of the taxpayer with the requirements of sound and efficient tax administration. Unfortunately, the IRS placed unnecessary limitations on field personnel by instituting IRM 4235, section 320(1) and (2).

This IRM guidance provides that the place of examination will be established consistent with the regulation and with few exceptions, the examination of the records should be made at the taxpayer's place of business. Also, this guidance indicates that consideration should be given to conducting the examination at the IRS office or the representative's office only if the taxpayer's place of business falls short in some respect relevant to conducting an examination. These guidelines are inadequate and should, therefore, be clarified legislatively.

22. Notice of Examination

The Internal Revenue Service initially contacts taxpayers either by telephone or letter to inform them of an upcoming examination. When the initial contact is made by telephone, it is followed up by letter in order to present the taxpayers' rights in written form. However, the process of allowing initial contacts to be made by telephone creates many problems in assuring taxpayers of their rights. The

revenue agent, however, may request an appointment with the taxpayer in that initial call. Sometimes the taxpayer believes that he or she must personally be at the appointment and the taxpayer does not understand that they have a right to representation.

In order to protect the rights of the taxpayer, the AICPA believes that section 7605 should be amended to require that the initial notification of an examination be made in writing. This requirement should be for all examinations. When the taxpayer receives a notice of examination, the rights accorded a taxpayer under section 7521 (explanation of examination process, right to be represented by an attorney, certified public accountant, etc.) shall attach at that time.

CONCLUSION

In conclusion, the AICPA wants to again thank you for the opportunity to present our comments and recommendations for more efficient administration of the tax system and improvements to the rights of the taxpayer. We will be glad to assist you or your staff with any questions or concerns.

Chairman JOHNSON. Thank you.

Mr. Keating, the executive vice president of the National Taxpayers Union, with Mr. Jack Wade.

STATEMENT OF DAVID KEATING, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION; ACCOMPANIED BY JACK WADE, CONSULTANT, NATIONAL TAXPAYERS UNION

Mr. KEATING. Thank you, Madam Chairman, for inviting us to testify. I am David Keating, executive vice president of the National Taxpayers Union, and with me is Jack Wade, who is an expert on taxpayer's rights issues. He once headed the revenue officer training program for the IRS and he can tell you that much needs to be done to protect taxpayer's rights.

We especially appreciate your scheduling this hearing today and your interest in these issues. We strongly endorse S. 258. We think it can be improved to better protect taxpayer's rights. At the outset I would like to note that the bill that passed in 1992, proposed establishing the office of the taxpayer advocate. That legislation proposed making that position a political appointment.

That is not in S. 258, and we think it should be. We think a political appointee would come to the job independent of the restrictive mission oriented mentality of just collecting taxes, and not providing service to taxpayers.

We believe it would be a very, very refreshing change from business as usual. There are too many problems that have literally festered for over a decade. Look at the many problems that were identified by the Administrative Conference of the U.S. two decades ago and nothing ever gets done about it.

We think a political appointee in this post will finally give the IRS a true taxpayer advocate who can get some of these problems settled.

The standard for issuing a taxpayer assistance order is much too high. The fact that a taxpayer has to be burdened by a significant hardship is unfair. The taxpayer advocate should be able to act in other situations. My written statement suggests some commonsense situations where the taxpayer advocate should be empowered to act.

One other issue that I would like to address is the provision that allows a taxpayer to sue for damages. We think the standard of proof there is too high. The original bill in 1988 would have allowed taxpayers to recover when the IRS was careless. During the 1980s we had all kinds of increased regulations on tax preparers and on taxpayers, requiring due diligence in the preparing of tax returns.

Why cannot we have a due diligence standard on the IRS? We think that is entirely reasonable. If the taxpayers have to exercise due diligence, then why not the IRS?

Attorney fee awards—it is great to have them, but let's face it, you cannot hire a tax attorney for $75 an hour, virtually anywhere in this country.

We think it is time to raise this cap. The bill proposes a $110 cap. That was in the bill that was passed in 1992. At the very least let us index that $110 for inflation since 1992. A $150 per hour cap would be more reasonable.

I would also like to concur fully with Ms. Walker's statements on interest, computations, and taxpayer representation issues. We agree with that 100 percent.

Another provision in S. 258 would create a 1-year pilot program for appeals of enforcement actions in collections to the appeals division.

We think this is a very, very interesting idea and we hope that this will be made permanent if this bill becomes law. There are many taxpayers who have very modest means. They get caught in these collection actions, they cannot afford to hire representation, they cannot hire an accountant, they cannot hire a tax preparer, they cannot hire an enrolled agent.

If they could at least go to some appeals division in addition to the taxpayer advocate, maybe some of these problems could be corrected.

We also think it is time to selectively modify the Declaratory Relief Act and the Anti-Injunction Act, because there are just too many barriers to taxpayers who are trying to enforce their rights.

Our statement gives some very limited examples of how these laws can be changed to improve taxpayer's rights.

It is also very important to safeguard the right to be self-supporting. The tax laws require a businessperson to keep just $1,100 of business equipment. This is ridiculous. The Foodstamp Program allows more than that. You can qualify for foodstamps with more assets than the IRS will allow you to keep.

It is time to raise these limits. There are many taxpayers who will declare bankruptcy simply to try to keep enough to produce income to pay their taxes. We think this would take some load off the bankruptcy courts, help the IRS, and safeguard the right to be self-supporting, which we think is very important.

The burden of proof can and should be shifted in some cases. Particularly for the 100-percent penalty on trust fund taxes.

We have seen many, many nonresponsible people get hit with this penalty and it is simply unfair for the IRS to come after a bookkeeper and people who are just acting at direction of their bosses.

We also have seen instances where this penalty gets collected more than once, even though it is not supposed to be collected more than once. There is nothing in the law that prevents it from being collected more than once.

There is a big problem on this issue of innocent spouses and I am very glad to hear that Professor Beck testified earlier. We think this reform is very important.

Almost everybody in the agency who works on the front line knows this is a problem and it just does not get fixed. We have heard reports of tax practitioners who cannot even get a power of attorney honored by the IRS in representing a divorced female spouse. They do not even get notified of what is going on.

So clearly something needs to be done in this area and we think Professor Beck's recommendations are very much on target.

I would like to say one last thing. The ultimate improvement to enforcing and helping taxpayer's rights would be to simplify the tax code. We are thrilled to hear that Congressman Archer will hold hearings on the issue of a greatly simplified tax code. The abuses and the problems come from a tax law that is so complicated that no one can understand it.

Thank you, Madam Chairman.

[The prepared statement follows:]

Statement of

David Keating
Executive Vice President
National Taxpayers Union

before the

Subcommittee On Oversight
Committee On Ways & Means
U.S. House of Representatives

on

Taxpayers' Rights Issues

March 24, 1995

Thank you for the opportunity to testify on reforms to improve taxpayer rights. I represent the 300,000 members of the National Taxpayers Union who strongly support providing taxpayers with additional rights and protections during the tax audit and collection process. I am accompanied by Jack Warren Wade, who is an advisor to National Taxpayers Union and author of many books on tax compliance. Mr. Wade once headed the national revenue officer training program for the Internal Revenue Service.

Representative Johnson, we commend you for scheduling this hearing to examine taxpayers' rights. The IRS touches the lives of more American citizens than any other government agency. Because the IRS has more power than any other agency, it is especially important that Congress establish safeguards to protect the rights of taxpayers and to regularly maintain oversight of the tax collection power.

We strongly endorse S. 258, which is similar to the Taxpayer Bill of Rights II provisions in H.R. 11 of the 102nd Congress.

It's Time to Make the Ombudsman More Independent.

The 1992 House bill established a new position, known as the "Taxpayer Advocate" within the IRS. According to the Conference report on H.R. 11, this Taxpayer Advocate "replaces the position of Taxpayer Ombudsman. The Taxpayer Advocate is to be nominated by the President, by and with the advice and consent of the Senate." The final version of H.R. 11 was similar to the House bill, but S. 258 does not include a provision for making the Taxpayer Advocate a political appointee. This would be a serious mistake.

We strongly believe that the Taxpayer Advocate should be a political appointee and not a career IRS employee. As a political appointee the Taxpayer Advocate would be free to be a true taxpayer advocate without concern for his career aspirations within the IRS. He would not have to worry about how other IRS managers view his input into their areas of responsibility. Also, a political appointee would come to the job independent of the restrictive mission-oriented mentality that besets many career agency executives. He would be more receptive to the needs of taxpayers and to changing business-as-usual. A four-year term would enable each new administration to replace the Taxpayer Advocate.

Some have expressed concern about the Taxpayer Advocate being a political appointee. When he was Commissioner, Roscoe Egger once testified that such independent power "would not provide a balance between protecting the government's and taxpayers' interests and would open up dangerous potential for political abuse of the tax system." That's absurd. The Taxpayer Advocate would have no powers for such mischief. After all, the Commissioner is a political appointee. We're convinced that there is room in the IRS for one more political appointee. We believe there are proper checks and balances within the agency to prevent any political abuses or mischief. These include oversight from the IRS Internal Security Division and Treasury's Inspector General as well as an agency culture that resists political pressure.

We also support the proposal to mandate that the Taxpayer Advocate annually report "at least 20 of the most serious problems encountered by taxpayers, including a description of the nature of such problems" and to make "recommendations for such administrative and legislative action as may be appropriate to resolve problems encountered by taxpayers." This is a sound proposal. Much of the agency's emphasis has been on

ensuring taxpayer compliance, which is certainly part of the mission. But taxpayer compliance also can be increased by reducing problems and taxpayer frustration.

`We believe a provision should be added to require the Taxpayer Advocate to form advisory groups from the public and the tax industry to provide feedback about IRS operations and their effects on the taxpaying public.

Taxpayer Assistance Orders and the Problem Resolution Program.

While the Problem Resolution Program has undoubtedly achieved a great deal of success in helping taxpayers, we think there is still room for improvement. Reports have surfaced about problem resolution officers (PROs) who have not been helping taxpayers even though the circumstances appear to warrant intervention. Bob Kamman, a Phoenix, Arizona attorney, who contributes to our Tax Savings Report newsletter, has written that after a Form 911 is filed with a PRO, "that person refers it to the branch of the agency where the difficulty originated. The response quite often is made by the person who caused the problem in the first place. It's not easy to tell co-workers down the hall, who may eat at the same cafeteria table, ride in the same carpool and bowl in the same league, that they screwed up. Sometimes the PRO does it, but often he won't. That's what happened to my client ..."

I have heard complaints that some PROs believe they are not technically qualified to pass judgment on a particular taxpayer's complaint and temporarily overrule the IRS action. If this is indeed a problem, it would account for the dearth of Taxpayer Assistance Orders (TAOs) that have been granted.

The IRS will undoubtedly say that the reason for the dearth of TAOs is that the mere threat of a TAO often will accomplish the task. Mr. Kamman makes the excellent point that "we don't evaluate the effectiveness of police carrying guns by the number of times they shoot them." But the TAO is hardly the equivalent of a bullet.

The Standard of Hardship is Unnecessarily High for a TAO.

One other potential explanation is that the IRS is using an excessively strict standard of hardship. We strongly support the S. 258 provision to reduce the hardship requirement.

If the IRS is violating its internal policies or the tax laws, the Taxpayer Advocate should have the power to issue a TAO. This is altogether reasonable. After all, why should the taxpayer have to bear significant hardships in order to qualify for a TAO?

Mr. Kamman makes several sensible suggestions about how to liberalize the criteria to qualify for a TAO. He suggests that the following questions be considered:

1) Is the taxpayer falsely being accused of filing an incorrect return, or not paying taxes owed?

2) Is the taxpayer incurring expenses paid to tax professionals in an attempt to resolve a problem, not just to calculate a liability?

3) Did an admitted IRS error cause the problem in the first place?

4) Has there been an unreasonable delay in IRS remedial action?

If the answer to any of these questions is yes, hardship should be presumed de facto, and further inquiry into the particular burden of the hardship need not be made.

The Taxpayer Advocate should have the right to intervene in any enforcement proceeding or activity when a taxpayer has made a petition to the Ombudsman that at least one of the following conditions exist:

- There has been an improper or possibly illegal assessment.
- There has been an assessment made without the knowledge of the taxpayer and without benefit of the taxpayer's appeal rights.
- There has been an action in violation either of the statutory procedures of the Tax Code, the policies or regulations of the IRS, or the procedural requirements specified in the Internal Revenue Manual.

Taxpayers Can Still Lose Even When They Win.

Although the Taxpayers' Bill of Rights passed in 1988 offers important new protections for taxpayers, the job of protecting innocent taxpayers from ruin is far from

complete. For example, I have serious doubts that it would have prevented the well-documented Council family tragedy.

The original Taxpayers' Bill of Rights proposal would have allowed taxpayers to sue for damages if "any officer or employee of the Internal Revenue Service carelessly, recklessly or intentionally disregards any provision" of the tax laws. As the bill progressed through the Congress, the word "carelessly" was dropped from what became Section 7433 of the tax code.

Was the IRS treatment of the Council family careless and negligent? Absolutely. The Court's decision was clear on this point. Was it reckless or intentional? It might have been, but that is a very difficult standard to prove.

In the 1986 Tax Reform Act, Congress substantially liberalized the definition of negligent actions by individual taxpayers. During the 1980s, tax preparers have also been subject to increasing penalties for not exercising due diligence. Yet incredibly, Congress refuses to require the IRS to exercise reasonable caution in using its vast array of enforcement powers. We believe Congress should require the IRS to practice due-diligence in its enforcement actions in order to prevail in litigation where a taxpayer sues for damages. Congress should require that the IRS issue regulations defining a due-diligence standard for actions by its employees. We expect that the IRS would include the procedures already outlined in the Internal Revenue Manual as much of the criteria to define this standard.

Taxpayers who have been financially harmed or devastated by IRS carelessness in ignoring a due-diligence standard should have the right to sue and recover damages. We strongly support allowing taxpayers to recover damages for negligent action by the IRS. We also strongly support the proposal in S. 258 to raise the cap for damages to $1,000,000.

If a U.S. corporation makes a product that injures a consumer, consumers don't have to prove that the corporation recklessly or intentionally harmed the consumer in order for the consumer to win an award. Neither should a taxpayer who falls victim to the negligence of the all-powerful Internal Revenue Service.

I would also like to note a flaw in Section 7432 of the tax law. While it appears to allow a lawsuit for damages for failure to release a lien, it only applies for a failure to release a lien under Section 6325, not the imposition of the lien under Section 6321 in the first place. Legislation should correct this flaw.

Attorney Fee Awards Are Woefully Inadequate.

As Kay Council's case showed, taxpayers can suffer enormous financial damages even when they win. Kay was fortunate to receive an award of attorneys' fees for her case. But the fee award didn't come close to paying her total costs. She still owed tens of thousands of dollars.

While her attorneys billed her at $135 per hour and $90 per hour, depending on the respective seniority of the attorney, the judge was restricted by the outdated $75 per hour cap in the current law. He therefore only allowed reimbursement at a rate of $75 per hour and $49 per hour, leaving Kay to pay the difference. Does Congress want to say to future Kay Councils that they'll have to pay through the nose for legal help to fight a careless, incompetent or abusive IRS?

It's very difficult to win attorneys' fees. Also, the courts are extraordinarily reluctant to award attorneys' fees in excess of the $75 per hour cap in the current law. Proving special factors is almost impossible.

Unlike the standard for award of attorneys' fees in the Equal Access to Justice Act, plaintiffs in tax cases must prove that the IRS "was not substantially justified" in pursuing the case. It would be much fairer to require that the government prove it was acting reasonably in order to prevent an award of attorneys' fees.

To protect taxpayers from enormous financial losses incurred while fighting the IRS, we strongly support the proposal in S. 258 to raise the outdated $75 per hour cap to $110 per hour, then index it to inflation. The court would still be limited to awarding only "reasonable fees," preventing excessive awards. The proposed change that would allow taxpayers to collect more costs is also very important. We strongly recommend that the $110 per hour cap be lifted to $150, or at least reflect inflation since 1992. The original Senate bill of the 102nd Congress contained the $150 figure.

Taxpayers' Rights Review.

One provision of S. 258 would create a "1-year pilot program for appeals of enforcement actions (including lien, levy, and seizure actions) to the Appeals Division of the Internal Revenue Service." This is an excellent idea, and we hope that such a program would be made permanent. Had this proposal been in effect years ago, it may have prevented the Council family tragedy. It will certainly help ensure fair treatment during the tax collection process.

Taxpayers who are being treated unfairly by the IRS often don't have the financial means to mount an expensive court fight. This new administrative appeal procedure can help ensure fair treatment for taxpayers of modest means.

The Berlin Wall Stopping Taxpayers' Rights.

In the rare cases when the IRS goes out of control, federal law largely prevents the courts from allowing taxpayers to enforce their rights. The Federal Tort Claims Act allows the government to be sued in certain instances but specifically excludes "any claim arising in respect of the assessment or collection of any tax or custom duty." Of course, the 1988 Taxpayers' Bill of Rights granted two very limited exceptions to that rule.

Another unnecessarily restrictive law is the Anti-Injunction Act, the law that we call the Berlin Wall against taxpayers' rights. Mr. Chairman, it's past time to tear down this wall.

Under Section 7421 of the Internal Revenue Code, no lawsuit can be brought by any person in any court for the purpose of restraining the assessment or collection of any tax, except in limited circumstances.

The case law around the Anti-Injunction Act indicates many problems in obtaining injunctions to restrain the collection of the tax. It is clear that injunctions will be granted where the failure to grant relief would result in irreparable damage to the taxpayer. But an injunction will only be allowed where it is clear that under no circumstances would the government prevail (or the taxpayer would not owe the tax). Otherwise only two remedies are available to the taxpayer: 1) pay the tax, file a claim for refund, and sue for recovery if the claim is rejected; 2) file a petition in Tax Court before assessment and within the short period of time allowed for filing such a petition.

We think that the Anti-Injunction Act should be amended to give taxpayers the ability to enforce their rights if necessary. Taxpayers should be allowed to file suit in a federal district court to enjoin the IRS from enforcement action because: the deficiency assessment was made without knowledge of the taxpayer and without benefit of the appeal procedures provided by law; there has been an improper or illegal assessment; there has been an action in violation of the law or tax laws or regulations providing for procedural safeguards for taxpayers; the IRS has made an unlawful determination that collection of the tax was in jeopardy; the value of seized property is out of proportion to the amount of the liability if other collection remedies are available; or the IRS will not release the seized property upon an offer of payment of the U.S. interest in the property.

Then, there's also the Declaratory Relief Act. This law says that citizens can file suit to get a court to declare their rights "except with respect to federal taxes."

In author David Burnham's excellent book, A Law Unto Itself, he quotes California tax attorney Montie Day and his views on these laws that prevent taxpayers from enforcing their rights. He says that allowing such limited lawsuits would make "the IRS more accountable ... and make the agency more likely to operate in a lawful fashion."

To illustrate this point, he said "assume you are under audit and somehow you learn that the revenue agent has decided the best way to investigate you is to break a window of your office, climb through it and examine your correspondence.

"You come into my office for advice, wanting the court to rule that the IRS agent can't conduct his audit in this way. We consider filing a suit for declaratory relief, but then we remember that the court does not have the authority to issue such a declaration of rights in tax matters because of that exception in the Declaratory Relief Act.

"Then we think about requesting a court order to enjoin the agent from conducting his tax investigation by breaking into your office. This approach, of course, cannot be followed because the court is forbidden to even consider such requests under the Anti-Injunction Act."

As long as taxpayers are largely banned from suing to enforce their rights, taxpayers will continue to be at risk of financial ruin and emotional devastation from the

IRS. It is completely unfair for the IRS to have all the powers and for taxpayers to have few rights that can only be enforced with great legal difficulty. We must ensure fair treatment of innocent taxpayers to continue respect for our Constitutional system of government.

Congress Should Safeguard the Right to be Self-Supporting.

The Taxpayers' Bill of Rights made the very necessary improvement of exempting a larger amount of a taxpayer's weekly salary from levy. But it made little change in the amount of property exempt from seizure.

The law lifted the amounts from a paltry $1,500 for personal property to $1,650 and from $1,000 for equipment and property for a trade, business or profession to $1,100. That's hardly any change, and it is far from sufficient to allow a taxpayer to be self-supporting.

What self-employed plumber could maintain his self-employment with just $1,100 in tools, equipment and a truck? What computer programmer or author could do so? Very few, if any.

Who can provide the basic essentials of clothing and furnishings for a family with only a $1,600 exemption?

The bankruptcy laws provide far more protection than this. The Food Stamp program allows citizens to qualify for benefits with more assets than allowed under the tax laws!

We would like to see the exemption amounts lifted to either $10,000 or to provide the same protection as the bankruptcy laws. Many taxpayers are forced into bankruptcy court by the IRS. Raising the exemption amounts would take some of the load off the bankruptcy courts and safeguard the right to be self-supporting. The current levels are ridiculously low, and the proposed increases in S. 258 are not adequate to safeguard the right to be self-supporting.

Employees Who Abuse the Law Usually Go Unpunished.

There are many fine employees in the IRS who care about helping taxpayers comply with the law and who care about respecting taxpayers' rights. But given the sheer number of employees and the billions of tax returns and documents that are received by the IRS each year, it is inevitable that mistakes will be made and that some employees will act out of line.

The IRS has issued rules requiring tax preparers to exercise "due diligence" in the preparation of tax returns. In certain situations, preparers must cite "substantial authority" for the positions they take on tax returns. Failure to do so may result in monetary fines, being disbarred from practicing before the IRS, and a full scale audit of all the preparers' clients.

Yet IRS employees are often allowed to violate the IRS rules, regulations, policies, procedures, and guidelines at will and without fear of recourse. The law is so overwhelming and sweeping in its power conferred upon the tax collecting authority that there are few checks and balances on the exercise of that authority.

Taxpayers need more protections from arbitrary and capricious actions, and IRS employees should be held accountable for their violations. One theme that comes across again and again in Burnham's book is that the IRS almost always will not punish employees who make big mistakes in handling taxpayer disputes.

It seems clear that the IRS is more interested in controlling, regulating, and punishing taxpayers and practitioners for their violations than they are in controlling, regulating, and punishing their own employees for comparable infractions. If this double standard continues to exist, the compliance system as we know it could be in serious trouble.

Burnham reports a "disturbing footnote" about the occasions "when the IRS has crossed the line in its zealous enforcement of the tax laws: Agency officials involved in questionable activities are seldom punished." He also notes that many lawyers are worried "that the zealous, anything-to-win tactics are more and more becoming the accepted practice of the government." One of the fundamental principles of the U.S. Constitution is that people's rights shall be respected, even if it means that some people will escape being penalized for the laws they break.

Several years ago, Congressman Andy Jacobs introduced an amendment to a tax bill that would have permitted federal judges to make IRS employees personally liable for attorneys' fees paid by taxpayers who proved IRS agents acted arbitrarily and capriciously in pursuing the taxpayers. While this proposal may have gone too far, the concept is a good one - it would serve notice to IRS employees that they should be careful to protect taxpayers' rights.

Section 552(F) of the Federal Freedom of Information Act contains a standard that may be useful in drafting such a provision in the Federal tax law. It says that "Whenever the court orders the production of any agency records improperly withheld from the complainant and assesses against the United States reasonable attorney fees and other litigation costs, and the court additionally issues a written finding that the circumstances surrounding the withholding raise questions whether agency personnel acted arbitrarily or capriciously with respect to the withholding, the Special Counsel shall promptly initiate a proceeding to determine whether disciplinary action is warranted against the officer or employee who was primarily responsible for the withholding."

We expect the tax return preparers will be careful in preparing tax returns. Is it too much to ask that IRS employees and the agency be subject to some limited financial sanctions if they act to intentionally harm the taxpayer? We think not.

Installment Agreements.

Another provision of S. 258 would provide the right to an installment agreement if the taxpayer had not been delinquent in the previous three years and the liability was under $10,000. We think this is a good proposal, especially since it is limited to individual Form 1040 taxes. More taxpayers would be willing to concede to the IRS after an audit if they knew they would have time to pay an unexpected bill. Currently, taxpayers have an incentive to stall if they can't pay. Of course, any interest and penalties that would normally be owed would still continue to accrue.

Marriage, Divorce, and the IRS.

One of the most common complaints I hear comes from taxpayers who have divorced and one spouse has disappeared. Perhaps following a tendency in human nature, the IRS often goes after the spouse it finds first, whose name and address the IRS readily has on its computer, even though that spouse may be innocent.

Of course, in some cases, taxpayers can be relieved of the tax liability on a joint return under the so-called "innocent spouse" rule. However, its provisions are so complicated that it should be known as the "lucky spouse" rule for the few people who can meet all of its tests.

In one case in Arizona, the IRS dunned Carol Bettencourt, even though she had been divorced for five years. Her former spouse ran out on a court-ordered $60-a-month child support payments. Carol never saw a dime from him, but she was expected to pay his tax debts. Carol turned to the IRS Problem Resolution Officer, who told her that since she had once filed joint returns with her ex-husband, the only solution was to pay up.

But the Problem Resolution Officer failed to note that the IRS hadn't sent Carol's notice of tax deficiency to her last known address which the tax law requires. Fortunately, an attorney volunteered to review her case. With his help, Carol got her tax refund, which had been withheld to pay her husband's tax debt.

It is especially important to simplify and ease criteria that taxpayers must meet to qualify for protection as an "innocent spouse."

I don't see any reason why the IRS should not be required to honor divorce decrees that apportion responsibility for tax liabilities, provided that a decree splits such potential liability in proportion to the income earned by each spouse. A court could, for example, rule that in the last three years of marriage the husband earned 55 percent of the income and the wife earned 45 percent and thus require that any federal and state income tax liability that may be assessed against the couple be split accordingly to that ratio.

If the Congress is unwilling to do that, it should consider evenly splitting the liability between spouses. We currently have a situation that creates joint liability where the IRS tries to collect from one person -- an innocent spouse who is complying with the tax laws and is easier to find -- rather than from the responsible spouse, and that is often grossly unfair. The IRS should be required to pursue the spouse responsible for the tax problem. Any tax that arises from a business entity such a reported on a Schedule C should be apportioned to the spouse who owns the business entity. If additional tax arises from unreported income, the additional tax should be collected from the spouse who failed to report the income.

A divorced spouse should also have the right to petition the IRS for a final determination of any outstanding or potential tax liabilities. This would provide protection from a tax surprise on one spouse after a divorce is final.

I have heard reports that the IRS computer system is unable to set up separate collection accounts when the two divorced spouses live in different IRS districts. If this is true, then it is not simply a question of the IRS trying to collect the joint tax liability from the spouse who is located first, but the spouse whose case is being aggressively pursued by one of the two districts. Or, a Revenue Officer may determine that another spouse lives in another district and refer his case to the other district for collection. Case closed, problem transferred.

Much more needs to be done to protect divorced spouses.

Administration of the Federal Tax Deposit System.

If an employer does not report and deposit withheld income and Social Security taxes, then certain responsible officers can be held personally responsible for the taxes plus a one hundred percent penalty. This is an area ripe for reform.

When the IRS seeks to collect these trust fund taxes, it often assesses liabilities on everyone in sight (including bookkeepers, accountants, bank officers, inactive directors, inactive or resigned corporate officers and family members), whether they are truly a responsible officer or not. Inside the agency, this is called the shotgun penalty approach. A lot of innocent people get hurt.

Unfortunately, the burden of proof is on the taxpayer to prove that he or she was not responsible for the lack of payment. You might as well ask the taxpayer "When did you stop beating your spouse?" Proving a negative is a difficult proposition at best.

The burden should be on the IRS to prove the taxpayer was responsible.

Why can't the tax laws define the responsible parties as the chief executive officer, the chief and senior financial officers, those who serve on the board of directors and own a significant stake in a privately held corporation, and other responsible parties designated on a schedule that could be attached to the corporation's last quarterly 941 tax return of each year? The attached schedule would clearly state the serious responsibilities to remit trust fund taxes and require the signature of each named responsible person to indicate their knowledge of and consent to these rules.

If the IRS had the names and addresses of such persons in its computer, then these responsible persons could be immediately notified when a payment has been missed. It would allow these officers and other responsible persons to immediately investigate why these taxes have not been remitted on time, protecting the Treasury and innocent taxpayers.

Tax Complexity Invites Abuse.

Burnham wrote that an IRS instructor once claimed that he could find mistakes in 99.9 percent of tax returns. While he may have been exaggerating, he made a valid point.

The tax laws are so incredibly complicated that many taxpayers can't say with absolute confidence that they know the law or have filed their tax returns with 100 percent accuracy. Year after year, Money magazine reports that virtually all of the tax professionals who take its annual test for professional tax preparers made at least one mistake and they all come back with a different calculation of the tax liability!

This incredible variation opens up the potential for abuse. Vague laws allow enforcement abuses. If someone in the IRS wants to "get" you, the complex laws allow the agency to make a plausible case against virtually anyone.

We hope that this Congress will thoroughly examine proposals by Congressmen Bill Archer and Dick Armey to scrap the current income tax system in favor of a greatly simplified sales or flat rate income tax.

Congress Should Require Equitable Use of the Levy Power.

Burnham's book presents an impressive array of statistics that the levy power is not applied equally across the United States. Burnham reports that in 1988 "for every 1,000 tax delinquent accounts, 892 levies [occurred] in the Western Region; 860 in the Mid-Atlantic; 735 in the Southwest; 714 in the North Atlantic and the Central; 708 in the Mid-West; and 532 for the Southeast."

There's even more variation in the seizure rate. Burnham reports that in 1988 "the seizure rates in the most active districts were 30 to 40 times higher than the rates in the districts with the least. The IRS has no explanation for the variations."

This is nothing new. As far back as 1976, the Administrative Conference of the United States issued a report titled "Collection of Delinquent Taxes" that said the IRS had no clear guidelines specifying when levy action was to be taken. The report said "lacking guidance, revenue officers vary in their criteria for seizure of assets of individual taxpayers ... So long as the Internal Revenue Service fails to delineate clear purposes for the use of summary powers, we believe that these divergent criteria will continue to exist. The variations in practice may lead to the appearance of arbitrariness and caprice in some actions, thus undermining the taxpaying public's confidence in (and compliance with) the taxing system."

These random variations have continued year after year. The guidelines that exist only in Internal Revenue Manuals are not enforceable. Therefore, Congress should require that the IRS issue regulations specifying the circumstances, conditions and situations under which a levy will be made.

Conclusion.

The job of protecting taxpayer rights will never end. Much progress has been made, but more legal protections are necessary. We sincerely appreciate the efforts being made by members of this subcommittee to formulate legislation to better protect taxpayer rights.

Chairman JOHNSON. Thank you, very much.

Mr. Thayer, president and CEO of the National Association of the Self-Employed.

STATEMENT OF BENNIE L. THAYER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION OF THE SELF-EMPLOYED

Mr. THAYER. Madam Chairman, and Mr. Hancock, I appreciate the opportunity to testify here today before this subcommittee on oversight. My name is Bennie L. Thayer, and I am president and CEO of the National Association of the Self-Employed.

And may I also, at the outset, thank you, Madam Chairman, for your efforts on behalf of those businesses who operate from their home and coupled with the efforts of Representative Hoagland and Representative Archer. We certainly appreciate those.

Our more than 320,000 members of the NASE, 85 percent of whom have five or fewer employees, have a great deal of concern about the initiatives of this type that tend to protect their rights.

According to a recent NASE survey 82.4 percent of the respondents stated that the IRS imposed the greatest regulatory burden on their business when compared to other agencies. It is for this reason that the NASE welcomes the opportunity to comment today on taxpayer right's proposal.

The House Ways and Means Committee has an excellent track record of supporting efforts to improve taxpayers' rights, and we clearly appreciate and recognize the committee's long standing tradition of fighting for taxpayers' rights.

That includes its involvement in the final passage of the Taxpayer Bill of Rights in 1988, and also in the drafting of the 1992 Taxpayer Bill of Rights II.

We believe today that there are a number of measures found in the 1992 legislation which could serve as a starting point for the drafting of the taxpayer rights legislation which you are considering today.

I would like to just talk about three of those momentarily, if I can. The first one is that we strongly support the provisions contained in the 1992 legislation which called for changes to the structure of the IRS office of the taxpayer ombudsman. The 1992 legislation restructured, as you know, the office of the taxpayer ombudsman and in its place, established the office of the taxpayer advocate. You have just heard a reference to that.

That legislation made the new taxpayer advocate a political appointee, and accountable to Congress. We, too, as you have just heard, believe strongly that this should happen.

The NASE strongly supports the inclusion of this proposal in any 1995 legislative initiative. We reject and we reject vehemently any arguments that an independent taxpayer advocate will result in a politicized office.

Previous presidents and congresses have nominated and confirmed people of outstanding abilities and reputations for the IRS positions of commissioner and chief counsel and we believe that future presidents and congresses will do the same thing.

The 1988 Taxpayer Bill of Rights gave the ombudsman the authority to issue taxpayer assistance orders. And although the tax-

payer assistance orders program is pro-taxpayer when we consider it on its face, only a limited number of taxpayer assistance orders have been issued over the years. Therefore, the NASE strongly recommends that the authority a newly created taxpayer advocate position also be expanded to ensure more effective utilization of taxpayer assistance orders on behalf of legitimate cases of taxpayer hardship.

Second, I would draw to your attention from the 1992 version, the prohibition on the Treasury and the IRS from issuing regulations having a retroactive impact on taxpayers.

To the average small business person retroactive regulations create perception problems for the Federal Government. A taxpayer should not be penalized for his or her good faith reliance on a tax law or regulation which was, indeed, the law of the land one day, although it might have been changed the next day.

The NASE believes that a prohibition on retroactive tax regulations will increase the average taxpayer's faith in the tax administration process and thus, should result in an improvement in tax compliance by the public.

Finally, the third thing I will mention although it was not included in the final House and Senate conference report of 1992, it was in the House version of the bill of rights. That was a measure that made IRS employees personally liable in situations of clear abuse.

The NASE strongly supports this proposal. We reject arguments that such a measure would change the balance of persuasion, if you will, between taxpayers and the IRS employees in the audit situation. Even with enactment of a measure that makes IRS employees personally liable for any egregious acts of misconduct, the NASE strongly contends that the power to intimidate the taxpayer will still remain with the IRS auditor.

If it is not politically feasible to make IRS employees personally liable for egregious acts of misconduct, we then recommend that Congress increase the limits on civil damage awards under the Internal Revenue Code section 7433 and we recommend that they be increased to $1 million from their current $100,000 level.

Section 7433 permits a taxpayer to bring a civil action in district court against the United States if an IRS officer or employee has recklessly or intentionally disregarded the tax law with respect to the collection matter. The NASE believes that a $1 million threshold will send a strong and, I repeat, a very strong message to IRS employees and help deter the egregious acts of misconduct that you have heard represented here today.

We thank you for this opportunity.

[The prepared statement follows:]

TESTIMONY OF BENNIE L. THAYER
NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED

On behalf of the National Association for the Self-Employed, I appreciate the opportunity to testify before the House Ways and Means Subcommittee on Oversight. My name is Bennie L. Thayer, the NASE's President; and I am pleased to testify today on the Taxpayer Bill of Rights and other proposals to improve the rights of taxpayers in their dealings with the Internal Revenue Service.

Taxpayer rights proposals are extremely important to the over 320,000 members of the NASE, individuals who operate businesses throughout the United States. Over 85 percent of the NASE members are business owners with 5 or fewer employees. The membership represents a very wide range of businesses, notably in the consulting and retail fields. If you ask the average NASE member which federal agency creates the greatest number of administrative burdens and headaches for their business, the answer will usually be the IRS.

According to a recent NASE survey, 82.4 percent of the respondents stated that the IRS imposed the greatest regulatory burdens on businesses when compared to other agencies. It is for this reason that the NASE welcomes the opportunity to comment on taxpayer rights proposals. We strongly support efforts to improve the privacy rights of taxpayers and ensure a more even-handed approach to enforcement of the tax laws. The NASE believes such efforts should lead to an increase in the respect taxpayers have for the tax administration process and thus, result in a meaningful increase in taxpayer compliance rates overall.

The History of Efforts to Improve Taxpayer Rights

The House Ways and Means Committee has an excellent track record of supporting efforts to improve taxpayer rights. We clearly appreciate and recognize the committee's long-standing tradition of fighting for taxpayer rights, including its involvement in the final passage of the Taxpayer Bill of Rights in 1988. The NASE also commends the committee for its active involvement in the passage by Congress of the Taxpayer Bill of Rights II ("T2") in 1992; however, it did not become law because the proposal was included in two broader tax bills which President Bush vetoed in 1992 for reasons unrelated to T2.

The 1988 Taxpayer Bill of Rights made a number of improvements to the tax administration process, as well as created a number of new rights for taxpayers overall. As a result of the 1988 law, the IRS is now required to disclose in simple and nontechnical terms, the rights of a taxpayer in his or her dealings with the IRS, including with respect to an audit or tax collection matter. The IRS fulfills this requirement through the issuance of Publication 1, entitled, "Your Rights as a Taxpayer." Also, the 1988 law mandates the IRS abate any penalties or additions to tax attributable to erroneous written advice provided by the agency. The Taxpayer Bill of Rights further requires the Service to issue all temporary regulations as proposed regulations -- with the proviso that any regulation that remains in temporary form for a 3 year period shall expire at the end of such time period.

Other beneficial provisions of the 1988 law include (among others) the right of the IRS Office of Taxpayer Ombudsman to issue taxpayer assistance orders, improvements in the standards regarding when a taxpayer may interview a client, legislative authorization that the IRS may enter into written installment agreements with a taxpayer for the payment of taxes, and the establishment of an IRS Office of Taxpayer Services.

The Beneficial, Pro-Taxpayer Provisions of the Taxpayer Bill of Rights II

The NASE believes there are a number of beneficial pro-taxpayer provisions contained in the 1992 Taxpayer Bill of Rights II and therefore, we recommend that the House Ways and Means Committee include these specific provision in any final taxpayer rights initiative acted upon during 1995 or 1996.

1.) IRS Office of Taxpayer Advocate

We believe T2 was a carefully crafted initiative which balanced the interests of the IRS and the tax administration process with a taxpayer's privacy and due process rights.

First, we strongly support the provision contained in the 1992 legislation which called for changes to the structure of the IRS Office of Taxpayer Ombudsman. IRS Commissioner Jerome Kurtz established the Ombudsman position in 1980, a position which currently has civil service status and currently reports directly to the Commissioner. The office was established because Kurtz wanted to help taxpayers who believed they were not getting their problems addressed through traditional IRS channels.[1] In 1988, with the passage of Taxpayer Bill of Rights I, the Ombudsman's office was given statutory sanction and authority.

The 1992 legislation restructured the Office of Taxpayer Ombudsman and in its place, established the Office of Taxpayer Advocate. T2 made the new Taxpayer Advocate a political appointee and accountable to Congress. That is, T2 made the Taxpayer Advocate independent of the Commissioner's direct line of authority. The NASE strongly supports inclusion of this proposal in any 1995 legislative initiative. While the NASE appreciates the IRS' stated purposes regarding the current Office of Ombudsman, we strongly believe an independent Taxpayer Advocate will greatly contribute to a more taxpayer friendly atmosphere among IRS auditors.

We reject any arguments that an independent Taxpayer Advocate will result in a "politicized" office. The IRS currently has two positions subject to political appointment -- and these are the offices of IRS Commissioner and Chief Counsel. Previous Presidents and Congresses have nominated and confirmed people of outstanding abilities and reputations for these two positions, and we believe future Presidents and Congresses will continue to act in a similarly "good government" fashion. We have immense confidence that the federal government's dire need for revenues will act as a brake on any serious attempts to politicize the Office of Taxpayer Advocate.

The duties and responsibilities of the current Office of Taxpayer Ombudsman are (under the current IRS administrative structure) carried out at the local level by the Problem Resolution Offices located in the IRS district offices and service centers. The Problem Resolution Program is very beneficial to taxpayers in that the program has been set up to help taxpayers who are unable to resolve their problems through normal IRS channels. Unfortunately, the Ombudsman's role can potentially be undercut at the local level since the Problem Resolution Officers are hired and supervised by the local IRS District Director. Therefore, in order to mitigate the potential for any resistance to helping a taxpayer with a significant problem at the IRS local level, we recommend that the Problem Resolution Officers report directly to a newly created Office of Taxpayer Advocate.

As stated previously, the 1988 Taxpayer Bill of Rights gave the Ombudsman the authority to issue Taxpayer Assistance Orders (TAO). A taxpayer can apply to the Ombudsman and ask him to issue a TAO based on the fact the taxpayer is suffering significant hardship due to an IRS collections effort. If warranted, the TAO can require the IRS to stop certain collection efforts, such as removal of a levy on the taxpayer's property. Although the TAO program is pro-taxpayer on its face, only a limited number of TAOs have been issued over the years. Therefore, the NASE strongly recommends that the authority of the current Ombudsman (or in the alternative, a newly created Taxpayer Advocate program) be expanded and broadened to ensure more effective utilization of TAOs on behalf of legitimate cases of taxpayer hardship.

2.) Prohibition on Retroactive Regulations

The NASE strongly supports the measure contained in the 1992 version of T2 which prohibited (except under certain limited circumstances) the Treasury and IRS from issuing regulations which have a "retroactive" impact on taxpayers. According to proponents of the 1992 legislation, this measure was a direct reaction of widespread practices by Treasury during the 1980s, in which the agency offered "temporary regulations which became effective

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[1]Zeidner, Rita L., "Taxpayer Rights and Collecting Taxes: Striking a Delicate Balance", *Tax Notes*, November 12, 1992, page 832.

immediately upon their publication."[2]

To the average small business person, it does not matter whether a federal agency has meritorious technical and/or substantive reasons for issuing a regulation which has a retroactive impact on a taxpayer's affairs. Retroactive regulations -- rightly or wrongly -- create perception problems for the federal government which are viewed by a small business person as being arbitrary on their face. A taxpayer should not be penalized for his or her good faith reliance on a tax law or regulation which was the "law of the land" one day and changed the next. We wholeheartedly support an effort to prohibit retroactive tax regulations. The NASE believes that a prohibition on retroactive tax regulations will increase the average taxpayer's faith in the tax administration process and thus, should result in an improvement in tax compliance by the public.

3.) Make IRS Employees Personally Liable for Clearly Abusive Acts

Although not included in a final House-Senate conference report in 1992, the House version of T2 included a measure which made IRS employees personally liable in situations of clear abuse. The NASE strongly supports this proposal. We reject arguments that such a measure would change the "balance of persuasion" between taxpayers and IRS employees in an audit situation. The NASE does not agree with arguments that this type of proposal is likely to result in taxpayers intimidating IRS auditors into readily agreeing with the taxpayer's position on audit. In act, when a small business person faces an IRS audit, we firmly contend it is the IRS agent which has the power to intimidate -- not the taxpayer.

Even with enactment of a measure which makes IRS employees personally liable for any egregious acts of misconduct, the NASE strongly contends that the power to intimidate the taxpayer will still remain with the IRS auditor. If nothing else, this kind of proposal would serve to curb to a modest degree the most outrageous acts of misconduct by an IRS employee.

If it is not politically feasible to make IRS employees personally liable for egregious acts of misconduct, we recommend that Congress increase the limits on civil damage awards. Internal Revenue Code Section 7433 permits a taxpayer to bring a civil action in district court against the United States if an IRS officer or employee has "recklessly or intentionally disregarded" the tax law with respect to a collection matter. The current statutory limit for such civil actions is $100,000. We strongly recommend that this threshold for taxpayer civil causes of action against the U.S. be raised to $1 million. The NASE believes that a $1 million threshold will send a strong message to IRS employees and help deter egregious acts of misconduct.

4.) Expanding the Ability of Taxpayers to Recover Reasonable Costs

Section 7430 of the Internal Revenue Code permits a court to award a judgment to a taxpayer for reasonable costs associated with an IRS administrative proceeding or tax litigation case. Such an award can be made to a taxpayer who establishes to the court that the government's position in the tax case was not substantially justified. The Code requires the taxpayer to exhaust all the administrative remedies available to him or her before the court can make an award of reasonable administrative or litigation costs regarding the tax dispute.

Senators David Pryor, Charles E. Grassley and others this year introduced S. 258, a very positive, pro-taxpayer initiative. Among other provisions, S. 258 permits a taxpayer -- once he or she has substantially prevailed in his or her case with the IRS -- to file a petition in court for disclosure of all information and copies of relevant records in the possession of the IRS associated with the case. Also, S. 258 increases the level of attorney fees that a taxpayer may recover from the government under Code Section 7430. In general, this

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[2]Kirchheimer, Barbara, "ABA Panel Examines Problem Areas in Taxpayer Bill of Rights", *Tax Notes*, September 7, 1992, page 1263.

particular provision increases the level of reasonable attorneys fee from $75 per hour to $110 per hour, and indexes the amount to inflation.

The NASE views Section 7430 as a powerful measure which is designed to dissuade the IRS from bringing unwarranted and egregious collection cases against U.S. taxpayers. Therefore, we are particularly supportive of the above provisions contained in S. 258. These provisions should provide taxpayers with improved privacy protections, as well as help level the playing field for taxpayers when faced with an unwarranted IRS position in a tax dispute.

5.) Other Positive Initiatives Under T2

There are a number of other pro-taxpayer proposals found in the 1992 version of T2 and in bills introduced in 1995 that the NASE strongly supports. First, we endorse an expansion of the rights and circumstances when small taxpayers may use installment agreements to pay a tax deficiency. Last, we urge that any final 1995 legislation protecting taxpayer rights include a requirement that the IRS abate interest when the agency is responsible for an unreasonable error or delay with respect to the agency's tax administration functions.

Chairman JOHNSON. Thank you for your very interesting testimony.

Mr. William Stevenson, president of the National Tax Consultants, on behalf of the National Society of Public Accountants.

STATEMENT OF WILLIAM STEVENSON, PRESIDENT, NATIONAL TAX CONSULTANTS, INC., ON BEHALF OF THE NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

Mr. STEVENSON. Good afternoon, Madam Chairman, Congressman Hancock, Congressman Portman. My name is Bill Stevenson, and I am here today in my capacity as chairman of the Federal Tax Committee of the National Society of Public Accountants.

NSPA consists of 20,000 independent accountant members serving 5 million small businesses and individuals throughout the country, and our membership consists of CPAs, enrolled agents, licensed public accountants, and other professionals serving smaller businesses. I, myself, am an enrolled agent, and I also hold a special license which allows me to practice before the U.S. Tax Court as a nonattorney.

I am not going to speak about the issues in the bill that everyone has been talking about today. I generally agree with just about everything that has been said. How could you not? But there are two issues I am going to laser-focus on that, if adopted, will greatly improve some of the things that we were discussing earlier.

The regrettable story of Mrs. Howden, while it really bothered us all to our hearts, I want you to know I come from the front lines. I am speaking to you here today after leaving cases like this and finding it very frustrating to deal with issues to help resolve taxpayer problems before the Internal Revenue Service.

The one problem that we are all having is the inconsistency of treatment throughout the country. One good example of inconsistent treatment, for example, is the Internal Revenue Service's program of offers in compromise. It is a program that was rewarmed about 2 years ago because the Internal Revenue Service felt that there was a lot of tax money out there that they could collect, but because of the circumstances of the individuals, it was not possible to get the money under such circumstances. So they—IRS—developed the offer in compromise program.

National Office made a policy. The problem is the policy was interpreted differently in 63 different districts throughout the country. So, Madam Chairman, if one of your constituents filed an offer in compromise, they might have a 40-percent chance of getting it approved. If somebody from Missouri filed an offer in compromise, they might have an 80-percent chance of it getting approved. If somebody from the districts that I worked, the Manhattan and Brooklyn districts, filed an offer in compromise, we would be lucky to get 25 percent or less approved.

It is different in every single district throughout the country. Some districts even say, "X district's offer in compromise policy," rather than Internal Revenue Service's offer in compromise policy.

The IRS employs over 100,000 individuals, probably closer to 110,000 people, and these individuals all have a different set of personal standards and values. While we recognize that the diversity that they have is important because it helps any organization

thrive, the problem that we have is balancing the diversity within the Service with our expectation of equal and fair treatment.

One way we can guarantee, almost, equal and fair treatment is through the Internal Revenue Service manual. I am not sure whether it is apparent to everyone, but when Congress passes Federal tax law, there are two things that happen. It asks the Internal Revenue Service to issue regulations based on that law, and the American public has to follow those regulations. If they don't, they can be penalized, fined, and even be sent to jail. On the other hand, the Internal Revenue Service is required by Federal law to write a manual for its own employees, so you don't have rogue employees running amuck throughout the different districts and making their own policy.

The sad fact is they don't have to follow that manual, and there are many court cases where the IRS was taken into court and said, "Gee, you guys aren't following the manual and you are causing us financial problems because of it." And the courts have ruled in many, many cases—I have 15 of them listed here—that the Internal Revenue Service manual does not have the weight of law, and, therefore, the Internal Revenue Service does not have to follow it. That is one of the reasons why you have this diversity of treatment of taxpayers all over the country.

Congress can enact legislation saying that the Internal Revenue Service manual has the weight of regulation, and it will be given equal status so that if the Service does not follow its own rules and regulations, then you can go to court and get some kind of redress.

Why should the IRS be allowed to write rules and regulations that the public has to follow, and when they write their own rules and regulations, they don't have to follow them? It certainly is a strange paradox.

I realize—my time is up. There was only one more thing I wanted to mention if you could give me a second.

Chairman JOHNSON. Go ahead.

Mr. STEVENSON. The IRS has instituted recently audit-like activities that they call compliance checks. This allows the Service to come into our office and review files. For example, if one of your constituents was in my office and we had an interview that dealt with more than taxes and I put the information in a file and we filed the return electronically, the Service could come into our office, demand to see their file simply because they filed electronically, without the permission of the taxpayer and without due process. There are many examples of this, not only in that area but in others as well.

We think this is really a violation of taxpayers' rights on a very broad scale, and we would like you to redress that problem, too.

I know the Service has dedicated people. We work very closely with them. But we do need to face the problem of inconsistency, and I think you have it within your means to do so.

In closing, I would like to thank you for the invitation to appear before the subcommittee today. These precious 5 minutes that you allowed me make me really proud to be an American, and NSPA stands ready to assist you in your efforts in every way possible.

[The prepared statement follows:]

TESTIMONY OF WILLIAM STEVENSON
NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

I. Introduction

On behalf of the 20,000 members of the National Society of Public Accountants (NSPA) and the 5 million small businesses and individuals they serve, I would like to thank Madam Chair and the members of this Subcommittee for the opportunity to express the Society's views on the development of "Taxpayer Bill of Rights II" (TBRII) legislation. The Society feels that the current Taxpayer Bill of Rights provides a great deal of assistance and comfort to the public in dealings with the Internal Revenue Service. However, our members have identified several areas in which the first bill could be more effective. First, a new bill of rights should promote consistency within the Internal Revenue Service in its treatment of similarly situated taxpayers. For example, taxpayers in Connecticut should be confident that they are treated similarly to taxpayers in California. Second, TBRII should empower the Internal Revenue Service to act more quickly in serving the taxpayer. Third, an expanded bill of rights should include protection for tax practitioners, who work daily to ensure that the proper amount of taxes are reported and paid. Finally, a new bill of rights should make certain that taxpayers know when they are being examined and exactly what rights they have in that particular examination.

II. Consistency Within the Internal Revenue Service

Currently, the IRS works in this country through seven regions which are further subdivided into sixty-three districts. In addition, there are ten service centers around the country which provide the main contact point for many taxpayers.[1] These centers receive most of the returns, letters and phone calls from the general public. Within this infrastructure, the Service employs over 100,000 individuals, each with a different set of personal standards and values that influence the way they perceive and serve taxpayers. This diversity is a vital asset to the organization, creating more insightful decisions by drawing from varied viewpoints. The problem for the Internal Revenue Service is balancing this diversity with the expectation of taxpayers that the Internal Revenue Code be administered consistently throughout the country.

A. Offers in Compromise

The offer-in-compromise (OIC) program provides an example of the difficulty the Service faces in administering the tax code through its thousands of employees. In 1992, OICs received a new emphasis at the IRS as a means to reduce the troublesome amount of debts labelled "currently not collectable." In that year, the program was expanded to allow those in financial difficulty to pay what they could and settle their federal tax liability. The procedure involves preparation by the taxpayer of an offer which accurately reflects his or her ability to pay off a federal tax debt. This offer is then submitted to the Internal Revenue Service, where it is accepted or rejected depending on the Service's analysis of the taxpayer's ability to pay.

According to a 1994 survey by Tax Analysts[2], taxpayers submitting an offer in compromise in 1993 had anywhere from a 79% likelihood of acceptance in Mississippi to a 19% likelihood of acceptance in California's Laguna Niguel district. On average throughout the country, 53% of offers were accepted. Taxpayers in Utah offered an average of 3 cents on the dollar in order to gain acceptance, while acceptable offers by taxpayers in New Hampshire averaged 31 cents on the dollar. The national average required for acceptance was 15 cents on the dollar.

This program points out the need for an IRS focus on consistency from the inception of a regulation or a program, rather than after a problem has arisen. It should be noted that since the publication of the above-mentioned survey, the Service has taken steps to promote consistency in the offer-in-compromise program. NSPA would like to suggest a provision for TBRII that could enhance consistency before such wide disparities come to light. Give the Internal Revenue Manual the force and effect of law, an action that would require IRS personnel around the country to follow the same guide.

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[1]Current plans indicate that these numbers will be subject to change in the near future.

[2]Guttman, George, "Compromise Offer Acceptance Rates Vary by Location," Tax Notes, Vol. 62, Number 3, Monday, January 17, 1994.

B. The Internal Revenue Manual

Today, the IRS invests substantial amounts of money every year in updating and revising the Internal Revenue Manual. It provides guidance to Service employees on every facet of the revenue collection process. Generally, it is available for public inspection. Millions of Americans are directly affected by the provisions of the manual and the interpretations thereof. However, in a line of precedent dating back to Sullivan v. U.S., 384 U.S. 170 (1954) and recently restated in Capitol Federal S&L, 96 T.C. 204 (1991), "[G]eneral statements of policy and rules governing internal agency operations or 'housekeeping' matters, which do not have the force and effect of law, are not binding on the agency issuing them and do not create substantive rights in the public." Consequently, if a taxpayer goes to court solely because an Internal Revenue Service employee failed to follow the manual, the taxpayer will lose that claim.

The Capitol Federal S&L case goes on to say that, "Generally, agencies are bound by regulations having the force and effect of law." In order to bind the IRS to the guidelines it sets forth in its manual, NSPA asks this Subcommittee to initiate legislation to give the Internal Revenue Manual the force and effect of law.

The manual's current lack of regulation status leads to inconsistency in the tax system because individual districts develop different methods for handling similar problems. Those methods do not necessarily agree with the national office policy as set forth in the Internal Revenue manual. To use the offer-in-compromise program again as an example, I know from personal experience of at least one district that has its own separate manual for offers in compromise. In that same district, when I reminded a revenue agent that an action he was about to take violated a national office policy, I was told, "That may be national policy, but it's not the policy in [this] district." Such inconsistencies are unfair to the taxpayer. The best solution to the problem is to require the IRS to live by the rules it puts forth for itself in the same manner that taxpayers are required to live by the rules that the IRS puts forth for them.

This is not to say that districts should not be allowed some flexibility. Clearly, in an organization as large as the IRS, not all solutions will work effectively for all parts of the country. If this subcommittee should agree that the manual should have the weight of regulation, we would also request that a process should be created whereby districts can petition the national office and be granted a right to develop their own guidelines on certain projects. These guidelines should then be released to the public. With public access allowed, taxpayers would have an opportunity to be aware of differences between national office policies and district policies before relying on either one. And, once a taxpayer relies on an IRS policy, he or she would have the comfort of knowing that it would stand up in court.

It is not NSPA's intention to handcuff the Internal Revenue Service with either of these proposals. In a system where diverse individuals analyze an Internal Revenue Code that is at times ambiguous and subject to varying interpretations, strict uniformity is obviously unattainable and to some extent even undesirable. However, a federal law should be administered as uniformly as is practical throughout the country. Today, that does not always happen. To remedy the current difficulty, NSPA respectfully recommends that this subcommittee consider giving the Internal Revenue Manual the force and effect of law. This would help to move the Internal Revenue Service toward a more consistent application of the tax law throughout the country.

III. Empowering the IRS to Serve Taxpayers More Quickly

Many taxpayers dread the receipt of an IRS notice not only for the possible monetary penalties that it may entail, but also for the loss of productivity that invariably follows as efforts are made to rectify the problem. This drain on resources is a substantial component of the cost of compliance, whether the money is spent on staff time, representation fees, or both. As a result, taxpayer rights that allow certain issues to be resolved quickly while still being fair to both sides are worthy of support. S. 258 contains a provision that is particularly helpful in this area and NSPA would like to submit another for your consideration.

A. Support for Section 501 of S. 258

Section 501 of S. 258 would allow the Internal Revenue Service to withdraw certain notices of

liens. Under current law, once the IRS places a lien on a taxpayer, it cannot be released until the full debt is settled. Often this hinders the taxpayer's ability to repay the money, as it limits the funds available through borrowing. Section 501 would allow the withdrawal of such a notice by the Service for several reasons, including facilitating the collection of the tax liability. NSPA supports this provision because of its common sense approach to removing liens where they hinder the taxpayer's ability to repay a debt.

B. Request for a Limited Power of Attorney Sign Off on Tax Returns

Another item which is currently in limited use by the Internal Revenue Service but which could be expanded to all returns is a limited power of attorney sign off directly on a form. Today, taxpayers who file electronically sign a Form 8453. In addition to meeting the signature requirement for the taxpayer's individual return, this form also allows the IRS to call the practitioner who transmitted the return in the event that any problems arise which delay the taxpayer's refund. The Form 706 estate tax return also includes a signature line which allows a practitioner to act as the estate's representative before the Internal Revenue Service.

Similar authorizations could save time and otherwise reduce taxpayer burden if they were included on all tax returns. Currently, practitioners who prepare returns for their clients sign the forms, but they are not empowered by that signature to discuss the return with the IRS. When taxpayers receive notices from the Service, their first call is usually to the person who prepared the return. The preparer in turn calls an IRS agent who asks, "Do you have a power of attorney on file?" Most often, this is not the case and the resolution of the problem is delayed while the proper form is completed and filed. If the taxpayer could assign a limited power of attorney on the return at the time of filing, the notice would still be sent to the taxpayer and the taxpayer would still, most likely, call the practitioner. The difference would be that the limited power of attorney would enable the practitioner to discuss the return with the Service immediately and to begin taking whatever steps are necessary to resolve the problem.

Provisions like these, which allow the Service and/or the practitioner community to more quickly resolve taxpayer problems when they arise are valuable elements of a taxpayer bill of rights. By saving taxpayer time, these provisions reduce the drain on taxpayer resources that can be caused by IRS notices. NSPA requests that this subcommittee consider section 501 and a limited power of attorney for inclusion in a taxpayer bill of rights.

IV. Protection for Practitioners

Within the tax system, practitioners provide many services to the taxpayer. Among the most important functions a practitioner performs is that of liaison between the IRS and the taxpayer. As a result, any discussion of taxpayer rights will, of necessity, include issues that impact the practitioner community. NSPA would like to raise two concerns with respect to practitioner rights in relation to the Internal Revenue Service.

A. Recognition of Powers of Attorney Before the Internal Revenue Service

First, many practitioners routinely experience difficulty in having IRS field personnel honor the valid powers of attorney described above. All too often, IRS employees make direct contact with taxpayers, even after receiving a power of attorney authorizing representation by an attorney, CPA or enrolled agent. In such instances, the taxpayer generally is either unaware that such conduct is improper or is afraid to question the propriety of the contact for fear of alienating the IRS employee.

NSPA recognizes that legitimate circumstances may on occasion necessitate a direct taxpayer interview. Nevertheless, where a power of attorney is on file, such an interview should be arranged through the authorized representative and conducted in that representative's presence.

This improper disregard of a power of attorney compromises the rights of both practitioners and taxpayers. NSPA believes that safeguards should be established, such as some appropriate form of sanction, to discourage this practice.

B. Removal of Preparer's Social Security Number from Tax Returns

Second, the practitioner community is becoming increasingly concerned with the requirement that a paid preparer's social security number must appear on returns. Currently, practitioners are required to include their social security number on every return they prepare. In today's world of instant access to volumes of sensitive information about an individual, the social security number is often the key to obtaining this information. Preparers feel that the requirement that they include their social security number on returns violates their privacy, as it provides the client with the opportunity to acquire certain records that would not otherwise be available. NSPA suggests that this committee review this requirement with the Internal Revenue Service and develop a separate system for identifying tax preparers.

V. Knowledge of Examination and Rights Therein

The first taxpayer's bill of rights focused heavily on making sure that taxpayers were aware of their rights in an examination and that those rights were protected. Since passage of the first bill, the IRS has created several new types of examinations. Questions have arisen regarding what a taxpayer's rights are under these new exams and often practitioners hear various answers. Two examples come to mind which illustrate the continuing need for legislation to protect basic taxpayer rights.

A. Current Examination Examples

First, the Internal Revenue Service now conducts electronic filing (ELF) compliance checks. This check often consists of a revenue agent and a member of the Service's criminal investigations division arriving at a practitioner's office, sometimes announced. The Service personnel are there to monitor compliance with the revenue procedures that govern electronic filing. The problem is that there are no clear guidelines on what these Service employees are supposed to be reviewing. Some agents ask only to see basic paperwork, while others demand the entire supporting file on the return. In addition, it can involve a review of taxpayer returns and supporting documents without notice to the taxpayer.

Another example of this problem is an examination known as an employment tax compliance check. In this procedure, the IRS sends a notice to a taxpayer stating that the Service will arrive at the taxpayer's place of business on a specific date to review compliance with employment laws. The notice requests that the taxpayer provide copies of all current employment-related returns, all of which the taxpayer has already filed with the IRS. When NSPA asked the Internal Revenue Service whether or not a taxpayer who received a notice of this examination was required to comply, the answer was no. Taxpayers can refuse to provide the information and basically tell the IRS, "If you want to audit me, do so." Nowhere in the letter for this examination is the taxpayer informed of the right of refusal.

B. Recommendation for Specific Notice

Taxpayers and practitioners undergoing these examinations have a right to know exactly what is required of them under the circumstances. The Service has in some cases been responsive to NSPA concerns about explaining the rights of a taxpayer in every examination situation. However, Service action often comes after the programs are already implemented.

To correct the problem, NSPA suggests that this Subcommittee include in a new taxpayer bill of rights a requirement that any notice of any type of examination or compliance check include a specific explanation of the affected individual's rights under that particular examination. If an examination is unannounced, those conducting the examination should have an affirmative duty to inform the taxpayer or practitioner of their rights before beginning the examination. The explanation of rights should specifically describe what a taxpayer or practitioner is required to show to the Service personnel. It should also tell taxpayers whether they are required to submit to the examination or not. If there is a right to refuse the examination, taxpayers should be informed of the consequences of refusal.

Before concluding, please permit me to point out that the issues raised here today are in no way intended to detract from the efforts of Commissioner of Internal Revenue Richardson and her

dedicated staff. They work tirelessly to administer the tax system in the United States, one of the most difficult and thankless jobs in the realm of public service. The National Society of Public Accountants hopes that the remedies sought here today will improve the current system, making it easier to administer and easing the burden on the Internal Revenue Service as well as the taxpayer.

VI. Conclusion

In closing, Madam Chairman, I would like to again thank you for the invitation to appear before the Subcommittee today. The National Society of Public Accountants applauds your leadership and that of the members of this Subcommittee in addressing the important issue of taxpayer rights. NSPA stands ready to assist you in your efforts in every way possible.

Respectfully submitted,

Dr. William Stevenson
Chairman of Federal Taxation
National Society of Public Accountants

Chairman JOHNSON. Thank you very much. Your testimony has been very helpful, and it is a pleasure to have those of you who are out there on the front line making good, constructive contributions and giving us the opportunity, through a number of different ideas that you have brought up today, to make the Tax Code not only more enforceable for the IRS but more user-friendly for the people affected.

I do want to ask a couple of things. First of all, I just want to put on the record that our current experience with political appointees isn't great, and I guess I personally take the view that Government, the legislative arm, used to be fairly bipartisan once the elections were over. And I think there is going to be a decade ahead when that is not going to be true.

I am not so keen as I used to be on solutions like ombudsmen confirmed by the Senate. I think you can see there have been some grossly unfair problems generated around nominees, and people's lives are being destroyed for no apparent reason. And I think this is going to mean for a time it may be hard for us to get good people who are willing to do this. So I guess at this point I would have to say that at least I am more interested in some other approaches and giving the system far greater guidance and exercising far more oversight.

I do think that perhaps if we were doing more aggressive oversight, we would catch some of these problems earlier.

I want to just ask your opinion, since we have such a good collection here in front of us. This issue of regulations is very difficult. It is very difficult for elected Representatives. You are out there, and people are saying, they gave us guidance, now that the regulations are out, they contradict their guidance, and they are making us liable retroactively, and that is not fair.

It seems to me that there are a lot of good reasons not to have laws go into effect until the regulations are prepared. First of all, I don't think you can really tell necessarily what the law is going to mean until you get regulations in place. For the IRS, that would be particularly difficult, and I understand that.

But I would like you to just comment on that. What has been in your experience the working relationship between guidance and regulations? Has the delay in the adoption of regulations been a problem? Or is the anecdotal evidence that tends to drive so much of an elected official's thinking not a major problem?

Anyone on the panel could volunteer.

Mr. Lane.

Mr. LANE. It is a serious problem. I mean, it literally is what created the tax shelter industry. You know, we had a very complicated series of laws passed, very close in time, generated a need for an incredible number of regulations to be issued. The time-lag between enactment and the regulations coming out caused the window of opportunity for unscrupulous people to go out and promote really baseless interpretations of what the law was going to do, and it created this environment.

I think that is a real problem, and it is going to continue to be a problem until we get this regulation thing squared away. One of the problems, quite frankly, is we have had what, 27 tax law changes in the last 29 years. You know, one of the best things the

Congress could do for this country would be to leave it all alone for a while. Quite frankly, it is a major complication for small business to try and keep on top of this stuff.

Chairman JOHNSON. You are stealing his theme. [Laughter.]

Well, there are a lot of ramifications to not letting a law become effective until the regulations are written, one of which is that you would get very different CBO estimates, and so it would make a big difference in actually how often we do change the tax code, because we would not get first year numbers of the same power. And I just want the others to have a chance to comment on whether it is worth the price that we will pay, and there are some significant prices if you do not let tax laws, particularly, go into effect until the regulations are written.

Any other comment?

Mr. THAYER. I would just like to kind of follow up. As you know, Congresswoman, we have just been debating, very avidly here on the Hill, and you have had input from us on this whole regulatory flexibility amendment act, and as you know, to get some teeth into the act, the 1980 Act, we called for the judicial review component of that.

I kind of go back to what has just been alluded to before. Obviously, from the business community, what our people are telling us, especially the smallest of small business, is that, you know, we are inundated now, and we really need you, just to leave us alone and let us do our business. But if you are going to regulate us, at least assess the impact of that regulation on our ability to do business as you have a law in effect, that says you are supposed to do that, before you put it into effect upon us.

And of course the number one perpetrator of not doing that has been the Internal Revenue Service, and that is why I represented the survey that I did in terms of my testimony.

Mr. JEROLD COHEN. Madam Chairman.

Chairman JOHNSON. Yes.

Mr. JEROLD COHEN. The regulations that are retroactive are interpreted regulations. They are not the substantive regulations. Substantive regulations must be prospective.

Chairman JOHNSON. What is the difference, though, from a taxpayer's point of view?

Mr. JEROLD COHEN. Well, from a taxpayer's point of view, the tax law is the law that you give us, that the Congress gives us, and there are many provisions of the code in which we have not been able to get regulations yet. What many of us are looking for from the regulations are some help in interpreting the provisions that the Congress has given us.

Now, to put in a requirement that the Service cannot make an interpretative regulation retroactive to the time Congress made that the law, leaves you with a real gap as to what the law is between——

Chairman JOHNSON. Mr. Cohen, I guess I wouldn't be recommending this as a policy governing past law made that doesn't have regulations, but only prospectively. That new tax law could not go into effect until——

Mr. JEROLD COHEN. That the law itself would not go into effect until——

Chairman JOHNSON. That is right. The law itself would not go into effect. First of all, it would force the Congress to want to write much simpler law, so that the regulations would be simple, so the whole thing would work.

Mr. JEROLD COHEN. I am totally in favor, and have written on the law being simpler, and also on the regs being simpler, and I think the Service is struggling with that now. I think that is an important measure.

But for the law not to go into effect until the regulation came out would put within the hands of the Treasury when a particular law goes into effect. And I don't think you would want to do that.

Chairman JOHNSON. Don't you think it would also force the Congress to write simpler law, and be clear about what it was they intended? And enable us to have shorter time frames?

Mr. JEROLD COHEN. I am not sure what forces the Congress to do anything. I have not been able to figure that out. Maybe another 30 or 40 years, that will come to me.

Ms. WALKER. But on the other side, it's Congress's responsibility to decide when that law is effective, and I don't think they should delegate that to the Treasury Department. We support the changes concerning the retroactivity of regs. However, in addition, the AICPA believes that by having these provisions the regs will get out sooner, and we think regulations in many cases are very, very important to efficient administration of the tax law.

Chairman JOHNSON. But aren't we delegating that authority anyway, because by the time they get the guidance out there, and then the interpretation of regs, the law is different than you thought it was, and so we have effectively delegated.

Ms. WALKER. Unfortunately, in today's world, which is much more complicated, you have delegated a lot more now than you did 20 years ago, and I don't know anybody that sees a way around that.

But to delegate the effective date, I——

Chairman JOHNSON. Well, let me yield to my colleagues here.

Mr. KEATING. Well, there is one other suggestion I might have on this. I don't know, procedurally, how you do this. If part of the problem is that the regulations don't reflect the law itself, maybe there could be a procedure that would require the regulations to be submitted to Congress, and for Congress to do some procedure to review them before they take affect.

Chairman JOHNSON. Well there is that process of regulations review in many States. Constitutionally, it has some difficulties, and I don't imagine that the Congress would adopt that. Also, I am not sure that any congressional committee would be up to evaluating whether the regulations were correct or not.

So I don't see that as a solution, but I am interested in this idea.

Mr. LANE. Could I add a comment here? One of the concerns we have as practitioners is we are dealing on a daily basis with taxpayers in our offices. We are trying to give them guidance as to how they can comply with the laws, and you know, the taxpayers have a brilliant way of really seeing through to the kernel of things sometimes.

And just by way of illustration, how this regulation thing can really get—and the tax law, the necessity for simplicity in the tax law. I am going to tell you a little story about a client I had.

Remember a couple of years ago, when we were going to enact a limitation on the amount you could deduct at a business meal, and it was going to be $25 per person? I had a client who did a tremendous amount of T&E entertaining.

And I said to him, you know, you really have to understand this. You know, I got him into my office, and I sat down, and I said, you really have to understand these rules because it really does affect you, particularly, because you do so much of this T&E.

And I started to explain this process, that no matter how much the bill is, it would be limited to the $25 or $35 per person. And after I got into about 15 minutes of explanation on this, he said, Wait a minute, I don't need to hear any more of this.

And I said, No, you have to understand this. He said, I don't need to hear any more of this. I said, Why not? And he said, Because I will wait till I get the bill before I figure out how many people were at the dinner. So what he was going to do, if the limitation was $25, and he had eight people at the table, and it was a $250 bill, he would put down he had 10 people at the table.

Now the taxpayers are going to look at this stuff. The point of that story is you can't set up regulations that are so complex, it breeds disrespect for the law.

Because when you do that, and they start to nickel and dime it on that stuff, before you know it they're not declaring major pieces of income they get.

Chairman JOHNSON. I guess part of my thinking is that if we could begin to see what the regulations are going to be, we ourselves might decide that that wasn't such a hot law, and fix it before it went into effect.

Mr. STEVENSON. I guess the bottom line is, maybe Congress does need to take another look at certain kinds of regulations, when it is brought to their attention that the regulations are not in keeping with the theme of the actual law, what their intention was.

Chairman JOHNSON. Let me recognize Mr. Hancock now.

Mr. HANCOCK. Frankly, I think it is a little ridiculous for Internal Revenue and their people to sit around thinking they can come up with something that is going to outsmart the people that are paying the taxes.

I mean, they are going to get outsmarted. They say it won't be dishonest or illegal. They will follow the plan.

One of the things that I would like to know—maybe you can answer this. In your estimation, does Internal Revenue get more money from people that do not take advantage of the deductions that they are entitled to, because they are afraid of Internal Revenue, than they have people that commit fraud, to try to cheat?

I realize it is strictly a speculation.

Mr. LANE. That is a tough one to answer because, you know, we don't know what the other side of it is. But I can tell you, there are very few people claiming the home office deduction——

Mr. HANCOCK. That are really entitled——

Mr. LANE. That are entitled to claim it, and are being told by their tax advisers not to run the red flag up. I can tell you that right now.

Mr. HANCOCK. But is this not true in a lot of other questionable areas, where they say, Well, you know, this would save me $300, but since it is a little bit of a gray area, I won't do it.

I mean, for instance, you mentioned the meals and entertainment deduction. I have had people say, Well, I have just quit deducting, even though I spent a lot of money for entertainment. I just don't deduct them anymore. A legitimate expense, but I don't want to take the chance.

I have even had people tell me, you know, I have got mileage. I just quit deducting my car mileage because I don't want to get involved with Internal Revenue. I fill out the 1040EZ form, if I can, rather than itemize.

I just wonder, you know, years ago, I remember my dad—his name was John Hancock, but not the one that signed the Declaration of Independence—but anyway, he made a comment that years ago that a person's No. 1 fear in many cases was a fear of dying. Now it is fear of the Internal Revenue Service. And I think you mentioned that. And I get this all the time, you know.

Mr. LANE. But you know, there is an old saying that there are two things in life that are always going to happen. That is death and taxes. But the punch line on that is that the death doesn't get worse every time Congress meets. That is the problem. [Laughter.]

Mr. KEATING. And death doesn't end your tax problems either.

Mr. HANCOCK. One of the taxes that I am worried about right now is the estate tax, which takes effect after I die. And, in fact, I think we are going to be addressing that on Monday.

You know, we have been talking all week about the rights of people on welfare. We talk about the rights of the criminal. We talk about minority rights. And I tell you, we have got to start talking about the rights of the people that are paying the bills for all of these things.

And if we don't—and I like Mr. Cohen's statement, I ran on the issue in 1988, that the best thing that could happen to really give this economy and this country the biggest boom that the world has ever seen, would be for the U.S. Congress to pass a moratorium on any change in the tax law for at least 5 years.

If we could get that job done, we would have the budget balanced a long time before the year 2002.

I have been up here 6 years, and I have been talking about it. Quite frankly, the problem is you have got too big a vested interest of people that benefit and make a living from changes in the tax law. I guess. Or maybe it's just a plain old lack of commonsense. I don't know what the answer is on it.

But Mr. Thayer, I am a small businessman. When I first ran for Congress, I knocked on a lot of doors and I remember one place in particular. A small businessman says, What are you doing for small business? And I said, What do you want done? He says, Nothing; leave us alone. [Laughter.]

And I think that is the message that we need to be sending and I hope we can do that over the next several months here on Ways and Means. So I have spoken my piece. Thank you.

Chairman JOHNSON. The gentleman from Ohio, Mr. Portman.

Mr. PORTMAN. Thank you, Mrs. Johnson. It is great having you all here. I wish we could stay here all afternoon and evening and talk about these issues because we have all these great minds, in small business, tax, and accounting, all together.

By the way, Mel, they are actually speaking against their own interest here, because they are talking about simplification and coming up with ways to end up with fewer, not more clients, which I appreciate from this panel.

Mr. HANCOCK. Well, that is right, but they understand what happens if we don't do it also.

Mr. PORTMAN. That is right; that is right.

Let me, just briefly, go back to some of the discussion about regulations, and the Chairman's idea, which I think is a very good one, of trying to tie the law, or the statute we passed here, more directly to regulations, so that we understand what we are doing.

We pass a law here and it is gone, we don't think about it again until enough of our constituents who are taxpayers come back in the case of the IRS, and complain to us about it, and we are shocked to find out what we have wrought.

But there is some precedent for this sort of a look back from Congress. The constitutional issue, as I understand it, is really more the delegation of powers. In other words, Congress is concerned, under the Constitution, rightfully so, about delegating our power to the Federal agencies.

And I think, in effect, we have done that over the years. But to have the agencies come back to us with proposed regulations, and have us, in essence, review them, and then approve them, I don't think would involve the same constitutional issues.

In fact in some sense it would solve existing constitutional problems of delegation of powers.

And just for those of you who don't know it, in this little unfunded mandate bill we just passed, we set in place a new procedure you might want to look at, whereby we have expedited procedures here in Congress to review Agency action down the line, after we pass a new mandate.

It is very complicated legislation. Our own Rules Committee had a lot of heartburn over it, and those of us who were promoting it on a policy basis are appreciative to them for letting us get it through.

But it handles some of the problems you are talking about, and does so in a way that permits the committees, like the Ways and Means Committee and the authorizing committees, to look at the regulations that come down the line after we act, and to decide whether or not those regulations are in keeping with what we have done, and if they are not we can change them, or we can simply rubberstamp them, approve them, and they will go ahead.

If we don't act, incidentally, which is the important incentive here, the regulations don't go forward. So there will be some incentive to actually review meaningful and important regulations, and perhaps to let die and to have the Agency start over again.

Second, I would say to Mr. Thayer that this same Act does provide, for the first time ever, judicial review of Agency action with regard to cost benefit analysis for the private sector regulations,

and of course, which is the focus of the legislation, local and State government regulations that we will be issuing in the future, that are mandates, without providing the funding.

So there is now some precedent to build on, I think, both to have judicial review of Agency action, including IRS action in the future, and to have some sort of a procedure for Congress to look at what we have wrought down the line.

But let me quickly get a couple of you into a dialogue, if I could, over one specific measure that is among the dozens that we have talked about today, and that is this whole notion of the new ombudsman or taxpayer advocate, and whether it should be an independent office, or not.

I talked to Senator Grassley, briefly, about it, whether a political appointee makes more sense, or an internal office, and I think Mr. Lane, you and Mr. Thayer, and perhaps Mr. Keating, have different notions of that.

I would like to hear the two or three of you speak about it. Maybe Mr. Thayer could start off, again, explaining why you think it is so important to have a political appointee in that position.

Mr. THAYER. Well, as we said to you earlier, we really believe that having a person in that position, responsible to Congress as opposed to being responsible to the Commissioner, relieves that person of a burden, obviously to account, and also gives at least the impression to the taxpayers—we would like to think more than that—that at least there will be a fair hearing, or a fair representation in terms of that office.

So we think it just remove that person, if you will, from being compromised in any way by the Office itself.

Mr. PORTMAN. Internal.

Mr. THAYER. That is right.

Mr. PORTMAN. And Mr. Lane, your concerns about that?

Mr. LANE. I guess our concerns are that the system in the field—where these cases happen—the district director is responsible for that district. The problem resolution officer reports to the district director.

So the district director has got a direct vested interest in resolving that case because he owns it.

And if the collection division is trying to levy on a taxpayer's wages, and problem resolution says they ought to not levy on it, the district director gets handed the decision. He owns the problem.

If you take the problem resolution function out from under that district director's jurisdiction, and now he is aligned with this national political appointee, I think you create a situation where the district directors can say, Well, you know, I don't have that problem, that is not my problem anymore, that is the ombudsman's problem, the taxpayer advocate's problem.

You know, if you are envisioning a taxpayer ombudsman, or a taxpayer advocate that is in the National Office, and that is the only one in the organization that is the political appointee, and everybody else still works for the district directors, then that situation might work very similar to the way you have chief counsel and the Commissioner appointed.

But I guess my reaction as a practitioner—and I deal with problem resolution probably three and four times a week—is that PRP is not broken. You don't need to fix it.

The testimony we got today: that ATAOs, went from 65 to 12, that, in Mr. Cardin's evaluation, could be looked upon as you are really having too restrictive a determination as to what qualifies for an ATAO.

But in the reality, what happens in the field, the stuff is getting resolved without having to go that far in the process. You bring it to their attention, and they are resolving it in some 80–85 percent of the cases.

I can tell you, I never had to go insisting that we get the ATAO. I have gone in with those situations, and it has been resolved.

Mr. PORTMAN. And partly being resolved because there is some accountability in the system to resolve it within——

Mr. LANE. Absolutely. It is in the district director's direct interest to get that issue resolved, so it doesn't turn into this case we heard about this morning with this poor woman from Texas.

Mr. PORTMAN. I think I have already run out of time, but Mr. Cohen, you are nodding your head regarding this. Do you have a similar story to tell with regard to your clients?

Mr. JEROLD COHEN. Yes, I do. I think it would be a mistake, and the Tax Section has been on record in this regard, to have a political appointee inserted within the Service. I really do think the system works as it is working now, and that the oversight of this subcommittee is the overall governing force to make certain that the system is working, and I think that it works best as it is presently set out.

Mr. KEATING. I would like to say something further about this. There is nothing in the bill that says the political appointee would change the current bureaucratic structure when problem resolution officers report to the district directors. Absolutely nothing. It is just independence of appointment.

Mr. PORTMAN. Yes, there is nothing that would necessarily say that all the taxpayer advocate local offices would report right up to the national office. But one thing that we found is that when there is a problem in the local office, it gets bumped, someone may go up to the National Office—it just gets bumped down. And in some cases, it just doesn't get resolved.

Mr. KEATING. The other problem is the IRS never comes in here to make substantial taxpayer rights recommendations. You can look at the IRS recommendations over the last 15 years. Every time there has been a bill, the Commissioner comes in, says no, we can't do this and we can't do that.

The fact is the installment agreement changes that have been made by the IRS and much of the positive things the IRS has done lately have come because of legislation introduced in the Congress. If we had a real taxpayer advocate, someone who comes from outside the Agency, who doesn't have to worry about where am I promoted after being a taxpayer advocate, would do a much better job, bring some fresh approaches, and actually come before this committee to say, Look, I know where the bodies are buried out there, I know where the taxpayers are being abused. I don't have to worry about my future with my buddies in the Agency.

Here are the problems that are out there, and these are my recommendations. We may even see some solid legislative recommendations. Now, we almost never get such recommendations from the IRS.

We get some trivial little things about interest abatements and whatnot, but that is shuffling deck chairs.

Jack Wade was in the bureaucracy in the IRS for many years. Maybe Jack could add a couple of comments about why he thinks this is very important. He has been in the bureaucracy, and I think he might have a couple of things to add on this point.

Mr. WADE. In one of my books, "When You Owe The IRS," I talked about the siege mentality inside the IRS, the sort of mission-minded mentality. The problem is that when you have been working for the IRS for 20 or 30 years, and the taxpayer ombudsman is typically somebody who has been around for that long, you tend to view things in a certain way. Often the attitude is, well, this is the way we have always done it, this is right, and anything else outside this, this is wrong.

We think that to be a true taxpayer advocate, you have to bring in somebody that has a fresh mind, somebody who is open to new ideas and new concepts.

People inside the IRS have known for a long time about the problem of the joint and several liability. They know the horror stories with spouses who get hit with tax liabilities caused by problems from their husbands—nobody has ever come up with a viable suggestion or solution from the IRS.

As David said, most of the suggestions that you get from the ombudsmen are very minor, such things as changing the Social Security number on the mailing labels. I think that is a good idea, but it is not a significant creative approach to solving some of the problems that need to be solved in dealing with taxpayers.

We are only looking for a way to bring in a fresh person with some fresh ideas, who can look at things a little bit more objectively.

The idea, for example, that you have user fees on taxpayers who need installment agreements, to me, is just absolutely abhorrent.

Now it is going to cost taxpayers, who can't pay their taxes, more money to pay their taxes in their installments. I think a true taxpayer advocate would have stepped in and said, This is not fair, this is violating the rights of the taxpayer, and this is something that we shouldn't be doing to people who are having difficulty paying their taxes.

There are a lot of instances like this, where we can cite, that these kinds of things should not be going on.

Now, we haven't really studied the idea of bringing the problem resolution officer in a direct line chain of command to the National Office, but when the ombudsman who talked here today—I kind of liked his approach of being involved in the selection process.

What we find in the field is that too many times there are a number of problem resolution officers who really do not have the guts to stand up to a functional division manager, such as a collection division or an audit manager, and say, This should not be happening.

Sometimes we found, and practitioners have reported to us, that the problem resolution officer bucks it back up to the division that started the problem in the first place.

The real problem is that the problem resolution officer, when he or she is done with that job, has to go back somewhere within the IRS to finish his or her career.

It is very unlikely, that somebody is going to stay a problem resolution officer for the whole length of their career. So they have to go back to their function, typically, where they came from—the Collection Division, or the Audit Division, or whatever.

So the problem resolution officer is not going to be butting too many heads, too many times.

So what we are looking at is a way to give the problem resolution officer some strength to be able to step in and issue a taxpayer assistance order, for example, if that is what it takes to get the job done.

We think that there needs to be some accountability here, and we need to find some way to strengthen that problem resolution officer so he, or she is not afraid of butting heads, if that is what it needs.

But in terms of taxpayer advocate, Mr. Thayer said it very eloquently. We don't believe that this is a job that is going to be held by a political hack.

We don't think that any of the Commissioners have been political hacks, nor any of the chief counselors who have held those jobs.

We think that the administrations, at least within the last 20 years, have held the IRS in high esteem. They have gone into the tax and accounting community and selected people with very impressive credentials.

If we ever found that this was going to be a dumping ground for a political hack, you can bet that we would be terribly upset and let you know.

We think that the IRS has been held in high enough esteem that a true political appointed ombudsman would also be someone of equal credentials.

Mr. PORTMAN. Thank you, Mr. Wade, and I think all the panelists, Ms. Walker, or Dr. Stevenson, may have additional comments. Madam Chairman, do we have time?

Chairman JOHNSON. Yes, absolutely.

Ms. WALKER. Let me just be real quick.

The AICPA is on record as stating that we don't believe it should be a political appointee, that it works best, the system that is in place now, as part of the overall Internal Revenue Service.

And in listening to all of this, I guess I would just say why isn't all this part of the Internal Revenue Commissioner's job, as being, you know, a friendly place collecting revenues for the Government as opposed to an adversarial relationship?

I mean, I would put it right at that level.

Mr. PORTMAN. Dr. Stevenson, do you have any comment?

Mr. STEVENSON. Very briefly. As a student of the administrative processes—that is what my doctorate is in—I think, in balance, the system that is in place at the local level has problems in various districts, but on a broad-brush stroke, as Joe said, it's not really broken.

However, there is one problem that we do meet with the Internal Revenue Service officials several times a year—and we bring this community that is sitting here—we bring advocacy issues to the Commissioner and the Commissioner's staff, and various other people.

They listen to us, but we're not really sure that they hear us. Now, when we come and speak to you about certain issues, I get the impression that you are listening and hearing.

So maybe, in balance, with the use of oversight for taxpayer advocacy, plus the work that we are doing at the ground roots level, may help the system along a bit.

Mr. PORTMAN. Thanks very much. I would just make one final comment, and that is, given all the testimony we have heard today, and particularly from this panel, that you all represent many powerful groups' interests out there in the tax community. I would hope that you all work with us toward simplification over time.

Because I think when you get right down to it, a lot of the concerns we have raised here are solved not so much by tweaking the code, or changing the administrative process, and so on, but by just simplifying the code and making it clear, not within the parameters of having to figure out what income has risen, if it is an income tax, but trying to make clear what the actual taxpayer responsibilities are, and clear what the IRS responsibilities are, to avoid a lot of these problems.

So I would hope you will stick with us, and work with us closely. I know that, again, as I said, initially, many of you, frankly, among your constituencies, will have conflicts of interest on that very issue. Because the more we simplify it in some senses, the fewer accountants and lawyers, and other tax advocates that one would need.

Mr. LANE. Mr. Portman, don't be concerned at all. Everybody at this table, I am certain, would be favor of tax simplification, even though it might cost us a couple of clients.

Because no one is more beleaguered by all the changes than the people that are in the business, that are constantly having to explain the changes.

I mean, if you had to sit down with a client that had a business car, he put in business use in 1982, and changed in 1984, 1986, 1988, and 1990, you would have some sense of the frustration we feel. There literally was a law change every other year in that category. A different way of treating the depreciation——

Chairman JOHNSON. Let me recognize Mr. Hancock.

Mr. HANCOCK. Yes. I think we are dealing with seven different depreciation schedules now in our company, and I will frankly admit, I don't think anybody can say absolutely, 100 percent, that we are accurate on it. But I mean, we do the best we can.

You know, maybe the solution would be to come up with a psychological examination for people that are going to go to work for the Internal Revenue Service and find out whether they are Socialist or Capitalist. [Laughter.]

Mr. HANCOCK. And then we can make them split it up anyway. Right now, I am wondering if we haven't got about 75 percent of them over there that believe in redistribution of the wealth. Thank you.

Chairman JOHNSON. Well, I would urge you to reflect on the comments that have been made on this panel.

You have pointed to some of the things that we have done together that, by people bringing recommendations to us, and our changing the law, we have accomplished.

I am not so sure that is not the best ombudsman, and maybe it is that we underutilize that oversight capability, and the ability to change the law, because we have traditionally hooked our ability to make those moves from this committee into the macro tax bills.

We are going to try to change that this session. I have the Chairman's backing in that. I am working with the Senators on that. We are going to try to see if we can't do small things that need to be done, just to fix up and clean up, and make more equitable the process, independently, and not as part of macro bills.

But the achievements you point to are ones that we heard testimony on and legislated on. I frankly have more confidence in that process than the process of a political appointee.

And you say if they became political, you would be the first to want to change it. It is very hard to change it, to get it in place, and what I am saying to you is, you really believe this should be a political appointee. That you need to think through and give me an example of where, in Government, that has really worked.

Because I have been a part of passing a lot of legislation that appointed czars for this, czars for that, overseers for this, and ombudsmen for that, and I don't know one, that after a few years, made any bit of difference, but it sure did increase the complexity.

And I am very concerned about the on-the-line front office, where one person has a different agenda than anybody else, and possibly a hostile agenda.

Their agenda may be to embarrass the people they worked with, because that is the agenda of their appointee, to show how important they are, how valuable they are, how you couldn't do without them, because look at all the awful stuff that is going on.

So don't believe that's not a real danger. It wouldn't be the first appointee. But we're talking about decades; we're not talking about weeks.

So if you want us to go down the path of a political appointee, you will have to prove to at least the chairman of this committee, that it has worked somewhere, at some time, for a decade.

I leave you with that challenge, and thank you for your input. I hope that you will work with us through this process, because it is apparent from this hearing that we could actually be doing a lot of interesting things that would work to make the administration of the code function more equitably, and I think that is our shared interest.

Thank you for being here, thank you for your patience in this day-long effort, and I look forward to working with you.

The hearing is adjourned.

[Whereupon, at 3:32 p.m. the hearing was adjourned, subject to the call of the Chair.]

[Submissions to the record follow:]

STATEMENT OF ERNEST J. DRONENBURG, JR.
VICE CHAIRMAN
CALIFORNIA BOARD OF EQUALIZATION
SUBMITTED TO THE OVERSIGHT SUBCOMMITTEE
OF THE HOUSE WAYS AND MEANS COMMITTEE

April 3, 1995

Many members are familiar with my record on taxpayer rights. I strongly supported the Taxpayer Bill of Rights 1 and have been a consistent advocate for protecting taxpayers from abusive tax enforcement practices. However, the purpose of this statement is to express my strong opposition to legislation, H.R. 390, sponsored by Representative James Traficant, that would shift the burden of proof from the taxpayer to the IRS for tax cases. This legislation would have far-ranging and negative consequences on not only the Internal Revenue Service, but also on State tax systems and honest taxpayers across the country.

I am an elected member of the California Board of Equalization. The Board of Equalization is California's major revenue agency and is responsible for the administration of State and local tax programs. The five member Board was created by California's Constitution in 1879 with four members elected from districts and the State Controller serving as the fifth member.

The Board of Equalization administers State and local sales and use taxes, motor vehicle fuels license taxes, and the cigarette tax. The Board also serves as the body which hears tax appeals. The Board of Equalization is also responsible for appraising all the properties of privately owned public utilities and railroad companies for local property tax purposes. H.R. 390 would severely cripple the ability of the Board of Equalization to meet its constitutional obligation to administer and enforce our State's tax laws and would likely amount to an enormous burden on honest taxpayers by protecting tax cheaters.

IMPACT ON VOLUNTARY COMPLIANCE

Both Federal and State tax systems depend on the voluntary compliance of taxpayers to fulfill their tax obligations and properly report their taxable income. We are very fortunate that the current system operates in a way that results in a high level of tax compliance. A key element to this success is that taxpayers understand it is their obligation to document their taxable income, their credits and deductions, be it a receipt from the Salvation Army for a charitable donation or a mortgage interest statement from their lending institution. The commonly accepted practice over the years has been that the party with the access to the evidence

should bear the burden of providing that evidence. It would be a radical departure to suddenly change the rules and say the tax agency must provide the documentation without full and careful consideration of the consequences.

A purported reason for this legislation is that taxpayers fear the IRS and this bill will lessen that fear. However, I contend the practical effect of this bill would be much different. Rather than allowing the taxpayer to provide the necessary documents to prove their case, it would require that tax auditors get that information from any source available, which could very easily involve interviewing neighbors, employers, other family members -- exposing alleged tax violations to a taxpayer's friends, family, co-workers and community. Imagine going to church one Sunday and having the minister tell you about a visit from an inquiring tax auditor -- how would you feel? Consequently, this proposal could prove incredibly intrusive on one's privacy and rather than being a contained matter between the IRS and the taxpayer, could instead escalate into a very public dispute involving anyone a taxpayer knows who could shed light on their taxable income.

If this burden of proof is moved from taxpayer to tax agency, it would, over time, encourage a disregard for compliance by those taxpayers intent on underreporting their income, because it is obviously easier for the taxpayer to not disclose information than it is for tax auditors to track it down. It is difficult to measure what would be the actual extent of the decline in taxpayer compliance -- but I am confident it would be significant and would increase as time passed.

Naturally, this errant behavior would spill over into noncompliance with State tax systems too. Thus, both Federal and State revenue systems can expect a dramatic drop in tax revenues due to increased noncompliance by Federal and State taxpayers. If Federal and State governments are forced to fill the revenue gap by increasing taxes, then noncompliance would increase even more because there would be even stronger incentives not to comply -- thus creating a vicious cycle of higher taxes to bring in adequate revenues, and falling compliance to avoid an ever-increasing tax liability.

INCREASE DEMAND ON IRS WILL HARM INFORMATION SHARING WITH STATES

State tax systems rely on the Federal tax audit program for assistance in identifying nonfilers and or other taxpayer deficiencies. If H.R. 390 is enacted, the IRS and others justifiably contend that their audit resources will be strained to the limit. Under the current system, the IRS audits approximately 1% of taxpayers annually. If the IRS must assume the burden of proof responsibility, two changes will occur. First, for the current level of audits, the paperwork demands would increase because it would fall to the IRS to collect the necessary documents to prove their claims against noncomplying taxpayers. Second, if the rate of

noncompliance jumps as tax officials expect, more resources will be needed for the higher case load. What does this mean for State tax systems? States often piggyback on deficiency assessments made by the IRS -- so any delays or backlog by the IRS trickles down to the States as well. Thus, States will have inadequate information to conduct their tax audits.

BURDEN OF PROOF COULD BE IMPOSED ON STATE TAX SYSTEMS

If H.R. 390 were enacted, State governments could soon expect similar legislative efforts in their respective legislatures. California is one of the States that conforms to the Federal tax system in many areas. If the burden of proof is shifted for Federal taxpayers, that new standard could potentially be adopted by the California Legislature. In that case, we would have a double hit of contending with the consequences of the burden of proof shift at the Federal level and at the State level.

During these times of extreme fiscal stress on government revenues, State Legislatures would be hard pressed to provide the additional funding to tax agencies to fully comply with the new demands of shouldering the burden of proof responsibilities. While implications for the rights of taxpayers is more troubling, the fiscal realities also make it clear to me that this bill is poison in a pretty wrapper.

UNDERMINE ENTIRE TAX SYSTEM

This proposal runs contrary to efforts by the IRS and by State tax systems to become more service-oriented, more accessible, and more cooperative in dealing with taxpayers and with sharing information among tax systems. Our current tax compliance system has a strong foundation of fairness and efficiency that in turn has created mutual respect for the system and for our taxpayers -- the high rate of compliance is evidence that this system works.

If instead, our resources are devoted to compiling evidence on every dispute like it was a criminal investigation, tax collectors would indeed become the "tax gestapo." I ask that you not let the tremendous progress we have made in improving our tax system backslide due to some misplaced understanding of what are appropriate procedures in handling tax disputes. Please oppose the advancement of H.R. 390. Thank you.

TESTIMONY OF HARLEY DUNCAN
FEDERATION OF TAX ADMINISTRATORS

The Federation of Tax Administrators is an association of the primary tax collection agencies in the 50 states, the District of Columbia and New York City. FTA is concerned that the far-reaching effects of H.R. 390 may not be fully understood. Specifically, we would ask the Subcommittee to consider the bill's deleterious effect on the states' ability to collect taxes.

On the surface, H.R. 390 applies only to the Internal Revenue Service. In simple terms, it would place the "burden of proof" on the IRS rather than on a taxpayer in civil matters. This is generally viewed as a Taxpayer Bill of Rights issue. While taxpayer rights are crucial and should be respected, they must also be balanced against the ability of government to effectively collect the revenues due it. Taxpayer burden of proof is a key element in that process.

Shifting the burden of proof from the taxpayer to the federal government would seriously undermine the federal income tax system. It would make it virtually impossible to assert deficiency assessments for all federal taxes. It will establish a legal system that allows taxpayers to underreport taxes, but not be required to produce information to support their tax reporting. The problem is most easily explained in the following example: an individual deducts $3,000 in charitable contributions, but has no receipts to back up the claim. The government would have to prove this was not true – and it is impossible to prove a negative.

Over time, the bill would destroy voluntary compliance. Taxpayers will quickly learn that they have little reason to report their taxes accurately, and that if they are inaccurate, IRS has little or no legal ability to prove they are wrong. In other countries where the government has the burden of proof, voluntary compliance is an exception, never the rule. In the U.S., some 85 to 90 percent of all dollars are voluntarily paid in full and on time without the federal or state governments having to undertake individualized enforcement actions.

If H.R. 390 is enacted, it would affect each of the states in three ways:

- Many state audit programs – particularly those relating to the individual income tax – rely heavily on the federal programs. When the federal government discovers a nonfiler or finds that an individual has underreported the federal tax due, IRS automatically notifies the state tax authorities. Similarly, states and the federal government are working very closely together to discover unpaid tax on motor fuels. This is modern and efficient government; it also allows states to reap the benefits of far more compliance activities than they could otherwise afford. However, if IRS is no longer able to effectively make deficiency assessments, the states will lose this critical compliance mechanism.

- The provision's harmful effect on voluntary compliance will directly flow through to states. When voluntary compliance drops at the federal level, it most certainly will drop at the state level. This will be especially true if the states have lost their most effective enforcement tool, piggybacking on IRS deficiencies.

- State legislatures often follow the Congressional lead, particularly on Bill of Rights issues. If Congress puts its stamp of approval on this concept, public pressure will be great for the state legislature to follow suit.

I urge you to consider these frightening consequences to the states if H.R. 390 is passed.

Harley Duncan
Executive Director
Federation of Tax Administrators
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TESTIMONY OF RUSSELL A. HOLLRAH
INDEPENDENT CONTRACTOR ASSOCIATION OF AMERICA, INC.

The Independent Contractor Association of America, Inc. (the "ICAA") is a national association — representing over 2700 businesses that engage, or operate as, independent contractors — that is dedicated to the preservation of independent contractor status.

ICAA strongly supports efforts to enhance the rights of taxpayers vis a vis the Internal Revenue Service ("IRS"). In worker classification disputes, the taxpayer is at a serious disadvantage relative to the IRS, and the IRS routinely engages in enforcement strategies that exploit its advantage. Small business taxpayers that engage independent contractors are currently suffering under the weight of an aggressive IRS enforcement program aimed at reclassifying such workers to employee status.[1]

In order to counteract the IRS's enforcement practices that relate to worker classification matters,[2] ICAA strongly supports the Taxpayer Bill of Rights proposals generally, and especially supports the proposals that would make it more feasible for taxpayers to recover the fees and costs incurred in prevailing against the IRS in a federal tax dispute. ICAA also urges that the Subcommittee consider additional taxpayer rights provisions that deal specifically with the IRS's attack on businesses that use independent contractors:

- ICAA urges that a taxpayer be deemed eligible *per se* to recover the fees and costs incurred in defending against an IRS challenge to the taxpayer's classification of a worker as an independent contractor if the taxpayer is ultimately determined eligible for protection under Section 530 of the Revenue Act of 1978 ("Section 530"), based on the taxpayer's reasonable reliance on a safe haven that the taxpayer asserted during the IRS's administrative consideration of the issue;

- ICAA urges that any IRS review of a taxpayer's classification of workers be deemed an "audit" for purposes of Section 530, irrespective of how the IRS characterizes the review; and

- ICAA urges that the IRS be prohibited from targeting small businesses for intensified enforcement efforts seeking the reclassification of independent contractors, as the IRS currently does through its Employment Tax Examination Program ("ETEP").

The Standard that a Taxpayer Must Satisfy In Order to Recover Fees and Costs Incurred in Winning a Tax Dispute Should be Relaxed.

Under current law, a taxpayer is not entitled to recover attorney fees or costs in an IRS dispute unless it can demonstrate, among other things, that the government's position was "not substantially justified."[3] The interpretation of the fee and cost recovery provisions has been overly strict. The statistics offered by the American Bar Association confirms the fact. The ABA testimony pointed out that while the provisions were "scored" as producing a revenue loss each year of $5 million, the actual aggregate awards under the provisions each year have been a mere $220,000. The data leave no doubt that the provisions are not working as the Congress had intended.

ICAA concurs with the witnesses who testified before the Subcommittee that the problem lies with the requirement that a taxpayer prove that the government's position was not substantially justified.[4] In order to remove that impediment, ICAA supports the proposals

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[1] The IRS's bias against independent contractor status is manifest. The bias has been proven to exist through quantitative analysis in Robinson and Hulen, *IRS Bias In Worker Classification Decisions*, Tax Notes 1741 (September 26, 1994).

[2] While ICAA supports the Taxpayer Bill of Rights provisions generally, ICAA is dedicated exclusively to the preservation of independent contractor status and, therefore, the comments contained herein are limited to the provisions that relate to those specific interests.

[3] Internal Revenue Code section 7430.

to shift the burden of proof to the government, so that instead of requiring the taxpayer to demonstrate that the government's position *was not substantially justified*, the government should be required to demonstrate that its position *was substantially justified*. This does not appear to be an onerous measure, particularly inasmuch as the IRS General Counsel testified at the hearing that government lawyers currently prepare for fee and cost recovery cases by assembling the evidence necessary to demonstrate that the government's position in the case was substantially justified.

ICAA also would support the proposal that would simply eliminate the requirement altogether, so that the issue of whether the government's position was reasonably justified is no longer relevant.

With respect to the cost and fee recovery provisions, the important point is that current law is inadequate. ICAA takes no position as to whether the inadequacies are better addressed by eliminating the need to determine whether the government's position was substantially justified, or by shifting the burden of proof on that issue from the taxpayer to the government. ICAA believes that either would represent a long stride in the correct direction and, therefore, supports both proposals.

Taxpayers Should be Deemed Eligible *Per Se* to Recover Fees and Costs Incurred in Winning a Worker Classification Dispute When the IRS Refuses to Acknowledge the Taxpayer's Section 530 Protection.

The IRS, when challenging the classification of workers by a small business, frequently provides the business with a Hobson's choice of either defending its classification of workers as independent contractors in court — and jeopardizing the financial viability of the business even if it prevails — or acquiescing to the IRS's demand that it reclassify the affected workers to employee status.

While a legal battle can be financially devastating to a small business, a reclassification can have severe financial consequences as well. Many businesses that have acquiesced to an IRS-demanded reclassification of independent contractors have found that their best workers refuse to work as employees and cease performing services for the business.

The Congress during 1978 sought to tame the IRS's aggressive attacks on businesses that engage independent contractors by enacting Section 530 of the Revenue Act of 1978. Section 530 was intended to protect a taxpayer that satisfies the Section 530 criteria against the IRS reclassifying its workers to employee status. The Congress expressly instructed that Section 530 is to be liberally construed *in favor of the taxpayer*.[5] In practice, however, the IRS construes Section 530 narrowly, *against the taxpayer*.

In other cases, particularly in the context of an IRS Form SS-8 request,[6] the IRS commonly refuses to even consider Section 530. In such cases, a firm eligible for Section 530 protection that responds to the Form SS-8 request is forced into a confrontation with the IRS over the application of the common law test to its workers — a controversy that the Congress sought to avoid by the enactment of Section 530.[7]

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[4] An example of a case were a taxpayer who appeared clearly entitled to recover fees and costs in an independent contractor dispute but who was denied recovery on the grounds that it failed to demonstrate that the government's position was not substantially justified was *In re Rasbury*, 93-1 U.S.T.C. ¶50,351 (N.D. Ala. 1993) *affirmed* 94-2 U.S.T.C. ¶50,319 (11th Cir. 1994).

[5] *General Investment Corp. v. United States*, 823 F.2d 337, 340 (9th Cir. 1987).

[6] The Form SS-8 is used by the IRS for soliciting facts from a firm and a worker for purposes of ascertaining whether the firm's classification of the worker as an independent contractor is proper.

[7] In *Queensgate Dental Family Practice, Inc. v. United States, 91-2 U.S.T.C.* ¶ 50,536 (M.D. Pa. 1991), the district court observed that the Congress made clear that a business that

ICAA suggests that the IRS's enforcement posture with respect to Section 530 would become more moderate if the fee and cost recovery provisions were modified to provide that if a taxpayer advises the IRS of its eligibility for Section 530, the taxpayer will be entitled *per se* to recover fees and costs incurred in winning its case. The recovery could be made contingent on the taxpayer ultimately being determined eligible for Section 530 based on a safe haven provision that the taxpayer relied on when asserting Section 530 protection during an IRS administrative proceeding.

Any IRS Review of a Taxpayer's Classification of Workers Should be Deemed an "Audit" for Purposes of Section 530, Irrespective of how the IRS Characterizes the Review.

Another means used by the IRS to undermine Section 530 is to seek to review a taxpayer's classification of workers without the review being considered an "audit" — in order to avoid the taxpayer qualifying for Section 530 protection based on the prior audit safe haven. The IRS frequently seeks to characterize such reviews as "compliance checks."

A primary objective of Section 530 was to protect taxpayers against recurring IRS audits concerning the classification of workers as independent contractors. To permit the IRS to accomplish a review of a taxpayer's classification of workers as independent contractors through "compliance checks" — without the review establishing a basis for Section 530 protection against subsequent similar reviews — would defeat much of what Section 530 sought to accomplish.

What is more, if the IRS is allowed to continue its current practice of reviewing a taxpayer's classification of workers as independent contractors through compliance checks, without triggering Section 530 protection for the taxpayer, the IRS will have succeeded in accomplishing a *de facto* administrative repeal of the prior audit safe haven of Section 530.

ICAA respectfully urges, therefore, that the Congress clarify that an IRS review of a taxpayer's classification of workers as independent contractors constitutes an audit.

The IRS Should Be Prohibited from Targeting Small Businesses for Intensified Enforcement Actions Involving Independent Contractors, as it Currently Does Through the ETEP.

The IRS has aggressively pursued small businesses that engage independent contractors in an effort to reclassify such workers as employees. The pursuit is attributable largely to the high-profile "Employment Tax Examination Program" that the IRS launched in 1988, known by the acronym "ETEP." The program unabashedly targets businesses with $3 million or less in assets for an intensive worker classification enforcement effort.[8]

The ETEP is patently discriminatory against small businesses. A common characteristic of many small businesses — which makes the program particularly inadvisable — is that such businesses typically do not possess the resources needed to aggressively defend against IRS efforts to reclassify workers as independent contractors.

Anecdotal evidence of IRS representatives pressing taxpayers into reclassifying workers to employee status on a prospective basis (known as the IRS's "prospective compliance" offer) — in cases where the taxpayer may well have prevailed if the matter was defended on its merits — abounds. As a matter of fact, there are legions of small business

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satisfied the requirements of Section 530 need not also be analyzed under the common law test.

[8] For further discussion of the ETEP, see *The Administration and Enforcement of Employment Taxes — A Status Report on Ideas for Change*, H. Rep. No. 861, 103rd Cong. 2d. Sess (October 19, 1994).

owners who have capitulated to the IRS's prospective compliance gambit — based on the IRS's overstated estimates of the how much it would cost the taxpayer to contest the matter — only to subsequently feel as though they had been tricked by their own government into the reclassification.

While there is no question that the IRS has the right to enforce the tax laws, ICAA contends that the IRS's enforcement efforts must be evenly applied, and that it is not appropriate for the IRS to focus its efforts on a category of taxpayers who are least financially able to defend themselves. What is more, the inappropriateness of such an enforcement strategy is compounded where the IRS unabashedly seeks to exploit the taxpayers' vulnerability, by aggressively urging them to settle the cases — without regard to the merits of the case — on the grounds that the expense involved in defending their position would be cost-prohibitive.

In light of the foregoing, ICAA respectfully urges the Congress to prohibit the IRS from focusing its worker classification enforcement efforts on small businesses and, in so doing, to require the IRS to terminate the ETEP.

Conclusion.

ICAA appreciates the opportunity to present this statement. While TBR 1 represents significant progress in the enhancement of taxpayer rights, much more needs to be done, particularly with respect to the manner in which the IRS currently administers the tax laws that relate to a worker's status. If you have any questions or would like additional information concerning any of the foregoing comments, please let us know.

Respectfully submitted,

Russell A. Hollrah
President
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1301 K Street, N.W.
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(202) 842-3400

TESTIMONY OF ROBERT M. TOBIAS
NATIONAL TREASURY EMPLOYEES UNION

Madam Chairwoman and distinguished Members of this Subcommittee. Thank you for the opportunity to submit this statement concerning taxpayer rights. As President of the National Treasury Employees Union (NTEU), which is the exclusive representative of employees from the Internal Revenue Service, we have a particular interest in the taxpayer rights issue. NTEU strongly endorses the concept of defining and protecting taxpayer rights, however, we are wary of creating a system which does not accomplish the goals and paralyzes IRS, rendering them unable to properly carry out their mission to collect taxes.

During the March 24, 1995, Ways and Means Committee, Oversight Subcommittee hearing, Congressman Andy Jacobs (D-IN) testified in support of a proposal to make IRS employees personally liable for "arbitrary, capricious or malicious" acts committed while performing their job duties. NTEU is vehemently opposed to this concept. As you may or may not know, the issue of holding IRS employees personally liable for "arbitrary, capricious or malicious" acts was considered and rejected by the 102nd Congress in the context of a major tax bill, H.R. 11. I am attaching for the record a copy of a letter, signed during H.R. 11, by eight former IRS Commissioners opposing the personal liability provision. In addition, the American Bar Association's Tax Section has publicly opposed this provision.

The reason for such widespread opposition is not difficult to imagine. Not only would the Jacobs proposal make it virtually impossible to recruit and retain IRS employees, it would also undermine the ability of any IRS employees, who were willing to stay in the IRS, to properly collect taxes. While we believe that most Americans are law abiding, compliant taxpayers, we also know that there are people who use the system to avoid paying taxes and others who would not pay taxes if they believed they could get away with it. IRS employees must deal with these noncompliant taxpayers every day. A noncompliant taxpayer would have every incentive to threaten suit against an employee when that employee sought to bring the taxpayer into compliance. The natural result of such a relationship is for the IRS employees to be unwilling to deal effectively with aggressive taxpayers for fear of personal liability. Ultimately, the government would collect far less revenue.

It would become virtually impossible for IRS employees to effectively collect taxes with the black cloud of personal liability hanging over their heads. It is unclear what acts under the Jacobs proposal would be considered "arbitrary, capricious or malicious" and therefore subjecting employees to personal liability. One Judge could find an IRS employee's actions totally reasonable while another Judge could find the *same* actions "arbitrary and capricious". The IRS employee, in an attempt to avoid liability, would constantly be second guessing his/her actions. It will be impossible for an IRS employee to know if his/her actions fall within an "arbitrary and capricious" category. This unworkable standard will result in a chilling effect on the employee's ability to collect taxes.

Not only would personal liability for IRS employees result in less effective tax collection, it would also subject IRS employees to constant harassment. In an effort to avoid IRS action, the noncompliant taxpayer would use every opportunity to raise the personal liability threat against the IRS employee. As the IRS employee found it necessary to increase his or her efforts to bring a taxpayer into compliance, the taxpayer would escalate the threat of personal liability against the employee. Ultimately, it would be the IRS employee who would be harassed by the taxpayer.

We do not approve of inappropriate actions by IRS employees or other federal employees. However, we firmly believe that taxpayers have appropriate recourse in such a circumstance. Aggrieved taxpayers may bring actions against the government for attorney fees and there are currently legislative proposals to increase the possible recovered amount from $100,000 to $1 million. We do not oppose these legislative proposals but we strongly oppose workers

who will risk losing the homes and their kids' college savings every time someone who doesn't want to pay his/her taxes charges them with acting in an undefined "arbitrary" manner.

There is not one group of federal employees who are held personally liable for non-criminal acts if they are acting within the scope of their work duties. Rather, the employer is the liable party. The proposal being set forth by Congressman Jacobs would treat IRS employees differently from all other federal employees, by subjecting them to personal liability. This would make recruiting people to do the unpleasant, but necessary job of collecting taxes set by Congress virtually impossible.

We would also like to remind this Committee that stiff penalties exist, including removal, for inappropriate actions by IRS employees. But, we believe that the dual goals of protecting taxpayers and collecting taxes can be achieved by enforcing existing rules against employees and continuing to allow or expand suits against the government. Requiring the personal liability of IRS employees will make it impossible to find qualified people willing to do the job Congress has directed them to do: collect taxes.

In closing I would like to say that NTEU is very willing to work with Congress and IRS employees to ensure that taxpayers are being fairly treated and at the same time revenue due is being collected in the most effective and productive manner. Thank you for allowing me to submit this statement for the record.

July 15, 1992

The Honorable Dan Rostenkowski
Chair, House Ways and Means Committee
House of Representatives
Rayburn 2111
Washington, DC 20515

The Honorable Lloyd Bentsen
Chair, Senate Finance Committee
United States Senate
Hart 703
Washington, DC 20510

Dear Sirs:

As former Commissioners of Internal Revenue for the past thirty years, we express our concern and strong opposition to certain provisions contained in Title V of H.R. 11 which we believe would seriously and adversely affect tax administration.

Each of us has worked with you or your predecessors in attempting to assure that the Internal Revenue Service ("Service") met its obligation to fully and fairly collect the proper amount of tax owed to the Federal government. In addition, each of us has represented taxpayers in dealing with the Service before and/or after serving as Commissioner. We therefore recognize, as we know you do, the difficulties that the Service faces in collecting the amount of tax properly owed and at the same time doing so in a fair, even-handed and professional manner.

We take seriously the importance of balancing the authorities needed by the Service to discharge its obligations with the rights of individual taxpayers in their dealings with the Service. You well know, and we recognize, that such balancing of the authority needed by the Service to properly perform its duties with the rights of individual taxpayers is often as difficult as it is important. And this is particularly true at the present time in light of the government's need for revenue, the complexity of our Federal tax laws, and the increasing lack of confidence and respect of our citizenry in governmental authority.

In view of these competing considerations, we have considered carefully the provisions of Title V of H.R. 11. Some of the provisions may be helpful, but we have substantial concerns about the impact of other provisions on our Federal tax system. There are three provisions that we feel so strongly about for the reasons indicated below that we urge you to reconsider and delete them from the legislation that you presently are considering.

1. Personal Liability of Service Employees. Section 5704 of H.R. 11 would impose personal liability on Service employees in certain circumstances. Presently, if a taxpayer is the "prevailing party" in tax litigation, then under certain circumstances a court can require the Federal government to reimburse the taxpayer for certain litigation costs. Under the pending proposal, the court could require a Service employee personally to reimburse such costs if the court determined that the proceeding resulted from any arbitrary, capricious or malicious act of the employee, and, in such event, the employee would not be permitted to recover such costs from the Federal government.

This proposal has been criticized publicly by the Taxation Section of the American Bar Association and the Tax Section of the New York State Bar Association. We concur with their criticisms and opposition.

We do not condone the arbitrary, capricious or malicious actions by Service employees in dealing with taxpayers. We believe, however, that present law and procedures provide an aggrieved taxpayer with substantial remedies to redress such conduct, including the Service's Office of the Taxpayer Ombudsman, the Problem Resolution Program, and the Office of the Chief Inspector, as well as the Treasury Department's Inspector General and the provisions of Section 7433 of the Code permitting a taxpayer to bring a civil action against the United States for damages sustained in connection with the collection of Federal tax due to the reckless or intentional disregard of Federal law by a Service employee. Likewise, there are substantial and serious disciplinary measures available to properly punish any employee who might engage in such unauthorized behavior.

Our collective experience in the public and private sectors suggests that although there are instances of inappropriate conduct by Service employees, they tend to be relatively isolated and unusual. It is further our collective experience that although most taxpayers make an honest attempt to cooperate with Service employees in determining their tax obligations, over the last thirty years we also have seen increasingly aggressive behavior by some taxpayers in dealing with Service employees, including a limited but significant number of instances in which certain taxpayers intentionally harassed or attempted to intimidate Service employees. IRS examination, collection and enforcement activities are inherently adversarial in nature; and, in such context, we submit that it may be difficult to delineate adversarial conduct from arbitrary, capricious and malicious behavior.

We believe that the proposal is unwise. We believe that it is likely to cause Service employees to be less willing to deal effectively with uncooperative, aggressive taxpayers because of the employees' concern about potential harassment and possible personal liability in such event. We further believe that such concerns will adversely impact upon the Service's ability to recruit and retain compliance personnel. As you know, similar concerns traditionally have resulted in the grant of general immunity to Federal employees acting in their official capacities.

It is, therefore, our judgment that in balancing the authority needed by Service employees with the rights of individual taxpayers, this proposal is inappropriate and should be rejected, and we urge you to do so.

2. Political Appointment of Ombudsman. Presently, there is a Taxpayer Ombudsman on the staff of the Commissioner of Internal Revenue who is appointed by the Commissioner and who oversees the Service's Problem Resolution Program ("PRP"). Section 5001 of H.R. 11 would replace the Ombudsman with a "Taxpayer Advocate" who would be appointed by the President and confirmed by the Senate and who would supervise all of the PRP personnel.

As you may know, the idea of an Ombudsman was developed by Commissioners Alexander and Kurtz. Most of the undersigned, therefore, have worked directly with the Ombudsman and PRP and all of us enthusiastically support the goals and activities of the Ombudsman and PRP. Each of us believes that the pending proposal is likely to substantially and adversely affect the goals and activities of the Ombudsman and PRP programs, and we therefore oppose the proposal.

Our collective experience indicates that the role and importance of the Ombudsman and PRP programs are increasing. We believe that among the keys to the continued effectiveness of these programs is the need to institutionalize the attitudes and objectives of the Ombudsman and PRP throughout the policies, procedures and personnel of all of the Service functions. Presently, the long-term goal of the Ombudsman and the PRP employees is to so institutionalize their attitudes and objectives across the Service that all of the Service employees will share such attitudes and objectives.

In our opinion, the proposal in H.R. 11 would do just the opposite. By creating a new office headed by an independent Presidential Appointee and given a function independent of the organization, the proposal separates PRP. In any large organization, once a program is separate, it is almost impossible to institutionalize the attitudes and objectives of the program. If the present proposal is enacted to statutorily mandate the Presidential appointment of a Taxpayer Advocate to whom the PRP program will be responsible, we believe that the detriments resulting from such change will more than offset any intended benefits.

We are particularly concerned that such change may politicize the Ombudsman and thereby render the Ombudsman less effective in leading and managing PRP. As you may know, the Ombudsman presently is involved personally on a daily basis in numerous audit, collection and other enforcement activities affecting specific taxpayers. Often, taxpayers or their representatives request the involvement of the Ombudsman. History has taught all of us, and particularly those who are signatories, of the dangers inherent in the involvement of political appointees in such activities on a day-to-day basis at the request of taxpayers. We oppose and urge you to reject this proposal.

3. Retroactivity of Treasury Regulations. Presently, Treasury and IRS officials have discretion about the extent to which regulations can be promulgated retroactively. Under Section 5803 of H.R. 11, proposed and temporary regulations could not be applied retroactively to periods preceding the date of publication unless Congress so provided or unless necessary to "prevent abuse of the statute to which the regulation relates" or "correct a procedural defect in the issuance of any prior regulation".

All of us as former Commissioners, and certainly as practitioners, support the notion that regulations should be issued promptly after legislation is enacted in order to provide affected parties with appropriate guidance and also to avoid the problems which retroactivity creates. However, because of the volume and complexity of tax legislation so frequently passed by Congress over the last thirty years, in our experience it has been increasingly difficult (maybe impossible) for the Treasury Department and the Service to issue regulations as promptly as desirable and needed. Further, it is our collective experience that, under our government of checks and balances, it is often easier for taxpayers and their representatives to block or defer the issuance of regulations than it is for the Service to issue them timely, particularly those regulations that are perceived to affect the interests of taxpayers adversely.

Each of us has had to deal with the delicate and difficult decision as to whether and to what extent a regulation should be retroactive or prospective. Each of us has had to deal with a variety of different situations in which retroactivity, rather than prospectivity, was called for or required. We do not believe that the exceptions in the proposal to permit retroactivity are sufficient to cover the myriad of situations and conditions in which the issue arises. Indeed, in light of these circumstances, we seriously doubt the wisdom of attempting to prescribe in advance when regulations should be promulgated retroactively or prospectively. We believe that flexibility to respond to the exigencies of the particular situation is critically important, and that that is fundamentally what is involved in the present provisions of Section 7805(b) of the Code.

In balancing the needs of the Service with the rights of the taxpayers, we believe that the present flexibility should be continued. Courts have fashioned numerous remedies to permit taxpayers to overturn or circumvent regulations in appropriate circumstances. Over the last thirty years the courts consistently have demonstrated a willingness to uphold taxpayers' actions despite contrary provisions of the regulations when the court determines that the taxpayer has substantially complied with his or her tax obligations or that the Service has abused its discretion in formulating or administering its regulations. See, e.g., Fred J. Sperapani, 42 T.C. 308, 333 (1964); Columbia Iron & Metal Company, 61 T.C. 5, 10 (1973); Jaquelin E. Taylor, 67 T.C. 1071, 1079 (1977); Chester Matheson, 74 T.C. 836, 841 (1980); Young v. Commissioner, 783 F.2d 1201, 1205 (5th Cir. 1986); Woodbury v. Commissioner, 900 F.2d 1457, 1460 (10th Cir. 1990); White Rubber Corporation v. United States, 781 F. Supp. 507, 511 (N.D. Ohio 1991).

For the reasons noted, we oppose the proposal and encourage you to reject it.

If you or your staffs would like to confer with us as a group or individually, we would be pleased to assist you.

Mortimer M. Caplin, Former Commissioner 1961-1964

Sheldon S. Cohen, Former Commissioner 1965-1969

Randolph W. Thrower, Former Commissioner 1969-1971

Johnnie M. Walters, Former Commissioner 1971-1973

Donald C. Alexander, Former Commissioner 1973-1977

Jerome Kurtz, Former Commissioner 1977-1980

Roscoe L. Egger, Jr., Former Commissioner 1981-1986

Lawrence B. Gibbs, Former Commissioner 1986-1989

cc: The Honorable Bob Packwood
Ranking Minority Member
Senate Finance Committee
259 Russell Senate Office Building
Washington, DC 20510

The Honorable Bill Archer
Ranking Minority Member
Committee on Ways and Means
1236 Longworth House Office Building
Washington, DC 20515

The Honorable Shirley Peterson
Commissioner of Internal Revenue
Internal Revenue Service
1111 Constitution Avenue, NW, Room 3000
Washington, DC 20224

The Honorable Fred T. Goldberg, Jr.
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 3120
Washington, DC 20220

The Honorable Abraham N. M. Shashy
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW, Room 3026
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Harry L. Gutman, Esquire
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

J. J. PICKLE
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Austin, Texas 78703

April 12, 1995

The Honorable Nancy L. Johnson
Chairwoman, Subcommittee on Oversight
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Madam Chairwoman:

Thank you for your invitation to appear as a witness at the Oversight Subcommittee's hearing on March 24, 1995, on "Taxpayer Bill of Rights 2" (TBR2). While I was unable to attend, I am pleased to provide you with my statement and observations for inclusion in the Subcommittee's printed hearing record. First, I want to commend you for holding a hearing on TBR2 as one of the first hearings conducted under your stewardship. By placing this issue at the top of your list, I believe you have sent a strong signal to the Internal Revenue Service (IRS) and the American taxpayer that the need for TBR2 has not diminished.

When I assumed the Chairmanship of the Subcommittee on Oversight in 1985, the IRS was not required to provide every taxpayer it questioned or examined with a comprehensive statement explaining taxpayer rights nor was the agency prohibited from evaluating its collection agents based upon their collection results. Taxpayers did not have a statutory right to pursue installment agreements with the IRS nor did they have a legal right to seek the abatement of interest in cases where the IRS had erred or caused delay. Taxpayers were powerless to seek redress for reckless IRS collection activities and were denied reimbursement for attorney fees even when they prevailed over the IRS. These and other rights, which were established in 1988 as part of the original Taxpayer Bill of Rights (TBR), make so much sense that today we tend to take them for granted.

When we enacted the original TBR legislation in 1988, we took a significant step forward in protecting the rights of individual taxpayers. We knew then that this was not a cure all for all taxpayer problems and our efforts to protect the legitimate interests of taxpayers were by no means over. Subsequent to the enactment of TBR, additional problems surfaced and the need for additional legislation became apparent. As you know, many of the provisions contained in pending legislation (H.R. 661 and S. 258, introduced by Representative Thornton and Senator Pryor, respectively), were actually developed by the Oversight Subcommittee over the past few years. In fact, much of the current legislation was actually passed by Congress on two separate occasions in 1992, only to be vetoed by the President for reasons unrelated to TBR2.

The IRS touches the lives of more people than any other government agency and, therefore, it is extremely important that Congress remain vigilant in ensuring that the enormous powers of the IRS are used properly and fairly. Some would say that Congress should not attempt to micro manage the IRS or seek legislative remedies to the administrative problems taxpayers encounter in their dealings with the IRS. In my judgment, the original TBR was probably the most important new tax law in recent history and helped restore confidence in our voluntary tax system by providing real and substantive relief for the average taxpayer. Looking back, I sincerely doubt whether IRS on its own would have taken the actions necessary to effectively address the serious problems identified by Congress. In my judgment, it is not only entirely appropriate, but essential for Congress to regularly oversee the operations and practices of the IRS and to establish safeguards, statutorily if necessary, where it is deemed appropriate.

Taxpayers deserve to be treated fairly, professionally, promptly, and courteously by the IRS. I think that IRS employees try to be understanding and helpful most of the time. But occasionally, they can seem awfully heavy-handed and hard-hearted. Although the job of collecting the nation's taxes is difficult, there is absolutely no reason to mistreat or abuse an individual taxpayer. This is especially true in the case of a taxpayer who is trying to comply with our complicated set of tax laws and who, for one reason or another, gets needlessly caught up in a never ending dispute with the IRS. It is to protect these honest, hard working, everyday American taxpayers that every effort should be made to enact TBR2.

As a general proposition, H.R. 661 and S. 258 are both very good bills and I enthusiastically support them. The bills, as well as the legislation I developed in the 103rd Congress, contain well-reasoned and responsible pro-taxpayer provisions which should be included in any Oversight Subcommittee package or legislation you develop this year. These bills will:

- Improve installment agreements by requiring prior notice of their cancellation, allowing for administrative appeals, and suspending certain penalties while they are in effect.

- Expand the authority of the IRS to abate interest payments and give taxpayers additional time after receiving a notice and demand to pay the tax without further interest.

- Provide protection to spouses filing joint returns and require IRS to take all reasonable steps to notify both spouses of any deficiencies on the return.

- Improve the procedures concerning liens, levies and offers-in-compromise.

- Require IRS to verify the accuracy of information returns, the inclusion of the payor's telephone number on such returns, and give the taxpayer a civil cause of action if an information return is fraudulently filed.

- Provide additional notice and protection for taxpayers who are determined to be "responsible officers" in Federal tax deposit situations.

I recognize there is more than one way to build a mouse trap and that some modifications to these provisions may be necessary and desirable. I also believe there are probably a few additional measures that ought to be included TBR2 and would encourage their consideration. As an example, I would encourage you to give serious consideration to including a provision requiring comprehensive crediting procedures for the netting of overpayments and underpayments for the calculation of interest. On three separate occasions, Congress instructed the IRS to implement comprehensive netting rules so that taxpayers would not be unfairly subjected to excessive interest charges during periods when there was a mutuality of indebtedness between the taxpayer and the Government. The IRS' continued failure to issue procedures, coupled with the inconsistent manner in which IRS is currently administering the interest provisions, has resulted in disparate treatment among similarly situated taxpayers. I would caution, however, against listening to the naysayers who argue that a particular provision in TBR2 is unnecessary, unworkable, or unadministrable. In my experience, I seldom found this to be true. It always seemed to be more of a reflection of an agency's desire to conduct business as usual.

Let me provide you with some of the circumstances which gave rise to the provisions under consideration today and why I think we need TBR2. Imagine if you will, a twenty-one old secretary-bookkeeper, working at her first job for a small business. Her duties

include making routine reports to the company president on the company's bank balances. In addition, she is authorized to sign checks, as a convenience to the president, who is frequently out of town on business. She never signs any checks without previous permission, and has no involvement with the company's financial and tax decisions. She is not a CPA, and is not trained or expected to know all the facts about the company's tax obligations. This secretary certainly does not know that this company has not timely deposited its payroll taxes for the past six months. More importantly, she does not know, and has never been told that she can be held personally liable for those taxes. Even if her boss says she was not responsible, she can be held personally liable by the IRS. This is not right, and the provisions contained in TBR2 would correct this problem.

Imagine that a taxpayer receives a letter from the IRS questioning a deduction on his tax return, asking for further substantiation, and telling him that, based on the information he supplied, the IRS will make a final decision. He promptly responds by certified letter, and he hears nothing more from IRS. A couple of years pass, and, out of the blue, the IRS writes the taxpayer, disallowing his deduction, and assessing tax, penalties, and interest. In checking into the matter further, he learns that the two year delay was the result of the IRS "losing" his file, because the person working the case was transferred, and the case was not promptly reassigned. In fact, the IRS even admits its mistake, does not try to defend the situation, and perhaps even apologizes for the delay. No matter, the IRS cannot abate the interest due to its own mistakes. The taxpayer is expected to pay the cost of the IRS delays, which he did not cause, did not want, and could not have prevented. This is not right, and the interest abatement provision in TBR2 corrects this problem.

Imagine a small business owner who recently settled a dispute with the IRS concerning the appropriate tax treatment of contributions she made to her company's employee pension plan. As part of this settlement, she is now paying her tax in full, with interest, in installments over the next six months. Unfortunately, the IRS agent handling the case accidentally files a lien against the company's assets, and has this lien publicly recorded. The company's credit is now destroyed, her commercial loan agreements are now subject to immediate repayment, and her ability to remain in business is in grave jeopardy. The IRS admits it made a mistake, and that the lien never should have been recorded. Too bad, the IRS cannot withdraw the lien until she pays the company's tax liability in full. This is not right, and the lien provisions contained in TBR2 correct this problem.

Imagine a divorced taxpayer who filed separate tax returns for the past several years. However, the IRS has audited the joint returns she filed with her husband when they were married. The IRS never notified her of the examination and has sent a notice of deficiency to her former husband. The IRS has never even attempted to call or write her until she receives a letter telling her that her bank account has been levied and a lien placed on her house. She is further told that her time for administrative appeal has passed, and that she has no choice but to pay the tax, penalty, and interest in full, and then sue the IRS in Federal district court for a refund. This is not right, and the provisions contained in TBR2 correct this problem.

Imagine a taxpayer who receives a letter from the IRS asking why he did not report $30,000 in additional income he supposedly received when he filed his income tax return two years earlier. Unfortunately, he has never heard of the company that supposedly paid him the money, nor does he have any record of ever receiving any money. He has no way of contacting the company, and the "information return" the company filed does not even provide a telephone number of where they can be reached. So the taxpayer calls the IRS to explain the situation and is told that the IRS is entitled to the presumption that this third party return is correct, and that he is responsible for reconciling the discrepancy. Even worse, if he can not straighten the mess out then he must pay the tax, penalty and interest. And even if the taxpayer discovers that the whole dispute was the result of a malicious act

by someone intent on harassing him, he can not sue for damages because there is no Federal cause of action available under existing law. This is not right, and the information return provisions contained in TBR2 correct this problem.

I could go on all day about the problems that taxpayers experience all too frequently in their dealings with the IRS. TBR2 effectively addresses many of them and would provide the American taxpayer with long overdue relief. TPR2 is a responsible package of reform measure and enjoys wide-spread support throughout the tax community.

In closing, I would like to discuss one area that may be the subject of some discussion in the months ahead. Included in TBR2 is a provision which would establish a new position of Taxpayer Advocate within the IRS. The Taxpayer Advocate would have the responsibility to supervise and direct the activities of all problem resolution officers and would have broader authority to act on behalf of individual taxpayers. The Taxpayer Advocate would be required to submit reports to the Congressional tax writing committees identifying significant problems that taxpayers face in dealing with the IRS and the Advocate's recommendations for improvement. Many have commented on whether the Taxpayer Advocate should be nominated by the President and confirmed by the Senate, in essence a political appointee.

While Congress cannot appropriate common sense or pass legislation to fix every injustice that takes place at the hands of the IRS, Congress can certainly see to it that the interests of taxpayers are fully protected by someone who has the stature, independence and authority within IRS to take appropriate action and seek improvements when necessary. I believe the only way to accomplish this is to have an independent Taxpayer Advocate who is required to report regularly to Congress, so that those who are truly held accountable for the actions of the IRS, might know exactly what is going on. The Taxpayer Advocate must be required to make reports directly to the Congress so that his or her voice on behalf of the everyday working American taxpayer will never be swallowed up in the halls of the IRS and Treasury bureaucracies, as is the case today. I believe the provision establishing a truly independent Taxpayer Advocate is the crown jewel of TBR2 and, in my judgment, it would be a terrible mistake to eliminate an independent selection process which ensures accountability to the American taxpayer. Claims that adding an additional political appointee would increase the potential for political abuse are simply unfounded and absurd.

I appreciate the opportunity to offer my thoughts and I wish you the best of luck in the months ahead as you champion the cause of TBR2. Please feel free to call upon me if I can be of any assistance.

With best regards, I am

Sincerely yours,

J. J. Pickle

cc: The Honorable Bob Matsui
The Honorable Sam Gibbons
The Honorable Bob Packwood
The Honorable David Pryor

HAROLD C. TINT
30 East 65th Street
New York, New York 10021

1 April 1995

Mr. Philip D. Moseley
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Moseley:

I write this letter in support of Congresswoman Nancy L. Johnson, Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, in her efforts to strengthen the protection of taxpayers through the proposed Taxpayer Bill of Rights II.

My recent experiences by members of the Internal Revenue Serices's legal department right up to the Chief Counsel's office in Washington, D.C. clearly demonstrates the need for change regarding the protection of honest taxpayers in legitimate disputes with the Service. The acts of apparent violations of my rights as an American citizen were systematic and most frightening and were carried out by the District Counsel who handled my case, the Regional Counsel of the North Atlantic Region and by an Assistant Chief Counsel in his refusal to accept any of my charges.

What makes my case so unusual is the fact that after all court hearings had been concluded, the District Counsel John M. Elias, Esq. gave a sworn deposition testimony which supported all of the claims I had made regarding the violation of my rights. In that testimony the District Counsel not only admitted stating a known false statement of great significance to the Tax Court but also that he had withheld an essential document in his files and in direct violation of the Tax Court's order to provide my attorney with all documents in his possession in pre-trial discovery.

In his deposition testimony, the District Counsel also detailed certain outrageous acts by his superior Regional Counsel Agatha L. Vorsanger, Esq. of the North Atlantic Region of the Internal Revenue Service. As recently as February 3, 1995, Daniel J. Wiles, Esq., Assistant Chief Counsel of the Internal Revenue Service stated in a letter to United States Senator Daniel P. Moynihan that "my complaints are unfounded."

I wish to suggest most respectfully that a change to require the government to be the plaintiff in actions against a taxpayer is necessary to prevent the type of abuse I encountered. Because I was required to be the petitioner after receiving a notice of a disallowance issued by the government without any known basis, I faced a government attorney who conducted all the required pre-trial conferences without knowing the facts and merits of the transaction that had been disallowed. Such a fundamental violation could not have occurred had the government been forced into the role of the plaintiff as is customary in the American judicial system.

Before outlining the specifics of my case, I wish to call to your attention the professionalism and integrity of staff members of the Internal Revenue Service. The people I wish to cite are a credit to the high ideals one should encounter from government agents: Revenue Officers Stephen A. Sica and Delma Marchand; Appeals Officer John L. Dotoratos; Supervisor Gilbert Moran; and Collection Officer Elizabeth Kishlansky. All of the named are members of the Manhattan District Office. I also wish to note the integrity of Revenue Officer Robert Aramayo who stated to me early on in my case:

> "Mr. Tint, I know you are a businessman and may have something to hide. If you do, you better pay up as they are going after you. They are bullying you like they do to a lot of people. If you have nothing to hide, I wish you would stand up for your rights. You will be doing a service for many people."

Having "nothing to hide", I accepted the challenge.

In 1978 I invested in two computer leasing transactions that were tax deferrals, not shelters, and received a Notice of Deficiency disallowing both transactions in April, 1983. One was accompanied by an agent's report as required; on the other the Service simply disallowed it based on its appearance on the Schedule E portion of my income tax return. The Service knew so little about this transaction that the amount was overstated for 1979 alone by over $ 50,000. It is this second transaction and the manner in which it was handled that is the subject of this letter. To compound this situation is the fact that my partner had been examined on his identical participation in this transaction and had been cleared after examination.

The IRS sent a formal notice with the disallowance "Rights of a Taxpayer" which provides for settlement discussions within the Service. At two meetings under this provision, my attorney and I were advised that the Service had no information and could not hold such a conference as stated in its Publication 5. As a law-abiding citizen, I then instructed my attorney to provide any and all the information I had. The letters of request - which I have - came over a period of almost ten months. However I received a letter from the Service to

the effect that the time for IRS settlement had passed and that the case was being forwarded to the legal department. No conference had occurred as provided in the "Rights Publication."

Many months later, my attorney and I met with the District Counsel John M. Elias, Esq. who had been assigned to my case. This was to be the informal settlement conference as is customary in such matters; but the District Counsel did not know anything about this transaction. I did tell him that my partner had been examined and cleared. The District Counsel explained that what was in another taxpayer's name could not be used by me. What he did not reveal at the time was the essential fact that he had an IRS Engineering Report in my name in his file and that report could have been used to clear me in the same way as my partner had been cleared.

The failure to disclose this information by deliberate withholding presents a clear violation of the law and my rights. It was only the beginning for me. But what makes this case so unusual is the fact that after all the unfavorable court decisions, the District Counsel somehow felt compelled to speak the truth about the systematic abuse of my rights by the IRS including himself and revealed all this in a sworn deposition. As will be shown, this act of integrity appears to have infuriated senior members of the Service's legal department.

After this futile conference I asked the help of my United States Senator Daniel P. Moynihan not to get a favorable decision but to have one conference where I could settle based on the facts and issues and not just receive a "take-it-or-leave-it" offer - i.e. pay up or go to court. The Senator's office then sent a letter based on my request to the IRS office here in New York.

In deposition testimony, the District Counsel testified that Regional Counsel Agatha L. Vorsanger, Esq. treated this letter from a United States Senator "in jest" and pretended "to give me a ribbing because of the accusations that were raised in the letter." There were two other letters written by the Senator's office over his signature with all answered by Regional Counsel Agatha L. Vorsanger, Esq. In the three lettrs of Regional Counsel Vorsanger, Esq., she appears to have directly lied six times to the Senator in stating "the merits of Mr. Tint's case had been discussed." The basis for my accusation also lies in the District Counsel's sworn deposition testimony that he was not prepared to discuss the facts at any meeting.

The most important protection for taxpayers against any arbitrary abuse of power lies in Tax Court Rule 70 (a)(1) which mandates that "both sides must conduct a pre-trial conference with an exchange of necessary facts, documents and other data between the parties as an aid to the more expeditious trial of cases as well as for settlement purposes." In deposition testimony, the District Counsel stated "He was not prepared to proceed further" at our

Rule 70(a)(1) Conference held on February 12, 1986.

About that time I was able to hold a conference with Jerome Kurtz, Esq. - former IRS Commissioner - who told me that I should report to the Tax Court that I had not had a proper Rule 70 (a)(1) Conference. I followed his good advice and told this to the Tax Court at trial. The District Counsel in reply gave the Court an entirely fictitious account of what had actually transpired at that Conference. The Tax Court accepted his false version.

I have been subsequently advised by counsel that a false statement, knowingly made, designed to mislead the Court constitutes perjury. I would never want to bring such an action against the District Counsel in response to his open and honest confession as I believe his integrity - although belated - is of the highest order. But it is seemingly impossible for me to understand how the Chief Counsel's office can dismiss my charges "as unfounded" as Assistant Chief Counsel Daniel J. Wiles, Esq. has noted in the enclosed letter of February 3, 1995 to Senator Daniel P. Moynihan.

On February 26, 1986, the District Counsel finally made and sent an analysis of the transaction. Upon receipt, my attorney called the Regional Counsel and asked for one settlement meeting based on that letter. Regional Counsel Agatha L. Vorsanger, Esq. * denied his request and then directly threatened him because I, his client, had written to Senator Moynihan. This was testified to in Court and was unchallenged by the government attorney and so stands. My attorney was a staff member of a New York accounting firm whose partners were fearful of the wrath of the Regional Counsel. The attorney resigned. This was six weeks before the scheduled court trial. The Tax Court ruled that the substitute attorney chosen in great haste was unprepared and I lost my case "For Failure To Prosecute."

The Regional Counsel in another matter abused me personally. The Chief Counsel's office had become interested in my case with its failure by the Service to afford a bonafide settlement conference. After much encouragement, the representative wrote a letter cancelling any further contact. In sworn deposition testimony the District Counsel testified that Regional Counsel Agatha L. Vorsanger, Esq. sent notice to the Chief Counsel's office that I had threatened the District Counsel at a conference. Such a threat constitutes a felony. I knew nothing about this at the time as there was no threat and if something as serious as that had indeed occurred, I believe the Regional Counsel had an obligation under the law to so advise me and not send such information to the Chief Counsel's office behind my back. This was all disclosed by the District Counsel in his sworn deposition testimony.

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* Regional Counsel Vorsanger stated "Counsellor, I am considering disciplinary proceedings against you for your client writing to Senator Moynihan."

The withholding of crucial evidence in pre-trial discovery ordered directly by the Court and throughout the entire case is the final and, perhaps, the most serious charge. Rather than try to condense it in this letter, I have supplied two booklets which cover this serious matter in detail and with proof. The District Counsel who had handled my case was no longer with the Service when this matter was discovered. I filed a fraud charge and represented myself before the Second Circuit Court of Appeals. An attorney for the Department of Justice said there was no fraud as the Engineering Report while in my name was in files not in the possession of the District Counsel and that he had no knowledge of this report. This information appears to have come from a staff attorney of Regional Counsel Agatha L. Vorsanger, Esq.

My appeal was dismissed. A year later in deposition testimony, the original District Counsel testified that he had "the other file", did not know about this court action, and that he had not been asked about it by Regional Counsel Agatha L. Vorsanger's staff counsel Michael J. Wilder, Esq.

There is ample proof to support all of the stated charges. Upon request, such proof can be supplied. In addition to the lengthy sworn deposition testimony of District Counsel John M. Elias, Esq., I have documents obtained under the Freedom of Information Act and correspondence with the Service directly.

As a result of Taxpayers Bill of Rights I, the Internal Revenue Service published PUBLICATION 1 - YOUR RIGHTS AS A TAXPAYER which sets forth the issue of the Service protecting "the rights" of taxpayers. But as long as top officials of the IRS legal structure - the Regional Counsel of the North Atlantic Region and an Assistant Chief Counsel - feel no constraints then it appears that Congress can do what it wants for the Rights of Taxpayers' without it affording real protection. However, I feel strongly that a change in legal procedure by making the government the plaintiff would go a long way toward reducing or even eliminating such type of absue. Had such a procedure been in effect, the District Counsel could not have conducted himself as exhibited in my case.

I further believe that if the government after issuing a Notice of Deficiency retains the burden of proof, then the excesses I have reported regarding the conduct of Regional Counsel Vorsanger probably would not have occurred.

Upon request, I am prepared to offer any additional information as requested.

[Attachments retained in Committee Files]

Very truly yours,

Harold C. Tint
(212) 570 1765

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

FEB - 3 1995

Honorable Daniel P. Moynihan
405 Lexington Avenue
41st Floor, Suite 4101
New York, NY 10174-4101

Attention: Deborah A. Famighette

Dear Senator Moynihan:

This is in response to your letter of December 20, 1994, regarding an inquiry from Mr. Harold C. Tint. As you are aware, your inquiry has been forwarded to this office by Eugene D. Alexander, District Director, Internal Revenue Service-Manhattan Office. Mr. Tint raises several concerns about the handling of his case in the United States Tax Court. At issue in that case were Mr. Tint's investments in two tax shelters. Mr. Tint has written to you and the Internal Revenue Service on several other occasions about this same matter.

Mr. Tint's inquiries to the Commissioner of the Internal Revenue and to you were fully considered by this office on these prior occasions, and it was determined that Mr. Tint's case was properly processed by the Service. The United States Tax Court and the Court of Appeals for the Second Circuit, on two occasions, considered Mr. Tint's case and his arguments about the Service's conduct; and on both occasions, the Court of Appeals upheld the Tax Court's dismissal of Mr. Tint's petition. As recently as September 12, 1994, this office again reviewed this matter at Mr. Tint's request and advised him that the Office of Chief Counsel had considered his inquiry and had determined that his claims were without merit.

While it is unfortunate that Mr. Tint believes his case was unfairly handled, the thorough review of his case by the Internal Revenue Service and the federal court system indicates that his complaints are unfounded. There are no further administrative remedies available to Mr. Tint through the Internal Revenue Service. We hope this information is responsive to your concerns.

Sincerely,

DANIEL J. WILES
Assistant Chief Counsel
(Field Service)

HAROLD CHARLES TINT

HOME ADDRESS: 30 E. 65th St., New York, N.Y. 10021 (212-570-1765).
OCCUPATION: President, Charal Investment Company Inc.
OFFICE ADDRESS: P.O. Box 1485, Brick, N.J., 08723 (212-570-1765).
DEGREE: A.B., 1944(45).
MARRIED: Eleanor Klugman, 1951 (divorced, 1964).
CHILDREN: Charles H. Tint, 1954 (Hamilton Coll. '76), *m.* Liz Schlesinger; Alexandra K., 1957 (Goucher Coll.'80).
GRANDCHILDREN: Two.
OFFICES HELD: President, Charal Investment Co., Inc. and Value Oil Company; director, Merit Oil Co.; director, 30 East 65th Street Corp.; director, Toreador Royalty Corp., Dallas, Texas.

In 1960 I opened a retail gasoline service station in Union, New Jersey. By 1982, I was fortunate enough to have built a chain of eighteen retail gasoline stations in northern New Jersey. In early 1983, I sold this operation to the Merit chain of retail gasoline stations and have been retired from active business since that time. Since 1983, I have been somewhat active as a director of three companies, as noted, and have become an investor in common stocks based on the proceeds of that sale.

I also spent some twenty-five years during that time as an active football recruiter for the Harvard Athletic Department. This experience was personally as rewarding as was my business career financially rewarding.

I also served three years—1943-1946—in the Army Air Force as a weather observer and code clerk.

From 1986 to 1990, I battled the Internal Revenue Service on the issue of the Service failing to grant its stated rights to an individual. I argued my case on a *pro se* basis before the prestigious U.S. Court of Appeals for the Second Circuit. I was not successful but did enjoy the vindication of my position as stated by an IRS attorney in a deposition taken in a related legal matter. The power of an entrenched bureaucracy is a most powerful force and, based on my expertise in this case, I have become a strong advocate against the death penalty. At one point, unknown to me at the time, I was falsely accused of having threatened a government attorney at a conference. This was no idle matter as a memorandum to this effect was circulated at the Chief Counsel's office in Washington, D.C.

LIST OF ENCLOSED EXHIBITS:

1. Three letters of Regional Counsel Vorsanger to United States Senator Daniel P. Moynihan stating six times that the "merits" and/or facts had been discussed at conferences when in fact the District Counsel testified he did not know the merits at his personal conferences and "there was no discussion".

2. Evidence that District Counsel withheld crucial IRS Engineering Report despite Court Ordered exchange of documents in pre-trial Tax Court discovery.

3. Evidence regarding the withholding of the crucial IRS Engineering Report; the "spy story" of its discovery; mis-leading information being given to the Dep't of Justice.

TESTIMONY OF THE HONORABLE JAMES A. TRAFICANT JR. OF THE 17TH DISTRICT OF OHIO BEFORE THE OVERSIGHT SUBCOMMITTEE OF THE HOUSE WAYS AND MEANS COMMITTEE

First of all, Madam Chairwoman, I would like to take this opportunity to thank you for permitting me to testify before the Committee. We, as Members of the 104th Congress, have the responsibility of re-establishing the trust the American people have lost in the Federal government. That relationship starts with the Internal Revenue Service. If Americans believe that the Internal Revenue Service and the tax code served them, and not the reverse, confidence in the federal government would most certainly rise.

I want to applaud the subcommittee for tackling the issue of taxpayers rights. It is an issue I have championed since coming to Congress in 1985. I like to talk about the taxpayer rights issue that is central to this whole debate.

Last year I introduced legislation to protect taxpayers from capricious behavior by the Internal Revenue Service. I have once again introduced the bill, H.R. 390 which would shift the burden of proof in all civil tax cases from the taxpayer to the IRS. Too often, the IRS is an agency out of control; too many Americans fear the IRS and that's wrong. So far this year, over 260 members of Congress have co-sponsored this bill.

Madam Chairwoman, my bill has three sections to protect Americans from IRS abuses. First, damages paid to the taxpayer are increased from $100,000 (current law) to $1,000,000. Second, the bill requires the Internal Revenue Service to notify the taxpayer promptly, in writing and upon request as to the specific implementing regulations the IRS claims they have violated. No more ambiguous computer generated letters using code numbers. No more unprepared confrontations with the IRS. These two seemingly innocuous sections of my bill are extremely vital, and will go a long way in rebuilding the American people's faith in our government.

The last part of my bill is the most important: it shifts the burden of proof from the taxpayer to the IRS in civil tax cases. Under current law, if the IRS accuses someone of tax fraud (which could be an honest mistake on the 1040 form), he or she must prove his or her innocence in civil court, the IRS does not have to prove your guilt. An accused mass murderer has more rights than a taxpayer fingered by the IRS. Jeffrey Dahmer was considered innocent until proven guilty. Mom and Pop small business owners, however, are not afforded this protection.

During the last session, I highlighted the need for this legislation on the House floor by reading letters and case histories sent be me by people across the country. You may remember the case of David and Millie Evans from Longmont, Colorado. The IRS refused to accept their cancelled check as evidence of payment even though the check bore the IRS stamp of endorsement. Or how about Alex Council, who took his own life so his wife could collect his life insurance to pay off their IRS bill? Months later, a judge found him innocent of any wrongdoing. I have heard hundreds of stories of IRS abuses like these on radio and television talk shows. Thousands of Americans have written to me personally with their horror stories.

Opponents argue that my bill will weaken IRS's ability to prosecute legitimate tax cheats. This bill will not effect IRS's ability to enforce tax law, it only forces them to prove allegations of fraud. My bill will ensure that IRS agents act in accordance with the Standards of Conduct required of all Department of Treasury employees and the Constitution of the United States of America. Innocent until proven guilty... that's what my bill is about.

Madam Chairwoman, I urge you to approve my bill. It should be your number one legislative goal for the 104th Congress. All I seek is fairness for the American people.

As I have stated earlier, I have championed this legislation for several years. The bill has enjoyed the strong support of both Republicans and Democrats. In fact, last year more than 120 Members signed a discharge petition to force the bill from the Ways and Means Committee to the House floor for a vote. Madam Chairwoman, a basic tenet of the American justice system is "innocent until proven guilty." H.R. 390 simply ensures that this sacred principle is extended to every corner of our justice system. All too many lives have been ruined unjustly and without cause by an IRS that is all too often out of control. Most average Americans don't have the financial resources to engage in a prolonged battle with the IRS. Most Americans, when accused by the IRS, simply pay the fine -- even though they know they did nothing wrong. Many of those who choose to fight either go broke or lose everything. My bill provides some modest safeguards to ensure that the IRS only brings a case when it has clear evidence that a taxpayer has engaged in fraudulent or illegal activity.

Any tax reform measure approved by the 104th Congress should include this provision.

Madam Chairwoman, again, I want to thank you for affording me this opportunity to testify before your august body. I hope to work with you on this and other tax measures in the weeks and months ahead.