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IRS RESTRUCTURING

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

H.R. 2676

JANUARY 28, 29; FEBRUARY 5, 11, AND 25, 1998

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IRS RESTRUCTURING

WEDNESDAY, JANUARY 28, 1998

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:07 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Grassley, D'Amato, Murkowski, Gramm, Lott, Moynihan, Baucus, Rockefeller, Breaux, Conrad, Graham, Bryan, and Kerrey.

The CHAIRMAN. The committee will please be in order. I would ask Secretary Rubin and Charles Rossotti to come forward, as they have done. It is a pleasure to welcome both of you gentlemen. We appreciate your being here.

I understand that the Leader has another meeting, so, with the indulgence of all the members, I would call upon him for any opening remarks he may have.

OPENING STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. Thank you very much, Mr. Chairman, colleagues. I look forward to working with you, Mr. Chairman, Mr. Moynihan, and all of the members this year. I think we have got a lot of very important things we can do.

I commend you for what we achieved last year in our tax cut bills and the progress that was made at the IRS oversight hearings that we all participated in. I thought that was a very illuminating and very important process to get to what we need to do in the IRS area.

Now, since you are giving me this opportunity, I will be brief. Mr. Secretary, it is always a pleasure to have you back here. But especially, Mr. Rossotti, I want to welcome you. In the back room we were joking a little bit about the task you have before you. We do wish you very well and we hope you have great success in the position you have.

You are undoubtedly a brave man for taking the job as IRS Commissioner. But I did have the pleasure to look at your resume and visit with you and I think that you are the right man for the job now.

I must be honest with you, you run an agency I do not like and wish did not exist, quite frankly. Some call IRS a necessary evil. I know I agree with the second part of that description, but I have not made up my mind if I agree with the first part.

Now, you are in the unenviable position of attempting to restructure an agency within an administration that sometimes does not seem to want to do all that needs to be done. We have a bill before us that came out of the House. Clearly, we think more needs to be done.

As I said last night, we just cannot have a government agency in America that people are afraid of, that they feel threatened by and intimidated. As the audits have shown, there have been quotas and there have been improper seizures. There are major problems over there.

But I look forward to studying your reorganization plan. I think you should have that opportunity. I hope you will lead. In the past, I think what we have had is a little lip service, while quietly the word is being sent down to the agents, just keep doing what you've been doing.

I am not going to say absolutely how much of that was going on. But you must make it clear that this culture of threats, intimidation, quotas, and unfair treatment of American taxpayers is going to end.

So we will look at your reorganization plan. We will have what I hope will be some helpful legislation for you to be able to do that. Until I have evaluated your proposal I will not deem it too little or say anything critical. I am going to be hoping for the very best.

But you are there at a critical time. You must be aggressive and work with us. If you need tools, tell us what it is. You do not work, really, for the President and you do not work for us, you work for the American people. This agency is in a mess and it is important that we restore the trust of the American people in at least being treated fairly. So we will look forward to seeing your plan.

Mr. Chairman, I would like to have my one-page statement put in the record at this point.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Lott appears in the appendix.]

Senator LOTT. Thank you all.

The CHAIRMAN. Thank you, Mr. Leader.

We will call on everybody to make an opening statement. We would ask everyone but Senator Moynihan and myself to be limited to three minutes, because we do have a full day this morning.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. Let me begin by welcoming my colleagues and members of this committee to the first in a series of hearings that I anticipate will have a profound effect on the life of every family and taxpayer in America.

Never before has Congress had the opportunity it now has to make necessary and lasting reform to the Internal Revenue Service. This, of course, is not the first time the issue of improving the agency that collects our tax revenue has come before Congress, and most likely it will not be the last, but never before has the agency been so ripe for reform.

Never has there been such agreement on the need for restructuring—agreement that runs not only throughout both houses of Congress—but includes the administration and the hierarchy of the IRS itself.

When conditions line up this way, I believe history is ready to be made. The potential for real reform that we have before us is certainly the result of efforts too numerous to mention. Both Houses of Congress have focused on this issue.

The work of the Restructuring Commission was invaluable to our effort, as are the ongoing investigation and oversight efforts of this committee, not to mention the determined leadership of the IRS's new Commissioner Charles Rossotti.

I appreciate the response and early efforts the agency made in the aftermath of our first series of oversight hearings last September. Commissioner Rossotti and I have met on several occasions, including attending a Taxpayer Service Day in Wilmington, Delaware. I find him sincere and very much resolved to press forward with reforms that will change the way the IRS does business.

Already the agency has increased the safeguards that must be taken before it can seize a taxpayer's property. It has admitted to using quotas, statistics, and standards of measurement that pit IRS employees against taxpayers in adversarial and potentially destructive confrontations. And it has made a concerted effort to strengthen taxpayer services. In fact, Commissioner Rossotti has undertaken an ambitious effort to bring balance to the agency's dual mission of service and enforcement. I appreciate his efforts and laud his leadership.

Now, these self-imposed reforms mark a noble beginning in our collective effort to bring real change to the agency, but they are just that, a beginning. The many shortcomings, abuses, and inefficiencies we are discovering within the IRS are not solely the fault of the agency itself. Congress and the administration must share in the blame.

Consequently, necessary change will not be made by internal efforts alone. We need legislative remedies, we need real enforcement, disciplined congressional oversight, and a long-term change in culture and attitudes.

If history has taught us anything about the IRS, it is that, despite past efforts to reform the agency, it has consistently succeeded in falling back into a pattern of mismanagement, abuse, and inefficiency.

There is a well-established history of accusations, congressional hearings, minor reforms, and then nothing! No further oversight, no followthrough, no real effort to get to the core of the problems that plagues the agency.

This—again, largely the fault of Congress—has led to cynicism in the taxpayer and a dismissive attitude within the agency that says, if we hold on long enough, this will pass and we can get back to our old way of doing things.

Well, this time around I am determined to change business as usual. As I have said, thanks to the efforts of many, we have the conditions necessary for real reform, for restructuring that will change the way the agency interacts with the taxpayer and the

way Americans feel about the IRS. In this effort, we must be thorough.

Reform must go beyond simply creating an oversight board to establishing one that is independent of political and internal influences, one that has the ability to be an independent check on the way the IRS does business.

Reform must go beyond making cosmetic changes that address personal concerns about abuse and ineffective management, to incorporate lasting change that gets at the very core of the agency's culture, constructively shaping it, and improving morale, efficiency, and service.

Reform must go beyond simply beefing up current internal inspections in our effort to root out abuses, lawless behavior, and derelict employees; to build an inspection system that is independent, able to operate openly, honestly, thoroughly, beyond the influence of management and other agency interferences.

Perhaps most importantly, reform must go beyond a few minor improvements of strengthening taxpayer protections to literally addressing the balance of power between the taxpayer and the agency.

This includes not only looking at changing burden of proof rules, but addressing how interest and penalties are assessed, How liens and seizures are used; how the agency imposes labels like "Illegal Tax Protesters" and "Potentially Dangerous Taxpayer," on Americans, and how those labels affect taxpayers, their futures, and their relationship with the agency. It also includes making certain that taxpayer cases are resolved expeditiously and conclusively.

A vital part of increasing taxpayer protection includes increasing accountability among IRS employees, bringing simplicity and consistency to the process that governs a taxpayer's interaction with the agency, and includes bringing sunshine to the IRS, stripping away the cloak of secrecy and mystery and the use of intimidating tactics, and making the Office of Taxpayer Advocate truly that, the taxpayers' advocate, completely independent of management influence and bureaucratic interferences.

Well, as you can see, what this committee, this Congress, has before it is a tall order. These areas I have listed, while they may appear to be a complete list, are only a sampling of what we need to look at in our restructuring efforts. In the interest of time, I will let them stand as an overview, a beginning.

Our hearings today, tomorrow, and the weeks ahead will serve to fill in the gaps. We will hear from experts, both inside and outside of the agency. I am particularly looking forward to the insights that Secretary Rubin and Commissioner Rossotti will share with us.

I remind my colleagues, as well as the media and all those who might be watching and listening, that while the current may serve our efforts today, we will only succeed through a sincere effort between Congress and the administration.

Our success will only be as strong and lasting as our mutual resolve to make real reforms and build into the system a mechanism that provides constant oversight. The IRS must have the power and the authority necessary to collect tax revenue, but that power

and authority must be used responsibly and under the direction of an ever-vigilant Congress.

Senator Moynihan.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Thank you, Mr. Chairman. You are very generous to welcome us back to our first hearing of the second session.

I know I have asked a number of colleagues how they passed the interval since we last recessed, and most said they spent most of their time watching advertisements on television for the new Roth IRA.

The CHAIRMAN. Chuck says they call it the Roth IRA.

Senator MOYNIHAN. We welcome Secretary Rubin, of course. We would hope that he might want to refer in his remarks to the extraordinary proposals and outline he made in his lecture at Georgetown recently on the financial situation in Asia and the prospects for international regulation of financial matters beyond the Breton Woods proposals, which are a half century old now, which of course is the task before Mr. Rossotti, who honors us with his presence.

Mr. Chairman, you said never before has there been such an opportunity to address the problems, the procedures of the Internal Revenue Service. I think you would perhaps agree that never before have we seen the advances in what could legitimately be called management science. It has quite transformed large American organizations in the last 20 years or so, with a theoretical basis. I mean, it is not just trying to see what works, but to figure out what ought to, and testing it.

I have had the privilege of seeing Mr. Rossotti's testimony. It seems to me he has brought that management science from the private sector where he flourished so to this assignment. He is dealing, after all, with an organization established in 1862.

This is a 19th century organization and it has all the regular features—stigmata, if you like—of the idea of a civil service organization of that time. Every century and a half you can take a new look at an organization, and you certainly have done, as did Senator Kerrey and Senator Grassley in their earlier efforts, which follow on from here.

I hope you will have a chance just to mention the year 2000 problem in your computers. The General Accounting Office has said that the potential here is catastrophic, far beyond any organizational changes in the near term. If we do not handle that, none of us will be back here, frankly, among other things because they will have turned the lights off.

What you are dealing with in the IRS, many of these same patterns will be found in the Social Security Administration, the only other comparably sized and functioning organization of our time. It is an early 20th century organization, but it still shows the patterns of an earlier age in organizations.

So I look forward to the hearing. I know that the Chairman will not mind if I express special gratification to see that Donald Lubick will be here before us for confirmation as Assistant Secretary of the

Treasury, a job he has been doing for a year and a half and did so well three administrations ago.

It says here he is from Maryland. If he wants to correct that before he gets up here, he has my vote, because, in fact, he is from Buffalo. But we will leave that to another matter.

Mr. Chairman, thank you for welcoming us back.

The CHAIRMAN. Thank you, Senator Moynihan.

Senator Kerrey.

OPENING STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Thank you very much, Mr. Chairman.

First of all, I want to thank Secretary Rubin. It is a pleasure, at this stage in the game, to be on the same side with you on this issue.

I must note for the record that, during Congressman Portman and my deliberation, and Senator Grassley and I's deliberation, that the Treasury Department, though we had disagreements on a couple of issues, responded to me changes for the IRS, and the most notable change, of course, made me say to Mr. Rossotti yesterday when we were having a conversation, that it was a good day's work just to see that you've broken with tradition and brought a manager on as a head of the IRS.

I must note what Senator Moynihan just said about management practices. There is no question that this has become a science, that this has become a new area of study. One of the areas of great controversy in our deliberation, I see you informed me yesterday that you were going to include, and showed me in your testimony, the need to reorganize the IRS along functions rather than the stovepipe organization that we had before.

Both Congressman Portman and I looked at that and liked it. We were unable, because of the time of our commission, to get our arms around it, but we did include it as a part of our recommendations.

I note that because I think it is terribly important, although I believe the law needs to be changed. I believe you need more authority. I believe we need incentives to go to electronic filing.

There needs to be more oversight and accountability. There are lots of things that need to be changed. None of it works unless you get the right person in there to manage it with the expertise, with the talent, with the understanding of how to manage an agency.

You told me yesterday that you had met a couple of times with the Treasury Employees Union. You know that if you propose any structural change, even if we give you the authority in statute, that it is going to be difficult and you have to get the employees' representatives on board to get that done.

One of the complaints that we heard in our field hearings, Mr. Chairman, was that the previous reorganization effort was actually pulling people out of the field, moving them back into central locations.

Your effort will reverse that. Your effort, as a consequence of organizing by function, will actually put more people out and give customers better service than they had before. It will not be politically easy; in some cases it is not without some controversy.

But I must note at the outset, Secretary Rubin, although our disputes and disagreements became quite public, it was not quite as public that you made an awful lot of changes, and the most significant was bringing Mr. Rossotti on board.

I hope, Mr. Rossotti, we can change the laws as quickly as possible. I appreciate and applaud the leadership that the Chairman of this committee has given us in this area. I know he has got some excellent ideas of how to make this legislation better and intends to get that done. I appreciate very much Senator Lott making it a high priority.

I hope that we can, 10 years from now, say that both with your leadership and the change in the law that we make this year, that the people of the United States of America look at the tax collection agency and say that it is a better and more friendly operation.

The CHAIRMAN. Thank you, Senator Kerrey.

Senator Gramm.

OPENING STATEMENT OF HON. PHIL GRAMM, A U.S. SENATOR FROM TEXAS

Senator GRAMM. Thank you for holding this hearing. I want to thank our witnesses for being here. I was somewhat taken aback last night to hear the President chiding the Senate for not passing legislation reforming the IRS, and urging us to pass the House bill.

I am not so feeble-minded as to not remember that the President originally opposed the House bill. I would simply like to say, Mr. Chairman, that we are here because we do not think the House did enough. I do not believe our problem is a management problem and I do not believe it is a problem of insensitivity. It is a problem because power corrupts.

We need fundamental changes. I want to shift the burden of proof so that every taxpayer, in dealing with the IRS, has the same presumption of innocence that every criminal has in every courthouse in America.

I want to try to find a way to separate powers. I think it is fundamentally wrong to have one agency that is the prosecutor, the judge, and the jury, that has the power unilaterally to take somebody's home or take somebody's business.

I do not quite know how to do it, but I am hopeful that in these hearings we will find a way of guaranteeing that, before somebody's home or somebody's business can be taken by the IRS, that they get their day in court to make their case, where they are heard, and where an independent judgment is rendered.

I also believe that if the IRS audits somebody, if the taxpayer spends thousands of dollars on attorneys and CPAs to defend themselves, if at the end of the day they have been found to have done nothing wrong, I believe that the Internal Revenue Service ought to be responsible for reimbursing them for those costs.

Finally, I believe that it would be helpful, Mr. Chairman, if we could come up with a system that guaranteed the rotation of senior executives from the private sector into the IRS so that not everybody in the senior management positions have been in the service for 20 or 25 years. We might set up a system where a third of the senior management would rotate in from the private sector, serve

for a period of time, maybe 4 or 5 years, and then rotate back in to the private sector.

So I believe fundamental reforms are needed. I believe we will pass a very strong bill. I do not know whether in the end the President will like it, but I believe he will sign it.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Grassley.

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

Senator GRASSLEY. I am glad we are here on this issue, finally, because restructuring the Internal Revenue Service is badly needed. It has already been mentioned by several my service on the Commission on Restructuring the IRS and working with Senator Kerrey on the introduction on the first piece of comprehensive legislation, which was the product of that year-long commission work.

I had hoped that we would pass this bill last fall, but this year certainly we must pass it and have it signed into law by April 15. In addition, we must pass solid, real reform. As the Chairman has noted publicly, we get one chance at this legislation so we had better do it right.

There are real problems dealing with the IRS and there are real problems at the IRS. In this committee's hearings last fall, we heard horror stories about our government's treatment of taxpayers. Every time I go home I hear constituents tell about these firsthand experiences, and rarely are these experiences good.

For this reason, it is not good enough just to try, we must try and we must succeed. I have a seven-point plan, and I doubt if very many people would disagree with whether it is seven, eight, or nine. But we need to get the job done.

Increase taxpayers' rights and assure fairness for the taxpayers. For starters, we must increase the independence of the taxpayers' advocate at both the local and national levels and make sure that the taxpayers can find these advocates.

We must also change the penalty system so that penalties are not accruing unfairly. We must seriously look at increasing innocent spouse protections and eliminating interest differentials between over-payment and under-payment.

Point Number 2. Focus on customer service rather than customer abuse. Any legislation we must pass must restructure the IRS so that it views the IRS as a customer and aims to give this customer the best and most helpful service possible. Thus, reorganize the IRS with the taxpayer in mind.

This means that there would be divisions to help small business with their concerns and problems, a separate one to help big business, and so on. This idea was considered by the Restructuring Commission and we came up with the idea that it needs serious exploration. Now I am glad to hear that Commissioner Rossotti has embraced the idea. This reorganization may be a good first step to reach our goal of focusing on customer service rather than customer abuse.

Third, provide for real, effective, constant oversight of the IRS, particularly making sure that we are very vigilant on this, to help the public and the press help us assist in this oversight.

Point Number 4. Make the IRS culture into that of a business rather than that of a government bureaucracy.

Point Number 5. The IRS must meet the same expectations that it expects from the taxpayers.

Point Number 6. Restore public confidence in the IRS.

Point Number 7. Make the Tax Code more user friendly.

If we stick to these seven principles, then we will have real IRS reform. Real IRS reform is a way that we can help American taxpayers. The IRS has unfairly ruined people's lives and we in the Congress should be here to help improve their lives.

The CHAIRMAN. Senator Bryan.

OPENING STATEMENT OF HON. ROBERT H. BRYAN, A U.S. SENATOR FROM NEVADA

Senator BRYAN. Mr. Chairman, thank you. Let me congratulate you on your decision to begin our legislative agenda hearings with the IRS reform. In my view, there is nothing more important we can do for the American people than to enact IRS reform this year, and to do so quickly.

The need for reform is well documented, both by the hearings conducted by this committee and by many other sources. While there are many specific improvements we can and should make at the IRS, the biggest problem we face at the IRS does not easily lend itself to a legislative solution. It is a well-entrenched corporate culture which often views taxpayers as the enemy rather than the customer.

The administration has taken an important first step in improving the IRS by selecting Mr. Rossotti. Unlike his predecessors who had distinguished backgrounds in law and accounting, Mr. Rossotti brings a management background and perspective and I think that that will be immensely helpful. I look forward to hearing the details of the IRS restructuring that he will share with us later this morning.

Mr. Chairman, there is no reason we cannot get IRS reform legislation on the President's desk by April 15, the tax filing deadline, and give Mr. Rossotti the tools that he needs to accomplish the difficult job that we have entrusted to him.

The Kerrey-Grassley bill contains many provisions, a host of refinements to improve the existing Taxpayer Bill of Rights, including such provisions as shifting the burden of proof in certain civil cases, and strengthening the taxpayer advocate by removing that position from the IRS career path.

In addition, the bill provides new encouragements and requirements for the IRS to move into the 21st century with additional paperless and electronic filing. I must say that is one encouraging aspect I see, the number of individuals who are availing themselves of telefiling.

Mr. Chairman, in Nevada we have had our share of negative encounters with the IRS over the years. For example, a few years ago the IRS established its own illegal book-making business in Ne-

vada in an ill-fated sting operation that yielded little and led to all sorts of suspicious dealings.

More recently, we have learned that, in spite of Congress barring the use of quotas for personnel evaluations in 1988, widespread use of quotas continued for years, including in Las Vegas, and information of that practice was sent to me by fax anonymously from IRS employees in Las Vegas during the hearings that we held last year.

Finally, let me say these types of incidents abuse honest taxpayers and reduce the credibility of an agency that will never be our Nation's most popular.

Mr. Chairman, I think that with your support and the bipartisan cooperation that characterized the activity of this committee early last year, we can and must enact IRS reforms prior to the 15th of April, and I look forward to working with you and the other members of the committee to accomplish that objective.

The CHAIRMAN. Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Than you, Mr. Chairman. I, along with other members of the committee, are very impressed that you are beginning this session of Congress with the hearing on this subject.

American taxpayers have never liked the IRS; that is clear. But their disgust and anger with it has obviously grown over the years, and I think it is very important that we do our very best to solve the problems as best we can very early on in this session of this Congress.

I suggest that we do our best to resolve a little bit of tension between, in some respect, your side of the aisle and this side. I sense, to some degree, your side wants to dig more deeply into all the IRS problems and improve upon the House-passed bill, and I understand that. There are a lot of things we can do to improve upon the IRS's, in many cases, inadequate performance.

But, on the other hand, we also have to act expeditiously as well, you know. So I suggest that we get together on both sides and work very aggressively, maybe speed up the hearing schedule slightly with more in-depth hearings, so that, as has been suggested, we can pass a bill by April 15. We do not do our country any service by delaying, dallying.

There has been a lot of work already on this subject, the Kerrey Commission, for example, and Senator Grassley has worked on it, and your very excellent work, Mr. Chairman, with the staff you hired last year and all the work you have done. The House has worked on it, has passed its bill.

So I urge us very strongly to dig down, work hard, and do our job in a cooperative basis, knowing that nothing around here of consequence ever gets passed unless it's on a bipartisan basis or we work together to get it done.

A second point. I was struck by Senator Gramm's statement that it is not a management problem, but an abuse of power problem.

Senator GRAMM. I did not say abuse of power, I basically paraphrased the ancient Greek who said power corrupts. The problem is, the agency has too much power.

Senator BAUCUS. I understand. Lord Acton said that, "Power corrupts, and absolute power corrupts absolutely." It is true.

I worked at the SEC as a lawyer right out of law school and I was amazed at the power we had. As a young kid out of law school, we got these attorneys and senior partners in big law firms, Gravath, Swain, Sullivan & Cromwell, that would jump. I learned right away that you have to be very responsible in exercising power.

So I think that this is also very much a management issue. It is very much a people issue. It is very much an attitude issue of the people at the top of IRS and down through the entire organization in just dealing with people.

I frankly believe that with all the talk we have had about reforming the IRS, that this time we are finally going to basically get it done. It is not going to be perfect. We cannot let perfection be the enemy of the good. But we can at least pass a good reform bill that helps our new Commissioner do his job so the American public is basically satisfied that a necessary collection agency is basically doing its job.

In one respect, it is a small part, I want to thank our new commission for the four categories. One for my State, Montana, is the category of small business. I think that is critical.

We have large business, small business, individual taxpayers, as well as the nonprofits. I think that is a very good way to go after this. It is a good first step. I feel good, as long as we just keep the ball rolling here and get the job done. Thank you.

The CHAIRMAN. Senator Graham.

OPENING STATEMENT OF HON. BOB GRAHAM, A U.S. SENATOR FROM FLORIDA

Senator GRAHAM. Thank you, Mr. Chairman. I wish to express my appreciation to you for having started this process in this committee last year and giving us the base of information from individual taxpayers' experience upon which these solutions can now be predicated.

I also want to thank Secretary Rubin and Mr. Rossotti for their very energetic work to see that we do not wait any longer than necessary in order to achieve effective reforms for the American people.

I heard this in a very dramatic sense last Thursday at a hearing held in Orlando, in which Mr. Henley LaMar, the district director for the northern district of Florida, and Bruce Thomas, his counterpart for south Florida, both testified about the changes that they were already making to deal with many of the concerns that have been expressed.

I wish to express my personal appreciation for their efforts and I know that it would not have happened had they not felt they had the support from the top of the department and the agency.

I have spent a lot of time over the past several weeks exploring the issues of IRS reform with Floridians, including that hearing in Orlando last week.

I would like to mention five of the concerns that have consistently been raised. These are examples of the types of concerns

against which I think any reform ought to be judged. These are the issues that we need to take action to resolve.

One, is that taxpayers feel as if there is an inability of the IRS to make a decision. We had one man from Jacksonville, Jim Stamps. It took him 6 years to get a simple letter saying that he had paid all that he owed in order to get his credit report cleared of a statement that he had an outstanding IRS dispute. I think we need to decentralize and focus decision-making so that these kinds of decisions can be made expeditiously.

Two. Excessive interest and penalties keep low and middle income individuals from ever resolving their cases. A 73-year-old World War II veteran from Tampa, Carl Jungstrom, has paid $181 a month for 90 straight months against a $25,000 indebtedness. Where is he now? Now his indebtedness, after having paid $26,000, is $28,000 because penalties and interest have continued to run during the time that he had this settlement agreement.

Three. IRS collection agents are insensitive to law-abiding citizens. Betty Bryant, a social worker, was threatened with a garnishment of her wages. After she contacted the Governor and our Senate office, it was determined that, in fact, IRS owed her a refund. Yet, she felt as if she was a criminal during this period.

I think we need to consider some system of rotation of collection agents out of high-stress, arrogant attitude-enhancing positions so that there will be greater sensitivity.

Just the last two points. Leverage and negotiation strongly favors the IRS. I think we need to consider third party dispute resolution procedures in order to make the taxpayer feel as if they have a greater equality of treatment.

Finally, the IRS is frequently unable to locate taxpayers' records. Application of modern, less paper-demanding information systems would facilitate a resolution of that issue.

So, Mr. Chairman, I appreciate the opportunity to continue to delve into these important issues and I hope that we will expeditiously come to a Congressional resolution.

The CHAIRMAN. Thank you, Senator Graham.

John Breaux.

OPENING STATEMENT OF HON. JOHN BREAUX, A U.S. SENATOR FROM LOUISIANA

Senator BREAUX. Thank you, Mr. Chairman. Thank Mr. Rossotti and Secretary Rubin for being with us.

One of my fears is that we are going to talk this issue to death and not get anything done. I think we are probably all ready to start marking up a bill this afternoon, if we were so inclined to do so. There is a lot involved here, but I think we all know the direction we have to go. I think we ought to move as expeditiously as we can and get the job done.

I was really shocked yesterday, I think, to learn that we probably have less than 80 days left in this session, legislative days, to get all this work done. I think we ought to move forward, get it done, send it to the President and let him sign it.

I think, Mr. Rossotti, that good things have already started to happen. I think things are changing administratively that are for the good. I have noticed a change in attitude in the feel in Louisi-

ana with some of the people that I had talked to following our first round of hearings that the Chairman set up; people that had problems went back and got treated differently. I think that is very important.

We all joke about, one of the greatest lies that was told was, I am from the IRS and I am here to help you. People are afraid of the IRS. Members of Congress are afraid to call the IRS because we feel intimidated—at least I did—because we get the attitude, how dare you call me on behalf of a constituent. That is wrong.

So I think that things are changing for the positive because of your appointment and the work the Secretary has done, and that really is to the good.

I was sort of shocked to learn, I did not know, that less than 2 percent of the individual returns in the whole country are ever audited. I mean, a lot of people think everybody is audited. Certainly anybody who has ever been audited thinks everybody is audited. But less than 2 percent of the people.

That means, I guess, 98 percent file their returns and that is the end of it. But the 2 percent, or less than 2 percent, that are audited have created a real uprising and legitimate concerns have been brought to our attention. So I think things are starting to move, because of the changes, in a very positive sense.

The second two points. I think a taxpayer advocate, as part of the legislation, is important. The taxpayer needs to know that there is someone there that is on their side, someone that helps represent their interests, someone that they can go to that is going to have their interests as their primary concern, not the interests of the government. We have enough people that have the government's interest as their primary concern. So the taxpayer advocate would establish that.

A final point. I think the burden of proof issue is very serious. I really think that if we as a government, with all of our forces, challenge someone that is doing something improper, it should be our burden to prove it. We should not have to prove ourselves innocent. I think that is a matter that needs to be considered very seriously.

I support changing the burden of proof and making sure that we have to show that wrong has been done in order to expose someone to criminal penalties. I think with that we could have a very good bill, and we should pass it as quickly as we can.

Thank you.

The CHAIRMAN. Senator Rockefeller.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Thank you, Mr. Chairman. I want to thank you and Senator Moynihan, and many others, for having this discussion.

Mr. Rossotti, I just want to give you a little bit of good news. There was a group of us sitting around the other night discussing Asia, but it got around to the IRS.

One of the people we were talking with—some members of the Finance Committee—said that if they had to construct an IRS

Commissioner from scratch to be the perfect IRS Commissioner, it would, in fact, be you.

That puts a burden on you to live up to that, but I would rather have a feeling of knowing the confidence that people have in you going into this than starting out, as is so often the case, with two strikes against you, just people assuming somehow that it is just another appointment. You are not just another appointment, you have been carefully picked. You have a superb boss sitting next to you. I really feel very good.

Now, the head of an agency does not make all the difference. We saw that yesterday in Japan when the head of the Ministry of Finance resigned, through absolutely no fault of his own, but simply because the bureaucracy which rules Japan and the Ministry of Finance in virtually absolute terms was unwilling to change.

On the other hand, you can turn that back around and say, if the administrator over there, the finance minister, or in your case the Commissioner, really has the will of the American people and the will of the people who work for you in your agency, you are going to get change.

It is not just the American people that know that something is wrong. IRS employees know that there is something wrong and they know that the system has to get better. We had a hearing when a number of them were shielded off from public view and they were talking honestly with their voices disguised.

I really think that you have an agency which, in many respects, wants very much to help you do a good job. There is a lot of talk about it. The President is for it, the Majority Leader is for it, Senator Moynihan is for it, the American taxpayers are for it, we are all for it. So you have got a very good backing as you go into this job and I simply want to wish you well.

I agree that the burden of proof is a very important principle. It has not been exercised in quite the same way as before. I like the idea of bringing in outside people on a timely basis just to kind of check your own checklist. But I think basically what I wanted to say is that we have an enormous amount of confidence in you going in. I suspect you are going to do a very good job, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Conrad.

OPENING STATEMENT OF HON. KENT CONRAD, A U.S. SENATOR FROM NORTH DAKOTA

Senator CONRAD. Thank you very much, Mr. Chairman. I want to thank the witnesses, Secretary of Treasury Rubin, who I think has provided real leadership on this issue, and our new head of the IRS, Mr. Charles Rossotti.

I understand the Internal Revenue Service has had serious problems. It has had problems of attitude by some, it has had problems of abusing taxpayers by some, it has had critical problems of being out of step with the changes in technology, and the basic systems of the IRS are out of date in terms of what the private sector is doing to manage the various problems that the Internal Revenue Service faces.

Mr. Rossotti, I have had a chance to study your plan and, as a former tax administrator myself, I think you are right on target. I think you are moving that agency towards modern business practices, modern organization, and the use of modern technology that will make a dramatic difference in the delivery of service to taxpayers, and I applaud you for this plan.

Senator Rockefeller was referencing that what was appropriate in the past in terms of a head of the IRS, because typically we have chosen tax lawyers, tax accountants, and those were the right people for the time. But at some point, things changed.

What we have needed is a manager, somebody that understood systems and technology, and you are that man. I think it is going to make a profound difference to the delivery of services to the American taxpayer.

So I want to salute you and salute Secretary Rubin, who had the vision to find you, for what you have started to do. Now, all of us understand, you do not turn a ship around overnight. I do not think we should raise expectations in a way that is unreasonable.

I must say though, I have detected an improvement in IRS operation since the hearings we had last year. I can tell you, we have had a number of cases come to us as a result of our hearings, Mr. Chairman.

We have gone to the Internal Revenue Service on behalf of those taxpayers, and I am pleased to report we have been getting a very good response. Not a perfect response, but a very good response. So I want to applaud you for the new direction that you are taking.

I want to add my voice to Senator Breaux's and the others who have spoken here today, Senator Moynihan. We ought to pass this legislation by April 15. We ought to set that as a goal for ourselves. Let us get this in place by the time the next tax returns are filed by the American people. There is no reason we cannot do it by then.

So Mr. Chairman, thank you for holding this hearing.

The CHAIRMAN. Well, thank you, Senator Conrad.

Finally, Senator Murkowksi.

OPENING STATEMENT OF HON. FRANK H. MURKOWSKI, A U.S. SENATOR FROM ALASKA

Senator MURKOWSKI. Thank you, Mr. Chairman. Good morning, Mr. Commissioner, Mr. Secretary.

I could not help but notice, Mr. Chairman, a reference from our friend from Louisiana, and I wondered if he was having a look at his Louisiana calendar. I do not think there are Mondays and Fridays on that Louisiana calendar, so we may have more days than the Senator from Louisiana suggested. In our State we have a 5-day calendar, and then a Saturday and Sunday to go with it. Anyway, that is just an observation.

Senator BREAUX. We do not work during Mardi Gras.

Senator MURKOWSKI. And you do not work during Mardi Gras. [Laughter.]

And we operate on Eskimo time. So I guess there is a push, regardless.

It is interesting to listen to my colleagues relative to their suggestions as we have all observed the political nuances of the IRS.

But it struck me that one thing that this particular agency has never had was accountability. It appears, to me at least, after viewing the structure, that it was never designed to have accountability.

I am very pleased, Mr. Commissioner, to reflect on your effort to restructure the organization so there is accountability. With accountability can come responsibility and, really, responsibility is what I think many of the people in the IRS are looking for relative to people who can commit to a future in that agency.

So I think, Mr. Chairman, the efforts of this committee to hold those hearings that were held last fall initiated not only public opinion, but a realization by the committee of just how far afield the IRS had gone in the manner in which it was being responsive to the American people. The reality was, it was not being responsible to the American people.

I think, as I quote from one of the internal audits, "There was an environment that had placed some taxpayers at risk of abridgement of their basic rights, and some taxpayers at the risk of an inappropriate evaluation atmosphere."

I am not going to go through my share of the horror stories that we have already recounted, other than to say that I certainly agree we should move with legislation now to change the relationship between the American people and the IRS, and I join with my colleagues in urging that this committee work with the members and the rest of the Senate to strengthen the bill.

We have got the House bill that passed last year, so before this year is out we can look our constituents in the eye and tell them that we have fundamentally changed the culture, the attitudes, and the arrogance of some of the people in the IRS.

So I wish you well, Mr. Commissioner, Secretary Rubin. I wish you well as you attempt to focus in on the crisis in Asia. Your experience in Asia may have application in that regard. Good luck.

Thank you, Mr. Chairman.

Secretary RUBIN. There is no oil here, unfortunately, Senator, as you and I discussed.

The CHAIRMAN. Well, thank you, Frank.

Now we will turn to our witnesses. It is always a pleasure to welcome our distinguished Secretary of the Treasury. We are looking forward to his comments on the IRS. Immediately following that we will turn to our new Commissioner, Charles Rossotti.

Mr. Secretary.

STATEMENT OF HON. ROBERT E. RUBIN, SECRETARY OF THE TREASURY

Secretary RUBIN. Thank you very much, Mr. Chairman. I think in many ways, as I listen to your testimony, I could probably have satisfied my purposes by simply identifying with much of what you said. Having said that, I will reserve the right, if I may, to say a few words myself. But I do think you have stated the case, in many ways, very well.

I became concerned about the IRS organization, about which I knew relatively little, very shortly after I became Secretary of the Treasury. It was obvious from my initial experience that there was much at the IRS that was not working properly, because the

phones were not working, taxpayers were not being satisfied, and there were many other problems, technology and the like, that have been discussed in this committee and elsewhere.

As a consequence, a little over 2 years ago, which was something less than a year after I became Secretary, we began a highly intensified process of reform and change.

Though I believe that we really have begun to make progress in a number of areas, there clearly is an enormous challenge ahead, very much including internalizing at the IRS a commitment to change and the kind of cultural change that several of you have spoken to, and I think is absolutely fundamental if we are going to have the kind of IRS that we all want to build.

Many have contributed, as the Chairman said, to what I believe the irreversible process of change that is under way at the IRS. Clearly, Congress, very much including this committee, has played an absolutely indispensable and powerful role.

We at Treasury have worked very closely with the IRS, particularly, as I said, in a highly intensified fashion over these last couple of years. The Vice President's National Performance Review, in conjunction with Treasury and the IRS, has produced an important set of recommendations on customer service.

The Commission on IRS Restructuring, on which Senators Grassley and Kerrey served, has clearly been a very important forum for analysis and for discussion.

As I said a moment ago, the Finance Committee hearings last fall brought to light serious, and I think without question intolerable abuses, abuses that have now been vigorously explored in two reports that the IRS mandated be done right after your hearings, and has been submitted to you, and there is a third report yet to come which I think is coming sometime in March or April.

I think, as you said, Mr. Chairman, there is a strong and effective—and as I said a moment ago, I believe irreversible—dynamic for change at the IRS involving Congress, the administration, the IRS itself, its new Commissioner, the Treasury Employees Union. I think, as you said, this is the time to act and to take advantage of this environment to accomplish what needs to be done for the American taxpayers.

I think as we look at all of these issues, it seems to me the only question ought to be, what do we do now that best serves the purposes of creating an IRS that meets the needs of the American taxpayer, provides taxpayer service, protects taxpayer rights, while at the same time collecting the revenues due?

As I said at the time, I was deeply troubled by the conclusions and the reports I just mentioned, that inappropriate use had been made of enforcement statistics. This is obviously unacceptable, and our new Commissioner has taken strong steps in respect to that.

We at the Treasury and our new Commissioner of the IRS are committed to fundamentally changing this agency, transforming this agency to serve the American taxpayers, to protect the taxpayer rights, while at the same time, as the Chairman mentioned, performing its critical task of collecting the taxes due.

I believe that in recent months significant steps have been taken toward the end of improving taxpayer service, including the stopping of the use of revenue goals in field offices, beginning the devel-

opment of a new set of performance measures, taxpayer problem resolution days, and a whole host of other measures.

It was gratifying to hear some of you say today, and also some of you said at the dinner that a number of us had the other night, that you are beginning to see some effect of this, some impact of this, at your local field offices.

Despite the enormity of the problems, and I think we can all agree on those, and the immensity of the challenge, I do believe that there is good reason, given the dynamic that is in place, to expect substantial progress in the years ahead.

The IRS is now guided by the firm hand of its new Commissioner, Chairman Rossotti. I have now had the opportunity to work with our new Commissioner for some time. He brings 28 years of experience in the private sector in the area of information technology which, as you know, is core to the future of the IRS. I have found in Charles Rossotti everything we had hoped, which is a very good, sound, practical business mind, plus a deep knowledge of the issues of information technology.

I believe that our new Commissioner will not only provide transforming leadership, but is a symbol of the commitment of the administration to that transforming leadership.

Over the last couple of years we have taken, I believe, very important steps to begin this process—and I emphasize the word begin, to begin this process—of transformation.

The crisis that most, it seemed to us, needed addressing at the beginning of this intensified process was technology, because effective technology underlines everything that you all and we want to accomplish at the IRS.

I think there is now universal agreement that the technology program has been put on a new track. We have canceled very large numbers of contracts. There is a new technology blueprint out, as you know.

As the new Commissioner will be the first to say, this is a very difficult undertaking and there is a long way to go, but I believe we have made a very good start.

We have substantially increased the use of electronic filing, telefiling. Quite a number of taxpayer service initiatives have been put in place, Taxpayer Advocate has been strengthened. I think we have made a good start in a goodly number of areas.

The bipartisan legislation that passed in the House last year and that is before you right now, it seems to me, is the next step, and the critical step, to bring the IRS into the new era.

Congress has been vital and integral to the reform process, and Congress will be vital and integral as it goes forward by providing adequate funding, by providing effective oversight, and most immediately, by passing the bill passed by the House as soon as possible.

This bill contains important measures that will help build the IRS we all want to see. In reference to Senator Gramm's comments with respect to the President's comments last night, let me say that the bill went through several iterations in the House process, as you may remember.

At the end of that process we wound up with a bill that we very strongly supported and we felt was a very good and workable path forward for the IRS, reflecting the changes that have been devel-

oped as a consequence of the process that Senator Kerrey addressed when he was here, if we all work together to produce an effective bill.

The bill before you provides for increased continuity in leadership by providing a Commissioner with a 5-year term. It provides a very important set of personnel management reforms. Nobody mentioned that in the course of your comments. But if our Commissioner is going to have the opportunity that he needs to do what he needs to do, we also have to create greater flexibility with respect to personnel practices within the IRS.

It contains additional steps strengthening taxpayer rights, many of which reflect taxpayer rights proposals the President made last year. I know the Chairman is very much focused on additional measures in that area. We very much look forward to working with you on that. There are important measures to expand electronic filing which, again, is key to having an effective IRS in the future.

Finally, the bill contained new government arrangements providing for valuable input from the private sector and effective outside oversight, while at the same time maintaining the authority and accountability with respect to the IRS within the existing structure of the Federal Government, with the ongoing oversight and synergies that that can provide and the Treasury is committed to providing, and I believe has been providing over the last couple of years.

In short, Mr. Chairman, I believe that the bill that is before you will help continue the process of change at the IRS in the years ahead, including intense focus on eliminating the kinds of abuses that were discussed at your hearing.

It is absolutely clear, and we are all committed to the IRS focusing more on taxpayer rights, on quality, and customer service, while at the same time, as you observed, collecting the revenue due.

I think it is important to observe in that regard that those who deliberately evade paying their taxes increase the burden on all of the rest of us.

Mr. Chairman, Internal Revenue Service reform and having an IRS that meets the needs of the American taxpayer and does so in an appropriate fashion, provides good taxpayer service, is an issue of immense national importance and one that we take with the utmost seriousness.

We can debate, as one Senator suggested in his remarks, whether to continue with the current progressive income tax system or change to some other system, but I do not believe we should let that debate affect our support for reforming the IRS to provide taxpayers with the service that they need and deserve.

Our society depends on effective tax collection for 95 percent of the revenues of the Federal Government, which support everything from defense to Social Security, and we have got to get this right.

The new IRS will be the work of many hands. As we go forward, we must all work together in a constructive spirit to help the IRS meet the many challenges it faces, including each year's tax collections, but also including the new challenges that are now before us, the fundamental transformation now under way and dealing with the year 2000 conversion, a subject that I know is of great interest

to some members of this committee and was absolutely critical to our Nation.

Again, Mr. Chairman, I would like to conclude on this note. I believe, as you said in your remarks, that we have a powerful, and I believe irreversible, dynamic in place involving Congress, the administration, and all others concerned for change at the IRS. We should take advantage of what you referred to as an historic opportunity to get the job done and to produce an IRS that provides taxpayers with the service they deserve, that protects taxpayers' rights, while at the same time collecting the taxes that are due.

I think the only question as we face this issue is, what do we do going forward to best serve this purpose? I think in that respect there are two things that we can now do that are most important, pass this legislation as quickly as possible, and to support our new Commissioner, Charles Rossotti, so that he can fulfill his commitment to change.

Let me also say, if I may, Mr. Chairman, that we have with us today Congressman Hoyer, who has been an ardent proponent of IRS reform through this whole process and has been integrally involved in our efforts at Treasury and at the IRS to do what needs to be done to accomplish the purpose that you and all of us have.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Secretary.

[The prepared statement of Secretary Rubin appears in the appendix.]

The CHAIRMAN. Now, Mr. Commissioner.

STATEMENT OF HON. CHARLES O. ROSSOTTI, COMMISSIONER OF INTERNAL REVENUE SERVICE

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman and distinguished members of the committee.

First, just let me say that I very much appreciate the very generous comments that Senator Rockefeller and others made about me. Every time I hear something like that, though, it makes me lose even more sleep because I wonder how anyone could live up to those standards.

Mr. Chairman, I noted at my confirmation hearing last October that your hearings were a call to action to the IRS. As you begin to consider the restructuring legislation here in the Senate, I want to begin this by laying out a concept of how we can take advantage of this legislation to modernize the IRS so it does what we all want, which is to provide a far better level of service to taxpayers.

Let me just stress at the beginning that the enactment of the restructuring legislation is crucial to the whole concept that I am about to outline. It is really a necessary enabler of the changes that the IRS must undertake.

In my written statement, to save time, I have provided some specific comments on the legislation.

The CHAIRMAN. Your full statement will be included as if read.

Commissioner ROSSOTTI. Thank you very much, Mr. Chairman.

[The prepared statement of Commissioner Rossotti appears in the appendix.]

Commissioner ROSSOTTI. Let me just say, in preparation for what I am going to talk to you about today, that I have carefully reviewed the transcripts of your hearings, the work of the National Commission on Restructuring which Senator Grassley and Senator Kerrey served on, and I have spoken to both of them in person. There are many thousands of pages of GAO studies and internal IRS studies on business practices, technology, and organization which I have tried to review.

I have had the opportunity in the last 3 months to meet in small groups with several hundred IRS employees, as well as from many other people that are interested in our tax system.

Of course, I have consulted carefully with the Secretary of the Treasury, and I have benefitted from the work of the National Performance Review that did considerable work on customer service, as well as from the hearings of the Ways and Means Committee.

I believe that from all of this work, as many of you have observed, a clear sense of direction has emerged. That is, the IRS must shift its focus from simply its own internal operations to thinking about how it can do its job from the taxpayers' point of view.

Now, right now, today, the IRS does do a rather remarkable job of processing annually 200 million tax returns, collecting with great integrity $1.5 trillion, and providing service to millions of taxpayers. These capabilities represent a great strength for our country and we can build on these to make a better agency.

But to meet the public's legitimate expectations in the future, we in the IRS know that we must fundamentally change the way we think about our agency. We must become fundamentally committed to customer service. We must shift our focus, as many large companies have done in the last 10 years, from expecting our customers to figure us out, from figuring out how to navigate our system and our process, to thinking about everything we do from the taxpayers' point of view. That means we must find ways to gain a better understanding of the taxpayers' problems and how we can help them meet their obligations under the tax laws.

A simple way to say it is, we have to become problem solvers, not problem creators, for taxpayers. That is exactly what I meant when I said at my confirmation hearing that everyone in the IRS should begin to think of themselves as a taxpayer advocate, not simply the people in the Taxpayer Advocate's Office.

Now, if we begin to think about the IRS from the taxpayers' point of view, we can note that we actually serve taxpayers in two different ways. One way, is that we serve each taxpayer one at a time when we deal with them directly.

These kinds of interactions with taxpayers range from routine interactions such as providing information or forms to much more complex and difficult interactions such as when a taxpayer may be thought to owe more money as a result of an examination.

Mr. Chairman, we have to be committed in the IRS to the fact that in each and every one of these interactions, from the most simple to the complex, we should provide first-quality service and treatment that is prompt, professional, and helpful to that taxpayer based on what we know to be their particular circumstances.

Now, the second way we serve taxpayers, is that we serve all taxpayers as a group, as a whole, because our tax system depends on every person who is voluntarily paying their taxes, which the vast majority of them, knowing and having confidence that his or her neighbor or competitor is also complying.

Now, I believe that the IRS, over time, can improve both kinds of service to the public. Furthermore, I believe we can accomplish this while also processing the increased work load that comes every year with the growth of the economy, largely with the work force we have.

Our work force I have found to be competent and dedicated, but very much handicapped by outdated structures, practices, and technology. That is what I am going to talk about in a moment.

But I do want to note, as many Senators have kindly observed, that we have taken action already to move towards these goals right now. We are not going to simply wait until everything has changed in the organization until we start to make progress on these goals.

The Problem Solving Days that I was glad to attend with you, Senator Roth and Senator Grassley, are good examples, I think, of the way we should be serving taxpayers. We are also extending our telephone service this season to be 12 hours a day, 6 days a week.

We have set up a special process to resolve the particularly difficult taxpayer cases that we are identifying through both our internal programs and through this committee.

We have taken steps, as people have noted, to raise the level of management review on enforcement actions, such as seizures, and to see that inappropriate use of statistics is ended. These are only a few of actually hundreds of actions that we are taking this year to improve service and provide proper treatment to taxpayers.

We are also closely managing our enormous and very challenging program to update our computer systems for the century date change, and also, I might add, for the tax law changes that are required by last year's tax bill. Most of this work has to be completed in the next 12 months, so this must be, and is, a very short-term priority.

As important as these steps are, and we are not going to take our eye off the short-term ball, they will not enable us to meet our goals unless we take more fundamental changes in the way we do business.

These changes will take a lot more time, but I believe they are essential for the IRS to meet the legitimate expectations of the public in how it receives service from such an important agency.

Let me just outline to you at a high level, a very high level, the concept that I would like to propose. This concept, which is outlined in this chart, includes a renewed mission of the service with emphasis on service to taxpayers and fairness.

It includes practical goals and some guiding principles, which I think will define the path forward. We can start to take action, as I have noted, on these principles and these goals right now.

But we will only reach our goal of providing service to each taxpayer, as well as to all taxpayers, through more major changes in five areas. Each one of these five areas complements the others, and these five areas, of course, are summarized here. I want to

stress that all five will be required in order for this concept to be successful.

First, let me turn my attention to the box on the far left there, which is that we must re-think and revamp all of the IRS business practices so that we will think about how these can work when we focus on understanding, solving, and preventing taxpayer problems. Remember, we want to become a problem solver, not a problem creator.

I have found that each of the IRS business practices, from customer education, to filing assistance, to collection, every one of them holds a great deal of promise for improvement simply by our gaining a greater understanding of the particular problems that taxpayers have in working with us and focusing continuously on solving them. Fortunately, in many cases there are close parallels in the private sector that we can draw on.

For example, our business practices should make filing easier for all taxpayers by providing easily accessible, high-quality assistance to all taxpayers who need help in filing and by making more returns filed electronically.

Now, how do we do this? Well, just as companies develop very specific marketing programs to reach customers with different needs, we can help taxpayers far more effectively by tailoring our publications, communications, and assistance programs for taxpayers with particular needs.

For example, college students, who often can file with a simple 1040EZ form and a 10-minute phone call, have very different needs from senior citizens with Social Security, dividends, and interest who may be best served through a network of volunteers who can specialize in the needs of seniors. Similarly, small businesses need a different kind of assistance.

So this principle of tailoring our services to the needs of particular groups of taxpayers is really a cornerstone of how we can dramatically improve our service to taxpayers, as well as our internal productivity.

As another example, Mr. Chairman, some of our most difficult interactions with taxpayers, as you well know from your hearings, occur when additional money may be due and collection activity is required.

One of the most important statistics I have come across in my 3 months at the IRS, is if you look at where the collection activity of the IRS is spent, both phone collection and field collection, 90 percent of it is spent on accounts that are more than 6 months old, and much of it is much older than that, 1 or 2 years.

Now, I can tell you from my personal experience in the private sector, that is exactly the reverse of what the private sector does when it collects money. Every business collects money from people.

The proven keys to collection are to identify, as promptly as possible, customers who may present a risk of non-payment and to work out very quickly a payment program that addresses the particular payment problems of that customer.

This helps the customer as well as the collecting agency, and it minimizes the need for enforcement action, which should always be a last resort. This is just one example, but collections is a very important example.

So now, let me turn to the second of the five elements of this concept. It is one of the most important factors that will enable us to make the kind of changes we need, and that is the organization structure itself.

The current IRS organization structure which is depicted on this chart that is about to be put up in simplified form, frankly, Mr. Chairman, no longer enables its managers to be knowledgeable about and take action on major problems affecting taxpayers. It is simplified, Senators. It is.

Senator GRAMM. You would never know it.

Commissioner ROSSOTTI. Well, let me just describe a few things about it to you. It is not only a matter of it not being simplified, it really is not capable, in my view, of modernizing the business practices and technology that we need in order to meet our goals.

Let me just point out a few highlights here, as shown on the chart. The heart, really, of the IRS organization structure is built around 33 districts and 10 service centers.

Each of these 43 units spread around the country is charged with the mission of administering the entire Tax Code for every type of taxpayer, large and small, simple or complex.

If a taxpayer moves, the responsibility moves to another geographical area, to another service center, to another district. Furthermore, every taxpayer is serviced by both a service center and a district, and sometimes more than one, and each of these units performs customer service, collection, and examination activities all for the same taxpayer.

For example, take my collection example. In the collection area there are three separate kinds of organizations spread over 43 organizational units that use 3 separate computer systems to support collection. Each of these three types of units collects from every kind of taxpayer, from small businesses to wealthy individuals. It is understandable why it takes so long.

Now, another element that is built up in this structure is that there are eight intermediate levels of staff and line management between a front-line employee and the Deputy Commissioner. The Deputy Commissioner, actually, if you analyze it, is the only manager besides the Commissioner who has full responsibility for service to any particular taxpayer.

Now, there have been some important improvements—some very important improvements—made in the structure over the last few years, notably the reduction in the number of district headquarters.

But a fundamental problem remains, which is that this structure is just too complex and, I think as Senator Murkowksi observed, really makes accountability quite weak and very difficult to achieve, despite the best efforts of people to achieve it.

Fortunately, there are solutions to this organizational problem which are widely used and proven in the private sector and which I believe can enable us to better serve the taxpayer.

This basic approach is simply to organize not around our own activities as much, but to organize around the needs of our customers, who are the taxpayers.

Just as many large financial institutions, such as large banks, have a different division that serves the retail consumer, small- to medium-sized business customer, and the large, multinational cus-

tomers, the taxpayer base of the United States falls naturally into four groups. This is not because of anything to do with the IRS, but simply because it reflects the structure of the American economy.

Therefore, as shown in this chart that has just been put up, a logical way to organize the IRS is into four units, each of which would be charged with complete, end-to-end responsibility for serving a particular group of taxpayers with a particular set of needs.

These units then could replace the existing four regional offices and a substantial part of the large national office, which would then allow our National office to better fulfill its responsibilities of oversight and broad policy rather than operations, which would be the function of the units.

Now, a great deal of study is going to be required of this concept, and that is the effort that we intend to launch very soon. But I believe we need to refocus and realign the efforts of IRS on our customers, the American taxpayers, and that is the underlying idea of this concept.

By organizing in this way, the management team for each one of these units could learn a great deal more than the managers in the current structure about the specific needs and particular problems that affect each taxpayer.

Now, the Tax Code is extremely complex, but most of it does not apply to each of these groups of taxpayers. So, a team can learn about the specific, narrower set of problems.

Let me just briefly begin to give you a little discussion about some of the particular problems that each of these groups of taxpayers has from the taxpayers' point of view.

On the left, there are a group of 100 million tax filers comprising, with joint filers, 140 million people. That is about 80 percent of the total number of people filing.

Now, for this large group of taxpayers the primary needs are improved assistance in filing or in getting information about an account or refund. Collection problems in this large group of taxpayers are relatively limited because almost all of the money that they pay in taxes actually comes in through withholding from their employers, and is not directly received from them. In fact, most of them get refunds.

The compliance problems are much more limited in this group because of the obvious fact that most of the income is withheld and reported. Most of the compliance problems are in areas such as dependent exemptions, credits, filing status, and deductions, and many of these particular kinds of compliance problems can be addressed by better education of taxpayers, with the assistance of volunteer groups and preparers.

Also, improved phone service and, yes, more walk-in retail sites throughout the country where taxpayers can get in-person, face-to-face assistance is also important for this group.

Now, another extremely important group for our country are taxpayers who are small businesses, which include sole proprietors as well as small business corporations and partnerships. There are about 25 million filers in this category.

Compared to other individual taxpayers, this group has much more frequent and complex filing requirements and pays much more money directly to the IRS because they are filing tax deposits,

quarterly employment returns, and many other types of income tax returns and schedules.

As a matter of fact, those 25 million filers file about 90 million returns a year with the IRS, not counting tax deposits, so we are much more closely involved with this group of taxpayers than with the other group. Therefore, providing good service to these group of taxpayers is more difficult than with the wage and investment taxpayers.

The compliance and collection problems are also much greater because they are sending us more cash and that is just closely related. Small start-up businesses, in particular, need special help so they do not get behind.

So by dedicating a unit that would be totally and completely responsible to provide all IRS services for self-employed and small businesses, I think such a unit would be able to work closely with industry associations, small business groups, and preparers to solve the special kinds of problems that these kinds of small businesses have.

Moving on to the larger businesses, which are far fewer in number, they will pay a very substantial share of the tax in the form of not only the income tax on their own income, but withholding, employment, and excise taxes.

In this group, the principal issues are complex tax law, regulatory, and accounting questions, and of course many issues that arise from international activities in which these taxpayers engage.

So a management team and a unit dedicated to serving these taxpayers will be better able to understand and solve these problems more effectively than at present.

Finally, there is the tax-exempt sector, which includes employee plans, exempt organizations, and State and local governments, and actually represents a very large economic sector also with unique needs.

Although taxpayers in this group really do not pay very much income tax, because they are tax-exempt, they actually send the IRS over $190 billion a year in cash in the form of employment taxes and withholding for employees. They also manage $5 trillion in tax-exempt assets. So this huge sector would also benefit, I think, from a group that understands its special needs.

Now, let me turn from the organization structure to some of the other key elements here of this concept. Since each of the units would be fully responsible for serving a set of taxpayers which have similar needs, the management teams that would be responsible for each of these units will be able to become knowledgeable about the needs and problems of their customers and will be able to be held fully accountable to solve those problems and to achieve specific goals set up to serve those taxpayers.

Furthermore, having learned about problems, managers can cut dramatically the time required to communicate with the work force and implement solutions. Because the organization would be flatter, there would be fewer layers of management. In fact, we could cut the number of layers in half, Senator Moynihan.

Front-line employees and first-line managers would have a much closer identification and communication channel to people who ac-

tually have general management responsibility and can actually act to solve problems.

I think for each unit we could establish a cohesive management team which will be able to organize itself internally in ways that are appropriate to the particular needs of the taxpayers they serve rather than the one-size-fits-all that we have today.

I also believe that we would be much more successful in attracting highly-qualified managers from internal or external sources with these kinds of management jobs because they are more comparable to the management jobs that exist in the private sector.

I think, Senator Gramm, this is one of the things that would enable us to do what you suggest, which I think is a very wise suggestion, which is to rotate people in from the private sector, which is exactly one of the ideas that I have in mind with this.

I will say that we will need some of the personnel flexibilities that are in the legislation that we need to talk to the staff about in order to make that possible, because it is difficult to do right now. But, with the aid of your legislation, I think we can do that.

Let me say, we are not waiting. We are doing that right now. We have, as I think I indicated in an earlier meeting, a search effort underway with an international search firm to find someone from the private sector to take over the job of the National Taxpayer Advocate. We can do that right now.

Longer term, with the structure that I proposed, we can have a special dedicated Taxpayer Advocate from the outside, one for individual taxpayers, one for small business taxpayers, and one for exempt organizations, so we can really enhance the role of the Taxpayer Advocates in a very, very concrete way.

The fourth element here which is important is to have performance measures which reflect what we really want to achieve with this organization. It is important, as we have already noted, to have organizational performance measures that balance customer satisfaction, business results, employee satisfaction, and productivity.

It is particularly important that the performance measures do not directly or indirectly cause inappropriate behavior towards taxpayers and, in fact, that they provide incentives for service-oriented behavior.

I think the establishment of management teams with clear accountability and responsibility for serving large groups of taxpayers, which internally have reasonably common characteristics and needs, will make it possible for the first time to develop realistic and meaningful measures of organizational performance in all of these areas, including customer satisfaction, and compliance on a continuing basis.

Senator Bryan, I think this will be the thing that will allow us, finally, to do what you suggested once before, which is to drive a silver stake through the idea of the use of enforcement statistics as a key measure of performance.

Now, finally, I would like to talk about technology, which is the other critical enabler. One of the limiting factors in our ability to modernize our business practices at the IRS today is our computer systems, which are extremely deficient in their ability to support our organizational mission.

But computers systems in a business setting essentially represent a detailed codification of the business practices and organization structure that exists. That is all a computer system is, really.

Building new computer systems to support the old business practices and complex organization structure will not work. It is like paving cow paths.

The recently issued modernization blueprint and the new CIO organization that has already been established by Secretary Rubin and Deputy Secretary Summers will provide, I think, an outstanding and professional basis for managing the evolution of our technology. That has already begun to be put in place.

But the revamped business practices and the rationalized organization structure I discussed will provide the other missing component, which is a sound basis for completing and implementing the modern systems that are envisioned in the blueprint.

I think one of the important elements here is that the management teams that are actually going to be responsible for managing will be able to act as knowledgeable and responsible business owners to work with the centralized and professional Information Systems (IS) organization, as well as outside contractors, in order to complete the blueprint.

I really believe that if we can do this, for the very first time this will establish all of the critical elements that are going to be necessary to manage a large-scale and very difficult technology modernization program.

So, to summarize the entire concept—and I stress it is a concept—it includes a renewed mission with an emphasis on service and fairness to taxpayers, some practical goals and guiding principles which define the path forward and which we can start to act on right now; revamped business practices that focus on solving and preventing taxpayer problems rather than creating problems; a new organization structure built around serving groups of taxpayers with similar needs; more accountable, and I think more attractive, management roles; balanced measures of performance tied to achievement of goals; a workable way, over the long term, of modernizing our technology.

I want to stress, Mr. Chairman, that this is a concept. A great deal of study is going to be required to validate this concept to decide on hundreds of details. We will need the assistance of an outside firm to assist us in this effort. Much consultation will be required, both internally and externally, during this process. We hope to complete an initial study of this by early summer.

So we have an enormous job ahead of us which we have to do while we are still keeping our eye on the short-term problems. I am confident that, given time and support from Congress and the public, this path will lead us to the goal we seek, which is an IRS which provides consistently first-quality service to all taxpayers.

Let me, finally, say that this concept is fully consistent with, and in fact complements, the oversight board that is created in the restructuring bill. Under the structure we propose, the Commissioner and the national office, I believe, will be better able to fulfill their appropriate top management roles and will be able to be accountable to the board for achievement of overall organizational goals,

as approved by the board, which is one of their main jobs under the legislation.

In conclusion, I want to assure the Committee that this is a new day at the IRS. The agency is fully committed to moving forward in ways that keep up with the changing world and the increased expectations of the American taxpaying public.

The restructuring legislation that is before you is essential to get there, and the work of your committee, Mr. Chairman, has served as one of the catalysts for change.

Thank you. I will be happy to answer questions.

The CHAIRMAN. Well, thank you, Mr. Commissioner. Let me start out by saying that I think your proposal for reform is, indeed, very promising.

I understand it is only a concept now, but in many ways it is embedded in what has happened in the private sector where large organizations similarly had a hierarchy, but they have restructured and reorganized around their customers. That is, as I understand, what you are trying to do here, is restructure, reform the agency to take care of the requirements of the various classifications of taxpayers. Is that a fair statement?

Commissioner ROSSOTTI. That is a fair statement, Mr. Chairman. I think you would find, when you get your other witnesses, this has been a strong trend throughout American business in the last 10 years.

It is to basically shift from inside looking out to outside looking in and saying, instead of worrying about our problems, let us think of what the customers' problems are and figure out how we can solve those problems. The best way to do that is to concentrate everything you do and think about it from the customer's point of view.

So I do not think there is anything novel about this at all. It may be different as far as the IRS is concerned, but I do not think it is novel at all as far as American business is concerned.

The CHAIRMAN. But it is true that it is this type of restructuring that has enabled our private sector to become very competitive.

Commissioner ROSSOTTI. Yes, indeed. I think Secretary Rubin has experienced, in his former life, how much it has helped some major companies to become more competitive.

The CHAIRMAN. Let me say to the members of the panel, there will be 10 minutes for Senator Moynihan and myself, and then the first round we will restrict to 5 minutes.

Commissioner Rossotti, you talked about the oversight board. As I understand the problem, we need independent oversight of the agency, both internally and by the Congress. Now, the purpose of the board is to give that independent oversight of operations to ensure that it is being operated in a manner consistent with the policies of both the administration, as well as the Congress.

Now, if you are going to have oversight responsibility, it is important that you have the information, the facts that are necessary to provide that oversight. As we all know, under 6103 authority it is very limited as to who can have taxpayers' information because we want to protect the privacy of the taxpayer.

But I am concerned here. The House bill does not give 6103 authority to the board. Now, I think we all agree that the board

should not be involved in trying to resolve specific cases, but in discharging its obligation of oversight it should look at it systematically. How can that be done if it cannot have the basic information about how the agency is handling, in a systematic way, the various taxpayers?

Let me just give an illustration. I think this is a copy of the Review of the Use of Statistics and the Protection of Taxpayer Rights in the Arkansas-Oklahoma District Collection Field Function. If you do not have 6103 authority, the problem is, you are going to have a lot of pages like this where it is deleted. It is not made available.

So my question is, if the purpose of the board is to correct significant problems in the IRS, does not the board need to have the facts? In that case, will the facts not include taxpayer information?

Commissioner ROSSOTTI. Well, I think this is obviously a question we could talk about at length if we get into the specific functions of the board. But as I understand the function of the board as it was worked out in the House legislation, it is the function of the oversight board, the new oversight board, essentially, to bring in outside, private sector expertise to work with the Commissioner and the staff to work out goals and long-range plans, and then to determine the degree to which those are being achieved and to hold the management accountable for those things.

I believe that in most boards that I have been involved in, that is also the function of the board as opposed to getting too deeply into specific issues. For example, in our previous life it would have been contracts or projects. I did not really see much need for our board to get involved in that.

The CHAIRMAN. No argument that they do not need detailed facts to look at it on a case by case basis.

Commissioner ROSSOTTI. Yes. Yes.

The CHAIRMAN. That is not the purpose. But if they are to be in a position to give effective oversight, it does seem to me that they have to have basic data, including that covered by 6103, to review the operations.

Commissioner ROSSOTTI. Well, with the case of audit reports, which is an important source of information, as it is now, the IRS is required to send all internal audit reports over to the Appropriations Committees for example, and certainly they could be sent to the Congress.

I think there are sometimes, as you noted there, some deletions that relate to specific cases. But in the case of the recent audit reports, I think the ones that dealt with the use of statistics really did not require that many deletions. The ones on specific seizures did require deletions because of the fact that they did get into specific seizure cases.

So I think that the board would certainly be able to look at most of the audit reports that we get, and the only thing that would have to be deleted would be the specific taxpayer cases.

The CHAIRMAN. I have to say, I am concerned about their having access to the basic information, for limited purposes.

Let me just point out that the original purpose of 6103 was to protect the taxpayer. I fear that the practice has become one to use

it to isolate and protect the secrecy of the agency. I see the Secretary wants to comment.

Secretary RUBIN. I do not have a practical solution, but I think you have stated the dilemma very well, Mr. Chairman.

Let me may a suggestion, if I may. It seems to me that I, as a taxpayer, even if I did have a terrible problem with the IRS—which hopefully in my present job I would not, but if I did today, at least I would know how to address it—I do not think I would want my personal information in the hands of a board that has a group of private sector member and non-full-time government employees.

On the other hand, I think your point is also valid. Maybe the idea would be for the Commissioner to work with the committee to find some way of getting you what you need, but in a fashion that disguises the individual characteristics enough so it protects the identities and particular personal characteristics of the taxpayers.

The CHAIRMAN. Well, we would be happy to work with you. I think there is a need here.

Let me turn to the question of the independent inspector. Back in 1986, I was chairman of the Governmental Affairs Committee. I asked GAO to report on the need for a statutory independent IG at the Department of Treasury. The GAO made a study and recommended the creation of an independent IG, but the Treasury, at that time, opposed it.

Anyway, in 1988 Congress partially acted on the GAO recommendation and we enacted the current arrangement of the umbrella IG. However, the 1988 conference report noted, Mr. Secretary, that, The Secretary of Treasury has the authority, under Section 9(a)(2) of the IG Act, to complete the task and transfer the Inspection Division of the IRS to the Treasury IG. Is it not time, Mr. Secretary, to exercise that authority?

Secretary RUBIN. Well, let me give you a partial answer if I may, then ask the Commissioner if he would comment. The Commissioner and I have talked about this. We have talked about a lot of matters. I think what you have got right now is an extremely good working relationship between the Commissioner and our Assistant Secretary Nancy Killefer, myself, Larry Summers, and others. It has been, I think, a very good and synergistic kind of relationship.

I think the question you have got is, on the one hand, if you did that you would have more of a pure IG kind of function, which is what you are driving at. On the other hand, the Inspection Service, as it is now organized, gives the Commissioner an arm, if you will, that he can use for accomplishing all sorts of purposes in terms of finding out what is going on at the IRS. I think the Commissioner can speak for himself, but my guess is that that is a very valuable arm for the Commissioner to have.

As I understand it, under the current system if you have problems with senior people—and this is, admittedly, limited to senior people—at the IRS, then the Treasury IG does get involved. But I, at least, think we may well have the appropriate balance, but let me ask the Commissioner to comment on that.

Commissioner ROSSOTTI. First of all, Mr. Chairman, let me just say that having a really strong internal audit inspection IG kind of a function for an organization like the IRS is critical. I think

that anyone that would take the job such as I have as a Commissioner would want to have that.

I think if you look at almost all the cabinet agencies and all the major agencies of government, the IG does report to the head of the agency and that is viewed as an arm of management.

I think one of the problems that we may have had with the Inspection Service at the IRS has to do more, not so much with the Inspection Service, but with the IRS itself. If you look at that complex structure that I showed up there, the national office is not really like a corporate office in a corporation, it is really sort of combined with an operations office, so it does not have that vertical separation that you would normally have in a large corporation.

I think there is a possibility here that we could rectify that—in fact, I think we would rectify it—by having more of a vertical separation, where the Inspection Service would be one level above the operating units, which is not the case today.

Having said that, let me just say that I think there probably are some ways that it would make sense to strengthen what is now the Inspection Service in terms of its independence and make it more like an IG without completely taking it out from under the Commissioner, and I think we would be happy to sit down and talk to you about some of those ideas.

The CHAIRMAN. Just let me say that I have no argument about the Commissioner needing an independent source of inspection, but I do think that in government and other agencies we need an external check to ensure that this agency is not isolated.

What I am concerned about is not today with you there and Secretary Rubin where he is. But what we are trying to put in place is the kind of organization that will ensure the kind of operation you are trying to bring about will continue. So we have to look at the possibility that you may have individuals, as in the past, who have misused these for their own purpose or they have been ineffective.

Commissioner ROSSOTTI. I am very sensitive to that. I think that maybe there are some things that we could do to strengthen the Inspection Service's independence and make sure that it does not, even in the long term or with another set of people, fulfill its role without undermining what I think is very important. That is, as you have acknowledged, the need for a Commissioner of the IRS to have, as all other cabinet officials or senior officials that run large agencies have, an Inspection Service. As you know, I have been actively using the Inspection Service.

Could I just comment on your other point about the information and follow up on the Secretary's comment about that. We would be happy to work with you to figure out how we could do that. As you know, one of my goals that I said at my confirmation hearing is to bring sunshine in and to have an open, honest communication. It is one of the five guiding principles that I have established here.

So certainly, from my point of view, I want to do everything we can to not use 6103 or anything else to slow down the appropriate flow of information, even internally within the IRS to me, let alone the outside board.

The CHAIRMAN. My time is up. I have a number of additional questions.

Senator MOYNIHAN. Sure. Go ahead.

The CHAIRMAN. Thank you, Senator Moynihan.

As you know, we have been concerned about the fact that the use of collection quotas and statistics to inspire IRS employees to shake down taxpayers was a major and disturbing finding of our September hearings.

On January 12, 1998, the IRS Chief Inspector issued a report which confirmed this practice in the 12 districts that were reviewed. The report concluded that the IRS has violated the law and has created an environment driven by statistics that place taxpayers' rights at risk.

The Chief Inspector reported, "In recent years, the Service focused on increasing productivity in the Collection Field function. Dollars collected was the most important factor in setting program goals and evaluating program accomplishments."

It goes on, "The former Assistant Commissioner (Collection) issued guidance on the use of enforcement statistics, which violated the provisions of the Taxpayer Bill of Rights."

My question to you, Mr. Commissioner, is what steps are being taken to remedy this situation?

Commissioner ROSSOTTI. Well, Mr. Chairman, we have taken quite a number of steps as we have learned more about this situation. Of course, one of the steps that was already taken before I got there was to suspend the use of all these statistics down to the district level and to issue restrictions on the use of enforcement statistics, which are going to be enforced, meaning the non-use of them will be enforced. We will make sure that that happens.

We have also, of course, instituted additional investigations to see if there are individual managers within the IRS who need to be held accountable for these violations.

As a matter of fact, I have set up a special process to receive the results of the facts that are gathered through these investigations so that they can be given to some objective people who are not part of the IRS to determine what kind of disciplinary action would be required. That process is instituted and will be playing out over the next couple of months.

In addition to that, we have done a number of steps, as you know, to change the process and to provide more management oversight for enforcement actions such as seizures, and we have taken those steps already and put those in place.

We are now studying additional steps that we might want to take in other kinds of enforcement actions, such as liens and levies, and to see if we need to change some of the process there. So, we have taken significant steps.

Of course, we have withdrawn the document that was issued that was incorrect. We have set up a process to ensure that any such policy documents are more closely coordinated, more appropriately coordinated with counsel. There are more that I believe we have given to you in a letter that we sent to the committee, Mr. Chairman.

Let me just say, as important as these are, and there may be more that we will take because we are still continuing these audits, that fundamentally we have got to change the whole thinking process here and how we do compliance, and that is what I was trying

to get to in my opening concept. We really need to turn this around and focus not on measuring our success by enforcement, but by basically how well we serve the taxpayer.

The CHAIRMAN. Let me turn to one additional question, if I may. Our hearings indicated a need for the Committee to consider protection for the taxpayer in a number of very specific areas. Taxpayers are angry because they feel that the IRS can arbitrarily assign income to taxpayers, who then have to prove that they do not have such income.

Should we change the system so that the basic rule would be that the IRS carries the burden of proof on income and the taxpayer, perhaps, the burden of proof on deductions? How does the burden of proof on the IRS square with the legal duties of taxpayers to file a correct return?

Commissioner ROSSOTTI. Yes. I think there is a provision, of course, in the House bill that deals with this issue and we support the idea of improving the way this proof is done.

The only concern we have with the House bill is that it could inadvertently lead taxpayers, as it is currently drafted, we think, in some cases to think that they would be better off, for example, not to keep any records at all, which would then lead to further disputes.

This is a very technical issue. We support the idea of shifting, as the House bill has done, to improve the rights of the taxpayers. But I think we need to really, as I would suggest, get our staffs together to make sure that we have got the drafting right so that we do not inadvertently create more disputes rather than resolving them.

The CHAIRMAN. One of the problems I see with the House approach is that it only applies when it is in court.

Commissioner ROSSOTTI. Yes.

The CHAIRMAN. I think what the American people are concerned about is that the IRS itself can impose or assign income, then the burden is on the taxpayer. So I do not see the House proposal really addressing that problem.

Commissioner ROSSOTTI. I am afraid, Senator, that gets into a highly technical area on which I need to get some staff support on to work with you.

The CHAIRMAN. This is one of the areas in which I think members of both sides have expressed real concern.

Commissioner ROSSOTTI. Yes.

The CHAIRMAN. Let me give you another example. The area of interest and penalties seems to be out of control and is a source of a great deal of unhappiness with taxpayers. I think it is a serious problem. It takes too long for the IRS to notify taxpayers of mistakes and resolve issues. This is not fair to the taxpayers who are trying to make a good faith attempt to comply with the tax laws.

We have an example, where a 10 cent error ballooned into a $500 cascading penalty. This is absurd. It should not happen. Do you agree that there is a problem in this area of interest and penalties?

Commissioner ROSSOTTI. Mr. Chairman, I definitely agree there is a problem, and I think it comes from a number of different sources. One of them is just the structure or the way the interest and penalties are set up in some cases.

Many former Commissioners before I ever took office advised me that this is an area that we ought to look at. I think there is a provision in the bill, as I recall, that specifically calls for study of interest and penalties by the Joint Committee, with which we would like to participate. But let me just say that the way that they are set up in the legislation and the regulations are not the only source of the problem.

A very big source of the problem is the statistic I cited to you, that 90 percent of the collection activity that we do at the IRS is after 6 months, which is, by that time, no matter what structure you have, a time in which you have got interest and penalties accumulated.

So I think we need to address it from both angles. One, is to perhaps reform the calculation of the interest and penalties. I think the study that is called for in the legislation would be helpful. We also need to reform our practices so we do what the private sector does and get in and help people not get in trouble in the first place.

The CHAIRMAN. Well, I think there is a serious problem. I am not sure that I am satisfied with just another study being made.

But my time is now up, and I do have some more questions.

Secretary RUBIN. Mr. Chairman, could I make just one comment, if I may?

The CHAIRMAN. Sure.

Secretary RUBIN. To go back to one of the earlier questions. On the burden of proof, as the Commissioner said, we have all been very sympathetic to the concerns that underlay the House provision. On the other hand, sometimes unintended consequences can overwhelm the purpose that they are trying to achieve.

As the Commissioner said, there is the potential for an unintended consequence in here in terms of an incentive for people to either not keep, or even destroy, records. That has a whole set of other consequences that would be very undesirable. So I think this is something that we would have to respectfully suggest be worked through very carefully.

The CHAIRMAN. I agree with that.

Senator Moynihan.

Senator MOYNIHAN. As do I, sir.

Mr. Chairman, at the risk of offering moral support to Senator Gramm, or perhaps immoral support. [Laughter.] I would like to comment just a moment and hear anything you have to say about the degree to which the problems of the IRS are a function of the complexity of the Tax Code, as created by this Congress and authorized by successive administrations.

On the last day of last year, Wednesday, December 31, the Wall Street Journal had an article on its editorial page called "The Market Value of the Tax Code," and told of the enormous increase in the value of the stock of H&R Block Company in the aftermath of what the Wall Street Journal described as the unsurpassedly complex Taxpayer Relief Act of 1997. Unsurpassedly complex. They said there were 800 new amendments, 290 new sections, and 36 new retroactive provisions. They are opening up 250 new offices around the country.

They note that in the 1960's when the H&R Block Income Tax Guide was first published, it had 196 pages. By 1988, it was up to 317 pages. This year, its pages will number 574.

Now, putting that kind of complexity onto an organization where people do not make a lot of money, let us face that limitation of what we can expect of a system like this, the salary structure, which is a civil service salary structure. We ask what I think we ought not to do.

I note that with respect to the year 2000 problem, I do not want to seem to be preoccupied by this, but if our tax system collapses because we do not get to this problem, we will have been to blame. Larry Summers not long ago said we are badly off track.

May I say, it sounds like it is a problem that happens in the year 2000. No, no. It happens about three months from now when you are at a point of no return. In Sydney, Australia, the hotels taking reservations for the year 2000 Olympics find their computers cannot do it and they are doing it on paper.

We understand from your very able spokesman, Mr. Art Gross, that this last tax bill will put a three-month delay in getting on with the year 2000 conversion problem, as the Secretary put it.

Now, could I ask you, with obvious political purpose but some residual public purpose as well, do you think we ought to pass another tax bill this year like the last one?

Commissioner ROSSOTTI. I think I ought to let the Secretary answer that one. [Laughter.]

Secretary RUBIN. Can I respond, Senator, with total public purpose and no political purpose. I, myself, think the last tax bill, though it certainly was not simplifying, I agree with you in that respect, had in other respects very important purposes we supported, and I think rightly so. There is a complexity problem. We believe in simplification.

I think the problem that you get, and you know far better than I having been involved in this longer, is that while simplicity is an objective we all have, once you start looking at particular tax reform proposals against the questions of what effect they have on the economy, on the deficit, and on fairness and things of that sort, you get into much more difficult issues and the kinds of proposals have been made, flat taxes, VATs, and things of that sort, in our judgment at least, are replete with very difficult problems, and in our view, at least, on present evidence, would seem to be not as good as the progressive tax system that we have.

Senator MOYNIHAN. Sure.

Secretary RUBIN. But I think we all do need to try to improve simplification, because I think clearly that is an objective that we share.

Senator MOYNIHAN. I wonder if I could just suggest that we might think, as we work through this bill, some metric about complexity. Maybe the Joint Tax Committee should do it, maybe the IRS should do it. Something saying, enough is enough, and that is too much. That is all I mean. But I do not see how, given the Tax Code we have presented you, you would have anything but the difficulties you now encounter.

Secretary RUBIN. Could I suggest the Commissioner, in addition to addressing what I just responded to, might also like to address your year 2000 comment.

Senator MOYNIHAN. Yes, sir.

Secretary RUBIN. It is obviously an extremely important question.

Senator MOYNIHAN. That was my last question.

Secretary RUBIN. I am sorry. I did not mean to. You had raised it and I just wanted to have it addressed.

Commissioner ROSSOTTI. I was just going to say that you are certainly right, that if it were not handled correctly it would have catastrophic consequences. That is why we are paying so much attention to it. I think that as a result of work that had already been done before I got there, there was a great deal of activity under way which is in the right direction to make sure this was done.

Since I have gotten to the IRS, that was one of the first things I did. We did establish some additional tasks and jobs to be done. We have a management process that I have set up that is reporting directly to me to make sure that we do the thing that we most need to do, which is to identify any risks that might prevent us from being successful as quickly as possible.

As you remember, we have got them very simply coded, green, red, and yellow. There are a lot of yellows on the chart right now. There is only one red one. That is the one that we are paying the most attention to.

So I think we have a lot of risk still ahead of us. This is an extraordinarily complex program. But I do think we have a process in place that has identified the risks and we are going to work as hard as we can to make sure that we address those right away.

Senator MOYNIHAN. I know you will, Commissioner. I think it simply is, for our part, to be restrained to give you the opportunity. By the year 2001, we can go wild with amendments again.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gramm.

Senator GRAMM. Thank you, Mr. Chairman, and let me thank our witnesses.

I just want to touch, very briefly, on the burden of proof. I think probably from the very beginning of the tax collection process in this country there has always been a slight shifting of the burden.

But I am in strong agreement with the Chairman. I do not think the House goes far enough in establishing the principle that the taxpayer is innocent until proven guilty. Only in rare cases, including an assertion of fraud, is that the case under the current statutes. I do not want to make it easier for crooks to not pay taxes.

On the other hand, I am willing to put a heavier burden on crooks with penalties, fines, in order to be able to expand the legitimate rights of honest taxpayers. I want to explain very briefly why I disagree with the prevailing sentiment on this issue.

I do not believe that the American public is ever going to come to view the tax collector as a consumer-friendly agency. Thinking back, the last tax collector that I remember who was generally loved was St. Matthew. That has been a long time.

I do not buy the idea that any consumer is ever going to get a telephone call from the IRS and say, wow, I am about to get

helped. [Laughter.] Also, quite frankly, at the risk of sounding cynical, if the duty of the IRS is to collect taxes, I am not sure how you ever totally get away from the position that ultimately you have to judge an agent on their ability to collect legitimate taxes.

So I again say that what we really need to be doing here is fundamentally change the structure of the system and restrain the government in its role as the tax collector using the police power of the State.

That is why I dwell on this burden of proof issue and I am totally in agreement with the Chairman. I do want to work with you on it, because I know there is a problem. I am not sure how we ought to solve it.

I would like to touch on an issue that I raised that I feel strongly about. I noticed in looking at the seal of the Internal Revenue Service—if you would put back up one of those charts—I noticed it has scales above a key. I assume the scales stand for justice, and I assume that is the key to the Treasury. But in the seal, justice is above the Treasury.

Now, I want to get your views of the proposal that I intend to put before the committee when we vote on this bill. If I am a taxpayer and I am paying my taxes, and I get audited and I have to go out and hire attorneys, and hire lawyers and go through a process that may embarrass me, my children, my family, hurt my business, and at the end of the day it is found that I have done nothing wrong, I have paid all my taxes, why should the Internal Revenue Service not have to pay the costs that I have incurred because they have imposed a burden on me by auditing my account and in the process forcing me to spend money? Why should that not be part of my legitimate taxpayer rights?

Now, if I did something wrong, it is a different ball game. But I am talking about a case where we go through the whole process and, at the end of the day, it was proven that I did nothing wrong, why should the IRS not be liable to pay the expenses that I incurred in defending myself?

Commissioner ROSSOTTI. Well, let me just say that there are certain circumstances, and I think they are enhanced in this bill, under which the taxpayer can recover costs. I think one problem that may exist, is the idea that an audit implies somebody has done something wrong.

I mean, there is not any way in the world that a tax system could be administered and know in advance, when you initiate an audit, whether it is going to produce revenues or not. I mean, right now audits are done, most of them, based on a statistical formula that looks at a return and attempts to predict whether there would be additional tax due.

Senator GRAMM. But does it bother you that in doing this we are imposing thousands, tens of thousands of cost on ordinary citizens who may not have done anything wrong?

I view this as a takings, that you have got a small, independent business person, he is audited, and he had to spend $15,000 defending himself. It turns out he did not do anything wrong.

Our response is, well, you know, we have to audit people. Well, what about his $15,000? I am saying, if there is a public good in

auditing, then if this taxpayer did nothing wrong the public ought to have to reimburse him.

Commissioner ROSSOTTI. Of course, there are a lot of burdens that are imposed by the tax system, including just filing the forms in the first place, which is just a part of the way the tax system works. So I think that is more of a policy issue.

I think the committee, the Congress and the Treasury would have to determine whether this particular form of burden is one that should be reimbursed, even though other forms of burdens in complying with the law are not reimbursed.

I mean, it is certainly an issue that is worthy of discussion, but I think it needs to be put in the broader context of all the burdens that are placed on taxpayers as a result of the fact that we have a tax system.

Senator GRAMM. Well, Mr. Chairman, my time is up. But I thought the committee would enjoy knowing that these are not new problems. I was reading from the 1924 hearings, which I guess were the first major hearings held on this problem. I just want to read one paragraph.

"Finally, rumors abound that a successful career in the Treasury Department would be aided by the collection of a large amount of taxes. These rumors were officially denied, but they may have been believed by some. If the board was left in the Treasury," and this was the debate about basically whether the IRS should be independent of the Treasury, "it would always be subject to the charge that ambitious members would seek to gain favor for future promotions by deciding cases against taxpayers."

The point being, this is not a new problem that came about yesterday, this is an old issue and one that we have never fully come to grips with, at least in the era when government has been a huge gatherer of resources from the general public.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Gramm.

Senator Grassley.

Senator GRASSLEY. I want to say to both of you that it is a real welcome atmosphere that we are in here. There is a real rational exuberance for reform. Twelve months ago, particularly I would say this to Secretary Rubin, I thought if we were going to get anything done we were just going to be fighting and pulling teeth and just have a terrible time.

To have the sort of attitude that you expressed today is very satisfying and very welcome. I think not only does it help get the job done between Congress and the administration, but also I think it is very good for the sort of culture that we want to change, from the highest to the lowest levels, of the IRS. It was kind of unpredictable 12 months ago and I am glad it is here and am glad we have this sort of cooperation.

I guess maybe along that line then we have already had some evidence of changes going on. From your standpoint, Secretary Rubin, not only the extent to which you probably are endorsing this direction already, maybe you have not made a final decision on every detail, but obviously somewhere up the chain I suppose OMB guides and directs every position that goes on.

Are we going to have this sort of enthusiastic support outside of your department as well to get the job done, do you believe? Second, within your department will there be the resources there to get the job done?

Secretary RUBIN. Senator, first of all, I appreciate your comment. Except for the budget aspects of it, this is an issue that lies in the province of Treasury. I can assure you that our commitment will continue unabated. We are exceedingly fortunate we have a new Assistant Secretary of Management, Nancy Killefer, who was a very senior person at McKenzie & Company and is dedicated to this with equal fervor. So I think you can be assured that this atmosphere will continue. And the President expressed his views on that last night.

Senator GRASSLEY. The reason I asked about OMB is, and maybe I would be wrong on this in this instance, but it seems to me like everything has got to clear OMB. They can become a hurdle, a terrible hurdle, to get over regardless of how sincere you might be. You do not see problems like that?

Secretary RUBIN. I really do not, Senator, other than budget issues which very properly belong in OMB. All of the other decisions and issues that we have to deal with lie within Treasury. Also, I might add, OMB has been very supportive of this reform perspective with respect to the IRS.

Senator GRASSLEY. All right.

Along that line then, for either one of you, do you see that the reforms that you are going to bring about are an excuse for the expenditure of a lot more money?

Secretary RUBIN. An excuse for, a reason for?

Senator GRASSLEY. Yes. I mean, getting more money for IRS, to have a bigger budget for IRS.

Secretary RUBIN. Let me give a generalized response, but I think the Commissioner can better respond than I can. I think that to have the purposes that you all want to accomplish and we all want to accomplish, we have to have an appropriately financed IRS. I do not believe, and I will let the Commissioner comment on this, there is a cheap way to do this.

I think this is an enormous undertaking and I think it is going to, very importantly, need adequate funding. I think this committee, while it is not obviously in your jurisdiction, the appropriations, I think your lending your voice to that could be very helpful.

Senator GRASSLEY. All right.

Commissioner ROSSOTTI. Let me just say this, Senator Grassley. I think one of the goals that was up there was productivity. I did not mention that as much because I talked about service, but the third one is productivity.

Here is what I believe about that. I believe that we can, as actually has happened over the last three or four years, if we do this, we can shrink continuously for at least the next four or five years. I do not know about longer than that. We can shrink the size of the IRS in relation to the economy. In other words, we can keep the work force we have and the economy can grow and we will become a smaller fraction year after year.

However, I do want to say one thing on the money side. The work force is the principal cost, but the one exception I have to

make, is we are going to need money for technology because the technology base that we have is just utterly deficient and is not comparable to anything in the world.

I know that there was great concern in the Congress about the fact that Congress did provide a lot of money over a long period of time and it did not succeed in solving the problem. All I can say is, there is nothing I can do about that. That happened.

But in the future we are going to try, at least on my watch, to spend every dollar we have on technology as carefully as we can, recognizing there are risks. I mean, technology is a very risky business. But we are going to try very hard to make sure we put it where it needs to be. So that is the one exception. We do need some incremental money for technology.

Senator GRASSLEY. All right.

My last question then would deal with something that has already been discussed pretty thoroughly by several people, including the Chairman, and that is your internal audit. You have already expressed strong actions you are going to take and how wrong this is, the policy to give people promotions based upon money collected, forfeitures, liens, et cetera.

Obviously, we legislated against that 10 years ago. Whether we legislated against it or not, it is bad policy. But it was part of the Taxpayer Bill of Rights I. Do you see what is wrong not only being bad policy, but do you clearly see it as a violation of the Taxpayer Bill of Rights as well?

Commissioner ROSSOTTI. Yes. I think that the audit report says that in some cases there was a violation of the Taxpayer Bill of Rights. I mean, they were dispersed. They were not all violations specifically. But regardless, I mean, the whole message we are sending is that we are just not going to do business this way.

We are sending that message in a lot of different ways. I think part of my longer term concept here is to reverse completely the whole emphasis and put it on compliance and service, not enforcement.

Senator GRASSLEY. So it seems to me that you would see this as just bad policy that maybe Congress should not have ever to legislate against.

Commissioner ROSSOTTI. Well, actually, I think there was policy beforehand. Even before there was legislation, the Congress reinforced it.

Senator GRASSLEY. All right.

Commissioner ROSSOTTI. What we have to do, is we have to figure out how to manage the agency that is consistent with those set of values, which is what I am trying to do.

Senator GRASSLEY. Thank you very much.

The CHAIRMAN. Thank you, Senator Grassley.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. Again, I expressed earlier my admiration for the Secretary and for the Commissioner, and their comments today have added to that admiration.

I believe the blueprint that the Commissioner has laid out is a very prudent and effective road map for how we can reverse this agency from being one that looked inward to one that looks out-

ward. That is a fundamental and extremely significant reversion of position.

I would like to go back to some of the concerns that were raised by Floridians at the hearing that we held in Orlando, starting with this issue of penalties and interest. I came out of that hearing with the impression that this was a very fundamental barrier to middle and lower income taxpayers being willing to settle a case.

Frankly, the gentleman who paid $181 a month for 90 months would have been better off declaring bankruptcy and discharging his responsibility in that manner, because he has ended up having made these substantial payments but still owes more than he did when he started the process.

A statement was made at the hearing by representatives of the IRS that they did not have the discretion to waive penalties and interest, that the law required them to continue the clock to run during the period of settlement. I wonder if you could comment on that.

Commissioner ROSSOTTI. Yes. Let me just say, again, this is where my not being a tax lawyer is not too helpful. But, as I understand it, we can in most cases waive penalties but not interest. I think that really does not get at the heart of your question. I think your point is right. I mean, one of the pieces of advice I got from former Commissioners before I came here was, get on to this interest and penalties thing because this is a problem area, and that it is.

It is a complicated area. I do think it is a good idea to do the study that is required in the legislation to look at the specific provisions that deal with interest and penalties, and perhaps some of the issues about what discretion the IRS has. I think that is one of the parts of tackling this problem, because it is a very big problem.

The other part of it, though, I get back to the business practices. I mean, one of the reasons these small business people and other people get into so much trouble, is, it is so late. It gets so far down the line. The compounding effect becomes very, very serious.

So that is a really fundamental problem in the way that the whole IRS does business, and it is completely the reverse of the public sector. Basically, our approach is, let things build up and then come in with a lot of interest and penalties and enforcement action.

It is not because the people at the IRS want to do that, it is just this whole process is really broken, I would say, in terms of the way it works. It is really a big job to fix it because it is an enormous operation.

So we really have to approach it from sort of a number of angles. One, is the reform, perhaps, of the legislation, which we have to study very carefully particularly the technical side of it.

The other is the business practices and the way we actually administer these things. I am not saying, by the way, there are not short-term things we are going to do. That is one of the things that we are looking at short-term as part of our near-term actions, within the next year. There may be more things we can do even within our own discretionary authority. If we can, we will.

But I would say, without a doubt, I really agree with your taxpayer and I agree with your observation. I think it is not going to be a simple one to fix. We need to approach it from a number of different points of view.

Senator GRAHAM. Another issue raised from the perspective that the taxpayer is feeling that the process is unfair in that the person who yesterday was the prosecutor relative to developing the case of the IRS against the taxpayer, tomorrow is the judge to determine whether the taxpayer is, in fact, liable.

The suggestion was made that some of the developments of third party dispute resolution procedures, which have been effective in a number of judicial and commercial settings, might be applied to render a greater sense of fairness within the IRS system. I wonder if you could comment about that.

Commissioner ROSSOTTI. Well, again, I think there are—and this is an area I am not yet entirely familiar with, so I have to be honest, I do not have a complete answer to your question—some experiments going on with third party resolution. That could be a very promising approach for certain kinds of disputes.

But I think another element of this is to really, as we go through this rethinking of our whole concept, is to be sure that there are the right kinds of channels that are truly independent. We actually have them on paper now, in many cases, Senator. We have different channels. We have an appeals process, we have a Taxpayer Advocate process, and of course, you have a court process.

So there are an awful lot of processes in place. Adding more of them is not always the answer. I think what we need to do is to think of how we can make those actually work better for the taxpayer, and I think there are some things we can do along those lines.

Senator GRAHAM. As you have analyzed taxpayers into the four discrete categories, I think the current procedures probably work reasonably well for the larger taxpayer who can afford the representation that those administrative and judicial procedures entail. They do not work well with the small taxpayer, particularly the small business taxpayer.

Commissioner ROSSOTTI. Actually, if you look at it, I think that is a very good observation because all of these issues we are talking about, I mean, the attempt to try to develop one process and one way of doing it that fits everybody from the largest corporation to a small, two-person business is just an impossible job to do. I think one of the concepts here, not just the organization structure, is let us not try to look at one size fits all.

As you say, if we want to have something that is an appeals process or a dispute resolution process, let us devise one that really works for a five-person business, where the owner has to wear six hats rather than try to devise the same exact thing for that person and somebody who has a much larger business. I hope, over time, that that principle will be one of the driving principles that we can work on through this whole agency.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Graham.

I have three questions. I will try to make them as short as possible. We have the same problem with liens, levies and seizures.

The oversight hearing showed people are very concerned that they do not receive real notice. They can wake up in the morning and find that their bank account has been frozen, or other assets, including their house, may have been taken. It goes back again to the question of the IRS being a prosecutor, judge, and jury.

In the private sector, if a creditor has problems, he has to go to court. Why would that not be appropriate here?

Commissioner ROSSOTTI. Well, first of all, I want to say that everything we are doing is being studied. The fact is, everything we are doing is being studied because we are trying to review everything we are doing. We have a study that we have just initiated recently. We started with seizures, but now we are trying to look more carefully at liens and levies. I hope that within a few months, and I do not remember the exact date for when that study is, we will be able to come up with some things that we can implement ourselves.

Beyond that, I think that another big point, the collection process. Frankly, Senator, of all the processes that we have in the IRS, and I talked about different business practices like filing and compliance, I think the one that has the most opportunity to improve is the entire collection process. I think some of your hearings observed that.

We really need to do a better job of getting in and figuring out solutions for taxpayers earlier and minimizing the use of some of these kinds of techniques. That does not mean we will ever get away from it. I think that the IRS does have to have these powers in order to be able to execute its role and to be fair to all taxpayers, making sure the ones that are voluntarily paying are not penalized by somebody else who is not paying.

But I think, over time, through a number of different techniques we can minimize or reduce dramatically the need to use some of these stronger techniques. So I hope that we will be implementing over time a continuous series of things to improve. Of course, through your oversight process you can observe and work with us to see how well that is going.

The CHAIRMAN. I appreciate your answer. I think this may be an area where we might want to legislate as well.

Let me go on to a couple of other questions. I know the Secretary remembers when he was here before and we talked about the Commissioner having his own management team. You assured me that the new Commissioner would be able to appoint his own team as a reasonable means of getting action taken in a meaningful way.

So I would like to ask the Commissioner, now that you have been on the job, what are your plans in regard to the senior executive service positions? Do traditional senior executive positions fit in with your plans to hire management for a specific time to accomplish specific results? If not, would you describe the tools you would like the Congress to provide.

Commissioner ROSSOTTI. Thank you very much. That is a very important point in being able to make this plan work. First, let me say that the Secretary has delivered everything that I have asked for, including letting me take one of his most important aides, which was probably the hardest decision he has made so far.

So we have already started to use some of the authority that has been granted to us. I mentioned that we have a national search firm searching outside for national taxpayer advocates. That is already under way. So, it is not that we are stymied, it is not that we cannot do anything, we are moving ahead.

Nevertheless, for this new concept, and I have talked about these management roles, I think we will have for the first time management roles that are comparable to the outside so that we will be able to bring in people.

And, yes, I think we do need some additional legislative authority as part of this, which we need to work with your staff to define. But the essence of it is to be able, for a limited number of positions, to bring people in, much as Senator Gramm has suggested, on limited term appointments that we could renew for a limited period of time. I think we do not need a large number of these, but these would be critical for filling some of these key roles.

We would also like to have for those positions some compensation authority that would allow us to have part of their compensation be variable so that it would only be paid if they achieved the goals that were set by management. Those are the two key things we need.

A third one has to do with some technical positions. The technical world has become very competitive, and salaries are going up. We would like to have some authority to hire a selected number of technical experts for certain positions in an expedited way. I think, in addition to what is already in the bill, those are the things that we need the most in order to be able to succeed with this concept.

The CHAIRMAN. Let me ask you this. If your reorganization causes positions to be eliminated, will you need new buy-out authority or any additional flexibility in the application of reduction in force rules?

Commissioner ROSSOTTI. Yes, we would like to have that. I think in my written statement, Mr. Chairman, we indicated some authority we would like in that area.

The CHAIRMAN. Yes. We will certainly want to work with you on that.

Now, let me go back a moment to the oversight board questions. The House bill establishes a board to oversee the IRS in its administration, management, conduct, direction, supervision of the administration of the tax law. What does oversee mean to you? What should be the relationship between the Commissioner and the board?

Commissioner ROSSOTTI. Is that to me, Mr. Chairman?

The CHAIRMAN. Yes. Sure.

Commissioner ROSSOTTI. All right. Well, the only thing I can go by is my experience in the private sector where I was in various roles over many years, both as the person being overseen and also as a person who was on boards overseeing other people.

I think that what it really means to me is that the board lends its expertise. It lends its judgment to the formulation of goals and plans which are the responsibility of the management, but it also lends its expertise and it gains an understanding of what those things are, usually on an annual basis. Then it monitors whether

it believes that the management is actually living up to the expectations that it has agreed to.

So it is almost like a contract to me between the board and the management. The board negotiates the contract. I mean, it is not literally a contract, of course, but it has sort of that character, where you say, here is what we are going to do, here are the resources we need.

The board provides its broad expertise in helping the management come to those conclusions and then it is up to the management to execute and make it happen. If it does not, the board then decides whether it needs new management or whether it needs to help the management do something different or take some other action. I really think that that is the way that this board can work.

I think it is going to be critically important to get the best people on this board that can really lend real judgment and expertise. I think no matter what kind of structure you set up, it is going to be critical. Of course, that will be up to the Secretary and the President to do that. But that is the way I see it. I think it can be very constructive. In the right way, it is a very, very constructive relationship.

I think if the board attempts to become part of management, it then eliminates its own role, first of all, and becomes, really, an impediment to management. So it is important that you have these two roles clearly defined.

The CHAIRMAN. Finally, I am troubled that the House bill prohibits the board from exercising any authority over law enforcement activities, an area, frankly, that our hearings showed to be rife with abuse. Would you care to comment on that?

Secretary RUBIN. Mr. Chairman, yes. I think the House bill and the bill I believe Senators Kerrey and Grassley submitted to this committee, on the governance issues, at least, track pretty well—in fact, probably very well—except for that one issue. That is my recollection, at least.

I think the thinking in the House, as I understood it, and I was part of the discussions, was that the notion of law enforcement reporting to a private sector group of citizens raises a lot of questions that were troubling. On the other hand, there are all these collection and other, what you might want to call, law enforcement issues, which you very correctly say need to be properly looked at.

My suggestion would be that, once again, it is one of these difficult kinds of issues we need to try to work our way through, since you have got conflicting considerations, if you will.

That is something we should try to work with your committee on and see if we can find some reasonable resolution because, on the one hand, I think the points that you have raised are right and valid, and on the other hand, I suspect the notion of having law enforcement authorities report to private sector citizens has a lot of troubling issues to it. I think we need to work on that and see if we can find something that reasonably meets both purposes.

The CHAIRMAN. Very good. We will work with you on this, as well as a number of other issues.

I do have additional questions. I will submit those in writing rather than propound them now.

I would be happy to give you, Mr. Secretary, the opportunity to comment on Asia at this time, if you so choose. We are having a hearing next week, and I understand you cannot be here.

Secretary RUBIN. Mr. Chairman, I gave a 37-minute speech the other day at Georgetown. If you would like, I could repeat that as best I remember it. [Laughter.]

The CHAIRMAN. I heard most of it.

Secretary RUBIN. Let me try to be a touch briefer. I know that both of you have been in Asia over the recess and are both enormously focused on this set of issues.

I think that the issues that we are seeing in Asia are obviously extremely important in and of themselves, but I think they are the issues of the new global economy.

I do not think it is an overstatement to say that these issues in their broader sense are perhaps as important as anything that the country has had to face in a long time because this is the new global economy we are living in, with all of its opportunities, but also all of its risks.

At the present time, Mr. Chairman, with respect to Asia itself, I think it would be fair to say that I do believe—in fact, very strongly—that we have good, effective, and strong IMF-centered programs that deal with the structural issues that have given rise to the financial instability.

These are not austerity programs, they are not predominantly fiscal or monetary policy programs, they are structural programs. Having said that, it is an extremely complex situation. The key is for each country to adhere to these programs on a sustained basis.

Korea is a very good example of a country in which both the existing government and the government-elect have really been doing and saying the kinds of things they need to. With the banks now coalescing around a program, I think one can have a very constructive view of that, although we all know there are no guarantees in such complex matters.

Our interests are vitally at stake because of the enormous exports that we have in the developing world, and also because depreciating currencies elsewhere hurt our competitiveness and our goods. The way to correct all that is to try to restore economic well-being to these countries.

I would say one other thing. I think these are enormously complex issues and I think there are no sure answers. I think my own view is that the IMF, with us, have made the best judgment that one of the right ways to go forward with these programs is they have to be adapted as we go along.

You saw that the other day in Indonesia. In Indonesia there obviously have been very considerable questions, or I would say concerns expressed, about the government's commitment to the program, and that is absolutely the key. Hopefully, that commitment will be manifest in many ways going forward.

We also need more broadly, Mr. Chairman, to figure out what kinds of changes need to be made in the architecture of the global economy for the years and decades ahead. We are in a new world.

The mechanisms we have now, although they are the best ones we have and I think we have to fully support them to deal with the crisis at hand lest it get out of hand and have all kinds of ter-

rible adverse effects on us—and it is not out of hand at the present moment, though it is very serious. But the mechanisms we have today are not as modern as the marketplace we live in. We expect to spend enormous intellectual energy with the Federal Reserve Board and others trying to work through those issues over the months ahead. But they are very, very complex issues.

Senator MOYNIHAN. And we can expect some proposals. We might reasonably expect some.

Secretary RUBIN. Senator, I think we all need to work toward trying to find—this is very tough. Deputy Secretary Larry Summers and I were talking about that this morning. We all need to try to work toward improvements.

On the other hand, I have noticed in the last couple of weeks op-ed pieces and articles and all sorts of things, comments about all sorts of ideas, many of which are very attractive on their face, but when you subject them to the kind of rigorous analysis that is going to be required if we are really going to do something that makes sense, you see all kinds of other consequences.

Senator MOYNIHAN. But it is a half century since Breton Woods.

Secretary RUBIN. It is a half century since Breton Woods. We certainly should hope to have proposals that are real and effective, serious and substantial. I guess the only reason I hesitate a touch at your comment was, there is an enormous amount of work to do between now and the day we get to those proposals.

Senator MOYNIHAN. Thank you, sir.

The CHAIRMAN. I certainly agree with Senator Moynihan as to the importance of receiving whatever recommendations you have as you develop them.

Let me just make a very basic observation. I do not think the public, yet, is aware of the significance that area has on our economy, the fact that we are in a global economy. I think it is critically important that the Administration make clear why this is important to the individual here.

Secretary RUBIN. Could I make a comment on that, Senator?

The CHAIRMAN. Sure.

Secretary RUBIN. Mr. Chairman, I think you are right. The President has said on a number of occasions, and I think what you have said is 100 percent right and it is a critically important issue, until the public understands what is at stake you will never have the public support for the programs and things that we need to do.

Senator MOYNIHAN. Yes or no, Mr. Secretary. Do you believe we should provide our regular replenishment of the IMF?

Secretary RUBIN. Yes, absolutely and unequivocally. The IMF is not perfect and the mechanism is not perfect, but lest there be a crisis, which none of us hope happens, in a relatively short period of time we need to have a capability to deal with it.

Senator MOYNIHAN. Right you are.

The CHAIRMAN. Well, gentlemen, you both have been very patient and very helpful in answering the questions raised by members of the committee. This is an important, I think, undertaking. We are going to move expeditiously, but we are not going to move until we have what we consider to be reasonable answers.

We look forward to working with you.

Senator MOYNIHAN. Thank you.

Secretary RUBIN. Thank you all.
Commissioner ROSSOTTI. Thank you.
[Whereupon, at 12:43 p.m., the hearing was recessed.]

IRS RESTRUCTURING

THURSDAY, JANUARY 29, 1998

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD–215, Dirksen Senate Office building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, D'Amato, Nickles, Gramm, Jeffords, Moynihan, Baucus, Rockefeller, Conrad, Moseley-Braun, Bryan, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order. Today we are beginning our second day of hearings on reforming the Internal Revenue Service, and the goal of our series of hearings is to lay the groundwork for legislation that will improve oversight of the agency, better protect taxpayers from unfair treatment and change the IRS internal culture.

Some of the major concerns I have that I would like to address in our series of hearings include: How can a board truly be an oversight board if it cannot get behind the IRS veil of secrecy? Is the IRS internal inspections doing an adequate job as an internal division?

Should the IRS be allowed to arbitrarily assign income to taxpayers, forcing the taxpayer to prove a negative? Shouldn't the IRS carry the burden of proof when it says that a taxpayer has a certain income?

How can we insure that taxpayers who are making a good faith effort to comply with the law are not hit with unreasonable penalties and interest? Should additional taxpayer protections be accorded when the IRS is about to freeze a taxpayer's bank account or seize their property, even a home?

For example, should the taxpayer have the right to court review before the IRS takes these types of actions? Are there additional personnel rule changes that should be made so that the IRS can be managed more efficiently?

For example, are the IRS personnel rules so burdensome that employees who abuse taxpayers are not disciplined? And what needs to be done to insure that employees are treated fairly by management and work in an atmosphere that is free of fear and intimidation?

Our September hearings provided evidence that too often IRS employees find themselves in a hostile work environment.

Well, these are a sampling of the concerns that our September hearings raised, concerns that we will address in our hearings as we build our reform legislation.

Now, today we will hear from representative Rob Portman, who co-chaired the IRS Restructuring Commission with Senator Bob Kerrey. We will also hear from a panel of former IRS commissioners. Their experience at the helm of the IRS gives them a unique and important perspective.

Finally, we will hear from a panel of tax practitioners.

Senator Moynihan will be here in a while, but I think we will just go ahead and proceed, as we do have a pretty full agenda.

Congressman Portman, it is indeed a pleasure to welcome you here today. Just let me say how much I admire the work you have done in this area. You have been an early leader on the need for reform, and I congratulate you for what you have done. And are doing.

Please proceed.

STATEMENT OF HON. ROB PORTMAN, A U.S. REPRESENTATIVE FROM OHIO

Congressman PORTMAN. Thank you, Mr. Chairman, and thank you very much for giving me the opportunity to testify before you today. I am honored to do so.

As you mentioned, I did co-chair the National Commission on Restructuring the IRS, along with your colleague, Senator Bob Kerrey. His vision, his ability to think outside the box from time to time and his creative ideas and commitment to reform were really key to coming up with the comprehensive commission recommendations and then our legislation.

Another distinguished member of your panel, as you know, Senator Charles Grassley, was also an active member of the commission and made very important contributions to our work, especially in the area of taxpayer rights.

And, as you may recall, Mr. Chairman, we met early in the process. I stayed in touch with you and worked continuously with your staff through the commission process and that input was very valuable, and we continue to work closely with you.

The Restructuring Commission, as you know, was created by Congress. In fact, it started here in the Senate. It was charged with auditing the IRS. For the first time since 1952.

We rolled up our sleeves. We spent over a year looking at all the problems at the agency, we conducted extensive public hearings and last June came up with a plan, a comprehensive approach to a new IRS. More responsive to the taxpayers; more respectful of their rights.

In July, Senators Kerrey and Grassley, Congressman Ben Cardin and I introduced legislation to implement the reforms. That legislation was then the subject of hearings before the Ways and Means Committee and passed the House by a vote of 426 to 4 at the end of the session.

But it was this committee, the Finance Committee's work and particularly your hearings last September that really focused all of

America on the need to fundamentally reform this troubled agency. And for that, Mr. Chairman, this committee deserves the gratitude of the commission members, of members of the House and the Senate and, most importantly, the American taxpayer.

I commend this panel for now using the House passed bill as a foundation for your reforms and further improvements. I know I speak for Chairman Archer, Congressman Ben Cardin and others, who worked so hard on this in the House, in saying we are very eager to work with you as partners in improving the House bill and giving the President legislation—as soon as possible—for his signature.

A number of questions were raised in your good hearings yesterday regarding the House passed legislation, and perhaps I can try to respond to them later, if there are questions this morning. But I would like to just briefly discuss a couple of issues that are difficult ones that this committee will be considering.

As you have rightly pointed out, Chairman Roth, we only have one shot at major IRS reform. So it is important we insure that the reforms we enact are comprehensible and sustainable. That is why the oversight board we have proposed, I think, is so critical.

Long after these important hearings have ended and the cameras and reporters have gone on to other stories, Congress and the American taxpayer need to know that there is a mechanism in place to hold the IRS's feet to the fire, a mechanism that provides ongoing oversight, with expertise, continuity and accountability.

The oversight board's role, simply put, is to guide the development and oversee the implementation of long-term strategies at the IRS, a function that we think is sorely lacking now, and to hold IRS management accountable for its performance.

In my view, to be effective, the board must focus on the big picture; strategic issues—like the modernization plan that the Commissioner unveiled before your committee yesterday—and allow the Commissioner then to be responsible for the day-to-day operations of the IRS.

The oversight board's job is to insure that the train is running in the right direction, be sure it is running on time, but not to micro-manage the conductor.

As envisioned in the House passed legislation, the oversight board is focused on strategic tax administration and not intended to get into specific tax cases.

The withholding of Section 6103 authority from the board was deliberate, and it was done for two reasons. First, it serves to prevent actual or perceived conflicts of interest.

As you may know, Mr. Chairman, there are a number of reasons that have been expressed for this. Most of them have been expressed very adamantly by the Secretary of the Treasury in previous testimony. Yesterday there was a different tone I detected.

But one of my personal concerns about this is the potential for such problems as perceived conflicts of interest. Particularly, it may make it difficult for us to attract the kind of people we want to serve on this kind of a board.

Second, the lack of Section 6103 authority, of course, will keep the board focused on the big picture and be sure that they are prevented from being mired down in individual tax matters.

There may be a way to grant something short of blanket 6103 authority to the oversight board without permitting access to individual taxpayer names and information. I am certainly interested in working with the committee on that.

Finally, I would like to commend Chairman Roth and the members of the committee for their strong endorsement and confirmation of Commissioner Charles Rossotti. As I believe we all witnessed in the hearing room yesterday, he brings the kind of credibility, expertise and new ideas that are clearly needed to guide the IRS out of these troubled waters.

The plans that he unveiled before this committee yesterday for a comprehensive modernization of the IRS, focusing on helping people comply with the tax laws and insuring fairness of compliance, are exciting to me, and they are entirely consistent with the commission report and the House-passed legislation.

Essential to this concept is designing, organizing and measuring the work of the IRS around major taxpayer groups with similar needs. I support this concept, which was recommended by the Restructuring Commission, and Mr. Rossotti deserves credit for moving it forward.

But, in order to be successful in this task, he must have the expanded authority and the personnel flexibilities that the restructuring legislation would give him. And, from your comment this morning, you would like to strengthen it even further.

And second, a strong board is needed to be able to enhance and support the bold reforms, if they are to be driven all the way through the system, and we have the kind of continuity in place to make sure, down the line, it actually works.

The era of big government, we are told, is over, Mr. Chairman, but now, of course, we must redouble our efforts to make sure that our government effort is more efficient; our government is more responsive.

The IRS, in its current form, to me, represents the worse, really, of the impersonal, antiquated and inefficient Washington bureaucracy. Meanwhile, the private sector has redefined the standards of customer service over the past couple of decades, delivering world class products, while achieving new levels of efficiency.

We should expect no less of the IRS as we enter the next century.

Congress, of course, has responsibility here, and that is to give the IRS the tools and oversight it needs to get the job done, including a more simplified tax code.

I commend you again for moving legislation forward to do just that; to give the IRS a board, to restructure the IRS, to put in place the taxpayer relief that you have talked about in your initial comments this morning, and I certainly look forward, Mr. Chairman, to working with you and the committee in the weeks ahead to provide this needed relief to taxpayers as soon as possible. Thank you.

[The prepared statement of Congressman Portman appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Portman, for your very informative statement. Let me say I particularly appreciate your interest in working with us as we seek to strengthen the legislation that hopefully will be enacted and become law.

Let me just make one comment. I support the concept of a board, and I thank the commission for recommending that. I do have some concern as to how we make sure they have adequate information to discharge the responsibility of oversight.

I agree with you very strongly, that the board should not be involved in minutia and that type of oversight. At the same time, I think that they have to have adequate information.

As I pointed out yesterday, you take the report that we have on the Oklahoma-Arkansas district office, and if you start deleting everything, how are you going to have oversight? That is very bothersome to me.

I absolutely agree that 6103 should not be made available to handle individual cases, but systematic problems with the organization should be a matter of interest, concern and oversight of the board.

So I think this is something that we have to try to address in a way that does not create a conflict of interest, but also enables the board to discharge its responsibility of true oversight.

The last thing I want to see is an advisory group created that really has no effective function, and it just sort of withers away on the vine, because I think the one critical thing we have to do in this reform is to insure that there is independent oversight of the agency.

I may not be so concerned now, with Charles Rossotti and others there, but what we are trying to do is bring about reform that will last through the years ahead.

And, for that reason, thank you very much for being here and your comments.

Congressman PORTMAN. Mr. Chairman, if I could just briefly respond? I couldn't agree with you more.

I think one of the great things about the board is the fact that we have staggered five year terms, and you will get the kind of continuity that you are unlikely to get even with a 5-year term for an individual commissioner.

And this is for the long term. After all, we haven't done this since 1952, and Congress may not be back at it for another 40 some years.

I will say that I also agree with you entirely on the need for independent oversight, and the question is whether 6103 authority is necessary to get that or not. Audit reports, of course, could be reviewed by the board. Names could be deleted.

I like your idea of having more independence, in terms of the Inspector General. Frankly, I think the commission report could have done more in that area. We did look at it.

We didn't come up with a specific recommendation. But that, directly reporting to the board, having the IG at Treasury in a more independent role, in a strengthened role, I think would also help to insure that there is that kind of independent oversight.

Finally, you might want to look at the powers of the board. As you know, I was always pushing for the board to have more power, in terms of actual approval, not just review, and there may be some things that could be strengthened there.

So I think there are ways to insure that precisely what you have expressed as your concerns are indeed addressed, perhaps without

going so far as to giving them blanket 6103 authority, which may have some negative implications.

Particularly as it relates—I said earlier—to attracting good board members who may be from the private sector and who may not want to be in a position of being accused of conflict of interest, even though it is only a perception. It is not reality.

Mr. Chairman. Thank you very much. Senator Moynihan, do you want to make any remarks?

Senator MOYNIHAN. I do want to thank Mr. Portman for all he has done and for his courtesy to come today and just to encourage us in our labors and to thank him for his comment about the need for a more simplified tax code.

At the risk of encouraging Phil Gramm yesterday, I read from an article in the editorial page of the Wall Street Journal on the last day of the year, talking about the booming stock in H&R Block, in a press release they put out about our unsurpassedly complex Tax Relief Act of 1997.

"This bill creates the most relief and causes the most confusion." They went on and on. "How can we not make millions more?" And indeed. Their stock went up by a third.

Just to point out that there is a metric here. When the H&R Block Income Tax Guide was first published in the 1960's, it had 196 pages. It now has 574. And that is our doing. You cannot find the regional director in Omaha, sir, who did that.

You have, in any large government or agency, the same kind of problems you have in education. The tales of school performance are filled with accounts of how five Beta Kappas from Brown went off to an inner city school in Providence and in 2 years time performance was right up on top of the possible scales, and in four years time those five were in Wall Street.

You are going to get average people doing these large tasks in government and making their life manageable is a task. If you were looking for a conspiracy in this town, and we seem to from time to time, do these K Street lawyers really write those bill because only they understand them?

You may be sure they make more in a week than the average inspector makes in a year, but I will leave it there.

Thank you for what you have done and for your comments, sir.

Congressman PORTMAN. Thank you, sir. One quick comment. There are some K Street lawyers here this morning this morning. We can talk to them.

Senator MOYNIHAN. Why not? [Laughter.]

Congressman PORTMAN. Last night I got home and, being a CSPAN junkie, I happened to hear your comments on simplification, and I will just make two quick comments.

One is—as you saw, I know, in the commission report—we were quite precise as to the connection between complexity of the tax code and the problems at the IRS.

Senator MOYNIHAN. Yes, sir. You were.

Congressman PORTMAN. And we actually put that up front. Senator Kerrey deserves a lot of credit for that.

When we initially began our process, that wasn't necessarily within our statutory mandate, and yet, we pushed the envelope

and made sure that that was front and center. When it came time to implement that legislatively, it was more difficult.

And I know the Joint Tax Committee is probably here this morning with us, but we came up with language which we think will help. It doesn't solve the problem. Ultimately we need to have this committee and the Ways and Means Committee and others, come up with major tax reform.

What we say is there has to be now, under this legislation, a new tax complexity analysis, which every new piece of tax legislation would carry. And then there is a procedure, much like the unfunded mandate procedure in the House and Senate, where someone can raise a point of order on the floor of the House or in the Senate, if that complexity analysis is not complete.

The complexity analysis is very simple. It says you have to say how many new forms is this going to require, what is the new burden on the IRS, what is the burden going to be on the taxpayer, so at least we, as members of Congress, and frankly, the press and the public, would have access to that.

And we think that will be an encouragement toward simplification, when everything else in this town seems to be an encouragement in the opposite direction, toward more complexity.

Senator MOYNIHAN. Well done, sir. Thank you.

The CHAIRMAN. Thank you very much, Mr. Portman. We appreciate your being here. We look forward to working with you in the future.

Senator KERREY. Can I ask a question, Mr. Chairman?

The CHAIRMAN. Well, we have a number of witnesses today, so I had hoped that we could proceed with our two panels. It is 10:25. But go ahead and ask one question, if you want.

Senator KERREY. Well, I would like to point out as well that one of the ways these tax codes get complex is not only the K Street lawyers write them, but very often, after we give a speech, and we see the audience give a round of applause and a standing ovation to this great idea that we have got, we go to our staff and say, "Would you convert that speech into a law."

It is our intent, with our proposal—and I think, indeed, with the Chairman's vision as well—that whoever the IRS Commissioner is, under whatever configuration the board has, they have a sufficient amount of independence to be able to say publicly, "Nice speech, Mr. President, but here is what it is going to do to the code."

"You have got a standing ovation there and you have got them all cheering and stomping their feet, but this is what it is going to cost the taxpayer if we write that into law."

The CHAIRMAN. I couldn't help but think about the complexity the other night.

Senator KERREY. Well, I think about the complexity a lot when I get the crowd going too.

Congressman Portman, one of the areas that both you and I think are important to address, and we attempted to address it both in our recommendations and the statute, and I would like to give you an opportunity to comment, is in electronic filing.

Can you just briefly offer some comments as to why you think we need to pay attention; to write the law so that we provide a suf-

ficient amount of incentives and resources to increasingly more to electronic filing?

Congressman PORTMAN. Absolutely. I must also mention, just briefly, along with the complexity analysis, Senator Kerrey has alluded to another provision in the legislation that I think is very important, which is to get an independent analysis from the IRS of tax legislation as it moves forward.

It is our understanding, from talking to people who were at the Joint Tax Commission 20 and 30 years ago, that was much more common. In the Ways and Means Committee, where I sit, that is no longer the case—and that part of the complexity challenge is to get the IRS at the table in an objective role.

Not representing Treasury, not representing tax policy, from the White House point of view, but saying, what is going to be the actual impact on the administration of the tax code. And, from the perspective of the taxpayer, how many new lines are going to be on the new schedule and so on.

So, this is another aspect of the legislation that I think, Senator Roth, you will find entirely consistent with your approach to tax policy and I think is a major improvement.

On electronic filing, it is kind of a no-brainer. It is win-win situation. The IRS currently spends somewhere like $7.00 to $8.00 to process a paper return. You have a 22 percent error rate. Half of that is caused by the IRS.

Imagine the downstream costs that are entailed there to the taxpayer, in terms of receiving notices. You have brought up some of that testimony; of, administrative foul ups because of the error rate at the IRS.

Electronic filing, on the other hand, probably costs a couple of dollars. About $2.85. When you take out the requirement to file a paper signature, of course, that cost goes down by more than half. And the paper signature, in our view, the commission's view, is unnecessary.

The taxpayer can keep that on file, or perhaps once in a life you can require that.

So, in terms of the cost to the system—roughly a dollar versus $7.00 or $8.00—and in terms of the cost to the taxpayer because of this enormous downstream cost that comes with the error rate that is so high, 22 percent, it seems, to us, that we should do everything we can, as a Congress, legislatively to encourage electronic filing.

We tried to do that in our legislation. We don't do everything that I would have liked to have seen, but in the end, by taking away the signature requirement and putting in place incentives to electronically file, we believe we can get to 80 percent electronic filing, rather than, roughly, 20 percent or less, within five or 10 years.

The CHAIRMAN. Thank you very much for being here today, Mr. Portman, and we look forward to working with you.

Congressman PORTMAN. Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, sir.

The CHAIRMAN. It is now my pleasure to introduce our first panel, comprised of former commissioners of Internal Revenue.

These witnesses have unique insight into the operations of the IRS, and we all look forward to hearing their views.

Witnesses on this panel include Mr. Don Alexander, who served as Commissioner from 1973 to 1977, is with Akin, Gump, Strauss, Hauer & Feld, in Washington, DC. Mr. Sheldon Cohen, who served as Commissioner from 1965 to 1969, is with Morgan, Lewis & Bochius, in Washington, DC.

Mr. Fred Goldberg, Jr., who served as Commissioner from 1989 to 1991, and was a member of the IRS Restructuring Commission, is with Skadden, Arps. And, of course, Ms. Margaret Richardson, our most recent Commissioner, who is with Ernst & Young, in Washington, DC.

Why don't we start with you, Ms. Richardson, and we will be happy to include your full statement, as if read.

We would ask each of you to keep your comments to five minutes.

Ms. Richardson.

STATEMENT OF MARGARET M. RICHARDSON, ESQ., PARTNER, ERNST & YOUNG, LLP, WASHINGTON, DC; FORMER COMMISSIONER OF INTERNAL REVENUE

Ms. RICHARDSON. I will certainly do my best, and thank you very much, Chairman Roth and other distinguished members of this Committee.

I do appreciate the opportunity to be able to join you today, and I commend you, Mr. Chairman, for carefully considering the issues and the various proposals that are out there for restructuring the IRS.

I believe it is important to take the time to weigh the potential impact of these proposals on our current tax administration system, the future of tax administration and on our self-assessment system.

The 4 years that I served as Commissioner of Internal Revenue, from 1993 to 1997, did mark a period of great change, as well as significant accomplishment, although I would be the very first to tell you that there was more that needed to be done.

We did set ambitious goals to improve service to taxpayers by providing more ways for them to obtain accurate and timely information to file their returns and to make payments. But we were also addressing concerns, expressed by many of you and your colleagues in the House of Representatives, about eliminating refund fraud, particularly the earned income tax credit program, closing the so-called "tax gap," decreasing the accounts receivable and improving compliance levels generally.

I actually began my career as a lawyer at the IRS in 1969, left in 1977, and when I returned as Commissioner, almost 25 years later, I found many of the same issues were still there. Managing in the public sector was still very challenging, as it had been before, but it was even more frustrating.

Not only had the Internal Revenue Code grown lengthier and more complex, but the IRS had been asked to shoulder many responsibilities beyond just collecting taxes.

In addition, everyone attempting to manage in the Federal sector was struggling with the sometimes conflicting requirements of the

Federal Managers Financial Integrity Act, the Chief Financial Officers Act, the Government Performance and Results Act and the Paperwork Reduction Act, just to name a few.

But I also found a number of IRS employees who were quite concerned about finding ways to provide better service to taxpayers. Although they wanted to implement change—and many of them spoke the language of change—often they did not have the training, the tools or the resources to implement change.

And frankly, there was a certain amount of skepticism, and I think, at times, even cynicism about whether or not change could be affected or whether there would be consensus among the overseers that could be reached on what kind of change should be undertaken. That was why so many of us at the IRS welcomed the creation of the National Commission on Restructuring the IRS, and we looked forward to its report.

The specific focus of attention of that report had been whether or not there should be an oversight board with private sector members, and if so, what authorities and responsibilities such a body should have.

I would just like to say that I don't believe there is any one form of organization or governance that is perfect, whether it be for the Internal Revenue Service or any other organization, nor do I believe that there is any one form of organization that will cause all of the concerns about the IRS, real and perceived, to evaporate.

We have all heard repeatedly, during the past year, about the problems of the IRS, that they were a long time in the making and that they will take a long time to fix.

But what we have to do, and I think what you need to do, is to identify with enough specificity what problems we are trying to fix, so that the steps to fix them can be specifically identified.

Some of the problems at the IRS are, no doubt, present in any large organization. Some of the same problems are present in many other government agencies, and some other problems relate to the complexity of the code that the IRS is charged with administering.

You in Congress have got to decide what you want to achieve through reform and restructuring. I think you really do have to identify what can be fixed and try to then find the best organizational structure and changes to produce those fixes.

There has also got to be an agreement among interested parties, particularly in the executive branch and the Congress, about what the mission of the IRS should be. Then I think you can achieve some kind of agreement about what governance and organizational structure would likely accomplish that mission.

Ideally, the structure would be so streamlined that there would be clear lines of authority and accountability throughout the organization, all the way from the top to the front line employee. The goal of the proposal that Commissioner Rossotti discussed with the committee yesterday was intended to do just that. I think it deserves very careful consideration.

The Commission, as Senator Kerrey and Congressman Portman had pointed out, did consider such an approach, but didn't have time to fully explore it. Obviously, without more details about the proposal, it is very difficult to predict, with reasonable certainty, whether it will be successful.

But what I can predict with reasonable certainty is that any new structure without the right kind of talent to perform the organization's mission will have little chance of success. Without maximum personnel flexibility so that the best qualified people can be recruited, trained and retained, any new structure will fail too.

In addition, without stable funding and focused, consistent and constructive oversight, a new organizational structure will have little success.

I see my time is short. I do want to mention that one of the things and one of the ideas that we talked about at the Commission, but we didn't think was politically feasible, was the idea of making the Internal Revenue Service an independent agency, much like the Social Security Administration.

I would be happy to talk a little bit more about that later, but I think it would provide the opportunity for the Commissioner to have that independent voice for good tax administration that was talked about by Congressman Portman.

And also, to be able to treat the agency somewhat differently. For personnel purposes, budget purposes and other purposes. Thank you.

The CHAIRMAN. Thank you, Ms. Richardson.

[The prepared statement of Ms. Richardson appears in the appendix.]

The CHAIRMAN. Don, it is a pleasure to welcome you. Please proceed.

STATEMENT OF DONALD C. ALEXANDER, PARTNER, AKIN, GUMP, STRAUSS, HAUER & FELD, LLP, WASHINGTON, DC; FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. ALEXANDER. Thank you, Mr. Chairman. First, I want to make it clear for the record that I am not on K Street. My office is on New Hampshire Avenue.

Ms. RICHARDSON. I guess I am not either.

Mr. ALEXANDER. Mr. Chairman, it is a pleasure to be before you and this committee today on this extremely important topic, and I want to second what Congressman Portman said and what my good friend, Peggy Richardson, said about complexity.

One of the really fine things in S. 1096, diluted a little bit in the House bill, is letting IRS have a seat at the table when you think about a tax proposal that affects many, many individual taxpayers. Let's at least have a mock-up return to find out what the new capital gains Schedule D is going to look like before we embark on having, say, five rates instead of one.

Let's look at what the child credit did, in comparison to an increase in the personal exemption.

While IRS has been bashed—and it deserves some of the bashing—lately, I don't see how any agency, composed of normal human beings, most of them trying to do their jobs well and trying to be courteous and fair to taxpayers, can cope with an ever changing mess like the one we have now in the Internal Revenue Code.

I am delighted to hear the approval that seems to be coming to study what is going to happen before you make it happen.

And, Mr. Chairman, you raised a number of questions, and I will try to give my views on some of them.

I was Commissioner during Watergate. That was a time when perception did equal reality. That was a time when all of us—and I was certainly not exempt—were accused of conflicts of interest, at a minimum, and out right crime, at a maximum. I went before two grand juries.

The President that appointed me tried to fire me within 3 months after I took office. I am delighted to see in both bills, the House bill and the Senate bill, a 5-year term for the Commissioner. The President could still fire the Commissioner under the House bill. But at least the President would have to give a reason for it.

Under S. 1096, the board could fire the Commissioner, and I don't think that ought to be.

I didn't want to serve at the pleasure of a President that tried to fire me August the 9th, 1973, and thereafter, nearly always about the 9th of the month, for quite a while. It is very difficult to make long range plans when you think you might have to leave the office the following day.

The five year term is long overdue, and I am glad that you are doing it.

Section 6103 authority for the board. All right. If IRS were an independent agency, as former Commissioner Richardson suggested a moment ago, the board would be a necessity. And given the political climate in which we live now, a board may be a necessity at this time.

I have some doubts about the board, and particularly, I hope you don't give the board authority to look into individual cases. The Ways and Means Committee has that authority. The Joint Staff has that authority. The Senate Finance Committee has that authority, and you certainly exercised it last fall.

That should be enough, rather than give the authority to the board, because the board members are going to be accused, rightly or wrongly—and I would say 99 percent of the time it is going to be wrongly—of conflicts of interest, particularly if the board includes CEOs or former CEOs.

If the board includes practitioners, you are going to have the same problem. So, giving them 6103 authority is going to exacerbate a problem that already exists.

The new Commissioner, Mr. Rossotti, has already put in some rules that I think make eminent sense.

Requiring further high level approval of seizures of property. I think the right of IRS to seize property from say a repeat offender who has been using trust fund taxes is necessary to the operation of an effective tax system, but that right has to be exercised very carefully.

I hope you leave Inspection where it is. The Commissioner needs to have a strong inspection arm, and certainly what has been shown recently about collection activities demonstrates, I think, the wisdom and the need of that.

On penalties and interest, clearly they need to be reconsidered. We pile penalty on penalty in an effort to raise revenue. That is not the purpose of a penalty, Mr. Chairman, as you know well.

Thank you for letting me appear, and I look forward to answering questions.

The CHAIRMAN. Thank you very much, Mr. Alexander.

[The prepared statement of Mr. Alexander appears in the appendix.]

The CHAIRMAN. Mr. Cohen.

STATEMENT OF SHELDON S. COHEN, PARTNER, MORGAN, LEWIS & BOCHIUS, LLP, WASHINGTON, DC; FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. COHEN. Thank you, Mr. Chairman, members of the committee. I appreciate the opportunity to give you my views on the restructuring bills, both the House and Senate, and the commission's report.

I served at a different time and there were different climates, of course. Wilbur Mills was chairman of the Ways and Means Committee, and Wilbur Mills used to invite me to his office and discuss the administerability of a bill or the effective date.

He would look me square in the face, "Can you do it this year?"

And I would say no, sir or yes, sir, as the case may be, and he would change the effective date to suit the administerability. I mean, I doubt if he would announce that in public, and I certainly wouldn't, but he was concerned, and we had regular chats about that.

Now, it would be difficult for the Commissioner to do that in public, when the Secretary is saying I want the effective date to be January 1. Or the President is saying I want the effective date to be January 1, or indeed, the chairman of either one of the two tax writing committees is saying publicly that he wants the effective date to be January 1.

So, you had better be careful how you structure that because you are going to put the Commissioner, whoever he or she might be, in a terrible vise.

On Section 6103—and I am skipping around, because you have my full testimony, and you know my views on a variety of things.

The CHAIRMAN. Your full statement will be made a part of the record.

Mr. COHEN. But I will try to address some of the issues that have come up this morning.

On Section 6103, Don is correct. He was the Commissioner. At the request of the Senate Government Affairs Committee, there was a study made of Sec. 6103 by the Administrative Conference of the United States. The Chairman of the Administrative Conference of the United States, at the time, happened to be Antonin Scalia (now Justice Scalia).

He was the chairman of the committee that studied that issue, and he made me vice chairman.

So much of what is the modern in section 6103 that was amended shortly after that conference report, encompasses what Justice Scalia, at that time, thought, and it was well thought through. It was an effective study.

Tax return information is terribly sensitive. If you put a corporation president or a presently practicing lawyer or accountant on this board, or a past practicing lawyer or an accountant who has affinity to a variety of people, his friend will ask him, "I had this terrible thing happen to me," he will have to go looking.

Or some—one of them—silly, will go look into an issue, and God forbid, there will be a favorable result come out, even if he didn't do anything to cause the favorable result. And it will be on the front page of every newspaper in the United States, and you will have a scandal.

So you have to think about all the "what ifs," because the "what ifs" will happen. Washington doesn't change. These things have happened over the years.

You see in my statement that I am wary of giving the board too much authority. I think the IRS does need an independent view, and it needs that independent view in private. I don't know whether this board meets in public or private. I can't tell. The two bills are somewhat vague on that.

This kind of oversight and this kind of effective discussion with the commissioner about the very essence of tax administration can't happen in a fish bowl. It won't be effective. Nobody will say what they really think, in the open. And, if you do say what you really think, you are giving a road map to tax evasion.

Anybody who listens to this discussion will know what you are planning to do and knows how to walk around it. So you have to think about your government in the sunshine and your other acts that require boards to have open meeting.

The commissioner meets by himself, in his or office, but boards have to meet in public, unless there are certain exceptions in the statute. I don't see any exceptions in the statute, so I think this board has to meet in the public.

I just don't think people are going to be candid in an open meeting. While I am not a great advocate of this board, as you will see from my testimony, if you are going to have the board [and I have been run over by this train before, so I know it is going to happen] be careful how you draft it, because you may get what you want, and you have to be careful what you want.

I am concerned about the union leader being on the board. I think the union leader is a fine person. He happens to be a first rate human being, but he has inherent conflicts of interest.

I think he should be an advisor to the board. I think he might be able to sit in on the board, but I don't think he ought to be a board member.

The five-year term for Commissioner is fine. I am one of the few—three commissioners, since the reorganization, to have served as long as 4 years. I am one of those three. So the odds of you getting someone to serve 5 years is slim or none.

The FBI director has had a 10-year term. Since Mr. Hoover left, no director has served yet more than four years, as I remember it. The present one is close to five. My bet is that he won't go 10 years.

So, naming the number doesn't make the event. I think there are a lot of things in your bill that require some careful thought.

The burden of proof is a mistake because it will give people the idea they have more rights than they really have, because they will misunderstand. I think the privilege is a mistake for the same reason, and I discuss that in my written testimony.

The CHAIRMAN. Thank you very much, Mr. Cohen.

[The prepared statement of Mr. Cohen appears in the appendix.]

The CHAIRMAN. Mr. Goldberg.

STATEMENT OF FRED T. GOLDBERG, JR., PARTNER, SKADDEN, ARPS, SLATE, MEAGHER & FLOM, LLP, WASHINGTON, DC; FORMER COMMISSIONER OF INTERNAL REVENUE AND FORMER TREASURY ASSISTANT SECRETARY FOR TAX POLICY

Mr. GOLDBERG. Thank you, Mr. Chairman. I would like to begin by thanking Senator Kerrey for his leadership on the Restructuring Commission and to thank you and your colleagues for the hearing you conducted last fall.

I think they focused a level of attention on this issue that will make action certain.

Yesterday's testimony by Commissioner Rossotti, I think, painted a compelling vision of reform for the IRS. In my view, he is absolutely right on the mark. I think his statement reflects a clear understanding of what tax administration is all about. I think it reflects an understanding of what is expected from the IRS and how to go about getting the job done.

It is all about focus on the taxpayer, the critical importance of using the right kind of measures and the need to keep it simple.

His testimony is the most graphic possible illustration of why the reforms you are considering, the reforms that were recommended by the Restructuring Commission and the reforms that have been approved by the House are absolutely essential.

There is no chance that he deliver on that promise without a 5-year term. By his statement, he is not going to start until some time next year. That is 1999. There is an election in the year 2000.

There is no chance he can deliver without giving him the authority and tools to build his own team. There is no chance he can do the job without continuity and oversight. Personnel are going to change in the administration. They always do.

Without the continuity afforded by an oversight board, he will not be able to do what he has promised to do. Without that kind of continuity and coordination from the Congress, he will not be able to do what he has promised to do.

Unless the members of the Senate and the members of the House, with all of the different pieces of the IRS under their jurisdiction sit in a room together, with him and his colleagues, to keep focus on his mission, he can't deliver.

If he doesn't have stable funding for his agency, he can't deliver. And if he does not have work force flexibility to make the changes that he wants to make, to reward the employees who perform and to get rid of the ones that don't, he can't do his job, and that is why the commission came up with a set of recommendations it came up with, why the House has improved on those recommendations, and why I believe you and your colleagues are considering moving forward.

It is the real world of why those recommendations make sense.

Now, the governance and management provisions have received a lot of attention, and I think they currently strike the right balance. I think the issues with respect to governance and management are in the all important details at this point.

I would encourage you to look at a smaller board. I think it may be unwielding in its current size. I would look very carefully at the work force provisions. We know what they are intended to; maintaining protections for workers, respecting the workers right, but at the same time giving necessary flexibility. But I would look at the details very carefully.

I think I would try to strengthen the provisions on Congressional oversight. I think I would vest, if anything, more authority in the Joint Committee on Taxation and the Joint Committee staff. I think I might formalize more directly some of the procedures for coordinated hearings. I would look at that area as well.

If you can find a way to minimize micro-management, do it. It is a problem up at that end of the street and, with all due respect, it is a problem down here.

I would like to comment briefly on access to taxpayer information. I agree with my colleagues. I think, on balance, it would be a serious mistake to give the board 6103 authority, for three reasons. It is a distraction, it creates the potential for appearance of conflicts of interest, and I believe it will make it harder to recruit people who will serve.

Don mentioned the tax writing committees and the joint committee. You have the IRS itself, you have the IRS inspection function, you have the Treasury Department and the Inspector General. You have lots of people looking at that. I think that is sufficient.

To the extent there are problems with 6103, I think you ought to deal with those separately.

I would like to comment on the Taxpayer's Bill of Rights provisions briefly. I think, on balance, changing the burden of proof is a mistake. It is a very powerful and very positive symbol, and I think people who disregard that are making a mistake.

On balance, however, my judgment is that at the end of the day it will do more harm than good.

The second reason is very practical. It is expensive. I believe there are other changes you can make that will have far more real world impact in helping taxpayers. You shouldn't nibble at the margins.

I believe attorney's fees should be pure and simple. Taxpayer wins, taxpayer gets it. No complexities, no lawyers words. They win, they recover.

Don't nibble at the edges of penalties and interest. Those provisions are crushing people. They are doing untold damage to the tax system. And don't worry about a little bit revenue here, a little bit of revenue there and try to fit it in a tiny box. Do it, in my judgment, and do it dramatically.

Look at the Anti-Injunction Act. There is room there. Look at codifying the ability of the IRS to act reasonably.

The notion of common sense in tax administration—there are a lot of folks there who want to do what is right, and they are told it is right, it is fair, but you can't do it. Give them the authority to act the way they want to act, because most of them want to get it right.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Goldberg.

[The prepared statement of Mr. Goldberg appears in the appendix.]

The CHAIRMAN. We will limit the first round of questioning to 5 minutes. Senator Moynihan and myself will have 10 minutes.

First of all, let me thank you, each of you, for your helpful testimony.

Our hearings have indicated a need for the committee to consider protection for the taxpayer in a number of very specific ways. Some of these were touched upon by one or more of you, but I would like to get the reaction of the panel.

I have to say that taxpayers are very angry that the IRS can arbitrarily assign income to taxpayers, who then have to prove that they didn't have such income.

I know some of you are opposed to any change, but if we change the system, should we change the system so that taxpayers must continue to maintain appropriate records, but the basic rule would be that the IRS carry the burden of proof on income and the taxpayer the burden of proof on deductions?

How does the burden of proof on the IRS square with the legal duty of taxpayers to file a correct return? Mr. Alexander, do you want to comment?

Mr. ALEXANDER. Yes. I will try to, Mr. Chairman. I would be quite concerned about a change which would put the burden of proof on the IRS on anything that would, say, increase the taxpayer's reported income, as opposed to reducing the taxpayer's claimed deductions.

In my limited experience, the assignment of income question comes up primarily when we are dealing with very large companies, very sophisticated taxpayers who have perhaps very much to hide; where we are dealing with whether a foreign subsidiary in a tax exempt or nearly tax exempt country actually earned the income which the IRS believes was actually earned by the U.S. parent.

The assignment of income to taxpayers comes up frequently in that area, and I don't think that the multi-nationals need any particular protection. In fact, you don't give them under any the burden of proof change, because it has a $7 million asset limit for corporations.

Individuals, many of them—most of them—are law abiding. They pay their taxes, and they stop at red lights. [Some not]. But some don't stop at red lights and some don't pay their taxes, and sometimes, particularly if they are in industries that permit the receipt of cash, they don't like to report that cash, and IRS has to try to arrive at some accommodation between the impossible practical task of unearthing everything, which IRS certainly shouldn't do, but trying to make the tax system work in cases where there are transfers of cash.

The IRS has a hard enough time there anyway, sir. I think it would be extremely difficult to carry that additional burden in a situation where someone is reporting $10.00 annually in cash tips, and he work at one of the fanciest restaurants on K Street.

The CHAIRMAN. Before I go to you, I just want to make one observation, and that is, admittedly, as the Commissioner said yester-

day, we have four different groups, and I think the problems are different for the large corporation, for example.

But I have to say that our hearings last fall showed that the assessment of taxes, the claim that an individual has more income than reported, in many cases, was directed at the low income. That was one of the real shockers of the hearing, that much of the time and the attention was on the low income, and I just put that into the mix.

It would be interesting to hear what you have to say, Ms. Richardson.

Ms. RICHARDSON. Well, I think Mr. Goldberg touched on one of the biggest problems that comes up and particularly for lower income taxpayers—perhaps disproportionately—and that is the whole penalty regime, which, in many cases, the penalties are mandatory.

They can later be abated, if it is shown that there is reasonable cause for the taxpayer having done something, but that is how one can build up a significant tax debt before very much time passes.

What concerns me, and I think many people who have worked in the tax area, is that the taxpayer really is in possession of the facts and does have the knowledge about——

The CHAIRMAN. Isn't a person accused of a crime, a murder, also the one, peculiarly, with the knowledge and information?

Ms. RICHARDSON. Well, we are talking about civil proceedings here, not criminal proceedings, and I think that there has always been a burden of proof on the government in criminal proceedings, as it well should be.

One of the concerns that this committee has expressed, and many taxpayers have, is that the IRS should be less intrusive, as opposed to more intrusive. One of the earliest challenges to the burden of proof in the 1920s, before there was a Tax Court, was heard by the Board of Tax Appeals. The judges concluded that taxpayers were in the best position to provide the information to the government. And once having provided it, then the presumption shifts to the government to go forward to determine if they are not entitled to the deduction or that they did mis-report their income.

But their conclusion was that without the burden of proof on the taxpayer, you might as well pass the hat, because it truly would become a voluntary income tax system before very long.

So I think that a less intrusive process is one that we have today. I understand the fairness issue or that there is a perception of being unfair, but I think there may be better ways to address this issue than shifting the burden of proof the way the House bill did.

The CHAIRMAN. Any recommendations in that area, we would welcome.

Ms. RICHARDSON. I would be delighted to.

Mr. COHEN. I would like to tell you my father's favorite joke. It is about the customer who comes into a cleaning store and hands the clerk his receipt, and he hands him a bill. And the clerk is the co-owner, and he gives the customer the cleaning and gives him change for a $5.00 bill.

Then he looks down and sees that he got a $50.00 bill, and he is struck with an ethical problem. Does he tell his partner? Or the IRS? [Laughter.]

The joke illustrates the point. That is, there are lots of small businesses in the United States; where the owner mans the cash register. I'm a painter. Do I report all my income? I know what I got in income. How does the IRS find it?

If you want to create an intrusive system, then the IRS is going to have to go out and subpoena the banks and subpoena all of a business' credit operations. I can go on and on and on, and you have just created a nightmare for that person who could have produced the records on his income, because he has them.

The CHAIRMAN. Mr. Goldberg.

Mr. GOLDBERG. This is getting very embarrassing, Mr. Chairman. I agree with my colleagues on this point as well. Two points, and I think it goes to a lesson that at least I learned from your hearings.

The IRS gets lots of messages from the Congress. One of the messages that the IRS gets from Congress is deal with a tax cap; improve compliance. All of the data says that the biggest areas of non-compliance and the most difficult areas of non-compliance for the IRS is unreported income.

The IRS tries to deal with this, and one of the ideas that the IRS has is a so-called lifestyle audits. That is what lifestyle audits are all about; people living at a lifestyle that is absolutely inconsistent with the income they are reporting.

And then Congress says, "Don't do lifestyle audits. They're too intrusive." And then Congress may say, "Oh. But by the way, IRS, in the context of unreported income," which involves lifestyle audits, "you have got the burden of proof."

That is a very confusing set of messages for the IRS, and I think you want to be careful about how you are sending those.

The final point, the *Portio case.* If you will pardon me. There was a case about unreported income, or the IRS said the taxpayer had income, and the poor taxpayer didn't know how to prove he didn't have income.

Hard cases make bad law, and I think that the way to deal with those kinds of cases—if you conclude on those facts, the IRS is way off the reservation—the taxpayer wins. The taxpayer gets his costs back. I think that is a surrogate that is going to get you a lot closer to where you want to go.

Low income taxpayers? One of the problems is that it is earned income tax credit, and it turns out, on the earned income tax credit, in figuring out that income you are talking about, the measure of income has nothing to do with taxable income. It has to do with Social Security payments and Welfare payments and whether the third generation—the extended family living in.

So it is a very difficult set of problems, and I just don't think that shifting the burden is the way to get at it.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, I found this absorbing, and I wonder if we could just continue on this matter of burden of proof.

When first presented, it seems so obvious that the burden of proof should be on the government addressing an individual. Then one learns that known in common law—codified I believe in 1993—

in civil matters the burden of proof has always been on the individual.

We are also told by learned persons—Mary Ann Cohen, who is chief judge, has written us, and a whole group of law professors who write a nice opening sentence. "We are law professors who teach tax." They ought to teach English, don't you think?

Mr. COHEN. They are not English professors.

Senator MOYNIHAN. The actual event will be to increase burdens on the individual. Is that your judgment? Could you volunteer this?

Mr. GOLDBERG. Without question, Mr. Moynihan.

Mr. COHEN. Absolutely. The IRS will begin to ask questions the first time because that is the only time they are going to get to ask their questions. So, they will go after everything, rather than what they believe is necessary the first time.

Ms. RICHARDSON. There is no doubt in my mind. And I think Judge Cohen's letter was excellent. It made some excellent points, and it has an excellent recommendation for what the committee could do, in lieu of shifting the burden of proof.

Mr. ALEXANDER. I agree completely with my colleagues and with Judge Cohen's letter. The burden of proof provision in the House-passed bill will create expectations that will be dashed; will create problems for the IRS; will create massive problems for the courts.

Ms. RICHARDSON. I had an interesting experience, Senator Moynihan, if you will permit me. Last week I had the occasion to run into someone who runs clinics for low income taxpayers to assist them in preparing returns.

She was very concerned, and I think has written this committee; that particularly people in low income situations might misunderstand what kind of records they may need to keep. Many of them don't keep good records today.

But she had also felt that a number of them had misunderstood what had gone on with the House-passed bill and thought that today they no longer had to keep any records.

So I think that that is a perception that could get fairly widespread and cause even more problems.

Senator MOYNIHAN. So, in that counter intuitive mode so much in life, this could have the opposite of what we seem to have been intended to fix.

Ms. RICHARDSON. Exactly. Exactly. And it may burden the people who need to be the least burdened.

Senator MOYNIHAN. Mr. Chairman, I just hope we can stay with this subject, and I thank you for the opportunity to hear these extraordinary public servants. It has been a joy.

Mr. CHAIRMAN. Thank you, Mr. Moynihan.

Mr. Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. These are difficult problems. There is no question about it. I think the IRS collects something in the neighborhood of a trillion dollars a year?

Mr. COHEN. A trillion five; a trillion six.

Senator CHAFEE. I missed that.

Ms. RICHARDSON. About a trillion and a half.

Senator CHAFEE. A trillion and a half. And I like the analogy that Mr. Alexander had in his statement about people obeying the

red lights. Somehow the suggestion seems to be that this is all going to work out in a lovely fashion if it is completely voluntary.

And Mr. Alexander, in his analogy, points out that most Americans do stop at red lights, but he also indicates that probably most of them stop there, because if they don't, they are liable to be arrested or summoned by the police.

I think this whole discussion we have had here on the burden of proof is a very, very valuable one and extremely helpful.

Was it you, Mr. Alexander, or you, Ms. Richardson, that said the largest single problem with the IRS is unreported income?

Ms. RICHARDSON. We would all say the same thing.

Senator CHAFEE. You would all agree with that? And so, that obviously leads you into the whole burden of proof question.

I can remember, as many of us here on this podium standing up and applauding our chairman in 1986, when we reported out, unanimously, a bill that greatly simplified the Internal Revenue code, and I think we got down to—was it two brackets?

Senator MOYNIHAN. Two brackets.

Senator CHAFEE. That was in 1986. And since then, we have done nothing but make the code more complex, and it isn't some villain out there some place. It was done right here, in this room and over in the other chamber.

Step by step by step, we reversed what we did in 1986.

When we marked up tax bills, one of the things that I felt was very valuable for this committee, was the presence of the Secretary of the Treasury. I can remember Secretary Baker, for example, being right with us as we marked up the bills.

I also think the suggestion that there be a—how did you refer to it? An accountability statement?

Ms. RICHARDSON. A complexity analysis.

Senator CHAFEE. What do you call it?

Ms. RICHARDSON. A complexity analysis.

Senator CHAFEE. Complexity analysis is a good one, and I presume that would be given to us in advance. These mark ups are fast moving. Up pops somebody with a splendid suggestion, and it carries.

Suddenly a new credit is established, and I don't know quite whether the Commissioner will be quick enough to be able to give us a complexity analysis right at the spur of the moment. But, in any event, the idea is a good one, and I think we should follow up on that, Mr. Chairman. Thank you.

The CHAIRMAN. Thank you. I have a lot of sympathy for the approach. I will have to say that a lot of the complexity does come into conference. Efforts are made to compromise, and the result of a compromise is to complicate. But it is still a significant proposal.

Mr. COHEN. Senator Roth.

The CHAIRMAN. Yes?

Mr. COHEN. When I was Commissioner and when I was a staff person, I sat in on a number of executive sessions, which the committees used to meet in, and I sat in on any number of conferences. I mean, IRS people were routinely invited 30, 40, 50 years ago. I started in this business about 45 years ago.

The CHAIRMAN. Another point I was making; that often, in an effort to bring two sides together, some kind of a compromise is made

that is necessary, politically, but doesn't make sense from the standpoint of simplicity.

Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. I would like to follow up on that point.

It is clear that generally we act too quickly. This is a hot house, Washington, with TV, the national press, politicians, media, and we often don't think through and usually don't think through the consequences of what we don't and don't relay it to something else that we have done in the past.

A minor example is pension law, which is layer upon layer upon layer; lots of dead wood that we never clear out, which has to be cleared out.

And with respect to this last point, it is true. Somebody comes up with an idea. It sounds good. It is a tax credit or deduction or whatever it might be. It has a lot of political appeal. The press trumps it up or we trump it up back home, and it is in law.

And it is true we often compromise in conference, which adds further complexities, and it is a mess, in many respects. And I agree with the statement made. I don't know how an agent or, let alone, a practitioner really knows what to do.

My uncle was a tax lawyer years ago. He told me he couldn't sleep at nights because he was afraid he wasn't giving the proper advice to his client, that he had forgotten something. It really rattled him.

So I would like you to think about how we kind of slow down a little here, be a little more reflective. I think the mock up return is a good idea. The complexity analysis is a good idea.

That is all mechanical. It is probably a good idea, but it is a bit mechanical. We need a little more thought even than that, frankly.

I would appreciate it if some of you could give your initial thoughts as to how we begin the process of starting to kind of slow down a little here and to think through what we are doing here much more and so forth. I think that is a good idea, but frankly, I don't think that really gets to the heart of some of the problems that are really causing the problems.

Mr. COHEN. Senator, there is no constituency for simplification. That is the problem.

Senator BAUCUS. Well, there is here.

Mr. COHEN. We were all for it in principle, but none of us are for it in fact.

Senator BAUCUS. In this room there is a constituency.

Mr. COHEN. Well, I will give you an illustration. In 1966 or 1967, the then chief of staff of the Joint Committee and I said it would be a wonderful idea if we got rid of the deadwood in the bill, in the Tax Code.

So we had a group. I provided some staff, Larry Woodworth provided some staff, and we set them off, and they had a bill. And that bill sat from 1966 or 1967 until about—it was 9 years before the committees would—and they finally attached it on to something.

In the meanwhile, of course, we had nine more years of deadwood that just accumulated. That is, provisions that were no longer effective. We all had to wade through them.

Senator BAUCUS. You defined the problem. I am looking for a solution.

Mr. COHEN. Well, the solution is discipline.

Senator BAUCUS. The idea isn't how we get there.

Mr. GOLDBERG. I think the problem with complexity analysis and mock ups of forms is it is defensive. You may slow the inevitable decline of the code, but it is still going to fall apart. I think you need a much more aggressive strategy.

And in looking around the government and having had the privilege of serving in a number of positions, there really is only one natural advocate for simplification, and that is the Commissioner.

The Commissioner does not have competing loyalties to political issues or constituents or theoretical policy. The success of tax administration depends on an easier system, and the Commissioner is the only one with an unambiguous job to get that done, and that is why it is not just giving the Commissioner a seat at the table to minimize the damage. I think it is much more fundamental.

The way Peggy was suggesting is giving the Commissioner to authoritatively be the public spokesman for making this stuff easier. You need an offensive component. A make it better component, as well as a slow the damage component.

Senator BAUCUS. All right. Ms. Richardson, do you have a comment?

Ms. RICHARDSON. I agree with what Mr. Goldberg said. And I also think one of the things, in terms of slowing the process down, is several years ago, or many years ago, there used to be draft legislation on which hearings were held.

Now, concepts are voted on. People never see the legislation until longer it has been "passed," and so some of the complexity that creeps in might be able to be addressed by having it see the light of day before you actually vote on it.

Senator BAUCUS. A very good point.

Ms. RICHARDSON. The other thought that I had, as a young lawyer—and I will throw it out, and I don't mean this facetiously—is I think if people who voted on the legislation had to read it and understand it, it would make a significant difference, and I mean that sincerely.

Mr. ALEXANDER. I agree with what Peggy said, and I agree with Fred, and I disagree with Sheldon. I think there is a constituency for simplicity. You did it in 1986. You can do it again.

Senator BAUCUS. Well, my time is up. The idea is that the Commissioner, Mr. Rossotti, should initiate ways to get at this problem.

Mr. Chairman, I just think that is critical, that we are on the verge of having the code fall of its own weight, and I just think we have an obligation to take the initiative to find some way to deal with this problem of complexity. We have no choice, in a fundamental way.

Ms. RICHARDSON. The Commissioner and the IRS probably know better than anyone in this country what provisions cause the most difficulty, in terms of administerability for taxpayers and in terms of enforcement. I think reports along those lines could be extremely helpful.

Senator BAUCUS. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman. I must say, as I have listened to each of you offer your comments, I am immensely impressed with the public service that you have rendered to our country during the times of your own service and how helpful and thoughtful your responses have been in response to the questions by members of this panel.

Let me ask you. In general there is a perception, not by the multi-nationals, not by the big mega corporations, but the average citizen, that when there is a conflict between him or her and the IRS, that what they face is a star chamber proceeding.

We are not talking about huge policy questions. We are talking about what I would call the garden variety of conflict and dispute that is part of any kind of a tax code and made considerably worse, as we have all agreed, because of the complexity of the code.

Let me ask each of you what your suggestion may be, if any, if there is some way, short of getting involved in a protracted legal proceeding that involves expense, which most taxpayers cannot afford to either have a high-powered legal counselor or sophisticated tax experts come to represent them, some type of resolution mechanism, short of a formalized procedure, in which the taxpayer would have the sense, "Look, I got a fair shot."

Obviously that person or that office—I understand what we have done with the taxpayer advocate—cannot be a part of the IRS. Or the inference is, Hey, look. I am not getting, truly, a person who is detached and independent.

Your thoughts. Is that possible? And, if so, how could we construct such a impasse resolution mechanism that would deal with, literally, the great garden variety of these cases?

Mr. COHEN. You have got it, sir. I mean, there is a system, whether the people have confidence in it is different question, but you have—the IRS provides for an appeals mechanism internally, which generally, by and large, operates fairly. As with any system, you can't say it is perfect.

Senator BRYAN. Mr. Cohen, without being rude, let me say that you may be right. That is not the perception.

Mr. COHEN. I see it as a perception problem. That is why the Tax Court was created—The Tax Court—maintains a small claims procedure, because some taxpayers are of such a mind that they need somebody sitting on a dias with a robe in order to tell them yes or no, and the Tax Court procedure works relatively fairly.

That is, the tax court has special trial judges who ride circuit and go to the various large cities in the country, so that anybody who wants to, can appear before that judge, present his or her case and have an impartial judicial person make that decision.

Most of those people don't have much of a case. Every once in a while you have got somebody who does have a travesty, and the judge usually straightens it out.

If you are going to go further than that, the question is how much elaborate gingerbread work do you want to build on this house?

Mr. GOLDBERG. Senator, there is a study out of the University of Wisconsin that suggests that the "S" case procedure in the tax court—it compared it to small claims—is one of the most effective systems in the country.

And I realize this is a very different perception, but it is a success story, in my judgment. My reaction is maybe there is a different place to start that question, and the Commissioner hit on it yesterday.

I think the lot of the frustration of the taxpayers is it takes so long to get it over. You know, they are dealing with this person, and then they are dealing with that person and they can't get a straight answer, and I think that that is really—of all of the surveys I have seen, what taxpayers want most is they want it over quickly, and they want to be treated courteously.

It gets to GIPRA. It gets to all of the stuff. All we measure now is enforcement. There are no measures out there that let the taxpayers say, "Yeah, I was treated fairly. Yeah, it was over quickly."

And I think, if you introduce those kinds of measures, you will change the behavior of the agency very quickly. It is not a direct answer to your question, but I think that in terms of getting something accomplished rapidly that makes a big difference, I would be inclined to focus my attention there.

Senator BRYAN. May we get the comments of the other panelists, if they have any thoughts?

Ms. RICHARDSON. I agree with Mr. Goldberg. I think that the place to start really is with that front line employee. I think many of them need additional training. They need to understand what kind of provisions they are dealing with.

I think many of them have to be more sensitized to the fact that anyone coming in for an audit is going to be very uncomfortable. I have to tell you, the first time I got my paycheck with a return address IRS on it, as Commissioner, I had to stop and shake a minute before I opened the envelope.

So I am very sympathetic. I do understand. And I think that training of employees and, as Fred said, finding ways to measure what it is you want them to do is probably the most critical thing, because if there was one thing that the hearings last fall demonstrated, you do get what you measure, which is not just limited to the IRS I might add.

But I think it is very important to find measures that do achieve the results that you want.

Mr. ALEXANDER. Now that we are on measurement, I put out, when I was Commissioner, in November of 1973, a policy statement, P–20, which said that you cannot use enforcement statistics to evaluate enforcement employees.

If that had been followed recently instead of ignored, as it was in certain districts, perhaps we wouldn't have many of the problems we have today. Certainly the IRS needs to move quickly, certainly the IRS needs to treat taxpayers courteously, and certainly we do have in place a good system for resolving small cases where a taxpayer can go before a judge in a robe and have his or her case carefully considered and dealt with.

There is a good, recent article in the *New York Times* that explains how that system is working.

The CHAIRMAN. Mr. Cohen, I think you have a very important point about resolving these problems quickly. The point was made yesterday that in the private sector, most credit claims are resolved within six months.

If it is beyond 6 months, it is looked at as almost impossible to do anything about it, whereas we have just the opposite situation. So I think there is a lot of merit to that.

Mr. GOLDBERG. Senator, it is so core to the problem. Commissioner Richardson's comment about penalties and interest, it is excruciating. It takes forever.

When a citizen has a problem and screws up, they don't file their return. I mean, that is the wrong thing to do. But when the IRS has institutional information on that failure to file 9 months later, but doesn't contact that taxpayer for 6 years——

The CHAIRMAN. You are subject to interest and penalties.

Mr. GOLDBERG. You are getting killed. And sure. The taxpayer should have filed the return. It is not to excuse the taxpayer, but it is to say that the government has some kind of responsibility here in making it systems work right by the citizens.

Whether you are talking the interest, whether you are talking the frustration of the taxpayer, whether you are talking problems in collecting taxes due, if your receivable is more than 6 months old, you are not going to get it.

So it affects every piece of what is going on in tax administration, and I think you are right. That is what needs to be attended to.

The CHAIRMAN. Senator Kerrey, please.

Senator KERREY. Thank you very much, Mr. Chairman. I thank you and I thank the panelists. This has been very helpful as we try to write this law, and I appreciate very much your experience and your willingness to come before this committee to give us the benefit of experience.

One of the concerns that I have got, and I suspect there won't be time to get all your answers, and it may be necessary to provide them in writing afterwards, is in the creation of a board, I think we should not create two bosses.

In other words, there is going to be a chairman for this board, and you don't want an IRS commissioner and a chairman competing for power, because I think it would make it difficult to function and create disfunction.

What I would like to do is to take a piece of work and examine through that piece of work what might happen with the board in accomplishing it. Yesterday Mr. Rossotti came before this committee. First of all, may I presume that you all would support his recommendation of having four service organizations? No?

Mr. ALEXANDER. I would not want to do that right now. I would want to study it very carefully. Right now, IRS is demoralized. IRS' morale is very poor, and I am sure that is not surprising to anyone in this room.

Announcing the concept, if you will, of a reorganization that might abolish as many jobs as apparently would be abolished does very little to improve morale.

Senator KERREY. I appreciate that. In fact, he is alert to that and knows that. Indeed, one of the reasons that I would argue, Mr. Cohen—in fact, we did argue, as the Commissioner did—for representation of the Treasury Employees Union. As we know, there is going to be a lot of tough personnel decisions. We wanted them inside rather than outside.

We have dealt with the morale issues, and now we are going to do this particular problem. Let's say now the Commissioner has made the decision that he or she believes that this kind of structure reorganization would be beneficial.

Mr. ALEXANDER. There are several problems that I can see with the proposed reorganization, one of which is where estate and gift taxes fit if at all.

Senator KERREY. What I was trying to do is not set off a debate as to whether or not Mr. Rossotti's proposal was sound, but trying to pick a piece of work and then walk through the steps necessary to accomplish that work. So I was just trying to presume.

Let's presume that you have decided that you are going to modify the proposal in some way; you have made a major decision like this, and you now want to accomplish it. You now want to do some kind of structural reorganization. I am using two or three years.

Mr. ALEXANDER. Two or 3 years. First, you have got to clear everything with the union. Will it be feasible at all?

Senator KERREY. But, does the law allow you to do this? Does the law allow you to make these kinds of personnel decisions? I mean, can you make these kinds of personnel decisions? Could you do the restructuring of this kind, of any kind like this, without some change in the law?

Ms. RICHARDSON. I am not certain that you can because the 1952 Reorganization Act, which Commissioner Cohen is much more familiar than I am—but I looked at it when we reduced the number of regions and districts—it requires a three-tier structure, I believe. A national office and district offices.

It basically provides for a three-tier structure, and we were not in a position, administratively, without legislative change. You can have a district that is comprised of part of a state, but you cannot combine parts of states.

So, in California, for example, I think there are now three districts, and we would like to have had Hawaii aligned with that because it made some sense. We could not do that.

Senator KERREY. Can I presume that all of you believe that whoever the commissioner is they should be given more management authority than they currently have to make these kinds of decisions, presuming that there is morale problems and details that have to be worked out?

Mr. COHEN. There was a reorganization act that gave the President, at the time, in 1952, that brought authority. That ended up in the 1952 IRS reorganization, a very elaborate procedure. It was continued several more times after that. But I don't think it is still in existence.

Ms. RICHARDSON. I think that you probably would need some legislation. I think the flexibilities, the management flexibilities and personnel flexibilities, are extremely important. And one of the major shortcomings in the House bill is the fact that it carves out about three quarters to 80 percent of the work force from those flexibilities.

If you are a member of the union, those personnel flexibilities do not apply to you, and so I think that could be a very serious problem.

Senator KERREY. I would appreciate very much your examining that question for us in the legislation, because I, for one, want to make certain that we give the commissioner the authority needed. Whatever the commissioner decides they want to do to manage this agency, we need to provide the authority, subject to rights and general personnel procedures that we have in the rest of the government.

And secondly, I would appreciate very much your evaluation of what I think could be a problem and that is we end up with two masters, and we definitely do not want that. We do not want to have a chairman of the board with so much power that you end up unable to carry out whatever management decision you decide you want to carry out.

The CHAIRMAN. I would say to the distinguished Senator that we did discuss at some length with the current commissioner what authority did he need, because I don't think there is any question we are going to have to address that if he is going to be able to carry out, I think, very promising proposals of reform.

I would now call on Ms. Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman, and thank you for convening these hearings, and the witnesses for their very thoughtful testimony.

I have a question. In my former life, I was an Assistant United States Attorney, and in that capacity, I represented the IRS, on more than one occasion, with different taxpayer cases.

And the thing that comes to my mind, the most vivid image I have of those cases was of a litigant who was about the size of Phil Gramm, a big football player looking guy, who sat in my office. Handsome, too. Handsome, too. A handsome devil. No. No. He wasn't a devil. But he was a very handsome, big guy. [Laughter.]

And he sat in my office one day, literally with tears in his eyes, over a case that we were prosecuting. He said, "Look, I am going to win this case." He said, "I will never get my reputation back, but as much the point, I won't be able to recover the money that I have spent in trying to defend myself against you and the government who have all the money and the resources and the time in the world."

And I mention that in connection with this issue because the whole question of taxpayers being able to recover—as it turns out, he did win, largely, the case that we were involved with. I won my part, by the way.

Looking at this code section 7430, which is the section on recovery of fees, quite frankly, it is an exercise that is second to none, frankly, in complexity. I am going to try to summarize as best as I can put this down and make it logical.

If you prevail and you get to the IRS within 91 days, you might possibly be able to recover the cost of expert witnesses and case preparation fee costs, and possibly for your lawyer, up to $110.00, unless the IRS decides—except that the IRS might decide that their case was justified, in which case you don't have to get paid anything, and only for those costs that happen after the notice of deficiency.

I think I have got that right. I have been sitting here trying to parse through this like you would an old grammar text, and it is impossible.

An individual who spends money on bookkeepers and auditors, on accountants, on lawyer fees over $110.00—now I understand the Court can make it more than $110.00, and the IRS can make it more than $110.00. I don't know. And I would like to know to what extent that ever happens.

But all of these costs, you could wind up breaking the average person if somebody goes in there with an investigation that turns out to be wrong. And, if it never gets to a notice of deficiency, a person is just out of that money.

Is there a reason why we are being so scrooge-like with regard to the taxpayers? After all, I think you have to start with the proposition that this is a service to taxpayers, and it shouldn't be this kind of punitive and draconian, I think, in its transaction costs if you will.

Mr. ALEXANDER. Well, if IRS is punitive and draconian and continues to litigate after it has lost and puts the taxpayer through that effort and that cost, IRS will properly have to pay up to the limits, which are still fairly low, in 7430, and IRS will have to pay the taxpayer's administrative costs, as well as a taxpayer's litigating costs.

I think that 7430, as proposed to be amended, draws a fairly good balance between the rights of the person that you describe, Senator, and the obligation of the Internal Revenue Service to try to make the tax system work, work sensibly, work fairly, but also work somewhat effectively.

Mr. GOLDBERG. Senator, I guess I come down a somewhat different place from Commissioner Alexander. We use these words, and people don't understand what we are talking about, and I think that this is an area where it is clear and it is simple.

If a citizen wins, a citizen recovers. That is easy to understand. It comports with notions of fair play, and it gets the incentives going in the right direction.

As we talked about burden of proof before, I believe in the real world the burden of proof gives the IRS an incentive to push taxpayers harder and harder and harder. I think, if you make it a no-fault recovery on attorney's fees, I think you give the IRS an incentive to say stop. Why am I doing this? Does it really make sense to go forward?

I come down where you do. I just think you ought to make it simple, get it done and get it over with.

Mr. COHEN. I will come out in the middle. You write the rules. You write the rules any way you want to write them. The law is what the Congress says the law is.

Now, if you are asking me if it is sensible, tell me whether you want to collect revenue or not. I mean, if you are going to put the IRS through this kind of reaming, and if you are not going to appropriate the money for the payments of these fees, and you are not, then you are going to stop tax administration.

Senator MOSELEY-BRAUN. Excuse me.

Mr. COHEN. Excuse me. Nobody will raise a questionable case. The question is not whether they will win the case. The question

is, is this a fresh point of law that has not been decided, which has no controlling authority and does the IRS need to know it?

Well, it needs to know it. So it has to find somebody. There is somebody out there who will do this thing, and then the IRS will test the point. That's what you told them to do.

Now, you have to be willing to pay the freight. Are you willing to pay the freight? If you are, then follow Fred's rule. If you are not, then you have to follow a different rule.

Senator MOSELEY-BRAUN. If I may. We do write the rules. Or they were written before I got here. I am not going to take any responsibility for some of this language.

I mean, I am a University of Chicago trained lawyer, and I am telling you, just to determine who has won after you go through the definitions, you get down to sub 2, and it says—and I am going to quote this because it is just ridiculous—"which meets the requirement of the first sentence of Section 2412D, Sub 1, Sub B of Title 28, as in effect on October 22nd, 1986, except to the extent differing procedures are established by rule of court and meets the requirement of Section 221, Sub D, Sub 2, Sub B, of such Title 28 (as so in effect)."

Now, you tell me.

Mr. COHEN. You wrote the rules.

Senator MOSELEY-BRAUN. We are talking about reform here. So I think we should have some conversation about just plain English; that a citizen who goes into the situation at least can know what does prevailing party mean.

I think I won my case, but this language makes it not so clear.

I thank the Chair, and I didn't mean to go past my time.

The CHAIRMAN. Next, we have Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much. I appreciate the panelists. This has been very interesting.

Also, I want to compliment you because I know that there was a great deal of effort to pass the legislation that passed the House last year in the last few days. I remember some of our colleagues—even this committee, one or two—saying let's pass this unanimous consent, and I think you wisely said wait a minute. I think we need to do some more homework.

And clearly, if one listens to the panel, although it wasn't unanimous, there were several suggestions, and I think several of them were very constructive suggestions.

Senator GRASSLEY. I am the member you are talking about.

Senator NICKLES. Well, no. Actually, a couple of members, and I think it showed wisdom. Sometimes the Senate should be the source to look and couldn't we improve upon what the House did.

As a result of the hearings that you had here, plus, I might mention, the hearings we had in Oklahoma, I think we can improve upon the House-passed language, and I think the House-passed language is good language, but I think we can make some further improvements.

So I appreciate your patience in saying let's look a little further.

I know that there has been some discussion as far as schedule. I would hope that we could meet this by the April 15th deadline, and I know that is a lot of work for the committee, because the more you get into this, the more significant of a challenge it is.

I would like to again thank the Chairman too for the hearing that we had in Oklahoma. I might mention that it had an impact. The day that we announced the hearing, we sent out the notice requesting the district director to testify, he resigned. I find that interesting.

This is a life-long employee of many, many years, but he resigned. He didn't testify before the committee.

We did have abuses in Oklahoma, in the Oklahoma/Texas district. We did find that seizure rates were about eight times the national average. We did find that people were compensated as a result of the number of seizures that they had on taxpayers. We did find cases where taxpayers were abused.

We did have some very interesting testimony. We did have a change in IRS policy as a result of the hearings.

They have expanded the protection from IRS liens and seizures, levies, by requiring a higher level management authorization and/or a court hearing. Used to be there was a very low level person that could authorize a seizure of an asset. Actually go in and lock the door.

We had Steve Nunno, who is the coach of Shannon Miller. An IRS agent had a problem. He was in arrearage. He worked it out. They were two thirds of the way of working it out, they changed agents, and the next agent came in and said, if you don't pay up by such and such a date, we are going to lock the doors. This made no sense.

We had another case where a female who had a pet grooming business and drove a bus, and she realized that she was paid as a contractor. So, she was supposed to pay self-employment. She realized that, went to the IRS, owed some money, was going to pay, make the payments, started making the payments, and IRS puts a lien against her home; a large amount.

She was willing to make payments and work it out in about 3 years. It wasn't a very large amount of money. The net result is the penalties and interest now exceed the value of the home, and IRS is embarrassed. And I think Shirley has fixed that case now.

But my point being, as a result of the hearings that we have had, post the Senate hearings here, just the field hearings, we have had a change in IRS policy, which I think we should codify in the language to require a higher level of approval by IRS before they seize assets.

I think we need to strengthen the current law language that deals with making sure that bonuses aren't paid on quotas and goals, because we did clearly find, and IRS reported in the report that was dated September the 12th, that there were cases of people being compensated directly on the number of dollars and stuff that were raised.

And I compliment several aspects of the IRS internal audit that came out December 12th. They pointed out that one third of the districts revenue officers feel like they were pressured from management to use enforcement tools, including seizure authority.

Thirty-four percent of the seizure cases reviewed by investigators did not meet IRS procedural requirements and resulted in the inappropriate treatment of taxpayers. At least five groups of revenue officers broke the law by setting statistical enforcement goals in

violation of the taxpayer's bill of rights, and they also said that group manager evaluations were sometimes based on illegal statistics.

And those were bonuses, and bonuses, in many cases, in $10,000.00 or something. So, I think the hearing has uncovered some things, and they have been helpful.

So again, I wanted to thank the Chairman. I would like to incorporate some of the things we found through the IRS audit to see if we can enhance the bill that is already passed. I heard several suggestions this morning, when I was here earlier and also in my office, when I was waiting to come back, from our panelists that I think are good suggestions.

So I look forward to working with the Chairman, and I throw out the goal of April 15th. I know we have a lot to do, but I think, time-wise, if we can accelerate this and try to get it done in the next two or three months, I think it would be productive, I think it would be wise, and I look forward to working with other members in the committee to try to make that happen.

And again, I wanted to thank our distinguished panel for their contributions in this effort as well. Thank you, Mr. Chairman.

The CHAIRMAN. Well, I just want to make one comment. I do think it is important that we move as expeditiously as possible, but I do feel we cannot set an artificial date as a goal, because it is more important that this time we do it right, rather than that we merely do it.

Senator NICKLES. I agree.

The CHAIRMAN. And I think that has been borne out by what the panel has had to say to us today, and I appreciate it.

Thank you, Senator Nickles. We now call upon Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. I agree with what you said just now, and I also agree with what Don Nickles said.

And I think it is possible to marry the two, either through intensive hearings—but also, this is the kind of thing which, if we don't stay on it, will slip away from us, or the interest of the committee will slip away. So I would agree with Don and also agree with you, saying that we have to do it right.

The question that I have stems out of, I guess, my major concern about the bureaucracy itself. The only really good evaluation system of a bureaucracy that I have ever seen work, and firsthand, in fact, was when the Peace Corps was started, and it is still in effect.

That was not a large proxy. I think IRS is 100,000 plus. VA, which has these problems rife within it, 200,000 employees plus. So, employee morale, people doing their jobs each day, how they feel about it, how quickly they operate, how much optimism and self-esteem that they have is incredibly important.

But then, on the other hand, somebody has to evaluate that. An independent board has been suggested. An independent board is originally in the language of the House bill. I think it has to do with budgets and things of that sort, but there is some who want to get into the management of the IRS, which is something that I would want to ask all of you about.

But the way that the Peace Corps thing worked—and maybe the Peace Corps is to be significant in this case—there was simply an evaluator. An entirely independent person. Senator Moynihan knows this person as Charles Peters. He runs something called the *Washington Monthly* right now, which gives, pretty much, everybody equal doses of the Dickens.

But what he would is he went out and he got entirely unbiased—and he tended to get writers, people who were skilled in analytic thinking. In your case, it would more than just that. I would be in some tax thinking.

And then, he would have an eyes only relationship with Sargent Shriver, then the director of the Peace Corps. The first director of the Peace Corps.

Nobody else saw what went on, and he had that confidence and his evaluators had that confidence. So, they told the truth.

And the truth really isn't very hard to tell, either good or bad, if you feel that it is going to get to where you want it to get, unopened by others so to speak, and thus, not putting yourself at risk.

Now, my question, therefore, from that, perhaps too easy an example, really stems about the independent board and the ability to focus on employee training. The question of low morale has been brought up.

I don't know that to be a fact, but, Mr. Alexander, you have said that. You wouldn't have to tell that to me. I mean, I would just know it automatically, simply having worked on the VA as long as I have, the Veterans Administration.

The morale is very low. Things are very big. People complain all the time. You never get good stories. It is always bad stories. You get hearings like this.

So, could you comment on the independent board and where you think its position, if you think its position belongs at all, does belong? And secondly, how is it that you address, most effectively, increasing the performance of the on-line IRS employees.

Mr. ALEXANDER. I will try to give a fragmentary answer, and I am sure my colleagues will join in, Senator Rockefeller.

First, the independent board and its need and its position and its activities. In my written statement, I expressed some concerns about the board. I heard this morning—and I agree with the thought—that 11 members in the House-passed bill is perhaps a little few too many.

I don't believe the union head should be on the board at all, and I think the commissioner should be on the board.

The board's relationship to the commissioner and to the Secretary of the Treasury is going to be awkward, I believe. What if the majority of the board wanted to take one action and the White House, speaking through the Secretary, wanted to take an entirely different action? Problems.

Nevertheless, the board, I think, is necessary in these times in which we live, and I think the board can serve a useful purpose in making sure, in this imperfect world, that some of the concerns that you and others have expressed are met.

The IRS has a very difficult job to do—we all know that—to try to make our tax laws work—where we don't have a truly voluntary system—and work fairly and reasonably and treating taxpayers

with respect, at the same time that it must try to extract money from their pockets, in certain cases.

The CHAIRMAN. Could I ask that they answer an additional question related to what you just propounded?

If you are going to have an oversight board, and you don't have 6103 authority, how are they going to have the information necessary to make a decision as to whether or not the organization is functioning properly?

We agree that they should not be involved in micro-management, but where do they get the information?

Mr. ALEXANDER. I think they will get it, Mr. Chairman, from the commissioner, who will report regularly to the board; from an internal audit that produced the audit reports dealing with Oklahoma and dealing with the other districts that have been mentioned at the hearings this morning.

I think they will get it from their work with other executives of the Internal Revenue Service, and I think they will be able to hear and will undoubtedly hear from the exercise of oversight responsibility by this committee, by the Ways and Means Committee, by the Joint Committee staff and by the press and the public.

Ms. RICHARDSON. I agree with that point as well. It seems to me that the board—and when we talked about it in the Commission, we debated between five and seven members. Now it is up to 11.

I think that is really an unwieldy number that would make it very difficult to reach any kind of consensus, much less have meetings that most people could attend, based on busy schedules that people have.

I think the board should be a smaller organization. I think it needs to be very clear what its duties are. We had talked about it having strategic focus, not day-to-day management responsibility, which may go a long way, Mr. Chairman, to resolving your concern about 6103.

If they are not looking at operational details, but looking at strategic plans, strategic focus, it may be much less critical to have that 6103 authority. And I think that the oversight that the internal audit function and this committee and other committees would provide is where the 6103 issues can be dealt with more effectively.

I think all of us worry that people who might serve on this board would feel a conflict or feel concern about accepting that responsibility if they had 6103 authority. So I think that is something you need to look at very carefully.

The CHAIRMAN. Would you please answer Senator Rockefeller's question.

Ms. RICHARDSON. I guess I would need to know a little bit more about that evaluation system.

Senator ROCKEFELLER. I only did that to set my question. My real question was what would you do to simply to take the employees that you have and to give them a better sense of focused mission, self-esteem and better morale so they can do a better job?

Ms. RICHARDSON. Well, I think it takes a combination of things. I mentioned earlier some training, but I think they also need to have some sense that they have some credibility with their overseers here in the Congress and in the administration.

I think that it is a difficult job, and it is never going to be particularly pleasant for some people to have to pay taxes, and so it has never been something that was an easy job at best.

But I think getting some respect from their overseers, from the administration would be very, very important in beginning to restore morale. I think also having a clear mission, and I think this is where Congress really needs to be very specific.

In the 4 years I was Commissioner, I would go from one hearing where we were very concerned about fraud and compliance and closing the tax gap, to another hearing where members asked: "what is a couple of billion dollars worth of fraud? You need to answer more telephones; you need to provide better taxpayer service."

And we tried to achieve a balance and met with some success in improving the quality of phone service and the amount of phone service, although it is certainly not at levels anybody is happy with.

But a really mixed message goes out when you tell people we want you to collect more money, and, in fact, you are doing such a bad job, we are going to go out and hire private debt collectors, hire private tax collectors to collect the tax debt, which is what happened.

So I think Congress needs to be very clear about what mission and what focus they want the Internal Revenue Service to have, and I think it will make it a lot easier for the front line employee to understand what their focus should be.

Mr. COHEN. I was a trench IRS employee. I was a first-year lawyer. I used to draft legislation in the IRS, in 1952, just after the scandals. Just at the time of the reorganization. So, the IRS was at the bottom of its morale.

I mean, we wouldn't admit we worked for the IRS. If somebody asked where I worked, I worked for the Treasury Department, which is literally true.

So I understand that. I have two daughters, both of whom are tax lawyers, both of whom work for the IRS. I know what their problems are, because we sit at the dinner table and talk about what is going on.

But the IRS is a very goal-oriented organization, as most large organizations are, and therefore, they need to know what your goals are. If you tell them go for that, they will go for it.

I often had to be very careful how I enunciated what I wanted them to go for, because by asking questions, often they went off running because they want to please the boss. They want to please you, and they want to please the commissioner.

So, mixed messages will get you bad results. If you, being the Congress, the Senate and the House, and the commissioner, can unite on what your goals are and can enunciate them clearly—and that is not so clear, I understand, because we are in a political climate. But, if you can, the organization will be responsive, given good leadership, and I think it does have good leadership.

It needs training. It will need a lot of other things. Assuming that you give it the money for the training and understand that taking people off the line to train them will cost you revenue, you have to understand that. I mean, if you take every employee off the line for "x" days, he or she is not doing their regular job for "x"

days. They may be getting more important lessons. I understand that, and it is absolutely important.

All I am saying is you must have a goal, and you must enunciate it, Mr. Rossotti and his staff must agree with it and then you will set about achieving it. And you will. I mean, that is not hard to do.

The commissioner has enough resources now, used properly, in the inspection service, in internal audit and internal security, to get the kind of information that he and the board will need.

There are three people who could walk into my office any time of the day or night. Really, in first of importance was the head of the inspection service, the deputy commissioner and the chief counsel. I mean, my door was never closed, except if there was a meeting going on.

So anybody could. Any assistant commissioner or anyone of that level could get in to see me, if they had an emergency, but those people were in every day. That is not a problem.

Your problem with your board is that we are all being too nice to you. I am not going to be. This board is going to be a political board. I mean, I don't know whether it is Republican or Democrat. That is not the problem.

It is going to be a political board because this committee is going to want Joe or Sarah and the other committee is going to want Sam or Ike, and the President is going to want somebody. This is going to be a political board. Now, I don't know how that is going to work.

This is not going to be an apolitical board. That isn't the way Washington works.

Mr. GOLDBERG. I think you are hearing two things, Senator. One is clarity of mission, and the second is the tools to do the job. I think there are some overlays on that, and if I have a very clear mission, but that very clear mission changes, it is sort of serial clarity, you are not anywhere.

I think we are all saying the same thing. How do you get there? That is what gets you back to the recommendations. The best we could come up with was a board with staggered membership that would give you the kind of continuity you need and give you the kind of expertise that you need to get, not just clarity of mission, but long term focus on that mission, and it is filling a hole.

And I think that is the same reason that we made the recommendations about Congressional oversight. Each committee has its own responsibilities, and it's important to respect that. Each chamber has its own responsibilities.

But at some level, the tax writing committees in the Senate and the House, and the budget folks in the Senate and the House and what used to be government operations in the Senate and the House, if you are getting six or seven different messages and they are changing, it is very hard.

I agree on the description of what is required, and at least my own judgment is that the combination of the board recommendation and the coordinated Congressional oversight recommendation is the best you can do to fill those holes.

Senator GRAMM. Mr. Chairman.

The CHAIRMAN. Yes. Just let me make one observation.

As far as the inspection division is concerned, they were pretty much in a state of denial until we held our hearings. So I am not satisfied that that guarantees the kind of independent overview that I think is so essential.

Senator Gramm.

Senator GRAMM. Well, Mr. Chairman, let me first say that I was in the Budget Committee with Alan Greenspan, discussing the budget. I am sorry I missed the testimony. I will read all of them.

I don't want to jump into the issue of loser pay, since I was not here to hear all testimony, and I don't want to re-plow the same ground. I simply don't want, through silence, to consent. I am not convinced about the loser pay issue.

The fact that our number one problem with the IRS is unreported income does not sway me. The number one problem in murder is the absence of an eye witness. Often, the murderer is the only person who really knows who committed the murder, and yet, we are still able to convict people, and every once in a while we put one to death.

So, this is something that I want to look at very closely, and I won't use my time to get into because I didn't get a chance to hear your testimony. But I want to make it clear to the members of the committee that I am unconvinced.

The second issue I want to mention is that I am in agreement with Carol, that we ought to have a system where if the IRS decides to audit a person and that person has to spend thousands of dollars defending themselves, and they are found to have done nothing wrong, the Federal Government and the IRS ought to have to compensate them for their costs.

Now granted, we will have to pay for it. There will be judgments against the Federal Government. But I think, to take a view that we shouldn't pay for it really violates the taking clause of the Constitution, because we are serving a public purpose by random audit.

If there is a public purpose and a public benefit, why shouldn't the public pay for it, rather than a taxpayer who just happened to be audited and he spends 15 or 20, or 50 or $100,000 and he didn't do anything wrong. And I think it will be a check on the IRS in terms of when to cut bait on some of these lawsuits, if, in fact, you force them to pay the cost.

Now, they don't pay. The taxpayer pays. The point is ultimately they have got to answer to it. I think it does affect behavior.

Let me try to direct my questions to two other areas. Number one, it seems to me that it might be beneficial to have a general guideline where maybe—the idea I have raised previously is that we have a third of the senior people at the IRS come in from the private sector, serve for four or 5 years and then rotate back into the private sector, so that not every senior person in the IRS would have had to have been there for 20 or 25 years in order to get into that position.

I think it would bring new insight, new perspective and might be beneficial. I would like to get, sort of quickly, your response to that.

Mr. ALEXANDER. I guess I will lead off, Senator. Getting new blood and new thought in the IRS is a very worthy goal. Right now, the Commissioner and the Chief Counsel and also some assistants

to the commissioner basically represent the new blood, unless someone comes in, like Mr. Arthur Gross, from New York State, to run the information program.

But balanced against the desirability of having new blood is a couple of things. First, I think the IRS is really trying to respond to what it believes and think it understands to be its goal, as laid down by Room 3000, the Commissioner, the Secretary of the Treasury and the Congress.

Sometimes it gets mixed signals. We talked about those.

Secondly, if you brought people in wholesale, bringing in folks from the outside who are going to serve the IRS in say major positions for four or five years and they are going to go back to the private sector, there is certainly a perception, if not the reality, of great big conflicts of interest.

I don't know whether, when they go out again, after serving 5 years, they would be subject to a 1-year rule, a 5-year rule or whatever rule, but having been accused several times when I was Commissioner—falsely—of serving my former clients, I think I know what it is like.

And I am sure that there would be crescendo of criticism, particularly if the people that came in were people that made their living for taxpayers, representing taxpayers against the IRS or in tax jobs with taxpayers, and they would be the logical ones to go out.

Senator GRAMM. Well, they would be the people.

Mr. ALEXANDER. And then went back out and did the same thing for the same taxpayers. What if a taxpayer got a great, big break, although the taxpayer actually deserved it, while that person was in the job of overseeing that taxpayer's case?

Senator GRAMM. Well, I think you would want to force them to recuse themselves on any case they worked on, but you would want people who knew something about it, who were involved in it and I think the trade off you make is the potential conflict of interest versus having new ideas and new blood and a check on the culture.

Ms. RICHARDSON. I think there is a concern conflict of interest. I think there are probably ways you can address that, and I don't know whether a third is the right number.

Senator GRAMM. I don't either.

Ms. RICHARDSON. I think it is good to have some fresh blood, but I think there is a practical reality and that is that it is not that easy to get people to come in.

When I was Commissioner, we had the vacancy in the chief information officer's position for almost one year. We had a national search firm go out to try to recruit people. The amount of the salaries being paid and the conditions under which they were being asked to work drove a lot of really potentially good talents away. They wouldn't even interview.

And I think that one of the advantages I mentioned in my testimony of the Internal Revenue Service being an independent agency, like the Social Security Administration, is the prospect of being able to recruit and retain good people from the outside because the Agency would have more status.

Right now, it is a bureau of the Treasury Department, and by the time you get down all the layers of the Treasury Department

to hire someone at the IRS, the salaries are not competitive with people in the private sector.

Senator GRAMM. I think that is a very good point.

Mr. COHEN. Senator, two points. On your first point, one is a civil case and one is a criminal case, and they are vastly different, but we can get into that at length. We don't have time now.

On the second point, we tried this in the 1960's. John Macy, who was then chair of the Civil Service Commission, had an idea. I worked with the Justice Department and John to work out rules, and, as Peggy indicates, many of the rules got hung up on these conflict issues.

That is, the very people who were useful to you on day one were people who were out of a law firm, an accounting firm, the tax manager of a large corporation, and you had these just perceived and real conflicts and the salary.

Our salary deferential back then was minor compared to today. That is, the government salaries were probably 80, 90 percent of the outside world in the 1960's, thank goodness, and it made recruiting easier.

Ms. RICHARDSON. Some were actually paid more, Sheldon.

Mr. COHEN. But you now have situations where it is a half or a third of what is being paid on the outside. A kid coming out of a very good law school, at the top of their class will get about $35,000.00 in the government, and they will get about 75 or 80, depending on where they go, in a law firm. Maybe even more. The better law firms even higher.

Mr. GOLDBERG. I have a bidding war, Senator Moynihan, for the guy behind you.

Senator MOYNIHAN. Goldberg is $100,000.00.

Mr. COHEN. My line supervisor was another Commissioner of Internal Revenue later. John Walters. Both of us came out of law schools. Johnnie out of the University of Michigan, and I out of George Washington University. I was first in my class. I think he was third or fourth in his.

But the IRS has trouble getting those kids today when Fred's firm and all of our other firms are paying, 70, 80 or 90, depending on where they go. Now, that is just lawyers.

In accountants, we didn't recruit below the 40th or 50th percentile. That is, we were not taking talents below that. Now, today, they are lucky if they get 50th percent.

Mr. GOLDBERG. I think there is a little bit of a divide here, Senator. I agree with the issue about conflicts, but my view is that what the service is most sorely missing—I think lawyers and accountants are an issue—in today's world of the IRS is technology based skills, management based—there are too many lawyers already, in my judgment.

Senator GRAMM. In the world.

Mr. GOLDBERG. In the world at large. Absolutely. The first thing we do is shoot them. Right?

So I think the conflicts are less serious when you are looking for those types of skills. I think there may be a misapprehension. I know Mike Murphy, back here, was a deputy when I was a commissioner. Mike was a career IRS person.

He and his colleagues, all of whom were career folks, we worked as hard as we could to get 25 to 30 percent of the executive development class from outside the IRS. It is not a lack of effort, and I think the IRS understands that. I think that the folks who have been there a long time appreciate the insularity. It is just very hard to recruit, and that is where I would be focusing my attention.

Senator GRAMM. Mr. Chairman, I think the question of independence is an important issue. I think we need to look at the pay scale too.

And I would just like to say that it is nice, every once in a while, to be reminded of your past as head of the IRS, as we work with people, like Don Alexander, who is one of the sweetest, mild mannered people I know. It is important to remember that in another life he was getting blood out of turnip. [Laughter.]

Mr. ALEXANDER. It was hard to get, too, Senator Gramm. [Laughter.]

The CHAIRMAN. Let me thank the former commissioners for being here today. I think your information has been extremely helpful, and we look forward to continue working with you. Thank you very much.

Our second panel consists of representatives of various tax practitioner groups who have a unique perspective as to the interaction of the IRS, with taxpayer and their representatives.

We are very pleased to have on this panel Mr. Douglas C. Burnette, President of the National Society of Accountants; Mr. Paul Cherecwich, Jr., International President of the Tax Executives Institutes, Vice President, Taxes and Tax Council of Thiokol Corporation; Mr. Bryan Gates, Chair of the Federal Regulatory Subcommittee of the National Association of Enrolled Agents; Mr. Michael Mares, who is the Chairman of the Tax Executive Committee of the American Institutes of CPAs, and finally, Mr. Stefan Tucker, who is Chairman-elect of the American Bar Association, Section of Taxation.

Gentlemen, I would ask that each of you keep your remarks to 5 minutes. Your full statement, of course, will be included as if read.

Mr. Tucker, we will start with you.

STATEMENT OF STEFAN F. TUCKER, CHAIR-ELECT, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION, AND MEMBER, TUCKER, FLYER & LEWIS, WASHINGTON, DC

Mr. TUCKER. Thank you, Mr. Chairman. As one of those lawyers of whom there are too many already obviously, it is a pleasure to start off. I am the chair-elect of the ABA Tax Section, and we are the national representative of the legal profession with regard to our Federal tax system.

Having heard what has gone on before, inasmuch as we do have a printed statement that has been presented, I would really like to just concentrate on a few items in our comments.

The first is on governance and the oversight board, recognizing that we may be swimming somewhat upstream or against the tide. It is our view that the oversight board ought to be very narrowly constricted. We think that it is both unwise and impossible to try

to split the fiscal management of the Internal Revenue Service from other issues involving administration, enforcement and policy.

Until you decide where your resources are going to be allocated and how your resources are going to be allocated, it is very difficult to decide how you are going to allocate your financial resources and your fiscal management.

We believe that Commissioner Rossotti's modernization concept, as was articulated yesterday, will, as and when implemented, go a long way to achieve both the control and the accountability that you are looking for. But it is clear, in our view, that the day-to-day management of the Internal Revenue Service ought to be left in the Internal Revenue Service, through the Treasury Department.

We would look to an oversight board as, in effect, a board of review. We think that it ought to be able to, through various procedures, understand what is going on and be, in effect, a watchdog for Congress and Congress', hopefully, joint oversight committee, in terms of watching over the Internal Revenue Service and reviewing the IRS.

We would, as an aside—and it is not in my statement—be very concerned about giving this board, whether an oversight board or board review, any Section 6103 power. We would agree with those persons who have said that this could cause micro-management.

It could cause either actual or perceived conflicts of interest, and we have learned, as we know everybody else has learned, that perception can be reality, and people do tend to talk too much because they are in fish bowls.

And I am always reminded of what my father told me was a slogan of World War II, that loose lips can truly sink ships, and we think that that is something that could occur here quite regularly.

You might want to think about putting this board together on a sunset. You might want to think about looking at a five year plan for the board, with the objective of determining, after 5 years, whether or not that board should be continued.

If it is seen as a need because of what we have seen through the hearings and what we have learned about Oklahoma and Texas and other places, 5 years should help us determine whether we still need it.

Sometimes you eliminate bureaucracy. You have a very fine tuned focus by simply putting a sunset into effect and your retaining the right, up here on the hill, to determine whether or not it should go forward and not having a constant evergreening bureaucracy that sometimes grows like topsy. And we would put that out to you.

We would also put out to you, and we may be the only ones suggesting this, that you consider putting into the Treasury Department an under secretary of taxation, somebody whose sole responsibility is to act as the person from the Treasury Department who would, in effect, oversee the operations of the Internal Revenue Service.

We have found that in the past there have been persons in that position. They have either been sporadic or they have been really in absence as to their oversight on behalf of the Treasury of the Internal Revenue Service, and we think that is something that is truly needed.

You have heard a lot about personnel policies and the need to get the best and the brightest. We agree with that. We think that a lot of fiscal impact on the Internal Revenue Service has come from the hill.

As a practitioner, and I am, my clients are, as a whole, entrepreneurs. One of the things that we run into is, as you have cut resources, the Internal Revenue Service has been compelled to cut back on both their appeals conferees and their district counsel, and it can take us 3 years to actually get an agreement that we have already received orally from an appeals conferee in writing and through the Internal Revenue Service mechanisms.

And, in the meantime, as you have said and others have said, interest and penalties continually run. And the other thing we ought to note that other people haven't said about the interest and penalties is they are an IRS negotiating tool.

Recognizing that in the case of many clients the interest and penalties exceed the deficiency, the IRS will often say, if you don't settle, we are going to assert the penalties. If you do settle, we may not assert the penalties. Interest, of course, cannot be abated, and that creates significant problems.

We have two other things that I would like to note. One is the burden of proof. We really agree the burden of proof ought not to be shifted to the Internal Revenue Service. We recognize the House has narrowed the shift to some extent. We think it ought not to be shifted at all. It is where it ought to be.

And lastly, on the extension of privilege to other tax advisors, we would note that we think that privilege for attorneys comes out of the English common law concept. It is, in effect, the everyday person's fifth amendment right against self-incrimination. You tell your lawyer because your lawyer is your advocate.

The accountants are not your advocate. They operate out of the public interest. What you are telling them is that you might grant a limited privilege in your bill, but that privilege will not extend to other matters. It will not extend to state law. It will not extend to domestic relations, to criminal matters.

You may be opening up a Pandora's box of unintended consequences. By seeking to do something in what you think is a relatively narrow context, it can be destroyed in every other context. Thank you, sir.

The CHAIRMAN. Thank you, Mr. Tucker.

[The prepared statement of Mr. Tucker appears in the appendix.]

The CHAIRMAN. Mr. Burnette.

STATEMENT OF DOUGLAS C. BURNETTE, PRESIDENT, NATIONAL SOCIETY OF ACCOUNTANTS, ALEXANDRIA, VA

Mr. BURNETTE. The National Society of Accountants is pleased to testify today. My name is Douglas Burnette, and I am a practicing accountant from South Carolina.

I am testifying today in my capacity as President with the National Society of Accountants. NSA represents 17,000 practicing accountants and provide accounting, tax and management advisory services to four million individuals and small business clients.

The National Society commends Chairman Roth and the Finance Committee for holding today's hearing on IRS reform, as well as last fall's meaningful hearings.

We feel confident Americans can rest assured that meaningful restructuring legislation will be enacted into law. NSA also commends Senators Kerrey and Grassley for their work on the Restructuring Commission.

For the convenience of time, I will summarize my written statements. With respect to the oversight board, Chairman Roth's statement in November, that the Finance Committee would investigate whether the oversight board should be permitted to look at audit and collection activities, was a point well taken.

According to NSA members, examination and collection activities of the IRS are the two areas generating the greatest number of taxpayer complaints. We hope the committee's investigation will result in legislation that will include oversight of examination and collection functions.

The National Society of Accountants also believes that an important function of the oversight board should be to address issues related to the ethics, integrity and civility of IRS employees. The hearings held last fall punctuated the need for this. Our organization strongly supports it.

In this connection, attorneys, certified public accountants and enrolled agents are subject to enforceable Federal regulations imposing rigorous standards of professional conduct with respect to their dealings with clients and the IRS. Perhaps IRS employees should be subject to a similar code of conduct for the work they perform.

At the very least, there must be oversight of their professional behavior.

It has been observed that 85 percent of the businesses in this country are comprised of small businesses. Compliance with the requirements of the tax laws and dealings with the IRS are an integral part of the lives of small business owners, yet they rarely have the people on staff to do such work and often cannot afford the cost of representation.

NSA strongly recommends that the legislation include small business representation on the IRS oversight board. The House bill already mandates that large businesses be so represented. Small businesses must be provided direct representation on the board as well. Without such representation, this critical constituency's needs will not be addressed.

Mr. Chairman, you mentioned last fall that the Finance Committee will investigate whether the taxpayer advocate should be made completely independent of the IRS and responsible directly to the oversight board. While we recognize the merit of the competing views on this subject, on balance, the National Society of Accountants feels the independence of the taxpayer advocate will be beneficial to the efforts of improving IRS customer service.

The National Society urges the Finance Committee to examine and consider changes to the offer in compromise program. Currently, less than half of the offering compromise submitted by taxpayers and deemed processable by the IRS.

Of those that can be processed, approximately one half are resolved. The program is administered by the IRS collection function,

is plagued by complicated application instruction, inordinate delays in processing, unprocessable submissions, delayed notifications and lack of consistency.

The National Society recommends the Finance Committee consider removing the offer-in-compromise program from collections and place it in a more suitable location within IRS, such as appeals or an expanded and independent taxpayer advocate's office.

By doing this, the committee will be protecting a taxpayer's right to a speedy and fair resolution of collection matters and bring the taxpayer back into compliance on succeeding years.

Another area of concern by this committee is the IRS conduct of employee performance evaluations, including the granting of performance awards to employees. NSA believes that a fundamental principle of the evaluation process is that no IRS employee should receive a cash reward based on quotas.

On the issue of electronic filing, the National Society strongly recommends the Finance Committee include in its bill provisions designed to encourage more tax professionals and taxpayers to utilize the electronic filing program.

We urge the Finance Committee to use the language on electronic filing contained in the Kerrey-Grassley bill, thereby avoiding what could be interpreted as a mandate for electronic filing. Congress and the IRS, therefore, are likely to circumvent many other perception problems that have underlaid implementation of the EFTS over the last 2 years.

The House bill calls for the Joint Committee on Taxation to complete a study on tax penalties within 9 months of the bill's enactment. The National Society not only supports this study, but believes that the tax penalty reform should become the next most serious phase of IRS restructuring.

The practitioner community has become increasingly concerned with the requirement that a paid preparer's Social Security number must appear on tax returns filed with the IRS. Practitioners feel that the requirement violates their privacy, as it can provide an unscrupulous taxpayer with the opportunity to access certain records that would otherwise be unavailable.

NSA suggests the committee review this requirement with the IRS and develop a separate system for identifying tax return preparers.

The National Society of Accountants is pleased to provide these comments on IRS reform and restructuring. NSA stands ready to work with the Finance Committee in any way we can.

The CHAIRMAN. Thank you, Mr. Burnette.

[The prepared statement of Mr. Burnette appears in the appendix.]

The CHAIRMAN. Mr. Cherecwich.

STATEMENT OF PAUL CHERECWICH, JR., INTERNATIONAL PRESIDENT, TAX EXECUTIVES INSTITUTE AND VICE PRESIDENT, TAXES AND TAX COUNSEL, THIOKOL CORPORATION, OGDEN, UT

Mr. CHERECWICH. Thank you, Mr. Chairman. I am the Vice President of Tax and Tax Counsel for Thiokol Corporation, in Ogden, Utah, but I am here today as President of the Tax Execu-

tives Institute, the largest group of in-house tax professionals in North America.

Mr. Chairman, TEI commends the committee for holding this hearing and for its work in this area, because we believe the IRS Restructuring and Reform Act holds great promise for improving the management and oversight of the IRS and for enhancing taxpayer rights, while giving the agency the tools necessary to fulfill its mandate.

My written statement describes TEI's position on the various provisions of H.R. 2676, as approved by the House of Representatives. Rather than summarize our entire testimony, I want to highlight just a few items.

But before doing so, I want to say that TEI is encouraged By Commissioner Rossotti's plans for reorganizing the IRS. Although still in the formative stage, the service organization approach he outlined not only is consistent with private sector trends toward organizing along lines of business, but it also compliments perfectly the overall thrust of H.R. 2676.

TEI looks forward to working with Commissioner Rossotti in refining and implementing his reorganization plan and ensuring that the IRS's goals of service and fairness to taxpayers are attained, while fulfilling the congressional mandate of collecting the revenues needed to fund the government.

Turning now to the bill, I wish to confirm that TEI supports the establishment of a balanced private sector/government IRS oversight board. We agree that the Secretary of the Treasury and the Commissioner, still appointed by the President, should serve on the board. Other members should be selected on the basis of their expertise in areas such as general management, finance, technology, and personnel.

Under the bill, the oversight board will review and approve the IRS's strategic plans and budgets. Although the board's involvement in these areas should be helpful, TEI does not believe the board should be involved in the development of tax policy or in managing the day-to-day operations of the IRS, and we do have significant concerns about granting board members access to confidential taxpayer information.

We believe such an approach is fraught with risks. Not only for maintaining taxpayer privacy and avoiding conflicts of interest, but in distracting the board from providing high-level, strategic advice to the Commissioner.

TEI supports proposals to streamline congressional oversight of the IRS by coordinating both the myriad GAO studies and the sometimes duplicative hearings by various committees and subcommittees. By making congressional oversight less reactive and more integrated, Congress can conserve the agency's resources and ensure that mixed signals are not being sent about what the IRS's priorities should be.

Better and more focused oversight should also contribute to an environment where the IRS can receive the stable funding that it needs to fulfill its mission.

An essential component of increasing confidence in the IRS is preserving and strengthening taxpayer rights. To this end, TEI believes the Taxpayer Advocate's position should continue to be

strengthened, and we applaud Commissioner Rossotti's decision to recruit the next Taxpayer Advocate from outside the agency.

Among the most important taxpayer rights proposals is the provision to eliminate the so-called interest deferential, which imposes a higher interest rate on deficiencies than on tax refunds and can have the effect of penalizing taxpayers who simultaneously owe and are owed funds by the IRS.

TEI supports the elimination of the differential for both individuals and corporations and urges the committee to confirm, in legislation rather than in committee reports, the IRS's authority—and responsibility—to deal with the inequities of the past by implementing comprehensive crediting procedures for all open years.

The Institute also supports efforts to clarify IRS's authority to issue a summons for third-party tax-related computer source codes. Mr. Chairman, taxpayers have found themselves stuck in the middle on this issue, obliged to respond to IRS requests for information while being legally bound by their licensing obligations to third-party vendors. We urge that this issue be addressed.

Mr. Chairman, I now wish to turn to a proposal that causes TEI considerable concern, the provision to shift the burden of proof. TEI opposes the legislation. Not so much because of how it will affect the few cases in which a court ultimately concludes the proposal's requirements are satisfied, but because it could diminish the overall level of voluntary compliance and lead to an even more intrusive IRS.

Listen to the sound bites, Mr. Chairman, and what you hear is not a limited proposal, but an extraordinarily broad one. Scan the headlines, and what you see is that the limitations and nuances have been lost and taxpayers are being told, or at least they are hearing, that they will not have to keep records or substantiate their claims.

The sky might not fall on those cases where the burden shifts, but the cumulative effect of the legislation and how it has been promoted will be to undermine voluntary compliance. What is more, we regret that if the proposal is enacted, the IRS will have no choice but to intensify its enforcement activities to satisfy a sustained burden. That certainly is not consistent with the overall thrust of this legislation.

Before concluding, I want to underscore a point that has been almost a mantra to TEI members. The most important step Congress can take to the meaningful reform of the IRS is simplifying the tax law. The biggest abuses of taxpayers come not from excessive actions by IRS personnel, but from highly complicated laws and onerous administrative procedures that Congress enacts and the President signs into law.

Mr. Chairman, Tax Executives Institute appreciates the opportunity to provide its comments. I should be pleased to respond to any questions you may have.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Cherecwich, Jr., appears in the appendix.]

The CHAIRMAN. Mr. Mares.

STATEMENT OF MICHAEL E. MARES, CHAIR, TAX EXECUTIVE COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, WASHINGTON, DC

Mr. MARES. Thank you, Mr. Chairman, and thank you for inviting the AICPA here today to testify before you. I am Michael Mares, Chair of the AICPA's Tax Executive Committee.

Your committee hearings last September highlighted the need for major reform at the IRS. While we commend Acting Commissioner Dolan, Treasury Secretary Rubin, and more recently, Commissioner Rossotti for their reform efforts, we believe more needs to be done.

Accordingly, the AICPA supports H.R. 2676 because it presents many sound and exciting ideas for revitalizing and reforming the IRS, thereby restoring public confidence in that agency.

My comments today will be limited to four issues of particular importance. Privacy in tax matters, the taxpayer advocate, electronic filing and tax law complexity. Of course, upon request, we will be happy to provide any additional comments the committee may desire.

First, the complexity of the federal income tax laws and the often surprising ways in which those laws apply to taxpayers means that millions of taxpayers must or elect to choose tax advisors. Advisors become privy to much private information about their clients in the course of forming recommendations.

For individuals, this may include intensely personal information. For businesses, it may include trade secrets and other sensitive data. The recommendations or tax advice given to clients may be based, in part, on such private information.

They may also involve professional recommendations and opinions, even pure speculation as to the outcome of financial transactions or events over time.

Taxpayers expect privacy and confidentiality in discussing tax matters with their advisors. As a matter of public policy, we believe a taxpayer has the right to expect the same protection of privacy for all information concerning tax matters provided to his advisor, if the advisor is authorized to practice before the IRS, regardless of that advisor's specific professional classification.

Section 341 of H.R. 2676 affords taxpayers needed confidentiality protection in non-criminal proceedings before the IRS for tax advice from any federally authorized tax advisor, to the same extent such advice would be protected under the attorney/client confidentiality privilege.

The AICPA supports the section 341 proposal, but we believe some changes are needed to clarify the appropriate taxpayer protections. We believe the key in this situation is recognizing the disparate treatment of taxpayers, based upon their choice of tax advisors, and providing all taxpayers the needed privacy protections.

With respect to the taxpayer advocate, the taxpayer advocate is in the unique position of being inside the Internal Revenue Service, yet charged with the responsibility of zealously representing the interests of American taxpayers.

For the taxpayer advocate to fulfill these responsibilities, he or she must have the taxpayer's trust, even though that office is part of the IRS. It is, therefore, crucial that the taxpayer advocate be

regarded by taxpayers as being independent, both in fact and in appearance.

We urge this committee to incorporate into the IRS reform legislation measures to enable the taxpayer advocate to operate in a manner that is truly independent and that is perceived as being independent.

The AICPA has supported, for many years, the concept of electronic filing; however, there are problems with filing electronic returns today. For example, all forms cannot be filed electronically, and there is no ability to attach white-paper schedules, disclosures or elections electronically, among other issues.

The AICPA supports the H.R. 2676 provisions that call for the removal of the barriers to and for promoting the use of electronic filing. We are concerned, however, that the language of section 203 of the current bill is weaker than that of the comparable provision in H.R. 2292, its predecessor, and we recommend that the language of H.R. 2292 be accepted.

It provides more time sensitive filing deadlines, and I think pushes the issue of electronic filing forward in a faster manner.

Finally, we recognize that the problem of tax complexity originates with complex tax legislation, not tax administration. We urge you to adopt section 422 of H.R. 2292 instead of the weaker provisions of H.R. 2676.

During our testimony before the National Commission on Restructuring the Internal Revenue Service and before the House Ways and Means Committee on its hearings on this provision, we made a number of recommendations concerning simplification and provided much detail on the type of complexity analysis we believe should be made part of every legislative initiative.

We believe that H.R. 2292 reflects that and better addresses the complexity problem in a practical, useful manner.

As always, the AICPA appreciates the opportunity to offer comments at today's hearing and stands willing to provide your committee with whatever resources and assistance we can as this bill moves forward. Thank you for your attention, and I will be happy to answer any questions.

The CHAIRMAN. Thank you, Mr. Mares.

[The prepared statement of Mr. Mares appears in the appendix.]

The CHAIRMAN. Mr. Gates.

STATEMENT OF BRYAN E. GATES, CHAIR, FEDERAL REGULATORY SUBCOMMITTEE, NATIONAL ASSOCIATION OF ENROLLED AGENTS, GAITHERSBURG, MD

Mr. GATES. Chairman Roth, my name is Bryan Gates. I am an enrolled agent from Clearwater, Florida. I am speaking in behalf of some 10,000 enrolled agents who have elected to be members of the National Association of Enrolled Agents.

Our testimony is divided into three parts. Briefly, with respect to the oversight board, we applaud that decision and will cooperate in whatever the outcome is. It is to our members benefit, and we see that as a positive move to change the culture at the service, which everybody talked so much about today.

With regard to electronic filing, we are totally and completely in favor of it. Our members love it. The faster the service is able to

implement it and we are able to bring those services to our clients, the better off we are going to be.

As far as the taxpayer advocate is concerned, it has been a boon to tax practice as long as it has existed. Sometimes it is the only way we could get ever difficult problems solved for our clients, and we felt almost like we were taking from the public, because it was set up for them, but we probably use it more than anybody else.

But in your areas of concern, Senator Roth, we want to spend a little more time. We are believers of Senator Grassley's efforts many years ago. At first, a taxpayer bill of rights was absolutely unbelievable to us; to establish, for the first time, the taxpayer's right of representation or right of consultation, in Section 7521 of the code.

We just wish all the taxpayers knew that they have that statutory right, because we have been trying to explain it to them for 10 years, and they are still not fully aware of it.

For 10 years, however, the service has not been aware of it as we are, and they continue to discourage and deny taxpayer's right to representatives. We believe that this is a rule without a sanction. You have given a taxpayer a statutory right to be represented, but when the Internal Revenue Service violates this right, there is no sanction; there is no punishment. There is nothing.

We strongly suggest you look into Section 7521 and see if perhaps something as stringent as an IRS employee who breaks a taxpayer's right of representation be suspended while the inspection service determines the facts of the case and IRS management determines what discipline is in order.

Secondly, Senator Roth, payments, installment agreements and offers in compromise, which is what our clients are all about, as Commissioner Cohen mentioned, we are in the trenches all the time.

The bill of rights gave the taxpayers, in Section 6159, the right to propose installment agreements. Or at least gave the Commissioner authority to listen to them. That was the first time they ever, in history, had the right to propose payment of tax in less than the full amount.

Offer and compromise has been on the books for years and years, but until Commissioner Fred Goldberg discovered that code section, 7122, very few people even knew about it. As a result, after he issued IRS policy statement P-5-100, saying offers exist, some parts of the country got them in boxcar loads because that was the only solution taxpayers saw to an inability to ever pay taxes in their entire life.

However, I can't say the service has done a wonderful job in administering either one of these provisions. They use enforcement personnel to investigate these proposals, enforcement minded revenues officers who are supposed to be out there preventing employers from incurring $9 and $10 million in employment taxes, not sitting down at a table with a small family who has to negotiate an $11,000 payment agreement.

So we really believe, if by legislation if necessary, that the investigation of installment agreement proposals and offers and compromise be taken away from enforcement personnel and put in this new taxpayer service area where they belong.

And third, Senator Roth, your area of seizures. Without question, the Internal Revenue Service has had the right to seize property of any kind, virtually with very few exemptions, for years and years, except they have a tendency to abuse that authority.

Now, if they abuse it by taking a bank account or if they are taking some stocks or bonds, that is one thing. But if they close down a man's business or physically seize a pickup truck from a person's backyard, that is the most serious confrontation that taxpayers and their Internal Revenue Service ever have.

We really truly believe those kind of seizures should require a pre-deprivation court hearing.

The Internal Revenue Service went out under black of night in the GM Leasing case, entered on private property without warrants and the Supreme Court was horrified in the GM Leasing case. Since, the Internal Revenue Service has had to get a writ of entry any time they want to enter on private property to seize assets.

We believe your committee should increase that to a writ of seizure so the taxpayer has an opportunity to present, in a show cause order, why his business shouldn't be closed or why property should not be physically taken away from him.

In the few seconds I have left, consider the statutes of limitation. Congress has seen fit to have 3 years to assess taxes and 10 years to collect, which is an increase from six, yet the Internal Revenue Service still coercively insists that taxpayers extend these statutes by agreement.

It is time for Congress to say 3 years to assess and 10 years to collect is enough. No extension.

I am going to steal a little bit of time because I know it is dear to your heart, Senator, as to financial status audits. You call it assignments of income.

Without question, the Internal Revenue Service, confronted with a person who has not kept records for years and years, who has failed to file, doesn't know exactly what to do.

So they will go to the Bureau of Labor Statistics and say, well, let's see. You are a construction worker in Philadelphia, and during those years, you should have made $57,000. So, since you have no records, we are going to take the position that you owe taxes on $57,000.

That is very convenient for the Internal Revenue Service, but terribly burdensome for that taxpayer, even though he may be somewhat of a non-complier. He now has to go to the United States Tax Court or United State District Court to undo that presumption against him.

I am sorry I took the extra time.

The CHAIRMAN. Thank you, Mr. Gates.

[The prepared statement of Mr. Gates appears in the appendix.]

The CHAIRMAN. I am going to ask a couple of questions. We have a series of questions. We will submit those to you and ask you to answer them in writing, if you would be so kind.

But I would like to go back to the question about liens, levies and seizures authority. Mr. Gates addressed that in part.

I am concerned about taxpayers who do not receive real notice and wake up in the morning only to find that the IRS has taken

their bank accounts, business or other assets. Sometimes their home.

Should the taxpayer have a right to a judicial hearing before seizure? Mr. Tucker, do you want to start?

Mr. TUCKER. Frankly, my practice does not entail seizures, liens and levies. My clients don't tend to run into those. The ABA tax section certainly has experience, and we would be more than pleased to answer that in writing.

The CHAIRMAN. Mr. Burnette.

Mr. BURNETTE. One of the most horrifying things that a taxpayer can do is find out that his bank account has been levied. Not only does that cause him embarrassment with his community, but a lot of the times the checks that he has already written that were outstanding are now going to bounce and cause him further distress.

I think, most definitely, we should have some measure before any levy is taken in this nature.

The CHAIRMAN. Mr. Cherecwich.

Mr. CHERECWICH. Sir, our organization does not get involved in those issues. We work for large corporations, and we pay our taxes and don't tend to have that issue arise. I would add, Mr. Chairman, that in striving to enhance the rights and protections of noncompliant taxpayers in lien and levy situations, Congress must take care not to send the wrong signal to the overwhelming majority of taxpayers who fully comply with the law.

The CHAIRMAN. Mr. Mares.

Mr. MARES. Mr. Chairman, I think there are three or four issues the committee should consider in addressing this.

First of all, I think it is important to recognize that the use of a judicial proceeding is a burdensome affair, both for the taxpayer and for the government, and would require additional resource allocations by both parties. But I think there are a number of steps that the committee and the law can take to prevent it from ever going that far.

First and foremost, I think it is very important that taxpayers be provided explicit, clear, understandable notice and procedures for appealing any collection action at the first notice that the taxpayer owes money.

Many times, as the former commissioners have noted and I have experienced in my practice, receiving a notice from the IRS creates a great deal of fear and apprehension, and many people tend to ignore it, simply hoping it will go away or there is a mistake.

We believe that by providing early notice, providing clear directions to the taxpayers as to what steps they have to take in order to appeal that decision, that many of the problems can be relieved. Secondly, we believe that a substantial change in the offer and compromise program will accomplish, again, much relief for the taxpayers.

We have recommended, in our written testimony, that a number of the standards be re-examined and that there be more local allocations of standards, rather than one national standard, which may not apply. We also believe that the offer and compromise provision should be reworded to encourage the IRS to use deviations from those standards, when appropriate.

My experience has been, and I think some anecdotal experiences of other members of the AICPA has been, that while this discretion exists now, it is not used very frequently by the IRS, and we believe that a more reasonable use of that discretion will, again, go a long way towards alleviating this problem without the necessity of judicial intervention.

The CHAIRMAN. Mr. Gates, do you have anything to add?

Mr. GATES. Yes, sir. The idea of judicial notice to every taxpayer who has fallen behind and is probably, by this stage, ignoring a lot of notices, we have anticipated, is probably more than the courts could conceivably handle.

In addition, the Congress has seen the need to give them more time when you instituted the 21 day holding period, so that a bank has to hold their funds 21 days now, and yet, gives them an opportunity to straighten out their difficulties with Internal Revenue.

But we cannot say so lightly of the closing of a growing business, what you are talking about—generally, our clients are small business; one, five, six, seven, eight employees. They are struggling with withholding tax. They don't fully understand it. The deposit system is incredibly difficult. They get behind.

The concept of cascading penalties is just absolutely unbelievable. When you explain to a small businessman that by your failure to make deposits, compounded by your late filing of the tax return, which now puts delinquency penalties on you, followed by late payment penalties, in just a few quarters, a couple of quarters—6 months to a small businessman is nothing.

But he has accumulated so much liability that he is overwhelmed by it and probably will need a year or more to work out an installment agreement to both remain viable and get back into full compliance.

Now, an IRS officer, until recently a very low level—until Commissioner Rossotti, almost on an emergency basis, raised that to the chief collection division level, a relatively low ranking revenue officer can make a decision, at that point, to close his business down.

At one time revenue officers needed no managerial approval whatsoever. Now he needs the approval of his manager, and as a result of Commissioner Rossotti, the approval of his division chief.

We don't think that is enough to close down a going business, of the small businessman, who has not got a record of over and over again avoiding his withholding tax responsibilities. It should require the scrutiny of a Federal judge before it takes place, and the Internal Revenue Service should have to go for a pre-deprivation hearing.

The CHAIRMAN. My final question is with respect to the inspections division. Should it be made more independent? Should the IRS inspection division be transferred to the Treasury IG? Mr. Tucker.

Mr. TUCKER. We believe that you ought to have more independence at the Inspector General division. We think, however, it ought not to be transferred to the Treasury Department. Treasury has a much broader scope. The Internal Revenue Service has to have a very definite delegation of authority to that inspector general, and it needs to be strengthened.

But we need it inside the Internal Revenue Service and not focusing on overall Treasury types of functions, but we do believe it ought to be strengthened.

The CHAIRMAN. Would you make it a report to the board, if a board is created?

Mr. TUCKER. I believe that the reports would go to the commissioner, we think to the Under Secretary of Treasury, for purposes of oversight on the IRS and to the board.

The CHAIRMAN. Mr. Burnette.

Mr. BURNETTE. I definitely think it should be more independent and should be referred to the oversight board. I feel like the oversight board gives us a breath of fresh air in looking at such issues.

The CHAIRMAN. Mr. Cherecwich.

Mr. CHERECWICH. Sir, I think that the best way to look at this is to use the corporate business model. The inspection division is analogous to the internal audit function that corporations like my employer have, which serves as a very valuable tool for the chief financial officer and chief executive officer to use in effectively running the business.

I really think, as Mr. Rossotti said yesterday, that the IRS needs to have a very strong internal audit function that reports to and, therefore, assists the Commissioner of Internal Revenue.

As to the interaction of the inspection division with the board, board members can meet with the persons who conduct these studies to assure themselves that those persons have the freedom and the unhampered ability to dig in and find out what is truly going on.

In the corporate business world, the internal auditor who is an employee of the corporation periodically meets with members of the board of directors, and particularly the outside members of the board of directors, just to reassure them that that internal audit function can operate in an unimpeded manner. I think that there is much that the IRS can learn from following that model.

The CHAIRMAN. But, of course, in a corporation you also have the independent audit annually, which is a further check.

Mr. Mares.

Mr. MARES. I was going to comment on that, Mr. Chairman. I think that the analogy of an internal audit program in the corporate world to that of the inspection service within the IRS is a reasonably valid analogy.

However, as you pointed out, the outside corporations that are publicly traded—in fact, many privately held corporations—do have an audit for the purpose of assuring the financial statements reflect the income or loss of the entity.

To strengthen, if it were this committee's goal, for example, the oversight of the board, you could certainly make that internal inspection agency or the internal inspection report to the board. But I, again, would be concerned that it would not allow the commissioner or other executives within the IRS ample opportunity to act on those, many of the problems of which will be day-to-day operational problems.

The CHAIRMAN. Thank you. Mr. Gates.

Mr. GATES. Inspection within the Internal Revenue Service is of two categories. The internal audit and what they call internal security.

The first is a true internal audit, much as my colleagues up here were speaking to. That service ultimately finds fault with the operations of a district or a service center or even a region, and the commissioner needs to know how well the regions are operating and so forth.

So, to that extent, it is a tool, as you heard the former commissioners themselves say, to improve management. How they work their peer relationship since it is essentially internal audit criticizing one of the top 25 or 30 executives of the service and how they work out the politics would depend, I suppose, from commissioner to commissioner.

However, from a practitioner's point of view, the other side of the inspection service is the one that deals with dishonesty of employees and operates much like the internal affairs division of a police department.

The most frustrated persons I heard speaking to you in the fall were current and former inspection officers of Internal Revenue Service who evidently were the most frustrated individuals I had ever heard, because they conducted internal affairs investigations and found IRS employees guilty, so to speak, of serious infractions, and it was their perception that nothing was ever done.

To the extent that that sort of activity goes on within the Internal Revenue Service, it, of course, has to be curtailed, because if the internal affairs people are whitewashing misconduct and not punishing it, then it should be transferred to somebody other than the commissioner so that the appropriate disciplinary actions can take place.

The CHAIRMAN. Well, gentlemen, thank you very much. I apologize for the lateness of the hour, but your testimony has been very helpful.

We will submit a number of questions to each of you, and I will appreciate their being answered as promptly as possible.

The committee is in recess.

[Whereupon, at 1:00 p.m., the hearing was concluded.]

IRS RESTRUCTURING

THURSDAY, FEBRUARY 5, 1998

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:00 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, D'Amato, Nickles, Lott, and Graham.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

Today we begin our third day of hearings on reforming the Internal Revenue Service. The goal of our series of hearings is to lay the groundwork for legislation that will improve the oversight of the agency, better protect taxpayers from unfair treatment, and change the IRS internal culture.

The first part of our hearing will focus on the Executive Branch, as well as congressional oversight of the IRS. Within the Executive Branch, the Treasury IG and the IRS Office of Chief Inspector share oversight responsibilities for the IRS.

To be effective, it is imperative that these units operate in a cooperative and complementary manner. I am concerned that this may not be the case right now.

I am also concerned about the serious problems raised about the IRS Office of Chief Inspector in our oversight hearing last September.

The Office of Chief Inspector is the equivalent of an internal affairs unit within a police department. It is responsible for investigating employee misconduct and conducting internal audit review within the IRS.

Yet, we heard testimony from IRS employees of the work environment at many IRS offices is one of fear, intimidation, and retaliation.

And we have heard testimony that the IRS Office of Chief Inspector may have close working relationships with IRS management.

I am concerned that the IRS Office of Chief Inspector is not sufficiently independent to enable it to conduct effective oversight of the

agency. Serious problems abound within the IRS and have gone unchecked. This is not acceptable.

I am pleased that Commissioner Rossotti has recently requested a top to bottom review of the IRS Office of Chief Inspector. That is a positive step.

But let me be clear, I will not be satisfied until there is an effective, independent oversight process established for this agency.

We are going to hear from the Treasury Department's Deputy Inspector General, Richard B. Calahan, who will discuss the current role of the IG in overseeing the IRS and its working relationship with the IRS Office of Chief Inspector.

We will also hear from the General Accounting Office on the role of the Treasury IG and the IRS Chief Inspector, as well as the role of the Taxpayer Advocate.

Our second panel today consists of tax practitioners from around the Nation who will discuss their views on current IRS collection tactics and their recommendations to enhance taxpayer protection.

Everyone has a responsibility, of course, to pay their taxes, but I am concerned that taxpayers may not be provided appropriate protections when property is levied or seized. The IRS should not be able to seize property from a taxpayer without sufficient warning.

I think it is just common sense that before the IRS is allowed to take property of any kind from the taxpayer, that taxpayer should receive sufficient notice and an opportunity to be heard.

Our witnesses will discuss this issue. I look forward to hearing the views on these and other IRS reform issues from our distinguished panel.

Now, I am pleased to introduce our first panel which consists of Mr. Richard Calahan who, as I said, is the Deputy IG for the Treasury Department.

We are happy to welcome again Ms. Lynda Willis who is the Director of Tax Policy and Administration Issues of the U.S. General Accounting Office. Would you care to introduce the gentleman with you?

Ms. WILLIS. Mr. Chairman, I have Mr. Mark Gillen with me. He is our Assistant Director who is responsible for our work around the IRS IG and Inspection Service.

The CHAIRMAN. We are pleased to welcome you, as well.

Mr. Calahan.

Mr. CALAHAN. Thank you.

The CHAIRMAN. I will say to both of you, your full statements, of course, will be included as if read.

STATEMENT OF RICHARD B. CALAHAN, DEPUTY INSPECTOR GENERAL, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. CALAHAN. Chairman Roth, Senator Moynihan, and members of the committee, I appreciate the opportunity to appear before you today to testify on the proposed legislation for restructuring the IRS and on the ways to strengthen the independence of the audit and investigative functions of the IRS' Office of Chief Inspector. I believe that this is a very important subject.

My written statement is rather long. And with your permission, Mr. Chairman, I would like to submit it for the record in its entirety and briefly discuss some of the most important points.

The CHAIRMAN. So ordered.

[The prepared statement of Mr. Calahan appears in the appendix.]

Mr. CALAHAN. As the committee is aware, the Office of the Chief Inspector performs the internal audit and investigative functions for the IRS. It is part of the IRS. And it is under the supervision of the IRS Commissioner's office.

The Treasury Office of the Inspector General has oversight authority for the Office of the Chief Inspector, but not line management authority.

The IRS Office of the Chief Inspector performs one of the most important audit and investigative functions in the government, but does not have the most important elements of independence provided to Presidentially appointed Inspectors General.

The most significant of these are that the Inspector General is (1) nominated by the President and confirmed by the Senate; (2) can be removed only by the President; (3) reports to the head or deputy head of the agency; (4) generally cannot be prevented from conducting an audit or investigation, in the case of some departments though, including Treasury, the Secretary may in unusual situations prevent an audit or investigation by giving written notice which the Inspector General must provide to Congress; (5) has a legislative mandate to communicate directly with the Congress; (6) has a separate line item in the administration's budget; and (7) generally has its own legal counsel.

Without these elements of independence, the Office of the Chief Inspector continues to face public and internal perceptions of its lack of independence.

The current arrangement for IG oversight of the Office of the Chief Inspector does little to mitigate the lack of structural independence. The present oversight arrangement is too cumbersome. And the resources provided for this function are too few to offset this lack of structural independence and the concerns that have resulted.

In fact, this has been implicitly recognized by the Congress, as it has requested the OIG to perform more and more assignments at the IRS over the years, several of which are ongoing.

Legislative impediments to the OIG's authority have resulted in cumbersome oversight arrangements. Current difficulties centers on two provisions of the 1988 Inspector General Act Amendments. First, the OIG is required to provide notice to the IRS of its intent to access income tax return or return information. Second, with reference to chapter 75 of the Internal Revenue Code, the OIG may report to the Attorney General only offenses under section 7214 without first obtaining the consent of the Commissioner of the Internal Revenue Service.

In terms of resources, let me point out that the Office of the Chief Inspector is four times larger than the OIG. This fact and the many other OIG responsibilities that require the use of our resources has limited severely the extent of OIG oversight coverage at the IRS.

I believe it is important to study the need for greater independence for the audit and investigative functions of the Office of the Chief Inspector, or at least to consider the need for strengthening OIG oversight.

I know that there are many considerations involved in this facet of IRS restructuring. I encourage you to maintain the need for independence and objectivity of the audit and investigative functions as a high priority in your deliberations.

Thank you, Mr. Chairman. I would be pleased to respond to any questions.

The CHAIRMAN. Thank you, Mr. Calahan.

I see our majority leader here. I wonder, would you care to make any comment?

Senator LOTT. Thank you, Mr. Chairman. No, I just want to be here to hear the testimony of the witnesses. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Lott.

Ms. Willis.

STATEMENT OF LYNDA D. WILLIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Ms. WILLIS. Good morning, Mr. Chairman and Senator Lott. As always, we are pleased to be here today to assist the committee in its continuing efforts to do oversight of the IRS.

At your request, my statement today covers four basic areas. The first is the adequacy of IRS systems to identify allegations of taxpayer abuse and employee misconduct. The second is the responsibilities of the Inspection Service of the IRS, as well the Treasury IG. The third is the placement of the Inspection Service. And fourth is the discussion of the Taxpayer Advocate which is another important office within IRS for protecting taxpayer rights.

Mr. Chairman, in spite of IRS senior management's heightened awareness of the importance of treating taxpayers properly, we continue to be unable to determine whether IRS controls for fair treatment of taxpayers are adequate to assure that process takes place.

This is because neither IRS systems nor other Federal information systems provide the information that is needed for management to identify allegations that are made, actions that are taken, or any remedial steps that are needed to prevent systematic actions from recurring.

From our review of the data from these systems, none of them have the common data elements necessary either individually or collectively to roll up the allegations and to be able to look at them from a service-wide perspective.

Our reviews that we have done over the years through Treasury and OIG, one in 1986 at your request, Mr. Chairman, have revealed that they have separate, but also some shared responsibilities.

The IRS Inspection Service is responsible for auditing and investigating the programs of the Internal Revenue Service on a day-to-day basis. They have responsibility also for investigating allegations against employees who are at the GS–14 level and below.

The OIG, under the statute, is responsible for providing oversight of the Inspection Service. They are responsible for investigating allegations against employees that are at the senior level, although they may refer these allegations back to the Inspection Service if they do not have either the resources or the expertise to pursue the allegations.

When we looked at the relationship between the two organizations in 1994 and 1996, we did not find that the relationship was not working. We found that according to the officials, it was working well. But it appears since that time that the situation has deteriorated and there are now problems between the two organizations.

Regardless of where the Inspection Service is located, whether it is the Internal Revenue Service or whether it is located in the Department of Treasury or a separate IG is set up, we believe that there is certain critical features that it must have.

And these include independence. They include proper resources, adequate staff expertise, and reporting lines that allow for the Congress, the management of the organization and the administration to be able to identify problems within the service.

We have always supported a strong statutory IG, believing that this would provide additional independent oversight of the agency, but we also have recognized that the Commissioner of Internal Revenue needs his or her own resources within the organization to be able to evaluate the programs and the employees of a very complex system of tax administration.

Moving now to the Taxpayer Advocate, 20 years ago, IRS set up its first executive level Taxpayer Advocate. It was originally known as the Taxpayer Ombudsman. It was later codified in the Taxpayer Bill of Rights.

Despite 10 years of executive level involvement in protecting the taxpayer, there is still serious questions about the advocate's office. We are currently in the process of examining these issues and the management of the office for the House Ways and Means Committee.

But some of the questions that have been raised include the organizational independence of the office, how the office is staffed. Frequently, they must rely upon line staff to assist them in their evaluations. And these line staff report to the same people who may have caused the problem in the first place.

And we are also concerned about whether the advocate has thoroughly looked at the systemic issues that are frustrating taxpayers across the board.

Mr. Chairman, that summarizes my statement. I would be happy to take any questions.

[The prepared statement of Ms. Willis appears in the appendix.]

The CHAIRMAN. Thank you very much, Ms. Willis. Let me ask you, you said I think since 1995, problems have developed between the two groups, the Treasury Inspector General and the Inspection Service within the IRS. Could you be more specific as to the nature of what has caused these problems, what they are?

Ms. WILLIS. Mr. Chairman, I am not aware of the root cause of the problems. But when we issued our report to you in 1996, offi-

cials from both organizations indicated that the relationship was working well.

Since then, however, there have been indications, especially around the response to referrals that things are not working as well as they had been. This is basically anecdotal information that we have received from members of the staffs of the various organizations. And perhaps, Mr. Calahan could comment more specifically.

The CHAIRMAN. Mr. Calahan.

Mr. CALAHAN. Well, I would like to comment that as our scrutiny of the Office of the Chief Inspector has intensified, the problems have been more frequent and more severe. And we have had less cooperation as our work has intensified.

The CHAIRMAN. Well, let me add, the Treasury IG has responsibility for overseeing the IRS internal audit, internal security functions, both of which, of course, comprise the Inspection Service. Are you able to provide effective oversight under the current situation?

Mr. CALAHAN. As discussed in substantial detail in my written statement, there are problems. More specifically, we have four categories of problems. We have resource problems. We have issues related to what is oversight, and how far does it go in terms of our authority. We have issues in terms of IG access authority. We have issues that are basically——

The CHAIRMAN. What do you mean by access?

Mr. CALAHAN. Whether or not certain records should be available to the Inspector General's Office. Sometimes, we are allowed to read things, but not copy them. There is a variety of those kinds of things.

The CHAIRMAN. Are you talking about 6103 now?

Mr. CALAHAN. Those are not 6103 issues. 6103 is a totally separate category in my written statement that is referred to as legal impediments.

Senator LOTT. Mr. Chairman.

The CHAIRMAN. Yes.

Senator LOTT. What is 6103?

Mr. CALAHAN. Internal Revenue Code section 6103 refers to taxpayer privacy, protecting taxpayer information from unauthorized disclosure to people who do not have a need to know.

Senator LOTT. Mr. Chairman, could I pursue your line of questioning just one minute more?

The CHAIRMAN. Sure. Please.

Senator LOTT. I was under the impression that the Office of the Inspector General had almost carte blanche authority. And as we look for ways to get a handle on the culture of the problems with IRS, perhaps this is one place we need to take a look. Is that what—are you saying that in effect?

Mr. CALAHAN. Well, that is true. I think one of the most severe problems that the IG's office has regarding the Internal Revenue Service is that for our office to access taxpayer information, we have to first notify the Internal Revenue Service of exactly what it is that we want to look at.

And, I might say related to that is when we find a disclosure problem regarding taxpayer information, we have to first obtain

the approval of the Internal Revenue Service before we can refer it to the Department of Justice. Those are very significant issues.

Senator LOTT. Thank you, Mr. Chairman.

The CHAIRMAN. Yes, I cannot underscore how important that is. How you can have effective oversight and not have the necessary documents available to you is incomprehensible to me. I think this is a very key problem.

Mr. CALAHAN. Well, it goes a step beyond that even in terms of just an investigative approach. The general strategy for any investigation is that you want to acquire information without the subject of the investigation knowing that you are doing it. You start the investigation under this requirement by providing a notification.

The CHAIRMAN. Now, it is my understanding that the Treasury IG is responsible for investigating the allegations of misconduct against senior IRS officials, grade 15 and above, and allegations concerning the IRS inspection employees.

However, the practical matter, you refer many of these allegations back to the chief inspector's office for action. Is that correct?

Mr. CALAHAN. That is correct. And a lot of that is because of resources. The number of employees, grade 15 or higher at the IRS is sizable. I do not have that number with me, but it is a large number.

The IRS itself has more than 100,000 employees. And the IG's office has 37 criminal investigators on its staff.

So we retain only the allegations on the highest level officials.

But allegations against lower level employees that are less significant, we refer to the IRS Chief Inspector. We do that through a letter that requests they provide us within 60 days their position in terms of what they are planning to do with the allegation. We also follow up on what they do with them.

The CHAIRMAN. I would like to go back to this idea of the importance of the independent audit. What concerns me is that what you are telling me is that grade 15 and above theoretically or by agreement is normally or should be handled by the Treasury IG. In fact, many of them go back to the Inspection Service.

So there is no independent audit in many cases of these higher IRS employees. Is that correct?

Mr. CALAHAN. In some cases, that is true. We do follow up on those issues. And we have an Office of Oversight that reviews the quality of work performed by the inspection service.

The CHAIRMAN. But you just told me you often do not have the data necessary. So that as a practical matter, you really do not have in many cases effective oversight. Would that not be a fair statement?

Mr. CALAHAN. I think that is a fair statement. I think it is fair to say that because of lack of resources, we do not know what happens in terms of the thoroughness of the investigations that are performed. We would have to perform a much larger sample of testing of those investigations than we do.

The CHAIRMAN. Now, what level are the auditors and those involved in collection? Are they grade GS–15s and below as a general rule, the ones that have contact with the taxpayer?

Mr. CALAHAN. I believe the regional managers for collection efforts are GS–15s, but the people that actually have contact with the taxpayer are below the GS–15 level.

The CHAIRMAN. So the ones that have the most—or the ones that have actual contact with the taxpayer, their oversight is within the hands of the inspector's office?

Mr. CALAHAN. I believe that is true.

The CHAIRMAN. So again, we really have no independent oversight probably at the most sensitive spot with those employees who have the direct contact with the taxpayers. Is that correct?

Mr. CALAHAN. I think you are right, Mr. Chairman.

The CHAIRMAN. Ms. Willis, would you like to comment?

Ms. WILLIS. I would just like to reaffirm what Mr. Calahan has said about the importance of independence. And he is right that most of the collection people are below the GS–15 level in the field.

You might have a GS–15 level branch chief at a district office. You would have that, but the people who are out there working with taxpayers are below that level, the ones who have the most interaction.

The Inspection Service is independent within IRS from the standpoint that it is a separate entity. It is not independent within IRS that the chief inspector is appointed outside the service and reports outside the service. That is very true.

The CHAIRMAN. And that is contrary to most departments. Is that not true?

Ms. WILLIS. That is contrary to the Inspector General. Right.

The CHAIRMAN. Yes, normally, the Inspector General is nominated by the President.

Ms. WILLIS. Right.

The CHAIRMAN. And confirmed by the Senate.

Ms. WILLIS. Right.

The CHAIRMAN. But that is not the case here.

Ms. WILLIS. That is not the case for the IRS inspection group.

The CHAIRMAN. Senator Lott.

Senator LOTT. Mr. Chairman, you were focusing on the points and Ms. Willis' testimony that causes me the greatest concern, too, the organizational placement of the IRS inspection.

Obviously, there was concern in 1988 about how that was being done. And those concerns have been expressed again in the testimony we heard last fall. And it continues.

You also noted that this problem has really been going on for 20 years. I mean, why is it so difficult to get appropriate oversight and inspection within this agency? Why are they so resistant to any transparency into how they do business?

I mean, that is why there is such outrage. One of the many reasons I think why there is such outrage in the Congress and by the American people because we have tried before to make it clear to them that there are problems and they had to be addressed. And they continue to resist. How do you react to that?

Ms. WILLIS. Senator Lott, it is very difficult to go into the minds of the people who work in these offices and say why they are resistant.

My experience as a GAO auditor, nobody likes being audited. And there is always a certain amount of resistance there. And

there is always a certain amount of I know what I am doing better and I do not need oversight that takes place.

In terms of the placement and the debate around the Inspection Service, there have been a variety of policy issues that have been traded off through the years.

One of those is the issue of size. The IRS Inspection Service has about 1,200 people in it. IRS is by far the largest component of the Department of Treasury.

And there has been concern on the part of IRS and others that if they are folded into the IG's office that those resources will no longer be available for the audit of IRS, that they might be moved to other critical parts of the department, but basically, they would not be available for auditing the programs of the tax system.

Another issue deals with expertise. There has been concern expressed historically that there is expertise needed in the evaluation of IRS programs that may not sit in the Office of the Inspector General and that in fact some of the people in the Inspector General's office have told us that when they make referrals back, sometimes it will be because there is a need for tax law expertise that they do not have.

There has also been concern around the issue of taxpayer data and how much the Congress wishes to wall that data off from people outside IRS, including Treasury and the Inspector General, although like us, they do have fairly broad access.

So I think there has just been through the years a number of sides that have had competing policy perspectives on these issues that led to the compromise which created the—or allowed the Inspection Service to continue in the IRS with the Department of Treasury OIG providing oversight. But those were some of the issues that have been debated historically.

Senator LOTT. With regard to the taxpayer advocate, we have tried in the Congress to put that in place. And we have really addressed it at least twice. And yet, you know, it is still a question that it is effective at all or is effective as we had hoped it would be even though it says it has handled, you know, a number of cases in 1997.

I think maybe you touched on it, but what could we do to help make that Taxpayer Advocate Office effective or more effective than it is?

Ms. WILLIS. I think you have some of the same issues with the Taxpayer Advocate Office that have been addressed with inspection. Is it truly independent and outside of the mainstream, day-to-day activities of IRS?

And what we have found so far in terms of staffing, etcetera, is that, no, it is heavily dependent upon the staff of the units that it is, you know, answering problems around.

There are also issues in terms of their ability to look systemically at problems, as opposed to a taxpayer-by-taxpayer basis.

I think there needs to be the capability in that office to kind of step back a little bit, take a look at cases, such as those that we saw in the hearings before this committee last September and say beyond this taxpayer's problem, what does this tell us about what is wrong with the system?

But I think most importantly, Commissioner Rossotti was very articulate in explaining that the culture of the organization has to shift its focus from being inward to being taxpayer based, to looking at its functions, its programs, and its responsibilities from the perspective of a taxpayer, especially a taxpayer who is attempting to be compliant.

Senator LOTT. How is the taxpayer advocate and how are the employees within that office selected? Who controls that?

Ms. WILLIS. The advocates are selected by the Commissioner.

Senator LOTT. Is that not the problem?

Ms. WILLIS. Well, it could be part of the problem in terms of independence.

Senator LOTT. And not reflecting on the Commissioner. I mean, you are automatically beholding to and you are there because.

Ms. WILLIS. They do report, yes.

Senator LOTT. We ought to move that somewhere else. Do we need to isolate it, wall it off, make it independent of and not dependent in any way in my opinion on IRS?

If you are connected, if you are selected, if you are paid by, you are not going to be independent. It just will not happen.

Ms. WILLIS. Senator, the thing I would be concerned about and one of the reasons that we are undertaking this review is that the Commissioner also has need of the information and the insights and the perspective that the taxpayer advocate can provide. And there also needs to be the ability to provide oversight, etcetera, of the advocate's office.

So I think in trading off organizational placement, etcetera, that there are a lot of different things that need to be considered.

And whether that means that the advocate has to be outside IRS, I do not know because I think you do have the issue of wanting someone in the system whose job is also to advocate for the taxpayer, as opposed to that person always being on the outside.

Senator LOTT. The lines are real simple, you know. You have the Treasury Secretary up here, the President above that. But if you have the Commissioner of IRS here and then a line somewhere below him to the advocate, it is lost. The lines have got to be parallel. Now, there has got to be somebody over him.

But I mean, I assume the Secretary of the Treasury and the Commissioner of IRS talk. So I would hope that the taxpayer advocate would be talking to the Commissioner, but without being beholding to or subservient to the Commissioner.

I think we really need to look at that, Mr. Chairman, and see if we could find a way to wall it off, but at the same time do make sure—I mean, they have got to be answerable to somebody, too, perhaps the Secretary of Treasury. I do not know for sure.

I mean, there is no system that is perfect. All we know is we have been muddling around with this for 20 years trying to make it better. And it has gotten worse. It has gotten worse in the last year. I believe you said that, did you, in your testimony? One of you did.

So we appreciate your input. We will read your statements carefully. And we will be looking for suggestions as we move toward making some hopefully helpful changes.

The CHAIRMAN. Thank you, Senator Lott.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. Again, I appreciate your bringing before us such a knowledgeable group of individuals who can help us understand the kind of questions that Senator Lott was just asking.

I would like to start by asking of the representative of the IG office, 2 weeks ago, we held a hearing in Orlando which we received testimony from citizens, as well as current and past employees of the IRS relative to how their offices were functioning, what the perception of treatment of taxpayers was.

One of the issues that we got into was the Inspector General Report on the use of statistics in collection in among other things the evaluation of IRS employees.

The north Florida office based in Jacksonville was one of the dozen or so offices which were selected for that IG evaluation.

Were you involved in that report, Mr. Calahan?

Mr. CALAHAN. I believe that the product that you are talking about was done by the IRS Inspection Service.

Senator GRAHAM. It was not done by your office?

Mr. CALAHAN. It was not done by the IG's office.

Senator GRAHAM. I see. Well, I had a very interesting question to ask, but I will ask it of someone else.

At that Orlando hearing, one of the concerns that we heard that appeared to be systematic, as opposed to anecdotal to a particular taxpayer was the difficulty of getting the IRS to make a decision.

We had one case that sort of epitomized this in which there had been a decision made relative to the taxpayer's non-liability, but there had been some discrediting comments made relative to the taxpayer which it took several years to get a letter to the appropriate agency to be removed from his files. It was just a matter of nobody would make the decision to send the letter.

Is that a difficulty that in your evaluation of the agencies you have found a recurrent problem? And if so, what cause and what recommended solution?

Mr. CALAHAN. Well, maybe, Ms. Willis can speak to that. I do not know. Generally, the IG's office does not get involved directly in tax matters. So that is really a question I am not going to be able to answer for you.

Ms. WILLIS. Senator, we have not looked at the issue of taxpayers having difficulty in getting letters of that type out of IRS. So I do not know, but I do recall that this came up last year at the hearings, as well that several taxpayers did express frustration about being able to get some of these type of issues resolved. But we have not looked at it in any detail.

Senator GRAHAM. Another issue that came out of that hearing was a pattern of insensitivity to taxpayers where taxpayers would have almost arithmetic questions to ask and could not get an agent to review their information. Any comment about that particular issue and how prevalent it is?

Ms. WILLIS. Again, we have not looked at it in terms of prevalence, in terms of how often where and under what circumstances that it looks, but it is a common complaint. And I think it is also one of the complaints that is driving the change in focus, you know, at the Internal Revenue Service.

Certainly, behind the problem-solving days, that was one of the issues was whether the IRS was meeting the needs of the taxpayer in responding and resolving their questions and having the people available to meet and make those decisions. So I think this is an issue that IRS needs to look at very seriously and is in the process of reexamining.

Senator GRAHAM. Related to that, the shift which you refer to and which I applaud as well of Mr. Rossotti to make the IRS more of a service-oriented, looking at the world from the perspective of the taxpayer rather than an internal perspective, I strongly support.

One of the concerns that I have is that in the evaluation of individual IRS agents, when you evaluate their collection function, it is subject to a high degree of quantification. In fact, maybe, this report indicates an excessive amount of quantification. Whereas, evaluating service is a more intangible quality.

What advice would you have as to how that concept of service as opposed to a collection orientation ought to be operationalized on things like the selection of IRS agents, the evaluation, the training of IRS agents?

Ms. WILLIS. Senator, coming up with performance measures or evaluation measures that address such things as customer service is difficult.

And I think that is one of the reasons why agencies, IRS as well as other agencies, have tended to evaluate their programs, etcetera, on what they can count, things that are much more easy to measure.

But what you value is communicated to people by what you measure. So I think it is imperative, as we have stated for any number of years, that IRS develop a balanced set of indicators that takes into account all of its roles, all of its values, and all of the things that are important to taxpayers and to the American public.

The fact that it is not easy does not excuse the lack of having those kinds of indicators. And again, I think IRS has acknowledged that and in their recent moves to develop customer satisfaction is making an attempt to somehow start collecting that information about their different functions and components, like much of the work that agencies are doing on the results act.

I think it is going to have to be an evolutionary process that the government will get better at over time. But you are absolutely right. If we are concerned about the quality of service that is provided to taxpayers, then that needs to be one of the things that employees are evaluated on.

Mr. CALAHAN. I might just add to that that I think there are serious tradeoffs between quantity and quality of work. And when you concentrate solely on quantities then often quality suffers. I think that that is perhaps part of the problem that we have seen here.

Senator GRAHAM. Can I just ask one last question?

The CHAIRMAN. Yes.

Senator GRAHAM. Over the time you have been evaluating this issue of quality versus quantity, service versus collection, is the situation today better than it was 5 years ago, about the same or

worse in terms of having a capacity to make that service quality an equal component in the evaluation of IRS agents?

Ms. WILLIS. On a day-to-day basis, I think it is probably about the same. But I think the fact that IRS as an organization is now acknowledging that it needs a broader set of indicators, it is now acknowledging that it has to develop indicators that will measure quality of service provided to taxpayers that at least it is a step in the right direction.

The CHAIRMAN. I would just like to make the observation that the problem of evaluating performance is not unique to the government. The private sector constantly has to do it. And if it succeeds, it has got to provide service. And that is true of credit agencies, those that have credit cards.

So it seems to me while I agree that it is going to take time, I would also say that it should not take that much time because there is experience in the private sector with this problem.

I would next call on Senator Nickles. We are getting a number of people here. We are going to try to limit questioning to 5 minutes.

Senator Nickles.

Senator NICKLES. Thank you, Mr. Chairman. And to our panelists, thank you very much. I am not sure exactly who I should direct this to. I guess Mr. Calahan. You are involved in the investigation review in the Oklahoma-Arkansas district?

Mr. CALAHAN. No, Senator. The IG's office was not involved in the Oklahoma City audit. That was performed by the Chief Inspector's Office of the IRS.

Senator NICKLES. The Chief Inspector's Office of what?

Mr. CALAHAN. The Internal Revenue Service.

Senator NICKLES. I thought you all were involved in it. So that is what I was going to ask a question about.

Mr. Chairman, I will pass for the time being.

The CHAIRMAN. All right. We will go ahead with Senator Grassley.

Senator GRASSLEY. Mr. Calahan, could you please explain to us why the Inspector General is not testifying here today in place of you?

Mr. CALAHAN. The committee requested that I testify today.

Senator GRASSLEY. All right. Is the IG going to receive a compensation package once she leaves office in March?

Mr. CALAHAN. I have no idea.

Senator GRASSLEY. All right. Then, would you please look into that and get back to me?

Mr. CALAHAN. I would be happy to do that.

Senator GRASSLEY. Let me just say for the sake of my colleagues that the Inspector General was forced to resign because of her abuse of authority in at least two matters.

First was her involvement improper investigation of two Secret Service agents which at first she denied on an investigation by myself and some of my colleagues, especially the Senator from Maine. Senator Collins proved that the IG had in fact improperly investigated two Secret Service agents. She later apologized for that.

The second was two illegal sole source contracts that she let to two friends. They were found to be illegal by the General Accounting Office.

Otherwise, the IG has presided over an office whose moral has been severely damaged and in much need of repair.

Mr. Calahan, you were the one individual who had responsibility to oversee the two illegal contracts. You also approved improper reimbursements to the contracts. You were also involved in the Secret Service investigation.

The reason I raise these issues is important because in November in a speech on the floor of the Senate, I called for the IG's resignation which, of course, eventually happened.

I also mentioned that other changes needed to be made because Congress had lost confidence in the office there at Treasury, that absence of Congress applies to you I think as her deputy, as well as it does to her and your testimony as well.

This committee, I bring this up, is considering whether or not to give the Inspector General more authority to oversee the IRS. That might be a good idea in theory. But because of the questions of credibility surrounding your office, that, of course, might not be an idea that we would have confidence in.

Your office has simply been too close to the department that you were charged with overseeing. And that includes, of course, what this committee is very much interested in and going to take major Congressional action on within the next few months.

And that is the restructuring of the IRS and obviously the relationship of the Inspector General to the IRS.

And we are looking at making sure that there is plenty of independence for the IRS and independence in the sense of doing their job, but also to make sure that there is adequate oversight over the IRS because there has not been some of that. And, of course, related to that is the powers and the resources that we would give to the Inspector General.

The problems that this committee uncovered were not uncovered by the Inspector General. In fact, according to information that you supplied to the Permanent Subcommittee on Investigations, your office conducted only 5 audits of IRS-related functions under this Inspector General.

That compares to 122 audits of other bureaus and functions within Treasury that arguably have far less impact on the lives of Americans than the Internal Revenue Service has.

So my question is then, what does this comparison of 5 audits that IRS related by the Inspector General compared to 122 audits of other bureaus and functions have to say about the priority of the Inspector General's agency in regard to overseeing wrongdoing within the IRS?

Mr. CALAHAN. Senator, I would like to point out that prior to the date that I became the Assistant Inspector General for Audit in March of 1995, there had been no program audits performed by the IG's office of the IRS. I initiated this type of auditing of the IRS by the IG's office.

Currently, we have several assignments that are underway. We would be happy to provide you a list of those for the record.

Senator GRASSLEY. Well, let us look at one of those. I understand that 1 of the 5 audits that you are referring to, the last one was the Office of Chief Counsel of the library deposit accounts. Does the IG think that the library deposit account is a major problem at the IRS?

Mr. CALAHAN. I do not know if I would refer to it as a major problem. I will say that that item was referred to us by the IRS Deputy Counsel as a potential violation of law. We have sole cognizance over the Chief Counsel's Office. So we, of course, performed that assignment because we are the only agency that could.

Senator GRASSLEY. Let me ask you to be very candid with me, whether or not you understand that some of us might have a real question about the IG's office when its big contribution to IRS oversight is an audit of the library deposit account?

Mr. CALAHAN. Well, I think that the question should be phrased probably more broadly in terms of what the IG's office has done at the IRS in terms of the resources it has available to it for that and for other activities.

We are currently involved in the financial statement audit of the IRS which I think is a very important assignment. We have performed audits of the integrated data retrieval system, which was the computer snooping work we performed at the request of Senator Glenn. And we did a follow-up audit to test corrective actions. I think these were very important jobs.

I think our office has performed some important work at the IRS. And I think we are performing more work there now probably than we have at any time in the recent past.

As I noted earlier, the intensity of our scrutiny of the IRS has increased over the last year or so. And I might say that I think that the Congress itself has validated the independence of our office by increasingly asking us to do more and more work at the IRS.

And I think that those requests are not related to the situations that the Inspector General of this Office might be involved in.

These requests from the Congress are related to a respect for the office and the people who work there and work hard and do independent work and work that is unbiased. I think that our independence and objectivity has served the office well in the past and will continue to do so in the future.

Senator GRASSLEY. Well, my time is up. But just remember that the Inspector General herself said that low morale was a very major problem in the Inspector General's office. And she had a program to bring that morale up.

I would also suggest to the chairman that the chairman is absolutely right in looking at how we can have better oversight over the IRS, both from the Congress, as well as other processes within our government.

But, Mr. Chairman, maybe, we need to take a look at the inspector General's office and see if there might not be some major changes that need to be there if we are going to give them more responsibility over the IRS. In other words, I think that we also need to start watching the watchdogs to a greater extent, as well.

I have great confidence in the inspectors general system generally throughout out the bureaucracy, but I think we have seen

some very major problems with the Treasury IG that we need to consider, as we consider what do we do about their involvement in greater oversight over the IRS. I would just ask you to consider that.

The CHAIRMAN. Well, as the distinguished Senator knows, one of the major reforms we are going to put about is the question of independent oversight. And it has to be effective. We do not have it now. And the question is, how do we establish it for the future?

Senator GRASSLEY. Thank you.

The CHAIRMAN. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you. And I would like to reclaim my time. And I appreciate very much the statement that you just made. And I kind of want to go back to this Oklahoma city investigation.

Mr. Calahan, you said that—did you say the IG was not involved in the Oklahoma city investigation?

Mr. CALAHAN. That is true.

Senator NICKLES. Not presently involved? The investigators in that situation now, that is all internal?

Mr. CALAHAN. If you will, excuse me, I would like to check with a member of my staff before clarifying my statement.

[Pause.]

Mr. CALAHAN. I would like to respond to that in two ways. First of all, IRS is a big place. It has a lot of district offices. And we were informed by the Chief Inspector's Office that they were performing both a nationwide investigation and audit of this whole matter.

The staffing for the performance of this job was significant. I believe I have pointed out in my written testimony that just the audit side of the Chief Inspector's Office alone was assigning 80 people to this work.

So our involvement was influenced by our available resources. We have fewer than 300 people in our office, and the Chief Inspector's Office has more than four times that many. For us to be involved in any kind of meaningful way with the same kind of resource commitment was just not realistic. We had to look at the more significant facets of the review on a nationwide scale and be involved in those and not be involved to any large extent at the district office level.

Now, in terms of investigative matters, we are involved in some investigative matters, but I cannot speak to those.

Senator NICKLES. Well, then, let me just ask a question. At the Oklahoma city hearing, one, we had allegations of abuse. We had a district director who resigned a week before we had the hearing, the day after we had notification of the hearing.

I understand that your office has responsibility to investigate that level and higher. Is that correct?

Mr. CALAHAN. That is true. That is true.

Senator NICKLES. We also had assurances from some top officials in this committee hearing and in Oklahoma. I think the Chief Compliance Officer, Del Hart, promised that there would be no retaliation taken against the employees who testified. Can you at least assist me to make sure that that is not the case?

I am concerned about an independent investigation. One, it does not sound independent. And this committee has said we are going to protect people who testify.

And I have now had people who testified say that they have had retaliation, retaliation in the form of their leave requests not being approved, travel vouchers not paid, negative evaluations from managers, managers who are under investigation are the ones who are giving—they are still in their jobs, still giving problems.

And I want to make sure that people are not retaliated against. And I am not saying that every person that speak before the committee is a saint either, but I want them to be treated fairly. And I am not positive that is the case if we do not have an independent investigation.

And I said that we are going to make sure that people were not retaliated against for presenting their views to Congress. And I want to make sure that that happens.

Mr. CALAHAN. I would like to point out two things. One is that we do have jurisdiction over grade 15s and higher. In this situation, we did ask the Chief Inspector's Office if the involved grade 15 employee was being investigated. We were informed that there was an audit being performed, but that there was not an investigation. And that is the reason we were not involved in that matter at that time.

In terms of the retaliation issues that you have raised, we have not received allegations like that.

Senator NICKLES. You have now. Can you help me on that or do I need to go through this IRS maze? I thought there was more of an independent investigation than evidently there is.

Mr. CALAHAN. We can take your statement as an allegation.

Senator NICKLES. I will give you some information.

Mr. CALAHAN. All right. That is fine.

Senator NICKLES. And again, I am not saying that everything that is on the allegations is correct.

Mr. CALAHAN. I understand that.

Senator NICKLES. I just want to make sure that people are protected. I am not taking a position, but I want to make sure that people are not retaliated against for speaking before Congress. And we have some problems there.

And I do not want them just investigated by the people who may be responsible for the problems. And that looks a little—I am sorry to use the word "incestuous", but a little self-serving.

Mr. CALAHAN. Well, I would like to point out that that is one of the reasons for establishing independent inspectors general. I think the Chairman, as one of the fathers of the Inspector General Act, can share that, historically from department to department in this government, there was a debate about whether or not there should be an independent inspector general.

One of the primary issues that came up is, do you want the IG to serve within the program function. And from one department to the next, the decision has been consistent and the answer has been no, we do not want the IG to serve within the program function.

The consensus was we want the IG to serve at least a level above. In fact, for the IGs, at least all the larger ones, they report

directly to the head of the agency. So I totally agree with your position.

Senator NICKLES. I appreciate your comments. And we will get you some information and maybe to Mr. Rossotti, as well. I am obviously concerned about it. Thank you very much.

The CHAIRMAN. Let me point out on this exact point what concerns me is that basically as the system is now set up, there is no independent oversight of those who are under classification 15, 14s or less.

Senator NICKLES. Right.

The CHAIRMAN. And that is one of the real problems.

Senator NICKLES. And that is exactly right. And in the Oklahoma city hearing, we heard names mentioned of people who really abuse the system who were telling people very directly, you are going to be evaluated on the cases that you close, you are going to be compensated on them, giving great incentive for seizing assets not in the most beneficial way for the taxpayer, but basically to close cases.

If you close the cases and get some money out, we are going to give you compensation. That was the—it actually came from part of the IRS review itself. They mentioned it.

Well, some of the people that were doing that, frankly, you are not looking at them. And they are still serving in those positions, although 1 or 2 people have been moved. And I do not know exactly what level GS. GS–15 is only the district manager? There is another person or two that I have heard.

Ms. WILLIS. It is the branch chief level.

Senator NICKLES. Well, there is another person or two that evidently or at least some people were alleging had significant pushing towards seizing assets in violation of the law, Mr. Chairman.

And I am not sure. Well, evidently, you are not—the IG is not looking at them. And I do not know what the IRS is doing. In their internal audit, if you remember, Mr. Chairman, they redacted a lot.

The CHAIRMAN. That is true.

Senator NICKLES. And some should be redacted. I am not trying to get into personal investigations. We are not the jury here, but I want to make sure that, one, people are not retaliated on. And, two, we have enough of an independent investigation to stop a bunch of the nonsense that is not compliant with existing law.

Mr. CALAHAN. I would just like to point out that, on a nationwide basis, the number of high-level people that are involved in this at the IRS and being investigated are so large that it was just not possible for the Inspector General's office to do all of those.

Senator NICKLES. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Well, we have another panel, but I just want to make one observation and ask one question perhaps of both of you.

It does seem to me important that within the IRS that there be audit. I think the Commissioner and those responsible for management need some auditors within the organization to judge how successful their management policies are being implemented.

But having said that, I think it is critically important that there be an independent oversight outside of the organization.

Now, as I understand it, and I asked you this, Ms. Willis, we have something like 1,200 in the IRS inspection group and 300 in the Treasury's IG.

Do you have any thoughts? One of the proposals I think you covered in your testimony is that you could reallocate the employees so that the Treasury IG had more personnel available. Is that a legitimate approach here? Can we reallocate and assure that there will be independent oversight, as well as internal oversight effectively?

Ms. WILLIS. Mr. Chairman, there is some precedent for doing that. Inspection resources have been transferred to the IG in the past I believe in one case in 1990 on a more permanent basis and for special projects.

Mr. CALAHAN. That is true.

Ms. WILLIS. So Congress could certainly move resources from the Inspection Service to the IG's office. The amount of resources and how you would want to do that I think would depend upon how ultimately the Congress comes out on the roles and the structure of the two offices together.

The CHAIRMAN. Well, I would appreciate if the General Accounting Office would give some consideration and thought to this matter because I think how we structure is going to be critically important.

And I agree with the Commissioner who I understand has said that he needs auditors available to him to effectively manage. And I think that is a reasonable requirement. I do not see it in conflict with what we are trying to do here.

Ms. WILLIS. No, Senator, I think both mandates are very important, that the Commissioner needs his resources, but you also need to be comfortable that the oversight capability that you have is independent.

The CHAIRMAN. Mr. Calahan, I would like to ask you one final question. You testified that the IG office has experienced certain problems in accessing information in the hands of the IRS and certain bureaucratic impediments have been raised.

Now, do I correctly infer that IG oversight is viewed with some hostility by IRS personnel? I want a frank answer.

Mr. CALAHAN. I do not know if I would use the word "hostility." I would say that in spite of the difficulties that we face in law and in other ways, a cooperative spirit would probably get us past all of those.

The CHAIRMAN. To me, you are failing to answer the question. Are they cooperating or are they not cooperating? Are they creating problems for you to effectively do the job or are they not?

Mr. CALAHAN. Well, that is how I was going to end my answer. An uncooperative spirit can in effect make these legal impediments and other difficulties a road block or a brick wall, or they can verge on harassment in terms of how we go about trying to get our work done. And that is the kind of difficulty that we have.

If I could provide an example it may help. There was one situation where we performing an oversight review of one of the regional offices. We pulled the sample of cases to look at. But when we provided management with the list of cases that were drawn in that

sample, they then told us that we had to obtain a waiver. That is, we had to provide an intent to access the data under section 6103.

And then, we provided over a period of several days this waiver, I mean, this intent to access. After that went through, we had a problem with the credibility of the sample that we had selected because prior notice of our test had been given.

Accordingly, we had to draw another sample. And, of course, that entailed a lengthening of the assignment, which was an ineffective or rather inefficient and time consuming approach to doing the job.

The CHAIRMAN. Well, just let me conclude that I am convinced we do not have independent oversight. And we are never going to have independent oversight until people are willing to call a spade a spade.

If you are in oversight, if you are an IG, you are not going to be liked by a lot of people because you have to call the shots as they are. And frankly, I do not see that situation existing in this organization.

Well, thank you very much. I appreciate you being here. We wanted to discuss this matters further with you, particularly you, Ms. Willis.

I would appreciate very much any suggestions or recommendations you and the General Accounting Office would care to make as to how we can effectively develop independent oversight. And we cannot wait 10 years for that. We have to have that now. Thank you very much.

Now, it is my pleasure to call our second panel which consists of tax practitioners from around the Nation who will discuss their experience with the IRS collection function.

Our panelists include Ms. Nina E. Olson who is the Executive Director of the Community Tax Law Project in Richmond, Virginia; Mr. Michael Saltzman of White and Case in New York; and Mr. Robert Schriebman who is a sole-practitioner from Rolling Hills Estates, California. Mr. Schriebman testified at our September hearings. And Mr. Bruce Strauss who is an enrolled agent from Jacksonville. Mr. Strauss also testified before the committee in September.

Gentleman, thank you, and ladies, thank you for being here today. And I look forward to your testimony.

Why do we not start with you, Ms. Olson, if we may?

STATEMENT OF NINA E. OLSON, EXECUTIVE DIRECTOR, COMMUNITY TAX LAW PROJECT, RICHMOND, VA

Ms. OLSON. Mr. Chairman and members of the committee, thank you for inviting me to testify today about taxpayer rights. I am the Executive Director and staff attorney of the Community Tax Law Project, a nonprofit, providing low-income Virginians with pro bono professional representation in tax disputes.

Because I screen cases for referral to volunteer attorneys and accountants, as well as handle the more complex or emergency cases, I hear directly from low-income taxpayers about their attempts to resolve their tax problems.

Low-income taxpayers are vulnerable because, first, like so many taxpayers, they do not understand the tax laws or their rights and responsibilities within the system.

Second, unlike more affluent persons, low-income taxpayers do not have representatives who can advocate on their behalf. This vulnerability is most evident in the collections arena.

For whatever reasons, collection employees do not view taxpayers as individuals who are asking their help in working out a tax debt. Instead, from managers on down to ACS phone technicians, they adopt an adversarial attitude toward the taxpayer.

It is not enough to provide taxpayers with a written explanation of the collections process. Revenue officers must orally describe the process and tell taxpayers about the full scope of payment schedules available to them, including describing offers and compromise, problem resolution offices, and the running of penalties and interest.

Before assessing the trust fund recovery penalty, revenue officers must explain the penalties elements and the taxpayer's right to protest the penalty both before and after assessment.

IRS collection cases are never just about collections. They are also opportunities to ensure that taxpayers remain within the tax system and feel justly treated by their government.

Thus, failure to advise a taxpayer of his rights within the system should lead to a negative employee performance review, as well as constitute grounds for awarding a taxpayer assistance order.

In the offer and compromise program and installment plans, the service must develop more realistic living expense standards and be willing to deviate from these standards where the circumstances warrant.

That the taxpayer has already paid the underlying tax and is seeking to compromise penalties and interest should be a significant factor in granting an offer.

There should be no minimum amount for an offer and compromise based as to doubt as to collectability. If one of my clients offers $500 and under the formulas that is the proper amount, then the service should process that offer regardless of the cost to the government. Any other policy allows certain taxpayers to buy piece of mind while others cannot.

The service should process offers based on doubt as to liability first before processing the collectability component. The taxpayer may actually be able to pay the correct tax due or already has paid it.

Pure liability offers should not require a payment or a financial statement, since the taxpayer is saying she does not owe the tax. Here, as in so many cases, no new rules or statutes are required. The service needs just to follow the IRM provisions already in place.

Earned income credit exams are a major growth area in our case load. We find that taxpayers often supply revenue agents with completely adequate information only to be denied the credit. Invariably, when we take these cases to tax court, we win.

With welfare reform creating thousands of new taxpayers, the service must develop an examination process designed to assist these taxpayers, keep them in the system, avoid errors in the future, and enable them to keep working.

Shifting the burden of proof in tax court proceedings will unfairly hurt low-income taxpayers. The unrepresented low-income tax-

payer will be a vulnerable target for aggressive examination procedures. He will not understand the legal nicety that the burden shift only applies to issues of fact and not to substantiation requirements.

With all the publicity about the burden shift last fall, the project was inundated with phone calls from taxpayers asking if they could throw their records away. This confusion is sure to cause future problems.

The new innocent spouse provision should explicitly state that relief under this section is available at all levels of tax administration and that this new tax court procedure is just an additional avenue of relief.

Further, the deadline for filing a post-assessment petition in tax court under this new provision should track section 6532 time limits, that is a permissive filing within 90 days of the 6-month anniversary for making an IRS claim and a mandatory filing within 90 days of the IRS notice of disallowance. The section's current time limits constitute a trap for the unwary.

Finally, the punitive innocent spouse should not be required to remove her case from the tax court where the non-innocent spouse files a refund suit.

The tax court form is specifically designed to be user friendly. And its judges are tax experts. To remove the innocent spouse from that form simply by the act of the other spouse is to perpetuate the situation that brought her to the tax court in the first place.

All the problems I have discussed today would be less frequent for low-income taxpayers if they had access to representation. There should be at least one clinic in every state and in some states two or more, given their diverse populations and size.

In light of this, I ask that you increase the funding for these programs to $5 million—no, $10 million. Let us make a real commitment to this population. No matter how warm and fuzzy we make the IRS, there will always be a need for representation.

I thank you for inviting me here today. I am grateful for your committee's concern and leadership in the area of taxpayer rights. And I hope my comments have been helpful.

The CHAIRMAN. Thank you very much, Ms. Olson.

[The prepared statement of Ms. Olson appears in the appendix.]

The CHAIRMAN. Mr. Saltzman.

STATEMENT OF MICHAEL SALTZMAN, WHITE & CASE, NEW YORK, NY

Mr. SALTZMAN. Thank you, Mr. Chairman and members of the committee. I am a practicing tax lawyer. And I have been practicing for 33 years part of the time in the Department of Justice in the U.S. attorney's office and in private practice as a sole-practitioner and with a large law firm.

I am an author of a treatise on IRS practice and procedure and a professor teaching procedure courses. I speak here today on behalf of myself and not on behalf of my firm or on behalf of a client.

I would like to address first an area of concern to the committee. And that is offers and compromise. One way to look at an offer and compromise is that it is quite similar to a bankruptcy proceeding.

One of the hallmarks of bankruptcy proceedings is that the debtor gets a fresh start. I believe that the tax system will gain more if taxpayers get a fresh start rather than the IRS spending resources on getting the last dollar from a taxpayer already in difficulties financially.

The problem that the delinquent taxpayer faces is enormous. Consider the fact that there is not only the unpaid tax, but interest on that tax. That interest runs, is daily compounded. It is quarterly adjusted. And it is usually accompanied by a penalty, the failure to pay penalty which also draws interest that is compounded daily and is adjusted quarterly and therefore is market sensitive.

In addition to those, that debt, the taxpayer must remain current on his taxes. So that is a task that would require a major feat of financial planning.

On the other side of the table, you have revenue officers who I may say have suffered most from changes in the service's management philosophy. And I think that to some extent, they get a bad rap with criticism.

However, their job is at the core, the collection of taxes, the collection of the maximum amount due. And therefore, their job is not one that is likely to be endearing.

It is unreasonable to expect, I think, that the two sides, the taxpayer in financial difficulty and the revenue officers are going to easily work out an agreement. And I do not think that the interchange between them will be particularly helped by national and local standards of expenses.

What I suggest be done is that there be a third party introduced into the proceedings between the revenue officer and the taxpayer. Perhaps, that party can come from the appeals office of the service. Perhaps, if the taxpayer's advocate's office, the problem resolution staff is increased to the point where there is additional staffing for that. The third party can come from that source.

And finally, the possibility that someone outside the service, a volunteer with a financial planning background or business background can be of assistance to break the——

The CHAIRMAN. How many people would that require if we followed your recommendation, how many additional people?

Mr. SALTZMAN. I cannot give you that number. I think in terms of the first recommendation, in terms of having appeals officers, many offers and compromise are actually worked out in appeals.

So I do not think that that would require any appreciable dedication of staff. There already are appeals officers who deal with offers and compromise. But I have no doubt that this may require additional staffing.

Secondly, and this is related, is the failure to pay penalty. The failure to pay penalty was a penalty that was introduced at a time when the interest rates were 6 percent simple interest and deductible by individual taxpayers.

And now, of course, as I said, that the interest rate is market sensitive and is adjusted quarterly and is compounded daily. Those are two different situations.

What has happened today is that the failure to pay penalty caps out at 25 percent. The penalty for misconduct under the accuracy

related penalty, such as negligence and intentional disregards is only 20 percent.

So a taxpayer who is unable to pay a tax bill is punished more heavily than a taxpayer who has actually been negligent in understating his or her tax. And that does not seem to be fair.

And therefore, I would take a look at the failure to pay penalty to see whether it still is serving a purpose rather than having interest serve the purpose of the payment of additional taxes delinquently.

Seizures of property, I know that this is an area of particular interest. I agree that high-level review of seizures will prevent abuse. I think any time you move up in the collection division, for example, that the level of abuse will decrease.

But I also recommend another procedure for review of seizures. The Supreme Court has ruled that taxpayers are entitled to a pre-deprivation hearing or a prompt post-deprivation hearing as a matter of due process.

This led in 1976 to the enactment of section 7429 of the code where jeopardy assessments are in fact reviewed in a probable cause type hearing. I recommend that that be done also for seizures.

There are other matters, Mr. Chairman, but I hope that we will have an opportunity to explore them fully later.

The CHAIRMAN. Thank you, Mr. Saltzman.

[The prepared statement of Mr. Saltzman appears in the appendix.]

The CHAIRMAN. Mr. Schriebman.

STATEMENT OF ROBERT SCHRIEBMAN, TAX ATTORNEY, ROLLING HILLS ESTATES, CA

Mr. SCHRIEBMAN. Mr. Chairman and Senator Graham, thank you for the opportunity to appear before you today and to offer my views on restructuring the Internal Revenue Service. I am a practicing tax attorney in the city of Rolling Hills Estates which is a suburb of Los Angeles. I am a full-time practicing tax attorney. I specialize in representing taxpayers before the IRS Collection Division and the Examination Division.

I am the author of several books on IRS practice and procedure. I have taught IRS practice and procedure as an adjunct professor at USC's Graduate School of Accounting, but I am by no means an academic. I am a full-time practicing tax lawyer, dealing daily with both the IRS audit and collection divisions.

Mr. Chairman, I come to you today with four proposals. My first proposal is the recommendation of an outside, independent forum to hear taxpayer complaints of IRS field level audit and collection abuses before the taxpayer is required to first pay what the IRS alleges is owed.

It is my recommendation that a system of administrative law judges be created with the chief administrative law judge located here in Washington, DC.

I believe that this will provide a low cost, fast, and informal forum where lawyers and highly paid professionals are not required as they would be required in the Tax Court or other Federal courts.

My second proposal is the guarantee of due process when it comes to matters of IRS seizures, levy, liens, and wage garnishment and also due process in something called the trust fund recovery penalty which used to be known as the 100 percent penalty. This is actually an assessment of a tax, not really a penalty against an individual when a corporation fails to pay over corporate level employment and withholding taxes.

The IRS currently uses a shotgun approach in assessing this type of a tax. It kind of reminds me of the old Army joke where the drill sergeant says I need volunteers, you and you.

The cases are not properly or thoroughly developed. The targeted taxpayer many times is innocent. But the taxpayer really has no place to plead his or her case initially instead of the IRS. They usually go there first.

And the IRS knows that most of these people cannot afford an attorney and cannot afford to go to court. So the IRS sticks them with this penalty, guilty or not. The bottom line is in effect an economic life sentence.

My third proposal is to adopt realistic acceptance procedures for the offer in compromise process. I believe, as Mr. Saltzman said, that it is a very workable process to give taxpayers a head start to get them back in the system.

However, the IRS changes the rules every few months, effectively making it much more difficult to obtain these offers in compromises. This is a very old part of American taxation. I believe that there should be adopted liberal acceptance procedures.

In 1996, Mr. Chairman, the GAO estimated that approximately $200 billion was owed by taxpayers having delinquent accounts. It is called the "tax gap." If the truth were known, it would probably be more like $400 billion.

Mr. Chairman, I believe that the Treasury is losing thousands of dollars per second in uncollectible accounts due to the expiration of the statute of limitations for collection.

The IRS is willing to force an otherwise productive taxpayer into bankruptcy rather than to accept a fair offer in compromise. I believe, Mr. Chairman, that this is the biggest scandal in American taxation today.

My final proposal is the award of civil damages for unauthorized collection activities. Historically, taxpayers have been allowed to go to court to recover attorney's fees and costs for violations of the Internal Revenue Code and the regulations, but this is quite limited.

My proposal would expand the award for not only intentional action, but negligent action for violations of the code and the Internal Revenue Manual which is the internal bible of the IRS and also violations of IRS national policies which are also set forth in the Manual.

The IRS has I believe an unofficial no-pay policy where the IRS attempts to wear down a taxpayer who has received an award. The IRS keeps appealing because it has free use of the Department of Justice.

I believe, Mr. Chairman, that once a judge awards these damages, the IRS should not be allowed to appeal and the Treasury must pay in full within 90 days after a judgment.

In summary, Mr. Chairman, what I am proposing is the legislation of basic fairness and respect into a system where it does not exist today and into a code where it does not exist today.

You are not going to get this by just trusting naively promises made by high-level Internal Revenue officials, no matter how sincere those promises might be.

Mr. Chairman, there are those in the IRS who right now are laughing at what this Committee stands for and its lofty aims. They are not taking you seriously. Strong legislation is absolutely necessary. Thank you for this opportunity to be of service.

The CHAIRMAN. Thank you.

[The prepared statement of Mr. Schriebman appears in the appendix.]

The CHAIRMAN. Mr. Strauss.

STATEMENT OF BRUCE A. STRAUSS, ENROLLED AGENT, JACKSONVILLE, FL

Mr. STRAUSS. Thank you, Senator Roth and Senator Graham. My name is Bruce A. Strauss. And I am currently an enrolled agent in Jacksonville, Florida. I have been practicing for the last 4 years. Prior to that, I spent 31 years in the IRS, the last 18 years as a division chief for the collection function. I was well recognized, performance awards, etcetera.

I sincerely appreciate the opportunity to reappear before this esteemed committee and talk about ways that we can deal with the issues of restructuring the IRS to remove the fear of the public from the IRS and to stop the abuses.

I would urge the members of this committee to conduct a comprehensive and in-depth analysis of the issues which need to be addressed before writing proposed corrective legislation.

It was less than 2 years ago when the Taxpayer Bill of Rights 2 was passed. Obviously, it did not address the core problem. The core problem as I see it is that the IRS writes the regulations which in effect is the law, determines the rules which in effect is the Internal Revenue Manual, and makes all the decisions.

Clearly, a problem or dispute system must be established independent of the IRS which has the authority to decide the appropriate resolution for taxpayers. This system must also be provided at a very minimal or no cost situation.

The purpose of my testimony today is to recommend legislative and IRS organizational changes which should provide the citizens of this great Nation: One, a system which taxpayers can be readily compensated for economic damages and reimbursed for expenses when the IRS exceeds its authority; two, a system which guarantees an independent, timely, low cost, and highly skilled binding decisions when problems or disputes with the IRS require resolution; three, a system which will provide continuous oversight of the Internal Revenue Service; and four, a system which encourages taxpayers to voluntarily comply with the Federal tax laws.

These systems should restore the IRS to a user-friendly, customer service drive which seeks only the tax which is legally due. Major changes need to be accomplished in our current Federal tax system in order to achieve these objectives.

Now, Senator, I list out 15 different recommendations. Let me just address a few of them. Number one, I do believe we need to establish an entirely new system outside of the IRS organizational structure that any taxpayer with a dispute or a problem with the IRS would utilize.

This system will replace the current Taxpayer Advocate Program. This system would have the authority to resolve all IRS issues and should be provided at a minimal cost to the taxpayer.

This system should also have the ability and authority to economically compensate the taxpayers when the IRS exceeds their authority. And in addition, it will make these awards to the taxpayer from the IRS district budget. And there is a rationale for that.

The staffing and administration cost of the system will be offset by the reduction of the IRS budget currently used to fund the Taxpayer Advocate Program. The system's management must be outside the IRS, clearly must be outside the IRS.

The second recommendation, Congress must create a central clearinghouse staff where all taxpayer complaints regarding the IRS are received and worked. This staff must be highly competent, having the ability to analyze the issues involved in any taxpayer complaint and to hold the IRS responsible to resolve these complaints fairly and objectively.

This clearinghouse staff would also advise Congress of potential legislative changes based on their analysis of the complaints and of the IRS ability to appropriately resolve these complaints. In essence, it would provide in part continuous oversight of the IRS.

Third, Congress must restrict the authority of the IRS to write tax regulations. It must also insist on Congressional approval prior to the implementation of any tax-related regulations.

The current ability of the IRS to write and implement regulations is one of the reasons why the complexity of the tax law exists. The more immediate concern is that Federal law is being created by non-elected Federal employees.

Four, Congress should conduct a review of existing tax regulations and the Internal Revenue Code and eliminate all current regulations and sections of the IRC which have little or no impact on tax revenue production or citizen's rights.

Just let me continue. I think we ought to conduct an amnesty program on compliance issues. Many folks are out there willing to file and pay. They just do not want to pay their dues, tremendous dues to come into the system now.

The issue of income, Senator Roth, I see where the House proposes a slight issue of income. If in fact it gets it, the tax burden of proof may shift to the IRS. I believe that burden of proof needs to shift right now in all cases. That is a major abuse. I think obviously, some abuses are occurring from a collection function. Just as many abuses are occurring from the examination function.

The Internal Revenue Code 7430-33 as far as rights of taxpayers to be reimbursed for damages, again, it has been addressed before today. It needs to get a heavy look at. Not only is it difficult, but it also is difficult to get into the process.

Thank you, Senator Roth.

[The prepared statement of Mr. Strauss appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Strauss.

I have several questions I would like to ask the panel. I would ask those of you who want to make a comment, try to be brief.

Mr. Strauss raised the question of burden of proof. As you know, taxpayers are pretty unhappy that the Internal Revenue Service can determine almost unilaterally that you have income. But there has been a lot of objection to changing the burden of proof on grounds that it will make the IRS even more intrusive.

I would like to ask each of you what your opinion on this is. If you do not think the burden of proof should be modified, what can be done to protect the taxpayers' legitimate interest?

Ms. Olson.

Ms. OLSON. Sir, I think that when most taxpayers get upset about the burden of proof what they are really thinking is that I have not kept my records and if I am called to the carpet, I will not be able to produce what I have written on the tax return. They do not make the distinction between the factual issues and the substantiation issues.

I think that what could help that is very clear rules and descriptions about what kind of documentation is required, a clear statement of when people are able to throw out records in the normal cases and a clear statement of what would be trouble areas and what kind of records to keep. And it cannot be buried in IRS publications that most people do not read. I think that is the real issue that people are very much upset about.

If I may say one more thing about the intrusive procedures, I spend a lot of time dealing with innocent spouse issues. So I try to think that there is this factual issue where it would affect the low-income taxpayer.

And I have tried to think if a taxpayer raises the innocent spouse issue, what kind of an investigation would the IRS have to do to make a case, you know, bearing the burden of proof to overcome the innocent spouse claim and the kind of questions that they would have to ask and who they would have to inquire into, perhaps the children of the couple, next door neighbors. It just sends shutters down my spine about what kind of investigation would go on.

The CHAIRMAN. Thank you.

Mr. Saltzman.

Mr. SALTZMAN. Senator, I find myself in opposition to this shifting of the burden of proof from taxpayers to the IRS. And I think what it does, especially if I take a look at the House bill, is that it will create side issues in the tax court or the small claims division of the tax court.

It will create issues about whether the IRS reasonably asked for information and whether the taxpayer reasonably refused to provide the information.

And so these side issues will create basically a two-stage procedure. First, you will have a proceeding about who has done what during the examination. And the second one will be the actual trial.

And I think these issues will impose a burden on the tax court that is really somewhat of an issue that should not be in the tax court because it has ruled and has for years stated that what happens in the tax court is a de novo proceeding and things start from scratch and what happened during the examination is not considered.

On the other hand, I recognize and the law is that service may not simply assert a naked assessment. It cannot just send somebody a notice of tax deficiency without any basis in fact. And in that situation, it seems to me that the taxpayers are already protected by the law.

I agree, however, with Ms. Olson that the service could do a better job in terms of elaborating the types of records that should be kept, the length of time that records should be kept, and assist taxpayers in doing so.

So in that sense, I both disagree that the burden should be shifted, but agree that the service can do more to help taxpayers in this area.

The CHAIRMAN. Mr. Schriebman.

Mr. SCHRIEBMAN. I find myself on Mr. Saltzman's side, Mr. Chairman. I think that if you shift the burden of proof, you are going to have a much more aggressive IRS as far as the issuance of summons. In my opinion, the summons process of the Examination Division is already grossly abused.

There is a provision in the Bill, section 301 of the Bill the way it currently stands is that the only way you are going to get a shifting of the burden of proof is if you have been fully cooperative with the IRS. Frankly, I see poor tax court judges——

The CHAIRMAN. Let us forget the question about fully cooperating because I think that muddies the water.

Mr. SCHRIEBMAN. Yes. Well, it is in the House bill.

The CHAIRMAN. Yes, I know it is, but that is not my question.

Mr. SCHRIEBMAN. I feel the burden of proof should stay where it is. After all, there is an argument for the fact that the taxpayer is the one who has the possession of the information, the documentation, the points of view, the motivation.

I agree with the point that Mr. Saltzman made about the IRS not being able to just issue a naked assessment. Apparently, now, they can do that. And you cannot look behind the deficiency notice because a Tax Court case called Greenberg's Express.

So I am for leaving the issue where it is.

The CHAIRMAN. Do you anything further, Mr. Strauss?

Mr. STRAUSS. I do, Senator. In the last hearing, we heard quite a few examples of the IRS box car, blue sky assessments. I have absolutely no problem if the IRS has some basis to assess tax, legal basis that they ought to have that authority.

I have a great problem, and I see this many times, where they simply pull a figure out of the air and say this is the income you have and dare the taxpayer to disprove it. Now, how is the taxpayer going to disprove it?

That is my point on that issue. That practice in my mind has to be stopped. And it would appear to be wholly illegal.

The CHAIRMAN. Let me turn to interest and penalty because to many people, they appear to be out of control and a source of a great deal of unhappiness.

It takes too long for the IRS to notify taxpayers of mistakes and resolve issues. This is not fair to taxpayers who are making a good faith attempt to comply with the tax laws.

For example, as I previously stated, we had an instance before the committee where a 10-cent error ballooned into a $500 cascading penalty. So on the face of it is absurd.

Do you agree that there is a problem? What are your thoughts on how the committee ought to deal with it?

Ms. Olson.

Ms. OLSON. I do think there is a problem. I get many phone calls from people who say this bill has become 2 times, 3 times, 10 times what it was. And I have already paid the underlying tax through credit offsets, etcetera.

I do not think, however, that people should be let off the hook because they are late in paying their tax. After all, those of us who are complying are footing the bill on that one. And I do not think there should be an amnesty.

I do think that the existing offer and compromise program could add a separate category besides collectability and liability and look at whether in certain instances the underlying tax has been paid or the amount of the offer being made is to pay the underlying tax in full and maybe look at it also in light of collectability, as well and come up with some kind of amount that would both satisfy the need to make the compliant taxpayers feel that they are not getting a raw deal, but also putting some closure on these cases.

The CHAIRMAN. Thank you.

Mr. Saltzman.

Mr. SALTZMAN. This penalty issue I think frequently revolves around the failure to pay penalty which is the reason why I suggested it before.

It also involves the running of interest on penalties. The general rule used to be that interest did not run on a penalty until you got a notice and demand, but now, most penalties bear interest from the due date of the tax return.

So the imposition of penalties, especially the failure to pay penalty, which as I say I think is outdated, increases geometrically the cost of a tax bill with the running of interest on the penalty from the due date of the return.

One area that I think can be looked at is having interest run from the determination that the taxpayer is actually liable for the penalty before interest begins to run. And that was the general rule and now is more the exception than the rule.

I think that as far as the penalty procedures are concerned, the service routinely and automatically imposes penalties, for example, for failure to pay at the service center. It is if payment does not accompany a return, the penalty is automatically assessed.

So then, the burden falls on the taxpayer. And that is where you get these failures in communication, inability to communicate.

How is that avoided? That has to be avoided by the expansion and use of either penalty appeals officers in the regions or the use

of the taxpayer advocate system to deal with penalties and that kind of issue.

The CHAIRMAN. Mr. Schriebman.

Mr. SCHRIEBMAN. Mr. Chairman, I have a philosophy. I practice it and I teach it, never take a penalty lying down. And I find especially, I have had a lot of penalty practice back in the last 12 months.

I have found one thing to be true. It has worked actually 100 percent of the time for me. These are service center level penalties, delinquency penalties.

If you ask the service center to abate the penalty, you are going to be turned down automatically it seems. But as soon as you go above that and you start appealing the penalty rejection and you get higher up into the IRS into the appellate people, the appellate sphere, my experience has been that I have had 100 percent success in getting these penalties abated.

I think what the IRS should do that they are not doing is letting taxpayers know the steps to take to abate penalties once they are initially turned down.

It is a labyrinth, but it is explainable. I have developed a multiple step procedure that I teach for abating penalties.

But my original point that I have made here today is if we institute a system of administrative law judges, for example, they will be able to quickly hear issues of penalties and be able to resolve them without going through the IRS. Have it heard by an independent, outside source.

In order to fight penalties in today's climate, Mr. Chairman, you have got to know where to go, what buttons to push. And if you are going to have a representative to do it for you, you have got to have the money in back of you to pay for it. I do not think that is right.

The CHAIRMAN. Well, the administrative judge proposal seems to me something worth investigating, something I have been interested in. I would appreciate any further thoughts you have on how that might be.

Mr. SCHRIEBMAN. I believe, Mr. Chairman, that the institution of administrative law judges, and this would be a casual forum, no black robed person. You go in a room. The judge sits at one end of the table with a tape recorder. You sit on one side. The government sits on the other side. It is very informal.

I believe that it will get rid of 95 percent of taxpayer abuses if you provide a broad jurisdiction for the administrative law judge.

The CHAIRMAN. Any further thoughts you have on that, I would appreciate.

Mr. SCHRIEBMAN. Oh, yes, I have plenty, Mr. Chairman. Thank you.

The CHAIRMAN. Mr. Strauss.

Mr. STRAUSS. Well, the cause of the increased cost comes from two primary issues. One is section 6622 which is the compounding interest on interest. The second is moving the collection statute from 6 years to 10 years.

Now, if we make the interest factor a realistic factor which it needs to be done, if we look at all of the penalties which have just grown totally out of proportion to what they were initially intended

to do and we move the collection statute back to 6 years, this issue of the cost of exceeding the actual tax will be greatly reduced and brought back into the appropriate posture.

Again, on the issue of the administrative judges, certainly I would support that process, Senator.

The CHAIRMAN. All right. Thank you, Mr. Strauss.

I would now like to turn to the question of liens, levies, and seizures. You know there has been a lot of concern expressed about their application.

I am concerned that taxpayers who did not receive real notice wake up in the morning only to find that IRS has taken their bank account, business, other assets.

Now, I think it was in our September hearing, Mr. Schriebman, you recommended that the taxpayer should have a right to have a judicial hearing before seizure. Do others of you agree? And what are your suggestions in this area?

Ms. Olson.

Ms. OLSON. I think in general for large seizures for large seizures, yes, I do agree with that. As far as wage levies, one procedure I have never understood is we have been told that even if we can show the revenue agent or the revenue officer rather that either the tax is not owed or the person is currently not collectible, the first wage levy will go into effect. They will not reverse it. And I have never understood why that has happened.

We have had no success in overriding that. By the time we get a TAO, the wage levy, because they happen so quickly, has already gone into place.

I think that is my thoughts on the subject at that point. The levies affect my people the most.

The CHAIRMAN. Thank you.

Mr. Saltzman.

Mr. SALTZMAN. Yes. I mentioned in my opening remarks that I thought that there should be, as apparently Mr. Schriebman does, a prompt post-deprivation hearing or a pre-deprivation hearing. And I also suggest that this hearing can be held by various types of people.

It could be special trial judges of the tax court. The tax court if properly funded could have available special trial judges to hear cases.

Secondly, I agree that the use of an administrative law judge or a commissioner could be used to hear these types of cases and that in large urban areas especially. This committee cannot expect that Federal district courts will be available to hear tax disputes.

Federal district courts are overwhelmed with criminal cases and other judicial business. They cannot hear these cases. So the answer has to be outside the district court. The answer has to lie in the local community or as close to the local community as possible.

And I believe that we should look to either expanding the tax court's jurisdiction or to administrative law judges or other subordinate or quasi-judicial officers to handle these types of cases and others.

The CHAIRMAN. Do you have anything to add, Mr. Schriebman?

Mr. SCHRIEBMAN. I agree with myself completely, Mr. Chairman. [Laughter.]

The CHAIRMAN. That is a surprise, Mr. Schriebman.

Mr. SCHRIEBMAN. Again, I think the answer is having a separate organization, a separate function. You want to have these disputes resolved before they take place.

The CHAIRMAN. IRS revenue officers have a great deal of discretion when they seize and sell a taxpayer's property. Some would argue that revenue officers have too much discretion. Property sales are not uniform. Should revenue officers maintain and sell taxpayer's property? If not, who should?

Ms. Olson.

Ms. OLSON. I think there needs to be better oversight of revenue officers' discretion. Our experience has been that when we have a conversation with their managers and their supervisors that the revenue officer is always the person calling us back. It seems that the oversight is peremptory at best. It is just not effective.

I do—I am sympathetic to the fact that revenue officers deal with people who are actively trying not to pay tax. And I think that the real problem is that that mindset carries over to dealing with a taxpayer who is just having a hard time paying the tax.

I am not sure that creating a separate bureaucracy is going to be the solution, as doing—continuing along the line of reeducation and this committee's continuing oversight. I see since the September hearings major changes in my dealings with revenue officers.

The CHAIRMAN. Thank you, Ms. Olson.

Mr. Saltzman.

Mr. SALTZMAN. Well, I would think that the revenue officers have enormous discretion in the sale of property. They are not professionals.

But in my experience when they have sought out professionals, they simply have not gotten good representation. They have been charged more. And they could care less what the property is sold for or what condition it is maintained in before the sale which affects, of course, the sales price.

I think that when, for example, in Manhattan, there used to be seizures of stock or securities, there was a brokerage account where the stock and securities could be sold on a public exchange. Well, that is a good idea. At least, you know you are getting the highest price for the stock and securities.

It is a difficult problem. Professional assistance for revenue officers is not going to be the complete answer unless there is a method of ensuring that the person assisting the auctioneer assisting in the sale of property is taken perhaps from a list of authorized individuals to assist.

The CHAIRMAN. Mr. Schriebman.

Mr. SCHRIEBMAN. My experience has been—actually my observation, Mr. Chairman, is that revenue officers have absolute discretion. If they are doing their job per the provisions of the Internal Revenue Code, nobody can stop them, not even the Chief Justice of the Supreme Court. That is a lot of power. And in some respects, it is more power than anyone in this room has.

I have heard and you probably have, too, the horror stories about seizing property, letting it sit there until it deteriorates, until the market is gone. There is no redress.

I think that if we install an administrative law judge system there would be some control there over the sales process, over the fact that it has to be sold quickly, the right to redeem it.

It is a problem that I do not really feel I would be doing you justice in giving you a fast answer. It is a tough problem. I believe it is solvable, but I think it needs some checks and balances.

And that is the whole thing that we are about here today, Mr. Chairman, is we have got to put some checks and balances in the system. I think the way we are going to have to do that is look at every activity and see where checks and balances are needed. I do not have a fast answer for you today. I am sorry.

The CHAIRMAN. Thank you.

Mr. Strauss.

Mr. STRAUSS. I think the primary issue is twofold. One, of course, is again this issue of bringing in an independent source, an independent authority from outside to make a decision on any given case.

Just as important is the environment within the organization, within the IRS. What is important? What drives? Is customer service important? Is getting down to the nitty gritty of a case and getting the facts and making an appropriate decision important? Or are you trying to do something which is not appropriate on the case?

And I believe that the significant issue is getting the appropriate environment within the organization.

The CHAIRMAN. We will submit questions in writing, but this will be my last question. And this is to Mr. Saltzman and Mr. Schriebman. In response to your answer opposing shifting the burden of proof, Mr. Strauss recalled testimony in our September hearings about blue sky assessments. How do we address that issue without shifting the burden of proof?

Mr. SALTZMAN. Well, first of all, I think perhaps sometimes when we talk about burden of proof, we confuse the burden of coming forward with evidence with the burden of proof.

I believe taxpayers should have the burden of proof in cases, but I also believe that when a service makes a determination of a deficiency or makes an assessment that absent some evidence that the assessment or the deficiency is suspect.

So I would say that rather than shifting the burden of proof, it would be appropriate to have the service come forward with evidence, some evidence to establish that its determination was probably correct. And then, the taxpayer would have to proceed from there.

The CHAIRMAN. What do you mean by some evidence?

Mr. SALTZMAN. Evidence showing that the amount involved is probably owed.

The CHAIRMAN. Is that based on labor statistics?

Mr. SALTZMAN. The service has used the Bureau of Labor Standards statistics information. That is some evidence. It is not terribly strong evidence.

But the point is that when a determination is completely unsupported by evidence, then the service's determination is suspect in and of itself.

So I would recommend some production of evidence to support a determination. And some evidence might include Bureau of Labor Standards statistics, but that would be very slight evidence indeed of an actual tax deficiency.

The CHAIRMAN. Would it be enough?

Mr. SALTZMAN. I could not answer that with all cases. I think, of course, that would shift the burden of coming forward with some other evidence to the taxpayer. And with that other evidence, then that would not—that may not be enough in the case.

In other words, the taxpayer would be obliged to say why that evidence, that slight evidence is not sufficient to establish the deficiency.

The CHAIRMAN. Mr. Schriebman.

Mr. SCHRIEBMAN. I do not like guesses. I do not like when somebody pulls something out of the air and then multiplies that by per quarter as they do in California sales tax or annually as they might do with the IRS.

If a person is being audited, the best way to protect yourself is with paper. I do not care if we are living in an electronic age or where computers are going to take us. You need the paper. If you do not have the paper, you do not win.

And I think we have got to do the same thing with the IRS. I have seen too many cases where assessments have been pulled out of the air. How the heck did they get this? And, of course, it never gets to the tax court because we manage to settle it.

But if they are going to go into court, where is the paper? Where is the evidence? Where is the hard evidence, not BLS statistics, charts, not graphs?

Paper, if you do not have the paper, there is no assessment. And I think it comes down to that, hard, tangible evidence.

The CHAIRMAN. Why is that not burden of proof?

Mr. SCHRIEBMAN. Well, I think that that is burden of proof. I think burden of proof is an elusive term. It is like a ping-pong match the way I look at it. Somebody has it for a moment. And then, it bounces back to the other person.

The government I think has to be able to show the tax court judge that they have documentary evidence of unreported income or the wrongdoing. If they do not have the paper, the documents, a mere allegation in a revenue agent's report that is not supported by the paper should not fly.

The CHAIRMAN. I think your testimony today has been very helpful. And we will want to continue to discuss some of these problems with you as we proceed with the oversight hearings. Thank you very much for being here today.

The committee is in recess.

[Whereupon, at 12:00 p.m., the hearing was adjourned.]

IRS RESTRUCTURING
(INNOCENT SPOUSE TAX RULES)

WEDNESDAY, FEBRUARY 11, 1998

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:09 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, D'Amato, Murkowski, Moynihan, Baucus, Breaux, and Graham.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

Let me begin by welcoming my colleagues and members of the committee to another in our series of hearings that are focusing on restructuring the Internal Revenue Service.

We have heard disturbing testimony since we began our hearings on the IRS last September, and I am pleased to say that the agency is taking steps to improve its service and effectiveness.

But we are also learning that much of what must be done remains with Congress. It depends on legislative solutions and ongoing oversight. One of the major issues that we have uncovered, one that concerns me greatly, relates to the treatment of innocent spouses who are caught in the cross-hairs of an IRS examination or collection effort who are often left to foot the bill alone once their marriages have come to an end.

The IRS restructuring legislation that passed the House contains language addressing the innocent spouse issue. The Treasury Department, just 2 days ago, also announced some reforms. And while these efforts are good, I am afraid they do not go far enough to protect those who need protection the most. Today our panels will address this issue.

Innocent spouses are unaware of their tax problems until they have divorced and tried to move on with their lives. The first time they hear of the problem is when the IRS tracks them down and tells them that their former spouse has filed a fraudulent return or underpaid their taxes.

The innocent spouse is then informed that she, or in some cases he, must pay the entire assessment. Most often, the innocent spouse is a former wife, a woman who knew little, if anything,

about her husband's financial dealings, his business concerns, let alone his tax debt with the IRS.

The problem we are finding with the innocent spouse provision is three-fold. First, that the legal definition of an innocent spouse is so narrowly drawn that it fails to protect many individuals who would be considered innocent by any objective and reasonable analysis.

Second, that even those who are covered under the narrow definition are not getting the information and support they need from the IRS.

Finally, the agency is all too often electing to go after those who would be considered innocent spouses because they are easier to locate, as well as less inclined and able to fight.

Part of these problems reside with the IRS, part of them are the fault of Congress. Though the agency officially acknowledges the status of innocent spouses under current law and has the ability to clear such an individual from his or her tax liability, it rarely does.

At the same time, the criteria to qualify are so narrowly drawn that many spouses who reasonably should be considered innocent spouses under the law are not able to claim such an important protection.

For example, for a wife to qualify for protection as an innocent spouse it has to be shown that the husband substantially understated the couple's income in filing the income tax. If he files an accurate return but does not pay the tax there is little, if any, protection.

Likewise, if the tax penalty is associated with his business, even though his spouse may have known nothing of the company's finance. We found many cases where the IRS had gone after the former wife anyway. It does not take much imagination to see how destructive this can be for a woman who is trying to rebuild her life after separation or divorce.

Financially insecure, many times struggling as a single parent to raise children, working for an income that is a fraction of what her ex-spouse earns, now she has to confront the often unrelenting Internal Revenue Service.

In an effort to acquire revenues owed, the agency will pursue these women with a vengeance. It will garnish wages, place liens against homes, and often jeopardize future relationships because a new person in her life might well be held accountable for her former spouse's tax problems.

Four long-suffering and courageous witnesses who will appear before us today will tell us of their experience with the IRS. While each of these stories may or may not qualify as an innocent spouse under the current Tax Code, they will illustrate the pain and frustration women across this country endure under similar circumstances.

As I said, reason alone would suggest that any one of them is an innocent spouse. The tax law, however, may dictate otherwise. Our responsibility is to ensure that reason and law walk hand in hand.

One of the witnesses we will hear has been wrestling with the IRS for almost 30 years. This is unconscionable. Her story, as well as the others, will expose the callous methods sometimes employed

by the IRS in its efforts to collect the taxes. It will show that such efforts are often unjust, irrational, and undertaken despite the consequences they have on the future of these women and their ability to work.

Perhaps most egregious of all, we will see that these efforts are often undertaken without regard to the impact that they will on the welfare of the innocent children involved, children who watch the IRS intrude into the lives of their struggling parents, take away precious financial resources, and penalize the family who subsists on a limit and often unlivable allowance.

So today we will learn about the impact of our Tax Code on the innocent spouse and hear recommendations on how to restructure the IRS in order to protect taxpayers and to ensure fairness and equity.

Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman, for once again having a most important hearing on the restructuring of the Internal Revenue Service. I would like to thank all of our witnesses in advance for what we expect to be very powerful testimony.

I know it is not easy to share such personal problems that you have had to deal with with the entire world and the Congress, and we appreciate you doing it because what you do today is going to have a very positive effect, hopefully, on other people around this country.

We talked about the innocent spouse. It is kind of unusual, what we are finding out with the Internal Revenue Service, is they consider nobody innocent. They consider everybody guilty and you have to come in and prove yourself innocent.

Some of the innocent spouses, kind of, there may be no such thing in the sense of the views of the IRS. It points to one of the problems that we are trying to fix which I think is very important, and that is, changing the burden of proof to have the IRS prove someone guilty, not having to have individuals prove themselves innocent when the IRS makes an accusation. I mean, it costs people hundreds of thousands of dollars, which most people do not have, in order to prove themselves innocent. That is not what this country is all about.

I was thinking about the innocent spouse further. I mean, I guess I am an innocent spouse, which may be hard to believe, in the sense that my wife does all of our finances. She does all the tax stuff. I obviously trust her to do it and do it properly and do it correctly.

The CHAIRMAN. Too complicated for you to do? [Laughter.]

Senator BAUCUS. Mine are extremely simple. You have no idea how simple my tax returns are. But she does it all. We trust each other. But I can understand how these things happen, then years later you are called to the carpet to prove yourself innocent for something that you had no knowledge of whatsoever.

So this is a very serious problem and we appreciate very much your being with us.

The CHAIRMAN. Thank you, Senator Baucus.

It is a pleasure to welcome our four witnesses today because they have firsthand experience with some of the results of involuntarily becoming the innocent spouse.

Now, we are swearing all witnesses, so I would ask that each of you rise and raise your right hand.

[Whereupon, the four witnesses were duly sworn.]

The CHAIRMAN. Thank you. Please be seated.

I will now call upon Ms. Cockrell for her testimony. Welcome, Ms. Cockrell.

STATEMENT OF ELIZABETH COCKRELL, NEW YORK, NY

Ms. COCKRELL. Thank you very much, Mr. Chairman and members of the committee. My name is Elizabeth Cockrell. I am a single mother of two living in New York City. I moved there over 18 years ago from Canada, when I married John Crowley. The marriage lasted less than 3 years.

The tax problem that arose from it has continued for almost two decades. I have been hounded by the IRS to pay a $650,000 tax bill, and I may yet have to file for bankruptcy.

I was a young woman of 23, recently graduated from a Canadian college with a degree in English literature. When I married and moved to America in 1979, I had been selling life insurance in Canada. My husband was a commodities broker. He and his company invested in the most complicated of business deals, like extremely complex limited partnerships containing leveraged straddle positions.

I worked a few part-time jobs, then took an entry-level job that provided the training and experience for my eventual career as a stock broker. Before my marriage I knew nothing about American tax laws. Especially foreign to me was the concept of a joint return. Canada does not have those.

When my husband told me that married people in the United States filed joint returns and instructed me to sign them, I did as he asked. I trusted him. A Federal judge later told me I should not have.

In 1982 we separated and I moved out of our apartment, taking only $2,000 for the security deposit on a one-room apartment and the pots and pans, literally, that I brought into the marriage. I was proud I took no alimony, even though I was entitled to it.

Many years after our divorce, in 1987, John called me and told me that he had been receiving mail for years addressed to both of us at our old address. Since our separation, I had been filing unmarried and separate for many years from another address.

He told me that he would take care of dealing with the IRS if I would just sign something he was mailing to me. He even gave me a letter saying that I knew nothing about the partnerships, that he was responsible for them, and that I in no way should incur any tax liability.

Thinking I was protected by this letter, I signed the papers. After all, he had been investing in these extremely complex tax shelters before he had even met me. I found out later that he had been taking the deductions from these partnerships during the years that I had just signed the joint tax returns with him and that the paper

I had just signed was for the IRS to waive the statute of limitations, which let them pursue me indefinitely.

Nine years after my divorce, I learned that the IRS was after me for over half a million dollars in back taxes because of a brief marriage I had had over a decade ago. I had to hire a lawyer. He told me that the law sometimes makes an exception for cases like mine, it is called the Innocent Spouse Rule. When a joint return is audited and the changes apply to the income and deductions of one spouse, the other may be excused from paying the additional tax.

I went to Tax Court convinced the judge would see I had nothing to do with these tax shelters. One of the four things I had to prove to win my case was to show that the tax shelters my ex-husband had invested in were shams, but the judge ruled against me because he said I did not give him any evidence that the tax shelters were shams.

Subsequently, I found out that the IRS withheld evidence from the court. They knew all along that these tax shelters were shams because the very same two IRS attorneys who tried my case had helped send the men who had peddled the shelters to jail, a fact they kept from the judge and me.

One of the men convicted of criminal tax fraud is now out of prison and the other is due to be released soon. Their sentences are completed. However, I do not know when my ordeal with the IRS will ever be over.

Not only did the IRS withhold crucial evidence which any other lawyers would be disbarred for doing, they also produced an expert witness to testify against me. He said under oath that he had a law degree from Georgetown University. We later found out this was not true, and still suspect that the IRS knew all along that he was testifying falsely.

After we found out he had lied to the court I had to request a new trial, at my own expense, because the witness had perjured himself. At no time did the judge ever once admonish the IRS attorneys for their outrageous misconduct.

The judge agreed that I did not know anything about the tax shelters, but ruled against me because he said I should have known. This is what is called constructive knowledge. That is when you do not know something but the IRS thinks you should know.

I was a young Canadian immigrant wife who trusted her experienced American commodity-broker husband. The judge told me, "Trust alone does not eliminate a spouse's duty to inquire when a perusal of the return would indicate that further inquiry is necessary." What does that mean?

When I appeared on Connie Chung's news program a few years ago, it took her producers, with a much smaller staff than the IRS, only a day to find seven-figure Swiss bank accounts belonging to my ex-husband. I have written the IRS with this information, but to my knowledge they have done nothing to collect the taxes from him.

I appealed to the second Circuit Court of Appeals and lost there, too. I have currently appealed to the Supreme Court and am waiting to hear if they will review my case. In other cases, other judges have looked at the facts more favorably for the ex-wife who claims innocent spouse status.

To pay the tremendous legal fees over the many years I have been fighting them I had to cash in my IRA, my 401(k), and all of my pensions, and, to add insult to injury, I had to pay taxes and penalties on the money I withdrew.

Today the IRS wants to collect $650,000—it is actually up to $680,000 today—from me for my ex-husband's tax-avoidance schemes. I do not know when this will ever be resolved. If I filed bankruptcy, it will be on my credit report until I am 50 years old, more than twice the age I was when I signed my first tax return at the age of 24.

I am lucky. I have fought my way back and was able to earn the resources to fight the IRS. I would like to be a voice for those women who are not so fortunate. I appeared on several news shows during the hearings held by this committee in the fall, I spoke about my case, and I received letters from women who were going through similar experiences with the IRS because of a former marriage. These letters are painful to read. These women are truly forgotten Americans. No one speaks for them; they are voiceless.

Most of them are struggling to raise children and are receiving no child support. They have lost their money, their hope, and their visibility. Because these women cannot be ignored, I have started an organization called W.I.F.E., Women for IRS Financial Equity.

The Wall Street Journal's Mr. Tom Herman, in his tax column, printed our address and I have received numerous letters from women whose cases are heartbreaking. I have literally even cried when I have gotten some of these letters. These are women who have lost everything.

One elderly woman wrote to me that she was afraid that she would soon resort to eating dog food; another, an accomplished pianist whose husband left her, was forced to sell her beloved piano and her house to pay back taxes from things she had no knowledge of. She is now in a poor folk's home in Florida.

Many of these women were forced to sign tax returns at the hands of an abusive husband. Some of their signatures were even forged by their husbands or their husband's secretaries.

A single mother of four small boys who gets no child support and whose meager earnings are being garnished. There are women whose husbands have bankrupted out of the whole tax liability, leaving their former wives stuck with the whole tax bill.

There are women who are on welfare who are ashamed to be on public assistance who want to work, but are told by the IRS if they go to work their pay will be garnished. One woman had to beg for money for diapers for her baby after her husband was long gone. How can a single mother raise emotionally healthy children when she herself is suffering having had the IRS on her back for years, with no end in sight?

These woman have the most important and critical job in the United States, raising the next generation. It is the children who are being hurt the most under this most inequitable law. Give these women their lives back. Give them their dignity.

I personally can attest to the anger, the depression, the anxiety, and weight of helplessness that accompany being at the mercy of the IRS. It is an overwhelming impediment to a happy and normal life.

Every New Year's Eve I pray that the coming year will be the one in which my IRS problem finally gets resolved. Many of these cases are so old that they stem from a time when men were the primary breadwinners. These are women who raised children while their husband handled the finances.

All they are guilty of is trusting their husbands and signing a joint tax return with him. Now, years later, they are suffering in great numbers. The General Accounting Office estimates that there are 75,000 to 80,000 instances per year of the IRS potentially pursuing the wrong spouse. Over 90 percent of these victims are women.

After I read several letters I started to see patterns and problems emerging from this joint liability law. I would now like to share these with you.

I noticed that the kind of man who would stick his ex-wife with a horrible tax burden also shirked his responsibility to his children and paid no child support whatsoever. Many desperate single mothers wrote to the IRS and gave the IRS their ex-husband's address after the IRS claimed they were unable to locate their ex-husband.

These women begged the IRS to stop garnishing their own well-needed pay and to collect from their ex-spouses. Some women even asked the IRS for assistance to enforce their ex-husband to honor his child support payments. The IRS ignored these requests. They seemed to arbitrarily decide which spouse to go after. I found no consistent policy in these cases. The law should be changed so that the IRS collects the taxes from the person who rightfully owes them.

One of the most common problems is that women feel falsely protected from any IRS liability if the judge in their divorce ruled that the husband is responsible for any back taxes owed.

All of a sudden the woman gets a lien slapped on her home and her pay garnished. Stunned, she writes to the IRS, encloses a copy of her divorce decree, and says there must be a mistake because, after all, a judge ordered it.

Here is what the IRS told one woman: "Civil agreements, such as a divorce agreement, do not dictate tax law." In other words, a court order means nothing to the IRS. One woman asked me, why do we even need divorce agreements if the IRS does not honor them?

Many women find that a well-needed tax refund she is expecting ends up getting applied to her husband's old taxes. Also, the IRS continues to send mail to the old marital address to both parties, even though these individuals have been filing separately and unmarried from different addresses for many years. As a consequence, penalties and interest accrue at an alarming rate without notice to the woman.

Additionally, under the Taxpayer Bill of Rights II, the IRS is required to tell one spouse what actions they have taken to collect from their ex-spouse. However, the IRS has recently denied this privilege, citing that they are unable to do so because of the old Privacy Act.

In my own case, I have inquired for over a year and a half about my ex-husband's payments to the IRS and yet have received no response.

While I appreciate the opportunity to tell you my story, the message I want to leave you with today is that the American tax system mistreats divorced women. In some cases, woman have been living through these ordeals for decades.

The IRS drags out many of these cases over the course of the years, filing brief after brief, executing liens, garnishing wages, ad nauseam, at your expense and that of all American taxpayers. I believe that if the taxpayers had their say, I am sure they would want these women back in the work force paying taxes and contributing to society.

Should there not be some time limit placed on resolving the struggle for these honest citizens? There must certainly be many fair solutions. Fairness begs that such equitable solutions be enacted immediately and made retroactive.

Mr. Chairman, we hope that you and your committee will seek out a resolution to this atrocious practice of the IRS.

Senators, thank you for listening to all of us here today and for giving us this opportunity to address such a critical issue.

The CHAIRMAN. Well, thank you very much, Mrs. Cockrell, for being here today. We appreciate it. We are seeking answers, as you know, to the problem.

Ms. COCKRELL. Thank you so much.

[The prepared statement of Ms. Cockrell appears in the appendix.]

The CHAIRMAN. I now am pleased to call on Ms. Pejanovic for her testimony. Please proceed.

STATEMENT OF SVETLANA PEJANOVIC, NEW YORK, NY

Ms. PEJANOVIC. Thank you, Chairman Roth, and the members of the committee for this opportunity to tell you my story. Please excuse my English. I will do best to be clear.

My name is Svetlana Pejanovic. I came to the United States from the former Yugoslavia in 1980 on a student exchange program. I was only 23 and spoke no English. Now, 18 years after my arrival in this great country, I am on the verge of losing everything that I have ever worked for.

My salary has been garnished and the Internal Revenue Service has placed a lien on my home. One evening just last month, an IRS collection officer came to my home unannounced, wanting to seize all of my personal belongings. I will now provide you with some of the background on me and how I arrived at this point.

I married an American citizen in March of 1982. For the 4 years I was married to him, my husband asked me to sign joint income tax returns. Because this type of tax did not exist in Yugoslavia, I relied on my husband to do the correct thing, since he was familiar with such requirements in the United States.

Our marriage did not last, and we separated in 1986. I did not receive any financial help at all from him after the divorce. After that experience, I filed my own tax returns under the guidance of my former husband's accountant. I was able to purchase a modest apartment for myself and worked hard to pay my mortgage. At the

end of 1993, I received a phone call from the IRS telling me I was in serious trouble, as I owed over $200,000 for back taxes from over a decade before when I was married to my husband. I was absolutely shocked.

I was totally honest with the IRS officer during this telephone call and provided both my home and work address and stated to him that I owned the condominium in which I lived. Immediately after this phone call, a lien was placed on my home.

I called my former husband about all that had taken place and he assured me that he would take care of the problem. I still trusted him, since he was the one who handled all our finances while we were married.

Roughly 3 months after he assured me the problem would be resolved, I received an extremely embarrassing call from my company's payroll department informing me that my pay would be seized within 2 days unless I could make a deal with the IRS.

It was only after I informed my ex-husband of this problem that he confessed that he had, in fact, been receiving mail from the IRS addressed to both of us for years. My former husband, the accountant we both had retained, even others at my former husband's company, all knew about this problem. They never told me.

My former husband even admitted to me that he really did not think the IRS would ever go after me. He claimed he had no money for lawyers and that I was the stupid one for cooperating and being open and honest with the IRS. At this point, he had now gone back to his former wife and had placed all his assets in both her name and his children's names.

Gentlemen, almost 16 years after my failed marriage my former husband is of no interest to the IRS for actions he alone is responsible for. Yet, as his former wife—not the current, but former—I continue to be the target of the IRS collection effort for the taxes he owes.

In effect, as recently as three weeks ago this past Monday, the IRS seized my checking account as well as my personal retirement account. Is it my fault that my former husband was faster at disposing of his assets than the IRS was in collecting from him? Am I to continue to be the victim of IRS rage?

Senators, my former husband is living in a home with his family and has an income. Why does the IRS not go after him for the taxes he owes? Are they coming after me because I cannot fight, or maybe I am just an easy target?

I contacted a lawyer who advised me that I had three options to choose from given my situation: bankruptcy, an offering compromise, or filing an innocent spouse petition. He claimed bankruptcy was the easiest and the cheapest way to resolve my problem. I responded, "But I am not guilty of anything." I told him I would never declare bankruptcy; to do so was against my principles. He then suggested that I should stop working altogether until I solved this problem.

After the lawyer charged me thousands of dollars and provided no solution, I turned to an accountant who was a former IRS employee, and then for 2 years he argued with the IRS that I should be let off the hook since I had never received, seen, or known about

any IRS notices that had been sent to my former husband. He insisted the statute of limitation had run out.

Regrettably, this argument went nowhere. Friends and colleagues urged me not to fight the system. They told me not to fight the IRS, but simply declare bankruptcy and get on with my life.

Just last year, a lawyer informed me that the facts of my case made me a classic innocent spouse, but in order to prove this in court I was told I would have to put up the entire amount of money the IRS claimed I owed based on my former husband's bungled finances.

Senators, the amount by then was roughly $300,000. I doubt if any of you can tell me how I can defend myself against the IRS. Alone I am no match, emotionally or financially, against their power.

Senators, I left a Communist country in Eastern Europe many years ago to study in the United States and to enjoy, even for a short time, the freedoms democracy bestows on its citizens. Today I am still thrilled to be able to live and work in this great Nation. However, I must tell you that the actions of the IRS against me were not unlike actions that took place in my former Communist homeland. To me, the IRS is too powerful and is responsible to no one. They do not care who they hurt or how they get their money.

Do not be mistaken. I am willing to pay taxes, as I have been for all these years, to support this great Nation. But the way the IRS has gone after me for them is simply not fair.

I am so grateful to be able to appear before the United States Senate to tell my story. My hope is that, by doing so, it will be in some small way helpful to you, as well as many women who may be watching this today themselves that have been overpowered by the IRS.

Thank you.

The CHAIRMAN. Well, thank you very much. Your being here today is extremely helpful to the committee, and we appreciate that.

[The prepared statement of Ms. Pejanovic appears in the appendix.]

The CHAIRMAN. Next, we will hear Ms. Andreasen.

STATEMENT OF KAREN J. ANDREASEN, TAMPA, FL

Ms. ANDREASEN. My name is Karen Andreasen and I reside in Tampa, Florida. I am currently teaching fourth graders at a small private school and taking classes to update my certification. Although I am presently divorced, I was married for 19 years and have 3 wonderful children, Christopher, Michael, and Brittany.

My ex-husband is a former field auditor for the Internal Revenue Service. For approximately the last 10 years of our marriage he had a tax and IRS representation practice. During the course of his career, he had also been an expert witness in litigation cases. His intimate knowledge of the IRS and tax issues far exceeded any knowledge I had.

During our marriage, my former husband kept all of our business and most personal information at his office. As a result, I was excluded from our financial dealings. I loved my husband, but mis-

takenly trusted him to handle the financial end of things while I was busy taking care of our children.

At the time of our divorce the value of my husband's practice and earnings became an issue for alimony and child support purposes. Under the advice of my attorney I engaged a certified public accountant, Gayla Brey Russell, who has particular expertise in the areas of tax and litigation. Upon reviewing my former husband's business documents it became apparent to the CPA that there were clear discrepancies between my former husband's sworn statements and what the documents said.

Two questions were becoming obvious, whether or not my former husband had actually filed the returns he said were filed and whether or not he had paid the estimated taxes as shown on the copies of documents we had in our possession. As neither had been done, the tax liabilities for these years would exceed $12,000, even before ongoing penalties and interest were added. This all started in the fall of 1995.

In February of 1996, I received a notice from the IRS inquiring into the whereabouts of my former husband's and my 1993 tax return. Although I knew I had not signed any such return, my former husband insisted that both the 1993 and 1994 returns had been filed. I was led to believe by my husband that the IRS had lost them.

That April, I submitted a request to the IRS for copies of both the 1993 and 1994 returns. However, they responded saying that no such returns could be found. It was now becoming very clear that no estimated taxes for those years had ever been paid. I realized at this point that one of two things should have occurred.

If the tax returns had been filed, we should have received notices demanding payment of the taxes due. However, if the estimated payments had been made and no returns sent in, the IRS would have sent us a notice of credit and inquired where we wanted those credits applied. In my case, neither of these scenarios unfolded.

My accountant advised me to file new separate tax returns for the 2 years in question. Upon learning of this, my former husband forged my signature and filed joint returns before my separate returns could even be prepared. Not knowing what had been done, I went ahead and filed my own forms.

Of course, these were returned to me by the IRS with a cover letter saying that his joint returns had already been received. Copies of these joint returns were included with the IRS's notice. My former husband had not even tried to disguise his attempt to forge my signature. The signature, in fact, was an exact replica of his own.

At this point, the battle lines were drawn. My CPA re-filed my separate returns with a cover letter stating that in the joint returns my former husband had reflected a forged signature. It informed the IRS that the IRS already had had a history of correspondence regarding these particular returns.

The letter also included samples of my signature along with the forged signature appearing on the on the joint returns. The IRS's response to my correspondence was that they were very sorry, but my only recourse was to file suit in civil court.

By this time I was deeply in debt and my mother sold her own home and moved in with me and my children to help us out. My husband remarried and was providing me with support payments only when he felt like it. My former husband has basically skated the IRS and the family courts. He has effectively accomplished exactly what he had set out to do.

A formal protest, along with more proof of the forgery and case law that should have been in my favor were filed. At the same time, I also received a letter from the IRS saying the case law was not applicable to my case because I was not currently undergoing an audit. It seemed to me that case law is used only when the IRS deems it proper or convenient.

In the meantime, I requested from the IRS an extension for filing my tax returns. I did this in an attempt to hold off on the actual filing, hoping the matter could be resolved during this period of time. I was, in fact, anticipating receiving a large refund and knew if the IRS did not reverse its decision that my refund could be applied to my former husband's back taxes.

By October 1997, I had heard nothing from the IRS so I sent my 1996 returns in to them, not knowing what was going to happen. By now, tax liens had been placed on my home and the bank had threatened foreclosure.

In December 1997, the dreaded IRS notice indeed arrived, stating that my refund was being applied to my former husband's back taxes. The $3,693 refund that I so desperately needed was to be used to benefit my former husband after all.

However, about three weeks ago I received a letter from the IRS stating that it was reversing its decision and that I would receive my refund in approximately eight weeks.

Mr. Chairman, it is now two and a half years since this roller coaster ride began. During this time my former husband was able to create a maze of papers that he thought no one could untangle. If it had not been for the devotion and persistence of my friends and family I would clearly not have made it here today.

However, my story is not over, for I now wonder how long it will take to remove the IRS lien that still remains against my home. The lien was in place against our home even before my husband relinquished it in our divorce settlement. My only hope is that getting rid of this lien, yet another reminder of my former husband, will not take years more to settle and take an even greater toll on my children and me.

Throughout this ordeal I was treated as if I were guilty until I could prove my innocence. I know now that I was naive in trusting. I can only hope my ordeal can help other women in similar situations and lessen their pain and frustration. My former husband knew and used the IRS system against me, a system that allowed itself to be manipulated in its quest to get the money, any money, right or wrong, just as long as they got it.

I feel lucky to be receiving any refund at all. I also feel lucky to be able to appear before your committee today. But luck should have nothing to do with it. There should be a logical process for disputes like mine, one that does not require unlimited personal funds to file a lawsuit.

I can only imagine the number of other innocent spouses that are out there now drowning in the same sea of red tape, fear, frustration, and a sense of helplessness that I did, a sea not calmed by the IRS and its effort to get anything it can from individuals who do not have the strength to fight back.

Although my personal battle is not completely over, I no longer fear that I am just another fatality of the tax system, but I do fear for those still caught in it.

Mr. Chairman and the members of this committee, thank you for your time, as it is a most precious gift. However, it is one that I cannot repay, just as you cannot repay me for the endless hours I have spent in vain so desperately trying to reason with an unreasonable and unrelenting system.

Thank you so much.

The CHAIRMAN. Thank you. I certainly agree with your statement that luck should have nothing to do with it. Hopefully we are all here to try to develop a logical process.

Ms. ANDREASEN. Thank you.

[The prepared statement of Ms. Andreasen appears in the appendix.]

The CHAIRMAN. Ms. Berman.

STATEMENT OF JOSEPHINE BERMAN, SOUTH ORANGE, NJ

Ms. BERMAN. Good morning. My name is Josephine Berman. I am here today to help put a human face on the issue before this committee. I am an innocent spouse. I have existed under the black cloud of an immense tax debt for the last 28 years.

The CHAIRMAN. Twenty-eight years.

Ms. BERMAN. My indebtedness is solely the result of having signed my name to joint income tax returns in 1968, 1969, and 1970.

Since that time I have been continually harassed, threatened, intimidated into signing waivers of the statute of limitations, and had my entire retirement nest egg seized by the Internal Revenue Service.

Due to circumstances beyond my knowledge and control, I stand before you today at the age of 68 unable to afford to retire, unable ever to repay a debt for which I am being unjustly held responsible, and without any means to reverse my fortune. This is my story.

This is not a case of tax evasion or fraud. The debt for which I am being held responsible is the result of a disallowed deduction claimed by my husband for the years 1968 through 1970.

During that time, my husband was a 50 percent stockholder of a subchapter S corporation. The deductions he claimed were for legal expenses incurred during litigation with his partner. The disallowance of these deductions was the result of the IRS's interpretation of whether the expenses were incurred to protect income or stock. I am not entirely sure what this means, but it is what has been told to me.

I have been held responsible for this tax liability as a result of signing joint tax returns during those years. The original debt of $65,000 is now approximately $400,000 with interest and penalties.

I was never involved in any of my husband's business activities, nor was I ever included in any business or tax decisions. As was typical for those times, I was the homemaker and he was the breadwinner.

During the years that my husband was in litigation, our marriage became troubled. In 1970, we were separated. Needless to say, communication between us became even more sparse than it had been before. I did not even become aware of any tax problems until 1972 or 1973, when an IRS agent—I will call him Mr. X—came to my home and threatened to post sheriff notices on the trees in the front of my house.

At this point, my husband and I had been separated for 2 years. My husband had not worked since 1970 and he would not work again for another several years. The entire responsibility of raising our 10-, 14-, and 16-year-old children was left to me. The family subsisted on money from insurance policies that my husband cashed in, on my $11,000 a year salary as a dental assistant, and welfare.

Mr. X was the first of many IRS agents that I would deal with over the years. He was brutal. He repeatedly harassed me and bullied me in front of my children. Under the threat of eviction, I signed the first of several waivers and a lien was put on my house. These conditions allowed us to keep the roof over our heads.

I cannot overstate the desperateness of our situation. My husband was in a state of deep depression, and the only thing that kept me going was my responsibilities to my children. I did not understand the intricacies of the tax laws or why I was being held responsible for the debts of my husband's business.

I was left to my own devices to deal with the situation. I was completely overwhelmed and racked with worry. I was also very often overcome by rage and tears. I had tremendous guilt because of the strife our situation clearly caused my children.

Eventually my husband abandoned us completely, leaving me to deal with the IRS on my own and a lien on our jointly owned home.

Over the years I have been harassed by agents from Holtsville, New York City, Pennsylvania, and New Jersey. Agents have come to my place of work, as well as called my employers, looking for information about my former husband and threatening to levy my wages.

My personal affairs have been exposed to my employers and coworkers. Not only is such conduct humiliating, it also serves to strain my relationship with my employers.

Agents have come to my home threatening to post sheriff notices for my neighbors to see or place foreclosure notices in the local newspapers. My credit rating has been destroyed.

I frequently receive solicitations from companies claiming that they can help me solve the debt with the IRS. My private life has become totally public. This conduct has been consistent and relentless over the past 28 years.

The utter impossibility of my situation was punctuated in late 1995 when, notwithstanding the lien on my home, the IRS seized my IRA account of approximately $40,000. Over the years I had to struggle, but by penny pinching and doing without I was able to set some money aside each year for my retirement. As I stated ear-

lier, with interest and penalties the tax debt now stands at approximately $400,000. The assessed value of my home is about $180,000.

Clearly, short of winning the lottery I will never be able to pay this debt in full. The IRA was the only asset I could hope to use for my impending retirement. When that money was seized, I was devastated. It was as if my government was stepping in and saying, "We know you're poor, now we're going to make sure you'll be destitute for the rest of your life."

What was even more upsetting was that this action was being taken by an agent in Pennsylvania, which is where my husband resides. I live in New Jersey. Ironically, to my knowledge my husband has never been subjected to the same oppressive treatment by the IRS as me.

In an effort to stop the seizure I contacted the Internal Revenue Service's Dispute Resolution Office in New Jersey. Agents in that office expressed surprise to learn of the seizure of my account. They advised me that this should not have occurred, and it was done so in error.

Unfortunately, nothing was done to stop this arbitrary act of the Pennsylvania agent and the money was, indeed, seized. I now live from paycheck to paycheck with nothing standing between me and abject poverty. I cannot adequately describe the horror of the position I am in, and knowing that it is my government that put me there.

I have lived nearly half my life under the weight of this crushing debt. Now, after slaving for all this time, all I will have to retire on is Social Security. Twenty-five years ago, I worked my way off welfare. With the indignity of stealing my retirement money, the IRS ensured that that is where I will end up, back on welfare.

Since being charged with this debt I have raised three children, I have worked my way off welfare, I helped put my children through college and paid off a mortgage, and I have paid my taxes all along the way. I have done all of this on a high school education and by my wits and guile.

Now at the end of my life I live in a home that I paid for, but I do not own. What little I was able to save has been seized, and I do not know how much longer I will be able to work to support myself. I have done nothing wrong. I am guilty only of contributing to society, as every hardworking American is supposed to do.

Senators, not long ago I heard a story about a man who had been sentenced to 15 years to life for manslaughter. He was released on parole for good behavior after serving just under 8 years in prison. A killer gets released from prison after 8 years, and I am serving a life sentence.

The laws as they exist are unjust and immoral. You have the power and the responsibility to change this. I urge you all to do so. Thank you for this opportunity to be heard.

The CHAIRMAN. Well, thank you very much, Ms. Berman, for being here.

[The prepared statement of Ms. Berman appears in the appendix.]

The CHAIRMAN. Let me say to each and every one of you how much I appreciate your being here, but how concerned I am that

it is necessary to have this kind of hearing. The reason we are all here today is to try to seek the kind of solution that will prevent this from happening again. Not one American housewife should have to go through this kind of ordeal and I just want you to know how much I appreciate the contribution you are making by your testimony today.

Now, let me ask you, if you would, to say in your own language why you believe you should be viewed as an innocent spouse.

Ms. Cockrell.

Ms. COCKRELL. I merely signed joint tax returns when I moved from a foreign country and my husband was involved in partnerships before he even met me. I never saw the partnerships, I never signed them, I knew nothing about them. I left with nothing from the marriage. I have got my own pension on my own. I worked my way up on my own and left him with nothing. Eighteen years later they are not after him, they are after me for things he did.

The CHAIRMAN. Ms. Pejanovic, would you please answer.

Ms. PEJANOVIC. First, I believe that innocent spouse should not exist. People get married. I mean, the law should be changed. But on the other hand, because it exists, it is law, I believe I should be innocent spouse because I just signed a tax return. I did not know what I was signing.

I was working every single year from the day I came to this country. The taxes were withheld from my payroll and I slowly earned what is the Federal tax, Medicaid, IRS. But I did not know afterwards, even for some years. They would not tell me what I am signing. Therefore, I just was not aware of any businesses of my ex-husband or anything and I did not benefit from anything.

The CHAIRMAN. Ms. Andreasen.

Ms. ANDREASEN. Through the divorce, my husband admitted my innocence and that I was not privilege to our financial dealings because he kept everything in his office. So I did not even know we were in debt until the divorce.

He admitted that he had forged my name on the 1993 and 1994 taxes. I found out also too that he had done this on others as well, claiming to have power of attorney. He admitted to not having the power of attorney.

I asked him, why is it that I am not signing income tax any longer, because at one point I was. Then all of a sudden, it stopped. He said, well, it is the way that he is filing now, and led me to believe that it had something to do with joint marriage and his business.

So I trusted him. He always flaunted the fact of how much he made after he had completed the income tax, so I just assumed that he filed it as well. So if the family court found me innocent, why do I have to prove my innocence to the IRS?

The CHAIRMAN. Ms. Berman.

Ms. BERMAN. I was an innocent spouse because all I did was sign the income tax returns, because it was expected of me to do so. I maintained the household, he was the breadwinner. I did not know how he earned his money. I knew he had a business, but I was never involved in any of his business activities.

I want to remind you that his situation was not one of fraud or of trying to skirt responsibility to the Internal Revenue, it was a

question of interpretation of a law as to whether he could deduct his legal expenses or not.

The CHAIRMAN. Well, as I listen to you there is a common theme. Each of you had nothing to do with what happened, it was acts of your ex-spouse.

Let me ask you this, and one or two of you did touch on it. Did the IRS pursue both you and your former husband equally, or do you believe you were singled out? Have you been made aware of any amounts paid by your former spouse?

Ms. COCKRELL. Well, as I testified, Senator Roth, I have inquired for over a year and a half now. I have sent letters to the IRS because this Taxpayer Bill of Rights II was passed, and I am entitled to find out what actions the IRS has taken to collect from him. I have heard nothing at all. They have not written back. Or they have written back, actually, once, but told me to write to a different address, and just kept stonewalling me.

So from what I have heard though, my ex has claimed that he is poor, has nothing. But we do know he has these Swiss bank accounts, and I have told the IRS about those as well.

The CHAIRMAN. Thank you. Ms. Pejanovic.

Ms. PEJANOVIC. I really do not know if they got any money from my ex. I know he told me that he was aware of the problem from 1987. I was aware from 1993, like 6, 7 years later. I do not know if they collected anything. When I receive the notices I try to see, do they put CC, do they put both of our names, but it is just my address. I do not know if they are doing the same thing.

The CHAIRMAN. Ms. Andreasen.

Ms. ANDREASEN. As far as I know, the IRS has not pursued my ex-husband. There has been no communication proving that. Everything has come to my address because that was what was on the income tax itself, so as far as I know they have only pursued me.

The CHAIRMAN. They have not pursued your husband at all.

Ms. ANDREASEN. As far as I know.

The CHAIRMAN. Ms. Berman.

Ms. BERMAN. I really do not know to what extent they have contacted my husband. I only know that I have been harassed constantly.

The CHAIRMAN. Let me ask you this question. How would you have been affected if there had been a rule of proportionate liability at the time you were determined liable for the joint tax bill? In other words, you would only be liable for those taxes based on your income, not that of your spouse. What difference would that have made?

Ms. COCKRELL. Well, I did pay my taxes. As Svetlana just said, she did as well. I did start working eventually when I came to the States and I paid my taxes. They were taken out of my paycheck, withholding. I feel I paid my taxes. I left him, I took nothing, and I am the one stuck with the debt. He did not pay his taxes and I am stuck with his taxes, and I paid mine. I have continued to pay my taxes over the years.

The CHAIRMAN. So if we would have had proportionate, you——

Ms. COCKRELL. I paid my share.

The CHAIRMAN [continuing]. You paid your share and you would have had no problems.

Ms. COCKRELL. Yes. I did not leave with any diamonds, furs, cars, property, nothing.

The CHAIRMAN. You so testified, I think, that you left with the pots and pans.

Ms. COCKRELL. Yes. I still have them.

The CHAIRMAN. Ms. Pejanovic.

Ms. PEJANOVIC. I think it would be great for me. I believe even, because I requested and I have every single return. I looked at them from the first year, and I started with, like, $14,000 as my part of my work and my taxes. Therefore, I would not owe anything to IRS. I would probably even get some money back. It would be great for me.

The CHAIRMAN. Thank you.

Ms. Andreasen.

Ms. ANDREASEN. That would be an answer to my prayers because the years in question I was a housewife, so I was unemployed. However, when I did file for 1993 and 1994 I paid $19 for those 2 years, and that was interest. So that would have been wonderful.

The CHAIRMAN. Thank you.

Ms. Berman.

Ms. BERMAN. I would not have been responsible for anything because I was unemployed. I was a homemaker. Therefore, he was——

The CHAIRMAN. You were not unemployed, you were working busy in the house.

Ms. BERMAN. You are right. I probably worked many more hours than I needed to. However, I did not earn any money at my job.

The CHAIRMAN. I would point out to the panel that we have a vote going on now. Senator Chafee has gone down to vote and will come back.

Senator Graham, you are next, please.

Senator GRAHAM. Thank you, Mr. Chairman. Again, I appreciate your tenacity in continuing to pursue these issues.

As was said in the opening statement, I think what we have here is a combination of both a problem that Congress is going to have to fix in terms of the law itself and continued review of how the IRS goes about its responsibilities of collecting the revenue for the Federal Government.

I am very distressed at what you have each said in your personal experience as to the way in which the law has operated and the mistreatment to which you were subjected.

Ms. Andreasen, you mentioned that in part of your odyssey in this case was when you determined that your signature had been forged on joint statements for two years and you pointed that out to the Internal Revenue Service.

Could you elaborate on what response you got when you indicated that the joint returns upon which your liability was, in part, predicated were, in fact, forged?

Ms. ANDREASEN. They were basically sorry that that had been done, but I would just have to take it through civil court. What family court stated would not hold up for them. It was not enough, even though my ex admitted to it.

Senator GRAHAM. So they indicated that they could not administratively reverse that.

Ms. ANDREASEN. Right.

Senator GRAHAM. Did they agree that it was a forged document but said they were without the ability to reject the legal significance and the tax liability of a forged document?

Ms. ANDREASEN. No. It was just, sorry, I would have to pursue it through civil court. They did not offer any particular help.

Senator GRAHAM. In reading the law which is called the Innocent Spouse Law that provides that an innocent spouse can be relieved of responsibility, there are four criteria that have to be met.

The first, is that a joint return was made. In most of your cases that was the case, although in Ms. Andreasen's case it was a fraudulent joint return.

That the understatement of tax exceeded $500, which I guess was the case in all of your instances. And that the innocent spouse did not know, and had no reason to know, that there was an understatement of tax. Finally, taking into all the facts and circumstances, it would be inequitable to hold the innocent spouse liable for the deficiency in this case. It sounds as if in each of your testimonies that all four of those points were, in fact, the case.

For instance, on the one about that you did not know or did not have any reason to know that there was an understatement of tax, when you presented your case to the IRS, what was their response to that aspect of your circumstance, that you did not know and did not have any reason to know? Yes, Ms. Cockrell.

Ms. COCKRELL. The judge said that, because I had a B.A. degree in English literature from a Canadian university, that I was educated and because I was educated I should have known that something looked funny on the tax returns. I have talked to tax lawyers who have looked at the returns that said they would never have known, and here I was from Canada.

The judge in the Tax Court said that I should have known. He believed I did not know, but that I should have known. I do not know how they can judge what someone should know, how you can possibly determine what someone should know.

Senator GRAHAM. So in your case, the Tax Court determined that you did not meet that standard of not having reason to be ignorant of the understatement of tax.

Ms. COCKRELL. Yes, they did, in the second trial that I had to get at my own expense after the IRS witness perjured himself and the IRS had also withheld evidence before that. They will do anything to win. The judge ruled against me the first time when they withheld evidence because I could not prove these were shams. Then we got another trial and he did not admonish the IRS attorneys for withholding this evidence that they had used to help put the men in jail who had done the partnerships.

The judges merely ruled, well, we agree that you probably did not know. He said, I agree that you did not know about the tax shelters, but you should have known, so therefore you are not an innocent spouse. But, clearly, it would be very inequitable to hold any of us liable for this. So I think we definitely meet that standard.

Senator GRAHAM. Would any other of the members of this panel like to comment on how the IRS responded to whether you met

those tests of not having reason to know that there had been under-filing and the inequitability of holding you responsible for it?

Ms. ANDREASEN. My CPA, in corresponding with the IRS, showed case law similar to mine to prove that I was innocent. Their response to that was, again, that I was not under audit at the time so it did not apply to me. Yet, they requested it as well, too.

Senator GRAHAM. I would like to take this opportunity to recognize the accountant who has served as your pro bono advisor throughout this long ordeal, Ms. Gayla Russell, and commend her for her service to you and to helping us to understand and reform this system.

I know she is representative of many professionals who have, on a pro bono basis, been of assistance to taxpayers who were caught in this cobweb of complexity that has fallen on each of you.

I have got to apologize. We are almost at the end of this time period for a vote. Chairman Roth has asked that we not go into a recess, but just a temporary pause. Senator Chafee, who left earlier, should be returning and it will be his round of questioning next.

So if you would please excuse me, I will return as soon as I have voted. Senator Chafee should be here shortly. Thank you very much.

[Pause].

Senator CHAFEE. All right. We will continue with this panel for a few minutes. The Chairman will be back directly and then we will go to the next panel. But I had a couple of questions for you ladies.

First, this has been very compelling testimony. I know it is difficult and embarrassing to reveal all of the things you have had to reveal, and we appreciate a great deal your coming here and presenting us with this testimony.

It seems to me one of the problems is, and this is not going to solve the situation, that you do not have a person to deal with in the IRS. It is a game of shuffle. I forgot who the lady was that said she was going to get a refund. Was it you, Ms. Andreasen?

Ms. ANDREASEN. Yes.

Senator CHAFEE. Have you gotten the refund?

Ms. ANDREASEN. Not yet. It was three weeks ago that they told me to be expecting it, and that it would take eight weeks. So maybe in five weeks.

Senator CHAFEE. Are you willing to bet the farm you get the refund?

Ms. ANDREASEN. No. In fact, my mother sold her farm.

Senator CHAFEE. Then I believe it was you, Ms. Andreasen, or maybe Ms. Berman, that talked about dealing in New Jersey and Pennsylvania. Frankly, as far as the Federal Government goes, whether somebody is in Pennsylvania or New Jersey should not make any difference. But you got the shuffle there too in trying to get your situation resolved.

So do you agree that if you had one person you could talk to, whether it is an ombudsman or whether it is just somebody who is assigned to your case, it would be a better situation? Would that make any improvements, do you think? What we are trying to do here is to improve this whole situation. What do you say to that?

Ms. BERMAN. In my case, I tried to have the situation brought to New Jersey and I was not able to accomplish that. That is what made me be in contact to these other agencies. I felt that it would be better if the situation were brought to New Jersey so that I could deal with a division of the Internal Revenue in New Jersey.

Senator CHAFEE. The thing I find so unusual and disturbing, in your cases is that the IRS did not seem to have gone after your spouses with the enthusiasm they went after you. Could you just touch on that, Ms. Andreasen? And some of your former spouses have remarried. But do you get the impression that they do not seem to go after them?

I think it was Ms. Cockrell that said the television lawyers were able to dig up a ton of information on Swiss bank accounts?

Ms. COCKRELL. Yes. They were not even lawyers, they were journalists. They found the actual account numbers that my ex had had in Switzerland from the early 1980's. It was over $1.2 million. So if the interest went like the IRS interest, it could be worth millions now.

Senator CHAFEE. But the IRS did not show much interest in all that.

Ms. COCKRELL. No, no. I did talk to a lawyer who said that they will not go after offshore bank accounts unless there is a felony involved. Because these tax shelters, I think, were later disallowed, it was not considered a felony.

In the letters I have received from many, many women who wrote to our organization it seems to be, they have always been the ones who were targeted, even when the women have written to them giving the address of their former spouse. Even child support agencies are not even enforcing that either.

Senator CHAFEE. Now, let me present you with a quandary here. Let us make a few assumptions. One, that your former spouse was completely responsible for the income tax return, did not do it correctly, did not report what should have been reported. In one case I think it was an argument over whether something was deductible or not deductible. Was that your case, Ms. Berman?

Ms. BERMAN. Yes.

Senator CHAFEE. That would not necessarily be a criminal offense. But, nevertheless, let us have the situation where the husband clearly was in charge of the tax return and failed to do it accurately, and you signed. You are the innocent spouse.

Now the IRS comes and seizes your home which is in joint names. That is very painful. However, the husband is the person who, by being the family earner, is the one who paid for the house.

Now, what do we do in a situation like that; is the IRS justified in going after a house that may be in joint names even though the wife and children are still in the house? That presents, it would seem to me, a quandary.

Ms. ANDREASEN. In my case, in the divorce there are a lot of debts. The judge—and I do not recall what the terminology is—said that that is my homestead and, therefore, the banks that are coming after us cannot place a lien on the home.

My quandary is, why can the IRS do it and no one else can? My judge specifically said no one can place a lien on the home because this is our homestead, this is for our children, we need a place.

Senator CHAFEE. Ms. Cockrell.

Ms. COCKRELL. Yes. Also, which was common in many, many of the letters we have been receiving at the organization too, that after the divorce the house is generally awarded to the wife so it is not in a joint name. It is probably the only asset she received. Generally, that is because she got custody of the children. So he got a similar amount of money, if they split the assets. He got the cash, she got the house. He can spend the cash and they can put a lien on the house.

Senator CHAFEE. Well, I hope we can do something to straighten this out. Your testimony has been very, very powerful.

I guess, was it you, Ms. Berman, who testified that your $40,000 IRA was seized?

Ms. BERMAN. Yes, it was.

The CHAIRMAN. You are left with nothing, practically.

Ms. BERMAN. That was taken away from me.

Senator CHAFEE. Thank you very much, Mr. Chairman.

Ms. ANDREASEN. Senator Chafee, you were beginning to ask a question to me about, do I feel like the IRS pursued me rather than my ex-husband. I felt like that I was an easier target for them because I was an employee and it was easier to have my wages garnished versus him because he is self-employed.

Plus, I cannot remember a time when we have ever gotten a refund. We have always had to pay, is my assumption. Now I am in the position where I could receive a refund and then I have the home. So I believe that they came after me for those, at least, three reasons.

Senator CHAFEE. Just in thinking, Mr. Chairman, I just wonder, if you listen to these cases, clearly the thought is, stop harassing these women and let us move on to something else.

Ms. COCKRELL. Hear! Hear!

Senator CHAFEE. I wonder if, in the IRS, anybody can take responsibility for saying, look, this is not the way to proceed. We are going to forget these cases. We are not going to chase Ms. Berman, Ms. Andreasen, Ms. Cockrell, Ms. Pejanovic, or whoever it might be. You just wonder if that is possible in the IRS, and you are not permitted to do that. The only person that can give you permission to do that is the commissioner.

The CHAIRMAN. Let me make two observations, as I listen to the testimony of these four ladies. First of all, there is nothing in the Code that prevents IRS from resolving these in an amicable matter. Nothing in the Code. I think that is important to understand.

But, second, having said that, in dealing with the American taxpayer one of the purposes of these hearings is to help ensure that they are taxpayer oriented. The IRS should be helping these people rather than badgering them, trying to find means of solving these problems rather than abusing them.

There is just something wrong when these cases drag on for years, and years, and years, or decades, according to you, Ms. Berman. There is just something wrong when innocent people find their lives being destroyed. Part of the responsibility is with the IRS, but I assure you we are going to try to build into law something that will help ensure fair and equitable treatment.

Senator Moynihan, did you want to comment?

Senator MOYNIHAN. I would just like to agree with you, Mr. Chairman, and say that the IRS seems curiously, at times, uninterested in the experience of other countries.

Canada does not have a joint filing and so does not have this problem. It is just across the river from Buffalo where the IRS has an office. They could go over and say, how do you handle it? They do not seem to do so, and they ought.

It is an agency that has stopped being interested in its subject and is just carrying out its routine. We are very much in your debt, all of you, for bringing this to us. It is not every day that you get to be the subject of a lead editorial in The Wall Street Journal

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Chairman, first, I want to thank you for holding these hearings. I must tell you that this is a problem that is nationwide. In my State of Montana we have a lot of complaints along these same lines, and clearly something must be done.

I am curious, though, with each of you, what you think the solution should be. One solution was alluded to by Senator Moynihan from New York. That is, require each spouse to file separate returns. That would solve some of this, but it gets into the other problem. That is, with joint returns we have one high income earner and one low income earner, and their joint tax liability is lower, which is something desirable. So one potential solution is that everyone files separate returns.

Another potential solution, it seems to me, for those who file separation agreements and who get divorced is to follow the tax payments provisions provided for in the separation agreement.

We would have to find some way, though, to prevent collusion somehow, because it is possible that separating couples, in their separation agreement, might make some provisions which are outside of the law. We do not want that to control, necessarily. But those are two possible solutions that come to my mind.

Then another has been suggested and that is the proportional liability. That is, even though there are joint returns filed, that each spouse is essentially liable for his or her proportionate share.

I am sure some of you have given a lot of thought to this question and maybe have a solution that would make sense to you, so I would be curious as to what you think the nature of the solution should be because it is obviously a big problem. It is a huge problem. Whoever wants to can jump in here and start first. If somebody has an idea, we would appreciate it.

Ms. ANDREASEN. Well, my name starts with A so I will start first. In talking with my accountant, one thing that would have helped her is if she could have gone to the same person or same department each time because every time she has talked to someone she had to start from ground zero up. That was difficult. One person interpreted something this way, another person interpreted it another way.

Another thing, too. I believe Chairman Roth, in his opening statement, said that we are innocent. The IRS needs to come up with evidence to prove that we are guilty and then come after us if you feel that we are guilty. But as long as we are innocent, I think that it should be up to them to find that instead of us spend-

ing all the money and energy in proving our innocence. They need to prove our guilt.

Senator BAUCUS. So your suggestion would be the burden of proof would be on the IRS to prove that you are a guilty party and also responsible for the underpayment of your spouse's tax liability.

Ms. ANDREASEN. Yes.

Senator BAUCUS. All right. Anybody else?

Ms. COCKRELL. I think the money could be spent in a much better way as well. The amount of taxpayer dollars spent pursuing all of us over the years would have been much better spent trying to track down these deadbeat dads, or given to cancer research. I lost a brother to cancer.

The amount of money they have spent going in and garnishing some woman's pay for a lousy 10 bucks a month, the amount of energy required to do that just seems to be a bad business decision. These women who are on welfare who want to work are told, you work, we are going to garnish your pay.

Now, if you ran the country like it was a business, that is a really stupid business decision. Let them work. Let them pay and have them contribute and put money in the IRS coffers instead of us supporting these women who want to work. We are paying for them.

Senator BAUCUS. All right.

Do you have a suggestion, Ms. Pejanovic?

Ms. PEJANOVIC. Yes. I would say that we are only talking here about IRS. I never had a chance to speak to anyone in all these 6 years at IRS, because I believe the legal system—the law should be changed because lawyers, friends, colleagues, everybody tells me, you do not fight IRS. It is so difficult. I never had anyone talking me, to IRS, like to have one person and make everything so simple. Maybe on a joint tax return, on every page, put you are liable for everything. Make everything so simple so people understand.

Senator BAUCUS. I do not understand. You said you never talked to the IRS?

Ms. PEJANOVIC. No.

Senator BAUCUS. What do you mean?

Ms. PEJANOVIC. I never had a chance all these years, never, ever, to defend myself. First they contacted me, like, 7 years later after my ex-husband knew about the problem, then they started just putting the lien on my apartment, a lien on my salary. But I never had a chance to defend myself.

Senator BAUCUS. So you were never approached by IRS until about 7 years after you separated.

Ms. PEJANOVIC. Plus, they were just putting the liens and taking the actions without giving me the opportunity to prove that I am not guilty.

Senator BAUCUS. All right. Well, there is clearly a major problem here that has to be addressed. Your testimony is certainly helping us a lot.

Mr. Chairman, I thank you for holding the hearing.

The CHAIRMAN. Well, I want to thank each and every one of you for being here. I know it is not the easiest thing to come here and testify in this environment. But your testimony has not only been

very eloquent, but I think most helpful to the panel as we address this problem.

Thank you for being here. We hope that we can get this resolved in such a fashion that others will not have to endure what you have had to endure.

Ms. COCKRELL. Thank you.

Ms. PEJANOVIC. Thank you.

Ms. ANDREASEN. Thank you so much.

Ms. BERMAN. Thank you.

The CHAIRMAN. Thank you again.

I would now call the second panel, which consists of three individuals who bring to the committee an in-depth knowledge and understanding of the innocent spouse issue, along with their thoughts and recommendations on how the IRS should revamp its approach in collecting revenue from such individuals who find themselves as innocent spouses.

Allow me to introduce the panelists. They include Mr. Richard C. Beck, a law professor at the New York Law School, New York City, New York; Ms. Marjorie A. O'Connell, a member of the O'Connell & Associates law firm; and David Keating, who is senior counsel and director of the National Taxpayers Union.

We are swearing in the witnesses. We would ask you to please rise and raise your right hand.

[Whereupon, the three witnesses were duly sworn.]

The CHAIRMAN. Thank you. Please be seated.

We appreciate your being here today. We look forward very much to your testimony. We will start with you, Mr. Beck.

STATEMENT OF RICHARD C. BECK, PROFESSOR OF LAW, NEW YORK LAW SCHOOL, NEW YORK, NY

Professor BECK. Mr. Chairman and distinguished members, my name is Richard Beck. I am a professor of law at New York Law School. I have been studying the problems of joint liability for over 10 years now and I have published 5 articles on the subject. I am very grateful for the opportunity to be here.

The shocking stories you have just heard are, unfortunately, very similar to thousands of other women's stories, women who are forced to pay their ex-husband's taxes every year.

Nobody knows just how many because the IRS keeps no records of collection attempts. To the IRS, it is apparently of so little importance which ex-spouse it pursues that it does not know, and it could not tell the General Accounting Office how often it collects from the wrong spouse or how much money is involved.

A good rough estimate is that the IRS makes about 50,000 collection attempts a year from the wrong spouse after separation or divorce.

Joint liability applies to nearly all married couples because nearly all married couples file jointly. That is because there is a slight tax savings.

I estimate that over 90 percent of the victims of joint liability collections are women. The IRS usually attempts collection from whichever spouse it finds first. After divorce, the wife often remains at the marital address on the joint return and the IRS will

usually look no further, even if the victim tells the IRS where to find her ex-husband. We have heard several accounts of this.

There is a very simple solution to all of these problems: joint liability should simply be repealed outright and retroactively. Repeal would cost very little, it would not open up any new avenues or opportunities for taxpayer abuse, and you would need to make no other changes in the tax system. You do not have to go to separate returns, do not have to change the rates. Desirable as some of these things may be on their own, nothing else need be done.

No other developed country in the world imposes joint and several liability for income taxes in the way we do, including countries which also offer income splitting on joint returns.

In many countries that once imposed some spousal liability, it has been repealed as archaic, unfair, and inconsistent with modern conceptions of women's rights to economic independence. It should be repealed here as well.

How do we get here today? Joint and several liability was first enacted in the United States in 1938. The story begins with an IRS error, which led to a 1935 decision in the Ninth Circuit by the name of *Cole*. In *Cole*, the IRS negligently allowed the statute of limitations to run as to the spouse who actually owed the tax.

When it discovered its error, the IRS then continued trying to collect from the wrong spouse anyway on a completely invented theory that filing jointly entailed joint and several liability.

In court, the IRS argued it needed joint liability because joint returns do not exhibit each spouse's separate income and deductions and so, the IRS claimed, it could not figure out which spouse to tax and for how much.

One may wonder whether the IRS made this argument in good faith because at that very same time in 1935 the Treasury was promulgating new regulations which would limit charitable deductions on joint returns to 15 percent of the donor spouse's separate net income, which necessarily involved the very same calculation of separate incomes which the government was arguing in *Cole* it could not make.

In any event, the Ninth Circuit rejected the IRS argument of administrative necessity because in *Cole* the separate liabilities of the spouses were stipulated. The court then noted that if a case should ever arise in which some doubt actually existed as to which spouse earned what, the IRS remained free to assess both spouses and let them prove their respective incomes.

The court then rejected joint liability on the ground that it would violate the cardinal principle of the income tax, which is that it is levied in accordance with ability to pay, which means in proportion to each taxpayer's own income and no one else's. The Ninth Circuit got it right in *Cole*.

After its 1935 defeat in *Cole*, the IRS urged Congress to enact joint and several liability, which Congress did in 1938. Congress got it wrong in 1938. The only explanation put forth in the committee reports in 1938 was the very same administrative necessity which had been rejected in *Cole*.

The new Treasury report which just came out yesterday and which I spent last night reading repeats the same red herring, that we need joint liability because the IRS cannot tell who earned

what. The IRS could tell in 1935 and the IRS could tell much more easily now in an age of information reporting on W–2s, 1099s, and so forth.

Joint liability was far too broad a solution in 1938 to the perceived problem, if indeed there ever was a problem at all. Congress improvidently handed the IRS a blank check in 1938 which it gradually emboldened itself to employ and abuse in situations very far removed from any administrative necessity.

The current application of joint liability to separated and divorced women seems entirely unintended. There were half a dozen cases decided before 1938 in which the IRS pressed its theory of joint liability, but not one had involved divorce, including *Cole*. Nor could Congress have foreseen in 1938 the post-war explosion in divorce rates.

To pursue divorced women for their husband's taxes without even attempting to collect from the husband first is certainly not an administrative necessity. Just the reverse, it is on its face a gratuitous and intolerable abuse of power.

Adequate reasons for imposing joint and several liability have never been provided. Contrary to widely held belief, joint return liability was not enacted as the price must pay, or quid pro quo, for lower tax rates on joint returns.

Joint returns were first introduced in 1918, apparently for the sole purpose of convenience and provided no special tax rates or privileges for married persons. For 20 years afterwards, we had joint returns but no joint liability.

The favorable tax rates for joint returns computed by income splitting were not introduced until 1948, some 10 years after enactment of joint liability.

The quid pro quo justification for joint liability is as weak logically as it is historically. The tax advantage of joint filing is usually quite modest, but even this advantage exists only when compared with the punitive rates applicable to married persons filing separately.

For nearly half of all couples, joint returns require higher taxes than the couple would pay if they were not married at all. This is the marriage penalty.

Also, the size of the alleged benefits of joint filing, if any, bears no relation to the joint return liability assumed, which can be unlimited in amount.

Finally, the alleged benefits of joint filing usually inure to the husband alone, while the liability is almost always borne by the wife. Joint return liability is not only unfair in principle, as applied it is highly discriminatory against women.

A second rationalization for joint liability which is no better than the first, is that the married couple is an economic unit and, as it shares its income and assets, it should share its tax burden. However, there was no evidence that couples who filed jointly share assets any more than couples who file separately. In any case, to apply the one pocketbook theory of marriage to couples who have already divorced and divided their assets is simply ludicrous.

To sum up, joint liability never had any legitimate purpose when it was first enacted and it is now a huge national problem. It per-

mits the persecution of women through the tax system and it is perfectly legal.

The CHAIRMAN. Thank you, Professor Beck.

[The prepared statement of Professor Beck appears in the appendix.]

The CHAIRMAN. Now we will call on Ms. O'Connell.

STATEMENT OF MARJORIE O'CONNELL, O'CONNELL & ASSOCIATES, WASHINGTON, DC

Ms. O'CONNELL. Thank you, Senator. Senator Roth, members of the Senate Committee on Finance, I have been a practicing attorney for 25 years. In those years I have specialized in taxation, especially as it affects the family. I have written numerous articles about this issue, and a couple of books.

Ten years ago I was involved in a project to bring relief to innocent spouses from that difficulty which had arisen under the current provisions then that only relieved people who had a problem with an omission, not deductions or credits.

In the decade since, I have watched what we believe was the rounder wheel really get battered into a misshapen block that does not any more in my judgment pull the wagon of equity at all.

I urge on you that the current innocent spouse law is unworkable. That which has been proposed in Taxpayer Bill of Rights III as a remedial legislation is better than what we have got, but it does not work either. It leaves us with two extraordinarily difficult burdens for people who would allege that they were innocent.

To be an innocent spouse a person, under both of these rules, the current rule even as it would be amended in TBR III, has to prove that she did not know, or have reason to know, of the item on the return that caused the understatement.

He or she has to prove also that it would be inequitable to hold him or her liable for the tax and the courts and the Congress have defined inequitable to mean that the party alleging innocent status must prove that he or she had no benefit. These two negative burdens of proof would be extraordinary in a commercial context in a well-funded litigation.

For the kinds of witnesses you heard this morning and the many, many more who try to tell their story on audit but can get no one to listen in the administrative quarter before they ever get to a court, it is an impossible mountain to crawl.

Notwithstanding that, even when you, in my opinion, in cases where I have had established precedent that you had no reason to know and that you had no benefit, which is, by case law, defined to be extraordinary benefit, not maintenance of the same standard of living but some extraordinary benefit, from the error on the return there are some decision makers, administratively and on the courts, who are going to find that if you are "smart enough to be in the marketplace," you "had reason to know," and you will never change their minds about that.

Similarly, there are decision makers in the Service and on the courts who believe that there is, indeed, a case that if, after a long-term marriage, you got any portion of the marital estate in a divorce, well, then you benefitted from that estate having been conserved by not paying taxes, therefore you are not innocent.

There can be a system designed that is fair to taxpayers, easy to administer for the Service, and simpler for all of us.

What troubles us about this problem? We have heard it articulated several times. It is people having to be held liable for income for which they are not responsible, in the case of reporting it incorrectly, when they made no mistake.

How did they get into that situation? It is not that they did anything wrong. They did what there might have been a lot of social pressure in their family to do, not to mention the economic pressures in the statute. They signed a joint return.

What we must do, is disassociate joint return signing from liability on the joint return. It is this solution to the problem that is that which was adopted a couple of years ago by the American Bar Association in a project in which I participated at great length.

In addition, we must provide relief to those residents in community property States who do not sign joint returns but, nonetheless, are liable because of community property laws for the income of a spouse of theirs when they have no economic involvement or benefit from accumulation of that income or reporting it.

Therefore, I recommend that married persons be taxed only on their own individual incomes without liability for tax on the income of their spouses, even when they file joint returns or are residents of a community property State.

I smiled this morning to hear how easy that is to understand. Four people, none of them trained in the law or trained in taxation, could explain to you the right result: I should only have to pay taxes on my income. If only I had to pay taxes on my own income, I would not be sitting here today because I always pay taxes on my own income.

There really is no difficulty in figuring out what should be an individual's gross income on a tax return. If there is any difficulty it might be in making allocations and apportionments of deductions, but this is done routinely in other sections throughout the Internal Revenue Code.

The audit process almost necessarily reveals sources of income and, as my colleagues have alluded to, information reporting overwhelmingly solves the problem for the bottom 90 percent of the taxpaying public with W–2s, 1099s, K–1s, and the like.

I would like to emphasize that separating liability from signing a joint return does not require getting rid of the joint return. It does not require huge tax structure changes. It does not require our having to solve, for this problem, that incredible debate of what to do about the marriage penalty and all of the social and emotional issues that can be raised in that. You can fix this problem for these people and all of my clients without having to have that debate, and I urge you to do so.

We have devised a formula in the proposal which is attached to my written testimony to determine the amount of tax that would be owed by an individual under our proposal. Each spouse's tax would be calculated as if he or she filed a separate return as a married individual.

Then the ratio of a spouse's separate tax to the sum of the separate taxes of each spouse would be applied to the total joint tax due. That way we do not up-end the tax structure, we do not ever

change the document we are signing, the sacred 1040 will not have another column, it will not have a special box.

As a matter of fact, under our proposal the whole system of separating liability will only come to the fore in those cases when, on audit, a deficiency is assessed and one taxpayer says, I can prove what is my income and that I paid taxes on my income. For all of the other people who signed joint returns, they are never even going to know you disassociated liability from signing the joint return.

We have got a Supreme Court case called *Poe* v. *Seaborn* that was decided in 1930 that causes community property residents to have to pay taxes on the income of a spouse. *Poe* needs to be legislatively repealed to solve this problem. After its repeal, it is our recommendation that the provisions of Internal Revenue Code Section 879(a), which already repeal *Poe* in certain circumstances, be applied to the income of community property State residents to determine who has which income. 879(a) says, for example, you earned it, it is your income. If you managed the business, that is your business income, et cetera.

So, in conclusion, I strongly recommend that the Senate pass a bill that eliminates joint and several liability and that, in substituting for joint and several liability, in those other kinds of policies we are recommending that you send a very strong message by making your proposal available to everyone who is being harmed now.

Gentlemen, I know how strongly you feel about retroactivity, but I urge you not to leave those four women you heard about this morning out in the cold and only save the people who the Service finds in 1999.

Thank you very much.

The CHAIRMAN. Well, thank you for your very helpful testimony. We particularly appreciate your coming forward with a specific recommendation. Just let me say, I am very sympathetic to the problem of, what do we do with people like the four that were before us today. They have already suffered tremendously and we are very sympathetic to what you are saying.

[The prepared statement of Ms. O'Connell appears in the appendix.]

The CHAIRMAN. Mr. Keating.

STATEMENT OF DAVID KEATING, NATIONAL TAXPAYERS UNION, WASHINGTON, DC

Mr. KEATING. Mr Chairman and members of the committee, I thank you for the opportunity to appear today on possible reforms of the innocent spouse rules. I represent the members of the National Taxpayers Union this morning.

Mr. Chairman, we commend you for the excellent series of hearings you have already held on how the IRS works, and does not work, and your decision to take a little bit of extra time to see that the IRS is reformed and restructured properly. We sincerely appreciate that decision, which we know may have been a difficult one politically.

Now, everyone makes mistakes. We are all human. That is why pencils have erasers. Even the IRS has Form 1040X for amending

a tax return. But there is one mistake Federal tax law will not forgive. That is the decision to file a joint return.

Now, strangely enough this is not something that is in the law itself. This is an IRS regulation. You cannot go back and amend and file separately once you have filed jointly.

Married couples do not have to file a joint return. They can choose to pay more tax, sometimes thousands of dollars more tax, for the privilege of filing separately and getting that legal protection.

I want to point out that this is in addition to the much criticized marriage penalty many couples pay for getting, or staying, married.

We have heard about the so-called innocent spouse rules. For many years my colleagues and I at the National Taxpayers Union actually have called these the "lucky spouse rules" because there are a few people who can meet all the tests involved.

This policy and this rule has simply not worked in the real world. In many marriages, wives are reluctant to tell their husbands, or vice versa, I am sorry, dear, I promised to stay with you for better or worse, but not through IRS collections and audits. So I think we should file separately, even though it means a few thousand dollars each year less to spend on our children.

But that is exactly the decision we are forcing people to make today. The lower the income, the less likely they can afford to file separately. They cannot afford to do it. The tax law changes of the 1990's are making it financially much more difficult, if not impossible, for low income and middle class spouses to file separately and get that legal protection.

One major factor is the growing importance of the Earned Income Credit during the 1990's, but it is not available to married couples filing separately. If you are a low income taxpayer you usually cannot afford to give up the Earned Income Credit. You just cannot afford do it.

The new 1997 Taxpayer Relief Act also barred couples filing separately from claiming the new educational credits, deducting education interest loans—which is an above the line deduction, I might add—or even converting to the new Roth IRA. Couples filing separately also cannot claim the child care expense credit.

I want to say a few things about this "reason to know" standard and joint liability requirement that some people think are necessary. We think this is a ridiculous position in today's day and age.

First, about half of all tax returns are prepared by professionals, yet the fact the return is prepared by a professional does not help to meet the "reason to know" test.

Second, filing separately often increases the marriage tax penalty on those who can least afford the penalty to begin with. So even though they may suspect their spouse is doing something wrong, practically speaking there is nothing they can do about it by filing separately, other than getting a divorce.

Third, how many spouses grill the other spouse, and how many members of this committee grill their spouses, with a range of due diligence questions concerning your tax return, and what questions

should be asked? I do not know. I am not sure anyone could tell you.

Senator MOYNIHAN. Could you give us a list? [Laughter.]

Mr. KEATING. But that is what is involved.

Fourth, I do not even like this terminology of innocent and guilt. Even if a wife suspects her husband is cheating on his taxes and gets some of the money, what is she guilty of? Filing a joint tax return. If she had filed separately, she would not have done anything wrong. This is crazy.

The house-passed legislation will not adequately protect innocent spouses and it is up to you in the Senate to fix it. There is a way out of this mess. I will not discuss it further. But the ABA—the American Bar Association, not the Bakers or the Bankers—have proposed a measure that simply divides the tax liability according to who earned the money or who was responsible for the mistake on the tax return.

Now, this may be a radical idea by IRS standards, but the rest of the world does not think so. I do not think Congress should enact legislation that denies to American married couples the taxpayer rights that Canadians, Europeans, and the Japanese taxpayers take for granted. We should have more rights in this country, not fewer.

There is another thing I want to add here. That is, we have to focus on taxpayer remedies, just not on legal rights. Too often the taxpayer right provisions of the Internal Revenue Code remind me of the civil rights provisions of the former Soviet Union constitution. On paper they look great, but in practice there is often no effective protection.

We often get a question from taxpayers, can the IRS actually do this? Well, we say, no, not really. What can we do about it? The fact is, many taxpayers cannot do anything about it because they cannot afford to fight for their rights. As you consider ways to reform the innocent spouse rules, I want to ask you to keep one very important thing in mind.

Please ensure these reforms will work for the many divorced working mothers who cannot afford an attorney to fight for their rights. Relief must be structured so that it can, and will, be granted through the administrative measures that are easily accessible to taxpayers. The ABA's proposal sets up the structure to do exactly that through the audit process that the IRS itself has.

I will leave you with one other suggestion in terms of tackling this problem, which we believe is a second-best solution compared to the ABA's recommendation, and only if you are unwilling to adopt the ABA recommendation would I suggest you look at this. That is, let divorced spouses file an amended return as married filing separately.

Why should taxpayers who are jointly filing not be able to amend their returns, especially for a divorced person who may realize after filing jointly that their ex-spouse was a liar or cheat, and not just on their taxes?

The first question that many widows and divorced women who are still making payments on their husband's taxes might ask the Congress is, why can I not amend my filing status from joint to separate?

In fact, a few days ago the IRS Taxpayer Advocate endorsed this approach even though the Advocate's suggestion was, in my opinion, flawed in the method of implementation. Our written statement has a suggested statute for filing an amended return separately, but again, I would encourage you to choose the ABA approach.

In conclusion, I would like to add just one last thing here. If I could choose just one taxpayer right to add to the IRS Reform and Restructuring Act it would be solving this problem of innocent spouses and adopting the ABA recommendation. The job of protecting taxpayers' rights will never end as long as we have a tax system.

We sincerely appreciate the time that you have spent, Senator Roth, and all of the members of the committee, over the last several months holding these extensive hearings and seriously considering how to formulate legislation to finally protect divorced spouses.

Thank you very much.

[The prepared statement of Mr. Keating appears in the appendix.]

The CHAIRMAN. Well, I want to thank each and every one of you for your excellent testimony today. I think it is extremely helpful. Frankly, certainly it is my intent at this stage to press ahead with the American Bar proposal.

Professor Beck, you heard the four cases we had before us. You testified that you would estimate there is something like 50,000 cases a year. I think the GAO has guesstimated that it could be as high as 75,000 to 80,000. But either figure is shocking, outrageous.

I would like to ask the other two, do you have any estimate of how widespread this problem is? Ms. O'Connell.

Ms. O'CONNELL. Senator, I would like to speak from my anecdotal experience in 25 years of practice. Virtually every time I start examining the financial records of a family I find some problem on a tax return. You have to remember that the Service only audits a little over 1 percent of the tax returns.

I think we have to realize that we have a Nation exposed to being pursued by the Internal Revenue Service. In a sense, there is something to be said for being on the lucky side of the audit if you are in the 98.5 percent that are not audited. So when I look at exposure, I have to say there is a very high exposure.

When we looked at how the Service actually handled innocent spouse cases that it got, we had the same problem trying to get information from them from administrative sources as the General Accounting Office did. They do not know. They really do not know.

Many times the people who mention innocent spouse to them do not mention it in writing, so even if it gets discussion it never gets appropriate or adequate attention.

The GAO numbers, as far as I can tell based on the sampling they did, are good to rely on for the amount of times the Service may document that it handled an issue. I would venture to say it handles the issue much, much more than it documents but it summarily rejects it as a defense. Beyond that, the issue is rampant throughout our Nation.

For people like Mrs. Berman, where there is no fraud, there is no tax shelter, there is a legitimate difference of opinion, at least at the time that the family filed the return, about whether a deduction was appropriate or there should have been an addition to basis for capital account. So in the most simple of situations, people can find themselves on the wrong side of this issue in a widespread way.

Mr. KEATING. We do not have any statistics at the National Taxpayers Union about how many people fall into this problem, but based on the comments and calls we have gotten over the years I would say it is certainly one area that causes the greatest series of difficulties for taxpayers who are trying to comply with the law and honestly pay their taxes.

The CHAIRMAN. Ms. O'Connell, I think you urged and recommended that whatever correction we take apply to people like those that were before us today, current cases. Mr. Keating, would you agree with that?

Mr. KEATING. Absolutely. Absolutely.

The CHAIRMAN. Professor Beck.

Professor BECK. Absolutely. Joint and several liability was a mistake when it was enacted and it should be repealed retroactively as a mistake.

Ms. O'CONNELL. Senator, may I offer something with respect to that?

The CHAIRMAN. Yes, please.

Ms. O'CONNELL. I would like to note for the record that when, in 1984, the last major remedial legislation for innocent spouses was enacted it was made retroactive to 1939, the first year that joint and several liability applied. So there is good precedent when one works in this field. The Congress and the President have already chosen to deal with everyone who is afflicted, not just work prospectively.

Mr. KEATING. The idea also that taxpayers are waiting literally decades to try to resolve these problems and would not be helped by a change today, I think, would be a crushing blow for many of them, that we have acted but not solved the problems that are outstanding for years and years.

The CHAIRMAN. Well, one of the things that shocked me at the testimony this morning was the time span of several of the cases, not just years, but at least in one case, decades. Is there a lesson here regarding the abuse of the way the statute of limitations is being enforced?

Ms. O'Connell.

Ms. O'CONNELL. Yes, Senator. I would suggest to you that if I were representing a client and a revenue agent suggested to me that he or she were going to start sticking signs on the trees in front of my client's home, I would suggest that they issue a deficiency letter so that I could see them in Tax Court. But these people did not know how to say that. All they knew was, they did not want some bad things to happen.

They were told if they would sign this piece of paper, we will just keep talking to you about the problem and we will give you some time to work out the problem. And maybe they even held out a hope that the really guilty person during the period of time would

be held responsible and pay the tax, but none of that ever happened.

So I do think it is the case that the Service, in negotiating extensions of statute of limitations, deals from a position of extraordinary power and intimidation when it gets that statute extended.

The CHAIRMAN. Any further comment?

Mr. KEATING. Well, it is a difficult problem and I greatly regret the fact that the statute for collecting a tax was extended not long ago. Not only was it extended in legal terms, but the taxpayers can waive the statute, so you get these cases that can drag on for decades and decades. I am not sure how to solve the problem either, other than I certainly would not want Congress to extend the statute for collection any further than already exists, which I believe is already too long to start with.

The CHAIRMAN. Professor Beck.

Professor BECK. Well, of course, if women are not liable for their ex-husband's taxes to begin with, which is all of our proposals here, we have all been saying the same thing, that the ABA proposal should be adopted, if there is no liability, then the problem of extending the statute of limitations, interest, and penalties, and so forth in these cases is just mooted, it is no longer important.

The CHAIRMAN. One final question. Can the American Bar Association proposal be administered by the IRS? I know, Ms. O'Connell, you touched on that. I would like to ask the panel, what are your views regarding the concerns raised in the Treasury report regarding the ABA proposal that equitable relief would still be required, married taxpayers and community property States would not be helped much by the proposal, and taxpayers would have to maintain records to establish the proper allocation of tax liability. Do you want to add to your comments?

Ms. O'CONNELL. Yes, Senator. My opinion is wrong, wrong, right. It is wrong that under our proposal we ever sought to achieve 100 percent proportional responsibility for taxes.

We understand in designing a system that there would be circumstances where it would be too difficult to give a refund or there would be a circumstance where a party's deduction actually had benefitted a spouse otherwise innocent of the problem on the return and we do not seek to readjust those historic developments.

So impugning the American Bar Association proposal because it is not 100 percent perfect in granting relief, I think, is kind of a smile considering the system that the Treasury Department would suggest you retain. We never said it was 100 percent perfect.

The second thing with respect to community property, I take issue with. I think that is wrong also. I have read the Treasury report in the 24 hours it has been made available, and I thank you very much for scheduling this hearing because I do not think its release yesterday was at all coincidental; we have only been waiting a little over a year.

The report, when it talks about the *Poe* v. *Seaborn* case, posits an example of a person who can bring a premarital tax liability to a new marriage in the community State, and then the new spouse's earnings would be responsible for old taxes from a prior marriage, even if *Poe* were repealed. I disagree with that interpretation of *Poe*.

Just to be sure that my disagreement was correct, I called my colleague Professor Susan Kalinka at Louisiana State University who has done an excellent paper on community property and the repeal of *Poe* in this issue which I will be happy to provide to the committee, and she concurs with me that that is not the result of the repeal of *Poe* and that, as a matter of fact, *Poe* succeeds in the needs we choose to meet.

The second thing the Treasury says is, well, if you repeal *Poe*, you are going to have to institute some other system. Senator, we already proposed what system to institute. It is already in the Internal Revenue Code under Section 879(a). We are just extending that application from couples where there is a nonresident spouse to all couples who have an issue about how to attribute community income. So those were the two wrongs.

The right was, you are going to have to keep records. Yes, you are. Yes, you do now, yes, you should, and yes, you will. I think every one of those women who are up on this panel today said something that amounted to saying, I only had W–2 wages and I could prove it. I knew exactly what I reported on the return. I had my pay stubs. If only I had the chance to prove it. They have their records.

The one new citizen, or I am not certain if the lady is a citizen, but the one woman new to the United States, I was interested to hear, has every single return since she has been here. So I do not think Americans have trouble keeping records, they do now. There is nothing more burdensome about what we propose.

The CHAIRMAN. Thank you.

Mr. Keating.

Mr. KEATING. As far as administration of the system, first of all, the IRS should be thankful that many taxpayers file joint returns. The computer systems would be swamped if everyone filed separately. After hearing some of these horror stories, maybe more people will. But there is an exception allowing a taxpayer to file an amended, separate return after filing a joint return. Unfortunately, you have to be dead to do that.

The IRS officials, as far as we know, have not reported any problems with the current rule which permits this as an alternative for personal representatives of deceased taxpayers, and this exception has been in the law for decades.

Indeed, the report that came out yesterday did not raise, as far as I could tell, any significant administrative concerns. Certainly some reprogramming of computers would be required, but the administration could easily be handled.

Certainly when you compare all of the nonsensical efforts to squeeze, as Professor Beck said in his written statement, blood out of turnips, perhaps the IRS could even save some administrative efforts by going after the taxpayers who morally really do owe the taxes and may have the capability to pay them.

The CHAIRMAN. Professor Beck.

Mr. BECK. I think the Treasury report greatly exaggerates the difficulties there would be in implementing the ABA proposals, largely with quibbles. We have rules to separate income and deductions of the spouses. They work.

I would point out to you that there is a huge amount of litigation reported in the innocent spouse area. I think there is around 700 reported decisions now. One of the elements that the claimant has to show is that the tax item in question is an item of the other spouse. To my knowledge, there is not a single decision in which that was a problem. It is simply not a problem.

As to the Treasury's analysis that our ABA proposal would still leave some nonproportional or unfair situations, I think that is based on a misunderstanding between the situation between past taxes already paid and future taxes that are being demanded.

In the case of taxes already paid, of course you cannot have a system where, if a husband overpaid the family taxes and gets a divorce, then 2 years later decides it was a bad thing to do and he wished he had not paid, he cannot ask the government to have taxes refunded to him and charged to his ex-wife.

We are talking about future taxes. If taxes are demanded that are in excess of what has been paid, at any time either spouse can say, no, I want to be assessed only on my separate income; I will pay that and no more.

The CHAIRMAN. Thank you, Professor.

Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, thank our panels, both. Many groups of citizens come before us and tell us about a problem, but you seem to have come with some answers, which is rare and welcome. Obviously there has been work at this for some time now, the Bar Association and all.

I guess I have two questions. One, is I congratulate Ms. O'Connell for having read this overnight. It would have taken me a week. I think, Mr. Chairman, we could ask Secretary Lubick to come in and talk with us about how to handle this.

I have the impression that the proposals from the Bar Association and from the American Institute of Certified Public Accountants are straightforward and do not require a large amount of new calculations within the IRS. Is that not right, Professor Beck?

Mr. BECK. That is correct. We have rules under current law for separating income and deductions of spouses. For example, in the case of a refund from a year in which a joint return was filed to a year in which the spouses are divorced, there are very specific rules for untangling, unscrambling the income and deductions and deciding what part of a refund belongs to which spouse. All we need to do is use those precise rules now in effect for the situation of untangling liability for unpaid taxes.

Senator MOYNIHAN. It is not every day we have someone come along with a problem and what seems to be a solution. I mean, this is clearly an untoward, unhappy situation. It evolves from a changed condition in our national life. The number of divorced couples is so very much greater than it was in 1935 when *Cole* was decided. It is a different social situation.

Could I add one comment. The IRS has a huge problem with the year 2000 matter and its computers. You are all aware of that in the audience. I got knowing smiles from everyone involved. The year 2000 comes first, because if it all closes down we close down. The lights go off. This could be handled without making the other impossible; would that be your judgment?

Ms. O'CONNELL. Yes, Senator, if I may address that. The Treasury Department, in its report, which I know you have not had an opportunity to read every bit of——

Senator MOYNIHAN. I have had an opportunity, just not the ability, will or——

[Laughter.]

Ms. O'CONNELL. Well, it shows you what I think good reading is. By my last evening's reading from the Treasury report on page 37, the Treasury says the IRS could handle the separation of liability questions under the proposal we have advanced as it currently does for joint tax assessments that are separated in the event that innocent spouse relief is granted.

This is currently accomplished on a separate computer system used primarily for collection actions on a former joint account. They already do it. They know how to do it, they could continue to do it. They introduced that remark by saying, well, you know we might have to make some changes in the master file programming, so I would say, make them. But they know what to make. The program already exists in another system. It is not rocket science.

Senator MOYNIHAN. Yes. Well, thank you very much, indeed, for that. My God, I read one paragraph of it. [Laughter.].

Could I ask just one last question. Before this hearing I think the matter that most pressed the committee with regard to this particular subject was the marriage penalty. But it is your view that we do not have to interfere with that whatever, just by providing the alternative, you can choose one or the other. Mr. Keating, I see you want to respond.

Mr. KEATING. This problem, I think, is a separate problem from the actual marriage penalty, the penalty two people pay in extra taxes for either getting or staying married. That is, I think, a severe tax and social problem. But this is a separate issue.

This is a question of liability, of just trying to ensure tax justice, in a way. We have, with this issue of joint and several liability, a situation where people are paying taxes that, on any moral basis, they do not owe.

The decision to file a joint return is, for many people, a much more risky situation than investing in short sales, options, or derivatives. Yet we require all kinds of signatures on special forms telling people they understand the risks of those kinds of risky investment strategies, but signing a joint return can cause massive bankrupting losses just as easily as these other investment decisions, with less knowledge.

Senator MOYNIHAN. Nicely said. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Grassley.

Senator GRASSLEY. Well, thank you all very much for your testimony, and particularly if it has not been acknowledged already.

Mr. Keating, I want to thank you for your service on the Commission for Restructuring the IRS. You worked hard on that issue with a couple of us from this body, and we appreciate very much your contribution to that as well.

In the United States Senate, most of us have people on our staff that we call case workers that handle most of the problems we

have with various government agencies, including the IRS. Our constituents come to us and we have people that are very well trained to wind their way through the bureaucracy to help, hopefully, solve problems and solve them successfully. We do not always bat 1,000, obviously.

But I became aware of this innocent spouse problem myself one time. I guess I have my name listed in the phone book in Iowa. I found out Christmas 1995 that that was not a very smart thing to do when an elderly lady, who was being hit as an innocent spouse and had had months and months, and maybe it has gone on for years, of problems.

She did not bother me for hours, but she bothered me for a long time. Well, I should not say she bothered me. I get paid for helping people like that. But it was on Christmas day and it was not exactly the time you want to receive a call.

Senator CHAFEE. I referred her to you. [Laughter.].

Senator GRASSLEY. I used to call you friend.

Anyway, she called about the problem she was having with the IRS. It was exactly this obligation she had. As cheerful as it was, the worst thing about it was, here was a woman that just feared the IRS. Total fear. Did not even want to even sit across the table from an IRS person. That was my first acquaintance with probably problems that my staff had been working on for years about innocent spouses.

But it brings home not only the problem that this hearing brings out, but it also brings home the fact, why do we have to have a government agency that people are afraid to deal with? As much as we do not want to have problems that have to be solved, you should not actually fear sitting across the table from somebody who is working for you. That is the situation that we have presented here so often.

I want to get on the record an entire statement that I am going to put in the record, but I want to make sure that there is a personal understanding of another constituent problem I have. This is from a letter. "I am writing to you at the 11th hour in the last desperate effort to avoid emotional and financial ruin at the hands of my ex-husband and the Internal Revenue Service." This kind of describes her problem. She owes $142,000 to the IRS for tax ramifications of an investment her then-husband made 17 years ago.

She had nothing to do with this investment, never read anything associated with this investment, never understood the particulars of the investment, never filled out a tax return claiming the deduction for an investment.

In addition, she never chose to spend the years her husband spent in Tax Court while penalties and interest accrued. As you can imagine, after 17 years much of the $142,000 is not the original tax owed, but rather the cost of spending nearly 20 years fighting the IRS.

Now, years after divorce after leaving an unfaithful husband, she is on her feet. Although she entered the workplace only a couple of years before her divorce, she is now a successful real estate who supports herself and prides herself on her work and her reputation in the community.

As she said, "At 58, I paid off the majority of my debts, a large portion of which was overhang from my failed marriage. I have managed to put away a small amount of money for retirement, but will have to spend a significant portion of my normal retirement years working full-time because I am told that the IRS will take my retirement funds and maybe even my home." So it looks like the IRS might even take her IRA, put a lien on her house.

She would consider filing for bankruptcy to escape all of it, but values her professional reputation too much to take this time-out. So she is left alone, hardworking, with no prospect for retirement or an end to her harassment.

Now, an editorial comment on my part. It seems to me that there are many things about this story that ought to disturb us, but first is the fact that there is a marriage based on trust. The current system holds spouses, usually former spouses, liable for trusting their spouses.

In the case of my constituent, she learned the hard way that she could not trust her husband who had a long-term affair that caused the divorce. Frankly, this affair should be the worst breach of trust that she suffers. Instead, our tax laws and the IRS are assuring that a 1981 tax deduction is an ongoing wrong that she has to suffer as she moves on in her life.

One of you said something about getting blood out of a turnip. I think the case that I had on September 25, 1995 is an example of where it should have been obvious to the IRS, why harass this woman, you are not going to get anything out of her anyway. She did not have it.

I want to ask just a question of all of you. That is in regard to not just the cases that are before us, but in particular, Professor Beck and Ms. O'Connell, to use your experience.

How could we reform collection procedures so they do not hurt people trying to get back on their feet, whether they are innocent spouses or whether they are other people that are being harassed by collection agencies when they do not have the resources to pay?

Mr. BECK. I think a good step has already been taken in that direction with offers and compromise. I think it is a good idea for the IRS to clear bad debts and give people a new start by letting them pay whatever they can on their tax debts and ending it.

If it is five cents on the dollar, take it. Give the person a new life, let him work and keep his earnings. We have a program like that which works now better than it did before, but we should probably do a lot more.

Senator GRASSLEY. Ms. O'Connell.

Ms. O'CONNELL. Senator, I would recommend with respect to the offer in compromise program that the Internal Revenue Service be instructed to modify the ratios it uses to determine whether it should accept an offer. The people who administer that law right now believe that they have to liquidate everything you have or they should not accept the offer.

So they are not operating in the way that a good business collection agency would, realizing that if your choice is all or nothing at all, maybe it would be a better choice to take bankruptcy and start fresh as opposed to spending 5 years paying the Internal Revenue Service and then having to start fresh.

The second thing that I would mention, is there is wide divergence among the offices of the Internal Revenue Service as to how they will structure an installment agreement to pay whatever you may have compromised your liability down to.

So you can be in one office where a collection officer will give you 5 years with lower payments the first year because you had other economic problems and then step up the installments, a taxpayer in a different community would be told, we never go more than 18 months and we demand 10 percent down.

So I would suggest that instruction to the Service that they have, on the one hand, some discretion to use, with, on the other hand, some rules as to how the discretion is supposed to be used to encourage the taxpayer to solve their financial problem and pay their taxes over a reasonable period of time, would be helpful.

Senator GRASSLEY. Thank you all. If you want to respond, Mr. Keating, I would be glad to listen.

Mr. KEATING. All right. If that is all right with the Chairman. Easing access to installment agreements, I think, is important. We have made some strides, and the IRS has made some strides, in recent years in that area. I also think the IRS should take a more holistic approach to taxpayers.

In some districts there is still a case-closed mentality; let us just close that case, get it finished, without any real evaluation of the total return. A business that is completely viable may be closed simply to close that case, and that business could pay off that tax in the space of months or a few years.

But if the business is closed, you do not collect the tax and those employees are out of work and may be collecting unemployment. So I think the IRS should look at that.

The other thing that I think should be done that we have not done lately, is the Tax Code does not recognize the right to be self-supporting, which I think is astonishing. If you are self-employed, the IRS can come and take essentially everything, except, I think, $1,650 of tools and equipment.

Now, how many people can run a small business or self-employment on that much in the way of assets? You cannot. If you are a self-employed plumber, just the truck, much less the tools, would cost far more than that.

I think we should not give the IRS the ability to come and take someone's livelihood away from them and leave them with no tools to earn income, yet the Tax Code does do that.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman. I want to join in the thanks to each one of you for your testimony here today.

When you were talking about the ABA proposal, I think you used the word proportional, is that correct?

Ms. O'CONNELL. Yes, Senator.

Senator CHAFEE. The liabilities would be proportional. How about the deductions, would they be proportioned too? Let us say the husband earned X dollars and the wife earned half X, and they had $1,000 charitable deduction. Under the ABA, would that be proportioned likewise?

Ms. O'CONNELL. Senator, it would depend on who really made the deduction. We are not advocating strict proportionality, we ac-

tually advocate what we call an item approach. Your example shows what I mean by that very well.

Suppose that the husband could clearly show that the deduction was made on a checking account that he alone maintains. So when it came time, first, under the proposal, there would never be a question of looking behind the items on the joint return as reported for attributing an item or doing a proportionality test.

But let us say an assessment came up and the husband said, that is not a tax which I owe because I can show you that this is my income, and when I took this appropriate charitable deduction from my sole account and I get credit for that deduction, I do not owe any more tax. At that juncture we only would use the item approach.

Suppose instead that the same deduction was made from a joint account. At that point we say, husband and wife, joint owners of the account, each own half of the deduction. Suppose instead that the nature of the item was one where it was not easy to track exactly the ownership.

That is when proportionality would come into play, so that if we had a husband who earned 50 and a wife who earned 150, we would say that 50 over 200, or one-quarter of the item, would be the proportional entitlement of the husband. So there are several steps in the process.

We believe that at virtually every juncture parties will, under a titling sort of system, be able to track whose is what, or provide for a split since they are married people if they are filing a joint return. Failing that, we go to proportionality according to income.

Senator CHAFEE. So that would apply likewise to, say, mortgage interest deductions.

Ms. O'CONNELL. Yes, sir.

Senator CHAFEE. Now, let me give you a situation. I am curious what your answer will be. Let us say the husband earns a half a million dollars, $500,000, and the wife earns $10,000. They file a joint return. She signs it, he does not pay the tax. Now, they have a $400,000 house which she has been awarded through a divorce proceeding. She is not totally protected, as it were, because I presume, under the ABA proposal.

Furthermore, I believe the law is that, whereas the divorce decree is a State decree, that does not take precedence over the power of the Federal Government, or the Federal Government would not necessarily recognize that she received the house in a divorce settlement. Am I correct in that?

In other words, is there not still a danger here that in going after him they would get his share of that house, which would probably require the house to be sold? Am I correct in that?

Ms. O'CONNELL. Senator, I think we stopped that problem. Let me walk through your example. I am going to assume in that circumstance, first of all, that this wife can prove that the problem is not her problem. She had $10,000 worth of income and she paid her taxes on it. Therefore, she has no responsibility for the tax in respect to that return. That should be the end of the focus on her. With respect to the fact that she was awarded a home in a divorce——

Senator CHAFEE. The home that he principally paid for.

Ms. O'CONNELL. Yes, sir. That is right. But the issue I am going to is how she got that asset. By virtue of it having been awarded in the divorce, I am going to assume now that it is solely titled in her name by the time collection time comes around for the Internal Revenue Service, with respect to a tax that is clearly his.

Senator CHAFEE. Right.

Ms. O'CONNELL. Because there was no intent to defraud the Service in the transfer of the home and because we are not talking about a community property environment where she may be carrying a community debt if we do not reverse *Poe* v. *Seaborn*, under common law rules, that home would not be at risk for his tax. That is really the problem we are trying to solve here. Whatever assets he may have would be at risk for his tax.

If he had a brother, and he also got the large vacation home in the divorce and he said to his brother, Jack, here comes the IRS, I am going to transfer my house to you for a few years until it is over, I expect you to give it back to me, then Jack has got a problem because that can be transferee liability and a fraudulent transfer to defeat the IRS's interests.

Senator CHAFEE. Well, that is a very interesting explanation. It does give me a little bit of trouble in that the wife is living in a very expensive house, let us say a $400,000 here, that came about partially, I assume, because he did not pay his income taxes.

Ms. O'CONNELL. Well, Senator, let us go back to the part of the example where she got that house in the divorce proceeding. In every State in the United States, whether through an allocation of community property or a distribution equitably of marital property, a State court judge is going to have weighed what is a fair allocation of property.

In my 25 years of practice I have never seen a judge say, 100 percent to wife, who I am assuming maintained during the course of the marriage a ratio of income $10,000 to $500,000. That judge is going to say, you know, Mr. Smith took care of her for all these years, they lived in that house for 20 years. She could never live in a comparable way without being awarded the house and some support.

So Mrs. Smith, that is what I am going to give you. Now, Mr. Smith, you keep your business which does $15 million a year, which is why you make $500,000 a year, and you go on and enjoy the rest of your life. In a real-world situation, Senator, there is plenty of Mr. Smith left for Internal Revenue Service to collect its taxes.

Senator CHAFEE. All right. Fine. Well, that is very helpful and I appreciate it.

Again, thank you, Mr. Chairman. These are very fruitful.

Mr. KEATING. Senator, might I add one other thing to this whole discussion.

The CHAIRMAN. Yes, sir.

Mr. KEATING. To re-emphasize a point earlier, which is, if that woman had filed separately to begin with, even theoretically you would not have a question or claim that the IRS might discuss. That is why I get to the point of, what are these people guilty of? They are guilty of filing a joint return and usually saving the husband money.

In this case, clearly, there is a marriage bonus for filing jointly. So he has gotten a tax savings for her filing jointly. She has only made the error of filing a joint return instead of a separate one.

The CHAIRMAN. I want to thank all three of you for the outstanding testimony. I think the matter you brought to our attention will be extremely helpful in addressing the problem. Frankly, we will be calling on you for further assistance.

Thank you very much for being here today.

Senator MOYNIHAN. Thank you, indeed.

The CHAIRMAN. The committee is in recess.

[Whereupon, at 11:42 a.m., the hearing was concluded.]

IRS RESTRUCTURING

WEDNESDAY, FEBRUARY 25, 1998

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Grassley, Bryan, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please be in order.

I know that Senator Moynihan is attending the funeral of Senator Ribekoff, so he will not be here. Because the hour is growing late, we will proceed.

First of all, let me welcome the panel. It is a pleasure to have each and every one of you here again.

Today, we are, of course, beginning our fifth hearing on restructuring the Internal Revenue Service. During our first four hearings we heard from Secretary Rubin, Commissioner Rossotti, several former IRS Commissioners, tax practitioners, the General Accounting Office, the Deputy Inspector General of Treasury, and perhaps most importantly of all, the taxpayers. This will be our last hearing in preparation to draft IRS restructuring legislation. We will, however, continue with oversight hearings in the future.

Our focus today will be on management of the IRS. We will hear from management experts and representatives of IRS front-line employees, professional managers, and senior executives. In light of many of the concerns that have been expressed in past hearings, I look forward to the testimony of these witnesses.

I recall one agency employee putting the importance of management in very simple terms. She said, ''Upper management determines the climate and policies for applying tactics and tax laws. Therefore, it is at this level that the greatest impact on the taxpaying public is affected.''

Given this employee's logic, logic that I agree with, it could be said that, from a practical standpoint, today's hearing will be our most important yet. When it comes to management, the buck stops there.

Good managers yield good employees. If they are knowledgeable, service-oriented, and motivated by the correct principles, their employees will be knowledgeable, service-orientated, and motivated by

the same. On the other hand, bad managers will yield bad employees, and that concerns me.

I was concerned to hear the testimony of an 18-year revenue officer, an officer in compromise specialist, who said, "The pressure is coming from management. We are told to ignore the law and do what we are told to do. We are encouraged to ignore any issues that might slow down the collection process. The hostility in the workplace is becoming unbearable."

Well, this is troubling and it is our intention today to look at restructuring proposals that will address these issues. Many remedies are already gaining broad support. For example, I agree with the members of the National Commission on Restructuring the IRS that there must be accountability and continuity of management at the IRS.

The concept of a staggered oversight board and fixed term for the IRS Commissioner was intended to provide continuity of management, a fresh outsider's view by private sector experts, and accountability.

If a board concept is ultimately implemented, one of the most important functions will be to ensure that taxpayers are treated fairly, honorably, and with efficient and effective service.

It is anticipated that an oversight board would be able to expose many of the abuses and misuses of power that we have listened to in our oversight hearings. To do this, however, the board should have oversight authority. Oversight does not mean intervening in particular tax cases, but it does mean having enough information to prevent some of the ills that have plagued this most important agency.

Certainly there are many issues that need to be addressed concerning the board. For example, who should and who should not be on the board; what are its benefits, pitfalls; would a board really foster accountability or merely distract those responsible for managing the agency? Likewise, there are many questions regarding what IRS management needs to turn the agency around.

There are questions related to what kind of flexibilities a Commissioner needs to manage the agency. For example, do the flexibilities included in the bill introduced by Senators Grassley and Kerrey, Senator Moynihan's Administration bill, or the House-passed bill, provide Commissioner Rossotti with the tools he needs? These are important questions, and today I look forward to finding some answers.

If there is no further comment, we will proceed. Again, it is a pleasure to welcome our distinguished panel. They include Paul Light, who is director of the Public Policy Program for the Pew Charitable Trusts. It is good to see you again, Mr. Light.

Dr. Ronald Sanders, associate professor of Public Administration at the George Washington University. Pleased to have you.

And, of course, Thomas Stanton, vice president of the Standing Panel on Executive Organization and Management of the National Academy of Public Administration.

We are pleased to not only welcome you, Mr. Stanton, but Mr. Jasper, who is an academy fellow at the National Academy of Public Administration.

Mr. Light, we will begin with you, please.

STATEMENT OF PAUL C. LIGHT, DIRECTOR, PUBLIC POLICY PROGRAM, THE PEW CHARITABLE TRUSTS, PHILADELPHIA, PA

Mr. LIGHT. It is a pleasure to be here, Senator. I am speaking here, of course, as a private citizen and scholar and not as a representative of the Pew Charitable Trusts.

It is a delight to be back in front of you, having served for some years behind you on Senator Glenn's Governmental Affairs Committee staff. It is a joy, actually, to know that this bill is under the leadership of someone who has a longstanding commitment to improving government management and has paid the dues on Governmental Affairs to prove it.

I am also delighted to be before two Senators from Iowa and Nebraska, States that are contiguous to my home State of South Dakota. We are delighted that those States produced such talented individuals, and we will claim the Minority Leader as our own.

I am here basically to talk briefly, and I will submit my statement for the record, regarding IRS taxpayer abuse as an issue of accountability. I think the committee has defined it thus.

I define accountability here as the clear expectation that individuals on the front line or elsewhere inside the agency can have a clear expectation that they will be rewarded, punished, or at least noticed, for their acts, whether for good or ill.

I believe the sources of accountability in any agency are clear signals from the top, and that includes the United States Congress as well as the President of the United States, a strong vision of where the agency is to go, committed professionals, which I most certainly believe occupy the IRS, and a clean organizational structure in which the top of the agency can see the bottom.

It is no surprise to you, given my past writing on the thickening of government, that I would suggest that it is impossible to see the bottom of IRS from the top. The bottom of the agency is enveloped in a fog of constant pressure and conflict, we might even call it a fog of war.

In my conversations with front-line revenue agents, now 3 or 4 years ago, I got the sense that the district offices were rather like Fort Apache, cut off from the headquarters, poorly supplied, poorly led, and in a constant struggle to do their jobs.

I believe that is the case at IRS and, whatever else this committee does by way of restructuring the agency, I think that we should talk about reducing the distance and removing the fog that currently limits our ability to see the top from the bottom and the bottom from the top. An oversight board, however well designed, will do little good if it cannot see what is happening down at the district offices.

Now, I will just briefly note that the problem of structure at IRS, indeed, in all of government, is that we believe in leadership by layering. Over the years, through legitimate efforts by Presidents and Congress to improve accountability in agencies, we have added layer upon layer of management that eventually has come to compose an administrative sediment of staggering proportions that makes it virtually impossible for the front line to see the top and receive direction from the top.

I challenged this committee, I challenge anybody in Washington. I have done a count of the titles inside IRS. I challenge anybody here to demonstrate to me how the Chief of Staff to the Assistant Commissioner for Support Services in the Management and Administration Division contributes to the overall ability of the agency to do the job.

If you start ticking off the titles between the top of the agency and the bottom, you immediately confront just a staggering number of layers, managers who I am sure are well-intentioned, who handle paper going down and direction going down and ideas coming up. Frankly, after a while it is impossible to know who we would hold accountable for the taxpayer abuse. That, I think, is a fundamental flaw here facing us as we legislate.

I would suggest by way of dealing with the layering problems in IRS that this committee take seriously its ability to eliminate the regional office structure. The regional office structure, to me, is an anachronism. It was created for the wrong reasons almost 30 years ago, and it serves the agency little good.

I would also suggest that this committee establish targets for mid-level de-layering. It cannot be done by exhortation, it must be done through legislation, I am afraid. And that we all aim here to achieve a smaller organizational structure so that, at a maximum, we have really no more than eight layers between the revenue agent and the President of the United States, because ultimately it is the President, not the Commissioner, who is responsible for the front-line abuse. I have other comments on the bill that I would be glad to share with you that I summarize in testimony.

I do want to suggest to the distinguished Chairman that he consider attaching to this bill, as we did with the Veteran's Department Elevation Act in 1988, a proposal that he has long held dear for creating a National Commission on Executive Organization and Structure.

It has been quite some time since I have drafted legislation, but I took out my pen and drafted out some new language for restoring that commission and I would urge you to consider attaching it. I am sure the Governmental Affairs Committee would embrace that as a warm gesture, not a violation of their legislative territory.

It has gotten to the point now in the Federal Government where we are just not going to get at these structural issues through exhortation, executive order, and constant pressure. We have got to really go through these agencies one by one and clean them out.

I commend to the Senator a good look at his past efforts on this, and I have appended the legislative language to my testimony.

The CHAIRMAN. Well, thank you, Mr. Light. As I said, it is good to see you again. I appreciate your plug for some legislation I think is important. I am not sure that this would be the time or place to offer it, but we will give it due consideration.

[The prepared statement of Mr. Light appears in the appendix.]

The CHAIRMAN. Dr. Sanders.

STATEMENT OF DR. RONALD P. SANDERS, ASSOCIATE PROFESSOR OF PUBLIC ADMINISTRATION, THE GEORGE WASHINGTON UNIVERSITY, WASHINGTON, DC

Dr. SANDERS. Thank you, Mr. Chairman, members of the committee. I appreciate the opportunity to be here. I, too, speak as a private citizen and scholar, and hope I can lend some insight into your deliberations.

I would like to talk about four main points. First, inevitably, the oversight board, its mission and composition. Second, the personnel flexibilities that have been talked about, but principally focusing on their collective bargaining aspects. Third, buy-out authority, voluntary separation incentive pay, which has been proposed as an essential tool for the IRS's transformation. And, lastly, but perhaps most importantly, proposals to revitalize the IRS's senior executive corps.

First, with respect to the oversight board. Mr. Chairman, you started by saying that management was important, that the buck stops there. I think the way these various proposals are constructed, the question is more, the buck stops where?

I think the oversight board is problematic in a number of respects. It is, in my view at least, not true to its title. I like the idea of an oversight board if its mission is oversight, but the legislation that I have read interposes it between the Secretary and the Commissioner and gives it all sorts of operational responsibilities, up to and including actually submitting the Service's budget.

The question I would have is, first, who is in charge? Who decides, if the Commissioner and the board disagree over budget matters? One could easily imagine this committee getting embroiled in that.

Second, who is accountable? If the board, the Commission, the President, and the Congress all agree on a strategic plan for the IRS, as well as a set of performance measures, and the IRS does not meet them, who is held accountable, who is responsible for that? Is it the board, the Commissioner, the executives, the employees, or all of the above? I agree with Professor Light's comments here in terms of the "fog of war" and adding another layer to an organization that is already quite layered, I would think, is problematic.

An oversight board, in my view, is necessary and appropriate and that also governs the question of membership on that board. I have no problem with the National Treasury Employees Union being a member of an oversight board for the IRS.

I think unions in the Federal Government have traditionally played that oversight role. NTEU, in particular, has been effective in that regard. But I have a great deal of difficulty with union representatives sitting on a board that has management and operational responsibilities.

I think it is redundant in one sense, because the union already bargains with the IRS. Second, NTEU and IRS have one of the most effective labor/management partnerships in government, so there is a second bite of the apple. I do not know whether they need a third.

As a former Federal executive, I wonder how it would be to sit across a table from the union and bargain one day, only to have

them sit in judgment of my performance the next. But again, I want to make it clear, unions in an oversight role, I think, are appropriate and effective, and I would support that.

The personnel flexibilities, Mr. Chairman. I have testified before Congress, in both Houses, on a number of occasions arguing for those flexibilities, so long as they fit within a framework that includes things like the merit principles, veterans preference, et cetera. I think all of that is at least implied in the legislation.

The language that I have seen is flawed in one respect. The House would give union veto over demonstration projects. And, while I wish they had used different language, I think that generally reflects the state of the law today. Under 5 USC Chapter 47, labor and management cannot proceed with a demonstration project unless both parties agree. That is fine if the object of the demonstration project is research. I think the object of the demonstration authority proposed here is different. It is much more serious.

In that respect, I would not leave this to a default option of the status quo. I would argue that either party should be able to submit a bargaining impasse to the Federal Service Impasses Panel, a body created by the Congress to resolve those sorts of disputes and let them deal with this, as opposed to just letting the status quo prevail if they cannot come to common ground.

I will not say a lot about buy-out authority, except that it is an essential tool, not just as a blunt instrument to reduce numbers. It has certainly been used to that effect across government, but it can be used, I believe, more surgically to deal with surplus skills and redeployments. I would be happy to answer questions in that regard.

Lastly and most importantly, let us talk about the IRS executive corps. They are among the most respected in government, but, like any organization, they need revitalization from time to time, and there are a number of proposals that would give the Commissioner authority to do that: special pay authority, critical pay authority, 40 new positions, et cetera.

I favor all of those, but with some conditions. I have actually had some second thoughts as I have thought about those proposals. The IRS, I think, depends on being seen as impartial and objective. While I know that the intentions of this Commissioner are entirely honorable when he says, let me bring in new people, new professionals, new executives, new technical experts, I am more worried about the next Commissioner.

So I would give him those flexibilities, but with some safeguards. Merit principles, for one, or perhaps even a sunset provision. If these positions are indeed, to help the IRS transform, then carry them through that transformation and then perhaps eliminate them. That would guard against politicizing the IRS and politicizing those positions.

Mr. Chairman, I would be happy to answer any questions later from the committee. Thank you very much.

The CHAIRMAN. Thank you, Dr. Sanders.

[The prepared statement of Dr. Sanders appears in the appendix.]

The CHAIRMAN. Mr. Stanton.

STATEMENT OF THOMAS STANTON, ACADEMY FELLOW AND VICE-CHAIR OF STANDING PANEL ON EXECUTIVE ORGANIZATION AND MANAGEMENT, ACCOMPANIED BY HERBERT JASPER, ACADEMY FELLOW, NATIONAL ACADEMY OF PUBLIC ADMINISTRATION, WASHINGTON, DC

Mr. STANTON. Mr. Chairman, members of the committee, thank you very much for the invitation to testify today.

Governance is an important topic for the IRS. We will always need an IRS. Whether we have some form of today's tax system, or a flat tax, or a consumption tax, issues of implementation and sound management will always be essential to the American taxpayer.

Our concern is that, while some provisions of H.R. 2676 make welcome improvements, the provision for an oversight board, as presently drafted, could gravely damage the accountability of the IRS and the quality of the IRS as an institution.

We urge this committee, as it did in legislation to create an independent Social Security Administration, to create an advisory board, and retain a single commissioner as head of an agency who can be held fully accountable to the Congress on behalf of the American taxpayer.

In our testimony on the IRS we would like to make four major points. One, we support the recommendations of the National Commission and provisions of H.R. 2676 to strengthen Congressional oversight. Greater involvement of the Tax Committees in oversight can help to increase accountability of the agency and to offset some of the problems of an ingrown organizational culture.

Mr. Chairman, you have played a major role in the enactment of the Government Performance and Results Act, and this committee could use that act to help create and ensure that IRS implements performance goals that balance the objective of collecting revenues efficiently against other objectives, such as consistent, fair treatment of taxpayers.

Two. The oversight board that H.R. 2676 proposes for IRS will greatly limit the accountability of IRS to the Congress, the President, and the Treasury Secretary and will damage the professional integrity of the agency.

The bill gives the oversight board authority to approve strategic plans, reorganizations, and budgets of the IRS. The bill thus allows private parties to determine the deployment of the Nation's tax collection apparatus, invites self-serving actions by the private board members, or invites the perceptions of such actions that could well lead to increased tax evasion.

By giving the oversight board authority in these important IRS decisions, the bill will make it very difficult for the Congress to hold anyone accountable for IRS performance. The Commissioner, individual board members, and the Secretary all will be able to point to others who hold partial responsibility for any actions that engender criticism.

Three. These problems can be overcome if this committee would turn the oversight board into an advisory board. That advisory board can help to infuse the IRS with the fresh points of view that you spoke about, Mr. Chairman, on behalf of the private individuals and companies who must pay taxes and deal with the IRS.

To the extent that an advisory board gives sound advice and has the ear of the Congress and the Secretary as well, its recommendations will very likely have significant influence with the Commissioner.

Four. Management improvements must enhance, rather than detract, from the professionalism of the IRS. We support the ideas of a fixed term and a performance contract for the Commissioner.

H.R. 2676 makes welcome additions to the flexibility of IRS personnel rules and provides that these shall be exercised in a manner consistent with merit system principles.

In our written statement, we suggest how this committee might strengthen provisions to assure that merit principles are applied to the hiring of all IRS employees below the level of Commissioner. Otherwise, over time the agency is likely to be offered a remarkable array of politically well-connected, but marginally qualified, people for special positions that were intended to be filled by experts.

Mr. Chairman, we would like to close by pointing out that, for all of the shortcomings that this committee and others have identified, the IRS continues to do a remarkable job. Each year, the agency processes over 200 million returns, collects $1.5 trillion of revenue, and provides information and tax advice 100 million times.

This committee needs to scrutinize the provisions of H.R. 2676, especially with respect to IRS governance, to assure that new legislation does not endanger that track record.

We urge that any IRS restructuring legislation include provision for prompt evaluation of particular features of the new law upon the ability of this country to collect the revenues that we need.

A 5-year sunset provision, especially upon any changes to the IRS governance structure, would provide this committee with an opportunity to refine its approach to these important matters in light of experience.

Mr. Chairman, thank you. We would be pleased to answer any questions.

The CHAIRMAN. Thank you very much, Mr. Stanton.

[The prepared statement of Mr. Stanton appears in the appendix.]

The CHAIRMAN. I would like to have my first question directed at what the House bill gives the board authority to do. As has been pointed out, under the House legislation the board can review and approve IRS strategic plans, it can review IRS operational functions including tax system modernization, outsourcing, managed competition and training; it can review the Commissioner's selection, evaluation, and compensation of senior managers; review and approve the Commissioner's plan for major IRS reorganization. It also has the authority to review and approve the IRS budget request, moving it forward to the Treasury.

I would like to have each of your comments on this authority. Would this specific authority provided to the board enhance protection of taxpayers and accountability? If so, how, if not, why? Mr. Light.

Mr. LIGHT. Well, the trouble I think my colleagues and I have with this particular proposal, or at least my problem with it, is the

addition of the approvement responsibility. I think it is perfectly reasonable for an oversight board, whether it is called an oversight board or reconfigured as an advisory board, to review the ongoing activities of the agency.

It is when the board interposes itself into an approval function that I think traditional organizational theory gets troubled. It tends to diffuse then the ultimate accountability that belongs with the Commissioner, on up to the President.

As I recommend in my testimony, actually, I think an oversight board, properly constructed, could be quite helpful to the agency. I recommend that this committee consider moving oversight of the Taxpayer Advocate's Office to the oversight board, and also, should this committee decide to create a separate Office of Inspector General for the agency, that you lash the OIG up to the oversight board in some fashion.

But it is when the oversight board gets into the business of, for example, recommending a budget directly that you diffuse and weaken the Commissioner's authority, and that is problematic for those of us study chain-of-command problems and the accountability problem, as we have described it today.

The CHAIRMAN. Dr. Sanders.

Dr. SANDERS. Mr. Chairman, I think the list of responsibilities you enumerated all say operations, not oversight. I agree with Professor Light and Professor Stanton, it attenuates accountability, it does not strengthen it.

You all know how powerful oversight and advice can be. An independent body that could look at IRS its management practices from a detached perspective, I think, could be very helpful.

On the other hand, you all have heard the expression "going native." I wonder how independent an oversight board would be if it actually is involved in making those decisions. It will become an advocate of those decisions, of the management strategies that it becomes involved in. That, I think, harms its ability to be independent and impartial and provide you the kind of input that I think you seek to oversee the IRS.

Mr. STANTON. Mr. Chairman.

The CHAIRMAN. Yes. Let me add a question for you, Mr. Stanton. You talked about making it over into an advisory board. Now, is there not already an advisory board to the Commissioner, and how would this differ?

Mr. STANTON. Mr. Chairman, there is an advisory board to the Commissioner. That advisory board has been weakened in recent years by the law of unintended consequences. There are various provisions, like Government in the Sunshine Act and the Federal Advisory Committee Act, that require openness in government and, of course, we support such principles.

But for an advisory board, it is very hard for the IRS to come forward, in the bright light of publicity, and confess weaknesses in the tax collection apparatus, because you know that every tax evader in that sector will promptly feed into that weakness.

So one important addition that we would recommend in creating a new advisory board would be to remove that kind of provision so that, in fact, you could have a group of outsiders talking in some detail with IRS and having some fairly candid conversations about

shortcomings and needs for improvement. That would be the first issue.

The second issue, sir, again relates to the law of unintended consequences. By putting a board between the Congress and the Commissioner, the bill basically will make it a lot harder for this committee to hold the Commissioner accountable.

Once that advisory board approves its first budget and its recommendations are accepted to redeploy, not, for example, to have one computer system, but to do something else instead, make all the trade-offs that are inherent in budget decisions, they become part of the problem rather than part of the solution. All of a sudden, it is their idea and they become the people that you are going to have to call up here and ask a whole bunch of questions of.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Not part of the legislation that has passed the House, but we have had some concern recently about the Treasury Department's Office of Inspector General. I believe very much in the Inspector General system, except for the fact that, from time to time, one department or the other might have trouble with the Office of Inspector General.

I very much support this system and I also think it is important for us to consider Treasury IG at the same time we are thinking about changing the IRS to be a better organization.

Do any of you have thoughts about how to make the IG's office more effective regarding oversight of the IRS, so we would be talking then just about the Treasury Department IG.

Mr. LIGHT. Well, let me comment on it. I have studied the IGs off and on over the years. I am not exactly sure why; it is a dense subject. Nobody can be particularly pleased with how the appointment of the most recent Treasury Inspector General turned out. It is a serious problem, which the Senator has clearly noted in his floor statements and other venues.

I would argue here that the Inspector General, the OIG, and Treasury should be strengthened. The appointments process should be changed so that we ensure that the highest caliber of individual is selected to serve as Inspector General in that agency, in fact, government-wide.

We might consider two options for strengthening the OIG vis-a-vis IRS. One, is to create a specific Deputy Inspector General in the Treasury Office of Inspector General for responsibility of overseeing IRS and really create that as a standing subunit within the OIG, or we should create a separate Office of Inspector General within IRS to assure attention to the kinds of problems that this committee has examined.

I make some recommendations in my testimony regarding how we might deal with the appointments process of Treasury. We are about to come up to the 20th anniversary of the 1978 Inspector General Act. I think we have got some issues that we can confront through that particular anniversary as we think about how to revise the Act for the next 20 years.

Mr. JASPER. Could I add a word to that, Senator?

Senator GRASSLEY. Yes, you may. Any of you can respond.

Mr. JASPER. Thank you. Paul Light touched on one aspect of the IG problem that is really endemic in government. That is, more re-

cently the Congress has put in statute the experience requirements to be met by the person to be appointed.

The White House is under enormous pressure to try to fill jobs with recommendations coming from all over town, all over the country, and oft times they do not pay as much attention to those qualifications you write into the statute as one would like. We touch upon this in our testimony and prepared statement with respect to the appointees to the oversight board.

If the Senate, as part of its confirmation process, would hold the executive branch's feet to the fire on occasion, then the White House Personnel Office would quickly learn that they had better pay attention to the statutory criteria.

So I would endorse Paul's comments about making sure that you get qualified people into these jobs because, as the Chairman's opening remarks, I think, indicated, if you have good people in management jobs, then you have good management.

Dr. SANDERS. Senator, I would defer to Paul and his comments on restructuring the IG. I would offer this note of caution in terms of any attempt to connect the IG with the oversight board. That may be appropriate for investigating patterns and practices of abuse, et cetera, which is part of oversight, but I would caution against creating another appellate body for employees or taxpayers to appeal if the IG is part of the oversight board.

Senator GRASSLEY. All right. On another subject, and I ask this question, existing personnel laws notwithstanding, and in regard to our recommendations from the commission about the Commissioner's ability to recruit experts not only on an occasional basis, but for full-time staff help for his being able to do his job.

Do any of you find any fault with that effort? You do not have to give a long answer. If there is any problem with that, voice it, otherwise I will assume your silence is acquiescence to the principle.

Mr. LIGHT. Are you talking, Senator, about the salary, the reward system, all of those?

Senator GRASSLEY. No. I am talking just about the ability of the Commissioner to have close to him at the highest levels, both administrative and staff, the ability to hire people from outside the usual way that they have been staffed in the IRS.

Mr. LIGHT. I think that you will hear in the next panel some objections to the proposed changes in the way the senior executive service would operate. My recommendation to you is not to tinker with the senior executive service, nor should you give the Commissioner the authority to appoint a new set of political lieutenants.

I would urge the committee to consider the possibility of creating a new type of senior position where the occupants would operate under 5-year performance-based contracts, selected on the basis of merit but on a short-term leash, which is a model that we have seen work in other countries as part of the overall reform efforts over the last 15 years.

So there is something in between what is recommended in the House bill which tinkers with the existing system, and trying something entirely different, perhaps a corps of no more than 20 senior revenue officials who would be appointed on short-term con-

tracts and paid at a much higher level than we would ordinarily expect in the senior executive service.

Dr. SANDERS. I agree with that. I agree with the concept of giving the commissioner that sort of authority, but with sufficient safeguards to ensure that those positions do not become political positions.

I think what Paul has described is something in between our traditional structure, political employees on one hand and career senior executives on the other. It could be 5-year employment contracts, or the authority itself could be sunsetted.

But, frankly, the ability to bring in these kinds of experts at higher salaries may be essential to the IRS's transformation. We need to find a way to do it so that it does not become yet another part of the political plum book on one hand, and threaten the senior executive corps on the other.

Mr. JASPER. I would like to add just a couple of quick comments. We detail in our prepared statement the scandals that beset the Internal Revenue Service in the early 1950's, which the Congress rectified by requiring that all appointees below the Commissioner be hired strictly on merit. As long as these new appointees are hired strictly on merit, I think that that is a constructive step that we could endorse wholeheartedly.

In that connection, however, we notice that the House bill would eliminate the 120-day get-acquainted period for Senior Executive Service persons, and we think that would be a mistake because it has worked so well that we think that it should be continued.

However, we suggested the possibility, if there is a feeling that the Commissioner needs a little bit more leeway, that perhaps you could exempt the Deputy Commissioner from the 120-day get-acquainted period, but only the Deputy Commissioner.

Senator GRASSLEY. I am done. I would only say that there is a difference between a concept of hiring a bunch of political hacks to back up a Commissioner of Internal Revenue to make sure that his ability to get the job is not curtailed by the professional service and bringing in people who are responsible to him to make sure that we get the job done that would be professional people.

Mr. JASPER. Right.

The CHAIRMAN. I guess the question is, how do you accomplish that; how do you make certain these people are appointed on the basis of ability and not politics? Should there be some kind of political limitation or assurance that you have people of both parties?

Dr. SANDERS. Senator, you could specifically ban it. That may be a gesture. But if it is in law that these folks are going to be professionally and technically qualified rather than traditional political appointees, that may have some moral suasion.

I think you could also interpose some procedural requirement so that, as with the case of a senior executive appointment, somebody independently reviews the appointment to make sure that the individual is qualified.

Mr. LIGHT. I think we have dozens of statutes, take the Veterans' Administration, where we require that the head of the Veterans' Health Administration be appointed without regard to political affiliation, et cetera, et cetera, we see in the case of the Inspector General at Treasury that an appointment was made that clearly

contravened the statutory urgings for selecting somebody without regard to political affiliation and with regard to their ability to do the job. It happens all the time.

The only option available to the committee, if you want to go that direction, is to have, for example, some sort of appointing body, as we use with the Comptroller General of the United States, that recommends a list of carefully vetted names to the President for appointment. You would only do that if the President and the President personnel process had failed you in following the letter of the law.

I think, in the case of the Treasury IG, that White House personnel did not pay attention to the quality of the appointments and has, therefore, lost a significant claim to discretion. So you can do this through exhortation, but it has a history of not working very well.

Mr. JASPER. We do address this specifically in our prepared statement. The invocation of the merit principles in H.R. 2676 is in connection with the exercise of the personnel flexibilities. We suggest that the requirement to follow merit principles be put further forward in the Act so it would be relevant to all appointments. That would be your statutory trigger for requiring it.

Dr. SANDERS. Mr. Chairman, this would be a perfect responsibility for an oversight board.

The CHAIRMAN. All right. With that, we will turn to Senator Kerrey, who is one of our experts on restructuring IRS.

OPENING STATEMENT OF HON. J. ROBERT KERREY, A U.S. SENATOR FROM NEBRASKA

Senator KERREY. Which makes me dangerous.

Well, first let me assert that I do not think just because something is political it is necessarily bad. Indeed, one of the objections and concerns that you have raised, that I think is very legitimate, with the board is that you want to make sure it increases accountability, not decreases accountability. By its nature sometimes, political decisions are in response to concerns that people have. I mean, fundamentally, the IRS has 535 members of its board of directors, members of Congress, who are elected by the people who respond to concerns that the people have.

This whole exercise began with the people's auditor, the General Accounting Office, saying that we squandered billions of dollars in tax system modernization, as well as other complaints raised by taxpayers who are saying that the status quo is, IRS is not accountable. It is not accountable to what we want. We call it, we do not get our question answered. We are not getting the kind of service that we are getting from comparable organizations in the private sector. So we want to improve the operational efficiency.

It is not just any executive branch organization. I would argue that the IRS, because it touches almost every single American, is critical in our capacity to maintain the citizens' confidence that government of, by, and for the people works. Difficult to do.

In fact, I find one of the most constructive suggestions that you make in this question of how to construct this board, is to put a 5-year sunset on it so we can evaluate it.

Indeed, our vision with the Restructuring Commission was that we wanted to have two companion organizations, a restructured oversight on the legislative side and restructured on the executive side, so that you could get shared consensus about what the mission of the IRS is going to be, so you would have support back and forth to one another.

I believe, Mr. Stanton, it was you that was saying that the advisory board has to have the ear of Congress. Most advisory boards do not have the ear of Congress because they do not have any authority. If you do not have any authority, you are probably not going to get a meeting scheduled. You are probably not going to have the opportunity to have much influence about what Congress does, if all you are doing is providing advice. I mean, that is all we need, is more advice. Executive branch and legislative people say the same thing.

Typically, if you are trying to respond to a problem by not really stirring up the pot very much, you create an advisory board that you know is not going to do anything other than just file reports.

So I think we have got to somehow take a step and give this board more authority if it is going to be able to do the kind of restructuring that is obviously needed and if we are going to be able to sustain all the other requirements that we impose on the IRS, privacy, lack of corruption.

I mean, we found in our hearings, most commendably, that no citizen has ever come forward and said that bribes are taking place inside of the IRS, and most tax collection agencies worldwide have that charge being filed against them.

But, in order to eliminate the bribes, we have also eliminated almost all flexibility on the part of revenue agents in being able to deal with taxpayers.

So I am just saying that, with the vision of this piece of legislation, the vision that attaches to this legislation, we need a venue whereby the legislative and executive branch can reach agreement on what we are going to be doing, and the context for all of it is a crisis of confidence that exits right now and a lack of accountability that exists right now between the IRS and the citizens, and Congress' frustration every time we think we are doing something that is going to improve the IRS, it does not work.

I mean, we provided the resources for tax system modernization. The promise was, that was going to radically change the environment. If you go back and look at the testimony that was offered at the time, man, taxpayers are going to love this thing. It is going to be easier, simpler, and the cost is going to go down, unit cost of collection, and life is going to be good.

Well, it turned out to be a disaster, an unmitigated disaster. What we heard, both from the private and public sector, was the reason it was a disaster was, there was not shared consensus.

There was not a shared vision between the legislative and the executive branch, between the Congress that writes the law, the ultimate board of directors, the 535 people that are elected to be a board of directors, and the executive branch agency.

I have to insert, by the way, as far as conflicts of interest, we deal with conflicts of interest all the time. I mean, I was a private sector person before I got into Congress. One of the first meetings

I had was with the Ethics Committee, telling me what I have to do in order to deal with any potential conflict. It seems to me that any private sector person that comes in to government is going to go through the same thing.

Secretary Rubin had to go through that. When he appears before our committees, there are procedures to be able to deal with conflicts. I do think it is an important issue. It is one that we need to pay attention to because, as I said, you do not want to create something that is going to make matters worse.

But the vision of this board is to give it a sufficient amount of authority that Congress is going to meet with it and talk to it when it is making decisions about both how to authorize and to appropriate.

As you say, the worst outcome is to end up with a two-headed monster with two lines of authority. I am more concerned about the board, frankly, than I am about a chairperson having so much authority that suddenly you have got two managers of the IRS.

But it has got to have a sufficient amount of authority that people listen to it, otherwise it is not likely going to have any impact at all on restructuring.

Mr. STANTON. Mr. Chairman, since my name was mentioned, may I respond for a moment?

The CHAIRMAN. Yes, please.

Mr. STANTON. We are on the same side of this issue in the sense that we are all concerned about the dramatic failure of taxpayer modernization.

Senator KERREY. And any comment on accountability has to be in the context of current accountability. How do taxpayers currently feel about the IRS, do they feel like it is accountable to their demands?

Mr. STANTON. It is possible to use tools like the Government Performance and Results Act to get accountability out of single-headed agencies or agencies with commissions like the Federal Deposit Insurance Corporation. It is possible to get accountability, but it is really hard to legislate competence. A board is not going to add much to that issue. The IRS already knows that it failed with taxpayer modernization, and having a board to tell it so is not going to give us the straight chain of responsibility.

Senator KERREY. The purpose of the board, I will say it again. You have got this vision of the IRS organization outside the context of the current situation which is 535 Members of Congress as its board of directors very unhappy with the IRS, unwilling both to authorize and appropriate the resources needed to do the job. That is context one.

Context two, is 270 million Americans who are also not very happy with the IRS. I mean, that is the context in which we operate. We are trying to design a solution to a very important and compelling problem. You are saying, by fiat, that you do not believe the board is going to add anything to solving that problem, and I do not find your argument very compelling in that regard.

Mr. STANTON. Let us take a hypothetical. I am an attorney, I am a small business person. Say I am on the board.

Senator KERREY. Bad hypothetical, but go ahead.

Mr. STANTON. It is not hypothetical, it is real. I am an attorney. Say I am on that board and I do not like the way the IRS has been dealing with small businesses like me. So the first time a budget comes up I say, I do not like that unit and I want them to be reallocated.

Senator KERREY. Say I am chairman of the Ways and Means Committee and I am a small business person and I do not like the way the IRS is dealing with small business people. Is that a conflict?

Mr. STANTON. That is an elected official. It is really different from somebody operating a very low level who, in fact, will not have the stature—this board will not have the stature——

Senator KERREY. But you are suggesting that I have got to get people without any point of view on the board, otherwise I could have a conflict.

Mr. STANTON. I did not say that, Senator. I am suggesting, with all due respect, that the board is not going to help improve the competence of the IRS and that this committee, as a group of elected officials, can help improve the accountability of the IRS to the taxpayer. This is where the buck stops.

That board, which will be a number of people of greater or lesser quality who are appointed who will definitely have points of view, is simply going to become enmeshed in that whole process that we are worried about now.

Senator KERREY. But now you have gone much further than your testimony and you are describing hypothetical possibilities with dire consequences without having any basis for the prediction. I mean, you simply do not like the idea, it seems to me, Mr. Stanton.

Mr. STANTON. No.

Senator KERREY. You have offered a rational reason to object to the idea in your testimony, but now you are just saying, by fiat, it is not going to add any value. Document that for me. Tell me how it is a given.

Mr. STANTON. I would be delighted to.

Senator KERREY. Again, inside the context, this Congress is torn. This Congress has not done a good job of overseeing the IRS. We have not added a sufficient amount of value to the task of improving its performance. We have failure on our hands, Mr. Stanton. We do not have success. So the question is, how do you improve upon the current situation? You are suggesting modest modifications of the status quo.

Mr. STANTON. In the area that I work, for example, financial institutions regulation, we have got an independent board, the FDIC, and we have got a comptroller of the currency, which is a single head.

What you find, is that the single head is much more accountable that the board. When the government set up the Thrift Retirement Systems Board, they set up a board in order to insulate the function of investing Federal retirees' pension money from the Congress.

Boards are a layer that, if you look at one sector of government activity after another, are a layer that interposes itself. It is a variant on Paul Light's thickening of government.

Senator KERREY. Like the Federal Reserve Board. Would you say that adds a layer of thickening that makes it difficult for us to engage in monetary policy?

Mr. STANTON. I would say they are quite independent from the U.S. Congress.

Senator KERREY. Would you say the Social Security Advisory Board adds a thickening layer?

Mr. STANTON. No, that is another——

Senator KERREY. Would you say the Postal Rate Commission adds a thickening layer?

Mr. STANTON. Yes.

Senator KERREY. So you are against the——

Mr. STANTON. We are not against the creation of boards in all cases. The purpose of our testimony here is merely——

Senator KERREY. But you just said that a board adds a thickening layer. You are now saying a board adds a thickening layer, except there are times when it does not.

Mr. STANTON. No. There are times when it adds value and there are times when it does not. We are saying, please be careful here because there may be a significant down side.

Senator KERREY. I am prepared to be careful, Mr. Stanton. I am very much aware that we can do damage to this agency and make things worse. I am very much aware of that and have given a great deal of consideration to the question of, how do we get that done in this legislation, and want to make certain we strike a balance between having a board that has a sufficient amount of authority that Congress will listen to it, that Congress will listen to what it is saying ought to be done, and not having a board that has so much power and authority that it undercuts the capacity of the Commissioner to do his or her work.

Mr. LIGHT. May I add just a word. I think the committee has an extraordinary task, given the current levels of public dissatisfaction with the agency. We have some survey data coming out in the next two weeks that show that IRS continues to exist in free-fall in terms of public confidence and its ability to do its job. Therefore, the pressure on the committee and Congress and the President is to be bold, to send a signal to the American taxpayer that something is being done.

I do not see the board as an extra layer of management, per se, if it is properly insulated from line operating responsibilities. But I think part of making the board successful is to consider a fairly radical flattening of that agency so that Americans can see the bottom from the top, and so on.

I think my colleagues in the profession are concerned that boards tend to accrete responsibilities to themselves over time and that you may have a situation where, 5 or 10 years after the current crisis is over—although Lord knows, IRS has been in crisis, after crisis, after crisis—would that we could expect in 10 years that the board will fade and that this problem will no longer exist.

I think the concern is, if you are going to create it, how do you insulate it? I think the sunset is one way to do so. Give it 5 years and put it out of business. Make an affirmative requirement by Congress to reauthorize it, and a more clear conversation about how to separate line operating responsibilities from oversight.

Senator KERREY. Another way is, in this legislation the law gives the President the authority to remove any Commissioner for cause. Any board member can be removed. By the way, there are lots of other protections out there as well. All of this concern about conflicts. Conflicts get dealt with on a regular basis around here, sometimes to the extreme, sometimes to the point of not being able to get anybody to serve in the public sector.

The CHAIRMAN. Time is moving on.

I would, on this matter, like to point out that the Commissioner has testified that he was quite positive about the prospects of an oversight board, suggesting that a good CEO profits from the direction and advice of a board of directors.

So in opposing the creation of an IRS oversight board, Mr. Stanton, do you find fault with the way corporate America is set up, or is it that the corporate analogy is not applicable?

Mr. STANTON. Thank you, sir. It is exactly the latter point. In other words, the corporate board of directors has a focus on a corporate bottom line. There is director and officer liability to assure that every member of the board of directors carries out a fiduciary responsibility to the shareholders to maximize value for the corporation.

By contrast, when you get a government board, there are as many visions of proper public interest as there are individuals walking around in the United States today. It is a quite different institution and operates according to profoundly different dynamics.

The CHAIRMAN. I would like to turn to another problem. I think everybody agrees, taxpayers have a right not to be abused by IRS employees. Do the current rules make it difficult for the IRS to discipline or terminate employees who abuse taxpayers; do IRS employees have more rights than taxpayers? Mr. Light?

Mr. LIGHT. Well, I think that the way that the appeal structure is currently designed creates a presumption in favor of not removing employees. We have been struggling with that for 20 years in one way or the other on both sides of the aisle. It is very difficult to remove an employee, and most of us would rather not do so. It is almost a lifetime task, in some ways.

There are ways to streamline the appeals process so that you can move more quickly to resolution, and I think that the committee and the House have struggled a little bit with how to do that, and you have got a panel of experts following here that can comment more artfully on it.

I think the presumption should be in favor of the employee to a point, but we ought not to be in sort of an endless appeals process where we cannot remove a clearly incompetent employee without sacrificing our own career to constant appeal and argumentation. There are ways to streamline this a little bit to make it easier.

The CHAIRMAN. Dr. Sanders.

Dr. SANDERS. Senator, I would differentiate between protections and appeals. Employees have protections, and civil service employees have considerable protections. Nevertheless, those employees can still be removed. What tends to deter managers from taking that on is the prospect of months, or sometimes years, in an appellate process.

At the end of the day, managers tend to be fairly successful in removing poor performers or employees who engage in misconduct, but the thought of going through that for a significant part of your working life is daunting.

I think the protections strike the right balance the way they are. I think the appeal system needs some fairly radical restructuring so that those protections can come to fore, can be adjudged, and then we can get on with business.

Mr. JASPER. I would just like to add a little bit to what Dr. Sanders said. I do not have current data, but data I used to be familiar with showed what he suggested has long been the case, that, by and large, disciplinary actions are upheld.

Most of the time that management loses in the appeal process, it is because it failed to follow its own established procedures, not on the merits of the case. So if people would do their homework and follow the procedures, they would almost invariably win. As Dr. Sanders suggested, if you shorten the appellate process, that should make it entirely possible to live with the current system.

The CHAIRMAN. Let me turn to another problem. Our hearings have shown that many IRS employees are concerned about retaliation if they report misdoings on the part of other employees. What can be done about that? How can we change a culture so that an employee who is doing a good job and tries to ensure that the agency is complying with its manual, and so forth, does not find himself or herself the object of negative action?

Mr. LIGHT. There has been a longstanding effort to deal with how to protect whistle blowers, which the Chairman dealt with on Governmental Affairs.

The CHAIRMAN. I am talking more than whistle blowers.

Mr. LIGHT. But, I mean, the fact that you are in an agency, within a department, that has an historically weak Office of Inspector General, historically weak commitment to self-policing, I think that reduces the desire of somebody to come forward with a complaint in the belief that he or she, by making the complaint, it will never be resolved.

I think part of giving employees confidence that if they see something wrong they ought to report it, is to make sure that when something is wrong it is fixed. I think we are struggling a little bit with that on the Treasury Department OIG problems.

Dr. SANDERS. Mr. Chairman, I would agree with that. I think, again, the protections are adequate. There are protections for whistle blowers and those who do something not quite reaching that threshold.

I think the confidence that they lack, as Paul said, is structural; once they raise the issue, will somebody do something about it, or do I put myself at risk? So I think the language is sufficient, the structure may even be sufficient, but the enforcement mechanisms, I think, could be strengthened.

Mr. JASPER. Another important consideration is what you touched on in your opening statement, and that is, the manager sets the tone for the agency. If the manager sets the tone of wanting to know about abuses and protecting the persons who report those abuses, everybody will get the message on both ends, the abusers and the reporters as well.

That is why we have stressed so much accountability. If you have a single person who is fully accountable for the performance of the agency, he can take that responsibility very seriously and not have it diluted.

The CHAIRMAN. Well, my concern is that we had many employees wanting to come forward with information, but there is a real fear and it is not localized, it is very broad throughout the organization, that people are very fearful that if they come forward to give information to, say, this committee, that there may be retaliation. So it is a very serious problem.

Gentlemen, we have a number of additional questions that we would submit to you and ask that you reply in writing. As we proceed with the legislation, undoubtedly we will want to call on you for further suggestions and recommendations. This is an important effort and we appreciate the fact that you took the time to be here with us today. Thank you very much.

[The questions appear in the appendix.]

The CHAIRMAN. It is now my pleasure to call forward the second panel, which is made up of employee representatives. We are very pleased to have Mr. G. Jerry Shaw, General Counsel of the Senior Executives Association; Mr. Robert Tobias, President of the National Treasury Employees Union; and Ray Woolner, National President of the Professional Managers Association. Again, gentlemen, it is a pleasure to have each of you here. We look forward to your comments.

I understand, Mr. Tobias, you have a scheduling conflict, so we will ask you to start with your testimony.

STATEMENT OF ROBERT M. TOBIAS, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION, WASHINGTON, DC

Mr. TOBIAS. Thank you very much, Mr. Chairman. I appreciate being invited to testify on the IRS Restructuring and Reform Act.

I recently had the opportunity to serve with two very able members of this committee, Senators Kerrey and Grassley, on the Commission to Restructure the IRS. The commission's report, which I supported, formed the basis for H.R. 2676, which I support and urge the committee to quickly enact.

The commission strongly believed, and I agree, that a key to the IRS's success is the creation of an oversight board. It is necessary to restore credibility, to ensure that the IRS becomes more responsive to taxpayers, to avoid another tax systems modernization disaster, and to provide needed long-range stability.

With respect to the powers of the board, I believe H.R. 2676 strikes an appropriate balance that will allow the IRS Commissioner to manage the agency without undue interference, while ensuring that longer term, broad-based decisions are reviewed, analyzed, and given support.

The makeup of the board has generated some interest because it includes "an individual who is a representative of an organization that represents a substantial number of Internal Revenue employees." I believe it is very important to have the voice of employees on this board.

First, this person can be removed at the will of the President if he or she acts improperly by interfering with the sound manage-

ment or administration of the Internal Revenue Service, as some have inferred or stated might occur.

Second, a representative of NTEU current serves in a similar role on the IRS Executive Committee and has done so for the last 6 years. I have been that person. While there has been some disagreement at times, the IRS believes, I think, that my service on that group has not been a detriment to the accomplishment of agency objectives, but rather an asset.

Third, an employee representative was put on the board because of, not in spite of, his or her role on behalf of IRS employees. Therefore, suggestions of a conflict of interest due to the representative's role with regard to employees, I believe, frankly, has no merit.

Fourth, and finally, it is important to point out that the board has no approval authority concerning senior manager selection, evaluation, or cooperation, as some have seemed to imply.

Unlike the attention generated by the IRS oversight board, the personnel flexibility section will allow the IRS to experiment with hiring, pay, classification, performance, management, and other personnel matters outside the current restrictions.

The bill uses current law on demonstration projects as the model. The demonstration project statute, as Dr. Sanders articulated, requires union and management to reach agreement on a change and then present it to OPM for approval.

H.R. 2676 eliminates the OPM oversight rule to allow for faster implementation, but retains the obligation to reach agreement before implementation.

While NTEU agrees that experimentation outside of the existing laws and regulations is important, I believe there must also be a check on the exercise of that authority. Requiring an agreement prior to implementation provides that check.

Now, some have characterized the written agreement language as providing the employee representative with a veto over agency proposals because it does not provide for appeal to the Federal Service Impasses Panel, which can impose a decision when an impasse is reached. While this approach does mirror the current law with respect to demonstration projects, NTEU would support a change to allow appeals to the Federal Service Impasses Panel.

Mr. Chairman, NTEU strongly believes that enactment of this legislation will allow employees to do the kind of job the American taxpayers expect and the American taxpayers deserve. Thank you very much.

The CHAIRMAN. Thank you, Mr. Tobias.

[The prepared statement of Mr. Tobias appears in the appendix.]

The CHAIRMAN. Mr. Shaw.

STATEMENT OF G. JERRY SHAW, GENERAL COUNSEL, SENIOR EXECUTIVES ASSOCIATION, WASHINGTON, DC

Mr. SHAW. Thank you, Mr. Chairman, for allowing us to testify.

Listening to the prior panel and some of the statements that have been made, one would believe that the IRS is in shambles and cannot collect the taxes. With all due respect, that is baloney.

This is a highly effective agency that has consistently accomplished its mission in the face of a constantly changing law, chang-

ing priorities from Congress, changing political leadership, and a constantly fluctuating budget. The fact that career management have made it work at all is astonishing; they have been bailing the Titanic for a number of years.

Mr. Tobias talks about, and the union always talks about, how the managers are responsible for all the wrongs at IRS, yet Mr. Tobias just stated that he has been on the IRS Executive Committee for a number of years. Obviously, as the union representative on the committee, he has not prevented all of these problems that supposedly his being on the IRS oversight board would prevent.

We believe an oversight board should be advisory, but if it is not, we strongly urge that there be public disclosure of the assets and the business relationships of all of the members of the oversight board, not just to Congress and the administration, but to the public. It is the integrity of the agency and the public's perception of it that is at stake.

We strongly oppose the union being on the oversight board. We think it has a clear conflict of interest. Agency managers are scared to death that the union will bypass agency management and complain to the board all the time, and they will be unable to deal with the union in a labor/management context.

We suggest a subcommittee of the board be established, placing a representative from the union, from the Professional Managers Association, from SEA, and from any other appropriate employee organization, that the oversight board can consult with any time they have questions about the views of employees.

The union is given veto power over personnel reform initiatives in H.R. 2676. The union has conceded now that they would allow the Impasse Panel procedure to be included now in the bill.

However, the problem is not necessarily the Impasse Panel procedure, the problem is the scope of that which the union has authority over, or would have authority to veto. Without their written agreement, as the bill now stands, the Commissioner and the oversight board could implement no personnel reforms that would involve bargaining unit employees. That is unprecedented in labor law history in the United States, in the civil service and in the private sector.

The Commissioner has told us that he has no problem with the 120-day get-acquainted rule provision remaining in effect and that provision that would do away with that should be stricken from H.R. 2676.

As far as Inspection Service, Mr. Chairman, I must confess proudly that I served as a government manager and executive in the IRS from 1970 to 1980, and as its agency ethics officer for a number of years. The internal security function of IRS is an extremely important one, and they were my client when I was in the Chief Counsel's Office.

If you believe it necessary to take the authority over the IRS Inspection Service away from the Commissioner, our suggestion is that you only do that for the internal security function. The allegations have been that Inspection has not conducted investigations when allegations have been made, they have held down complaints, et cetera.

Our suggestion is that the internal security function report not only directly to the Commissioner, but to the General Accounting Office. GAO, by a continuous review of the Inspection Service internal security function, would be able to ensure that citizens and employees of the IRS's complaints are, in fact, being acted on and being investigated.

Second, GAO already has a hotline that employees could utilize to make their complaints. So that would give them the outlet and GAO could have some oversight over the internal security function. We think the internal audit function, on the other hand, must remain under the Commissioner's authority.

On the demonstration project authority, we would like protected the MSPB appeal rights for Federal managers, the current leave rules, and the current retirement system.

On restrictions on terminating or beginning audits, we think that should be expanded to include all political employees in the Executive Branch, and provide that only employees who are in charge of enforcement or administration of the tax laws should be able to recommend initiation or termination of audits.

The proposal to allow a number of executives to be brought in from outside government, we do not object to so long as they are nonpartisan. And when we say nonpartisan, we mean nonpolitical. We are not talking about politics, generally, but party politics.

So long as they are nonpartisan and so long as they are required to meet the same kind of qualifications for the job that any other hire would have to meet we are comfortable with the proposal. With those two caveats, we do not care how many people the Commissioner brings in, remembering that the integrity of the IRS as a nonpartisan agency is absolutely essential.

On the personnel flexibilities, generally, and to talk about the problems that managers have, we have a whole section in our testimony on that. But the fact is, managers are at a decided disadvantage in trying to deal with problem employees. They have been. So long as the structure remains as it is, they will be.

They wind up becoming the defendant themselves in any number of actions before a multiplicity of Federal agencies, and we suggest a consolidation of those agencies we have provided information about that in our written statement.

We believe that to change the culture of the IRS, it is absolutely necessary that there be training on exactly what the expectations are for every single employee in the IRS. You do not change the culture of an agency unless the Commissioner and every employee, manager, and executive knows what the expectations are.

We think that is absolutely necessary and the funds should be included in this bill to ensure this happens. Every IRS employee, every person who comes to work for the IRS, must receive the same orientation and training. That does not exist now. It has never existed, so far as I know. It is something that is badly, badly needed if you are trying to restructure an agency. Thank you.

The CHAIRMAN. Thank you, Mr. Shaw.

[The prepared statement of Mr. Shaw appears in the appendix.]

The CHAIRMAN. Mr. Woolner.

STATEMENT OF RAY WOOLNER, NATIONAL PRESIDENT, PROFESSIONAL MANAGERS ASSOCIATION, WASHINGTON, DC

Mr. WOOLNER. Thank you, Mr. Chairman. Mr. Chairman, we appreciate this opportunity to present our members' concerns and suggestions on IRS restructuring and reform to your committee.

The managers and management officials of the Internal Revenue Service are dedicated to the fair and efficient administration of the tax law, and these dedicated people have spent their working lives in the public service pursuing the goal of fair and efficient tax administration on a daily basis.

PMA members believe that improving the government's operations is at the core of their role as a Federal manager, and it is in that spirit that we offer the following comments concerning IRS reform.

The ultimate standard to which any reform legislation must be held is the best interests of the American people. Whether the bill currently before your committee will best serve the American taxpayer, it seems to us, is still an open question.

PMA supports Charles Rossotti's restructuring plan as outlined before your committee, and we look forward to participating in the process that will ultimately lead to those reforms.

We are concerned, however, that the bill now before the committee has serious structural and procedural flaws that will significantly diminish the effort to improve IRS operations and will hinder Commissioner Rossotti's ability to implement his plan.

Specifically, PMA has serious concerns about the viability of the oversight board concept as set out in the bill. We do not oppose an oversight board. However, this board and its role in the operations of IRS has the potential to seriously negatively affect tax administration. Because of that potential, we believe all steps should be taken in the legislation to limit the opportunity for the board to directly affect ongoing tax administration operations.

The focus of the board should be long-term planning and resource identification or allocation and not the daily operation of the tax administration system. In that regard, PMA does not believe that the oversight board should be granted the authority, under 6103 of the IRS Code, to allow access to taxpayer account information.

Our second concern with the bill, is the placement of the head of the employee union on the board. With all due respect to Mr. Tobias, we believe that that placement is both unnecessary and ill-advised. In addition, it compromises the balance intended by the labor/management relations title of the Civil Service Reform Act and creates serious conflict of interest issues.

The balance of power has been carefully established in statute to allow that labor and management, in the spirit of cooperation and collaboration, work together through their differences and ultimately engage the help of third parties.

Powers granted by this seat on the board, along with powers assigned in other parts of the legislation, would give the representative of this one segment of employees of the agency an inordinate amount of influence over agency operations. Decisions and directions assigned by the board must ultimately be bargained with the union, where any of their concerns can be appropriately aired.

At the same time, the union as a part of the board would oversee the activities, evaluations, and perhaps even selections, of managers and leaders of the agency, including the Commissioner.

These two roles clearly present conflicts and barriers to the operation of labor/management relations under the statute, and to the goal of this legislation, IRS reform.

We strongly endorse the previous testimony of former Commissioners Donald Alexander and Sheldon Cohen, that the union not be given a seat on the oversight board. However, if the role of the board is such that employee views are necessary for it to function, we recommend that a representative of IRS managers also have a seat on the board to ensure the benefit of the widest range of IRS management and employee views.

On another front, Section 9301(b) of the bill gives the union far too much control over the personnel flexibilities through which the Commissioner is charged with reforming the agency. It results in what can only be called a union veto of management's actions, and this section of the legislation should be stricken as well.

PMA would like to offer some specific suggestions on the legislation for your consideration. First, we believe that the labor/management relationship in the IRS should adopt a standard based on good government. The standard should require the parties to pursue solutions on the basis of how they promote customer service, mission accomplishment, quality, productivity, and efficiency.

This standard would put the interests of good government before all others in resolving disputes between the parties, an especially important matter given the flexibilities in the legislation.

Second, we believe that there is a need for an alternative system of pay and benefits for managers, supervisors, and management officials. Under present systems, managers are not provided incentives to think and act in innovative ways about their organization's goals and mission. A human resource system that rewards managers and supervisors and motivates them to reinvent and reform their operations is needed.

Third, we need to reform the system for dealing with poor performers to promote speed of decision making and appeals. We would endorse Mr. Shaw's views in his written testimony to improve the appeals process for quicker and more efficient decisions on cases.

Fourth, we believe that you should grant the IRS authority for voluntary separation incentives in the form of buy-outs in order to help them through the period of transition that Commissioner Rossotti is involved in.

Fifth, we would ask you to allow pay banding to permit managers to properly compensate those employees whose work is deserving, and to withhold pay increases from those whose work is lacking.

Real authority to grant increases or withhold them will significantly change the employer and employee relationship and empower managers to create better performers at the work place by connecting compensation with performance.

Last, the wide grant of authority given to this Commissioner under this legislation to create demonstration projects and develop other personnel flexibilities should be accompanied by a require-

ment to consult with representatives of managers and management officials over how those changes will affect them.

Reformation of the culture of the organization must begin with its managers and its leaders. Participation in decisions about matters affecting the working conditions, personnel practices, and policies for managers should be mandated by this legislation.

Thank you. I would be happy to answer any questions.

The CHAIRMAN. Thank you, Mr. Woolner.

[The prepared statement of Mr. Woolner appears in the appendix.]

The CHAIRMAN. Mr. Tobias, I know you have to leave, but I thought I would give you the opportunity to make any rebuttal you may care to make.

Mr. TOBIAS. Well, Mr. Chairman, I think this is a very important hearing and I am going to stay through the end. I do appreciate the opportunity to make rebuttal, but I am going to stay. So, if you have additional questions, I will be happy to answer.

I think that, as I said in my opening statement and in the full testimony submitted for the record, this issue of conflict of interest, labor/management, really ignores what is happening in the private sector today and what is happening in some parts of the Federal sector.

This idea of labor management conflict is something that is a holdover from the 1930's, 1940's, and 1950's. It is not the way we are trying to have labor and management deal today.

That is, in the context of recognizing overlapping interests and pursuing those overlapping interests of increasing productivity, increasing efficiency, and increasing job satisfaction, and eliminating the conflict, eliminating the adversarialism.

I think that that is really the focus, and ought to be the focus, of attention. It has been the focus of, certainly, my efforts with the Internal Revenue Service over the last few years.

This idea that somehow the union gets a double bite at the apple, or whatever, I think is just not the case because we are not bargaining over budgets in the IRS and NTEU. We do not bargain over budgets. This board has the approval authority only in three areas, and they are not bargainable matters: strategic plans, major reorganization, and budget.

So I do not see this conflict of interest that has been articulated by the other folks. I believe that the voice of employees on this board can add value to the decision making process, and I think that is why the commission supported having an employee representative on the board, and I think that is the value that can be added to the decision making process.

The CHAIRMAN. Mr. Shaw, do you want to make any further comment?

Mr. SHAW. Well, I agree with Mr. Tobias. I have a tremendous amount of respect for him. We have not only started organizations together, but served on boards together. Bob is a very, very astute individual and a highly regarded person in this town.

He is speaking of partnership. Partnership is a very important concept. IRS has been involved in partnership, that is why Bob Tobias has been on the IRS Executive Committee for all these years, and I would assume that he should remain there.

However, partnership requires, in a public sector context, accountability and responsibility. Managers wind up being held accountable for whether the place works or not and have the responsibility for making sure that it works. The union does not.

The union has, through testimony, through individual employees, and through other means, participated in this painting of IRS management as a bunch of "damn devils" that are out there trying to abuse all of the taxpayers, and they are allegedly doing it through these poor puppets that sit out there in the workplace and are driven to do these terrible things to taxpayers, and that is baloney. Bob knows it is baloney, I know it is baloney, and frankly I think the American public knows that a lot of it is baloney.

Tax protesters are a very artful crowd. Employees sometimes have to be stern. Some employees go overboard; they should be dealt with. Some managers go overboard; they should be dealt with.

But to say that partnership means that the union should sit in judgment of this agency and be able to interact and bypass the Commissioner, bypass all the managers in the normal labor/management relationship dealings, be able to have power and authority over the managers with no managers on that board other than the Commissioner, possibly, as a political appointee, is a total distortion of the labor and management relationship and the concept of partnership. Because, the union will be in a position of dictatorship, not partnership. We believe in partnership. We do not believe in dictatorship. In partnership, both parties have to be accountable and responsible.

The CHAIRMAN. Mr. Woolner.

Mr. WOOLNER. Yes. I would just add that the idea of partnership is one that I was involved with personally as the director of Labor Relations in IRS in 1981, and we began cooperative efforts at that time in that agency. It has worked well ever since.

There are times, however, when partnership should find its rightful place. With respect to the oversight board, I think that partnership rightfully belongs in the context of the agency's deliberations, not the oversight board's deliberations.

The CHAIRMAN. All right. Thank you.

I would like to go to a couple of questions I asked the earlier panel about the rights of the taxpayer, as well as the rights of the employee.

Taxpayers, I think, have a right not to be abused by IRS employees. I think we all agree that the majority of employees are good, hardworking, well-meaning individuals, but there are exceptions. How do we address that problem? One of the problems is, do the current rules make it difficult for the IRS to discipline or terminate employees who abuse taxpayers? Mr. Shaw?

Mr. SHAW. The answer, Mr. Chairman, is yes. Now, when I am talking about employees here, I am not talking about bargaining unit employees, I am talking about all levels of employees.

Employees have a tremendous number of rights. Bargaining unit employees have more than other employees throughout the chain of command because they have a collective bargaining agreement and can go to arbitration.

But employees who a manager is trying to hold accountable has many avenues, I listed seven different avenues in my written statement that they can take to try to go after a manager who was trying to hold them accountable.

They can file an EEO complaint, they can file a grievance under their labor contract, they can file an allegation that there is sexual harassment or they are part of a workplace that is not comfortable for them. It just goes on and on.

They can file a whistle-blower complaint or a complaint with the Inspector General anonymously. They can try to get the Office of Special Counsel to come in and conduct an investigation and prosecute the manager. This is why managers do not take actions against employees.

The system is totally out of balance. The system has got to be streamlined. There has got to be one appeal of any action, performance or conduct. There has got to be one decision, and that has got to be the end of it.

Every person should have due process. They have got a right to know what they are supposedly doing wrong, and they must have a right, if it is performance, to correct that. Then they have either got to cut the mustard, or they do not.

If they do not, then they get disciplined, discharged, or retrained, or rehabilitated, or whatever you do. Then if they want to appeal that action to the Merit System Protection Board or to another alternative that we have outlined in our testimony, appeal it, have one hearing, one decision, and that is the end of it.

Right now, you can have four, five, or six agencies beating up on a manager because an employee has made all these allegations, just because the manager is trying to get them to do their job, trying to get them to come to work on time, trying to get them not to abuse sick leave, trying to get them to do day to day stuff. And I am not just talking about bargaining unit employees, I am talking about all Federal employees at whatever level.

The CHAIRMAN. Mr. Woolner.

Mr. WOOLNER. Yes. I generally agree with Jerry's comments. It has been my experience, however, that managers have a different experience with causing disciplinary actions to take place when it comes to conduct matters versus performance matters. Performance matters are a very, very heavy burden on managers. They, in fact, distract managers from involving themselves in the performance of the remainder of their employees once they are taken on.

With conduct matters, I have seen and have been a part of the process there and I know that conduct matters come quickly to fruition in terms of disciplinary actions in most cases. It is when a manager anticipates the kind of appellate hell, if you will, that Jerry was just talking about that the manager steps back and wonders about whether or not to take the action.

With respect to performance-based actions where someone is just not doing the job, I think that what we need in that process is a reformation of that process to shorten its time frames, to make more agile its appellate process so that it does not take forever, and that managers do not have to basically set aside their responsibilities for the remainder of their work force that they are trying to manage in order to take care of this one case.

The CHAIRMAN. Mr. Tobias.

Mr. TOBIAS. Mr. Chairman, I think that the prior panelists answered the question by saying that employer-initiated actions in the Federal Government are, for the large part, sustained. The last time I looked, I think it was about 82 or 83 percent of those actions are sustained. That is the first thing.

The second thing is, you asked, what about employees who abused taxpayers, do the rules in existence prohibit action. I think Mr. Woolner is right on track; that is a conduct case in the Internal Revenue Service.

We are not talking about performance here, it is a conduct case. When that happens, the IRS moves very quickly. For bargaining unit employees, there is arbitration. There are not these multiple levels of appeals that Mr. Shaw was talking about here.

If somebody is discharged for conduct, that is it. It goes to arbitration, the arbitrator makes a decision, it is up or down, it is over. So when we are talking about conduct cases and we are talking about abuse of taxpayers, the rules are very clear.

I might add that when we see these cycles of abuse of taxpayers, they have come three different times in the IRS in my history, and I have been with the union since 1968. They have all come, predictably, two, three, four years after the Internal Revenue Service has changed the way it measured employees and managers.

When those measures turn out to be dollars collected, cases closed, obviously, that leads to abuse of taxpayers. I think that is what the internal security audit that has already been furnished to this committee has found once again for the third time in the history of the IRS.

So I think if we are looking for the root cause of this issue, I think we have to look at how the agency views its mission, how the agency measures that mission, and if the mission is correct and the measures are correct, there will not be abuse of taxpayers, there will be taxpayers who are supportive of the IRS.

The CHAIRMAN. Well, as you know, we have been very concerned about the use of statistics data as a means of judging performance.

Mr. TOBIAS. You have. You have and, I think, quite rightly so.

The CHAIRMAN. Let me ask one more question, then we will turn to Senator Kerrey. Time is growing late.

I would like to go back to the question that IRS employees also have a right not to be abused or retaliated against by other IRS employees, or by management, for that matter. As I mentioned, we had a number of employees come forward with concerns and problems, but very much concerned with the question of retaliation. What can we do about that; how much of a problem is this?

Mr. Shaw.

Mr. SHAW. Well, it is a problem. I think it is a problem in any agency. It is also a problem by the organization that receives the allegation determining whether or not it has validity. But the suggestion I made about putting the internal security function of the IRS under a supervisory mode of the General Accounting Office, I think, would solve that problem.

One, employees should be told that if they have problems or they think there is something going wrong, they should contact the GAO. GAO has a hot-line now. It is an arm of Congress. As an arm

of Congress, the committee is going to be able to consult with GAO to make sure that investigations are ongoing and things are being done.

GAO would be able to ensure that the inspection service was, in fact, conducting the investigations that they should conduct and could call them to task so that nothing could get buried.

Three, GAO would know who, in fact, had made the allegation or would be able to determine. If they did that, then if an employee had a legitimate complaint they could tell GAO about it and GAO could intervene through any number of ways, and the committee could, too. So I think that is one way to do it.

I think GAO is a better alternative than a Treasury IG, again, for the simple reason that Congress will have some oversight.

The CHAIRMAN. Does that raise a constitutional question?

Mr. SHAW. I do not believe so, if GAO's role is to ensure that all the allegations that are made are, in fact, investigated—I think that is an extension of the oversight role of Congress—and that people are held accountable. Their report, obviously, is going to be to the committee rather than to the Treasury. And I am not saying that internal security should not also be reporting to the Commissioner, it should, but directly to the Commissioner.

In recent years, the internal security function and the Inspection Service has been reporting to the Commissioner through the Deputy Commissioner, and the Deputy Commissioner is a career employee that is where some of the allegations have come from, that the Deputy Commissioner somehow has not allowed cases to be pursued against buddies, and that kind of stuff. Again, I do not think there is any substance to that, but that is the allegation.

When originally set up, Inspection reported strictly to the Commissioner, not to the Deputy Commissioner, not through any other chain, and that should be reinstituted in the statute. They also should be reporting to GAO and GAO should be providing them allegations that they receive, and overseeing them to make sure they are investigated.

The CHAIRMAN. Well, my concern about the GAO is, of course, they can investigate but they cannot direct.

Mr. SHAW. I understand. What they are going to do is monitor, in my suggestion.

The CHAIRMAN. Yes.

Mr. SHAW. Again, I do not think they should have direct-line authority over them. I think that should remain the Commissioner.

The CHAIRMAN. But it would raise, I think, a constitutional issue.

Mr. SHAW. Right. They could monitor that. They could refer the allegations made by IRS employees to the Inspection Service and require that the Inspection Service give them reports on whether they are following up and doing investigations, et cetera, and providing that information to the committee.

The CHAIRMAN. Mr. Woolner.

Mr. WOOLNER. Mr. Chairman, I spent some time as the Ethics Program Manager for the Internal Revenue Service, and in that regard we studied the feelings and perceptions of employees with regard to retaliation.

What we found, was there were those persons who perceived that they would be retaliated against if they were to come forward on

some matter, but we found almost no one who was willing to report situations in which retaliation had occurred. Now, that report is on people's perceptions, and it seems to me that the facts of whether there are or are not retaliation almost become secondary to the perception issue. If there is that perception, then we do not have a system that is working openly. That, to me, is a matter of the culture of the organization.

I think that the kind of tone that is being set by the new Commissioner is one in which the doors are opening, there is more open communication coming down, and it is tending to be two-way, which is very important as well. In that regard, over time you will see, I believe, if that track continues, that people will not feel as hesitant to come forward as they have in the past.

The CHAIRMAN. Mr. Tobias.

Mr. TOBIAS. I would say two things. I agree with Mr. Woolner about the idea of the openness that Commissioner Rossotti has created in this agency. For example, two or three weeks ago we did anonymous focus groups of over 2,000 people with a video conference where these folks reported on the barriers that they saw between themselves and providing effective customer service. It was an incredible list of barriers and solutions.

I have traveled extensively since that time, but every person that I have spoken to has said this is a new way I am being heard, my complaints are being heard, my solutions are being considered in a way that has never happened before. So I think that the way the Commissioner is engaging the work force is one way of driving away this fear of retaliation.

But, second, and fundamentally and systemically, I think the change that has been recommended, that the IRS change its measurement system to one which includes employee evaluation, customer service evaluation, and business measures, will, indeed, create a more open IRS because those who are managing will have to be paying attention to those they are supervising on an annual basis in the context of their own evaluation. That is a systemic solution to a very difficult, real, perception problem. So I think that really gets at the nub of what has been an IRS problem for a long time.

The CHAIRMAN. Senator Kerrey.

Senator KERREY. Thank you very much, Mr. Chairman.

I would ask Mr. Shaw and Mr. Woolner, do you consider the Treasury Secretary and the Commissioner of the IRS to be part of the management team; are they managers?

Mr. SHAW. Yes, sir.

Senator KERREY. And they are included on the proposed board, at least as it came out of the House. Now, the House expanded the number of people on the board from the original legislation, but they certainly are two very strong voices for management on that board, are they not?

Mr. SHAW. They are the ultimate managers, Senator. But they do not deal with the union on a day to day basis. They do not conduct the negotiations with the union, they do not deal with labor/management problems at the local district level, or whatever level. That is the role of the career managers and career executives. They

do not have the types of information that is going on on a day to day basis.

Senator KERREY. There are lots of things they do not have, lots of things they do not understand, but they are clearly management representatives on the board.

Mr. SHAW. Yes.

Senator KERREY. I mean, there are lots of things that they may not be, but it is not fair, as one of you indicated, that the Commissioner is just a political appointee. They manage the agency. At least, that is what they represented to us when they came before the commission. Are you aware that both of them support having a labor representative on this board?

Mr. WOOLNER. I am aware of that, Senator.

Mr. SHAW. I am not aware of that.

Senator KERREY. Well, I have informed you that they are both in support.

Mr. SHAW. Well, I am sorry, Senator, but that is not my information. I mean, politically, the administration is backing that. That is not necessarily the views of all interested parties.

Senator KERREY. You are saying that they came before Congress and testified they are for it, but privately they——

Mr. SHAW. I am not saying anything, Senator, other than that I am not aware of that being the case.

Senator KERREY. It is the case. They have both, before this committee, indicated that they support that change and support having a labor representative on the board.

But what I am saying to you is, the commission judgment was, because of the restructuring that is going to be required, that a representative ought to be on there and that management needs to be represented as well, and that they were well represented with the Treasury Secretary and the Commissioner.

Mr. SHAW. Senator, I do not think that either the Secretary of the Treasury, nor the Commissioner, has the time nor the inclination to know about and deal with the local labor/management problems at an IRS district or an IRS service center, or whatever. Mr. Tobias does. He has a tremendous network of people out there that are going to be feeding him information, and to which he can feed information.

It is going to place the career management at such a disadvantage that, in effect, you are turning over the agency to the union. If that is your policy decision to do that, Senator, then that is one set of circumstances. If it is not——

Senator KERREY. One vote of 11, sir. Earlier you set up a comparison. You are for partnership, but you are against dictatorship. One vote in 11, sir, is not a dictator.

Mr. SHAW. Well, I beg to differ, Senator, when also included in H.R. 2676 and in the recommendations is absolute veto power granted to the union over any changes that the Commissioner or the oversight makes that would affect bargaining unit employees.

Senator KERREY. Well, let us deal with that on a separate issue. I was going to raise that up as a separate issue. But as far as representation on the board, your objection to the union representative being on the board is that management is not being represented. Management is represented.

Mr. SHAW. Senator, not the kind of management that has to deal with the union on a day to day basis. I am sorry, but that is not a factual statement. The career managers of that agency have to make that agency work. They have 100,000 employees working for them.

When they can be bypassed by a union president sitting on a board complaining about them, and even though Bob Tobias has sat on this executive board, he has not taken any responsibility or accountability for the IRS problems. They are all managers' problems. The union has no accountability, they have no responsibility.

The only thing that they are accountable for or responsible for are to the people that elect them, which are their bargaining unit employees. This gives them too much power. Managers and executives in government will be unable to deal with them. That is a fact, sir.

Senator KERREY. It is not a fact. You are drawing what I would call a draconian, hyperventilated conclusion about the possibilities that could occur as a result of labor being represented on this board, a position that is not shared by the two top managers that I suspect would disagree when you say that they have neither the time nor the inclination to be aware of what is going on down in the lower ranks.

You are saying they do not have the time to be informed and they do not have the inclination. My guess is that Mr. Rossotti would strongly disagree with that. My guess is that Mr. Rossotti, as Commissioner of the IRS, would not agree with the assertion that you just made on his behalf.

Mr. SHAW. Senator, we can all guess at what Mr. Rossotti might or might not do, or say. But I can tell you that the career executives at the Internal Revenue Service unanimously are absolutely opposed to the union being on that board. They know that they will be totally unable to manage. They know that they will be bypassed. They know that they will be in a position subordinate to the union and the union will run the agency. I speak not for myself, sir, I speak for them. I have met, talked with, and surveyed many of them.

Senator KERREY. I appreciate your speaking for them, sir. But you are arguing on the basis of them, with one vote out of 11, having dictatorship power, and then you reference another section which I think is an important section.

As far as being on the board, the two top managers support them being on the board. The two top managers that you say do not have the time or the inclination to be involved with labor/management disputes support them being on the board.

My guess is that Mr. Rossotti would say that he does have both the time and the inclination to understand what is going on in those negotiations. As to the second part, I would like Mr. Tobias to have a chance to respond.

Mr. SHAW. All right. I would like to make one other suggestion. If you believe it is absolutely imperative that this union representative be on the board, then there has to be a representative of the career managers and executives on that board.

Senator KERREY. Sir, there is a representative.

Mr. SHAW. There is not. Not of the career managers and executives. The Commissioner cannot deal with 100,000 employees day to day. He relies on the management structure to do that.

Senator KERREY. That is going to come as a rude shock to Mr. Rossotti, who is the top manager of the IRS. My guess is, he is going to say that he can represent management and that the Treasury Secretary can as well. I mean, that is my own view. Now, if you want to argue that you ought to have a representative on there, argue that you ought to have a representative on there, a representative from your association on there.

Mr. SHAW. I think that with the union on the board and career managers being on there would make it difficult for a policy board to function. But, if the union is going to be on the board, there is going to have to be a voice of the managers and executives at IRS that are career.

Senator KERREY. Well, let me ask Mr. Tobias to respond to the statements that Mr. Shaw made, that you would become a dictator, that this legislation vests you with the authority to essentially run the IRS and be a dictator of the IRS.

Mr. TOBIAS. I think to merely state the supposition is to come to the conclusion that that is absolutely impossible unto this legislation. One vote out of 11 does not a dictator make.

As to this issue of having more information, I have no idea what that means in the context of the board's responsibility to be approving strategic plans and major reorganizations and participating in the development of the budget. These are not the subjects which are discussed in any manner, under any circumstances, in any labor/management relationship in the Internal Revenue Service.

Senator KERREY. There are two issues here. One is the board and your representation on the board, and we have addressed that. The second, is the representation having to do with personnel flexibilities and veto power over the use of personnel flexibilities and the organizational units they represent.

Mr. TOBIAS. The language which is in the House bill reflects the existing law on demonstration projects. In my testimony, I have said that we would be perfectly willing to send any impasse to the Federal Service Impasses Panel, if that be the wish of Congress.

We are not interested in having veto power. The language was drafted to reflect existing law for demonstration projects. If Congress believes so, we would support these decisions go to the FSIP, the panel in the Federal sector currently empowered to decide and resolve impasses.

Senator KERREY. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Gentlemen, thank you for being here today.

Again, we will keep the hearing record open for a sufficient amount of time to allow the committee to request and obtain written responses to questions from our witnesses.

Thank you very much for being here today, gentlemen. The committee is in recess.

[Whereupon, at 11:58 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF DONALD C. ALEXANDER

I. INTRODUCTION

My name is Donald C. Alexander and I served as Commissioner of Internal Revenue from 1973 into 1977. I am appearing before the Committee to express my personal views on the recommendations, embodied in S. 1096, of the National Commission on Restructuring the IRS. While I support much of S. 1096, I cannot support some proposals in their current form. I will also comment on certain changes made by the Ways and Means Committee in the House-passed counterpart, H.R. 2676.

That there is widespread dissatisfaction with the Internal Revenue Service at the present time is beyond dispute.[1] Some of this undoubtedly stems from the highly publicized troubles of the Service in its Tax Systems Modernization project. Some stems from frustration with a perceived inability of the Service to deliver prompt, responsive and accurate service to taxpayers. Some stems from highly publicized instances of taxpayer abuse.[2] Taxpayers should be treated fairly and courteously, and some of them have clearly not received such treatment. Some IRS revenue officers and agents seem to believe that all taxpayers are dishonest and some of their supervisors seem to share this belief. But while it is wrong to believe that all taxpayers are dishonest, it is equally wrong, I think, to pretend that all of them are always honest

Part of the widespread dissatisfaction, I believe, stems from a pervasive antigovernment attitude nurtured by political rhetoric. Because of its wide-ranging contacts with voters and its duty to try to collect the nation's revenues, IRS is in the forefront. In his recently-released instructions for candidates, Mr. Frank Luntz stated:

> Don't forget the IRS. Nothing guarantees more applause and more support than the call to abolish the Internal Revenue Service. . . . The IRS should be a major focus of Republican efforts over the next two years. I urge you in the strongest of terms to allocate significant time and attention to this political "winner."

Unfortunately, some have apparently followed Mr. Luntz' advice.[3]

In considering what legislative and administrative changes should be made to and in the IRS, a basic question is: "What is the job of the Internal Revenue Service?" In section 2 of S. 1096, we are told that IRS should be transformed into a "world class service organization." We are also told that the bulk of Federal revenue is generated through voluntary compliance. This is true, and most drivers stop at red lights and, occasionally, at stop signs. But how long would you expect compliance with the traffic laws to last if no traffic police enforced such laws? Are the tax laws so different (is money worth less than time?) that voluntary compliance at the present level would continue if there were no meaningful enforcement of the tax laws?

I think the job of the Internal Revenue Service is to try to collect the proper amount of revenue due under the Internal Revenue Code. While this job necessarily includes assisting taxpayers to understand and meet their responsibilities and to assert their rights, should taxpayer service be the primary function of the Internal Revenue Service? I continue to differ with those who push the so-called "Compliance 2000" strategy that is apparently based on the notion, unrealistic to me, that substantially all taxpayers will comply if the Internal Revenue Service is warm and fuzzy and educates them about their rights. Moreover, I question whether "taxpayer satisfaction" must be IRS' sole goal, for I don't believe that the Internal Revenue Service has an obligation to satisfy such taxpayers as Leona Helmsley.

Having expressed these antediluvian views, I support many of the proposals to reconstruct the Internal Revenue Service as embodied in S. 1096 and H.R. 2676.

II. SPECIFIC PROVISIONS IN S. 1096 AND H.R. 2676

Section 102 of S. 1096 provides a five-year term for the Commissioner of Internal Revenue. This is a sound proposal. While the Commissioner could still be removed within such period, the Commissioner's tenure would not be nearly so precarious as it was in my Watergate time. Continuity in office is important for long-range planning and administrative effectiveness. If this proposal is enacted, future Commissioners should commit themselves to serving the full statutory term. I also favor the proposal to revise the IRS Chief Counsel's position and job title. The Chief Counsel should not be an Assistant General Counsel of the Treasury Department, and I regret that the House Bill no longer contains this provision.

Also in section 102 is a wise provision to grant additional funding for IRS Employee Plans and Exempt Organizations office. The workload of this office has doubled since enactment of ERISA when I was Commissioner. Unfortunately, the funds available for the conduct of this office's vitally significant duties in overseeing retirement plans and exempt organizations are now less than half what they should be. I think it unfortunate that the House Bill would delete the authorization of increased appropriations from the Code. Apparently, the pension trade associations became concerned about possible costs to their members. It seems to me that to the extent such fears are right, they can be met without such a drastic step.

Easing the present restrictive personnel rules is a highly meritorious idea, and I am glad to see that this issue is addressed in Section 111. Unfortunately, in both S. 1096 and the House Bill, much of the proposed flexibility cannot be implemented without the Union's consent. This should be reconsidered. Also, Title II promotes electronic filing. Since electronic filing is in the interest of both taxpayers and the Internal Revenue Service, encouraging such filing by legislation is a sound concept. I hope, however, that this objective can be attained without imposing unrealistic mandates on the Internal Revenue Service and taxpayers.

Moreover, section 203 of S. 1096 requires IRS to develop procedures for the acceptance of signatures in digital or other electronic form and states that until such procedures are in place IRS must accept electronically filed returns and other documents on which the required signature appears in typewritten form. The filer is required to retain a signed paper original of all such filings until the statute of limitations expires. What if the filer loses the signed paper original? The Ways and Means Committee Bill as reported takes a somewhat different approach, permitting IRS to waive the requirement of a signature. Both of these approaches to a desirable goal—electronic filing—may create substantial administrative problems. Code section 7206(1) states that a taxpayer who "willfully makes and subscribes" a false return is guilty of a felony. Does the taxpayer "subscribe" a paperless return without a written signature? The House Bill attempts to remedy the problem by stating that a return "filed without signature" shall be treated for all purposes, civil and criminal, "in the same manner as though signed and subscribed" and establishing a presumption tracing the return to the taxpayer. I am not sure that this solution will work, and I think that further study is needed.

The proposals in Subtitle C, Title IV, of S. 1096 dealing with tax law complexity and the role of the Internal Revenue Service in the tax legislative process are long overdue. Most, but not all, survived the Ways and Means mark-up of the House Bill. The Senate Bill's provisions are preferable. If these or similar measures were already in effect, perhaps both the taxpaying public and the Internal Revenue Service might have escaped the monstrous obligations imposed upon them by the "Taxpayer Relief Act of 1997." The IRS is regularly blamed for complexities, ambiguities and just plain mistakes enacted by Congress and signed into law by the President. How could any private "world class service organization" cope with an ever-changing mess like this?

And I don't fully subscribe to the argument that the Administration and Treasury must speak with one voice (Treasury's); this argument muzzles the IRS until after the mistakes are made. There is some substance, however, to the "one voice" argument, and if it continues to prevail, at least Joint Committee on Taxation staff could be directed to work with IRS to develop mock tax returns so that the tax-writing committees would see, in advance, what they propose to do to the American public.

Subtitle B's proposals with respect to the IRS budget are highly constructive. IRS badly needs funding in excess of the discretionary caps, and IRS also needs funding stability. Multiyear budgets are highly desirable, if not essential, for long-range planning. Unfortunately, these provisions were very severely curtailed in the Ways and Means Bill.

Similarly, the proposals in Subtitle A of Title IV expanding the powers of Joint Committee on Taxation are useful, and the effort to centralize and coordinate oversight responsibilities (although perhaps unrealistic) is sound.

While many of the recommendations in Title III to strengthen taxpayer protection and rights are reasonable, I have some specific concerns. For example, section 302, expanding the authority to award costs and fees, defines prevailing party (p. 72), literally so as to render the IRS' position "not substantially justified" unless IRS had prevailed on the same issue in at least three Courts of Appeal. I think the intent is to reward the taxpayer and punish the IRS if the IRS (actually the Justice Department) continues to force trial of an issue after it has lost in at least three Courts of Appeal. This correction has been made in the Ways and Means Bill.

Section 303 would grant taxpayers the right to sue IRS if a collection officer acted negligently. The Code now permits such suits only if the collection officer's action is reckless or intentional. I think the extension to mere negligence is an invitation to further litigation and I hope this provision will be reconsidered.

III. WAYS AND MEANS COMMITTEE BILL—ORNAMENTS ON THE TREE

One of the ornaments that crept into the House bill (action 341) is an extension of the privilege of confidentiality in certain non-criminal cases to certified public accountants and enrolled agents. As I see it, this has little to do with restructuring the Internal Revenue Service but much to do with impeding the search for truth in tax controversies. This issue deserves independent review by the Congress, perhaps with the assistance of the General Accounting Office, to test its advantages and disadvantages. Should the confidentiality privilege be extended to 32,000 enrolled agents who can hardly contend, as the CPAs do, that they are a "learned profession?"

Another ornament (section 344) in the House bill would strictly limit IRS' authority to require production of computer source codes. Does the ordinary taxpayer really need such protection? A further provision (section 349) would prevent IRS from threatening an audit "in an attempt to coerce" a restaurant into entering into a tip agreement. The likely effect of this, as I see it, would be (a) to increase IRS' audits of restaurants if any effort is made to secure something more than the minimal compliance we now have with the reporting of tips or (b) to lessen compliance in an area where it is already unacceptably low. A further provision (action 343) added in the Ways and Means Committee bill would purportedly limit so-called financial status audits. I strongly believe that IRS should have the authority to probe for unreported income in situations where the taxpayer's lavish living style demonstrates the likelihood of noncompliance, but perhaps the House bill's limitation may not substantially impede the fulfillment of IRS' obligation to see to it that dishonest taxpayers (or non-taxpayers), particularly those with illegal income, are called to account.

S. 1096 calls for a study of whether the burden of proof in taxpayer-IRS controversies should be changed. Unwisely in my judgment, the Ways and Means Bill would put the burden of proof on factual issues in court proceedings on the Internal Revenue Service (section 301). Whether this would actually abrogate the long-standing judicial rule that agency action is presumptively correct may be an open question. As limited by the Ways and Means Committee explanation, this change might not severely damage tax administration and, consequently, might not materially aid taxpayers whom it is apparently intended to benefit. All individuals, including billionaires, would be beneficiaries of the new rule, but partnerships, corporations, and trusts would be subject to a limitation of less than about $7 million in net assets. A wholesale shift in burden of proof would devastate tax administration for taxpayers would be encouraged to play hide-the-ball and, without extremely expensive and intrusive efforts, the Internal Revenue Service could not determine the facts. While this shift appears to be much more restrictive, the legislative language of the House Bill is troublesome and would produce further controversy (perhaps a preliminary trial) about whether the taxpayer complied with the conditions precedent to the shift in burden. Under the House Bill, the taxpayer must have "fully cooperated" with the Internal Revenue Service, including satisfying the reasonable requests of the Service as to witnesses, information and documents "within the control of the taxpayer." What does "within the control" mean? Is a third-party witness within the taxpayer's control? What if the taxpayer loses records, inadvertently or deliberately? What are "reasonable" requests? If "full cooperation" actually includes "exhaust administrative remedies," why not say so? Cf. Code Section 7430(b).

Moreover, the House provision contains a questionable reservation that it shall not be construed "to override any requirement of this title to substantiate any item." The basic requirement in Code section 6001 for the keeping of books and records

is not a substantiation provision like that in section 274(d). Despite Committee Report language, is there a negative inference that section 6001 is overridden?

In response to the Committee's request, the Chief Judge of the Court has substantiated a thoughtful letter about the House's proposed change in the burden of proof. I strongly recommend reconsideration of this provision.

IV. IRS GOVERNANCE

Title I, Subtitle A of S. 1096 proposes a basic change in governance of the Internal Revenue Service. It would create a nine-member Oversight Board that would apparently share responsibility with the Treasury for the "administration, management, conduct, direction and supervision of the execution and application of the Internal Revenue laws or related statutes and tax conventions to which the United States is a party." Exceptions to this general grant of authority are (i) the making of tax policy, (ii) "specific law enforcement activities" of the IRS, and (iii) certain other specific activities under procurement and other delegation orders. While the Board would include a union representative (presumably Mr. Tobias), and the Secretary of the Treasury (or Deputy Secretary), the Commissioner would not be a member. The other seven members would be part-time government employees appointed on the basis of experience and expertise in management of large service organizations, customer service, compliance, information technology, organization development, and the needs and concerns of taxpayers. The Board would have the authority to select and remove the Commissioner. The Internal Revenue Service would remain a component of the Treasury Department.

I think that such a Board, with the composition and the authority assigned to it by the present wording of S. 1096, could and likely would create serious operational and other problems for the Internal Revenue Service. The first problem is the presence of the head of the union on a Board having the right to select and remove the Commissioner. As I have said before, I think the union head has no business whatever being on such a Board. Second, I think the Commissioner should be a member of the Board. Third, I don't think the Board should have the right to select and remove the Commissioner. The Commissioner should be appointed by the President for a five-year term and the President should retain the right to remove the Commissioner for cause. The President's power to remove the Board is, in my judgment, insufficient.

If the changes suggested above should be made, I would be much less troubled by the Board. However, problems will still remain so long as the Internal Revenue Service stays a component of Treasury. One of these is to whom the Commissioner would actually report and to whom he or she would be accountable. Would it be the Secretary of the Treasury, or would it be the Board, or would it be both? What if there should be a flat disagreement between the Secretary and the Board on a major matter?

The authority given to the Board, even with the limitations on such authority, would present the perception, and possibly the reality, of conflicts of interest. While Board members would be forbidden from participating in "specific law enforcement activities," they would have major duties with respect to IRS' plans, programs and budget. These projects involve the assignment of IRS enforcement personnel and the allocation of such personnel among IRS' service and enforcement responsibilities, not excluding the coordinated examination program through which the IRS regularly audits the largest corporations in America. What if the Board should decide that IRS' primary role is indeed that described in the Commission's findings and it is devoting far too much of its resources to enforcement such as examining the tax returns of large corporations? Would a skeptical public, much less the press, believe that a budget decision to beef up taxpayer service and weaken compliance activities directed at large corporations (including those that had employed or were currently employing Board members) was done entirely for proper reasons?

Furthermore, the efforts evident in S. 1096 to prevent Board members from interfering in specific administrative and enforcement actions are insufficient. Since Watergate, a time when the Internal Revenue Service was sorely tested and came through well, I think there have been extremely few, if any, instances of improper interference with specific taxpayer audits or collection actions.[4] However, there have been a number of efforts, some successful, to cause IRS to reverse itself and concede, through a ruling, an industry-wide action or otherwise, an interpretative position which IRS was taking in the examination of a particular group of taxpayers or a particular industry. This is where the problem exists. What if a Commissioner having the duty to decide a material issue affecting the tax treatment of a particular industry, as well as a personnel question on which the union is taking a strong stand, should face a Board with removal authority among whose dominant members

are an executive from the particular industry and the union executive? What if the Commissioner should decide, solely on a sound analysis of close questions, to concede both the industry issue and the union issue? Would the public (and the press) believe that there had been no improper influence by the Board? It goes without saying that I strongly oppose granting Board members authority to pay into individual cases.

Therefore, while I think that there is genuine merit in having an outside Board with responsibilities and duties much greater than those of the advisory groups now providing outside assistance to IRS, I have serious questions about the Board as proposed in S. 1096 with the right to appoint and remove the Commissioner. If the Board were reconstituted and its powers limited as suggested above and if the IRS were an independent agency, a Board would be not only helpful but necessary to guide IRS during this difficult period and to deflect unjustified criticism.

H.R. 2676's counterpart provisions reflect material changes. First, the number of Board members would be increased to 11, but the Commissioner would be a member of the Board. Second, the Board would not have the authority to appoint and remove the Commissioner but would instead have the responsibility to recommend candidates for appointment as Commissioner and, more significant, recommend the removal of the Commissioner. The Board would retain the authority to submit its own IRS budget to the Congress. While the changes made in the House Bill reduce to some extent the problems of overlapping authority, I believe that so long as the Internal Revenue Service remains a part of Treasury, the concept of an oversight board is problematic.

A final point: Under S. 1096 almost all of us who have had the privilege of serving as Commissioner of Internal Revenue for the last 45 years would be ineligible for appointment. Section 102 now provides: "[T]he appointment [of the Commissioner] shall be made on the basis of demonstrated ability in management and without regard to political affiliation or activity." I like the latter requirement; politics should be irrelevant. But neither I, nor my successors (except the current Commissioner) and living predecessors, could show the required "demonstrated ability in management." My managerial experience, prior to IRS service, consisted of co-managing a Cincinnati law firm and managing more than 200 men in World War II. Maybe we have all done lousy jobs since the Internal Revenue Service was removed from politics, but I don't think that a tax professional should be forever barred from serving as Commissioner. This problem was corrected in the Ways and Means Bill.

ENDNOTES

[1]: Some of the most vocal critics stress that IRS does not measure up to the best of the private service sector. This is true, but is it the right comparison? When compared to any other tax administration system, IRS measures up very well indeed. It is ironic that at the very time that IRS is being bashed by Congress, the Ford Foundation, Harvard School of Government and the Council on Excellence in Government gave it the Innovation in American Government Award for its TeleFile program.

[2]: In contrast to the impression given at the recent Senate Finance Committee hearings that abusive behavior might be the IRS norm, the Restructuring Commission's Report (p. 43) stated: "The agency spends significant resources educating personnel to treat taxpayers fairly, and the Commission found very few examples of IRS personnel abusing power."

[3]: On June 4, 1997, I received a fund-raising letter that stated the following:

"Armed with your responses and demands, GOP Senate Leaders can call for TELEVISED SENATE HEARINGS ON THE IRS!

Working together, we can publicly expose the IRS's worst transgressions against honest, responsible taxpayers like you."

[4]: H.R. 2676 contains a provision explicitly forbidding the President, Vice-President and certain other high-level executives to request the conduct or termination of an audit or other investigation of a particular taxpayer. If any such provision is adopted, why not extend the prohibition to Members of Congress?

RESPONSES TO QUESTIONS FROM SENATOR ROTH

STRENGTHENING OVERSIGHT

Question 1. Should the Inspections Division be more independent? Should the IRS Inspections Division be transferred to the Treasury IG?

Answer. I think that Inspection should be left within IRS. The internal Security component of Inspection has an essential police function, protecting IRS men and women and assuring the integrity of IRS. It has served both IRS and taxpayers well

in the past, in my judgment, and I think moving it to Treasury would disrupt it and lessen its effectiveness. Internal Audit, the other Inspection function, has a different mission: to examine various IRS operations and to determine whether activities have been carried out correctly, fairly and efficiently. It reports to the Commissioner, and I found it an essential tool for managing IRS. I believe that subsequent Commissioners have had the same experience. Particularly if Congress agrees that Commissioner Rossotti is on the right track, he should not be deprived of this essential element in his management of IRS.

Moreover, recent problems with Treasury's Inspector General have been widely publicized. Until Treasury demonstrates that its inspection function is operating (a) efficiently and (b) nonpolitically, I think it unwise to give Treasury additional inspection authority.

Question 2. One of the most important lessons learned from the Committee's oversight hearings last September is the need for greater oversight of the IRS. The Congress needs to do more oversight—which we intend to do. But also there must be more oversight on the IRS in the Executive Branch. There are, at least, two ways we can improve that oversight. The first is to vest significant oversight responsibility with the Oversight Board that is created in the House-passed bill. The second way is to substantially increase the power of the Treasury Inspector General. What are your views on both of these ideas?

Answer. For the reasons stated above, I would not give the Treasury Inspector General any additional authority over IRS. Nor would I give such authority to other Treasury minions. The Secretary of the Treasury should be the person to whom the Commissioner reports, and the Secretary should give IRS, by far the largest component of Treasury, more of his time and his judgment.

I think the Oversight Board has been given sufficient, if not more than sufficient. authority under H.R. 2676.

Question 3. Is the Oversight Board created in the House bill an executive board, or merely advisory? Does the Board have legal authority to direct actions taken by the Commissioner?

Answer. I believe that the Oversight Board is an executive board. It shares authority with the Secretary of the Treasury, and, as I indicated in my written statement for the Hearing, I think this divided authority can and likely will create problems.

Question 4. If the Oversight Board is created and Commissioner Rossotti is able to turn the agency around, should the Board be sunsetted?

Answer. So long as IRS is not perceived as "turning around" sufficiently (and this may last as long as demonizing IRS is popular) I doubt that IRS will ever turn around sufficiently to make certain of its critics happy. Therefore, I doubt that the Board will be sunsetted. On the other hand, I hope that Congress will sunset the Board in a few years.

Question 5. Our hearings have also indicated a need for the Committee to consider protection for the taxpayer in a number of very specific areas.

> *(a).* What are your thoughts on changes the committee ought to consider in the penalty and interest area?

Answer. I think that the Committee should study and revise our overlapping penalty structure. For many years penalties were inadequate; now there are too many of them and they are too heavy. Some of them have been enacted for revenue-raising reasons, and penalties should not be viewed as revenue-raisers. If our system worked perfectly, no penalty would be assessed. The penalty area is long overdue for basic reconsideration and reform. I will be glad to submit specific recommendations if this would be helpful.

> *(b).* The Committee's oversight hearings showed considerable problems with the IRS's exercise of its lien, levy, and seizure authority. This has to be fixed. I'm concerned about taxpayers who do not receive real notice and wake up in the morning only to find that the IRS has taken their bank account business or other assets. Should the taxpayer have a right to a judicial hearing before seizure?

Answer. Taxpayers certainly should receive notice before IRS exercises its lien, levy or seizure authority. In my experience they always have received such notice. To the extent that there are cases where breakdowns have occurred, the system should be fixed. However, I would recommend that you limit the right to a judicial hearing before seizure to a seizure of the taxpayer's residence.

> *(c).* The current Offer in Compromise program doesn't seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they get out they are socked with horrendous interest and penalties. Is this program broken? How would you improve it?

Answer. IRS has a current project to reconsider and improve its offer in compromise program. I agree that overly tight standards, frequently imposed in the past, have lead to failures. IRS should adopt more liberal standards, uniform except for cost of living variations in different sections of the country, which would make the offer in compromise program and Installment Agreements work better for taxpayers and for the IRS.

(d). The IRS has the power to label a taxpayer as an "illegal tax protester." Such a label is important for the IRS in its efforts to protect its agents. But such a label also brings serious consequences for the labeled taxpayer. It is important to protect IRS employees. However, our investigation has revealed that some taxpayers may have been labeled as illegal tax protesters merely because they wrote an article in a newspaper. Should there be a review of such labeling to prevent abuse of the labeling system to the detriment of law abiding taxpayers?

Answer. The label "illegal tax protester" should apply only to those that fit all of such label's requirements. Simply writing an article derogatory about IRS in a newspaper clearly does not meet such standard. Nor, for that matter, does writing a nasty letter to the Commissioner (I used to receive plenty of those). Administrative action should go tar towards solving this problem.

(e). The case of Father Ballweg indicated to all of us the importance of a system that is customer friendly. Shouldn't most correspondence be signed so that agency personnel are accountable? At some stage in the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. Requiring mass communications to be signed in a particular person's name is difficult for all mass communicators, including the IRS. On the other hand, specific communications should be signed by, or in the name of, a live person that the taxpayer can talk with.

Question 6. Should the Taxpayer Advocate and problems resolution officers be independent from the IRS?

Answer. The Problem Resolution Office (which I created) and the Taxpayer Advocate should remain a part of IRS, but the Taxpayer Advocate should report directly to the Commissioner and the Taxpayer Advocate Office should be given additional powers and stature.

Question 7. Are you aware of any instances of IRS employees who were abusive to taxpayers or retaliate against other employees who were not disciplined because management believed the disciplinary process is too burdensome?

Answer. Yes. The process is too burdensome, the Union throws up too many obstacles, and the system doesn't work very well. For a recent example, look at the Boston browser.

Question 8. The Committee's hearings last September dramatically demonstrated the need to institute greater taxpayer protection. I think we were all very disappointed by the poor performance of the taxpayer advocate's office. The idea, though of a tax ombudsman—someone who has the knowledge to guide taxpayers and the power to resolve snafus—seems to me to be a good one. On the other hand we should be striving for an IRS where problems are solved right the first time by the front line agency personnel that deal with the public.

Until we achieve such a happy state one avenue open to the Committee is to increase the resources devoted to the advocate's office develop a separate professional career path for the people who work in it, and have the office report to both the Commissioner and the Oversight Board. What is your reaction to that?

Answer. I like it.

CHANGING THE CULTURE

Question 9. Improving oversight and protecting the taxpayer are not the only things we need to be doing to respond to the problems uncovered at the IRS. We need to change the very culture of the agency itself. That will require a complete new look at its organizational structure, its managerial rules, its performance measures, and its training programs.

(a). One of the surprises of the Committees investigation into the IRS is how fearful many employees are at how they are managed. They paint a picture of the IRS as a vindictive and unhappy place to work. What changes would you like to see in personnel rules and other procedures to change the culture of this organization?

Answer. In any large organization, there are always some unhappy people. There are also some bad managers, and IRS' Oklahoma City office was a good example. But I continue to believe that most IRS managers are not vindictive and most em-

ployees are not unhappy most of the time at IRS any more than they are at this law firm. I would like to see more openness at IRS, more mingling of top managers with the troops and less destructive political criticism of IRS. How can you be happy when you are told by the Senate Majority Leader that you are evil? IRS needs to shape up, but so do its most vitriolic critics.

(b). There are a considerable number of people who feel that it is not possible to reform the culture of the IRS without dismantling the agency. For these people a whole new tax system that isn't dependent on a collection agency is the way to go. What is your response to people who, because of their experiences with IRS, believe this agency beyond saving?

Answer. I know of no tax system that isn't dependent upon some collection agency. A truly voluntary tax system wouldn't work. Some people hate paying taxes and, therefore, hate the tax collector. Sometimes, this hatred has some justification. Nevertheless, I continue to believe that IRS is a good agency that has an enormously difficult job to do and, on the whole, has done its job pretty well. Why don't we try comparing IRS to other tax collection agencies and find out how it measures up?

(c). In 1994, Congress passed the Government Performance and Results Act (GPRA). This was an effort to get the Congress and the Executive Branch to focus on performance standards. Do you support such standards for the IRS? If you do, what do you think the performance standards should be?

Answer. I think that OMB's directives in implementing the Government Performance and Results Act and IRS' attempts to comply with such directives created at least some of the problems for which IRS has recently been blasted. Imposing performance measurement standards on an agency that has law enforcement duties, like collecting taxes and curbing tax evasion, is a very risky thing to do at best, and I think that careful thought should have been given to (a) either exempting law enforcement from the Government Performance and Results Act or (b) probably better, making as certain as possible in this imperfect world that applying the Act to law enforcement activities did not create the reality or appearance of unwise goals or, even worse, a quota system.

(d). During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures?

Answer. Certainly IRS employees should follow IRS' official procedures and Manual directives. I remain skeptical that the employees who testified in September were a representative sample of IRS employees.

OVERSIGHT BOARD QUESTIONS

Question 10. The House bill establishes a board "to oversee" the IRS in its "administration, management, conduct, direction, and supervision" of the administration of the tax laws. What does "oversee" mean to you? What should be the relationship between the Commissioner and the Board?

Answer. To me, the word "oversee" means periodic (at least quarterly and probably monthly) review of IRS' functions and programs. I hope that the Commissioner will be a member of the Board, and I think that the Commissioner should regularly report to and work with the Board in much the same way as a CEO reports to and works with a corporate board of directors, having in mind the Commissioner's responsibilities to his boss, the Secretary of the Treasury. I have previously expressed my concerns about dual, and possibly conflicting, authority.

Question 11. I am troubled that the bill prohibits the board from exercising any authority over "law enforcement activities" such as collections—an area which our hearings have shown to be rife with taxpayer abuse. Should the Board have oversight authority over law enforcement activities to prevent taxpayer abuse?

Answer. I repeat my strong view that the Board should not have any authority over individual cases, whether examination or collections, and should not have 6103 access to tax returns. Working with the Board and the Treasury, Commissioner Rossotti will have a strong hand in curtailing future abuses.

Question 12. If an IRS Oversight Board is established within Treasury, should Board members be part-time or full-time employees?

Answer. I think the Administration's Board of full-time Treasury political appointees was a bad idea. It is much better to have a part-time Board of outsiders than a Board composed of a group of Treasury political types. I remember Watergate; while the then-Secretary of the Treasury was a tower of strength and a strong force for sound tax administration, many others were not. I have little more confidence in the present group, apart from Secretary Rubin and Assistant Secretary

Lubick, both of whom I admire, than the crowd that President Nixon appointed to Treasury positions.

Question 13. What is your opinion regarding who should serve on the proposed IRS Oversight Board? Should a union representative be guaranteed a slot on the Board? Should the Commissioner and Secretary of Treasury be on the Board?

Answer. I think that the Secretary of the Treasury and the Commissioner of Internal Revenue should be on the Board. A Union representative should not be on the Board. In this Administration, there are enough problems with the mislabeled "partnership" with the Union anyway; I understand that the Union forced IRS to rehire the Boston browser.

SIMPLIFYING THE CODE

Question 14. I think that we would probably all agree that a significant part of taxpayers problems with the IRS stem from the complexity of the code. What parts of the code do you think are prime candidates for simplification?

Answer. I agree completely that a significant part of taxpayers' problems are created by the Code being so complex. While it would unduly delay and lengthen this reply for me to list everything that should be changed, I do have some basic suggestions:

(1) Refundable credits like the EITC and the 1997 child credit are actually welfare grants or wage supplements to the extent that they exceed income taxes otherwise payable. Move them out of the tax system and let HHS try to administer them.

(2) Try to return to the 1986 model of lower rates and a broader base.

(3) Get rid of the alternative minimum taxes.

(4) Refrain from enacting any future spending programs through the tax system (such as the Hope Scholarship and the Administration's current silly proposals for environmental credits) and remove as many of these ornaments as possible from the existing Code. Use the savings to reduce rates or increase personal exemptions.

(5) Don't use penalties as revenue-raisers; instead simplify the penalty system and reduce overlap and excessive penalties.

PREPARED STATEMENT OF KAREN J. ANDREASEN

My name is Karen Andreasen and I reside in Tampa, Florida. I am currently teaching 4th graders at a small, private school and taking classes myself to update my certification. Although I am presently divorced, I was married for 19 years and have 3 wonderful children Christopher, Michael and Brittany.

My ex-husband is a former field auditor for the Internal Revenue Service (IRS). For approximately the last 10 years of our marriage, he had a tax and IRS representation practice and, during the course of his career, he had also been an expert witness in litigation cases. His intimate knowledge of the IRS and tax issues far exceeded any knowledge I had.

During our marriage, my former husband kept all our business and most personal information at his office and, as a result, I was excluded from our financial dealings. I loved my husband but—mistakenly trusted him—to handle the financial end of things while I was busy taking care of our children.

At the time of our divorce, the value of my former husband's practice and earnings became an issue for alimony and child support purposes. Under the advice of my attorney, I engaged a Certified Public Accountant (CPA), Gayla Brey Russell, who has particular expertise in the areas of tax and litigation. Upon reviewing my former husband's business documents it became apparent to the CPA that there were clear discrepancies between my former husband's sworn statements and what the documents said. Two questions were becoming obvious—whether or not my former husband had actually filed the returns he said were filed and whether or not he had ever paid the estimated taxes as shown on the copies of documents we had in our possession. If neither had been done, the tax liabilities for these years would exceed $12,000, even before ongoing penalties and interest were added. This all started in the fall of 1995.

In February 1996, I received a notice from the IRS inquiring into the whereabouts of my former husband's and my 1993 tax return. Although I knew I had not signed any such return, my former husband insisted that both the 1993 and 1994 returns had been filed. I was led to believe by my husband that the IRS had lost them. That April, I submitted a request to the IRS for copies of both the 1993 and 1994 returns, however they responded saying that no such returns could be found. It was now becoming very clear that no estimated taxes for those year had ever been made. I real-

ized at this point that I of 2 things should have occurred: if the tax returns had been filed, we should have received notices demanding payment of the taxes due. However, if the estimated payments had been made and no returns sent in, the IRS would have sent us a notice of credit and inquired where we wanted those credits applied. In my case, neither of these scenarios unfolded.

My accountant advised me to file new separate tax returns for the 2 years in question. Upon learning of this, my former husband forged my signature and filed joint tax returns before my separate returns could even be prepared. Not knowing what he had done, I went ahead and filed my own forms. Of course these were returned to me by the IRS with a cover letter stating that his joint returns had already been received. Copies of these joint returns were included with the IRS' notice. My former husband had not even tried to disguise his attempt to forge my signature. The signature, in fact, was an exact replica of his own. At this point the battle lines were drawn.

My CPA refiled my separate returns with a cover letter stating that the joint returns my former husband had filed reflected a forged signature. It informed the IRS that the IRS already had a history of correspondence regarding these particular returns. The letter also included samples of my signature along with the forged signature appearing on the joint returns. The IRS' response to my correspondence was that they were very sorry, but my only recourse was to file suit in civil court!

By this time I was deeply in debt and my mother sold her own home and moved in with me to help with the children. My husband remarried and was now providing me with support payments only when he felt like it. My former husband had basically skated passed the IRS and the family courts—he had effectively accomplished exactly what he had set out to do.

A formal protest, along with more proof of the forgery and case law that should have been in my favor were filed. At the same time, I also received a letter from the IRS saying the case law was not applicable to my case because I was not currently undergoing an audit! It seemed to me that case law is to be used only when the IRS deems it is proper—or convenient.

In the meantime, I requested from the IRS an extension for filing my tax returns. I did this in an attempt to hold off on the actual filing, hoping the matter could be resolved during that period of time. I was, in fact, anticipating receiving a large refund and I knew if the IRS did not reverse its decision that my refund could be applied to pay my former husband's back taxes. By October 1997, I had heard nothing from the IRS so I sent my 1996 returns into them not knowing what was going to happen. By now tax liens had been placed on my home and the bank had threatened me with foreclosure.

In December 1997, the dreaded IRS notice indeed arrived stating that my refund was being applied to my former husband's back taxes. The $3,693, refund that I so desperately needed was to be used to benefit my former husband after all.

However, about 3 weeks ago I received a letter from the IRS stating that it was reversing its decision and that I would receive my refund in approximately 8 weeks.

Mr. Chairman, it is now 2½ years since this roller coaster ride began. During this time my former husband was able to create a maze of papers that he thought nobody could untangle. If it had not been for the devotion and persistence of my friends and family I would clearly not have made it here today. However, my story is not over, for I now wonder how long it will take to remove the IRS lien that still remains against my home. The lien was in place against our home even before my husband relinquished it in our divorce settlement. My only hope is that getting rid of this lien, yet another reminder of my former husband, will not take years more to settle and take an even greater toll on my children and me.

Throughout this ordeal I was treated as if I were guilty until I could prove my innocence. I know now that I was naive and trusting. I can only hope my ordeal can help other women in similar situations, and lessen their pain and frustration. My former husband knew—and used—the IRS system against me, a system that allowed itself to be manipulated in its quest to get at the money—anyone's money, right or wrong—just as long as they get it.

I feel lucky to be receiving my refund at all. I also feel lucky to be able to appear before your Committee today. But luck should have nothing to do with it. There should be a logical process for disputes like mine, and one that does not require unlimited personal funds to file a law suit! I can only imagine the number of other innocent spouses that are out there now, drowning, in the same sea of red tape, fear, frustration and sense of helplessness that I did. A sea not calmed by the IRS in its effort to get anything it can from individuals who don't have the strength to fight back. Although my personal battle is not completely over, I no longer fear that I am just another fatality of the tax system—but I do fear for those still caught in it.

Mr. Chairman and members of this Committee, thank you for your time, as it is a most precious gift. However, it is one that I cannot repay—just as you cannot repay me for the endless hours I spent in vain trying so desperately to reason with an unreasonable and unrelenting system.

PREPARED STATEMENT OF RICHARD BECK

Mr. Chairman and distinguished members, my name is Richard Beck and I am a Professor of Law at New York Law School. I have published five articles on the problems of joint and several liability for joint returns, one of which is the only study which attempts a historical and comparative analysis of how we got where we are, and how our law compares with other countries. I was instrumental in the American Bar Association's project which culminated in our recommendation four years ago that Congress should simply repeal joint liability altogether. Two years ago I testified before the House Ways & Means Oversight Committee and argued for repeal. And just two weeks ago I submitted an amicus brief for certiorari to the Supreme Court on behalf of Elizabeth Cockrell, whose testimony you have just heard. That brief was joined by the National Organization for Women, the National Taxpayers Union, and the Womens Bar Association of the State of New York. I am very grateful to you for the opportunity to be here today.

The shocking statements you have just heard are unfortunately very similar to the stories of thousands of other women who are forced to pay their ex-husbands' taxes every year. Nobody knows for certain how many, because the IRS keeps no records of such collection attempts. To the IRS it is apparently of so little importance which ex-spouse it pursues that it does not even know, and could not tell the General Accounting Office, how often it collects from the wrong spouse or how much money is involved. My own rough estimate, and the GAO's as well, I believe, is that the IRS attempts collection from the wrong spouse after the couple's separation or divorce in at least 50,000 cases every year.

Joint liability applies to nearly all married couples because almost all file jointly, and that is because filing separately usually results in a slightly higher tax. But very few taxpayers are aware, or have any reason to be aware that by filing jointly they incur joint and several liability. There is no joint liability clause at all on the Form 1040 itself, not even in fine print, much less the big and bold warning such a risk deserves. Even tax preparers and divorce lawyers generally do not take this liability into account, or mistakenly think they can protect their clients by agreement with the ex-husband. The victims of joint return liability are always taken by surprise.

Based on the composition of the reported innocent spouse decisions, I estimate that over 90% of the victims of joint liability collections are women. The IRS usually attempts collection from whichever spouse it finds first. This has a significantly negative effect upon women, because after divorce the wife often remains at the marital address on the joint return, and the IRS will usually look no further, even if the victim tells the IRS where to find her ex-husband. Elizabeth Cockrell's case which we have just heard is all too typical: the IRS clearly knows her ex-husband's whereabouts, but has apparently done nothing to collect from him.

No other developed country in the world imposes joint and several liability for income taxes in the way we do, including countries which also offer income-splitting on joint returns. In many countries which once imposed spousal liability, it has been repealed as archaic, unfair, and inconsistent with modern conceptions of women's rights to economic independence.It should be repealed here as well.

How did we get where we are today? Joint and several liability was first enacted in the U.S. in 1938, and it appears that the IRS (then called the "Bureau of Internal Revenue") may have misled Congress into enacting it. The story begins with an IRS error which led to a 1935 decision in the 9th Circuit by the name of Cole. In Cole, the IRS could not collect a large tax deficiency due from the wife's separate income because the IRS had mistakenly assessed her husband instead. As a result, the IRS negligently allowed the statute of limitations to run as to the wife. When it discovered its error, the IRS then continued trying to collect from the husband anyway, on its completely invented theory that filing jointly entailed joint and several liability. In court, the IRS argued that it needed joint liability because joint returns do not exhibit each spouse's separate income and deductions, and so, the IRS claimed, it could not figure out which spouse to tax and for how much.

One may wonder whether the IRS made the argument in good faith, because at that very same time, the Treasury was promulgating new regulations which would limit charitable deductions on joint returns to 15% of the donor spouse's separate

net income, which necessarily involved the very same calculation of separate incomes which the government was arguing in Cole that it could not make.

In any event, the Ninth Circuit rejected the IRS' argument of "administrative necessity" because the separate liabilities of the spouses were in fact stipulated in Cole. The court then noted that if a case should ever arise in which some doubt actually existed, the IRS remained free to assess both spouses and let them prove their respective incomes.

The court then rejected joint liability on the ground that it would violate the cardinal principle of the income tax, which is that it is levied in accordance with ability to pay, which means in proportion to each taxpayer's own income, and no one else's.

After its 1935 defeat in Cole, the IRS urged Congress to enact joint and several liability, which Congress did in 1938. The only explanation put forth in the committee reports was the very same "administrative necessity" which had been rejected in Cole.

Joint and several liability was far too broad a solution to the perceived problem, if indeed there ever was a problem at all. A much better and more focussed solution, for example, might have been to authorize an extended statute of limitations applicable to a taxpayer if he has notice of an incorrect assessment against his spouse. Another obvious answer to the IRS' pretended dilemma would have been for the IRS to redesign its own joint return forms to show the information it needed for each spouse in two columns, as many state joint tax returns do.

At any rate, Congress improvidently handed the IRS a blank check in 1938 which it gradually emboldened itself to employ—and abuse—in situations very far removed from any administrative necessity. It appears that Congress originally intended to do no more than provide the IRS with a shield to prevent IRS mistakes from resulting in a perceived unjust enrichment of still-married couples in cases like Cole. Eventually, however, the IRS turned this shield into a sword to attack divorced women. The current application of joint liability to separated and divorced women seems entirely unintended. There were a half dozen cases decided before 1938 in which the IRS pressed its theory of joint liability, and not one had involved divorce, including Cole. Nor could Congress have foreseen in 1938 the postwar explosion in divorce rates.

To pursue divorced women for their husbands' taxes without even attempting to collect from the husband first is certainly not an administrative necessity. Just the reverse, it is on its face a gratuitous and intolerable abuse of power.

Adequate reasons for imposing joint and several liability have never been provided. Contrary to widely held belief, joint return liability was not enacted as the "price one must pay" for lower tax rates on joint returns.

Joint returns were first introduced in 1918, apparently for the sole purpose of convenience both for taxpayers and for the government, and provided no special rates or privileges for married persons. The favorable tax rates for joint returns computed by income-splitting were not introduced until 1948, some 10 years after enactment of joint liability. Income-splitting was not enacted as a quid pro quo 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 had been allowed on separate returns since 1930 under the Supreme Court's decision in *Poe v. Seaborn*.

The quid pro quo justification for joint return liability is as weak logically as it is historically. The tax advantage of joint filing is usually quite modest. But even this advantage exists only when compared with the punitive rates applicable to married persons filing separately. For nearly half of all couples, joint returns require higher taxes than the couple would pay if they were not married at all. This is the "marriage penalty."

Also, the size of the alleged benefits of joint filing, if any, bears no relation to the joint return 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.

And finally, the alleged benefits of joint filing usually inure to the husband alone, while the liability almost always is borne by the wife. Joint return liability is not only unfair in principle, as applied it is highly discriminatory against women.

A second rationalization for joint liability, which is no better than the first, is that the married couple is an economic unit, and as it shares its income and assets it should share its tax burden. However, there is no evidence that couples who file jointly share assets any more than couples who file separately. In any case, to apply the one-pocketbook theory of marriage to couples who have already divorced and divided their assets is simply ludicrous.

To sum up, joint liability never had any legitimate purpose even when it was first enacted, and it is now a huge national problem. It permits the persecution of women through the tax system, and it is perfectly legal.

What should be done about it? Congress should repeal joint liability outright and completely, as the American Bar Association recommended in 1995. Congress should repeal joint liability now, and it should make the repeal fully retroactive for all open cases, because joint liability was a mistake.

Repeal would not open any doors to abuse. Any tax schemes based on separate liability are possible right now by just filing married separate returns. And repeal would probably not cost much in revenue, if it cost anything at all. The IRS might have to do a little more work to find the husband, but it also might find its administrative costs lowered if it stopped trying to squeeze blood from turnips. The IRS might actually collect more revenue at less cost if joint liability were repealed, although the IRS own failure to keep records makes this hard to prove. I have seen in my own work the IRS waste taxpayer money pursuing single mothers on public relief for assessments they could not possibly pay. Elizabeth Cockrell's case is the same writ large: if the government wins, it will succeed only in bankrupting her at enormous cost to all involved, and then if it wants actually to collect its taxes it will have to look to her ex-husband John Crowley, which is where the IRS should have started and ended.

I would like to close with two other recommendations which I will make very quickly. The first is that Congress should also repeal the other form of spousal liability by which women in community property states are forced to pay their husbands' taxes, which is the doctrine of *Poe v. Seaborn*. The reasons are very similar, and they are spelled out in my written statement, as they are also in the American Bar Association's Report and Recommendation.

The second is that Congress should not try to solve these problems of abuse by amending the innocent spouse rules yet another time. The innocent spouse rules can never be made to work properly because the underlying rule of joint liability is wrong. There is no natural stopping point for innocent spouse relief. Wherever you draw the line you will unfairly exclude some women, when no woman should ever be forced to pay her ex-husband's taxes. We should make a clean break with a past that should never have happened at all, and we should make the repeal apply retroactively to help the women in this room who have testified today, as well as the tens of thousands of others who are currently embroiled with the IRS.

Thank you very much.

PREPARED STATEMENT OF JOSEPHINE BERMAN

"INNOCENT SPOUSE ISSUES"

Good morning. My name is Josephine Berman. I'm here today to help put a human face on the issue before this Committee. I am an innocent spouse. I have existed under the black cloud of an immense tax debt for the last 28 years. My indebtedness is solely the result of having signed my name to joint income tax returns in 1968, 1969 and 1970. Since that time I have been continually harassed, threatened, intimidated into signing waivers of the statute of limitations, and had my entire retirement nestegg seized by the Internal Revenue Service. Due to circumstances beyond my knowledge and control, I stand before you today at the age of sixty-eight unable to afford to retire, unable to ever repay a debt for which I am being unjustly held responsible, and without any means to reverse my fortune. This is my story.

This is not a case of tax evasion or fraud. The debt for which I am being held responsible is the result of disallowed deductions claimed by my husband for the years 1968–1970. During that time my husband was a 50% stockholder of a subchapter S corporation. The deductions he claimed were for legal expenses incurred during litigation with his partner. The disallowance of those deductions was a result of the IRS's interpretation of weather the expenses were incurred to protect income or stock. I'm not entirely sure what this means but it is what has been explained to me.

I have been held responsible for this tax liability as a result of signing joint tax returns during those years. The original debt of $62,000 is now approximately $400,000 with interest and penalties. I was never involved in any of my husband's business activities nor was I ever included in any business or tax decisions. As was typical for those times, I was the homemaker and he was the breadwinner.

During the years that my husband was in litigation our marriage became troubled. In 1970 we separated. Needless to say communication between us became even

more sparse than it had been before. I did not even become aware of any tax problems until 1972 or 1973 when an IRS agent (I will call him Mr. X) came to my home and threatened to post tax sale posters on the trees in front of the house.

At this point my husband and I had been separated for two years. My husband had not worked since 1970 and he would not work again for another several years. The entire responsibility of raising our 10, 14 and 16 year old children was left to me. The family subsisted on money from insurance policies that my husband had cashed in, my $13,000 a year salary as a dental assistant and welfare.

Mr. X was the first of many IRS agents that I would deal with over the years and he was brutal. He repeatedly harassed and bullied me in front of my children. Under the threat of eviction I signed the first of several wavers and a lien was put on my home. These conditions allowed us to keep the roof over our heads.

I cannot overstate the desperateness of our situation. My husband was in a state of deep depression and the only thing that kept me going was my responsibilities to my children. I did nor understand the intricacies of the tax laws or why I was being held responsible for the debts of my husbands business. I was left to my own devices to deal with the situation and I was completely overwhelmed and wracked with worry. I was often overcome by rage and tears. I also had tremendous guilt because of the strife our situation clearly caused my children.

Eventually my husband abandoned us completely leaving me to deal with the IRS on my own and a lien on our jointly owned home. Over the years I have been harassed by agents form Holtsville, New York City, Pennsylvania and New Jersey. Agents have come to my place of work as well as called my employers looking for information about my former husband and threatening to levy my wages My personal affairs have been exposed to my employers and co-workers. Not only is such conduct humiliating it also serves to strain my relationship with my employers.

Agents have come to my home threatening to post sheriff notices for my neighbors to see or place foreclosure notices in the local newspapers My credit rating is destroyed. I frequently receive solicitations from companies claiming they can help resolve my debt to the IRS. My private life has become totally public. This conduct has been consistent and relentless for the past 28 years.

The utter impossibility of my situation was punctuated in late 1935 when, notwithstanding the lien on my home, the IRS seized my IRA account of approximately $40,000. Over the years I had to struggle but by penny pinching and doing without I was able to set some money aside each year for my retirement. As I stated earlier, with interest and penalties the tax debt now stands at approximately $400,000. The assessed value of my home is about 180,000. Clearly, short of winning the lottery I will never be able to pay this debt in full That IRA was the only asset I could hope to use in my impending retirement. When chat money was seized I was devastated. It was as if my government was stepping in and saying "we know your poor, now we're going to make sure you'll be destitute for the rest of your life."

What was even more upsetting was that this action was being taken by an agent in Pennsylvania which is where my husband resides. I live in New Jersey. Ironically, to my knowledge, my husband has never been subjected to the same oppressive treatment by the IRS as me.

In an effort to stop the seizure I contacted the Internal Revenue Service Dispute Resolution Office in New Jersey. Agents in that office expressed surprise to learn of the seizure of my account. They advised me that this should not have occurred and it was done so in error. Unfortunately, nothing was done to stop this arbitrary act of the Pennsylvania agent and the money was seized.

I now live from paycheck to paycheck with nothing standing between me and abject poverty. I cannot adequately describe the horror of the position I'm in and knowing that it is my government that put me there I have lived nearly half my life under the weight of this crushing debt. Now, after slaving for all this time all I will have to retire on is social security Twenty-five years ago I worked my way off welfare. With the final indignity of stealing my retirement money, the IRS insured that is where I will end up.

Since being charged with this debt I have raised three children. I have worked my way off welfare. I helped put my children through college and paid off a mortgage. And I have paid my taxes along the way! I have done all this on a high school education and by my wits and guile

Now, at the end of my life, I live in a home that I paid for but I don't own. What little I was able to save has been seized and I don't know how much longer I will be able to work to support myself. I have done nothing wrong. I am guilty only of contributing to society as every hard-working American is supposed to.

Senators, not long ago I heard a story about a man who had been sentenced to 15 years to life for manslaughter. He was released on parole for good behavior after

serving just under 8 years in prison. A killer gets released from prison after 8 years but I'm serving a life sentence.

The laws as they exist now are unjust and immoral You have the power and responsibility to change this; I urge you all to do so.

Thank you for this opportunity to be heard.

PREPARED STATEMENT OF DOUGLAS C. BURNETTE

The National Society of Accountants (NSA) is pleased to testify on the issue of Internal Revenue Service restructuring and reform. NSA commends Chairman William V. Roth, Jr., and the other members of the Committee on Finance for holding this most important hearing on reform of the Internal Revenue Service. NSA strongly supports the goal of creating a modernized, efficient and responsive tax agency.

My name is Douglas C. Burnette and I am President of the National Society of Accountants. I have been in the practice of public accounting in Lancaster, South Carolina for 27 years. My firm offers a wide range of accounting services, from individual tax preparation to corporate tax and consulting projects.

NSA is an individual membership organization. Through our national organization and affiliates in 54 jurisdictions, we represent the interests of approximately 30,000 practicing accountants. Our members are for the most part either sole practitioners or partners in moderate-sized public accounting firms who provide accounting, tax return preparation, representation before the Internal Revenue Service, tax planning, financial planning, and managerial advisory services to over four million individuals and small business clients. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct.

The National Society of Accountants commends you as Senate Finance Committee Chairman for the landmark hearings held this fall on IRS reform. We are confident that these historic hearings will result in the enactment of meaningful legislation to restructure the IRS by Spring 1998. NSA also is grateful to Senators Robert Kerrey and Charles E. Grassley, two Finance Committee members, for their active work on the recent National Commission on Restructuring the IRS and in their sponsorship of (S. 1096) legislation to implement the Commission s recommendations.

For the purpose of helping you in your deliberations on IRS reform, NSA is pleased to provide comments on H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997, which was approved by the House of Representatives on November 5, 1997. The National Society is also providing comments on certain provisions contained in S. 1096.

THE IRS MANAGEMENT STRUCTURE

Internal Revenue Service Oversight Board

H.R. 2676 establishes an Internal Revenue Service Oversight Board. The Board would oversee the administration, management, and direction of the Internal Revenue Service. Its specific functions include the approval of the IRS strategic plan, review of the agency's operational functions, and review of the selection of a Commissioner.

The National Society of Accountants views this provision of H.R. 2676 as being one of the legislation's most important measures. We believe the Oversight Board will enable the IRS to become a more customer service oriented agency. An independent Oversight Board has the potential of affording the opportunity to take an objective look at the agency s procedures and programs—as well as creating a real opportunity for overcoming problems concerning the agency.

H.R. 2676 requires the eight Board members (appointed from outside the federal government) to have, among other attributes, information technology backgrounds. However, it prohibits the Oversight Board from having any responsibilities in the specific procurement activities of the IRS. The National Society finds this dichotomy ironic and troublesome. Since the IRS largest procurement purchases will come from the area of technology, NSA believes the Oversight Board should have the authority to review the agency s procurement activities. We believe the Board s authority to review procurement activities should extend to a review of such specific procurement activities as the purchase of computers and telephone systems.

Chairman Roth stated in a November 7, 1997 Senate floor speech that the Senate Finance Committee will investigate whether or not the Oversight Board should look at audit and collection activities. According to National Society of Accountants members, the IRS examination and collection activities are the two areas generating the greatest number of taxpayer complaints. For this reason, we support an expansion

of Board authority to oversight of audit and collection activities. We believe such authority will enable the agency to achieve an even higher level of customer service. An emphasis on customer service—as opposed to increased compliance—is what NSA believes is needed to significantly improve the federal tax administration process.

Another area on which the legislation should focus regarding the Oversight Board's duties relates to the ethics, integrity, and civility of IRS officers and employees. Recent hearings have punctuated the fact that such officers and employees do not all subscribe to acceptable levels of professional conduct in their dealings with taxpayers and practitioners. This is harmful to the tax system and the public. It also is at variance with the customer service goals of the legislation.

The National Society of Accountants believes the legislation should address the ethics, integrity, and civility of IRS officers and employees as a specific objective of the Board's oversight. Attorneys, certified public accountants, and enrolled agents, under Treasury Department regulations, subscribe to enforceable standards of conduct in their duties to their clients and the IRS. Those who work for the IRS also should have standards of conduct in the work they perform.

In addition, as a separate matter, the National Society recommends that Board members be provided with a separate staff and a small expense account allowance for telephone calls, mailings, and other miscellaneous expenses.

Small Business Representation on the IRS Oversight Board

We all have heard stories of small business people working 60 to 80 hours a week in their businesses. Small business persons wear many hats. For example, they are the firm s salesperson, marketing agent, bill collector, and service provider. At the same time, the small business person must comply with a complicated federal tax laws and regulations. The unfortunate result is that a small business person often pays—proportionately—a greater level of tax penalties than large businesses; a clear indication that smaller firms are more susceptible to pressure from zealous IRS collection personnel. Large business establishments are better able to afford and contest a tax matter as opposed to the average small business person.

The National Society of Accountants believes that the frustrations of small taxpayers and small business persons played a critical role in the reasons for formation of the IRS Restructuring Commission. To give small business interests an opportunity for further input, NSA strongly recommends that the Senate Finance Committee include small business representation on the IRS Oversight Board. H.R. 2676 already mandates that large businesses be represented on the Oversight Board as reflected by a requirement that Board members have professional experience and expertise in the area (among others) of management of large service organizations. Small business must be provided with direct representation on the Board as well. Without such representation, NSA believes the IRS might not receive input from a key and critical constituent group, small business. With such representation, the needs and concerns of all taxpayers, large and small, will be heard at the IRS.

Office of IRS Commissioner

The National Society strongly supports the provision contained in H.R. 2676 making the Commissioner of Internal Revenue position a five year appointment, similar to the Chairman of the Federal Reserve Board and certain other federal agencies. We also support the provisions of the legislation which give the Commissioner greater flexibility in the hiring, firing, and salary decisions involving IRS senior management.

H.R. 2676 states that the appointment of Commissioner shall be made without regard to political affiliation or activity. The legislation also suggests that any new Commissioner must have the capacity and expertise to manage a large establishment or entity—in a similar fashion to a chief executive officer managing and running a Fortune 500 company. While the National Society clearly appreciates the need for the IRS to have the very best management possible, we recommend that the Senate Finance Committee include safeguards in the legislation to ensure that a new Commissioner is sensitive to the needs of small business. In order to appreciate the unique needs of these taxpayers, we recommend the Senate bill (or report language) stress the need for the Commissioner to meet on a regular or routine basis with the IRS national office small business specialist and with representatives of the small business community.

By providing the IRS with a new management culture, NSA believes that fundamental and positive changes will take place within the agency. In many ways, legislative enactment of these management oriented proposals will begin the process of restoring the respect of IRS employees for themselves and by the public. The last several years of budget cutbacks for the IRS has contributed to a high level of de-

moralization and dissatisfaction within the agency s work force; in turn, it has had a clear and negative impact on the level of customer services provided by IRS employees.

CUSTOMER SERVICE

Overview of Customer Service

One of the major objectives of this IRS reform legislation is to upgrade the level of customer service provided by IRS employees to that which private financial services companies offer the public. The tax practitioner community is an important stakeholder relative to customer service. A great number of taxpayers deal with the IRS through their tax practitioners. Consequently, they experience IRS customer services at all levels, from telephone contact through examination audits, collections, and appeals. Based on their repeated and varied contacts with the IRS, practitioners have a unique perspective on customer service.

The legislation emphasizes the concept of customer service over compliance. This is unlike the traditional view that the IRS main mission is tax compliance, i.e. audits and collections. While the importance of compliance obviously is clear, NSA agrees that the service component of the IRS should be the primary engine which drives the agency s mission. We believe that a customer service oriented mission will bring out the best in all who deal with the tax system. This is what the American public wants, and it is what we believe IRS employees want as well.

There should be improvement in all aspects of IRS customer service. For example, from the public s perspective, the front lines in IRS customer service is what they experience when they speak with an IRS employee on the telephone. The quality of IRS telephone systems, as well as the way in which the IRS employees answer the telephone, has shown substantial improvement in recent years. Nevertheless, the IRS telephone system and customer relations process continue to cry out for further and dramatic improvement.

The proper training of IRS employees and providing them with technology are important keys to quality customer service. The Report of the Commission on Restructuring the IRS strives to portray IRS employees as competent, hard-working employees who want nothing more than to deliver the highest quality service to the public. In order to turn around the supertanker we call the IRS, there needs to be a change in the management structure of the IRS along the principles described above. This includes better training of IRS employees. They also need to be provided with more of the basic technology tools of the 1990s, tools which NSA s members often take for granted. This includes providing employees with more fax machines, copiers, and computers.

Office of Taxpayer Advocate

As part of a Senate floor speech on November 7, 1997, Chairman Roth mentioned that the Finance Committee will investigate making the Taxpayer Advocate completely independent and responsible to the IRS Oversight Board. The National Society of Accountants believes that this is an excellent idea. We urge the Finance Committee to adopt this concept as part of the Committee s IRS reform bill. We view this proposal as a critical component of any effort to improve customer service at the IRS.

By including an independent Taxpayer Advocate provision as part of its bill, the Finance Committee would be adopting a measure which builds on the beneficial customer service provisions found in the Taxpayer Bill of Rights II (P.L. 104-168). The Taxpayer Bill of Rights II (TBORII) created the office of Taxpayer Advocate within the Internal Revenue Service. TBORII empowered the Advocate to resolve individual taxpayer problems, to analyze problems with the nation s tax system, to propose legislative and administrative solutions to those problems, and to report to Congress on the operations of the Advocate s office. Moreover, TBORII empowers the Advocate with broad authority to affirmatively take any action as permitted by law with respect to taxpayers who would otherwise suffer a significant hardship as the result of IRS action.

The National Society of Accountants stated, in testimony earlier this year, that in order for the Taxpayer Advocate to be successful in these tasks, he or she must possess an intimate knowledge of the functioning of the Internal Revenue Service, knowledge gained from years of experience within the Service. At the same time, we stated that in order to truly be the taxpayer's advocate, this individual must be willing to question, publicly as well as internally, the functioning of the very agency to which his or her career has been devoted. The position of Taxpayer Advocate requires an individual with special talent to represent the taxpayer's position while drawing upon his or her intimate knowledge of the IRS.

H.R. 2676, the House Ways and Means Committee bill, requires the Advocate to have substantial experience in representing taxpayers before the Internal Revenue Service or with taxpayer rights issues. A Taxpayer's Advocate, who previously has worked a significant time period for the IRS is required by H.R. 2676 to agree not to accept any employment with the IRS for at least 5 years after ceasing to be the Taxpayer Advocate. NSA supports inclusion of these criteria in the final bill.

It is fitting that taxpayers not be foreclosed from benefitting from the appointment of a Taxpayer Advocate who may happen to have the experience and insight of an IRS veteran. Requiring any IRS veteran interested in the Taxpayer Advocate position to take an oath that he or she will not work for the IRS for at least 5 years after leaving the Advocate post, would be a critical step to help ensure open reporting about potentially sensitive issues within the IRS.

H.R. 2676 broadens the scope of the Taxpayer Advocate s annual report to identify areas of the tax law that impose significant compliance burdens on taxpayers or the IRS. The scope of the report is broadened to identify—in conjunction with the National Director of Appeals—the ten most litigated issues for each category of taxpayers with recommendations for mitigating such disputes. In addition, the legislation makes certain improvements in the selection process, geographic allocation, and career opportunities of problem resolution officers. The National Society strongly supports these measures as improvements in the Taxpayer Advocate's position. We are particularly supportive of the requirement that the Advocate take steps to ensure that local telephone numbers for the problem resolution officer in each internal revenue district be published and made available to taxpayers.

Performance Awards

Another area the Senate Finance Committee should investigate is the IRS conduct of employee performance evaluations, including the granting of performance awards to employees. The National Society of Accountants strongly supports this area of investigation by the Finance Committee. We believe that no IRS employee should receive a cash reward based on tax enforcement results. IRS revenue officers should never be paid based on the amount of tax revenues they collect.

H.R. 2676, as passed by the House of Representatives, requires the IRS to establish a performance management system covering all IRS employees, with the exception of members of the IRS Governance Board, the Commissioner, and the Chief Counsel. As part of this performance management system, the bill generally provides the IRS flexibility in granting awards to employees. More specifically, the legislation provides that A cash award . . . may not be based solely on tax enforcement results. For the reasons stated in the preceding paragraph, the National Society is concerned that this particular sentence could be misconstrued to authorize IRS officials to make cash awards to employees principally on tax enforcement results. This must be corrected.

The National Society believes that H.R. 2676's criteria for cash awards should be redrafted to highlight the point that customer service should be considered as an important, positive factor with respect to any determination to make a cash award to an IRS employee. Tax enforcement results should be considered as only one factor in a determination of making a cash award to such employee. The Finance Committee's adopting this language as part of the IRS reform bill will be consistent with the focus of the IRS Restructuring Commission report calling for the IRS to place greater reliance on customer service and less on tax enforcement. This kind of change in the final IRS reform language is good for tax compliance and for taxpayers as well.

ELECTRONIC FILING

Overview of Electronic Filing

The National Society of Accountants strongly recommends the Finance Committee to include provisions in the IRS reform measures designed to encourage more tax professionals and taxpayers to utilize electronic filing. However, we also recommend the Committee avoid mandating the use of electronic filing.

One can interpret H.R. 2676 as not mandating electronic filing based on a review of Title II, Section 201(a) of the legislation. This provision states It is the policy of the Congress that paperless filing should be the preferred and most convenient means of filing tax and information returns and that by 2007, no more than 20 percent of all such returns should be filed on paper. However, in describing goals of an electronic filing strategic plan for the IRS, section 201(b)(1) states, To the extent practicable, such plan shall provide that all returns prepared electronically for taxable years beginning after 2001 shall be filed electronically. NSA is concerned that

this statement may actually amount to a back door method of imposing electronic filing on many taxpayers and on all tax preparers and professionals.

In this regard, S. 1096, as introduced by Senators Kerrey and Grassley, rejects the notion of requiring preparers by a certain date to file only electronic returns. We recommend the committee support this position. It will avoid many of the daunting perception problems which harmed implementation of the Electronic Federal Tax Deposit System (EFTPS) over the last two years.

The EFTPS system is an excellent program and the National Society of Accountants fully supports its implementation. NSA recognizes that electronic filing contributes to significant efficiencies in terms of the tax administration process. Nevertheless, the fact EFTPS is largely a mandatory system generated antagonism towards the program by small business persons and some practitioners. The drafters of S. 1096 chose the wiser course of letting the market place determine the future growth in the overall electronic filing program.

Under H.R. 2676, the IRS is required to develop a plan within 180 days enactment to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next 10 years . . . To facilitate development and implementation of the plan, the legislation requires the IRS to establish an Electronic Commerce Advisory Group. The IRS also is required under H.R. 2676 to implement procedures for providing incentive payments to transmitters or persons utilizing electronically filed returns.

To encourage more tax professionals to embrace electronic filing, the National Society of Accountants recommends the Finance Committee examine inequities currently existing between practitioners who file returns electronically and practitioners who file paper returns. For example, a practitioner who files using the paper method is not prohibited from continuing to file paper returns if he or she is assessed with a tax penalty or preparer penalty. However, a practitioner enrolled in the electronic filing program is prohibited from filing any returns electronically once he or she, for any reason, is assessed with any kind of tax penalty. The assessment of a preparer penalty is more damaging to an electronic return originator than to a preparer who does not participate in the electronic filing program. This is a strong disincentive to use of the electronic filing program for many professional preparers.

Another example of inequities between electronic filing and paper filing may come to the forefront next year when IRS plans to accept electronically transmitted payments in conjunction with electronically transmitted returns. An electronic payment will be debited from the taxpayer's bank account on April 15. A check included with a paper return postmarked April 15 could take up to two weeks or more to clear the taxpayer's bank. This presents taxpayers who might have temporary cash flow difficulties a clear advantage for filing a paper return rather than using e-file. If the IRS wants to encourage taxpayers and tax professionals to use electronic filing, these inequities must be addressed.

The National Society of Accountants views the overall thrust of the requirement—that the IRS develop a plan to spur growth in the use of electronic filing—as being very positive. We are hopeful that this plan will be responsive to many of the concerns practitioners have had with utilization of electronic filing in the past. According to previous surveys of our membership, it is our understanding that only about 35 percent of NSA members transmit electronic filed returns on behalf of their clients. Tax practitioners who file complicated tax returns are the least apt to use electronic filing. The IRS electronic filing program to date has principally focussed on the filing of simple returns by taxpayers expecting a refund. H.R. 2676 clearly attempts to rectify these problems by making significant attempts to reach out to the practitioner community.

Checkoff Box and Regulation of Preparers

The National Society of Accountants strongly supports the provisions of H.R. 2676 involving a checkoff box on electronic returns. Under the checkoff provision of H.R. 2676, the IRS is required to establish procedures for taxpayers to authorize the preparer of electronically filed returns to communicate with the IRS on matters included on such returns. This should be expanded to include paper returns as well.

However, NSA is concerned that H.R. 2676 does not include a provision to regulate all preparers of tax returns, a concept which we strongly recommend for the Finance Committee to include in its upcoming IRS reform bill. According to the National IRS Commission report, uniform requirements of this kind will increase professionalism, encourage continuing education, improve ethics, and better enable the IRS to prevent unscrupulous tax preparers from operating. NSA supports these policy goals.

Electronic Commerce Advisory Committee

As stated above, H.R. 2676 requires the IRS to convene an electronic commerce advisory group. The House bill further requires that the advisory group include representatives from the small business community and from the tax practitioner, preparer, and computerized tax processor communities and other representatives from the electronically filing industry. We strongly support implementation of this electronic advisory group. NSA views the group as a central component of any strategy designed to foster the growth in the use of electronically filed tax returns.

The National Society is pleased to note it was our recommendation that small business representation be included on the electronic commerce advisory group that resulted in an amendment to H.R. 2676 during the House Ways and Means Committee markup of the legislation. Including small business input at the early stages of development of any new electronic filing program will avoid some of the public relations mistakes the IRS made in the implementation of EFTPS.

Procedures for Facilitating Truly Paperless Electronic Filing

H.R. 2676 requires the IRS to develop procedures for the acceptance of digital signatures. Until the IRS develops a method for acceptance of digital signatures, the bill states that the IRS may waive the requirement of a signature for all returns or classes of returns or provide for other alternative methods of subscribing all returns or other documents.

The National Society of Accountants supports the elimination of any signature form. We believe this will help expedite the filing process for practitioners. However, NSA recommends the Finance Committee not include any measures in its bill requiring filers of electronically filed documents to retain a copy of a signed return. NSA is concerned that this type of requirement if not implemented properly may increase the professional liability exposure of tax preparers, thereby negating any real prospect for spurring the use of electronic filing overall. Several models exist where organizations accept electronic tax returns without signature documents, including Canada, Australia, and the state of California. Rather than adopt a new complex system using transmission codes or Personal Identification Numbers (PINs), NSA recommends the Senate consider simply allowing the taxpayer to maintain the original signed copy of his or her return.

H.R. 2676 also requires the IRS to establish procedures to receive explanatory statements or schedules in electronic form. We believe this is a positive provision, one which is designed to facilitate the filing of complex tax returns electronically.

TAXPAYER PROTECTION RIGHTS

The National Society commends the Finance Committee for holding its September 1997 hearings on the IRS. These hearings clearly substantiated the need for enhanced taxpayer protection rights. While the hearings uncovered a need for increased taxpayer rights and serve as a starting point for drafting legislation, NSA is pleased to provide the following comments on additional taxpayer protection initiatives.

Burden of Proof

As a general concept, the average taxpayer is likely to be very supportive of the provision contained in H.R. 2676 which shifts the burden of proof from the taxpayer to the IRS under limited conditions for certain tax disputes. The average tax practitioner also is likely to support the concept of a shift in the burden of proof. Unfortunately, NSA does not believe the burden of proof measure of H.R. 2676 accomplishes its intended objectives.

H.R. 2676 imposes the burden of proof in any court proceeding with respect to any factual issue relevant to ascertaining the income tax liability of a taxpayer. However, before the burden of proof can be shifted, it must be shown that: (1) the taxpayer fully cooperated with the IRS with respect to the issue in dispute and (2) the taxpayer has provided the necessary backup documents and books and records for purposes of substantiation of the item in dispute.

Based on the criteria stated in the immediately preceding paragraph, NSA believes that the burden of proof measure (as contained in H.R. 2676) will help only a very limited number of taxpayers. In all likelihood, with respect to perhaps over 90 percent of all tax cases before the IRS Examination or Appeals Divisions, the burden of proof measure of H.R. 2676 is likely to have little or no impact.

While the burden of proof provision of the House bill is unlikely to have any significant impact on most tax cases, you have expressed concern that the measure may actually make things more complicated for taxpayers when facing an IRS audit. It is possible that the provision might actually result in the IRS becoming more intrusive in audit examinations. As stated in H.R. 2676, the provision allows a shift

in burden of proof only when the taxpayer can demonstrate cooperation and proper substantiation. It is possible the IRS could insist on intensive examination in order for the taxpayer to show "full cooperation" and extensive documentation, even to excruciating detail, for the taxpayer to demonstrate adequate substantiation. Similar "judgment call" situations have created problems in the Offer in Compromise program and could lead to uneven IRS treatment of taxpayers in audit situations. These are valid concerns which must be addressed before enactment into law of a provision which is likely to help only a very small number of taxpayers. The National Society strongly recommends that the Finance Committee carefully review the impact of this burden of proof measure.

Taxpayer Rights Involving Certain Court and Administrative Proceedings

H.R. 2676 provides taxpayers with expanded rights when involved in a tax proceeding. Specifically, the bill provides for an expansion of the authority to award attorney s fees based on the complexity of the issues involved with a case, the award of administrative costs incurred after the 30 day letter, and the award of other costs and fees under certain defined circumstances involving a tax proceeding. The House bill also permits a taxpayer to sue for up to $100,000 in civil damages to the extent an IRS officer or employee had negligently disregarded the tax law and regulations. A taxpayer would not be eligible to bring such action unless he or she exhausted all administrative remedies. Further, the House bill increases the dollar cap with respect to cases on the small case calendar of the U.S. Tax Court from $10,000 to $25,000. The House bill provides for certain positive reforms in the area of innocent spouse relief, and it suspends the statute of limitations on filing refund claims for taxpayers suffering a physical or medical impairment.

The National Society considers all of the above measures involving certain specified court and administrative proceedings as being positive, pro-taxpayer provisions. For this reason, NSA recommends that the Finance Committee include these measures as part of its bill.

Privilege of Confidentiality

Under current law, no privilege of confidentiality exists when a taxpayer is represented by a non-attorney in a federal tax matter. Conversely, under current law, the attorney-client privilege is limited to communications between a taxpayer and his attorney. H.R. 2676 extends the privilege of confidentiality to communications between a taxpayer and a non-attorney [meaning a certified public accountant (CPA) or enrolled agent].

The National Society of Accountants supports the confidentiality provision of H.R. 2676. However, in order to help ensure the provision accomplishes its intended objectives, we believe tax practitioners need further guidance regarding the scope and meaning of the measure. First, H.R. 2676 does not extend the privilege of confidentiality to tax cases before the U.S. Tax Court or with respect to a refund case before a federal court. In a Commerce Clearing House Federal Tax Weekly article (dated November 13, 1997), the article's author suggests that IRS attorneys may be able to subpoena a written communication between a taxpayer and a CPA or enrolled agent through use of normal litigation discovery procedures. Ironically, the article also suggests that these papers might not have been attachable through IRS summons authority during the earlier audit examination or appeals stages of the case.

NSA also believes guidance is needed with respect to the impact of the confidentiality provision on state tax proceedings or cases involving private litigants. The written communications between a CPA or enrolled agent and a taxpayer might be subject to discovery in such proceedings without any privilege protections. Under these circumstances, once the accountant s papers have been made available in a state proceeding or to a private litigant, the IRS (arguably) would have a right of access to those otherwise confidential papers.

We fully understand it will become incumbent on professional societies like NSA to educate their memberships about risk management techniques and how to best utilize the confidentiality privilege to protect a taxpayer s rights. For example, H.R. 2676 states the privilege of confidentiality (between a taxpayer and a non-attorney) is not available in criminal tax matters. In this context, NSA believes clarification is needed with respect to how a non-attorney should handle a case which starts out as a traditional IRS audit examination, i.e. a civil administrative matter, but later ends up being referred to the IRS Criminal Investigation Division (CID).

In order to ensure a taxpayer s rights are afforded the strongest protections possible, the National Society is interested in working closely with the Finance Committee to address the questions we have raised about the meaning and scope of the House s confidentiality measure.

Expansion of the Authority to Issue Taxpayer Assistance Orders

In order for a Problem Resolution Officer (PRO) to issue a Taxpayer Assistance Order (TAO) under current law, the PRO must determine whether the taxpayer is suffering or is about to suffer a significant hardship. If a significant hardship is determined to exist, the PRO then makes a determination as to whether the IRS action warrants being changed. The Tax Regulations define a significant hardship as meaning a serious deprivation caused or about to be caused to the taxpayer as a result of IRS administration of the tax law.

The National Society of Accountants supports the provision contained in H.R. 2676 expanding the authority of the Taxpayer Advocate to issue a Taxpayer Assistance Order. H.R. 2676 provides the Taxpayer Advocate consider several factors when determining whether to issue a TAO. The factors include an analysis as to (1) whether there is an immediate threat of adverse action, (2) whether there has been unreasonable delay in resolving taxpayer account problems, (3) whether the taxpayer will be forced to pay significant fees for professional representation due to the problem, and (4) whether the taxpayer will suffer irreparable injury.

While NSA supports the measure contained in the House bill, we believe the language contained in S. 1096 regarding the expansion of the issuance of TAOs provides a clearer definition of "significant hardship." The language contained in S. 1096 specifically defines by statute what constitutes significant hardship for purposes of issuance of a TAO. Of critical importance, it is the definition of "significant hardship" which constitutes the operative language for issuance of a TAO under Internal Revenue Code section 7811. We recommend that the Finance Committee adopt the language of S. 1096 when crafting the provision on TAOs.

Protections for Taxpayers Subject to Audit or Collection Techniques

Under H.R. 2676, the IRS is generally not permitted to use financial status or economic reality examination techniques to determine the existence of unreported income of a taxpayer unless the agency has a reasonable indication that there is a likelihood of such unreported income. NSA views this measure as an important pro-taxpayer provision, particularly since financial status or economic reality audits can often become very vexatious for taxpayers. These specialized audit techniques, when utilized by IRS Revenue Agents in civil audit examination cases where there is little possibility of unreported income, create the impression of a criminal tax investigation.

Another important provision of H.R. 2676 is the measure involving the extension of the statute of limitations by agreement. This measure requires the IRS to notify the taxpayer of his or her right to refuse or to limit the extension of the statute of limitations with respect to an audit or collection matter. NSA strongly recommends inclusion of this measure in the upcoming Senate Finance Committee bill on IRS reform.

Offers in Compromise

H.R. 2676 provides for the IRS to develop and publish schedules of national and local allowances to ensure that taxpayers entering into a compromise can provide for basic living expenses. While the National Society of Accountants believes this particular provision attempts to address a real problem underlying the IRS collection process, we are concerned that the provision (as currently drafted) does not provide any practical relief to taxpayers.

NSA members believe the current allowable expense standards for Offer in Compromise and Installment Agreements are inconsistent with the real cost of living for families. Our members are concerned that the expense standards do not adequately compensate for such factors as family size, housing and utility allowances, and the cost of car ownership. We also are troubled that with respect to the Offer in Compromise process, IRS Revenue Officers are adhering strictly to the expense standards rather than using them for general guidance.

The National Society of Accountants believes better guidance should be given to IRS collection personnel. There should be allowance for exceptions with respect to a taxpayer s expenses under an Offer in Compromise, particularly when a reasonable basis exists relative to the taxpayer s state of health or his or her ability to generate income. Further, IRS Revenue Officers should be given authority to weigh available options for achieving the most realistic result. Often a taxpayer who cannot negotiate an Offer an Offer in Compromise simply files bankruptcy, causing the IRS to recover even less than if the original offer had been accepted.

Our members have found there are often inordinate delays in the processing of Offers in Compromises by IRS Revenue Officers. Accordingly, NSA recommends that the IRS should have a set time for completion of an Offer. Should the agency not complete the Offer within this specified time period, the agency should inform the

taxpayer why the Offer has not been completed. The National Society believes the Finance Committee must address the issue of time delays and taxpayer notification in its bill.

The National Society urges the Finance Committee to consider further changes to the Offer in Compromise program. Currently, less than half of Offers in Compromise submitted by taxpayers are deemed processible by the IRS. Of those that can be processed, approximately one-half are resolved. The program as administered by the IRS Collections function is plagued by complicated application instructions, inordinate delays in processing, unprocessible submissions, delayed notifications and lack of consistency. The National Society recommends the Finance Committee consider removing the Offer in Compromise program from Collections and placing it in a more suitable location within the IRS, such as Appeals or an expanded and independent Taxpayer Advocate's Office. By doing this, the Committee will be protecting a taxpayer's right to a speedy and fair resolution of collection matters.

Other Taxpayer Rights Issues

In his November 7, 1997 floor statement, Chairman Roth raised a number of very important initiatives for possible inclusion in the Finance Committee s IRS reform bill. These proposals include the establishment of an independent inspector general within the IRS, the implementation of new procedures for due process in IRS liens and seizures, a prohibition on the use of false identifications by IRS employees, the requirement that all correspondence be signed, and a ban on use of Bureau of Labor Statistics data in determining a taxpayer's income.

The National Society believes these initiatives should prove very significant in future terms of protecting a taxpayer's rights, and therefore we are supportive of the proposals.

Tax Penalty Reform

The National Society of Accountants supports the provision contained in H.R. 2676 calling for the Joint Committee on Taxation to complete a study of tax penalties. Within nine months of enactment, the legislation calls for a review of the administration and implementation by the IRS of the penalty reform provisions of the Omnibus Budget Reconciliation Act of 1989, including legislative and administrative recommendations to simplify penalty administration and reduce taxpayer burden.

NSA believes tax penalty reform should become the next serious phase of IRS restructuring. Moreover, we strongly urge the Finance Committee to require, as part of its IRS reform bill, a review of the extent to which the federal government relies on tax penalties for revenue raising purposes.

Removal of Preparer's Social Security Number from Tax Returns

The practitioner community is becoming increasingly concerned with the current requirement that a paid preparer's Social Security number appear on returns. Revenue Ruling 79-243 states that under Section 6109(a)(4) of the Internal Revenue Code, any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, the preparer s employer, or both . . . (and) that the identifying number of an individual shall be the individual's Social Security number." Revenue Ruling 78-317 gives some relief by stating that "an income tax return preparer is not required to sign and affix an identification number to the taxpayer's copy of a federal income tax return," being required only to affix his or her Social Security number to the copy of the tax return filed with the Internal Revenue Service.

In today's world of instant access to volumes of sensitive information about an individual, including even credit reports accessible over the Internet, practitioners are understandably concerned that their Social Security number could be the key to unauthorized release of their personal financial information. Practitioners feel that the requirement they include their Social Security number on returns violates their privacy, as it could provide a possibly unscrupulous taxpayer the opportunity to access certain records that would not otherwise be available. Once the taxpayer leaves the practitioner's office, there is no guarantee the original copy of the tax return will be filed before making additional copies. There is always the possibility copies could end up in an undesirable location. As part of the Senate Finance Committee s deliberations on IRS reform, NSA suggests that the Committee review this requirement with the Internal Revenue Service and develop a separate system for identifying tax practitioners.

The National Society is please to provide these comments on IRS reform and restructuring. NSA stands ready to work with the Finance Committee to develop a comprehensive approach on this most important issue for taxpayers and practitioners.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

STRENGTHENING OVERSIGHT

Question 1. There are two ways for improving Executive Branch oversight of the IRS. One is to vest significant oversight responsibility with the Oversight Board, and the second is to substantially increase the power of the Treasury Inspector General. What are your views on both of these ideas?

Answer. The National Society of Accountants concurs with the Finance Committee regarding the need for significant oversight of the Internal Revenue Service. This oversight role can successfully be accomplished through the Internal Revenue Service Oversight Board, as provided for under H.R. 2676. NSA also could support a stronger Treasury Inspector General, an individual who would have significant investigatory authority over the IRS. NSA believes that there is room for both oversight programs in any final legislation. There is room both for a strong, effective oversight Board and an activist Inspector General.

Question 2. Is the Oversight Board created in the House bill an executive board, or merely advisory? Does the board have legal authority to direct actions taken by the Commissioner?

Answer. NSA supports the concept of making the Oversight Board a truly executive board, as opposed to merely an advisory panel. We support the specific functions delegated to the Board under the House legislation, including the authority to approve the IRS strategic plan, review the agency's operational functions, and review the selection of a Commissioner. The National Society also believes the Oversight Board should have the authority to review agency contracts, particularly since the agency's largest procurement purchases will come from the area of technology. NSA further supports an extension of the Board's authority to an oversight of audit and collections activities, as we believe this kind of authority would enable the agency to achieve an even higher level of customer service.

Question 3. If the Oversight Board is created and Commissioner Rossotti is able to turn the agency around, should the board be sunsetted?

Answer. NSA views the concept of an IRS Oversight Board as being one of the most important provisions of any final IRS reform legislation. Even after we reach the point that the Oversight Board and Commissioner Rossotti have been successful in restoring public confidence in the IRS, we do not support the notion that there should be any hasty sunsetting of the Oversight Board's legal authority. In many ways, the success of the Board should demonstrate a need for it, rather than for its abolishment.

PROTECTING THE TAXPAYER.

Question 4. What are your thoughts on changes the committee ought to consider in the area of interest and penalties?

Answer. We believe there is a clear need for comprehensive reform in the areas of interest and penalties. As part of any comprehensive reform effort, we support the concept that interest on a penalty should only begin to run after the time has expired for the taxpayer to pay the bill. In contrast to current law, interest on penalties should not be retroactively applied back to the due date for the tax return. Moreover, we also support reforms in the areas of the substantial understatement penalty, the failure to pay penalties, and payroll tax related penalties. These particular areas are mentioned most frequently by accountants who report taxpayer problems and complaints to NSA's national office.

Question 5. Should the Taxpayer Advocate and problems resolution officers be independent from the IRS? What are the advantages and disadvantages of separating the Taxpayer Advocate from the IRS?

Answer. NSA supports making the Taxpayer Advocate an independent official within the IRS. By making the Taxpayer Advocate independent, we believe the Finance Committee would be building on the beneficial provisions found in the Taxpayer Bill of Rights II, enacted into law in 1996. The 1996 Act created the office of Taxpayer Advocate within the IRS.

Question 5(a). Is the current offer in compromise program broken? How would you improve it?

Answer. The National Society believes that the current Offer in Compromise program could be made a much more effective program. We believe meaningful changes must be made with respect to the IRS' current expense standards, which the agency uses to administer the Offer in Compromise and Installment Agreement programs. NSA considers the current expense standards as not adequately compensating taxpayers for such factors as family size, housing and utility allowances, and the cost of car ownership.

Further, the National Society of Accountants recommends the Finance Committee consider removing the Offer in Compromise program from Collections and placing it in a more suitable location within the IRS, such as Appeals or an expanded and independent Taxpayer Advocate's office. less than half of Offers in Compromise submitted by taxpayers are deemed processible by the IRS. Of those that can be processed, approximately one-half are resolved. We believe relocating the Offer in Compromise program would be the best way of protecting a taxpayer's right to a speedy and fair resolution of collection matters.

Question 5(b). Should there be a review of labeling (a taxpayer as an "illegal tax protester") to prevent abuse of the labeling system to the detriment of law abiding taxpayers?

Answer. NSA could support a call for a study regarding the factors used by the IRS in terms of when the agency label's a person an "illegal tax protester." We do not have enough information to support enactment of substantive legislative changes in this area at this time.

Question 5(c). Should most (IRS) correspondence be signed so that agency personnel are accountable? At some stage in the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. The National Society appreciates the concern by many taxpayers that most correspondence should be signed by agency personnel to make them more accountable. In this regard, NSA also supports the requirement that the Taxpayer Advocate take steps to ensure that local telephone numbers for the problem resolution officer in each Internal Revenue District be published and made available to taxpayers.

OVERSIGHT BOARD QUESTIONS

Question 6. The House bill establishes a board "to oversee" the IRS in its "administration, management, conduct, direction, and supervision" of the administration of the tax laws. What does "oversee" mean to you? What should be the relationship between the Commissioner and the board?

Answer. The National Society of Accountants believes the Oversight Board should work with the IRS by bringing together an experienced, knowledgeable management team to contribute outside ideas and expertise. The Board would work with the Commissioner to present peer viewpoints on key management issues that may be examined. The Board would also provide the influx of outside opinion concerning taxpayer rights issues. By bringing fresh ideas into the mix, the Board would operate as a check to the more static nature of the bureaucratic form of doing business. The Oversight Board would function by providing the Commissioner with guidance in the development and oversight of implementation of long-term strategies at the agency. The Board should have authority to hold IRS management accountable for the agency's performance. The Oversight Board should not have authority to remove the Commissioner, but should have authority to recommend to the President and to the Secretary of the Treasury that the Commissioner be removed from office.

Question 7. . . . the bill prohibits the board from exercising any authority over "law enforcement activities" such as collections—an area which our hearings have shown to be rife with taxpayer abuse. Should the Board have oversight authority over law enforcement activities to prevent taxpayer abuse?

Answer. According to National Society of Accountants members, the IRS' examination and collection activities are the two areas generating the greatest number of taxpayer complaints. For this reason, we support an expansion of Board authority to oversight of audit and collection activities. Many IRS abuses have been reported regarding seizures of taxpayer's property without proper notification or proper procedures having been followed. The Board should have authority to examine these situations and determine if taxpayers' rights have been protected or violated, and to take appropriate action, if necessary.

The National Society of Accountants also believes the Board should have authority to examine the ethics, integrity, and civility of IRS officers and employees. Recent hearings have punctuated the fact that such officers and employees do not all subscribe to acceptable levels of professional conduct in their dealings with taxpayers and practitioners. Attorneys, certified public accountants, and enrolled agents, under Treasury Department regulations, subscribe to enforceable standards of conduct in their duties to their clients and the IRS. Those who work for the IRS also should have standards of conduct in the work they perform.

Question 8. If an IRS Oversight Board is established within Treasury, should board members be part-time or full-time employees?

Answer. The National Society of Accountants supports full-time status for Oversight Board members. This would enable Board members to focus their full concentration on the needs of taxpayers and the IRS. We would envision IRS Board members serving for a term of years, in a similar fashion to SEC Commissioners and Federal Reserve Board Governors.

CHANGING THE CULTURE

Question 9. Improving oversight and protecting the taxpayer are not the only things we need to be doing to respond to the problems uncovered at the IRS. We need to change the very culture of the agency itself. That will require a complete new look at its organizational structure, its managerial rules, its performance measures, and its training programs.

(a). What changes would you like to see in personnel rules and other procedures to change the culture of this organization?

Answer. The Commissioner must be given the flexibility to experiment with new administrative processes, procedures and programs. He must be given time and resources to reorganize the system and develop his personnel. Most of the individuals working for the IRS at the national, regional and district levels are hard-working people who pride themselves in providing quality and courteous service. However, antiquated computer systems and outdated processes have sometimes made their jobs difficult. It is very important that funds be allotted to improve equipment, including computers, fax machines, e-mail systems, and phone systems, that will allow IRS employees to efficiently perform their duties.

Another very important change is a change in the IRS mission from one primarily focused on compliance to one emphasizing service. For example, in a compliance-oriented agency, answering taxpayer phone inquiries is not a primary consideration. Therefore, taxpayers experience frustration when they cannot get an answer to their tax filing questions. For many years, the Service tolerated a telephone condition where significant numbers of taxpayers were unable to speak to anyone who could help them resolve a problem. In a service-oriented agency, the ability to respond to taxpayers by telephone is crucial. Taxpayers who today can get answers to their questions will not be tomorrow's non-compliant problems for the Service.

Hiring practices at the IRS should be made more flexible to allow more individuals from outside to be brought into the agency. The practice of only promoting from within allows a culture to grow that very seldom has an infusion of new ideas and different viewpoints. The IRS needs an employee culture that is as open to change as is the nation's business culture. In the past year, the Service has been forced by the National Commission on Restructuring the IRS to consider outside input to a much greater degree than at any time previously. It is this outside input that has caused the agency to reassess its methods and even consider new ways of addressing old problems.

Finally, the IRS needs to expand training and education opportunities for employees, especially those that deal directly with the public. Private industry, such as banks and credit card companies, have been able to create knowledgeable, efficient workforces to deal with customer service. There is no reason why IRS cannot devote more resources to creating a similar type workforce to administer the nation's tax programs.

Question 9(b). What is your response to people who, because of their experiences with IRS, believe this agency beyond saving?

Answer. The National Society of Accountants believes that before the IRS is dismantled, it be given an opportunity to reform itself. The new Commissioner of Internal Revenue, Charles Rossotti, has shown a desire to change the way the IRS does business. We think he should be given the chance to implement his ideas. It is the tax code that needs to be reformed as much as the agency itself.

Question 9(c). Should the IRS employees be required to follow the Internal Revenue Manual and other official procedures?

Answer. Yes. The Internal Revenue Manual contains all IRS policy statements and provides guidance to IRS employees on agency policy and procedures. The IRM is designed to serve as the one official compilation of policies, delegated authorities, procedures, instructions and guidelines relating to the organization, functions, administration, and operations of the Service. It sets a standard for IRS employees in dealing with taxpayers. We believe IRS employees should be required to follow the IRM standards. In addition, we believe the IRM should be made public, in an easy to use and understand format, and easily available to taxpayers.

SIMPLIFYING THE CODE

Question 10. What parts of the code do you think are prime candidates for simplification?

Answer. The National Society of Accountants recommends numerous items for consideration under "tax code simplification," including:

—elimination of the various "phase-out" provisions;
—elimination of the Alternative Minimum Tax;
—elimination of multiple capital gains rates and holding periods;
—consistency in use of tax terms and definitions across different sections of the tax code;
—simplification in the Earned Income Tax Credit;
—simplification in the passive activity loss limitation rules; and
—simplification/elimination of estate and gift taxes.

PREPARED STATEMENT OF RICHARD B. CALAHAN

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you today to testify on legislation for restructuring the IRS. Specifically, I have been asked to discuss the importance of establishing independent oversight of IRS. Let me start off by saying I commend this Committee's efforts to reform the IRS. The proposals that are under consideration by this Committee and contained in House bill H.R. 2676, clearly signal a desire to see the IRS become a better managed, more customer driven agency that works for, not against the American taxpayer. I think it is critical that a strong, independent oversight function be part of that reform. It can help Congress, the Secretary of the Treasury and the Commissioner of IRS ensure that these reforms are taking hold and no unintended consequences result.

The discussion regarding an Office of Inspector General (OIG) for Treasury goes back a long time. When the Inspector General Act of 1978 was being debated, the question of having an Inspector General for the Department of the Treasury was discussed extensively. A major item of debate at that time was the Inspector General's access to the programs, activities and functions of the Department of the Treasury law enforcement bureaus (Alcohol, Tobacco and Firearms; Customs; Secret Service; and IRS). At the time, it was decided not to have a statutory OIG for the Treasury, but this debate continued for the next 10 years.

In the meantime, the Treasury Department did establish an Administrative Inspector General, but it was small and did not include the internal audit and internal investigative units of the four law enforcement bureaus. In 1986, GAO issued a report entitled, Treasury Department: An Assessment of the need for a Statutory Inspector General." GAO was critical of Treasury for only giving the administrative Inspector General direct responsibility for about one tenth of the Department. GAO recommended that the Congress establish a statutory Office of Inspector General at the Department of the Treasury. In making that recommendation, GAO also suggested the Congress consider special legislative provisions to accommodate the Department's concerns over the possible disclosure of sensitive law enforcement and tax information.

When the Inspector General concept was expanded with the Inspector General Act Amendments of 1988, Congress created a statutory Inspector General in Treasury despite continued concerns about access to the law enforcement bureaus. As with other departments that handle sensitive matters, Congress acknowledged that some special provisions were required. Accordingly, Congress created a unique structure for the Treasury Inspector General. Under the 1988 Amendments, the internal audit functions of the Bureau of Alcohol, Tobacco and Firearms, the Customs Service and the Secret Service were transferred to the Department of the Treasury's Office of Inspector General, with the Office of Inspector General providing oversight. However, those three bureaus retained their internal investigative units. The Office of Inspector General was given oversight, but not supervisory authority, for those internal investigative units.

With respect to the IRS, the internal audit and investigative functions were retained by the IRS Chief Inspector. As defined by the Congress and the Department's implementing procedures, the Inspector General's authority is carried out through an oversight function that determines the degree of compliance with applicable professional standards and with Departmental and Service policies and procedures. Additionally, the OIG is authorized to investigate alleged misconduct by senior-level IRS officials (officials in positions at the grade 15 level or higher) and employees in the Office of the Chief Inspector and the Office of the Chief Counsel. The Act

did not provide the new statutory OIG with any resources for IRS oversight. However, subsequent to passage of the 1988 Amendments, 21 Full-Time Equivalent positions (FTEs) were provided to the OIG through a Memorandum Of Understanding between the IRS Commissioner and the Inspector General.

The end result of this is that the IRS Chief Inspector has primary cognizance for internal audit and investigative activities in the Service. The purpose of the Chief Inspector's Office is to promote public confidence in the IRS by providing management with professional audit and investigative products. The Chief Inspector pursues his mission through two major organizational components Internal Audit and Internal Security. The IRS Office of the Chief Inspector carries out its duties with approximately 1200 FTEs located in the four IRS regional offices and headquarters. The IRS Office of the Chief Inspector performs one of the most important audit and investigative functions in the Government, but has none of the elements of independence provided to the Presidentially-appointed Inspectors General. The more significant of these are that the Inspector General:

1. Is nominated by the President and confirmed by the Senate.
2. Can be removed only by the President.
3. Reports to the head or deputy head of the agency.
4. Generally, cannot be prevented from conducting an audit or investigation. (In the case of some departments, including Treasury, the Secretary may, in unusual situations, prevent an audit or investigation by giving written notice which the Inspector General must provide to Congress.)
5. Has a legislative mandate to communicate directly with the Congress.
6. Has a separate line item in the Administration's budget.
7. Generally has its own legal counsel.

Without these elements of independence, the Office of the Chief Inspector continues to face public and internal perceptions of its lack of independence. The current arrangement for OIG oversight of the Office of the Chief Inspector does little to mitigate the lack of structural independence. The present oversight arrangement is cumbersome and the resources provided us for this function are too few to offset the perception of lack of independence and the concerns that have resulted. In fact, this has been implicitly recognized by the Congress as it has requested the OIG to perform more and more assignments at the IRS over the years, several of which are ongoing.

ORGANIZATIONAL STRUCTURE AND RESOURCES FOR OVERSIGHT COMMITMENTS

Let me briefly describe for you how we are organized to carry out our oversight responsibilities for the IRS. Most of the work we do at IRS is performed by our audit and investigative units, although we also perform work out of our evaluations and information technology groups. Within our Office of Audit. we have 168 FTEs to conduct audits at ten Treasury Bureaus and the Department This includes 65 FTEs devoted full time to helping improve financial management in the Department and across government through financial statement audits. Within the Office of Audit, we have one unit of 13 auditors responsible for conducting and coordinating audit work at IRS as well as the Financial Management Service (FMS) and the Bureau of the Public Debt. This group also performs oversight reviews of the Chief Inspector's internal audit operations.

Within our Office of Investigations, we have approximately 60 FTEs to conduct investigations at the ten Treasury bureaus and the Department. With that staffing, we have responsibility for investigating all employees at the six non-law enforcement bureaus and the Department, as well as senior level officials and all employees in the Offices of Inspection, Internal Affairs and Chief Counsel at the four law enforcement bureaus. The Office of Investigations has an oversight unit with a current staff of 11 which conducts oversight reviews of the four law enforcement internal investigative functions, including IRS. In addition, this unit handles most of our special reviews which result from congressional requests and hotline complaints. Currently, almost all of that unit's staffing is devoted to issues involving IRS.

BENEFITS OF THE OVERSIGHT FUNCTION

With its organizational placement in the IRS, the Office of the Chief Inspector has encountered problems that could have been avoided if it had been structurally independent. in this regard, the Office of Inspector General has had to serve as the vehicle for maintaining the Office of Chief Inspector's independence.

For example, the Office of Inspector General twice stepped in to inform the Secretary of the Treasury about the Chief Inspector's position on Tax System Modernization (TSM) problems that should have been classified as material weaknesses under the Federal Managers' Financial Integrity Act (FMFIA). The Service had

taken a different position and did not initially report the TSM problems as material weaknesses, despite the Chief Inspectors' objections. Without Inspector General intervention, two material weaknesses identified by the Office of the Chief Inspector would probably not have been included in the Secretary's assurance letter to the President. In both instances, once the position of the Chief Inspector was communicated to Department management. the FMFIA assurance letter was changed to reflect this position.

PROBLEMS WITH THE OVERSIGHT ARRANGEMENT

Should the Congress decide to continue the Inspection Service in its current organizational context, there are important issues to be considered regarding improvement of the current oversight arrangement. We have grouped issues on oversight of the IRS audit and investigative functions into four general categories; resources, the definition of oversight, access and legislative impediments.

One of the most significant problems with the current oversight arrangement is resources. The OIG this year has an FTE ceiling of 292 from which we must provide audit and investigative coverage to the nine other Treasury bureaus and the Department. We have established a number of processes to keep us apprised of significant audit and investigative activities by the Chief Inspector Within our existing resources, we have reviewed the Chief Inspector's operations, conducted numerous investigations of senior IRS officials and performed our own audits of IRS programs where it was more appropriate for us to do so. While all of this in total has given us some presence in IRS, with the size, complexity and highly decentralized nature of an agency such as IRS, it does not provide the level of independent oversight that most other agencies are given with the more traditional Inspector General structure. A good example of the difficulties we face is the current work being performed on the inappropriate use of enforcement statistics. The Chief Inspector's office has close to 80 auditors assigned to this project. The size of this undertaking makes it impossible for the OIG to perform the assignment, work in partnership or perform meaningful oversight on a real time basis. This is just one of many significant reviews the Chief Inspector's office is performing.

With regard to the definition of oversight, the 1988 Inspector General Act Amendments did not specifically define what oversight is or how it would be carried out. One key question has always been at what point does OIG recommended action become "line management" and therefore fall outside of the intent of the Act. There have been some situations where the OIG recommended actions that in its view fit within the meaning of oversight, but the Chief Inspector's office thought constituted exercise of line management. Resolution of these problems has taken a considerable amount of effort and delayed completion of the assignments.

Some current examples where this has occurred include:

Reviewing a Chief Inspector report prior to issuance. There were important issues being reported that the OIG thought should be commented on before the report became final. The OIG was not provided the opportunity to do this.

Recommending that a Chief Inspector report be issued to an official in line management above the IRS Commissioner. All the officials in line management, including the then Commissioner, had been interviewed for the report. The OIG recommendation was not followed.

Supervising Office of the Chief Inspector employees on the OIG audit of the IRS' administrative financial statements. When the OIG assumed responsibility for this audit from GAO, this became an issue which needed to be resolved.

Reviewing a Report of Investigation sent to the Office of the Assistant Chief Counsel (Disclosure Litigation). The position of the Chief Inspector was that oversight authority did not cover this. The OIG was eventually allowed to review the Report of Investigation, but could not obtain a copy.

With regard to access, the Inspector General does not have the same level of access to IRS information that is afforded to the Chief Inspector. While for the most part we have been able to obtain the needed information, we have had instances where access was refused or delayed and we had to expend unnecessary time and effort to resolve the matter or find alternatives to accomplish our objectives.

Legislative impediments center around two provisions in the 1988 Inspector General Act Amendments. First, the OIG is required to provide notice to the IRS of its intent to access return or return information, such as taxpayer returns. Second, with reference to Chapter 75 of the Internal Revenue Code, the OIG may report to the Attorney General only offenses under section 7214 without first obtaining the consent of the Commissioner of Internal Revenue. This provision restricts the authority of the Treasury OIG to refer violations of Inter-

nal Revenue Code, such as section 7213 pertaining to unauthorized disclosures of return or return information to the Department of Justice.

Both of these provisions have affected our work. For example, on some assignments, repeated notices of intent are required as the OIG is informed that the notice on file does not quite cover records it is trying to obtain. This can be frustrating and time consuming. More importantly, it is a process totally inconsistent with normal investigative procedure because it requires OIG investigators to notify others of the direction in which their investigations are going. Such a process risks compromising audits and investigations, particularly in situations where Office of Chief Inspector employees may be under review or in some way related to the review.

Similarly, the requirement for obtaining IRS Commissioner consent on referrals to the Department of Justice creates the potential for conflicts of interest. This situation also precludes the opportunity for an objective review by a party outside of the Department, namely the experienced Department of Justice prosecutors. Revision of these two provisions, which would require either an amendment to the Inspector General Act or enactment of separate legislation would greatly enhance our independence and the effectiveness of our operations.

These issues also need to be considered if the Congress decides to leave the structural arrangements between the Office of the Chief Inspector and the OIG as they are.

I would like to add that I met recently with Commissioner Rossotti and discussed these issues and he assured me of his full cooperation in helping to resolve them. In the long term, I believe more direct OIG authority to access IRS information is a better solution.

BENEFITS OF AN INDEPENDENT STRUCTURE

An independent Inspector General function for the IRS has a number of benefits. Among these benefits are organizational objectivity that is independent of management control (and particularly independent from the program function) in performance of audits and investigations, department-wide perspective, and greater accountability to the Congress. I would like to elaborate a little more on each of these benefits.

First, having an Inspector General function that is not under the direct supervision of the top program manager places the office in a structurally independent position. By its very design, this arrangement helps ensure organizational objectivity because the Inspector General is established as a separate line of business with its own mission, vision and values reporting directly to the Secretary or Deputy Secretary.

Second, an independent Inspector General helps avoid the real or perceived conflicts of interest often present when the activity is an internal function of another program area. By having control over its own resources. the independent Inspector General structure would be less prone to interference or influence by IRS management.

Third, the organizational independence places the OIG in a position where it can maintain a department-wide perspective of issues and problems. The OIG is the focal point for audit and investigative activity in the Department. From this vantage point as an independent bureau within the Department of the Treasury. the Inspector General is less likely to view issues from a parochial level and it can bring the broader knowledge of department-wide activities into play.

Fourth, the independent Inspector General structure provides more direct accountability to the Congress. This is accomplished through semiannual reports to the Congress, budget submissions and other statutory reporting requirements, and Congressional hearings.

OPTIONS

There are several options for the Committee to consider. From our point of view there are serious considerations pertaining to each option. In our view, the predominate consideration should be to provide as much independence to audit and investigative functions as is consistent with practical considerations. There are tradeoffs in this analysis. Historically, in this mix of tradeoffs, the Congress has properly established Inspector General-style independence as the standard The options, as I see them, are:

1. Maintain the Chief Inspector within the IRS and retain the current oversight structure for the Treasury Inspector General.

Both the internal and external perception of a lack of independence will continue because of the lack of structural independence.

If this is the result, Congress will need to at least resolve the difficulties in the current oversight arrangement, particularly the restrictions on OIG access to Internal Revenue Code 6103 material and related restrictions on referrals to the Department of Justice.

The Congress will also need to provide the OIG with legislative authority to designate its investigators full law enforcement authority to at least provide the OIG investigators comparable standing with those in the Office of the Chief Inspector.

Consideration should be given to adding some of the OIG elements of independence to the Office of the Chief Inspector, such as independent legal counsel and a line-item budget.

2. Establish an IRS Office of Inspector General with most or all of the Inspector General independence elements, and incorporating the IRS Office of the Chief Inspector into it.

This would be a unique arrangement. No other department has two presidentially nominated and Senate confirmed Inspectors General. (Consideration should be given to the IRS Inspector General reporting directly to the Treasury Deputy Secretary to remove many of the difficulties presented under the following points.)

Under this arrangement, the IRS Inspector General would continue to be part of the IRS whether it reports to the Commissioner, the Board, or the Deputy Secretary. (The Treasury OIG is a separate bureau reporting directly to the Secretary or Deputy Secretary.)

There would be serious difficulties with the IRS OIG reporting to a part-time board that lacks access to Internal Revenue Code 6103 material The amount of knowledge the Board could have of specific program issues would be seriously limited.

If the IRS OIG reported to the Commissioner or the IRS Board, some oversight or coordinating arrangement with the Treasury OIG would continue to be appropriate to provide for a focal point in the Department for audit and investigative activity.

The question would have to be resolved as to which of the two Inspectors General would have authority and responsibility to perform the financial statement audit of IRS. This could impact our ability to render the opinion on the Treasury Consolidated Financial Statement.

3. Move the IRS Office of the Chief Inspector under the Treasury OIG.

The Commissioner would lose the direct control of audit and investigative staff. This is a practical management disadvantage which would be offset by the added credibility of the audit and investigative products produced in a structurally independent OIG.

There would be practical difficulties with reorganizing, such as the differences in comparative size between the OIG and the Office of the Chief Inspector, differences in organizational structure, differences in authorities to access Internal Revenue Code 6103 material, law enforcement authority, and so forth. Because the Office of the Chief Inspector does not have legal counsel under its own supervision, additional legal staff should be provided to the new combined OIG.

4. Move a part of the Office of the Chief Inspector under the Treasury OIG, retaining an internal affairs unit and possibly other internal review or evaluation functions reporting directly to the Commissioner.

This would strengthen the independent oversight of IRS, while recognizing that the Office of the Chief Inspector has certain responsibilities that should remain in IRS. It can also give the Commissioner resources under his control that he can use to assess how well the agency is being managed.

This would be more consistent with the other three Treasury law enforcement bureaus which have their own internal affairs units. Also, the Chief Inspector performs some functions in IRS which are traditionally not part of an Inspector General function. This includes protection of IRS employees and conducting background investigations. This would enable the Commissioner of IRS to retain these functions and have resources available to perform special reviews. This option would have to be carefully studied to determine appropriate staffing levels and how to establish clear lines of jurisdiction between this function and the Treasury Inspector General.

CONCLUSION

In conclusion, let me say that establishing the right structure for strong independent oversight of the IRS is as important as any of the other organizational and tax

law changes currently under consideration. Many of these are significant departures from the way IRS has done business in the past. This same thinking needs to be applied to changing the oversight structure. My office would be happy to work with this Committee to come up with the best possible solution.

PREPARED STATEMENT OF PAUL CHERECWICH, JR.

Good morning. I am Paul Cherecwich, Jr., Vice President-Taxes and Tax Counsel for Thiokol Corporation in Ogden, Utah. I appear before you today as the president of Tax Executives Institute, the largest group of in-house tax professionals in North America. The Institute is pleased to submit these comments on proposals to restructure and reform the Internal Revenue Service H.R. 2676, which has been styled The IRS Restructuring and Reform Act of 1997, and its Senate counterpart, S. 1096. The legislation, which passed the House of Representatives last November with overwhelming bipartisan support, is based on the work of the National Commission on Restructuring the Internal Revenue Service (of which Senator Kerrey was co-chair and on which Senator Grassley served). In the Institute's view, the legislation holds great promise for improving the management and oversight of the IRS and for significantly enhancing taxpayer rights while giving the agency the tools necessary to fulfill its congressionally approved mandate.

I. BACKGROUND

Tax Executives Institute is the professional association of corporate tax executives. Our 5,000 members are accountants, attorneys, and other business professionals who work for the largest 2,700 companies in North America; they are responsible for conducting the tax affairs of their companies and for ensuring their compliance with the tax laws. Hence, TEI members deal with the tax laws and with the Internal Revenue Service on almost a daily a basis. (Most of the companies represented by our members are part of the IRS's Coordinated Examination Program, pursuant to which they are audited on an ongoing basis.) They also have day-to-day dealings with senior corporate management and corporate boards of directors, and accordingly, know first-hand the strengths and weaknesses of the corporate governance model. TEI believes that the professional training and experience of our members enable the Institute to bring an important, and balanced, perspective to the issues involved in efforts to restructure and reform the IRS.

II. SETTING THE TONE FOR A CONSTRUCTIVE DEBATE

A. The Emerging Consensus. At the outset, TEI commends the members of the National Commission on Restructuring the IRS, the House Committee on Ways and Means, and this Committee for their unstinting efforts to identify areas of concern, to seek out the views of interested parties, and to craft thoughtful solutions. We especially commend the members of Congress who have cosponsored comprehensive restructuring legislation, and who have remained open to modifications in an effort to develop a bipartisan consensus for enhancing the management and administration of the IRS. Even though TEI disagrees with certain provisions of H.R. 2676, the Institute is convinced that the proposed legislation holds great promise for improving the Internal Revenue Service. The daunting support the bill garnered in the House of Representatives (426 to 4), coupled with the Clinton Administration's constructive support, speaks volumes not only of the bill's appeal but of the care the sponsors have taken in addressing a plethora of complicated issues.

This is not to say, of course, that the bill cannot be improved. As this statement makes clear, TEI clearly believes it can. As the legislative process moves forward, however, TEI believes it is important that the perfect not become the enemy of the good. We also believe it is imperative that everyone concerned Congress, the Administration, the IRS itself, stakeholders in the private sector, and the public acknowledge that consensus has already been attained on a wide variety of issues, including the critically important issue of Executive Branch governance. Hence, the biggest obstacle to reform acceptance of the need to bring greater continuity, accountability, and expertise to the management and oversight of the IRS has already been removed. The key now is to ensure that whatever changes are adopted do not impede the IRS's ability to do its job collecting the revenue necessary to run the government today and into the future.

B. The Need for a Balanced Approach. TEI is especially pleased that nearly all parties recognize that there is no single solution to what ails the IRS. What is needed is a balanced, integrated approach. One change say, the appointment of an IRS Oversight Board will not transform the agency unless it is effectively coupled

with others, including coordinated and streamlined congressional oversight, stronger leadership by the Commissioner and senior IRS management, an increased focus on customer service, and the assurance of effective performance measures. Indeed, one of TEI's primary concerns is that the establishment of an oversight board not become just another layer of bureaucracy within the IRS. By itself, such a board will not make the agency more responsive and may even impede the government's ability to improve the development and administration of our tax laws. In tandem with other changes, however, enhanced Executive Branch oversight of the IRS can increase management accountability and contribute to a tax system that properly focuses on customer service without minimizing the importance of ensuring taxpayer compliance.

C. Focusing on the Future. Once again, the focus of these hearings should be on the future. We should concentrate on clearly defining expectations, on streamlining and strengthening oversight of the agency by both the Treasury Department and Congress, and on providing the IRS with sufficient (and stable) budget resources to modernize its systems, to serve the public, and to ensure compliance with the tax laws. To the extent TEI has a regret about the process that has brought us to this point (including the Finance Committee's hearings last fall), it is the tendency by some to "play to the gallery" and engage in unconstructive, vitriolic criticism of the IRS and its personnel. To be sure, IRS management can be improved, but there is plenty of blame to go around. Unfounded, misplaced, and exaggerated attacks on the agency may have surface appeal and score well in public opinion polls, but in our view, they are not constructive; they are part of the problem, not the solution. The keys to giving the American people the tax system they deserve are to remain focussed on the future, to resist the temptation to micro-manage the IRS's day-to-day activities, and to complete the legislation as soon as possible so the IRS can get on with its work.

III. THE NEED FOR MEANINGFUL SIMPLIFICATION

Although the focus of these hearings is on improving the Internal Revenue Service, we believe it both proper and fair to observe that Congress itself bears a full measure of responsibility for the problems that plague the tax law and its administration. TEI respectfully submits that the biggest steps Congress can take toward meaningful reform are, first, to resist the temptation to use the tax system to address every social or economic ill that confronts the Nation and, second, to work to simplify the tax laws already on the books. Without a doubt, the taxpayer rights title of H.R. 2676 is important and TEI agrees that many of the proposed protections are laudable and merit enactment. At the same time, it should be remembered that the biggest abuses come not from excessive actions by IRS personnel but from the highly complicated laws and onerous administrative procedures that Congress enacts and the President signs into law. One need look no further than the complexity, complications, and confusion spawned by the Taxpayer Relief Act of 1997 for a prime example of how not to write the tax laws. As Winston Churchill might have said, never have so many provisions inflicted so much complexity for so (relatively) few tax benefits.

TEI believes that the complexity of current law is a primary impediment to the effective operation of the tax system and the efficient management of the Internal Revenue Service. Stated simply, if the law is unadministrable, how can the IRS be expected to administer it in an efficient manner? Accordingly, TEI supports the provisions of the bill that would require Congress to focus more finely on the complexity of tax law proposals, for example, by requiring the Joint Committee on Taxation to prepare a "tax complexity analysis" for legislation reported out of the tax-writing committees and for all conference reports that would amend the Internal Revenue Code. By requiring that some attention be paid to exploring the relative complexity of tax law proposals and less complex alternatives, H.R. 2676 may enable Congress to make meaningful incremental changes. We also support the requirement that the IRS provide Congress with an independent view of tax administration and, further, that the tax-writing committees receive testimony from front-line IRS technical experts on the administrability of pending changes. At the same time, we believe it would be imprudent to divorce totally the IRS's role in evaluating the administrability of legislation from the Treasury's tax policy responsibilities. It is the Treasury that should be ultimately responsible and accountable for determining the Administration's position on proposed legislation.

The provisions in H.R. 2676, however, are not a panacea. For example, the availability of a tax law complexity analysis, with or without a complementary point-of-order mechanism, would not have prevented the 1997 tax law from being so complicated. The troublesome provisions were enacted not because their mind-numbing

complexity was unknown but because it was ignored. TEI well appreciates that other policy objectives may sometimes outweigh the goal of tax law simplification, but until the Administration and members of Congress (and, concededly, private-sector interest groups) go beyond paying lip service to simplification and exercise self-discipline in championing complex measures, the goal of tax law simplification will remain illusive.

IV. ENSURING EFFECTIVE OVERSIGHT OF THE INTERNAL REVENUE SERVICE

Tax Executives Institute supports the provisions of H.R. 2676 that would establish a joint government-private sector oversight board to institutionalize enhanced Executive Branch oversight of the IRS. As previously explained, however, we do not believe that the establishment of a board by itself will solve the IRS's problems. Indeed, unless care is taken in establishing the board, it may become just another layer in the bureaucracy, impairing the IRS's ability to manage its affairs rather than facilitating it.

A. Composition of the Oversight Board. As approved by the House of Representatives, the Oversight Board would have eleven members eight "private-life" members who would be appointed by the President with the advice and consent of the Senate, plus the Secretary of the Treasury (or, if the Secretary so designates, the Deputy Secretary), the Commissioner of Internal Revenue, and a representative of a union representing a substantial number of IRS employees.

TEI supports the decision to provide for a reasonably balanced oversight board. Having representatives of both government and the private sector on the board would afford the IRS the benefit of private-sector expertise (which would be lacking on a government-only board) while recognizing the unique mission of the IRS as a tax-collection agency. TEI commends the decision to include the Commissioner, as well as the Secretary of the Treasury, on the board the Secretary (or Deputy Secretary) because he or she is ultimately accountable for the proper oversight of the IRS, and the Commissioner because he or she effectively serves as Chief Executive Officer of the agency. Although TEI appreciates the reasoning underlying the decision to include a union representative on the board (specifically, the buy-in of IRS employees will be critical if the agency is to meet the challenges of the 21st century), the Institute generally believes that members should be selected solely on the basis of their expertise in areas such as general management, finance, technology, and personnel. In other words, no particular group should be guaranteed a position on the board. Hence, we support the delineation in the statute of the various "skill sets" management of large service organizations, customer service, federal tax law (including tax administration and compliance), information technology, organization development, and the needs and concerns of taxpayers that should characterize the private-sector representatives on the board.

B. Duties of the Oversight Board. Under H.R. 2676, the principal function of the oversight board would be to oversee the Internal Revenue Service in the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws, related statutes, and tax conventions to which the United States is a party. The board would be involved in (1) reviewing and approving IRS's strategic plans (including the establishment of its mission, objectives, and standards of performance), (2) reviewing operational functions of the IRS (including plans for modernization of the tax system, training, and education), (3) providing for review of the Commissioner's selection, evaluation, and compensation of senior managers, and (4) reviewing and approving the Commissioner's plans for major reorganizations. In addition, the board would review and approve the budget request prepared by the Commissioner (to ensure that it supports the IRS's annual and long-range strategic plans), which would be submitted to Congress without revision. (The President's ability to submit his own budget request for the IRS would not be affected by the legislation.) H.R. 2676 provides that the oversight board would have no responsibilities with respect to (1) the development and formulation of federal tax policy relating to existing or proposed internal revenue laws, (2) specific law enforcement activities of the IRS, including compliance activities such as criminal investigation, examinations, and collection activities, and (3) specific procurement activities. Finally, the board would have authority to recommend candidates for Commissioner to the President and to recommend removal of the Commissioner.

TEI has no serious quarrel with the duties that the legislation proposes to assign to the oversight board. In general, however, TEI believes the board should serve in an oversight rather than a decision-making capacity. Hence, although we believe the IRS can learn much from the private sector, we recognize that the corporate governance model is not perfect and we have residual concerns about the requirement that

the board-approved budget be forwarded to Congress, even though the IRS's budget would formally be presented (with or without changes) as part of the Administration's overall budget proposal. (The proposal could blur the lines of accountability or heighten the possibility of conflict between the board and the Administration.) Hence, we believe it is important to remember that, with or without a board, it is the Secretary of the Treasury who will remain ultimately responsible and accountable for management of the IRS.

Moreover, although we support the proposed prohibition on the board's becoming involved in the development and formulation of federal tax policy as well as the proposed prohibition on board members' receiving confidential taxpayer information experience teaches that the dividing line between policy and administration is not always easy to discern and maintain. For example, budgetary decisions regarding research or compliance programs could well affect how the tax law is interpreted or applied, thereby affecting policy. Hence, we agree that the presence of private-sector representatives on the oversight board raises conflict-of-interest issues of real moment. While these issues cannot be minimized or ignored (and, in our view, they would be exacerbated if board members were granted access to confidential taxpayer information), they should not be overstated. Institutional protections can and should be implemented (just as they have been in the private sector where the same individuals serve, for example, on multiple boards of directors).

C. Appointment of the Commissioner. Under H.R. 2676, the Commissioner would continue to be appointed by the President with the advice and consent of the Senate, but the oversight board would have authority to recommend candidates to the President and, in appropriate cases, to recommend removal of the Commissioner.

TEI strongly agrees that the Commissioner should continue to be appointed by the President. We also agree that the President should retain the authority to dismiss the Commissioner, who will be responsible for all functions of the IRS, including those beyond the board's areas of responsibility (such as specific enforcement and customer service functions).

V. OTHER MEASURES TO IMPROVE TAX ADMINISTRATION

A. Continuity and Flexibility of Management. Under H.R. 2676, the Commissioner of Internal Revenue would be appointed to a five-year term. We agree with this provision, as well as with the provisions to accord the Commissioner greater flexibility in hiring, firing, and salary decisions. The goals of continuity and accountability at the top of the agency will be advanced by appointing the Commissioner for a fixed five-year term and granting the Commissioner broader authority to manage the IRS.

Indeed, we believe that granting the Commissioner greater discretion in recruiting, rewarding, and retaining the agency's top managers is critical to fulfilling one of the objectives of IRS restructuring and reform ensuring that taxpayers deal only with IRS employees who are trained adequately and possess the skills and tools necessary to do their jobs well. Continuity among the IRS's senior managers assuming they are qualified to do their jobs is essential if the IRS is to operate efficiently and regain the trust of Congress and the American people. Thus, we believe care must be exercised to balance the twin goals of flexibility and stability; in our view, the last thing the IRS needs is massive turnover in senior management ranks whenever a new Commissioner is appointed.

B. Stability of Funding. TEI believes that the Internal Revenue Service should receive stable funding. If the leaders of the IRS are to undertake the proper planning to rebuild the agency's credibility and effectiveness, the agency must be assured that programs initiated and funded in one year in furtherance of the IRS's strategic plan are not eviscerated in the next.

To be sure, the nature of government is such that Congress will retain authority to set the IRS's budget and to readjust priorities as times change and developments warrant. At the same time, we believe more can be done to stabilize the IRS's operational budget and insulate the agency from political winds. Hence, TEI supports the inclusion in the final legislation of provisions stabilizing funding for tax law enforcement and processing, assistance, and management. (The National Commission on Restructuring the IRS recommended funding be maintained at current levels for the next three years.) Moreover, although recognizing that Congress remains ultimately responsible to the American people for how the tax system operates, we believe the overall management of the agency would benefit from the implementation of multi-year budgets. More immediately, Congress must ensure that the IRS is given adequate funding to address both its modernization challenges and Year 2000 Compliance activities.

C. Streamlining of Congressional Oversight. Title IV of H.R. 2676 addresses congressional accountability for the IRS. TEI agrees that congressional oversight of the agency should be streamlined. Reforming the Internal Revenue Service requires more than the IRS and the Executive Branch officials who oversee it getting its house in order. With due respect, it requires Congress to get its house (or houses) in order. Currently, there are seven congressional committees and subcommittees that engage in oversight activities. The U.S. General Accounting Office not only undertakes projects assigned to it by those bodies but also "self-initiates" numerous projects each year. And each of those projects regardless of whether it leads to hearings or legislation consumes considerable IRS resources and may send mixed signals to the agency and the public about the proper direction for tax administration.

While responsible oversight is absolutely essential to effective government, TEI agrees that steps can be taken to streamline congressional oversight activities and to make it at once less reactive, more constructive, and more integrated. In our view, coordinated, as opposed to reactive and sometimes disjointed, oversight by Congress must be part of the drive toward continuity and accountability. Thus, TEI supports the proposal that the Joint Committee on Taxation review and approve requests for investigations of the IRS by the GAO, and recommends that its coordinating role be extended to requests by committees or subcommittees. Such a process will permit Congress to eliminate overlapping investigations, ensure that the GAO has the capacity to handle the requested investigation, and ensure that investigations focus on areas of primary importance to sound tax administration.

TEI also supports the proposal that joint hearings be held annually to review the IRS's strategic plans and budget and, further, to review the IRS's progress in meeting its objectives, improving taxpayer service and compliance, and implementing its modernization initiatives. In our view, the involvement of the oversight board in reviewing the IRS strategic plans and budgets should imbue them with greater credibility and contribute to a more positive and coordinated reception of the agency by Congress.

Finally, we recommend that Congress carefully weigh the potential costs and benefits of requiring the IRS (or its constituent offices or advisory groups) to complete numerous studies (as H.R. 2676 would do) and to make periodic reports on various specific subjects (such as electronic filing), which can consume considerable IRS resources and distract the agency's management from attaining its policy objectives. Congress's role should be to provide oversight and ratify the IRS's strategic decisions, not become involved in managing day-to-day operations. In our view, the oversight board's involvement in the IRS's strategic planning and budget processes should help restore congressional confidence in the agency, thereby facilitating coordinated and streamlined legislative oversight.

VI. STRENGTHENING TAXPAYER RIGHTS

TEI agrees that further steps should be taken to preserve and strengthen taxpayer rights. Thus, we support efforts to ensure not only that taxpayers are treated fairly and impartially by the IRS, but also that they are able to seek redress or review of IRS actions by the courts and to resolve conflicts creatively and expeditiously with IRS cooperation. An essential ingredient in protecting taxpayer rights is an independent, effective taxpayer advocate program. TEI has long regarded the IRS's problem resolution program as one of the agency's success stories, and we believe increased attention should be given to promoting the independence and effectiveness of the Taxpayer Advocate. Thus, although TEI believes that the Taxpayer Advocate should be appointed by, and report to, the Commissioner, we believe it would be appropriate for the oversight board to play a role in the Taxpayer Advocate's selection. We are also pleased by Commissioner Rossotti's testimony last fall, obviously before any legislation was enacted, that he intends to look outside the IRS for the next Taxpayer Advocate.

TEI offers the following comments on specific taxpayer rights proposals in H.R. 2676:

A. Refining IRS Performance Measures. TEI believes that, for IRS reform to be successful, the agency must address training, operations, technology, culture, and taxpayer education. More particularly, the Institute believes it is critical for the IRS to refine its performance measures to guard against real or perceived "quotas" as well as the evaluation of examination and collection personnel on the basis of increased production.

Earlier this month, IRS issued an internal audit report on the use of enforcement statistics in the direction, achievement, and evaluation of the collection function. The report discussed the IRS's focus on increasing productivity and concluded that dollars collected had become the most important factor in setting program goals and

evaluating program accomplishments. In response to the report, Commissioner Rossotti outlined a number of steps the IRS has already taken to address the concerns, including a redirection of the efforts of the IRS's Measures Advisory Group to identify performance measures that will promote quality and appropriate case actions consistent with customer service and taxpayer rights.

Although the IRS's internal audit report focussed primarily on the collection function, concerns about the improper use of statistics go beyond that. TEI has previously voiced concerns that the National Office's concentration on increased production (as measured by "dollars recommended" during the examination process) could impair the overall effectiveness of the Coordinated Examination Program by encouraging revenue agents to pursue questionable issues. In response to such concerns, the IRS has undertaken to ensure that case managers and team members are not evaluated on the basis of "dollars recommended." Any perceptions to the contrary, by IRS field personnel as well as the public, must be corrected.

The adoption of meaningful performance standards is essential to the long-term success of the IRS's examination programs. Measures for overall programs and functions and for the individuals who execute them must be in harmony if the IRS is to achieve its mission of collecting the proper amount of tax (not the highest amount of tax) from taxpayers. The Institute is committed to working with the IRS to improve various performance measures, not only eliminating any hint that the IRS uses "dollars recommended" in evaluating agents but also encouraging the use of innovative techniques such as case management settlement authority, advanced issue resolution, early referral to Appeals, and the involvement of taxpayers in the audit planning process. We believe that District Offices should be evaluated on a range of performance criteria, including an in-depth review of any gap between the dollars proposed and the dollars sustained. Criteria such as the number of agreed issues, the number of issues sustained in Appeals, and the currency of audit activity should also be used, especially in long-term evaluations. The IRS's goal should be to conduct cost-effective, quality examinations with the least burden on both the taxpayer and the government. Although TEI has no formal position on whether the restructuring legislation should be amended to specifically address the issue of IRS performance measures, the Institute stands ready to assist the Committee should it decide to do so.

B. Shifting the Burden of Proof. H.R. 2676 would shift the burden of proof in tax cases from the taxpayer to the government (once the case reaches court and assuming certain net worth requirements are satisfied). Although this provision has been promoted as advancing taxpayer rights, it would undermine the 50-year old principle that taxpayers have the responsibility of proving the correctness of items reported on their tax returns. TEI regrets that it could diminish the level of voluntary compliance and lead to a more intrusive IRS. Accordingly, the Institute recommends that it be stricken from the IRS restructuring bill.

Currently, the burden of proof in tax cases is on the taxpayer in that the IRS's determination of tax liability will be presumed correct unless the taxpayer can rebut it. Proponents of shifting the burden of proof argue that it is inconsistent with the rule that the individuals are "innocent until proven guilty." Except in criminal cases, however, the burden of proof already generally rests with the party who has control over the facts (here, the taxpayer). Otherwise, the party with the facts but not the burden could prevail by concealment.

The burden-shifting proposal is subject to several limitations. First, it only applies to those cases that go to court each year. (Only one percent of all tax returns are audited, and of those, fewer than 2,000 land in court.) Second, it applies only where the dispute between the taxpayer and the IRS is "reasonable" and where the taxpayer has "fully cooperated" with the IRS. And third, the proposal does not overturn specific recordkeeping requirements Congress has already enacted. Whether the burden-shifting law is as narrow as its proponents contend, however, will not truly be known until the courts become involved and define nebulous terms such as "fully cooperated" and "reasonable." This prospect that prompted many commentators to lament that the burden-shifting proposal is unduly cumbersome, raising more questions than it answers. The technical problems with applying the proposal were carefully analyzed by Chief Judge Mary Ann Cohen of the U.S. Tax Court in a letter to the Committee dated December 19, 1997, and we urge the Committee to consider her comments carefully before proceeding.

Indeed, in our view the real problem is not with the few cases in which the taxpayer satisfies the statute. It is with all the other cases. The message that the burden-shifting proposal sends will be mixed. Listen to the sound bites, and what you hear is not a limited proposal but an extraordinarily broad one one that promises to get the IRS out of taxpayers' lives. Scan the headlines, and what you see is that the limitations and nuances have been lost and that taxpayers are being told (or,

at least, are hearing) that they will not have to keep records or substantiate their claims. The sky might not fall in those cases where the burden ultimately shifts, but the overall effect of the legislation may be to undermine voluntary compliance.

Indeed, TEI is very much concerned about how the IRS might respond to burden-shifting. Although advertised as a "get the IRS out of your life" proposal, it may ironically move the tax system in the opposite direction. This is because, if the burden of proof is shifted, the IRS will likely intensify its enforcement activities to sustain its heightened burden. In other words, the few taxpayers who push their cases to court and satisfy the myriad requirements of the statute (after hiring lawyers to help them navigate the complicated provision) may find themselves better off than in the past, but most of us will probably be worse off. As former IRS Commissioner Fred Goldberg once testified, "Change the burden of proof and IRS tactics of today will seem like child's play. . . . It's hard to imagine a more well-intentioned idea that would have more undesirable consequences."

Concededly, the proposal to shift the burden of proof in tax cases resonates with taxpayers. It is fraught, however, with risks for the tax system. Indeed, it is the archetypal "easy solution" that journalist H.L. Mencken warned existed to every human problem: It is neat, it is plausible, it is wrong. Because shifting the burden of proof could lead to a more intrusive IRS, decrease tax revenues, and cause a less efficient tax system, the proposal should be removed from the IRS reform legislation.

C. Authority to Award Costs and Fees. H.R. 2676 would amend the Internal Revenue Code's current provisions relating to awarding taxpayer costs where the IRS's position is not substantially justified, thereby enabling more taxpayers to recover the cost of disputing proposed IRS adjustments. TEI supports the proposal and urges Congress to carefully weigh proposals to eliminate the "net worth" limitations on awarding costs and attorney's fees (which currently operate to deny most corporations any relief even where the IRS's position is wholly unsupportable).

D. Eliminating the Interest Differential. Under current law, the Internal Revenue Code imposes a higher interest rate on tax deficiencies than it pays on tax refunds, which can have the effect of penalizing taxpayers who simultaneously owe and are owed funds by the IRS. H.R. 2676 would eliminate the harsh effects of the Code's interest rate differential (though only on a prospective basis) by (1) eliminating the differential in its entirety in respect of noncorporate taxpayers and (2) providing for other taxpayers that, during periods of overlapping interest (or mutual indebtedness), a net interest rate of zero would apply on equal amounts of tax underpayments and overpayments. The provision, however, would only apply in respect of income and self-employment taxes.

TEI strongly supports the elimination of the interest differential during periods of mutual indebtedness. Indeed, we urge the Committee to consider eliminating the differential not only for noncorporate taxpayers but for everyone, thereby ensuring that the Code's interest provisions operate not to penalize (for example, in the case of so-called large corporate underpayments or overpayments) but rather only to compensate for the use or forbearance of money. Moreover, we urge Congress to confirm in the legislation (not merely in the committee reports) that the IRS has the authority and the responsibility to deal retrospectively with the inequities of the interest rate differential by implementing comprehensive crediting (netting) procedures for all open years.

E. Extension of Privilege of Confidentiality to Non-Attorneys. H.R. 2676 would in effect extend a privilege of confidentiality to communications between taxpayers and non-attorneys authorized to practice before the Internal Revenue Service. Thus, accountants and enrolled agents who represent taxpayers in noncriminal proceedings would be able to interpose a privilege to prevent the IRS from securing communications that would have been privileged had they arisen in an attorney-client relationship.

As an organization whose members include both attorneys and accountants and whose members routinely engage the professional tax services of both attorneys and accountants, TEI has no formal position on the privilege proposal. We do, however, wish to make the following observations that may be of benefit to the Committee as it assesses the proposal. First, taxpayers (including the companies represented by TEI members) are interested in securing the best advice and counsel available, regardless of the professional status of their advisers. Second, we are convinced that there are occasions where the guarantee of confidentiality and the candor it encourages between clients and their advisers can contribute to the quality of that advice. Third, we are concerned that, because the proposal is framed in terms of limitations on the IRS's summons authority (rather than as an amendment to the Federal Rules of Evidence), the benefits of the privilege might well be vitiated by the knowledge that, if a dispute proceeds to court (or involves the IRS Criminal Investigation

Division or a grand jury), the promise of confidentiality would disappear. That is to say, because the non-attorney privilege would apply only at the administrative level in respect of noncriminal tax matters (and not at all in respect of state tax matters), its overall effect might well be muted.

Finally, we are concerned by the so-called law of unintended consequences, which would come into play with an amendment to the IRS's longstanding authority to issue summonses for relevant materials. More to the point, we are concerned that limiting the IRS's authority to reach communications between taxpayers and their non-attorney advisers might well prompt the IRS to pursue relevant information through other, more intrusive means. All these concerns prompt us to urge the Committee to move cautiously in this area.

F. Limitation on Authority to Require Production of Computer Source Code. H.R. 2676 would limit the IRS's authority to issue a summons for third-party tax-related computer source codes, i.e., the human readable instructions for any computer software program that is used for accounting, tax return preparation, tax compliance, or tax planning, along with design and development materials related to such software program. The proposed legislation would provide exceptions for criminal offenses or internal use software. The House report on this provision notes its belief that "the intellectual property rights of the developers and owners of computer programs should be respected."

Mr. Chairman, this is an extraordinarily sensitive issue, and many taxpayers have found themselves often caught in the middle. Although taxpayers are indisputably obliged to make their own "books and records" available to the IRS, they are finding their audits held hostage while the IRS seeks access to software programs that are not in the taxpayers' possession and indeed do not relate specifically to any transactions they have engaged in. While taxpayers accept their responsibility to substantiate items on their returns, they must also respect their licensing obligations to third-party vendors whose very business may depend on the computer code's remaining confidential. In at least one appellate case, the court recognized the need to balance these competing interests by imposing restrictions on the IRS's use of a third-party software program. To date, however, the IRS has refused to accept similar limitations in other cases and persists in involving taxpayers in costly litigation to obtain the source codes despite their tenuous relevancy. No satisfactory explanation for the IRS's position has been offered, other than an assertion of its unfettered right to the information.

Given the attenuated relevance of the source code information to the examination of the taxpayer's return and the highly sensitive nature of the trade secrets inhering in the code TEI is at once frustrated and disappointed that matters have reached this point. Although the Institute has previously supported the development of an administrative solution to this matter, we now believe a consensus exists for legislative action.

VII. CONCLUSION

Tax Executives Institute appreciates this opportunity to provide its comments on proposals to restructure the Internal Revenue Service. I should be pleased to respond to any questions you may have.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

STRENGTHENING OVERSIGHT

Question 1. One of the most important lessons learned for the Committee's oversight hearings lust September is the need for greater oversight of the IRS. The Congress needs to do more oversight—which ire intend to do. But also there must be more oversight of the IRS in the Executive Branch. There are, at least two ways we can improve that oversight. The first is to vest significant oversight responsibility With the Oversight Board that is created in the House-passed bill. The second way, is to substantially increase the power of the Treasury Inspector General. What are your views on both of these ideas?

Answer. Tax Executives Institute believes that the House-passed version of the IRS Restructuring Bill strikes the proper balance in respect of enhancing Executive Branch oversight of the Internal Revenue Service. Although we agree that a strong inspection function is critical to an effective IRS, we also agree that an Oversight Board should be established that oversees the IRS in the administration, management, conduct, direction, and supervision of the execution and application of the tax laws. The Board should be more than an advisory body (such as the current Commissioner's Advisory Group). It should be involved in (1) reviewing and approving the IRS's strategic plans (including the establishment of its mission, objectives, and

standards of performance), (2) reviewing operational functions of the IRS (including plans for modernization of the tax system, training, and education). (3) providing for review of the Commissioner's selection, evaluation, and compensation of senior managers, and (4) reviewing and approving the Commissioner's plans for major reorganizations. The Board should also review and approve the budget request prepared by the Commissioner (to ensure that it supports the IRS's annual and long-range strategic plans). In general, however, TEI does not believe the Board should become involved in day-to-day decisionmaking at the IRS.

TEI also believes that, regardless of whether the inspection function is part of the IRS or the Treasury Department, the Commissioner should be able to call upon, and use, Inspection personnel as a resource in identifying and resolving problems. The Institute is aware of no friction between the Treasury Inspector General and the IRS's Chief Inspector. We also think that internal audit reports should generally be shared with the Oversight Board (subject to appropriate safeguards to prevent improper disclosure of confidential taxpayer information).

Finally, TEI agrees with Chairman Roth that an essential ingredient to improving the management and operation of the IRS is enhanced congressional oversight and accountability. Responsible, focused legislative oversight is needed for effective government, and TEI supports steps to streamline congressional oversight activities (including those of the U.S. General Accounting Office) and to make it at once less reactive, more constructive, and more integrated. Accordingly, the Institute recommends that the provisions in the House-passed bill on streamlining congressional oversight be restored to the Restructuring Bill.

Question 2. Is the Oversight Board created in the House bill an executive board, or merely adsvisory? Does the board have legal authority to direct actions taken by the Commissioner?

Answer. As stated in our response to Question 1, TEI does not believe that the Oversight Board should become involved in day-to-day management of the IRS; rather, the Board should be involved in developing and overseeing the implementation of the agency's strategic plans (including the development of balanced performance measures). We also believe that? strictly speaking, the Board should not have legal authority to direct the Commissioner to take particular actions. At the same time, the Board should and will have considerable influence. through its access to the Secretary of the Treasury, the reports it files with Congress, and most significantly, the expertise and experiences of its members.

Question 3. If the Oversight Board is created and Commissioner Rossotti is able to turn the agency around, should the board be sunsetted?

Enhanced oversight of the Internal Revenue Service (by the Executive Branch as well as by Congress) cannot be a passing fad. It must be ongoing and consistent. Because the need for strategic guidance is continual, we do not believe the Restructuring Bill should provide for an automatic "sunsetting" of the Oversight Board. We do believe, however, that the Board should not be retained if, after a period of years, it becomes an empty vessel. In other words, there should not be an Oversight Board just to have an Oversight Board. If Congress determines that the appropriate cultural and management changes have been effected at the Internal Revenue Service and further determines that Congress itself is providing consistent, credible oversight of the agency, then it should consider abolishing the Board. We do not anticipate that occurring for some time.

PROTECTING THE TAXPAYER

Question 4. What are your thoughts on changes the committee ought to consider in the area of interest and penalties?

Answer. TEI agrees that significant changes in the Internal Revenue Code's interest and penalty provisions should be considered, and we applaud the decision of the House of Representatives and the Senate Finance Committee to include ameliorating provisions in the Restructuring Bill. For example, we strongly support the proposal to eliminate the so-called interest rate differential pursuant to which a higher interest rate is imposed on tax deficiencies than is paid on tax refunds. (Indeed, we believe the proposal should be broadened to reach all types of taxes and all open years.) We also support the call for a comprehensive study of the Code's interest and penalty provisions. As the process moves forward, we recommend that Congress keep in mind the following general principles:

- The Code's interest provisions should operate not to penalize but rather only to compensate for the use or forbearance of money.
- Penalties generally should not be imposed for "foot faults" or for violations that involve non-purposeful behavior. Given the horrendous complexity of the Inter-

nal Revenue Code, taxpayers who strive in good faith to comply should not be penalized.

- Taxpayers who do not strive in good faith to comply should not be given a "pass" in respect of interest charges or penalties. To be sure, the Code's current interest and penalty provisions can sometimes operate to create inequitable (or at least highly sympathetic) situations. In seeking to enhance the rights of noncompliant taxpayers in lien and levy situations, however, Congress should take care not to send the wrong signal to the overwhelming majority of taxpayers who fully comply with the law.
- Congress should abjure the enactment of new (and onerous) interest and penalty provisions to raise revenue. Indeed, just as the Senate Finance Committee has rightly urged the IRS not to use penalty assessments in evaluating the success of its compliance programs, it is unseemly for Congress or the Administration to attempt to "pay for" other provisions by imposing higher penalties or interest rates out of all proportion to the market rate.

Question 5. Should the Taxpayer Advocate and problems resolution officers be independent from the IRS? What are the advantages and disadvantages of separating the Taxpayer Advocate from the IRS?

Answer. TEI believes that the Problem Resolution Program represents one of the IRS's success stories and that Problem Resolution Officers (PROs) are some of the unsung heroes in the tax system. We acknowledge that our members (as tax professionals) are more tax-savvy than most taxpayers, but nevertheless believe their generally satisfactory experiences with PROs are reflective of those of the taxpaying public as a whole. This is not to say that the Office of Taxpayer Advocate or the Problem Resolution Program cannot or should not be improved. As Commissioner Rossotti has acknowledged, all IRS employees should become taxpayer advocates. We do not believe, however, that the Taxpayer Advocate and PROs should be wholly independent of the IRS. Indeed, the Taxpayer Advocate and PROs need to be intimately familiar with the IRS and its functions. Yes, they need to exercise independent judgment, but they also need to know how to cut through the procedures and protocols that might otherwise hinder their ability to resolve particular problems. We believe the necessary knowledge and experience will only come if the Taxpayer Advocate and PROs are part of the agency. If the Taxpayer Advocate were separated from the IRS, his or her ability to do the job could well be imperiled. Finally, although we believe that the Taxpayer Advocate should be appointed by, and report to, the Commissioner, we believe it would be appropriate for the Oversight Board to play a role in the Taxpayer Advocate's selection.

Question 5(a). The current offer in compromise program does not seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they, get out they are socked with horrendous interest and penalties. Is this program broken ? How would you improve it?

Answer. As an organization whose members work for large corporations. TEI does not have significant experience with the offer-in-compromise program, which is intended to give taxpayers who fail to meet their obligations to the tax system (through inadvertence, volitional noncompliance, or pure happenstance) a second chance. Based on our limited experience, we believe it is inaccurate to conclude that the program "does not work" or is "broken" and that nothing gets resolved." To be sure, improvements are possible (and TEI is pleased that efforts are underway to improve the program), but not all the complaints that have been lodged against the program are well founded.

Question 5(b). The IRS has the power to label a taxpayer as an "illegal tax protester." Such a label is important for the IRS in its efforts to protect its agents. But such a label also brings serious consequences for the labeled taxpayer. It is important to protect IRS employees. However, our investigation has revealed that some taxpayers may have been labeled as illegal tax protectors merely because they wrote an article in a newspaper. Should there be a review of such labeling to prevent abuse of the labeling system to the detriment of law-abiding taxpayers?

Answer. TEI agrees that care must be taken in labeling a taxpayer an "illegal protester" or as "noncooperative." Clearly, the IRS must respect taxpayers' right to free speech and not unfairly impugn the integrity of particular taxpayers while striving to safeguard its own employees. This is an area where there must be a balancing of competing interests. Accordingly, we recommend that the Taxpayer Advocate be charged with reviewing the IRS's procedures for labeling taxpayers as "illegal tax protesters" or "noncooperative" and establishing a mechanism to guard against abuses. This subject would be an appropriate one for the Taxpayer Advocate to report on in his or her annual report to Congress.

Question 5(c). In our September hearings, we heard from Father Ballweg who indicated to all of us the importance of a system that is customer friendly. Shouldn't

most correspondence be signed so that agency personnel are accountable? At some stage in the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. TEI agrees that the IRS must be more taxpayer friendly, and we applaud efforts by Commissioner Rossotti and others to move the agency in that direction. We also agree that IRS correspondence should generally contain the name and telephone number of a person who can be contacted about the taxpayer's situation. It should be recognized, however, that given the broad range of topics that IRS correspondence might address, the high volume of correspondence, varying work hours, and myriad other issues, it may not always be possible for each notice (especially computer-generated notices or math errors) to contain the name of a specific individual to be contacted. The key is to ensure that whomever the taxpayer contacts is able to access the pertinent information and either handle the taxpayer's case or immediately refer the taxpayer to someone who can.

OVERSIGHT BOARD QUESTIONS

Question 6. The House bill establishes a board "to oversee" the IRS in its "administration, management, conduct, direction, and supervision" of the administration of the tax laws. What does "oversee" mean to you? What should be the relationship between the Commissioner and the board?

Answer. See response to Question 1.

Question 7. I am troubled that the bill prohibits the board from exercising any authority over "law enforcement activities" such as collections—an area which our hearings have shown to be rife with taxpayer abuse. Should the Board have oversight authority over law enforcement activities to prevent taxpayer abuse?

Answer. Although TEI agrees that one case of abuse (in the collection function or elsewhere) is one too many, we caution against overreaction in respect of involving the Oversight Board in law enforcement activities. To be sure, if the Inspection function identifies an area of systemic concern relating to the IRS's collection activities or other law enforcement activities, the Board should likely be informed of the problem and become involved for both oversight and strategic planning purposes. In our view, however, the Board should not become involved in individual cases, which could distract the Board from its primary mission-strategic oversight and long-term planning. In addition, we believe that providing members of the Board with access to confidential taxpayer information (especially on a non-aggregated basis) is fraught with danger, not only to the privacy interests of particular taxpayers but also the members of the Board, who may find themselves confronting conflicts of interests.

Question 8. If an IRS Oversight Board is established with Treasury, should board members be part-time or full-time employees?

Answer. TEI believes that members of the Board should be considered as part-time employees of the government. We also believe that the majority of the Board should come from outside the Treasury Department and the IRS.

CHANGING THE CULTURE

Question 9. Improving oversight and protecting the taxpayer are not the only things we need to be doing to respond to the problems uncovered at the IRS. We need to change the very culture of the agency itself. That will require a complete new look at its organizational structure, its managerial rules, its performance measures, and its training programs.

(a). One of the surprises of the Committee's investigation into the IRS is how fearful many employees are at how they are managed. They paint a picture of the IRS as a vindictive and unhappy place to work. What changes would you like to see in personnel rules and other procedures to change the culture of this organization?

(b). There are a considerable number of people who feel that it is not possible to reform the culture of the IRS without dismantling the agency. For these people a whole new tax system that isn't dependent on a collection agency is the way to go. What is your response to people who, because of their experiences with IRS, believe this agency beyond saving?

(c). During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures?

Answer. The task confronting the IRS is a daunting one—enforcing the tax laws, processing 200 million tax returns annual, and collecting the $1.5 trillion revenues

necessary to run the federal government in an efficient, fair, and evenhanded manner. Most people pay their fair share of taxes voluntarily, without problems—indeed, without even coming into contact with an IRS employee. Other taxpayers, however, for a variety of reasons do not. The Senate Finance Committee's hearings last fall demonstrated that the IRS has not always succeeded in its dealings with those other taxpayers. Although TEI and its members have experienced the same frustration that has prompted calls to "abolish the IRS" or "tear the tax system out by the roots," we regret that the "easy" solution to what ails the IRS—dismantling the agency—would likely be the wrong one. Some type of organization is necessary to collect the taxes Congress imposes, and it would be unwise to assume that a new agency could avoid all the shortcomings of the IRS simply because it is a new agency. The key, again, is to focus on particular problems, to attack and resolve them, and to move forward.

There is no magic cure for what troubles the IRS, no panacea. For IRS reform to be successful, the agency must address training, operations, technology, culture, and taxpayer education. These issues are interrelated. TEI agrees that the culture of the IRS must be changed. Granting the Commissioner greater discretion in recruiting, rewarding, and retaining the agency's top managers is critical to fulfilling one of the objectives of IRS restructuring and reform—ensuring that taxpayers deal only with IRS employees who are trained adequately and possess the skills and tools necessary to do their jobs well. Continuity among the IRS's senior managers—assuming they are qualified to do their jobs—is essential if the IRS is to operate efficiently and regain the trust of Congress and the American people. Stated simply, employees must be given the training, tools, and resources necessary to do their job, they must be rewarded for doing it well, and they should be held accountable for failing to do so.

In any large organization, there will likely be disenchanted employees and their legitimate concerns must be addressed (and not blithely dismissed as coming from malcontents). At the same time, the agency's organizational standards—whether set forth in the Internal Revenue Code, the Internal Revenue Manual, or elsewhere—should not be compromised. In this regard, we note that the type of guidance provided in the Internal Revenue Manual is varied: some provisions are mandatory in nature, and others are intended only to be advisory, with the affected employees having discretion to use their own judgment in applying general standards to particular situations. Clearly, mandatory procedures should be followed, and employees should be held accountable for violating the Manual's dictates. We also believe that in appropriate cases, Congress should consider codifying certain provisions in the Manual (as it has in the past).

SIMPLIFYING THE CODE

Question 10. I think that we would probably all agree that a significant part of taxpayers' problems with the IRS stem from the complexity of the code. What parts of the code do you think are prime candidates for simplification?

Answer. Congress itself bears a full measure of responsibility for the problems that plague the tax law and its administration. TEI respectfully submits that the biggest steps Congress can take toward meaningful reform are, first, to resist the temptation to use the tax system to address every social or economic ill that confronts the Nation and, second, to work to simplify the tax laws already on the books. Without a doubt, the taxpayer rights title of the IRS Restructuring Bill is important and TEI agrees that many of the proposed protections are laudable and merit enactment. We submit, however, that the biggest abuses come not from excessive actions by IRS personnel but from the highly complicated laws and onerous administrative procedures that Congress enacts and the President signs into law.

TEI believes that the complexity of current law is a primary impediment to the effective operation of the tax system and the efficient management of the Internal Revenue Service. Stated simply, if the law is unadministrable, how can the IRS be expected to administer it in an efficient manner? Accordingly, TEI supports the provisions of the bill that would require Congress to focus more finely on the complexity of tax law proposals, for example, by requiring the Joint Committee on Taxation to prepare a "tax complexity analysis" for legislation reported out of the tax-writing committees and for all conference reports that would amend the Internal Revenue Code. By requiring that some attention be paid to exploring the relative complexity of tax law proposals and less complex alternatives, the IRS Restructuring Bill may enable Congress to make meaningful incremental changes. Among the areas of the law that we believe deserve attention are the following: the alternative minimum tax, the provisions dealing with the taxation of international operations, and the employee benefit provisions. In addressing these provisions, we believe it important

for Congress to receive testimony from front-line IRS technical experts on the administrability of pending changes.

* * * *

Tax Executives Institute appreciates this opportunity to respond to Chairman Roth's questions. We should be pleased to respond to additional requests for assistance.

PREPARED STATEMENT OF ELIZABETH COCKRELL

Mr. Chairman and Members of the Committee: My name is Elizabeth Cockrell. I am a single mother of two living in New York City. I moved there over eighteen years ago, from Canada, when I married John Crowley. The marriage lasted less than three years. The tax problem that arose from it has continued for almost two decades. I have been hounded by the IRS to pay a $650,000 tax bill and may yet have to file for bankruptcy.

I was a young woman of 23, recently graduated from a Canadian college with a degree in English Literature. When I married and moved to America in 1979, I had been selling life insurance in Canada. My husband was a commodities broker. He and his company invested in the most complicated of business deals, like extremely complex limited partnerships containing leveraged straddle positions. I worked a few part-time jobs, then took an entry-level job that provided the training and experience for my eventual career as a stockbroker.

Before my marriage, I knew nothing of American tax laws. Especially foreign to me was the concept of a "joint return"—Canada does not have those. When my husband told me that married people in the United States file joint returns and instructed me to sign them, I did as he asked. I trusted him. A federal judge later told me that I should not have.

In 1982 we separated, and I moved out of our apartment, taking only $2000 for the security deposit on a one-room apartment and the pots and pans that I brought into the marriage. I was proud I took no alimony, even though I was entitled to it. Many years after our divorce, in 1987, John called me and told me that he had been receiving mail for years from the IRS addressed to us both. Since our separation, I had been filing separate and unmarried for years from another address. He told me that he would take care of dealing with the IRS if I would just sign something he was mailing to me. He even gave me a letter saying that I knew nothing about the partnerships and that he was responsible for them and I should in no way incur any tax liability. Thinking I was protected by the letter, I signed the papers. After all, he had been investing in these extremely complex tax shelters before he had even met me! I found out later that he had been taking the deductions from these partnerships during the years I had signed joint returns with him, and that the paper I had just signed was for the IRS to waive the statute of limitations which let them pursue me indefinitely.

Nine years after my divorce I learned that the IRS was after me for over half a million dollars in back taxes because of a brief marriage I had had over a decade ago. I had to hire a lawyer. He told me that the law sometimes makes an exception for cases like mine. It's called the "innocent spouse" rule—when a joint return is audited and the changes apply to the income and deductions of ONE spouse, the other may be excused from paying the additional tax.

I went to Tax Court, convinced that the judge would see that I had nothing to do with these tax shelters. One of the four things I had to prove to win my case, was to show that the tax shelters my ex-husband invested in were shams. But the judge ruled against me, because he said I didn't give him any evidence the tax shelters were shams. Subsequently, I found out that the IRS withheld evidence from the Court. They knew all along that these tax shelters were shams, because the very same two IRS attorneys who tried my case had helped to send the men who had peddled the shelters to jail, a fact they kept from the judge and me. One of the men convicted of criminal tax fraud is now out of prison and the other due to be released soon. Their sentences are completed. However, I do not know when my ordeal with the IRS will ever be over.

Not only did the IRS withhold crucial evidence, which any other lawyers would be disbarred for doing, they also produced an expert witness to testify against me. He said under oath that he had a law degree from Georgetown University. We later found out that this was not true and still suspect that the IRS knew all along that he was testifying falsely. After we found out he lied to the court, I had to request a new trial at my own expense because the witness had perjured himself. At no time

did the judge ever once admonish the IRS attorneys for their outrageous misconduct.

The judge agreed that I did not know anything about the tax shelters, but ruled against me because he said I should have known. It's called "constructive knowledge." That's when you don't know something but the IRS thinks you should know. I was a young Canadian immigrant wife who trusted her experienced American commodity-broker husband: the judge told me that "trust alone . . . does not eliminate a spouse's duty to inquire when a perusal of the return would indicate that further inquiry is necessary." What does that mean?

When I appeared on Connie Chung's news program a few years ago, it took her producers (with a much smaller staff than the IRS) only a day to find seven-figure Swiss bank accounts belonging to my ex-husband. I have written the IRS with this information, yet to my knowledge they have done nothing to collect the taxes from him.

I appealed to the Second Circuit Court of Appeals and lost there too. I have appealed to the Supreme Court and I am waiting to hear if they will review my case. In other cases, other judges have looked at the facts more favorably for the ex-wife who claims "innocent spouse" status.

To pay the tremendous legal fees, I had to cash in my IRA, 401K and pensions. To add insult to injury, I had to pay taxes and penalties when I withdrew that money. Today, the IRS wants to collect over $650,000 from me for my ex-husband's tax avoidance schemes.

I don't know when this will ever be resolved. If I file bankruptcy, it will be on my credit report until I am 50 years old, more than twice the age I was when I signed the first tax return at 24.

I am lucky. I fought my way back and was able to earn the resources to combat the IRS. I would like to be a voice for those women who are not so fortunate.

I appeared on several news shows during the hearings held by this Committee last September. I spoke about my case and received letters from women who were going through similar experiences with the IRS because of a former marriage. These letters are painful to read. These women are truly forgotten Americans. No one speaks for them; they are voiceless. Most of them are struggling to raise children and are receiving no child support. They have lost their money, their hope and their visibility. Because these women cannot be ignored, I have started an organization called W.I.F.E.—Women for IRS Financial Equity. The Wall Street Journal printed our address and during the last month I received numerous letters from women whose cases are heartbreaking. I have even cried while reading many of them. These are women who have lost everything.

One elderly woman wrote that she was afraid she would soon resort to eating dog food. Another, an accomplished pianist whose husband left her, was forced to sell her home and her beloved piano to pay back taxes from things her ex-husband had done without her knowledge. She is now in a poor folks home in Florida.

Many were forced to sign returns at the hands of an abusive husband. Some of their signatures were forged by their husbands or their husbands secretaries.

The single mother of four small boys who gets no child support and whose meager earnings are being garnished. There are women whose husbands have bankrupted out of the tax liability, leaving their former wives stuck with the whole tax bill.

There are women who are on welfare, who are ashamed to be on public assistance, who want to work but are told by the IRS that if they go to work their pay will be garnished. One woman had to beg for money for diapers for her baby after her husband was long gone. How can a single mother raise emotionally healthy children when she herself is suffering, having had the IRS on her back for years with NO END IN SIGHT!! These women have the most important and critical job in the United States—raising the next generation. It is the children who are being hurt the most under this inequitable law. Give these women their lives back. Give them their dignity!

I can attest to the anger, depression, anxiety and weight of helplessness that accompany being at the mercy of the IRS. It is an overwhelming impediment to a happy and normal life. Every New Year's Eve, I pray that the coming year will be the one in which I finally resolve this IRS nightmare.

Many of these cases are SO old, that they stem from a time when men were the primary breadwinners. These are women who raised children while their husbands handled the finances. All they are guilty of is trusting their husbands and signing a joint tax return with him. Now, years later, they are suffering in great numbers. The GAO estimates that there are 75,000—80,000 instances per year of the IRS potentially pursuing the wrong spouse. Over ninety-percent of the victims are women. After I read several letters I started to see patterns and problems emerging from this joint liability law. I would now like to share these with you.

I noticed that the kind of man who would stick his ex-wife with a horrible tax burden also shirked his responsibility to his children and paid no child support. Many desperate single mothers wrote to the IRS and gave the IRS their ex-husband's address after the IRS claimed they were unable to locate the ex-husband. These women begged the IRS to stop garnishing their own well-needed pay and to collect from their ex-spouses. Some women even asked the IRS for assistance to enforce their ex-husband to honor his child support payments. The IRS ignored these requests. They seem to arbitrarily decide which spouse to go after. I found no consistent policy in these cases. The law should be changed so that the IRS collects the taxes from the person who rightfully owes them.

One of the most common problems is that women feel falsely protected from any IRS liability if the judge in their divorce ruled that the husband is responsible for any back taxes owed. All of a sudden the woman gets a lien slapped on her home and her pay garnished. Stunned, she writes to the IRS, enclosing a copy of her divorce decree that clearly shows her ex is liable for these taxes and there must be a mistake, because after all, a JUDGE ordered it. Here is what the IRS told one woman: "Civil agreements, such a divorce agreement do not dictate tax law." In other words, a court order means nothing to the IRS One woman asked me, "Why do we even need divorce agreements if the IRS doesn't honor them?"

Many women find that a well-needed tax refund she is expecting, ends up getting applied to her husband's old taxes. Also, the IRS continues to send mail to both parties at the old marital address, even though the individuals have been filing separately and unmarried from different addresses for years. As a consequence, penalties and interest accrue at an alarming rate without notice to the woman.

Additionally, under the Taxpayer Bill of Rights II, the IRS is required to tell one spouse what actions they have taken to collect from their ex-spouse. However, the IRS has recently denied such requests citing that they are unable to do so because of the Privacy Act. In my own case, I have inquired for over a year-and-a-half about my ex-husband's payments to the IRS and yet have received no response.

While I appreciate the opportunity to tell you my story, the message I want to leave you with today is that the American tax system mistreats divorced women. In some cases, women have been living through these ordeals for decades. The IRS drags out many of the cases over the course of years, filing brief after brief, executing liens' garnishing wages, ad nauseum, at your expense and that of all American Taxpayers. I believe that if the taxpayers had their say, I am sure they would want these women back in the work force, paying taxes and contributing to society. Shouldn't there be some time limit placed on resolving the struggle for these honest citizens? There must certainly be many fair solutions. Fairness begs that such equitable solutions be enacted immediately—and made retroactive! Mr. Chairman, we hope that you and your Committee will seek out a resolution to this atrocious practice of the IRS.

Senators, thank you for listening to all of us, and for giving us the opportunity to address such a critical issue.

PREPARED STATEMENT OF SHELDON S. COHEN

Mr. Chairman and Members of the Finance Committee: I am pleased to appear before you today at your request. I have been asked to give you my views on the recent Report of the Restructuring Commission on the Internal Revenue Service and the Treasury Department's proposals as well as HR2676 which has been passed by the House of Representatives and S. 2676. My testimony represents my own personal views and is not on behalf of any client nor of my law firm.

My experience is as a practitioner who has worked at the Internal Revenue Service on two different occasions; once in the early 1950's as a legislative draftsman (1952-1956) in the Eisenhower era and later as Chief Counsel (1964-65) and Commissioner (1965-69). I have also been a member and officer of the National Academy of Public Administration and in that role I have been on several panels which have studied various aspects of tax administration. I have served as a consultant to the Comptroller General and his staff. Likewise I taught tax and accounting subjects at The George Washington University Law School and several other universities over the years and have provided services as a consultant to the United Nations Development Program on tax administration issues in developing countries. I recently served as a consultant to the U.N. Ad Hoc Group of Experts on International Cooperation in Tax Matters, held in Geneva in December 1997.

The Introduction to the Commission Report suggests that the President, Congress, Treasury and IRS must:

- develop and maintain a shared vision with continuity;

- set and maintain consistent priorities and strategic direction;
- improve accountability of senior management;
- develop appropriate measures of success;
- ensure that budget and technology support and strategic direction; and
- coordinate oversight and identify problems at an early stage.

On these ideas just about everyone can agree. Thus, the goals are fine. My problem with the Commission's report and the House and Senate bills in some respects is in the means of achieving these goals. It seems to me that they have chosen inappropriate means in at least the governance structure.

I would discuss the House bill alone, but I have heard that several members of the Senate have suggested moving back to the Commission's report, or in some instances going even further to "privatize" the IRS function. Therefore, I have discussed both the House bill in some respects as well as the Commission report.

The Commission leadership has stated that its central recommendation is the creation of an outside board of directors that would select the Commissioner and other key officials and oversee the budget and direction of the IRS. This board would determine the pay and working conditions in the IRS and set its strategic goals. These are all inherently Executive Branch functions. In order to overcome Constitutional separation-of-power objections, the Commission would give the President, as head of the Executive Branch, the right to remove those appointed by the board or to overrule its budget determinations. This is inefficient at best and an invitation to political firestorms at worst. No other agency is so managed, and there is no precedent to suggest that such an approach would enhance rather than detract from sound tax administration. I noted a long legal discussion of the constitutionality of this in the Joint Committee's Staff Report for this Hearing. Do you want to raise serious constitutional issues involving the agency which collects the vast majority of our taxes? I would think not. The director of the Brooks Institution's Center for Public Management has strongly recommended against such a board. He feels it will degrade accountability and create new conflict of interest problems. The IRS is the major fund-raising entity in the federal government; we cannot risk making its operation worse. The first rule in making any changes should be "first do no harm."

The House bill has the Board recommend the appointment of the Commissioner, but the selection is up to the President. The Senate bill seems to leave it to the Board, what I feel is a mistake.

If the Commissioner and board were to have sharp policy differences on collections, audits or criminal investigations or any detail which may be at odds with the President, or the Secretary, what happens? There is no explanation of this possible issue. In the first year of a new President's term (of whichever party), he will have control over only two (or possibly three) votes on the board: the Secretary or Deputy Secretary, the Commissioner, and one appointee (in fact, on the first day he will have only the Secretary). Thus, the board could be moving in completely different management directions from that which the President and Secretary may wish: more corporate audits; less corporate audits; more collection activity or less collection activity; more criminal enforcement or less; more concern for foreign corporations doing business here or less; and so on. This is not the recipe for a smooth working IRS and Executive Department.

The IRS is responsible for carrying out one of the two most essential government functions—the collection of taxes and the enforcement of internal revenue laws. (The other being defense, which is paid for by the funds collected by the tax system.) The Congress cannot and should not allow privatization of such an integral part of the government. The Commission and the Senate bill adopt a schizophrenic approach which looks to corporate America and yet creates something that is neither a private corporate model, nor a government model. The House has modified this a little, made it better but still not as smooth as it should be. In my view, such a Board would serve the system better if it were advisory. Even with this structure it would have a reforming effect since it would report to the Congress periodically in an open and public way.

The board will have many inherent conflicts, both real and perceived, and the Commission and the House and Senate bills fail to recognize how these may undermine the credibility of the Internal Revenue Service. How do a board member and the President of Y corporation handle himself when an issue which affects Y corporation arises, or when an issue affects his or her industry, or indeed when the issue affects a competitor? Some conflicts will be so obvious that recusal may work, but some will be so subtle that they may not be recognized until it's too late. The Commission attempts to address this concern by stating that the new board will deal only with budgetary and strategic planning and not be involved with tax policy, audits or enforcement. Both the House and Senate bills follow this line also. Will the public really believe that, and even more important, will it be true? The power

to set budgets is the power to set priorities and policies. Budgets have a direct role in tax policy and law enforcement. How the IRS spends money determines tax policy. What it is willing to enforce is the real policy, not what is said.

Moreover, the appearance of conflicts may be almost as damaging as the conflicts themselves. Even if each board member comports him or herself perfectly, the inevitable coincidence of issues will raise perception problems with the public and will drive the press and Congress to a frenzy on occasion. An example will illuminate this. Suppose the audit of the company employing one of the board members ends fantastically well. Suppose further that the board member comports himself perfectly and never mentions it at any meeting. Who will believe it when the great result comes out and the news-making journalist draws the coincidence to its illogical conclusion?

As a safety valve the Commission says that the Treasury or the President could overrule the new board on budget. Look at how complicated this could be for a new management strategy and think of the extra time consumed in this negotiating process. There are presently four sets of negotiations to make a budget after those within the Service itself: first at the Treasury, then at OMB, then two on the Hill (or perhaps three with the Conference Committee). We would add another, fifth, at the beginning of this process, and it would be in public so we can fight about the details in public. This process can add months to an already arduous process. All this would make for less efficiency, not more.

We recently saw criticism of Commissioner Richardson because she had worked on the Clinton Campaign in 1992. Now we are to have a large board, each of whom will have potential soft spots in his or her career, each of whom have political friends or enemies, and each of whom will be criticized for one reason or another. And so each will put a blemish on everyone's perception of IRS management at some time during his or her term. This will be so regardless of the realities. We need better IRS management, but in my view decentralizing it to a board does not make it better. The present system has the advantage; it has worked well over the years because it centralizes responsibility. If we are unhappy at the moment, we can appoint a new manager (which has recently been done), and let him move forward with bringing better management to the IRS. The very issue which gives rise to the creation of the Commission, the failure of the new computer system, seems to be fading. The appointment of a new person, Arthur Gross, to manage the computer system and now with the appointment of a new Commissioner, Charles Rossotti, with fine management experience we are seeing new confidence in the IRS' ability to develop a workable and advanced computer system.

The Commission recommended and the House and Senate bills set a fixed five-year term for Commissioner. I am in favor of a four to five-year term. The Commissioner provides a fresh voice from outside with new and different ideas. It is good to have a new perspective every four or five years so that new ideas and views are introduced. However, I should point out that only three of the last 15 Commissioners (since the Reorganization in 1952) have served four years. (I am one of them.) Fixed terms do not bring long service. Many agency heads have five, ten or even longer terms; very few people actually serve that long. Since Mr. Hoover's death, the FBI Director has had a fixed 10-year term, however, no one has yet served the full term.[1]

I found that four to five years was about all my blood pressure would take; I served a year as Chief Counsel and four as Commissioner. My experience tells me that few people serve five years now, so pretending they are going to do it will not make it so. I too favor longer terms and more continuity, but I would do so by making the request come from the President and by the Congress having a more understanding and cooperative attitude. Too many combative hearings and heavy criticism of minor items will not be good for one's digestion, and my wife for one was happy to have me out of the meat grinder.[2]

It is more important that the top career staff have long continuity. I disagree strongly with the Commission on this point. They seem to feel that the career service of the IRS has too much longevity. During my term as Commissioner, there were 15 top staff members: a Deputy Commissioner, seven Assistant Commissioners in

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[1] Mr. Hoover served over 48 years, although he had no fixed term.

[2] The Commissioner has a five-year term, except if he is appointed to fill a vacancy, then he/she has the remainder of the old term. While I think the five-year term serves no real purpose, if you are going to have it, why not give it to all who serve, even as replacement for someone else. This remainder of someone else's term seems to conflict with the House's stated purpose to have a longer term. Suppose someone is appointed with only six months to run on an existing term. Does he need a new appointment and confirmation at the end of six months? This seems odd in light of the stated purpose of longevity.

charge of functional areas and seven Regional Commissioners. In my four years in office there were only two changes in this group, the Deputy Commissioner was appointed as Deputy in another agency and was replaced by an Assistant Commissioner, and one Regional Commissioner retired. Thus, the people who planned the installation of the IRS's first computer system were the people who installed it and made it operational and that is why it was a success.

Pay in the 1960's was better in comparison to private industry, and more important, government workers were respected. A beginning lawyer in my day received about 80% of outside pay (now it less than 50%), that difference, considering the opportunity to develop expertise and work on cutting edge issues encouraged the best people to come to the government to work. It was that respect and the opportunity to do new and important things which kept the workforce steady and refreshed. The continuity of the career staff is important in accomplishing long term projects and providing a history of what works and what has failed. I would agree with the Commission that introducing career officials from other agencies is a healthy objective. It adds new points of view and ways of doing things.

Statements of the respect and honor we ought to give to our public servants will not help, if we do not really follow through with that respect. The current climate of suspicion and nit-picking is conducive to rapid turnover and consequently lower levels of service. No one wants to work for a boss (the Congress) which never compliments you, but always finds a career person to target as the cause of the problems.

A few comments on the House bill's views of the board.

The board may not have a practicing lawyer, or accountant. The bill says that such a practitioner may not serve. Likewise, anyone who has served may not represent anyone before the IRS for one year after leaving the board. Thus, for example, none of us who are on this Panel could serve on the board unless we are willing to give up our active practice. I don't know if that is what you want, but it is in the bills.

There is a two-term limit on the board membership. However, if someone is appointed to a remaining term of one year and then reappointed for a full 5-year term, I assume that he or she could not be appointed to a second full term. At least this is unclear at best.

The board, according to the House bill, elects its own chair every second year. In most board structures, the President selects the chair. Thus, the President selects the chair of the SEC, the Federal Reserve and of the commissions he appoints.

My own view is that the oversight board suggested by the Commission and the House should be advisory.

When the Advisory Group of the IRS first started it was a valuable asset, ten to twelve well-known persons with tax, business, computer and other valuable experience met with the IRS Commissioner and top staff four times per year for one or two days at a time. The meetings were private and confidential. Then came the Advisory Committee Act and government in the sunshine, which required that such meetings be held in public with the press in the back of the room. These meetings became "Show and Tell." No more candid discussion, only remarks intended for the press in the back of the room. So the value of this group declined. I don't know what the rules are with the board you are considering, but I suspect the board that the Commission and the House suggest would both have this defect. It appears that the House bill makes all the Board members special government employees, so perhaps the meeting will be private. That is the only way they will be productive.

Serious discussions of flaws in the tax system cannot be held in public, unless you want to alert every tax cheat of how to do it better. I would applaud something like the advisory board if its meetings were closed, or at least if portions could be closed to accomplish real reform of the tax system. Perhaps appointment by the Secretary or even the President would enhance the prestige of the group and help get the very best people to participate.

I applaud more participation by the Secretary and Deputy Secretary. Secretary C. Douglas Dillon and later Henry H. Fowler were very much involved in my time. I found this advice and support very helpful. Secretary Rubin has indicated that he and the Deputy Secretary intend to be more involved. That is good.

An interesting alternative comes to mind here. The Comptroller General of the United States has a consultants group. I have served on this group for over 15 years. The group meets as a group with the Comptroller General and his top staff for two days at least twice a year. The Comptroller tries out on this group new ideas or tough problems he faces. The group is composed of corporate presidents, investment bankers, lawyers, accountants, retired military types and former government officials. A broad range of experience is represented. Subsets of this group meet periodically within various divisions of the GAO to assist them in developing work

plans or in evaluating their work product. A small subset of this group acts as the Audit Committee of the GAO. (I am privileged to Chair that Committee.) This group meets periodically over the year with the Comptroller General and his staff and also meets privately with the outside accounting firm which audits the GAO. This process allows the GAO the benefit of fresh outside ideas and reviews on a regular and ongoing basis. Another example is the trustees of the Social Security system. They likewise exercise an oversight function.

The board, as suggested by the House and Senate bills, is required to have a union leader as one of its members. This creates an additional conflict. Is he serving as an officer of the union or a board member? How does he comport himself when he negotiates with lower level IRS officials?

I serve on the board of a university. It was determined many years ago that the current students and current faculty have a conflict of interest and may not serve on the board, although former students and retired faculty members have served. In that situation, the current Student President and Chair of the Faculty Senate are invited to sit in on board meetings and are often asked for their views. They don't vote, nor do they sit in on executive sessions which establish tenure rules, or makes salary or tuition decisions when the conflict is obvious, just as in the union leaders' case.

The Commissioner and Secretary serve on the board only so long as they hold office. The union leader serves as long as he/she is employed as a member of the union. Suppose he/she is no longer the union leader, they seem to continue as a board member. This should be clarified.

Likewise the union seems to be given extraordinary powers when it comes to apply the employee flexibility rules in Chapter 93 of the bill to a unit where the union has exclusive bargaining rights. The bill seems to give the union absolute veto over such changes. This is an odd way to modernize the IRS. I am a person whose grandfather was a co-worker with Samuel Gompers, I am sympathetic to union needs. However, I understand that it is tough enough to run the IRS without giving union veto power over certain changes.

The board is required by the House bill to meet once each month. This seems odd. There may be reason to have two or more meetings in one month and not have a meeting in another month. Such a statutory rule seems out of place. Too much direction by statute is stifling.

Many of the problems in our tax system are created in the legislative process. Last year was not much different from other years. The Ways and Means Committee worked up its draft legislation and revealed it on June 9th and 10th. The bill passed the House less than a month later. No hearings were held on the actual bill. It was funny (if that is the proper word) to watch the Chief of Staff of the Joint Tax Committee on June 12 describe the bill to the members. He was speaking at a rapid pace, so fast that most of the members could not possibly have understood him. I, as a tax expert, had a very tough time in following his rapid explanation. He answered questions very narrowly, and there was a vote. A few good lobbyists got advanced word and were able to change a few things, but most of us only watched in awe or disbelief that this was the way to make a law. The Senate followed suit. We are only now, a few months later, coming to know what is really in the House or Senate bills as passed. The President has now signed a bill which adds more, not less, complexity to tax administration. Indeed, we are now learning of errors in this bill and a bill will soon be introduced to correct obvious errors.

Thus, the Congress which promised us simplification has produced a bill and explanation of about 1200 pages. The Commission wants a simpler tax law; the Congress says it wants simplification. If this is the Congress that will bring us simplification, I will be shocked. We can have a simple law only when the Congress has the discipline to say that every problem in America does not have a solution which must be in the Tax Code. This Congress, like those that have gone before it, clearly does not have that discipline. Incidentally, the Administration is no better than the Congress in this respect. In the Eisenhower days, the planning for the 1954 Code began in January 1953. There was a one-year study period, the bill was then introduced in January 1954. Hearings on an actual bill were held in both Houses and the law passed in August 1954, twenty months from start to finish. There were fewer errors or corrections needed, people had a chance to comment and think about the legislation and its consequences. I don't believe quick legislation is the way to go.

The Commission believes that the oversight function of the IRS should be better coordinated by creating a new entity to handle this oversight function. I suspect that everyone at the IRS and Treasury would applaud this recommendation if it were to occur. Back in 1926 the Congress created the Joint Committee on Taxation ("JCT") for this express purpose. However, oversight has not been as "sexy" as legis-

lation, so the oversight function at the JCT has withered until it is almost nonexistent. Instead of recommending the abolition of a committee or the reinvigoration of a committee, the Commission does what commissions usually do, it wants to create a new entity. How will this mesh with the existing oversight function of the Congress?

I do not see the substantive committees, House Ways and Means and Senate Finance, giving up their right to ask the IRS probing questions on its functioning under a statute which those committees drafted. Likewise, does anyone believe that the Appropriations Committee will not probe into how the money they appropriated is being spent or worse yet as they occasionally do, delve into changes into substantive tax provisions, or for that matter the Governmental Affairs Committees of each House when they are moved to examine an area. Thus, the suggestion about the need for one oversight group is good. The Congress ought to have one committee to oversee the IRS and it should be bipartisan and coordinated by the House and Senate. That is easier said than done and the report gives us little reason to believe it would succeed. The Congress is great at criticizing the Executive Department for redundancy or overlapping jurisdiction. While the idea is good, the implementation would require a kind of coordination in Congressional committees that I have not seen before. The House bill merely requires coordination of GAO audits with the Joint Tax Committee staff. There is also a schedule of Joint Oversight hearings set for each Spring. That is a far cry from one effective oversight function.

The Commission wants stable funding for the IRS; three years is its goal. The IRS wants stable funding; the President wants it. What stands in the way is the appropriations process. What fun is it to be on the Appropriations Committee if you cannot hold hearings on how the IRS is doing on this or that sexy item, and give line item instructions to the Service to do this, or not do that? A large IRS initiative is like a large aircraft carrier; it may take several years to recruit and train the people needed to do the job. It is only then that you get the payback. So stable funding is a necessity. I see that the current legislation ignored this recommendation.

What happened to the Hoover Commission recommendation for performance-type budgeting? The Congress tried it for a few years in the 1960's and it worked very well. Under such a budget, the agency is given a budget and an agreed mission. It is up to the Commissioner then to accomplish the mission within the agreed budget. However, new people came and did not remember Herbert Hoover and detail budgeting came back with all its inefficiencies. See what some of your sisters and brothers up here do annually to the issue of "employee" versus "independent contractor" or with electronic tax payments. The Congress is unhappy with the IRS' position but cannot decide what its role will be.

The Commission seems to want the IRS to have more political appointments in the management of the IRS. I am pleased to see that the House bill does not take this position. I was happy with only two. It was great to be able to say that only the Chief Counsel and the Commissioner are political appointees. The last thing we need is a return to the 1950's when every collector (there were over 60) was appointed through the political process. I believe we want our tax system to be run in an apolitical manner. Thus, we do not need to return to the days when politics regularly entered the decision-making process. This type of change can lead to less respect for the IRS, not more.

Section 7217 of the House bill prohibits Executive Branch influence over audits or other investigations. I suspect this is superfluous but if you are going to do this, I suggest that you cover yourselves. I had no problem with the President, Vice President, Secretary of the Treasury, but I had many requests in writing and orally from various members of Congress. If you are going to do this by statute, which I believe is inappropriate, then I suggest you make it unlawful for anyone in Government, including yourselves, whose official role does not encompass law enforcement to become involved in audits, collections and investigations.

As to flexibility of pay for the top staff, this is a good idea that I would applaud. However, there is no discussion of the fact that this type of decision has been rejected by the Congress time after time. Each member of Congress feels that the problems in his or her state and in other agencies are just as important as those in the IRS, so Congress has refused this idea many times, both for the IRS and other agencies. Also performance-type pay is usually a "no-no" in a tax-raising agency. You want the staff to do the right thing, not necessarily the thing which brings in the most revenue. If you set the incentive system it will change behavior, not always for the good. That is why the IRS should never operate on a quota system for revenue agents or collections personnel. (Although occasionally some supervisor will do this, because it seems to them to be clear and does not require careful thought.) I know the House suggestion says that revenue production is not to be considered in setting bonuses, but sometimes it is the most important factor. Sup-

pose someone is able to make his group more effective, at the same time being more fair, but also raising more revenue on less manpower. They should get a bonus, it won't be solely on the revenue production, but it will be partially. I am not sure how the House language works. You should also be careful about the law of unexpected results. The Congress a few years ago passed the "Government Performance and Results Act." This requires agencies to keep data and statistics and show you how well they do with the money you give them. Sometimes requiring that data allows lazy supervisors to use it as the "only" criteria for advancement. That is wrong, of course, but asking for the data seems to encourage such behavior.

The Commission feels that Customer Service is a vital element of a good tax system. So do I, and most of those who have served as Commissioner agree. Yet past Administrations have cut the funds for taxpayer service, and the Congress went along with those cuts. The Congress vacillates; one year it wants enforcement and collections, the next it wants niceness and service. The IRS gets into trouble when the Congressional pendulum swings.

The IRS used to have a rule that they would be nice to the taxpayer (but strict); the nice people deserved it and the nasty ones would not be able to complain. Then came years of low budgets and cuts in training and the taxpayer services got cut. Congress often decrees cuts in training, believing that this will save money. It does not; in fact, it may cost money by making the IRS less effective. The public may judge the IRS by the service they get from the best customer services organization as is stated in the Commission's report, and indeed the IRS should give that kind of service. However, we all realize that sometimes we get shunted on the phone line from one number to another in a commercial outfit without the ability to talk to a human. Even private enterprise has these problems. Just last week my wife gave up trying to reach someone in a large department store because the computerized phone system kept shunting her around and back again.

The Commission seems to feel that customer service comes first before compliance and efficiency. The House seems sympathetic to that view. Most IRS employees I deal with are courteous and respectful. However, they are often doing things which many of my clients don't like. They are questioning how taxpayers treat an item. Thus, this is not like dealing with a bank or credit card company. Banks are assisting me in financing my purchases; they are not questioning my purchases, or my motives. Thus, I suspect the Commission was comparing peaches with pears. They are both fruit, but they are different.

The report talks constructively about improving compliance through research and preventive measures. The integration of research and compliance efforts is a worthy goal. However, recently Congress has not shown proper appreciation of TCMP. TCMP is the test audit program which provides data from which returns are selected for audit. Some in Congress discourage this program. If the IRS is to undertake adequate research it will need larger appropriations, which the Commission and the House did not address. If the IRS gets the test data, it will audit the returns which really deserve an audit; without that data it is guessing and will audit nonproductive returns. This means more bother to taxpayers who should not be audited.

While there are some good ideas in the Commission's report and the House bill, much of it is a rehash of old ideas, some good, some bad. The Commission could have suggested that the Congress and others stop some of its IRS bashing. The IRS gets the blame when it enforces the rules which Congress writes. Individual members of Congress make gleeful exercises in blaming the IRS for trying to enforce tax rules they write. I suspect this IRS bashing has more to do with IRS morale and improvement than any of the other ideas.

TAXPAYER RIGHTS

I am concerned that the Congress may go overboard in the taxpayer rights area. First, I should say that the IRS should turn square corners with all taxpayers. It should do so with the honest and cooperative taxpayers, because they deserve courteous treatment; the nasty or dishonest ones should also receive fair attention because that is their right and also it will give them nothing to complain about. Being fair does not mean you need to be a wimp. Tax collection is not always a gentle sport so the IRS needs to be prepared for tough treatment. On occasion I authorized special agents to accompany revenue officers in collection cases where there was violence threatened. You cannot walk away just because the taxpayer is not a nice person.

In collection matters, remember the debt is usually acknowledged. The taxpayer owes the money. Most other taxpayers have paid and paid on time. Any extension of time is a privilege, not a right. Hence, much of this is a judgment call as to what

is a "serious hardship" or whatever standard you wish to apply. If you want the agency to be liberal, take a position and tell them the standard you want applied. Remember when you give relief to someone who is late in filing or paying, your act may cause a decline in compliance. It is tough to judge when you can be gentle, and when such action will encourage more people to slow up their payments.

The Commission recommends that the IRS be required to pay damages after it has lost in three Circuits . That may look reasonable but you must remember that these Circuits are not the Supreme Court. We don't know for sure what the law is until the Supreme Court speaks. I can recall at least one case where seven or eight Circuits were adverse to the government's position, but the Supreme Court decided the case in the government's favor.[3] It is your prerogative to do what you think is right since you are writing the law, I am just saying go a little slow and think it through, unemotionally.

The House bill continues the present Code's designation of an Assistant Commissioner for Employee Plans and Exempt Organizations. I do not understand why the Congress needs to single out one Assistant Commissioner over all the others and provide for it in the statute. Originally the designation came out of the ERISA statute in 1974 when the Commissioner was required to institute such an Assistant Commissioner. It has now been in place for over 20 years and it seems odd for the Congress to be concerned with one Assistant Commissioner and not any of the others. I think the Assistant Commissioner for Employee Plans and Exempt Organizations is important, but not more than others.

The Office of Taxpayer Advocates is created by statute in both bills. The House bill makes the salary of the Taxpayer Advocate equal to that of the highest level official reporting directly to the Commissioner. That official is the Deputy Commissioner of IRS who is currently paid at the level V of the Executive Pay Scale. I believe they should designate the Taxpayer Advocate at this as the highest level after the deputy, which is an SES rating.

The House bill seems to try to make the Taxpayers Advocates staff a self-contained group with no interchange with others in the IRS. I don't think that is healthy or wise.

If you want everyone in the Service to be cognizant of taxpayer service issues, then you want people moving in and out of this activity as they do with other activities, particularly at the supervisory level. You also should be concerned that a small self-contained unit will have little means of promoting and using its best people. Hence, I don't believe it is wise to put in the rule that House has on page 20 of its bill which does not let taxpayer advocates move to other positions in the IRS. Suppose you have a super taxpayer advocate and the Commissioner wants to make him Deputy Commissioner under Section 7803(c)(1)(B) he could not take the job until after five years of leaving the Taxpayer Advocate's position.

The House bill sets very tight schedules for reports by the Taxpayer Advocates. I am not sure that three months is sufficient time to gather the data, check it and get a written report prepared. Again, someone has put in statutory language with very tight rules which may make it worse, not better.

The House bill wants to know about the 20 most serious problems as seen by the Taxpayer Advocates. Twenty is a large number, I suspect five or ten would be sufficient. That is about all you could deal with in trying to remedy in a year or so in any event.

Regarding the House's mandate that electronic filing is the "thing." It probably is, or should be. However, passing a law which requires reports and in great detail won't make it happen. The IRS and Treasury want electronic filing too; give them a little credit for intelligence. If it is more efficient and cost effective, then everyone gains. So encourage it, but don't mandate it. It will come as soon as technology and cost allows it to come.

Giving someone an extra month to file electronically seems overkill. It is more cost effective for the taxpayer to file electronically, so why delay the movement of information. If a paper information document is required on February 28, why should electronic information have an extra month? I see no purpose to this.

It would be nice to have a paperless system. But don't count on it so soon. I can remember when someone had the brilliant idea about the W–2. They suggested back in the 1950's that the back of the W–2, Wage Report be used as a 1040A. It was virtually a painless return. However, the system broke down because taxpayers often have two or more jobs in a year, so they erroneously filed multiple returns which were not correct. They filed the W–2 form and a regular form and made a variety of other errors. Therefore, the system was abandoned because of the confusion it caused. It would be great if we could work out such a system, or a similar

[3] *Comm'r of IRS v. LoBue,* 351 U.S. 243 (1956).

system. However, you must not anticipate what has not yet been developed. We don't yet have a return-free system. We don't yet have a computer system sophisticated enough to handle such a system. In this case, wishing will not make it so. A great deal of hard work is necessary to make it work.

The burden of proof idea in the House bill is a mistake. It won't help taxpayers and it will confuse the tax system. Everyone knowledgeable about the tax system will tell you that the taxpayer has control of the necessary information so he should have the obligation to produce the required information to justify his deduction. If the IRS gets concerned about the burden it will have, then it will intensify the audit in order to avoid the burden of proof issues; that is not what you want.

Taxpayers will misunderstand these provisions and will sit back and say to the IRS: "prove I am wrong," without cooperating in the audit. Thus, they will think they have new rights which may well prove illusionary. It seems to be a bad idea.

Innocent spouse relief is a nice idea. I am the originator of the innocent spouse concept in the Code today. It came because we had a hard case which I felt was unfair. A woman in Texas who was a school teacher with two children was married and filed a joint return with her husband who ran a gasoline station. Unknown to her, her husband had a second family in another town a few miles away and had a second job there repairing cars. He did not report the income from the second job on the joint return. The revenue agent found the extra income and set up a deficiency on the joint return. The husband ran and could not be found. The tax deficiency was set up against the joint return and under the law then in effect the wife was liable. I was faced with a revenue officer threatening to seize the teacher's house to pay the tax of her deadbeat husband for income which she never knew of. I held the case in abeyance and sought legislation to give her relief. That legislation is the present statute. If it does not work as you believe it should, then change it, but be careful you are not too liberal. You have the choice as you write the laws, but you need to take into account that other taxpayers bear the burden when you relieve one group or another.

The House rule relies on someone's judgment about "equity" or "inequity." These are not rules which can be uniformly applied. I was once asked by a member of the Appropriations Committee if I didn't agree that the Commissioner should have "equity" powers to forego, or forgive a tax. I immediately answered "yes," since I said I had confidence in my judgment. I quickly added that I might not have such absolute confidence in the judgment of those who followed me, so perhaps you ought not give me the power, as they might not have confidence in my judgment. The collection of taxes should not depend on judgment as to what is reasonable. This is not the imposition of a penalty but the relief of tax.

The House has a provision to grant relief by suspending the statute of limitations in situations where the taxpayer is incompetent. While such situations are trying and raise all types of personal problems, it is difficult to gear the tax system to save the records for many years after the event, to find that someone 10 or more years later with a refund claim which they attempt to sustain by saying the person was incompetent. You then go through the proof, 10 years after the fact. Many claims will be made, few will be sustained. It is a very tough area to make a judgment as to what policy is best.

The House has a provision which grants a privilege of confidentiality to nonattorneys for the first time. I am again concerned about people thinking this is more than it is. Taxpayers who go to accountants or tax preparers or even lawyers for the preparation of a tax return, do not get confidentiality. Anything which is done in preparation of a return is discloseable to the IRS or in a court of law. This will not be clear to most taxpayers seeking advice and I suspect many preparers will use the provision to say they have privileges when that may not be so. I believe the courts have been curtailing privilege; I don't like to see the Congress granting more confidentiality. Tax returns ought to be open, and what goes on behind them should likewise be open.

Seeking legal counsel is different than seeking tax return information or accounting advice. They have been different for centuries; I do not see a good reason to change now. Accountants have a general duty of disclosure and are often in a conflict position when they are certifying to the public the financial records of a business and at the same time trying for privilege in dealing with the IRS.

The House bill also has a provision which attempts to deny the IRS the right to "Computer Source Codes." This is an attempt by the accountants, some computer people and some in the business community to play by rules foreign to the United States. We go around the world lecturing foreign governments on tax, banking and financial systems which have "transparency" and openness. All of our treaties require full open exchanges of information. Today most information in the business world is kept on computers. Full access to such information and how it was manipu-

lated to get to their tax return is necessary for an efficient revenue service. If the IRS needs to go through and replicate the computer program, that would be outlandishly expensive and frustrating. Thus, I do not see the equities on this issue at all.

If the information is run through a computer system to produce numbers which are reflected on a tax return, the IRS ought to have access to how the material is produced, hence the complete computer program. Are we going to be a tax haven? The House version puts unreasonable burdens on the IRS.

The House seems to believe that financial status audit techniques should not be used unless their is an indication of the existence of unreported income. If I am being audited and the agent sees I live in a $500,000 home, drive a $50,000 automobile, and have a similar living style, yet report an income of only $50,000, I believe he should have the right, and duty to use financial data to show what my standard of living costs are likely to be. I would hope the Congress would not champion tax cheats. A look at the recent GAO audit of financial status audits shows no increase in their use.

The House bill has a provision dealing with complexity analysis. I commented earlier on our complex law. Having the IRS comment to you on the difficulties of administration or enforcement would be useful. But you have to take their concerns seriously.

Likewise, there is now a delegation order, see Footnote 14 of the House report on its Restructuring bill which forbids the IRS from issuing rulings, revenue procedures, forms and other guidance without Treasury approval. This provision commencing in 1981 has cut off much guidance to the IRS field as well as taxpayers in general. It was not the rule when I was either Chief Counsel or Commissioner. This requires all rulings and similar material to flow through the Office of the Assistant Secretary for Tax Policy. That is a relatively small organization and it cannot put out sufficient guidance to meet the public's needs. I would suggest the Secretary change this delegation order, or the Congress ask him to do so.

In closing I would like to thank the Committee and its staff for allowing me to give you my views on IRS management issues. We all want to make the tax system work better. A good system poorly administered will not work properly. A poor system well administered will succeed.

Heretofore we have had a pretty good system and excellent administration. One of the IRS's burdens has been its ability to make a complex system work. Unfortunately that has encouraged various Administrations and the Congress not to the be concerned about the complications they have added to the Code. Like the straw which breaks the camel's back, all this catches up to you after a while. My own view is that we still have very good tax administration. I say that from my experience working in the system, working with clients caught up in audits, collection issues and the like, and viewing it from outside the U.S., we are still the model for most countries around the world. It can be better, and I believe Secretary Rubin and the new Commissioner, Charles Rossotti will address the issues of concern to the Congress and the rests of us. Radical solutions may kill the patient; I am in favor of incremental and significant improvements.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

Strengthening Oversight

Question 1. Should the Inspection Division be more independent? Should the IRS Inspections Division be transferred to the Treasury IG?

Answer 1. The Commissioner needs an inspection group. I believe it is a necessary part of his management oversight of the agency that he have the capacity to look into internal audit matters as well as internal security. I found it very useful, in fact the Assistant Commissioner who I saw most often was probably what is now called the Chief Inspector. The inspection group needs to be independent of the rest of the IRS, but it should be responsive to the Commissioner.

Question 2. One of the most important lessons learned from the Committee's oversight hearings last September is the need for greater oversight of the IRS. The Congress needs to do more oversight—which we intend to do. But also there must be more oversight of the IRS in the Executive Branch. There are, at least, two ways we can improve that oversight. The first is to vest significant oversight responsibility with the Oversight Board that is created in the House-passed bill. The second way is to substantially increase the power of the Treasury Inspector General. What are your views on both of these ideas?

Answer 2. Yes, Congress and OMB ought to exercise more oversight, and more regularly. Sporadic looks at the political hot buttons is not good oversight. It has

to be regular and organized. The Oversight Board can be helpful in oversight, but it should be advisory. See the testimony of NAPA with which I agree.

The Treasury Inspector General should have the necessary people and money to do a competent job when needed. This is not to the exclusion of the Commissioner having his own staff; there are separate functions.

Question 3. Is the Oversight Board created in the House bill an executive board, or merely advisory? Does the Board have legal authority to direct actions taken by the Commissioner?

Answer 3. The Oversight Board is not designed to be the day-to-day manager of the IRS. As you know, I prefer it to be advisory capacity, but advisory or not, it is not the manager to which the IG or Chief Inspector reports.

I didn't think the Board was designed to direct the Commissioner in law enforcement functions. Much of what the Chief Inspector does is a law enforcement function.

Question 4. If the Oversight Board is created and Commissioner Rossotti is able to turn the agency around, should the Board be sunsetted?

Answer 4. Yes, I believe the Board should be sunsetted. I say this because you don't know if it will make life better or worse. If Commissioner Rossotti achieves managerial success, the Board may prove superfluous, it may be a failure in any event. If it appears to succeed and needs more time, I am sure you could extend its life.

Protecting the Taxpayer

Question 5. Our hearings have also indicated a need for the Committee to consider protection for the taxpayer in a number of very specific areas.

(a). What are your thoughts on changes the Committee ought to consider in the penalty and interest area?

Answer 5(a). Penalties: The Congress in recent years has used penalty provisions as fund raisers. I thought this to be a mistake and I would go through the Code to remove overbearing and redundant penalties. I would be glad to work with your staff to try to identify overkill.

(b). The Committee's oversight hearings showed considerable problems with the IRS's exercise of its lien, levy, and seizure authority. This has to be fixed. I'm concerned about taxpayers who do not receive real notice and wake up in the morning only to find that the IRS has taken their bank account, business or other assets. Should the taxpayer have a right to judicial hearing before seizure?

Answer 5(b). Judicial hearing before seizure: This is a dangerous suggestion. You must consider that it would stop all enforcement for "x" days (the period you set to bring the action, plus the time for the Court to decide). This would raise the cost by requiring more lawyers at IRS and Justice, at a large cost. And, it would accomplish little. The overwhelming majority of seizures were proper, and would go through anyway. You would raise the cost of both sides, reduce revenue, in order to try to rectify a very few tough cases. I suspect the cost is too high for any possible benefit.

The true test of sovereignty of any country is running and operating an effective tax system. If you put in too many road blocks to collection, you will allow deadbeats to bend the system and transfer the cost to the compliant taxpayer. I doubt that is what you desire.

(c). The current Offer in Compromise program doesn't seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they get out they are socked with horrendous interest and penalties. Is this program broken? How would you improve it?

Answer 5(c). The Offer in Compromise system works, but it could be better. I suspect you need to let the IRS work out better direction for its people governing the program. My recent experience is that it is getting better. This is a management problem, not a problem with the law.

(d). The IRS has the power to label a taxpayer as an "illegal tax protester." Such a label is important for the IRS in its efforts to protect its agent. But such a label also brings serious consequences for the labeled taxpayer. It is important to protect IRS employees. However, our investigation has revealed that some taxpayers may have been labeled as illegal tax protesters merely because they wrote an article in a newspaper. Should there be a review of such labeling to prevent abuse of the labeling system to the detriment of law abiding taxpayers?

Answer 5(d). Illegal tax protester: Yes, there should be a review. I don't believe legislation is needed to accomplish that. A single discussion with Commissioner Rossotti should resolve this.

Question 6. Should the Taxpayer Advocate and problems resolution officers be independent from the IRS?

Answer 6. Taxpayer advocate independence: No, I don't think you want to set up another government agency with all the complications that go with that. If you isolate the taxpayer advocate so much you will breed suspicions and lose cooperation. Appeals now operates as an independent group, but it is not a separate group. I suspect that is a good model.

Question 7. Are you aware of any instances of IRS employees who were abusive to taxpayers or retaliate against other employees who were not disciplined because management believed the disciplinary process is too burdensome?

Answer 7. Employee Disciplinary System: I believe effective management takes care of this problem.

Question 8. The Committee's hearings last September dramatically demonstrated the need to institute greater taxpayer protection. I think we were all very disappointed by the poor performance of the taxpayer advocate's office. The idea, though, of a tax ombudsman—someone who has the knowledge to guide taxpayers and the power to resolve snafus—seems to me to be a good one. On the other hand we should be striving for an IRS where problems are solved right for the first time by the front line agency personnel that deal with the public.

Until we achieve such a happy state, one avenue open to the Committee is to increase the resources devoted to the advocate's office, develop a separate professional career path for the people who work in it, and have the office report to both the Commissioner and the Oversight Board. What is your reaction to that?

Answer 8. Taxpayer Protection: (See 7). Yes, you should strive for the right answer the first time, but you have to know that will not always occur, so you need a sensitive supervisory system. The first level supervisor is a key to this problem. Commissioner Rossotti is aware of this.

Changing the Culture

Question 9. Improving oversight and protecting the taxpayer are not the only things we need to be doing to respond to the problems uncovered by the IRS. We need to change the very culture of the agency itself. That will require a complete new look at its organizational structure, its managerial rules, its performance measures, and its training programs.

(a). One of the surprises of the Committee's investigation into the IRS is how fearful many employees are at how they are managed. They paint a picture of the IRS as a vindictive and unhappy place to work. What changes would you like to see in personnel rules and other procedures to change the culture of this organization?

Answer 9(a). I don't believe the ability to change the culture lies in writing new or expanded rules. This is a management problem, in a few places, not in the entire agency. It starts with better training for first-level supervisors. It is easier to manage by the numbers, so the weak or lazy supervisor will do that. The better ones maintain balance between quality of work, attitude toward taxpayers and production. Thus a better training program for first-level supervisors would be my suggestion for a start. Most of the employees I have dealt with over the years have been competent and effective.

(b). There are a considerable number of people who feel that it is not possible to reform the culture of the IRS without dismantling the agency. For these people, a whole new tax system that isn't dependent on a collection agency is the way to go. What is your response to people who, because of their experiences with the IRS, believe this is an agency beyond saving?

Answer 9(b). I believe that people who say the agency is not worth saving are speaking nonsense. I travel all over the world working with the U.N. to train developing country tax administrators in the principles of good administration. Wherever I go the IRS is well respected and emulated. If you recreated a new agency you would do it just about as it is now, only with small changes.

My major suggestion for making the system better is for the Congress and the Administration to resist the urge to use the Tax Code to do everything from educational programs to encouraging R&D. Each provision begets another and thus we have a complex Code which is difficult to administer.

(c). In 1994, Congress passed the Government Performance and Results Act (GPRA). This was an effort to get the Congress and the Executive Branch to focus on performance standards. Do you support such standards for the IRS? If you do, what do you think the performance standards should be?

Answer 9(c). The Government Reform and Performance Act is partially to blame for the results-oriented performance you are hearing revealed. If you ask for quantification, people think you are judging them on quantity. Both modes of operation and quality need to be judged. Good employees will perform well in both areas, but you need to enunciate your goals. Employees will try to meet the standards expected, at least that is my experience.

(d). During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures?

Answer 9(d). Writing more rules will only make the system more complicated. This issue is again one of management. Good supervisors will hold their employees to following the rules. I find that most of them do, and when they don't, calling attention to the manual instructions will usually bring them into line.

Oversight Board Questions

Question 10. The House bill establishes a board "to oversee" the IRS in its "administration, management, conduct, direction, and supervision" of the administration of the tax laws What does "oversee" mean to you? What should be the relationship between the Commissioner and the Board?

Answer 10. I recommended in my testimony that the Board be advisory. If it is a Board composed of important and knowledgeable people, it will have a tremendous influence on the Commissioner's thinking. See particularly the testimony of NAPA with which I agree.

Question 11. I am troubled that the bill prohibits the board from exercising any authority over "law enforcement activities" such as collections—an area which our hearings have shown to be rife with taxpayer abuse.

Answer 11. See my testimony, re: possible conflicts, real and apparent. If the Board gets into casework, it will push one direction or the other, then conflicts will be real.

Question 12. If an IRS Oversight Board is established within Treasury, should Board members be part-time or full-time employees?

Answer 12. Part-time or Full-time Employees: Nature abhors a vacuum. The work will fill the existing time. If they are full-time, they will get into minutiae. This Board should meet six to eight times per year or more, if needed, but not every day. It is not the Commissioner, unless you mean to defy every rule of good management. No Board of Directors of a corporation has all full-time members.

Question 13. What is your opinion regarding who should serve on the proposed IRS Oversight Board? Should a union representative be guaranteed a slot on the Board? Should the Commissioner and Secretary of Treasury be on the Board?

Answer 13. Who Should Serve on the IRS Oversight Board: I do not believe a Union President should serve. He has access to management now on all important issues; he could be an observer at meetings when needed, but he has a conflict on management changes. See my testimony and the NAPA testimony on this subject. Yes, the Commissioner and Secretary of Treasury should serve. The Commissioner is the CEO of the IRS. If you are to have an effective Board, the Commissioner should be a part of it since he/she will be the one who will execute the direction to change the management focus.

Question 14. I think that we would probably all agree that a significant part of taxpayers' problems with the IRS stem from the complexity of the Code. What parts of the Code do you think are prime candidates for simplification?

Answer 14. See my testimony of January 29 and also my Griswold Lecture, pages 7-15.

Congress often puts in restrictions on various provisions, not on the merits, but to save revenue. This is one of the most frequent causes of complication. I would be pleased to assist your staff with Code provisions which could be simplified.

PREPARED STATEMENTS OF HON. ALFONSE M. D'AMATO

[JANUARY 28, 1998]

Mr. Chairman, I commend you for quickly beginning a series of important and necessary hearings on restructuring and reforming the Internal Revenue Service (IRS). I want to welcome Secretary Rubin and Commissioner Rossotti today and look forward to their comments on how to go about successfully restoring taxpayer confidence in our tax system.

The IRS is one of the few federal agencies which interacts on a daily basis with tens of thousands of Americans, and is charged with the management and enforcement of the tax laws enacted by Congress. The American people expect and deserve a tax system that ensures their rights under the laws, and an IRS that is not abusive in enforcing those laws.

Our hearings last Fall made it very clear that too many taxpayers are being denied their fundamental rights, and too many are paying money they do not owe. In

fact, a recent Internal Audit initiated by the IRS as a result of those hearings, which reviewed the use of enforcement goals and statistics in the Collection function of a number of IRS District Offices, supports the findings of those hearings.

Mr. Chairman, in drafting IRS reform legislation it is imperative that this Committee not only establish an oversight board and increase taxpayer protections within the Taxpayer Bill of Rights, but also strengthen and expand the authority of the Taxpayer Advocate, whose office is currently the sole defender of taxpayers within the IRS. As such, the Advocate should not just get involved with problems after the fact, his or her office should be part of the policy making process up front.

That is the only way to change the current culture within the IRS, and assure a balance between fair treatment of taxpayers and enforcing compliance with the tax laws. Transforming the IRS into a customer service organization will restore confidence in our tax system.

Thank you, Mr. Chairman.

[FEBRUARY 5, 1998]

Mr. Chairman, this hearing will focus on what I believe to be the most important task in reforming the Internal Revenue Service (IRS)—ensuring taxpayer rights. I want to commend you for continuing these hearings into IRS abuses of taxpayers' because it is important that the American people know unequivocally that Congress has gotten their message and will no longer tolerate it.

I still shudder at the thought of what we heard in the first hearings last Fall. The incredible tales of taxpayers spending ten and fifteen years trying to resolve disputes with IRS employees who didn't want to be bothered with collecting the correct tax. They just wanted to collect any tax even though? in some cases, it wasn't actually owed.

I continue to receive phone calls from constituents who tell me about coercive tactics used by IRS agents during audits. For example, an agent telling a taxpayer that he will audit other tax years, or assess a higher tax if they don't extend the statute of limitations. No wonder a 90 percent of Americans surveyed want Congress to make IRS reform a top priority. And 86 percent want additional protections for taxpayers during an audit or a tax collection action.

I commend Commissioner Rossotti for recognizing the importance of fundamental reorganization within the IRS—a recommendation made by the National Commission on Restructuring the IRS. His quick and forceful efforts to refocus IRS operations around the needs of taxpayers instead of the needs of the bureaucracy are noteworthy. I trust he will continue to incorporate new ideas and find inventive ways to put a better face on the IRS. One suggestion I believe will help accomplish that goal would be to ensure that when upgrading the IRS computers a "tracking system" be included that would track payroll deposits and warn the IRS that a particular business had stopped making its deposits.

Mr. Chairman, as you know? most taxpayers, both individuals and businesses, pay their taxes in full and on time. However, when businesses have cash flow problems the owner has to make a choice between paying the creditor who's immediately on his back (i.e., suppliers, electricity, etc.), or paying the IRS. Mr. Rossotti told us last week that IRS probably won't contact him for six months or more. By then the payroll debt, including interest and penalty, is more than the business can handle and the result is that the taxes don't get paid. Having this type of preventative measure will cost the IRS less in the long run, keep businesses operating, and help to eliminate the almost $100 billion tax gap we currently have.

I welcome our distinguished witnesses today, and look forward to their testimony on this very important issue.

[FEBRUARY 11, 1998]

Mr. Chairman, I commend you again for taking the lead in holding hearings on issues that should and do concern us about the tax laws in general, and the IRS's practices in particular, especially as it relates to "innocent spouses"—mostly women—who are powerless to put up a winning fight. I am outraged and, frankly, growing very weary of all the issues that keep coming out about the IRS and its unfair and unethical behavior towards law-abiding Americans.

Today, two of my constituents, Elizabeth Cockrell and Svetlana Pejanovic, will tell similar stories about their contact with the IRS and their losing battle in trying to prove that they are innocent spouses and should be entitled to relief from tax assessments perpetrated by the actions of their spouses.

Both came to this country and married American citizens. Unfortunately, their marriages ended after three or four years, but both were able to find jobs and get on with their lives, even though they received no financial support from their ex-

husbands. Then bang, years later the IRS is on their doorstep demanding payment for taxes they never knew were owed. They never knew about these back taxes because the IRS only made contact with their ex-husbands.

Here we have two women who have been filing their own tax returns for over five years, noting their social security numbers on those returns—the same ones used on the joint returns they filed—and the IRS doesn't even bother to contact them. No, the IRS considers that it has satisfied its obligation by sending a letter to the deadbeat who caused the problem in the first place. It's beyond me that the IRS does not do a current check on both parties, especially when they are trying to collect a tax assessment that is five years old or more. You'd think that would be standard procedure.

Mr. Chairman, we must do more to protect our lawabiding taxpayers. The innocent spouse provisions we currently have are totally inadequate and very difficult, if not impossible, to meet. As Mr. Keating stated in his testimony . . . . "its provisions are so complicated and arduous that it should be known as the 'lucky spouse' rule for the few people who can meet all of its tests." That is why I fully support the Senate bill going much further than the House on the innocent spouse issue. I have reviewed the American Bar Association (ABA) proposal, which advocates repeal of the joint and several liability provision. I support that also.

I trust that the testimony we are about to hear today will convince Members of this Committee that a drastic change is needed. We have the opportunity to do that this year.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF BRYAN E. GATES

Chairman Roth, Ranking Member Moynihan, and Members of the Committee, my name is Bryan Gates and I am an Enrolled Agent in private practice in Clearwater, Florida. I am pleased to have this opportunity to present testimony on behalf of the Members of the National Association of Enrolled Agents.

Enrolled Agents are tax professionals licensed by the Department of the Treasury to represent taxpayers before the Internal Revenue Service. The Enrolled Agent designation was created by Congress and signed into law by President Chester Arthur in 1884 to ensure ethical and professional representation of claims brought to the Treasury Department. Members of NAEA subscribe to a Code of Ethics and Rules of Professional Conduct and adhere to annual Continuing Professional Education standards which not only equal but exceed IRS requirements. Today, Enrolled Agents represent millions of individual and small business taxpayers at all administrative levels of the IRS, in addition to preparing their tax returns.

By way of background, I am a third generation Floridian and a graduate of Florida State University where I received my degree in business administration in 1963. I joined the IRS shortly after graduation and for five years served in various field positions. In 1968 I was selected for senior staff development in the IRS National Office in Washington where I was assigned to the Assistant Commissioner for Compliance. My duties included IRS operations analysis and editing portions of the Internal Revenue Manual which, as you know, is the definitive procedure reference book for IRS field personnel. During my service with the IRS, I received a number of superior work performance awards and a Commissioner's Letter of Commendation. Since leaving the Service in 1973, I have become, in addition to representing hundreds of taxpayers, an authority on IRS practice and procedure, a frequent lecturer, and author of several books and numerous articles on IRS representation. As originator of NAEA's National Tax Practice Institute (NTPI) I have educated over a thousand graduates in representation.

My testimony this morning will be divided into several parts. First, I would like to comment on the IRS reform legislation pending before the Committee. Secondly, I would like to propose additional taxpayer safeguards which should be considered by the Committee. Finally, I will discuss the role of the Taxpayer Advocate.

1. GOVERNANCE ISSUES

Representatives of NAEA testified at five public hearings conducted by the National Commission on Restructuring the IRS, and we submitted written testimony for the record for a sixth hearing. In addition, our National staff attended numerous informal meetings with Commission staffers and Commissioners. We have praised the work done by the Commission in focusing on constructive ways of improving our tax administration system and making the IRS more responsive to taxpayer input. We support the Commission's recommendations which have been incorporated into the pending legislation as we believe the true bipartisan nature of the Commission's

deliberations and the earnest give and take of the democratic process have produced a set of recommendations which are carefully woven together and interdependent upon each other to bring about the change all agree is necessary in the way our tax administration system works.

A. IRS Oversight Board

We strongly endorse the concept of establishing an IRS Oversight Board. It became clear to everyone who attended the hearings and deliberations of the Commission over the past year that the IRS had significant lapses in the skills sets needed to manage the technology conversion process they have underway; to guide the enhancements needed in expanding their customer service focus; and to steer the marketing of their new initiatives. We have often expressed our concern about a trend toward greater centralization of decision making authority into the IRS National Office and believe this contributed to a major degree to the problems the Service has encountered in recent years. The Commission's contribution has been to force the Service to consider outside input on a far greater scale than at any previous time. Healthy developments have already occurred as a result. We have the first IRS Commissioner with significant technology integration experience now in that post. We have seen the Service select a new Assistant Commissioner for Electronic Tax Administration from private industry who has extensive experience with marketing electronic tax services, and we have seen the issuance of a request for proposals from the private sector for ways the IRS could improve its overall systems.

Many organizations spent considerable time and resources to help the Commission in its deliberations to insure that the recommendations were going to improve the tax administration system and insure IRS was able to reverse the decline in taxpayer confidence in its ability to impartially and efficiently manage its resources. The final recommendations were the result of compromise in the best sense of the word. Not everyone got what they wanted or thought would be best from their perspective, but we believe the blend of different views resulted in a package which, when implemented, will significantly help get our tax system back on its feet and restore the Service to the ranks of the best managed government agencies.

We truly believe that the Oversight Board is precisely what the Service needs at this moment in time and prefer to focus on the positive aspects to be derived from its establishment. If we focus on the true nature of the Commission's objective—to make the IRS more responsive to America's taxpayers—especially the 85% who comply with all of their tax obligations every year—we see that instead of presenting a threat, the Oversight Board could bring an outstanding group of advocates for the Service to the table. These advocates, given the status of their own professional accomplishments and positions, would enjoy significant credibility with the Congress and the taxpaying public. We would envision a consultative role for the Oversight Board, one in which the expertise of Board members would contribute to the resolution of long-standing organizational and management issues.

In past times of crisis we have seen Presidents appoint outside Boards to help government fulfill its mission. During World War II, President Roosevelt used many "dollar-a-year" men to guide our efforts and relied on extensive input from corporate and civic leaders outside of the federal government to resolve problems. We prefer to view the potential of the Oversight Board in the same light. Let it help IRS redefine its relationship with the American taxpayer. Let it bring to the table the best ideas, the best people, and the best systems to deal with our complex problems. The appointment of Charles Rossotti to be the new IRS Commissioner is a prime example of how this new system will work. We understand that Mr. Rossotti was identified as a possible Commissioner candidate by Josh Westin, CEO of ADP and a member of the National Commission on Restructuring the IRS. Mr. Rossotti's background in technology and management made him superbly qualified for the critical tasks IRS is facing, although he did not have any tax law expertise. One has to ask whether his name would ever have surfaced if the process for his nomination had been business as usual.

The Department of the Treasury initially expressed opposition to the establishment of the Oversight Board and we were very concerned that its position was contrary to the bipartisan message of the Commission. If the Commission identified anything, it exposed the fact that there were significant problems with the way Treasury performed its oversight role in past years. It is only because of your hearings last September that the Administration realized the very serious nature of the situation. We are pleased that Treasury and the Administration came around on this critical issue.

We believe there are sufficient safeguards written into the proposed legislation to insure the IRS will not be deterred in its mission. In our opinion, the Service will work effectively with an Oversight Board in much the same way it currently works

with the Commissioner's Advisory Group. The one benefit the Oversight Board brings to the table is the planned management focus lacking in the more procedural and regulation orientation of the Commissioner's Advisory Group, which is authorized under the Federal Advisory Committee Act, to provide an organized public forum for discussion of relevant tax administration issues between IRS officials and representatives of the public. We see the Oversight Board as working hand in glove with the Commissioner to bring much valuable peer viewpoints on key management issues that arise.

B. Other Measures

We support the other legislative proposals which would modify the current laws with respect to posts of duty, employee details to other functions, compensation schemes, and bonus and award structures. These changes could go a long way towards making the upper management of the Service more competitive and more motivated and help the Service retain more of the truly excellent people they have working in their executive ranks.

C. Electronic Filing

We believe that at long last the IRS is on the right track with respect to implementation of electronic filing of tax returns. The enormity of the task will prevent immediate results, but we are confident that the recent appointments of Commissioner Charles Rossotti and Robert Barr to head the Electronic Tax Administration, will greatly enhance IRS' ability to get the job done. Rather than suggesting new approaches, we would prefer to see these professionals be given free rein to address the issues before them.

2. TAXPAYER RIGHTS ISSUES

As the Commission on Restructuring the IRS deliberated, NAEA representatives were invited to testify before it to offer suggestions on how to further protect taxpayer rights. Many of those suggestions were incorporated into the Commission's recommendations and later into the reform legislation itself.

If Congress wishes to protect the rights of taxpayers, one of the best things this Committee can do is provide for sustained, regular oversight of the IRS. We were heartened to hear that this will be a major focus of your Committee in the coming year.

Through its oversight activities, the Committee can see what needs to be done to improve our system of tax administration and, more importantly, keep apprised of the steps which are being taken to make the system better. We would emphasize the latter as much as the former: many good things are happening at IRS these days and you should know about them. To give you just one example, I attended our Florida Society's board meeting last weekend which included a practitioners' liaison meeting with the IRS. I was impressed with their candor, cooperative attitude, and willingness to work to resolve taxpayer issues. And that attitude was shared by all the IRS personnel: the North and South Florida District Directors, Henry Lamar and Bruce Thomas, and their senior management. It was clear to all of us that—at least in Florida—taxpayer service will be indeed a large part of the IRS mission.

We would, however, offer the following comments for consideration by the Finance Committee to further protect taxpayer rights.

A. Taxpayers' Right of Consultation (IRC 7521)

Enacted as part of the first Taxpayer Bill of Rights, Congress created a statutory right to representation which had not previously existed except when taxpayers were compelled to appear before officers of the IRS by administrative summons. As significant as this statute is for taxpayers, it still represents the worst kind of law: a rule without sanction. Officers and employees of the IRS continue to deny, disparage and interfere with taxpayers' statutory right with impunity. IRS officials have, in the face of clearly stated wishes to consult an attorney, even asked taxpayers if they committed a crime to chill the taxpayers' exercise of their statutory right to consultation.

Taxpayers are still being advised in some quarters that "they don't need to consult with a tax advisor" and worse yet, when IRS has a valid Power of Attorney on file, IRS employees sometimes resist meeting with the taxpayer's representative and instead go around the tax practitioner to speak with the taxpayer directly in violation of the taxpayer's express wishes and statutory rights.

It is time for Congress to add sanctions for abuse of the statutory right of consultation. We believe IRS officials and employees who are charged with abuse of a taxpayer's right of consultation should be suspended from duty pending completion

of an investigation by the IRS inspection service and a disciplinary decision by IRS management.

B. Registration of All Commercial Tax Return Preparers

We would like to see the recommendations of the IRS Commissioner's Advisory Group regarding the registration of all commercial tax return preparers enacted into law. Rather than another instance of governmental intrusion into the lives of taxpayers, we believe that a fundamental taxpayer right is the right to be able to rely on the expertise of the individuals who assist in helping citizens meet their tax obligations. We have, for too long, had an uneven playing field where those tax professionals who have made the most significant commitment to their profession—Enrolled Agents, attorneys and Certified Public Accountants—are the most regulated. Only those professions require continuing professional education. Only those professions have developed standards of professional practice and published standards of professional ethics. The tax laws of this country are too complex to permit paid tax preparers to offer services to taxpayers without requiring that they maintain a minimum level of technical proficiency and that they stand by their product in the event of error. Taxpayers deserve no less.

C. Extension of Client Privilege to Enrolled Agents and CPAs

We were pleased to see the extension of client privilege in civil matters extended to Enrolled Agents and Certified Public Accountants in the IRS reform legislation. It is a basic right of taxpayers not to have their own advisors used as witnesses against them. We believe there are adequate safeguards available to the Service in regulating the practice of taxpayer representatives covered by Circular 230. The extension of the privilege to these private taxpayer advocates is long overdue.

D. Payment of Tax (IRC 6159 & 7122)

Also in the first Taxpayer Bill of Rights, Congress added Section 6159 to the Code authorizing the Secretary to allow payment of tax in installments. Section 7122 of the Code has long permitted the Secretary to compromise any civil tax case arising under internal revenue laws. In our opinion, the Service is not administering these statutes fairly. The Service has instituted income and asset standards which they administer inflexibly in deciding the extent to which taxpayers will be permitted to use these provisions of the law and the Service unreasonably delays its decisions, claiming lack of resources and vagaries of contract law.

We believe it is time for Congress to broaden these statutes and prohibit the IRS from using enforcement personnel to evaluate installment payment and compromise proposals. Once enforcement personnel determine that a taxpayer cannot pay what is owed in full without incurring hardship, taxpayer service personnel should negotiate payment arrangements or settlements with dispatch.

E. Enforcement (IRC 6331)

Section 6331 of the Code has long permitted seizure of taxpayers' property, real and personal, tangible and intangible, for nonpayment of federal taxes. Congress has authorized continuous levy on wages and salary and recently added authority to levy continuously on such nonmeans tested benefits as Social Security retirement payments. The Service has abused this seizure authority from time to time and has been admonished by the Courts. The Supreme Court ruled in *G.M. Leasing, 429 U.S. 338 (1977)* that IRS entry on private property without a warrant to seize tangible personal property violated the Fourth Amendment of the Constitution. IRS—Taxpayer confrontations frequently occur when IRS agents physically seize real and tangible personal property which is in taxpayers' possession. IRS statistics reveal that only 10,000 seizures of property in the possession of taxpayers are made each year, but the statistics do not reveal any significant amount of dollars these physical seizures produce.

It is time for Congress to broaden Section 6331 of the Code to require the Service to obtain judicial approval in the form of a *Writ of Seizure* prior to seizing real and tangible personal property in a taxpayer's possession. The procedures for obtaining such a writ would provide taxpayers an opportunity to show cause why the seizure should not be permitted. Having heard complaints about seizures for years, we think this may be the best way to diffuse what have become at times highly charged situations and provide a dispassionate setting for full airing of both taxpayer and IRS positions.

F. Statutes of Limitation (IRC 6501 & 6502)

Congress has limited the time the Service can assess additional taxes on a return to three years and the time the Service can collect an assessed tax to ten years in Code sections 6501 and 6502, respectively. The statutes contemplate extension of

these periods if the Service and taxpayers mutually agree. The Service has been known to bring coercive force on taxpayers who are reluctant to extend these periods. It has been reported that Service employees have exacted twenty year extensions of a collection statute as a condition to approving installment proposals which, in fact, represented the taxpayer's maximum capacity to pay. It has also been reported that taxpayers who were reluctant to extend the statutory period for assessment have again and again been threatened with inflated and exaggerated assessments.

It is time for Congress to end the possibility of statute extensions. Three years to assess and ten years to collect is enough.

G. Indirect Methods of Proving Income (IRC 446)

Congress has given the Secretary authority to compute taxable income using a method of accounting, which, in the Secretary's opinion, does clearly reflect income. The Service has frequently overreached without probable cause with this authority. The Service is also prone to use the statistical averages (BLS) produced by government agencies to charge taxpayers without further basis with underreporting income. These proposed assessments based on charts and graphs are expensive for taxpayers to protest at IRS Appeal or in Tax Court. Ordinary taxpayers facing accusations that you spent more than you received or that your "T-Account" is out of balance cannot always recall that they borrowed money, received insurance benefits, or got a $5,000 helping hand from Mom.

It is time for Congress to end the abuse in this area by requiring a finding by the Service equivalent to probable cause before using the authority to determine taxable income by a method of the Service's own choosing.

3. POSITION OF TAXPAYER ADVOCATE

We agree with the proposals in the legislation concerning the Taxpayer Advocate. We suggested the same in our prior testimony before the Commission and believe that in order for the Taxpayer Advocate to fully meet the expectations laid down in Taxpayer Bill of Rights II that the individual selected must come from outside the Service and report to Treasury. We believe it is completely unfair to civil servants to place them in the position where they are expected to issue reports and recommendations to Congress that may be in opposition to their superiors' wishes. It creates an untenable situation in which no one could perform well.

Our only suggestion for change to the statutory language would be to prohibit any current IRS employee from appointment to the position. We would like to see a requirement that if the President wishes to nominate an IRS employee to the job, that person must either resign or retire before confirmation. This would insure a completely independent Advocate.

4. SUMMARY

We thank the Committee for this opportunity to share our Members' views on these important issues. I will be pleased to respond to your questions or comments about my testimony.

PREPARED STATEMENT OF FRED T. GOLDBERG, JR.

Mr. Chairman and Members of the Committee: My name is Fred Goldberg. I have served as IRS Chief Counsel (1984-1986), IRS Commissioner (1989-1991), Assistant Secretary of the Treasury for Tax Policy (1992), and as a Member of the National Commission on Restructuring the IRS (1996-1997). I am appearing today on my own behalf and not on behalf of any client interest.

Much has happened since the Commission released its Report last July. Many of the Commission's proposals are included in legislation that was approved last year by an overwhelming, bi-partisan majority of the House. The Administration had legitimate concerns that have been resolved to their satisfaction (properly, in my view), and they now support the measure.

In the meantime, the Administration has nominated, and the Senate has confirmed, Mr. Charles Rossotti as the new IRS Commissioner. By all accounts, and based on his actions to date, Mr. Rossotti is the right person, at the right time, with the right experience and expertise for the job. The Administration's success in finding him, recruiting him, and convincing him to take the position is a great accomplishment.

Your Committee hearings last year were rivetting, and make a compelling case for change. Without doubt, they will be a catalyst for additional reforms, especially in the area of taxpayer rights.

In light of these developments, I will limit my statement to three observations: the need to reform IRS governance and management; the need for closure; and suggestions relating to taxpayer rights legislation.

* * * * *

Above all, I want to emphasize the direct connection between reform of IRS governance and management, on the one hand, and the concerns highlighted by your recent hearings. The Commission's Report and your hearings described the same concerns using very different terms. The Report makes clear that the cases you focused on are symptomatic of a fundamental problem: the IRS is not delivering the quality of tax administration that the American people have come to expect and demand. For this reason, it is absolutely certain that the problems you identified, and many others that did not surface, can only be remedied by reforms that start at the top.

The current IRS governance and management structure is fatally flawed. Unless you address those flaws, you and your colleagues will be back here two years from now, five years from now, and ten years from now—wondering why nothing really changed. Wondering why, despite all the promises, apologies, and taxpayer rights legislation, things aren't much better.

The answer is really quite simple: the current governance and management structure fails on three counts: (i) in your words Mr. Chairman, it does not assure a "powerful and undiluted commitment" to what we want from the IRS; (ii) it does not provide the expertise, accountability and continuity to get the job done; and (iii) it does not give the Commissioner and the IRS the tools to deliver what's expected of them. There is a direct cause and effect between these failures and the problems your hearings identified.

That's why the Commission's Report and the current Reform Legislation call for the following:

Embrace two fundamental principles of tax administration: (a) The IRS should not contact a taxpayer unless the IRS is prepared to devote the resources necessary to provide that taxpayer with a prompt, high quality resolution of the matter in question. (b) The IRS should not force the taxpayer to deal with an IRS employee unless that employee is adequately trained and has the tools to do the job properly—and proper job performance requires the fair and courteous treatment of taxpayers.

These standards are a business necessity and a democratic imperative in our system of government—but at present, and for all too many years, the IRS has failed to live up to these standards. That's obvious from your recent hearings, Mr. Chairman. I believe that every problem identified during those hearings can be traced back to a failure to adhere to these standards.

Appoint the Commissioner for a five-year term. Changing any institution, especially one like the IRS, is hard—very, very hard. Give the Commissioner the time he needs to fulfill the promises he has made.

Give the Commissioner the authority and tools to build his own senior management team, and hold those individuals accountable for performance. The Commissioner can't do it alone.

Create an IRS Oversight Board—ultimately accountable to the President of the United States—with the expertise and continuity to focus on strategic, long-term objectives, and hold the Commissioner accountable for performance. Traditional Executive Branch oversight of the IRS just doesn't work. Personnel who don't have the relevant expertise and experience, the universal urge to micro-manage, and the overwhelming lack of continuity doom every Administration's efforts to failure. It isn't Republicans or Democrats and it's not a question of good intentions—it's the nature of the beast. Getting what we want from the IRS will be very difficult. An IRS Oversight Board within the Treasury Department is essential to provide the expertise, accountability and continuity to get the job done.

Coordinate Congressional oversight among those responsible for all aspects of the IRS, with a specific focus on strategic and long-term issues. The IRS Oversight Board is necessary, but it is no substitute for Congressional leadership and oversight. There's only one way that the IRS will know what's

expected from Congress, and only one way that Congress can assure continuity and hold the IRS accountable. Representatives from the IRS, Treasury, the Oversight Board, and all seven Congressional Committees with responsibility for the tax system and tax administration should spend time together, in the same room, at the same time, addressing the strategic and long-term issues that matter most to tax administration.

Provide the IRS with stable financing over a three year period—in return, the IRS must develop appropriate performance measures and obtain "clean" financial audits. "Feast or famine" financing has wasted billions of dollars since the early 1980's. The lack of certainty and stability in funding the IRS makes it impossible to plan and execute its mission. Of equal importance, the lack of appropriate performance measures and adequate data make it impossible to manage effectively—or hold those in charge accountable for performance.

Provide workforce flexibility to change the way the IRS does business, enable the IRS to recruit and retain those who measure up—and get rid of those who don't. While leadership and focus must come from the top, tax administration is delivered on the front lines.

Mr. Chairman, this is an integrated package. Each of these elements is essential to provide focus on mission; the requisite expertise, accountability and continuity; and the tools to do the job. No single approach, standing alone, would be sufficient. And without these changes, the problems identified in your hearings will recur all too frequently.

If I might digress for a moment, Mr. Chairman. You have received well-earned headlines for the IRS hearings you sponsored last year. You have received little public recognition for your leadership in the enactment of GPRA, the Government Performance and Review Act. Nonetheless, Mr. Chairman, I think GPRA will have a far more lasting impact. It's not glamorous, but it matters. Mr. Chairman, the governance and management portions of the IRS Reform Legislation, are the heart and soul of GPRA. They provide the structure and tools to assure focus on mission, and the expertise, accountability and continuity to get the job done. They are essential to making the vision of GPRA a reality at the IRS.[1]

* * * * *

The second point I want to emphasize is the need for closure. To illustrate, consider the new Commissioner's job description. Until IRS Reform Legislation is enacted: he will have no idea how long he will be permitted to serve as Commissioner. He will not have the latitude and tools to build his own management team. He will be subject to Executive Branch oversight by an ever-changing cast of well-meaning individuals with far less experience and expertise than he has. Unless human nature has changed in the last 24 hours, these individuals will suffer from the universal urge to micro-manage his performance (which he will endure in silence). He will be managing in a vacuum—with little access to those with the expertise and experience that can help him, no hope for continuity, and no group to hold him accountable. He will not benefit from—and will not be subject to—coordinated Congressional oversight and guidance on the strategic and long-term issues facing tax administration. He is likely to face "feast or famine" budgets, with no ability to align funding of the IRS with the promises he has made. He and his colleagues at the IRS will not have the flexibility to redesign the way work is done, hire and reward employees who deliver, and fire those who don't measure up.

Now, consider the Commissioner's job description, once the IRS Reform Bill has been enacted. The Commissioner will serve for a five year term. He will have the latitude and tools to build his own executive team, and hold them accountable. He will benefit from—and be subject to—coordinated Congressional oversight that focuses on long-term and strategic issues. He will benefit from—and be subject to—Executive Branch oversight that provides expertise, accountability and continuity. He will be able to run the Agency with a reasonable expectation of stable, long-term funding. He and his colleagues will have more latitude to redesign the way the IRS does its job, recruit and reward employees who measure up, and fire those who don't.

It is impossible to overstate how important these changes are. They are essential to reforming the IRS. The sooner they are in place, the better.

At the same time, however, I recognize the need to fully consider any IRS Reform Legislation before it is enacted. The House improved on the Commission's recommendations. Undoubtedly, you and your colleagues will make further improve-

ments. As you know, the governance and management portions of the legislation have received thorough consideration over a protracted period of time, and now enjoy widespread support—both inside and outside government. In my judgement, these provisions strike the right balance. They should be enacted substantially in their current form; any changes should focus on ironing out the all-important details. In this regard, you may wish to consider the following:

- Reduce the size of the Board.
- Ensure that the workforce flexibility provisions achieve their stated objectives and allow the Commissioner to reorganize the way the IRS does business.
- Strengthen the provisions dealing with coordinated Congressional oversight.
- Explore ways to minimize Administration (and Congressional) micro-management of the IRS.

At this point, I think its far more important to preserve certain basic features of the governance legislation. Above all, I think it would be a terrible mistake to provide the Board with access to taxpayer information; it is essential that the Board have no involvement whatsoever with tax policy matters or specific taxpayer cases. These activities would distract from the Board's mission, create apparent and real conflicts of interest, and make it far more difficult (if not impossible) to recruit high calibre Board members. The purpose of the Board is to fill and existing vacuum, not replicate the work of the IRS, the IRS Inspection function, Treasury, GAO, the tax writing committees, and the Joint Tax Committee.

By the same token, I recognize the importance of "real life" stories reflecting IRS failures—along with those reflecting IRS successes. Without question, the Board, as well as Congress and the public at large, should have access to these stories—but only in a way that does not violate the privacy of taxpayers and IRS employees. Section 6103 was not intended as a barrier, and should not be used as a barrier, to prevent an honest accounting.

* * * * *

Finally, I would like to comment on taxpayer rights measures. In many ways, legislation to protect taxpayer rights is an admission of failure. If taxpayers and the IRS "got it right the first time, every time," there would be no need for taxpayer rights legislation. From this perspective, the best way to protect taxpayer rights is to simplify the tax law and improve tax administration. That's why governance and management reforms, and simplification, are essential. They are the only way to prevent problems from arising in the first place. Without question, they will have a far greater impact than all the laws in the world to correct mistakes after they occur.

At the same time, however, while perfection is a laudable goal, it is an impossible standard. Bad things will always happen. That's why measures to protect taxpayer rights are an important part of the IRS Reform Legislation you are considering.

I will limit my comments today to the proposed change in burden of proof, and other areas where you may wish to consider additional legislation.

Most of the "experts" oppose changing the burden of proof in tax cases. In my opinion, those who dismiss the proposal out of hand fail to appreciate its extraordinary power as a symbol of what most Americans want from their government in general, and from the IRS in particular. We want to be treated with respect, courtesy and dignity. We want rules administered reasonably. We want to be treated with common sense, not treated like common criminals. The notion that taxpayers are somehow "guilty until proven innocent" is profoundly contrary to our fundamental values as a country.

Having said as much, of course, there are many logical reasons to oppose changing the burden of proof. While I'm sure you've heard them all, they bear repeating:

- As a practical matter, the chance that changing the burden of proof in litigated cases will make a difference is about like the odds of flipping a coin and having it land on its edge.
- In our system, taxpayers have the information necessary to prepare their returns. The IRS doesn't. Under these circumstances, it only makes sense to have the taxpayer prove up his or her case. The current rules reflect this reality; they have nothing to do with treating taxpayers as guilty until proven innocent.
- Changing the burden of proof will encourage a small group of dishonest taxpayers to abuse the system, give false hope to millions of honest taxpayers, make the IRS more aggressive in auditing taxpayers, and encourage more litigation.

Mr. Chairman, you and your colleagues face a difficult decision—whether to support legislation that embodies a powerful and positive symbol, but will result in a

substantial loss of revenue and create incentives that will move the system in the wrong direction.

On balance, I would not change the burden of proof for two reasons: First, the change would do more harm than good. Second, as a practical matter, you can use the revenue associated with that proposal to make other changes that respond more effectively to concerns of the taxpaying public.

The reason it would do more harm than good can be found in your hearings last year. The most important lesson of those hearings is that the IRS and its employees—like all organizations and workers—always respond to what they think is expected of them.[2]

If you change the burden of proof, I guarantee you that the IRS will respond by deciding that it must do a better job of building its cases during audit. That is not be the message you are trying to send, but that is the message the IRS will receive. The result will be far more intrusive and expensive examinations of taxpayers. On occasion, IRS employees will "make clear" that if a taxpayer doesn't "cooperate," then the taxpayer will have the burden of proof—coercing the taxpayer into satisfying the agent's every unreasonable request. Meanwhile, virtually every IRS audit will eventually settle, and shifting the burden of proof will have no practical impact on the remainder. Changing the burden of proof is a powerful—and positive—symbol. I just don't think it's worth the price of more intrusive and expensive IRS audits, frustrated taxpayer expectations, increased non-compliance, and more litigation.

I am convinced, however, that you can make other changes that are powerful and positive symbols—while providing the IRS with the proper incentives. My guess is that most of these changes could be "paid for" with revenues otherwise going to change the burden of proof.

First, I recommend that you dramatically expand provisions allowing taxpayers to recover their costs. Changing the standard from "reckless" to "negligent" may be helpful, but it's largely a lawyer's game. The rule should be simple and straightforward: if the IRS loses, the IRS should pay the taxpayer's costs, including costs incurred during examination. No if's, and's, but's or qualifiers. Period.

Taxpayers should be able to recover their costs if the IRS loses in court or substantially concedes an issue following conclusion of an examination. The IRS should also have administrative discretion to pay some portion of the taxpayer's costs if an issue is compromised at any time, or if an issue is conceded during an examination, but only if the IRS concludes that it imposed unnecessary costs on the taxpayer. Finally, I believe this remedy should be available to all taxpayers.

This approach embodies fundamental notions of fair play. Taxpayers understand the need for audits, and taxpayers want everyone to pay their fair share—but if the taxpayer got it right to begin with, why should the taxpayer be saddled with needless costs and expense?

Unlike changing the burden of proof, this proposal would create proper incentives for the IRS. It will make the agency better aware that, while its audit and collection activities are essential, those activities impose costs on taxpayers. It will not unduly inhibit the IRS from enforcing the law—but it will encourage the IRS to reach early closure on matters, and pause before lunging ahead on issues of dubious merit.

Second, I suggest you scale back most of the current penalty and interest provisions. They may sound nice in theory, but forget the platitudes about encouraging voluntary compliance and charging a fair interest rate for the late payment of taxes. Penalties have become little more than a revenue grab and a tool to coerce taxpayers. My guess is that most of the interest that the IRS collects is attributable to IRS delays, not taxpayer misconduct. These provisions are destroying lives and doing untold damage to the tax system. It's just like attorneys fees: don't nibble around the edges. Make changes, and make them dramatic.

Third, current restrictions imposed by the anti-injunction act should be scaled back. While current law serves a legitimate function in protecting the revenue, it can and should be modified—with adequate safeguards—to give taxpayers additional recourse, both with respect to collection matters and interpretations of the tax law. Again, this comports with basic notions of fair play. The IRS has to do its job, but citizens ought to be able to protect themselves through resort to an impartial third party. It also properly aligns IRS incentives. It will make the Agency better aware that prompt closure is important to taxpayers, and encourage the IRS to exercise greater care because its actions are subject to expedited review.

Finally, I suggest you clarify Section 7801, et. seq. with a provision authorizing "common sense in tax administration." I have always believed that this authority is inherent in IRS administration of the tax laws. It is evident in everything from law enforcement tolerances and offers in compromise to Taxpayer Assistance Orders, the APA program and administrative short-cuts in various IRS rules, regula-

tions and closing agreements. The reason for making a provision of this type explicit is simple: it reaffirms your expectation that the IRS should act reasonably and use common sense. It provides positive reenforcement for the many IRS employees who want to do what's right, and may help thwart the obstructionists who say, "It makes all the sense in the world . . . BUT, it's not in the rule book; it can't be done." Most IRS employees are well-meaning, hard-working and fair-minded. Congress should empower them to do what's right.

ENDNOTES

[1]: I would also like to comment on recent stories regarding IRS misuse of enforcement measures. While enforcement quotas are illegal and abhorrent, I think much of the current discussion misses the point. The IRS can and should measure its enforcement activities. The problem is two-fold: First, the IRS does not properly measure those activities. Second, the IRS does not even try to measure most other aspects of what it should be doing (e.g., fair and reasonable treatment of taxpayers; timely closure; reductions in taxpayer burden).

[2]: If Congress and the Administration are concerned about EITC fraud, the IRS will go after non-compliance in that area. The result will be more audits of low income taxpayers. If raw enforcement statistics are the only performance measure, then that's what mid-level managers and front-line employees are going to deliver. If the IRS does not measure prompt resolution of disputes and timely and courteous treatment of taxpayers—and does not reward employees who meet those standards—we won't get prompt resolution of disputes; we won't get timely and courteous treatment of taxpayers.

PREPARED STATEMENTS OF HON. CHARLES E. GRASSLEY

[JANUARY 28, 1998]

We are here today to resume discussion of a very important issue—the restructuring of the Internal Revenue Service. As my colleagues know, I have worked very hard on this issue—serving on the National Commission on Restructuring of the IRS, and joining Senator Kerrey to introduce the first piece of comprehensive legislation.

I want to urge the Chairman to move rapidly on this issue. had hoped that we could pass a bill last Fall. But this year, certainly, we must pass legislation and have it signed into law by April 15.

In addition, we must pass solid, real reform. As the Chairman has noted publicly, we get one chance at this legislation, so we must get it right. There are real problems in dealing with the IRS and at the IRS. In this committee's hearings last Fall we heard horror stories about our government's treatment of taxpayers. Every time I go home, I hear from constituents who tell me about their first-hand experiences with the IRS. And rarely are they good. For this reason, it is not good enough to just try—we must try and succeed.

We must pass a bill that meets my seven-part plan.

Point number 1. It must:

Increase Taxpayer Rights and assure fairness to taxpayers

Let me explain this point. For starters, we must increase the independence of the taxpayer advocates—at both the local and national levels and make sure that taxpayers can find these advocates. We must also change the penalty system so that penalties are not accruing unfairly. Also, we must seriously look at increasing innocent spouse protections and eliminating the interest differential between overpayments and underpayments. These are just a few specific points, but I will be more specific as the process continues.

Point number 2. The IRS must:

Focus on Customer Service rather than Consumer Abuse

Any legislation that we pass must restructure the IRS so that it views the taxpayer as a customer, and aims to give this customer the best and most helpful service possible. One way of accomplishing this goal is to reorganize the IRS with the taxpayer in mind. This means that there would be divisions to help small businesses with all of their concerns and problems, a separate one to help big business, and so on. This idea was considered by the Restructuring Commission, and the Commission said that the idea deserves further exploration. Now Commissioner Rossotti has embraced the idea. This reorganization may be a good first step to reaching our goal of focusing on customer service rather than consumer abuse.

Point number 3. IRS reform must:

Provide for real? effective and constant oversight of the IRS

Besides diligent and constant Congressional oversight, we must help the public and the press to assist us in this oversight.

Point number 4. We must pass a bill that:

Makes the IRS Culture into that of a business rather than that of a government bureaucracy

This means creating an effective, tough, and independent Board of Directors with full time, independent staff.

Point number 5:

The IRS must meet the same expectations that it expects from taxpayers

The IRS expects taxpayers to be financially accountable and to justify expenditures that they claim as deductions. Yet, the IRS spends $4 billion dollars of taxpayer money for computer modernization and has little to show for it. The GAO has been unable to express an opinion on the reliability of the IRS financial statements for any of the four fiscal years from 1992 through 1995. In order to have credibility with the American people, the IRS must be financially accountable and justify its expenditures.

Point number 6. Any legislation must:

Restore Public Confidence in the IRS

For starters, we must improve employee training so that IRS employees always have the same answers when they are asked.

Point number 7. Legislation must work towards:

Making the tax code more user-friendly

We must work to make the tax code understandable and to give the taxpayers the resources and information they need to work with it. People want to pay their taxes, and we must help them understand the tax code so that they can accurately do this.

If we can stick to these seven principles, if we pass only legislation that meets this seven-point test, then we will have real IRS reform. And real IRS reform is the way we can help American taxpayers. The IRS has unfairly ruined people's lives. We, in Congress, are here to improve people's lives. This is one area where we can make a real difference. We have an opportunity—a responsibility—to reform this part of the government that touches more Americans' than any other part of the government.

My seven-part plan stands for real IRS reform. I intend to continue working diligently to make sure that real reform is enacted. Thank you.

[FEBRUARY 5, 1998]

I want to thank Chairman Roth for holding another hearing on the important issue concerning us today—Restructuring of the Internal Revenue Service. As I have said on many occasions, this issue is a priority for me, for my constituents, and for all taxpayers. I also believe that it is a priority for the Chairman. Hearings such as this one, and the two we had last week, prove that we are working to create the strongest, most effective legislation possible on this issue.

We are not here to do a half-way job. We are not here to dispose of this issue so we can move on to other issues. We are certainly not here to use this issue as a partisan amendment to an unrelated bill.

We owe our constituents, all taxpayers, and yes, IRS employees, a thoughtful and diligent effort that results in real change for all involved. I have confidence that our current efforts will result in the passage of a bill that truly reforms and restructures the IRS. We all must continue to contribute to this work, assessing the challenges and presenting solutions.

I look forward to hearing from all of our witnesses today. We will hear from a variety of tax practitioners and administration officials. One witness we will hear from today is Richard Calahan, the Deputy Inspector General for the Treasury Department. As most of you know, I have had a special interest in the actions of the Treasury Department's Inspector General. The current Inspector General, Valerie Lau, cost the taxpayers hundreds of thousands of dollars by awarding a government contract on a noncompetitive basis to friends. These actions and her targeting of two Secret Service agents in retaliation for their Congressional testimony led me to call for her resignation from the Senate floor. I am pleased that she finally announced her resignation. I also have questions about the actions of others in her office.

I will be looking at options to improve this Inspector General's office. It is my strong desire that a new acting IG come from outside that office to restore confidence, integrity, credibility and morale in the IG's operation. In addition, I will be considering whether IRS restructuring legislation should or could prevent this situa-

tion from reoccurring. But I will continue to look into this issue carefully. I thank the Committee for having this hearing.

[FEBRUARY 11, 1998]

We are meeting today to look at a very important issue. This issue is how our tax laws hurt innocent people. The stories we will hear today will show us how our tax laws make a bad situation worse; how our government hits people when they are down.

Our tax laws were written for the purpose of collecting taxes, not for harassing people or ruining their lives. They are not meant to take away people's chance at a new life; they are not created to keep people down despite repeated attempts to get back on their feet.

Let me tell you about one of my Iowa constituents. This woman—a very nice woman, a woman who works hard and tries hard to meet her civic obligations—this woman has been mistreated by the system.

Her letter begins, "I'm writing to you at the 11th hour in a last desperate effort to avoid emotional and financial ruin at the hands of my ex-husband and the Internal Revenue Service." She owes $142,000 dollars to the IRS for the tax ramification of an investment her then-husband made 17 years ago. She had nothing to do with this investment, never read anything associated with this investment, never understood the particulars of the investment, never filled out the tax return claiming the deduction for the investment. In addition, she never chose to spend the years her husband spent in tax court while penalties and interest accrued. As you can imagine, after 17 years, much of the $142,000 is not the original tax owed, but rather the cost of spending nearly 20 years fighting the IRS.

Now, years after the divorce, after leaving an unfaithful husband, she is on her feet. Although she entered the workplace only a couple of years before her divorce, she is now a successful real estate agent, who supports herself, and prides herself on her work and her reputation in the community. As she says, "at age 58, I have paid off the majority of my debts, a large portion of which was overhang from my failed marriage. I have managed to put away a small amount of money for retirement, but will have to spend a significant portion of my normal retirement years working full time because I'm told the IRS will take my retirement funds and maybe even my home." Now it looks like the IRS will even take her IRA and put a lien on her house. She would consider filing for bankruptcy to escape all of this, but values her professional reputation too much to take this way out. So she is left alone, hardworking, with no prospect for retirement or an end to the harassment.

There are a many things that deeply disturb me about this story and the stories that our witnesses will tell us today. First, marriage is based on trust. The current system holds spouses, usually former spouses, liable for trusting their spouses. In the case of my Iowa constituent, she learned the hard way that she could not trust her husband—he had a long term affair that caused the divorce. Frankly, this affair should be the worst breech of trust she suffers. Instead, out tax laws and the IRS are assuring that a 1981 tax deduction is an ongoing wrong that she must suffer long after she has moved on.

Our laws and the IRS insure that no one can escape a bad marriage where one spouse lied to the other. We should be in the business of promoting the family—the centerpiece of our society—and that means expecting wives to trust husbands and husbands to trust wives—not the other way around. In the current system, we punish trust.

Another aspect of these stories that bothers me is that, in many of them, the IRS seems unwilling to go after the other liable former spouse. In all of the hearings of the IRS Restructuring Commission and the Finance Committee regarding IRS actions, it has become clear that the IRS sometimes, even oftentimes, pursues the weakest among us. The IRS agents think they can win against the unrepresented and those who do not understand the process. The sad truth is, they often can win. In the cases we will hear today, it is clear that the innocent spouse is the person most vulnerable to the IRS. The innocent spouse didn't fill out the tax return, didn't understand the transaction that caused the tax problem, and often, does not know, until many years later, that there is a tax problem. Innocent spouses often have left bad marriages and are working hard just to make ends meet. The IRS chooses these people to pursue.

In an even worse case scenario, the IRS becomes a tool of an abusive former husband to continue the abuse after the marriage ends. And the government allows this abuse to continue.

For these reasons, and many more, I believe that this is an area that deserves our full attention, and I thank the Chairman for giving us this opportunity to focus

on it. I want to thank all of the witnesses for taking the time to join us today, and for having the courage to share their stories.

PREPARED STATEMENTS OF HON. ORRIN G. HATCH

[JANUARY 28, 1998]

Mr. Chairman, I commend you for holding this first hearing of the year on reforming the Internal Revenue Service. I clearly remember the testimony that was presented before this committee last September by courageous taxpayers and IRS employees. Since then, my office has received thousands of letters and phone calls concerning practices of the IRS. I look forward to working with this committee to enact legislation to reform and restructure the IRS.

I do not think anyone can dispute the assertion that the IRS is severely overdue for a restructuring. However, the changes we make must go beyond a mere shifting of who oversees this organization at the top. Evidence has been clearly presented that rules for enforcement and collection need to be changed; that the web of penalties and interest charges need to be simplified; and the power of IRS field agents and managers to levy and seize taxpayer property must be curtailed. These reforms are essential so that the rights of the taxpayers are protected.

Mr. Chairman, it is simple, IRS agents and mangers must be and will be held accountable for improper actions. The responsibility to do this is ours, the Congress. As has been mentioned, IRS abuses have been happening for decades. If we do not step up to the challenge soon, we will regret it and will be falling short of our constitutional responsibility to protect the rights of the citizens.

Before taxpayer antagonism toward the IRS grows worse, we must ensure this powerful and essential agency is responsive to the needs and concerns of the taxpayers. Complaints about the practices and procedures of the IRS are all too common. Whenever I meet with Utah families in an open forum, I hear about the treatment that taxpayers are receiving from the IRS. The people are scared and they are angry.

Mr. Chairman, what was begun last year started us on the proper path to better administration of the tax laws. I am pleased to hear the IRS is beginning to catch the vision of its duty as a taxpayer service organization. However, to make the transformation complete we in Congress must update the tax laws to ensure it stays a taxpayer service organization.

I look forward to the testimony of the witnesses here today and to the work ahead in this committee to begin a new era at the IRS.

[FEBRUARY 5, 1998]

Mr. Chairman, I commend you for holding this hearing today to discuss the ability of the Treasury Department and the IRS to oversee and inspect the activities of IRS employees. This hearing is very important to taxpayers in my home state of Utah and across the country because it goes at the heart of the government's ability to ensure that taxpayer rights are protected and that IRS employees are properly complying with all laws, regulations, and procedures.

We in congress have the responsibility to oversee federal agencies, including the IRS. However, the day to day oversight of these agencies is done internally or by an independent inspector general. These functions are critical to maintaining confidence in the federal government.

Earlier hearings held in this Committee have opened our eyes to specific operations of the IRS and its employees. Like any part of government, there exists a public trust. With respect to the IRS, that trust is gone. This committee found and the GAO has confirmed that the IRS is unable to effectively track taxpayer abuses within its own agency. To regain that trust and control, we must pass meaningful reform and strengthen the oversight functions with better internal controls that effectively protect taxpayers from abuse.

Mr. Chairman, in order to ensure the integrity of the IRS, the inspector general's office must be able to function without restriction and conflicts of interest. I believe it must be independent. With respect to the inspection service, it must be as independent as possible with sufficient authority given to the Commissioner to effectively review the agency's operations.

One of the best ideas for taxpayer protection is the Taxpayer Advocate. Like the name suggests, the Taxpayer Advocate needs to be free from IRS influence and truly represent the concerns of taxpayers. The final product of IRS must strengthen the ability of the Taxpayer Advocate's office to quickly and effectively resolve taxpayer disputes.

Mr. Chairman, I look forward to hearing the testimony from the witnesses here today and to continuing our efforts to reform the IRS and strengthening internal controls and the office of the Taxpayer Advocate.

[FEBRUARY 11, 1998]

Thank you, Mr. Chairman. I commend you for holding these hearings today. The subject of IRS reform is an important one. The American people are frustrated and angry. The stories of improper and confrontational techniques used by the IRS are sad and disheartening.

However, we must take the time to do this right. Any changes we make to the IRS will have far reaching effects. To make a mistake now could cost the federal government the trust and confidence of the American people for years to come. We must separate fact from rhetoric. We must make sure that the changes we make will mean real changes in the way the IRS interacts with the taxpayer. Nevertheless, it is important to move forward, and I agree we must get this effort off the ground promptly.

The issue of innocent spouse protections is a good example of one that warrants further review. The legislation passed last year by the House granted some additional relief for an innocent spouse by making it easier to obtain the innocent spouse protections. Today, we will hear the stories of only a few of the American taxpayers dealing with this difficult issue.

The story here is more than just that of divorce, however. These stories involve more than just improper and intimidating techniques, although they are one part of the problem. These stories involve a much more serious problem—the IRS is going after the wrong taxpayers. Instead of putting their resources into collecting from those truly liable for the taxes, the IRS appears to be targeting the easiest spouse to find, and often the one with the least amount of resources to fight the system. This must stop.

The Administration has announced that they will prepare a new form to assist taxpayers like those here today in claiming innocent spouse relief. It is also going to step up the training of IRS workers in dealing with this issue. This is not enough. We need to go further. We must make it easier for an innocent spouse to receive the relief she—or he—deserves.

Today's hearing will focus on proposals to fix the problem. I look forward to hearing the testimony. The problem is clear—we must stop the IRS from going after the wrong taxpayer. I hope that we can come closer to a solution after the hearing today.

PREPARED STATEMENT OF DAVID KEATING

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify on possible reforms of the innocent spouse rules. I represent the 300,000 members of the National Taxpayers Union (NTU) who strongly support providing taxpayers with additional rights and protections during the tax audit and collection process. As you know, I served on the National Commission on Restructuring the IRS that Senator Bob Kerrey ably co-chaired. I would like to acknowledge the assistance of Phoenix attorney Bob Kamman, Counsel for NTU's Taxpayer Rights Project, who contributed substantially to our analysis and my written statement.

Mr. Chairman, we commend you for the excellent series of hearings you have already held on how the IRS works with average taxpayers and your decision to make substantial improvements to the House-passed legislation to restructure the IRS and provide additional taxpayer rights. Because the IRS has more power over more citizens 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.

Without Reforms, Divorce-Related Tax Problems Will Get Worse

Everyone makes mistakes. That's why pencils have erasers, and the IRS has Form 1040X for amending a tax return. But there's one mistake that federal tax law won't forgive: the decision to file a joint return.

Married couples do not have to file a joint return. They can choose to pay more tax—sometimes thousands of dollars more—for the privilege of filing separately. (That's in addition to the much-criticized "penalty" many couples pay for getting, or staying, married.) And once they decide to file jointly, they cannot change to separate returns, after the due date of their Form 1040. There is no exception for divorce or death (at least for the survivor).

One of the most common complaints we hear comes from taxpayers whose former spouse has disappeared, at least from the IRS's radar screen. The IRS often, if not most of the time, pursues the former marriage partner it finds first, usually looking no further than for the name and address it has in its computer. She is often a single parent, working to support a family with little or no help. Tax-debt deadbeats are often child-support deadbeats, as well. The biggest mistake made by these targets of IRS collection and audit activity is that they filed a joint return.

In certain narrow circumstances, a spouse can be relieved of liability for taxes assessed by an IRS audit after a joint return is filed. The complicated rules for claiming such relief are known as the "innocent spouse" exception. 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.

This policy simply has not worked in the real world. In many marriages, wives are reluctant to tell their husbands (or vice versa), "I'm sorry dear, I promised to stay with you for better or for worse, but not through IRS collections and audits. So I think we should file separately, even though it means a few thousand dollars less to spend on our children each year."

Unfortunately, unless the law is changed this year, more single working moms will become victims of the current unfair innocent spouse rules. The tax law changes of the 1990s are making it financially more difficult, if not impossible, for many low-income and middle-class spouses to file separately and protect themselves from a spouse who might be consciously or unconsciously making erroneous declarations on the tax return. One major factor is the growing importance of the Earned Income Credit, which is unavailable to married couples filing separately. The 1997 Taxpayer Relief Act also barred couples filing separately from claiming the new educational credits, deducting interest on education loans (an "above the line" deduction available to nonitemizers), and converting to the new Roth IRA. Couples filing separately also cannot claim the childcare expense credits.

The Innocent Spouse Rules Have Not Worked, and Must Be Replaced

If the litigation on these rules is any indication, it is almost always an ex-wife who seeks relief from paying taxes that are owed because of an ex-husband's errors, or cheating, on a joint return. The position of the courts is clear: Women shouldn't trust their husbands.

In many cases, the couple's tax return involves a business run by the husband, and the wife knows little about the day-to-day workings of the operation.

If a married couple remains together, responsibility for taxes on a joint return stays within the family unit, and there may be no need for the IRS to allocate responsibility between the spouses. But what should the policy be in the event of divorce or death?

Suppose John and Mary file a joint return for 1997 and pay all the tax they owe. They get a divorce in 1998 and the IRS discovers in 1999 that John had additional income he kept hidden from Mary. Is Mary liable for paying the tax on the income, plus interest?

The answer, under current law, is usually yes. The IRS can collect from either spouse all of the additional tax owed on a joint return, regardless of whose fault it was that the original return was wrong.

As explained by the IRS, to qualify for Innocent Spouse relief, "you must establish that you did not know, and had no reason to know, that there was a substantial understatement of tax that resulted because your spouse: 1) Omitted a gross income item, or 2) Claimed a deduction, credit, or property basis in an amount for which there is no basis in fact or law."

Some observers say the "no reason to know" standard and joint liability requirement are needed so that spouses will carefully review a prepared tax return. While we can understand this view, we believe it is unrealistic and unfair.

First, about half of all tax returns are prepared by professionals. Most people have confidence in their tax professional to do the job properly and to guide them to comply with an incomprehensibly complex tax law. The fact that a return is prepared by a professional does not help meet the so-called "reason to know" test.

Second, many couples already pay a substantial tax penalty for being married. The only way to avoid joint and several liability is to file separately. But filing separately often increases the marriage penalty by hundreds or thousands of dollars on those who can least afford the penalty to begin with!

Third, how many spouses grill the other spouse with a range of due diligence questions about the tax return before signing the return? Marriage is built on trust. Does Congress really want spouses to ask questions that show distrust of the other spouse? If so, just what questions should a spouse ask to meet the "reason to know" standard? Filing separately can be a multi-thousand dollar statement by one spouse

that "I don't trust you, and I'm filing separately." Many, if not most, taxpaying families can't afford the legal protection of filing separately.

Fourth, you can't draw a fair line anywhere to separate the "innocent" from the "guilty." Even if a wife suspects her husband is cheating on his taxes and gets some of the money, what is she guilty of? Simply of filing a joint return! If she had filed separately, she wouldn't have done anything wrong.

The House-passed Legislation Will Not Adequately Protect Innocent Spouses

The IRS Restructuring and Reform Act, passed by the House in October 1997, kept much of the existing "innocent spouse" rule while removing the current requirement that the IRS audit adjustment be an understatement of tax that is "grossly erroneous." The word "grossly" would be removed, so an "erroneous" item would qualify. The House bill also removed the requirement that the tax adjustment has to exceed $500, or a percentage of the innocent spouse's adjusted gross income in the "pre-adjustment year," whichever is greater.

And the House bill would create a new taxpayer right, which certainly would be the subject of courtroom debate for several decades. It might be known as the "not quite innocent but far from guilty spouse" rule. Included in this category would be spouses who should have known about an error on a return, but "had no reason to know the extent of such understatement." In such a case, the IRS or the courts would decide, and the spouse would have to pay the percentage of the tax that the spouse should have known about.

While these provisions are constructive and beneficial, many deserving innocent spouses will still be denied relief. In most cases, the House proposal would still effectively deny relief to deserving spouses because most will not be able to afford a lawyer. Even the ones who can afford a lawyer will have to pay costly and unnecessary litigation expenses.

Unfortunately, the House bill also still places the burden of proof on the spouse to prove both lack of knowledge about the understatement and that the spouse had no reason to know about it. Proving such a vague negative can be extremely difficult and is contrary to the bill's other provisions shifting the burden of proof in Tax Court cases from the taxpayer to the government.

Overall, the House's attempt to "restructure and reform" the innocent spouse rule falls far short of the help needed for many innocent divorced and widowed taxpayers. It is now up to the Senate to find a workable solution.

Separate Liability Will Bring Tax Justice To Divorced Spouses

Fortunately, there is a way out of this mess. The National Taxpayers Union strongly supports the recommendations of the American Bar Association to repeal the obsolete and unfair provision of joint and several liability and "to substitute separate liability for tax shown to be due on the joint return" and to provide for proportional liability in certain circumstances.

Most of the difficult innocent spouse cases arise when the IRS finds an error or omission on a joint tax return after a divorce has become final. The American Bar Association recommends that "if, [after a tax return is filed], a deficiency in tax is determined with respect to the joint return," then such assessed deficiencies should be handled by "an 'item' approach, in which liability for the tax follows responsibility for the item." Here is more detail on how it would work, according to an ABA report:

> For deficiencies which are determined with respect to a joint return after it has been filed, liability for the tax would be imposed on the responsible spouse and would not be allocated between the spouses proportionately. Separation of liability would therefore mean that only the spouse responsible for the item in question could be required to pay the tax. . . .
>
> The proposal would make the allocation of liability explicit. Thus, if the deficiency arises from an omission or improper statement of an item of income, liability is placed on the spouse to whom the income item would be apportioned. If the deficiency arises from any improper or overstated deduction, liability is placed on the spouse to whom the deduction would have been apportioned to the extent that the deduction offset income of that spouse. . . .

This may be a radical idea, by IRS standards, but the rest of the world doesn't think so. In explaining its proposal, the ABA points out that "no marital liability for income tax is imposed in any form in Canada, Australia, Japan, Italy, Sweden or the United Kingdom. In France, married taxpayers who have not separated must file a joint return . . . but taxpayers who are no longer living with their spouses at the time of enforcement proceedings are nearly always excused from liability for tax on the spouse's income. Under the German income tax, either spouse may at

any time request a 'restriction of liability,' and obtain a separate tax assessment upon his or her separate income alone but still at the favorable joint rate."

Should Congress enact legislation that denies to American married couples, the taxpayer rights that Europeans and Japanese take for granted? We think not.

Focus On Taxpayer Remedies

In the last decade, many proposals have been made about granting rights to taxpayers who must deal with the Internal Revenue Service. Some of these suggestions have been enacted into law.

Too often the taxpayer rights provisions of the Internal Revenue Code are like the civil rights provisions of the former Soviet Union's constitution. On paper, they tell a wonderful story. In practice, for many taxpayers there is no effective protection against government abuse.

The first question that taxpayers may ask about an IRS action is, "Can they do that?" But when the answer is "No," the next question has greater importance: "What can I do to stop it?" Too often, the answer is "not much, or nothing at all."

As the Committee considers ways to reform the innocent spouse rules, please ensure that the reforms will work for the many divorced working mothers who can't afford an attorney to fight for their rights. Relief must be structured so that it can and will be granted through administrative measures that are easily accessible to taxpayers. The ABA's proposal meets this critical test with flying colors.

A Second Best Solution: Allow divorced spouses to file an amended return as married filing separately.

If Congress is not willing to adopt the ABA recommendation, then we strongly believe that it should allow divorced spouses to file an amended return as married filing separately.

The decision to file a joint return should not be irrevocable, especially for a divorced person who might realize after filing jointly that their ex-spouse was a liar or a cheat.

The first question that many widows and divorced women who are still making payments on their husband's taxes might ask their Senators is: Why can't I amend my filing status from joint to separate? Every year, the IRS send millions of dollars in refund checks to thousands of taxpayers who filed amended returns. Allowing separate returns, after joint ones, would probably cost the federal government nothing. In fact, the amount eventually collected on separate returns could exceed the taxes owed on joint returns.

Why would spouses want to file separately and pay more tax than they would have to pay if filing jointly? To protect themselves if the IRS comes knocking on the door in the future asking them to pay tax on their former spouses' incomes.

Would the IRS be able to administer a system that allowed an amended, separate return after a joint one is filed? IRS officials have not reported any problems with the current rule, which permits this as an alternative for personal representatives of deceased taxpayers. That exception has been in the law for decades.

The IRS can ruin your life if you made a mistake and filed jointly with a tax cheat. Why not give such spouses a second chance? Most divorced couples would not use this procedure, but it would provide equitable relief to innocent spouses.

Our proposal for changing the Code to allow separate returns after filing jointly is contained in Attachment 1. While we strongly believe all taxpayers should have a right to file an amended separate return, there may be too much resistance at IRS, or in Congress, unless such amended returns were only allowed to divorced taxpayers. Therefore, the proposal below is drafted to apply only to divorced taxpayers. Divorce decrees should not be required to order it or permitted to prevent it.

Since the added tax caused by filing separately may run to thousands of dollars, we strongly urge that a provision be added to allow such spouses up to five years to pay the extra tax in installments and that there should not be any late payment penalties other than those for late payment of an installment payment.

Other Observations

Taxpayer Bill of Rights 2 required that the Treasury Department study this issue and report to Congress by January 1997. We are still waiting for that report. Why is it that the Treasury Department and IRS expect taxpayers to file on time, but that studies required by law are often extremely late? In at least one state, state judges are not paid if they fail to reach a decision on a pending matter within 90 days. If Congress impounded the paychecks of Treasury Department executives until required reports were delivered, perhaps these officials would find a way to turn in their homework on time.

IRS personnel should be trained in the provision of the 1996 Taxpayer Bill of Rights 2 requiring them to tell one spouse what efforts have been made to collect a joint-return debt from the other. In one recent case, a service-center Problem Resolution caseworker told a taxpayer who made such a request that this information is not available, because of the Privacy Act. The request was made again, to the District Problem Resolution Officer. A month later, no response had been received, but the taxpayer—a single-parent father—had his paycheck levied by IRS.

A divorcing spouse should also have the right to petition the IRS for a final determination of any outstanding or potential tax liabilities, under the "prompt assessment" procedures now available to deceased taxpayers (that is, their executors and personal representatives). This would provide some protection from a tax surprise, after a divorce is final.

Reportedly, 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. But a fair solution would still elude the unfortunate taxpayer.

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 Committee to formulate legislation to finally protect divorced spouses.

Attachment 1—

THE PROPOSED STATUTE:

Section 6013 (relating to joint returns of income tax by husband and wife) is amended by adding at the end the following new subsection:

"(i) Separate returns after filing joint returns and dissolution of marriage.—Under regulations prescribed by the Secretary,

(1) If a husband and wife have filed a joint return and their marriage is subsequently dissolved by final decree or order of a State court, either spouse may elect to file a separate return for any taxable year for which the limitation on time for assessment, under Section 6501, or for collection, under Section 6502, does not apply.

(2) A separate return under this subsection shall relieve the filing spouse of joint and several liability under paragraph (d)(3) of this section.

(3) Such separate return shall include only the income, deductions and nonrefundable credits allocable to such spouse, which should properly have been included on an original separate return.

(4) Refundable credits shall be reduced by any amounts either refunded to the taxpayers on the original joint return, or applied to other obligations owed by either spouse. If such refundable credits allowed on the joint return exceed the amount allowed on the separate return, the difference shall be an addition to tax owed by the spouse electing to file the separate return.

(5) Upon assessment of such separate return, the Secretary shall notify the other spouse, by sending a copy of the separate return by certified mail to his or her last known address.

(6) Such other spouse may also elect to file a separate return, according to the rules set forth in paragraphs (3) and (4).

(7) If the other spouse elects to file a separate return, the tax assessed on the joint return shall be abated. Otherwise, the non-electing spouse shall remain individually liable for all of the tax owed on the joint return, including subsequent assessments.

(8) Any overpayment on either separate return shall not be refunded unless the balance owed on the other separate return (or remaining joint return) has been paid in full.

Here are a few examples of how our proposal to allow amended separate returns would work:

(1) John and Mary filed a joint return showing tax of $2,000 and withholding of $3,000. They received a refund of $1,000. They get divorced, and Mary decides she doesn't want to be liable for an audit of John's income and deductions. On a separate return, her tax is $1,000, and her withholding is $1,500. She must reduce her withholding by the $1,000 already refunded, so she can claim

only $500. So she owes IRS $500—in this example, half of the refund she shared; also, the amount of tax saved by filing jointly.

It won't work out that neatly, in every case; all it will do is keep IRS from collecting John's taxes from Mary. IRS is required to send John a copy of Mary's return. He can choose to do nothing; until and unless he is audited, he owes nothing. The "joint return" is still his. Suppose that his tax on a separate return would be $1,500, and his withholding was (like Mary's) $1,500. Like Mary, he can't claim $1,000 of the withholding, because it has been refunded. So on his separate return, if he elects to file one, he'll owe $1,000. IRS gets to subtract the $1,000 refund, from both accounts. While this may be an imperfect result, it will rarely happen, and is worth it to avoid most of the worst cases of the tax laws crushing innocent spouses. Remember that John can hold the hand he was dealt, and pay nothing.

(2) Same facts, but the tax withheld was only $1,000—$500 each—so they owed (and still owe) $1,000 on the original joint return. Mary's separate return now shows tax of $1,500, and withholding of $500, so she owes $1,000. If John keeps the joint return, he owes $1,000. If he files a separate return, he owes $1,000. Is anything wrong with this picture? No. If they had filed separately in the first place, they would owe IRS $2,000.

(3) Same facts as Example #1, but on the original return there was also a $1,000 Earned Income Credit not allowed on separate returns. That made the refund on the original return, $2,000. Mary's separate return shows $1,500 tax. She had $1,000 withheld, but after subtracting the $2,000 refund, she's $1,000 in the hole. She must add the $1,000 difference to her tax, which is now $2,500. That's a lot of money, but it's what she would have owed in the first place ($500) plus the EIC, plus the refund of tax withheld. She doesn't have to file separately; she's only doing it because she suspects John understated his taxes. If John suspects that Mary understated her taxes, IRS gets the full refund back from him also.

(4) John and Mary's tax on a joint return was $2,000. They had only $1,000 withheld—all of it from Mary. Her tax, on a separate return, is only $500. In other words, had she filed separately in the first place, her refund would have been $500. However, she can't now claim the $500 refund, until John pays the $1,000 owed on the original joint return (or whatever amount is owed on his separate return).

PREPARED STATEMENT OF PAUL C. LIGHT*

It is indeed a pleasure to be before this committee today to testify on the herculean task of restructuring the Internal Revenue Service to enhance accountability to Congress, the Chief Executive, and the American public. Having worked with the distinguished Chairman across the aisle at the Senate Governmental Affairs Committee in the One-Hundredth Congress, I can testify that he recognizes the seriousness of the task ahead of this Committee. Many have tried to reform government over the years, but few have achieved anywhere near the lasting impact that the Chairman has made through his sheer persistence, whether in his ten-year effort to win passage of the Chief Financial Officers Act or in his campaign on behalf of the Government Results and Performance Act. As with the pending legislation, the Senate has long been the point of last consideration in testing the merits of management reform. I expect that this bill will be much the better for it when the Chairman completes his review.

Let me add that I am also delighted to testify before a committee so ably anchored by the distinguished ranking member. Having been able to observe the senator work his will in a host of settings, I know well his commitment to rigorous analysis and thoughtful application. From the 1983 Social Security rescue, where he almost singlehandedly rescued the rescue, to the 1988 Family Support Act, where he converted two decades of painstaking research into a welfare reform that was sadly rooted out before it could fully take hold, to his recent work on the intelligence community, where he has demonstrated an acute sense of the impact of administrative thickening in creating a culture of secrecy, the senator has forced all of us to think carefully before we enact. I will never forget his admonition to the National Commission on Social Security Reform: "We are all entitled to our opinions, but not to our facts."

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*This testimony reflects the views of the author as a private citizen and scholar and does not reflect the views of The Pew Charitable Trusts or its grantees.

Defining Accountability

Let me now turn to the subject at hand: accountability at the Internal Revenue Service. There is no question that there has been a serious erosion of accountability. Even acknowledging the fact that almost all IRS employees are dedicated to upholding the law and providing high quality service, the organizational structure of the agency has created a weakening of the accountability that has encouraged the small percentage of unethical employees to have their way with their authority. As the Founders of this national clearly understood, government cannot rely solely on the good intentions of its employees as the protection against abuse. Much as they hoped that government would be administered by able and virtuous human beings, they also understood that accountability resided in a firm commitment from the Chief Executive to oversee the operations of government and on thoughtful congressional review.

This is not to suggest that the Founders imagined a thicket of continual second guessing. They most certainly believed in the efficient execution of the laws. Recall Alexander Hamilton's notion in *Federalists No. 70:* ". . . a government ill executed, whatever it may be in theory, must be in practice a bad government." Although they hardly used the modern language of organizational theory, they believed in clear chains of command, through which the Chief Executive could deliver clear direction to the front lines of government, and an absolute commitment to the highest ethical standards. They clearly understood that human nature could undermine the best intentions, which it most certainly has in the IRS case.

Having studied questions of accountability for the better part of ten years, I must admit that I am not surprised by the revelations of taxpayer abuse at the IRS. It is not because I believe revenue agents are deserving of suspicion. The agents I have met in my analysis of bureaucratic structure are deeply committed public servants. I had the opportunity to meet many of the agents in the St. Paul district office as part of my research in 1993-94 on the thickening of the federal hierarchy and was impressed by two findings: (1) they were enormously dedicated to doing their jobs well, even though they were clearly confused by changing signals from headquarters about just how tough or soft to be, and (2) they were thoroughly isolated from their regional offices and headquarters. They had little respect for the regions, if only because they saw the regional offices for what they were and still are: an organizational anachronism that added little value to doing the job of the Revenue agent well, and they had very little sense of the national mission of their own agency.

If there is a single conclusion from my research it is that if you've seen one IRS district office, you've seen one IRS district office. Like Fort Apache, the front-lines of the agency are completely surrounded by what many Revenue agents see as hostile forces, cut off from the body of the corps. It is no wonder, therefore, that some offices and agents would go wrong. They are enveloped in the fog of war, relying on the modern equivalent of the pony express, if that, to get information back and forth to their commanders.

To me, the essence of accountability is not to be found in good technology, though it certainly helps, oversight boards, which often add yet another layer of confusion to an already foggy situation, or special pay grades for senior managers, which hardly make the job of the front-line employee more livable. It is instead to be found in a clear vision of the agency's mission and an administrative structure that communicates that vision constantly and clearly. To me, the success of an agency's vision is not to be found in the number of leaders at the top scurrying around making grand pronouncements of the future, but in the simple ability of that vision to flow smoothly to every corner of the agency. Luckily, you now have a Commissioner who has the strength of commitment and foresight to articulate such a vision. If this Committee truly wants to do him a favor, it would attack the administrative clutter that is simply impossible to remove without statutory force. The Commission can exhort and order, but he does not have the statutory authority to delayer, or bulldoze, without your help. What good will an oversight board do the Commissioner if it competes with him in providing direction to the agency? How effective can it be if it cannot see any further down the chain of command than the Commissioner?

Again, the essence of accountability is not to be found in the presence of new units or structures, but in the natural ease with which guidance flows down to the front-lines of an agency and the quality and timeliness of the information flowing up. As near as I can tell from this Committee's dramatic hearings, taxpayer abuse has been occurring for some time. The first step in creating legislation is to determine why the abuse has been so long in coming to light. If it is up to this distinguished Committee and this Committee alone to ferret out the problems, we are all at significant risk, for to do so would mean that you would be unable to discharge your other duties. Although some abuse will always elude the internal oversight mechanisms of government, sneaking past the Office of Inspector General, the Taxpayer Advocate,

the Commissioner, the Secretary of the Treasury, the Office of Management and Budget, and the Oval Office, this Committee cannot and should not be the first line of defense against abuse.

The Search for Accountability at the IRS

As we all search for culprits in the taxpayer abuse at the IRS, I believe we need look no further than government's own flawed vision of how to make its employees obey. Government has long believed that accountability resides in having more layers of leaders and/or more leaders per layer.

The result has been a steady thickening of the federal hierarchy that renders no one ultimately accountable for what goes right or wrong on the front lines where government meets the citizen. Absent a clear chain of command between the top and bottom of the IRS, district managers could invent just about any scheme they wanted to monitor their employees, while rogue revenue agents could easily persuade themselves that no one at the top would ever catch on.

The thickening of the IRS has been underway for decades. In 1960, for example, the senior leadership of the IRS consisted of just thirteen people: a commissioner, two assistants to the commissioner, a deputy commissioner, five assistant commissioners, and four deputy assistant commissioners. By 1996, the senior leadership had grown to over 60. The IRS still had the one commissioner and deputy commissioner, but had added a chief of staff and two assistants to the commissioner, one assistant to the deputy commissioner, a new associate commissioner/chief information officer, five assistant commissioners, five deputies' assistant commissioners, and a host of lesser new titles, including at least one chief of staff to an assistant commissioner, with parallel thickening at the middle levels of both the Washington headquarters and the field offices. I challenge the IRS to demonstrate to anyone how the Chief of Staff to the Assistant Commissioner for Support Services in the Management and Administration Division contributes to the overall ability of the agency to do its job.

The IRS has never had more leaders at its middle either. At my last count in 1994, there were sixteen layers of supervisors between the President of the United States, who is the ultimate chief executive of the agency, and revenue agents far below. Most agents report to a district group manager who reports to a branch chief who reports to an assistant chief of their division who reports to the assistant district director who reports to the assistant regional commissioner who reports to the regional commissioner who reports to the chief of staff to a deputy assistant commissioner in Washington who reports to the deputy assistant commissioner who reports to the assistant commissioner who reports to the chief operating officer who reports to the deputy commissioner of the IRS who reports to the commissioner who reports to the Deputy Secretary of the Treasury who reports to the Secretary who finally reports to the president (assuming that the White House deputy chief of staff and chief of staff don't get in the flow). No wonder rogue agents concluded they could get away with harassment.

Supervisory chains are only part of the equation, however. The number of layers involved in making and executing basic policy affecting the field are even more complicated. Again at last count, there were sixty-six distinct steps in making policy decisions affecting examining agents, including Treasury department reviews, IRS policy analysts and assistant chief counsels, and assorted team leaders in Washington and field offices. Had the agency added agents as it created new layers of middle and top level management, perhaps district managers might not have invented the collection quotas that fueled the taxpayer abuse.

I would be remiss in singling out the IRS for special criticism without noting the remarkable expansion in senior-level thickening that has occurred over the past few years. Much as we can applaud the president and vice president for overseeing both the downsizing of government that began with passage of the 1990 Defense Base Closure and Realignment Act, which ultimately resulted in the shuttering of 243 installations, and implementing the 1993 Workforce Restructuring Act, which has driven federal employment down by nearly 300,000 positions, the thickening of the senior hierarchy has continued, indeed accelerated over the past five years.

Although the number of senior positions has barely changed at all, the roughly 2,400 senior executives of government now sort into a much taller hierarchy. According to my most recent count, which is based on a careful, even mind-numbing coding of *The Federal Yellow Book*, there are now forty-nine layers open for occupancy at the upper levels of government, a gain of sixteen new titles in the past five years. The total full-time-equivalent federal workforce may have returned to pre-1960 levels, but the senior hierarchy continues to expand with what appears to be accelerating force. It took thirty years, from 1960 to 1992, for the senior political

and career hierarchy to grow from seventeen layers to thirty-three, but only five years to go from thirty-three to forty-nine.

Among the new titles? Deputy to the Deputy Secretary, which now exists in three departments where it had never existed before, Assistant Deputy Secretary, which also exists in three where it had never existed before, Principal Assistant Deputy Under Secretary, Chief of Staff to the Associate Assistant Secretary, Chief of Staff to the Assistant Assistant Secretary, and Deputy Assistant Deputy Administrator. (I have attached the current list of titles open for occupancy for the Committee's review.) I can assure you that I take no pleasure in assembling such lists, for they confirm the continuing fascination in government with leadership by layering. Indeed, I challenge anyone in this room or elsewhere in Washington to explain how a Chief of Staff to an Assistant Assistant Secretary strengthens the president's leadership or the faithful execution of the laws. It is a formula for diffusing accounting, and, to paraphrase the distinguished Senator from New York, for defining leadership downward.

These layers translate into staggering distances between the tops and bottoms of government, which in turn weakens accountability in every agency. Whether the front line is a VA nursing ward, an immigration office, or a national park, the bottom of government is virtually cut off from the top. VA nurses work eighteen supervisory layers below the president, air traffic controllers and park rangers nineteen; policy making for public housing agents can involve as many as seventy-one steps, air traffic controllers eighty-seven, and immigration inspectors sixty-five. Most agencies have evaded efforts to slim the middle layers of government by calling their supervisors something else. There are more team leaders in the federal hierarchy today than in all of Peewee basketball, but no real reduction in the distance between top and bottom.

Given this analysis, it should hardly surprise the Committee that I would argue that the way to improve accountability at the IRS is not to add new layers of leaders or write a simpler tax code. More leaders will only make it more difficult to see the bottom from the top, and a flat tax that administered by a thick agency will be just as vulnerable to abuse. Rather, the first step toward accountability is to express the Committee's strong preference for a leaner, flatter organization.

That means, for example, elimination of the regional office structure and redeployment of those employees down to the front lines where they can get back to work serving the nation's taxpayers. Most of the regional offices in the federal hierarchy were created by earlier administrations to further presidential control of the front-line in furtherance of the layers=leaders philosophy, and most currently add little by way of value to the front-line task. I believe that is the case with the IRS and strongly urge the Committee to do what Commissioners cannot do: eliminate the offices, lock, stock, and barrel.

Slimming the hierarchy also means setting a deliberate target for reducing the layers of management between the Commission and the front-line. Instead of imposing an arbitrary goal of, say, a 50 percent reduction in the total number of layers, which I believe this agency could easily absorb without the slightest reduction in productivity, or setting a supervisory-subordinate target of, say, one supervisor for every ten or fifteen employees, which this agency could also achieve without a hint of decline in effectiveness, I strongly recommend a careful counting of each layer of management, be it formal or informal, be it occupied by a supervisor or a team-leader, followed by aggressive use of reductions-in-force and augmented buy-out authorities to remove specific layers from the organizational hierarchy. Where there are now sixteen layers between the president and the front-line, I suggest that this Committee set a goal of eight. To achieve such a reduction would be a significant achievement not just in achieving enhanced accountability for the IRS, it would also constitute a model to the rest of government about how to winnow through the assortment of nonsensical titles and outright interference that now preoccupy so much of the senior and middle-levels of the hierarchy.

Further Considerations Regarding IRS Restructuring

This Committee need not stop at a thinning of the hierarchy, however. Once undertaken, the agency needs to create an administrative culture of responsiveness. It will not surprise the Committee to note that I disagree with any proposal that would add new layers of management, be they occupied by political appointees or highly-paid senior executives, as the path to greater accountability. I see no reason to alter the longstanding commitment of this agency to a management corps composed of career civil servants. Add new layers of political appointees and we introduce the very real specter of partisan abuse of taxpayer files. But leave the current hierarchy untouched and we risk a "wait-it-out" mentality among career executives

who have seen past reformers come and go through a veritable revolving door in the Commissioner's office and above.

While I applaud the agency's commitment to career service, I also recognize the need for the Commissioner to have at his or her disposal a senior cadre of managers who are responsive to change. It is just this search for responsiveness that motivated your colleagues in the other chamber to argue for alterations in the rules governing the Senior Executive Service. My sense is that alterations will have limited effect on the administrative culture, possibly coupled with great risk to the merit principle that undergirds the career service.

Toward resolving this tension between responsiveness and career leadership, let me suggest that the Committee consider creating an entirely separate Senior Revenue Service to be composed of individuals appointed under a five-to-seven year performance-based contract. Such a SRS, if you will, could be easily modeled on the senior career services that have evolved in New Zealand and Britain over the past decade.

Consider, for a moment, how the concept has been applied under New Zealand's *State Sector Act of 1988*. Under the Act, the Senior Executive Service is composed of a unified force of highly trained, deeply dedicated career executives who are appointed by the chief executive of each department under merit principles. Appointments are to be made on the basis of each candidate's ability to

(a) imbue the employees of the Department with a spirit of service to the community;

(b) promote efficiency in the Department;

(c) ensure the responsible management of the Department;

(d) maintain appropriate standards of integrity and conduct among the employees of the Department;

(e) ensure that the Department is a good employer; and

(f) promote equal employment opportunity.

Every person appointed to a position in the Senior Executive Service is to serve for a term of not more than five years, subject to reappointment on the basis of performance under a clearly defined contract. Employees cannot be removed before the end of their term without cause and can earn substantial bonuses upon meeting annual performance goals. The concept offers that rare balance between demand for high performance and career continuity. Although it has not worked as well as hoped in the New Zealand setting, in part because it was implemented government wide without regard to the specific circumstances in which it might provide an enhancement in accountability, a similar performance-based, term-specific system has worked much better in Britain.

Much as I admire the other chamber's effort to design greater incentives for performance, I am concerned that the envisioned awards do not provide enough quo for the proposed quid, no pun intended. I would much prefer that IRS be given authority to create a set of carefully defined positions, perhaps as few as 20 in number, that would give its current career Senior Executives a first chance to trade in their life-tenured positions for much higher pay based on performance. I believe many would rise to the challenge. Not only would such a system provide the Commissioner with the opportunity to build a performance-based team, it would constitute the kind of innovation that I believe this Committee and body have long admired in public management. As such, I urge you to substitute such a trial system for Section 111 of the pending proposal.

Before concluding, let me briefly assess the proposed structure and duties of the Oversight Board. Truth in advertising requires that I note my serious reservations about creating such an board in the first place. Well intended though it may be, the Board would likely diffuse accountability within the IRS even further, adding an entirely new layer to a patchwork of already confusing accountability systems.

If Congress and the executive must create such a board, I urge you to properly segregate its duties so that it has no program operating responsibilities of any kind. You can refer to the Inspector General Act for the needed language that might make the prohibition stick. I also urge you to consider establishing a sunset for the board so that this Committee can revisit the decision after a reasonable interval of time. Government is filled, as you know, with mechanisms established for missions that have long ago lapsed. These kinds of mechanisms have a remarkable tendency to take on a life of their own. Finally, I would urge you to keep the board reasonably small and insulate it fully from active participation by any sitting officials, including the Secretary of the Treasury and Commissioner. If there is to be an oversight board, let it be solely an oversight board, separate from the line supervisory responsibilities that must reside with the President of the United States and the appointees who serve with Senate advice and consent.

Should this Committee decide to proceed with the Oversight Board, I would urge you to place the Taxpayer Advocate under its care, at least until it is able to establish itself as a source of independent advocacy on behalf of the American taxpayer. To date, the unit has not fulfilled its promise. Placed as it is in the direct chain of command, the advocate has virtually no place to turn when he or she confronts obvious abuse. Put under the care of the Oversight Board, the Taxpayer Advocate might finally be seen as a safe harbor for citizen complaints. Ever aware of the difficulties of an agency to investigate itself, the unit needs at least some umbrella of independence to persevere in its difficult task.

I would also urge this Committee to undertake a full review of the current status of the Treasury Department's Office of Inspector General. It is no secret that the Office is in a state of disrepair following the recent resignation of its head. Although I understand that the House Government Reform and Oversight Committee is planning a major review of the Inspector General concept on the occasion of the twentieth anniversary of the 1978 Inspector General Act, this Committee is well within its authority to assess the merits of two possible approaches to strengthening this important source of independent oversight. The first would be to create a separate Deputy Inspector General for Internal Revenue Service Operations within the larger Treasury Department Office of Inspector General. Such a Deputy Inspector General would have to be given a separate staffing complement equivalent to the task. The second path would be to create a separate Internal Revenue Service Office of Inspector General reporting simultaneously to the Oversight Board and the Commissioner.

Should the Committee take this second course, I would urge it to consider giving the Oversight Board responsibility for recommending a list of three names for appointment from which the president would be invited to choose. It is a perfectly constitutional approach that is currently used for the appointment of the Comptroller General of the United States. As the recent resignation of the Treasury Department Inspector General suggests, the appointment of this specific IGship is simply too important to leave to the ordinary vagaries of the White House personnel process. As I will argue should I be called to testify on the Inspector General Act, it is a change that should be made for all presidentially appointed Inspectors General. At the risk of further limiting presidential discretion, the Committee might also consider a similar appointment mechanism and term of office for the Commissioner, the Chief Information Officer, and the Chief Financial Officer. I should add, however, that this appointment mechanism has not proved noticeably effective in filling the Comptroller General's post, which has been vacant much too long.

I make these recommendations with some trepidation, of course. I believe strongly in the caliber of the civil service at work in the agency. The vast majority of IRS employees are dedicated public servants who can be trusted to discharge their duties with integrity and skill. They should not be doomed to constant suspicion, lest that suspicion turn them into what we most fear. Give them the support they deserve, the front-line resources to complete their tasks, and the leadership to set a clear, unwavering standard of performance. They will rise to the task, if only because so many are already doing their work with pride and integrity in spite of a top-heavy bureaucracy, antiquated information systems, and a tax code of staggering complexity.

A Modest Final Proposal

At the risk of overstaying my welcome, let me turn in my last paragraphs to an idea whose time has clearly come. The Chairman will remember how hard he fought lo these many years ago for establishment of a National Commission on Executive Organization and Management. The Senate Governmental Affairs Committee succeeded in attaching his commission to the Department of Veterans Affairs Act in 1988. Alas, the Commission was never activated by the president. It was long overdue in 1988 and remains so today. I urge the Committee to attach such a Commission to this bill with two simple additions. First, the Commission should be given the widest latitude to sort through the existing structure of government in an effort to remove the sediment of past reform efforts, whether that sediment comes from administrative layers that have been tossed ashore in past hurricanes of concern or in defunct procedures that distract departments and agencies from more promising reforms such as the Government Performance and Results Act. Second, the Commission should be given authority to propose to Congress and the president a unified list of statutory adjustments that could be accepted or rejected en masse. Although it has been some time since I have drafted legislation for a living, I have attached a draft proposal that this Committee might consider should it decide to establish such a National Commission that would make its report at the beginning of the new millennium.

Secretary
Chief of Staff to the Secretary
Deputy Chief of Staff to the Secretary

Deputy Secretary
Chief of Staff to the Deputy Secretary
Deputy to the Deputy Secretary
Principal Associate Deputy Secretary
Associate Deputy Secretary
Deputy Associate Deputy Secretary
Assistant Deputy Secretary

Under Secretary
Chief of Staff to the Under Secretary
Principal Deputy Under Secretary
Deputy Under Secretary
Principal Associate Deputy Under Secretary
Associate Deputy Under Secretary
Principal Assistant Deputy Under Secretary
Assistant Deputy Under Secretary
Associate Under Secretary
Assistant Under Secretary

Assistant Secretary*
Chief of Staff to the Assistant Secretary
Principal Deputy Assistant Secretary
Associate Principal Deputy Assistant Secretary
Deputy Assistant Secretary
Principal Deputy to the Deputy Assistant Secretary
Deputy to the Deputy Assistant Secretary
Associate Deputy Assistant Secretary
Assistant Deputy Assistant Secretary
Principal Associate Assistant Secretary
Associate Assistant Secretary
Chief of Staff to the Associate Assistant Secretary
Deputy Associate Assistant Secretary
Assistant Assistant Secretary
Chief of Staff to the Assistant Assistant Secretary
Deputy Assistant Assistant Secretary

Administrator
Chief of Staff to the Administrator
Assistant Chief of Staff to the Administrator
Principal Deputy Administrator
Deputy Administrator
Associate Deputy Administrator
Deputy Associate Deputy Administrator
Assistant Deputy Administrator
Deputy Assistant Deputy Administrator
Associate Administrator
Chief of Staff to the Associate Administrator
Deputy Associate Administrator
Assistant Administrator
Chief of Staff to the Assistant Administrator
Deputy Assistant Administrator
Associate Assistant Administrator

*The Assistant Secretary compartment includes all Executive Level IV titles, including Commissioner, Director, Administrator, Inspector General, General Counsel, and Chief Financial Officer.

NATIONAL COMMISSION ON EXECUTIVE ORGANIZATION AND STRUCTURE

SECTION 1. THE COMMISSION

(a) ESTABLISHMENT.—(1) Within 30 days after the effective date of this Act, the President shall establish the National Commission on Executive Organization and Structure under this section.

(b) MEMBERSHIP OF THE COMMISSION.—A commission established under this section shall be composed of 16 members appointed not later than 90 days after the effective date of this Act. The members shall be appointed as follows:

(1) Six citizens of the United States appointed by the President, one of whom shall be designated by the President to be the Chairman of the Commission. Not more than four of the members appointed by the President may be from the same political party as the President.

(2) Two members of the Senate and one citizen of the United States appointed by the President pro tempore of the Senate upon the recommendation of the majority leader of the Senate.

(3) One Member of the Senate and one citizen of the United States appointed by the President pro tempore of the Senate upon the recommendation of the minority leader of the Senate.

(4) Two members of the House of Representatives and one citizen of the United States appointed by the Speaker of the House of Representatives upon the recommendation of the majority leader of the House of Representatives.

(5) One Member of the House of Representatives and one citizen of the United States appointed by the Speaker of the House of Representatives upon the recommendation of the minority leader of the House of Representatives.

(c) RESTRICTIONS ON PAY AND ALLOWANCES.—(1) Except as provided in paragraph (2), members of the Commission shall receive no pay, allowances, or benefits by reason of service on the Commission.

(2) Members of the Commission appointed from among private citizens of the United States may be allowed travel expenses, including per diem, in lieu of subsistence, as authorized by law for persons serving intermittently in the Federal Government.

(d) FUNCTIONS OF COMMISSION.—The Commission shall examine and make recommendations with respect to—

(1) the organization of the executive branch, including the appropriate number of departments and agencies, the organizational structure of each such department and agency, the advisability of reorganizing or abolishing any such department or agency, and the advisability of establishing any new executive department or agency;

(2) the internal administrative structure of departments and agencies, including the appropriate number of administrative units and their responsibilities, the appropriate number of administrative layers and positions, the conditions governing the management and appointment of such layers and positions, the advisability of setting fixed targets for reducing such layers and positions, and the advisability of creating, consolidating, and/or abolishing specific units of departments and agencies;

(3) the most effective and practicable structure of the Executive Office of the President for conducting oversight of the executive branch, including examination of the need for an Office of Management, and criteria for use by such Office in evaluating and overseeing the performance of the executive branch;

(4) the most effective and practicable structure of the President's cabinet and means of operation of such cabinet, including recommendations concerning the number, composition, and duties of the members of such cabinet.

(e) REPORT.—(1) Not later than 12 months after the completion of appointment of the members of the Commission, the Commission shall submit to the President, the Senate, and the House of Representatives a report which contains a detailed statement of the recommendations of the Commission, including a list of specific proposals in response to the investigation conducted under section (d).

(2) The date on which the report is due may be extended to such date as the President may prescribe in an Executive Order, except that such date may not be later than six months after the date on which such report is otherwise due under paragraph (1).

(f) POWERS OF COMMISSION.—(1) The Commission may, for the purpose of carrying out this section, hold such hearings and sit and act at such times and places, as the Commission considers appropriate.

(2) The Commission may adopt such rules and regulations as may be necessary to establish procedures and to govern the manner of the operation, organization, and personnel of the Commission.

(3) (A) The Commission may request from the head of any department, agency, or other instrumentality of the Federal Government such information as the Commission may require for the purpose of carrying out this section. The head of such department, agency, or instrumentality shall, to the extent otherwise permitted by law, furnish such information to the Commission upon request made by the Chairman.

(B) Upon request of the Chairman of the Commission, the head of any department, agency, or other instrumentality of the Federal Government shall, to the extent possible and subject to the discretion of such head—

(i) make any of the facilities and services of such department, agency, or instrumentality available to the Commission; and

(ii) detail any of the personnel of such department, agency, or instrumentality to the Commission, on a nonreimbursable basis, to assist the Commission in carrying out the duties of the Commission under this section.

(4) The Commission may use the United States mails in the same manner and under the same conditions as the departments and agencies of the Federal Government.

(5) The Commission may, to such extent and in such amounts as are provided in appropriations Acts, enter into contracts with State agencies, private firms, institutions, and individuals for the purpose of conducting research or surveys necessary to enable the Commission to discharge the duties of the Commission under this section.

(6) Subject to such rules and regulations as may be adopted by the Commission, the Chairman of the Commission may appoint, terminate, and fix the pay of an Executive Director and of such additional staff as the Chairman considers appropriate to assist the Commission. The Chairman may fix the pay of personnel appointed under this paragraph without regard to the provisions of chapter 51 and subchapter III of chapter 53 of title 5, United States Code (relating to the number or classification of employees and to rates of pay), the provisions of such title governing appointments in the competitive service, and any other similar provision of law.

(g) APPLICABILITY OF THE FEDERAL ADVISORY COMMITTEE ACT.—The Commission shall be an advisory committee for purposes of the Federal Advisory Committee Act (5 U.S.C. App. 2).

(h) TERMINATION OF COMMISSION.—The Commission shall cease to exist on the date that is 30 days after the date on which the Commission submits the report required under subsection (e).

(i) PREPARATION FOR THE COMMISSION.—Not later than 90 days after the effective date of this Act, the Comptroller General of the United States, the Director of the Congressional Research Service, the Director of the Congressional Budget Office, and the Director of the Office of Technology Assessment shall each submit to the Commission established under this section an index to and synopses of materials of the organization of the official that such official considers useful to the Commission. Subject to laws governing the disclosure of classified or otherwise restricted information, such materials may include reports, analyses, recommendations, and results of research of such organization.

(j) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated to the Commission not more than $2,500,000 for carrying out this section.

SECTION 2. CONSIDERATION OF THE COMMISSION REPORT

(a) IN GENERAL.—The President may not carry out any of the recommendations contained in the Commission report unless—

(1) no later than June 30, 2001, the President transmits to the Committee on Governmental Affairs of the Senate and the Committee on Government Reform and Oversight of the House of Representatives a report containing a statement that the President has approved, and the departments and agencies of government will implement, all of the recommendations recommended by the Commission in the report referred to in section 1 (e);

(b) TERMS OF THE RESOLUTION.—For purposes of section 2(b), the term "joint resolution" means only a joint resolution which is introduced before March 15, 2001, and—

(1) which does not have a preamble;

(2) the matter after the resolving clause of which is as follows: "That Congress disapproves the recommendations of the National Commission on Executive Organization and Structure," the blank space being appropriately filled in; and;

(3) the title of which is as follows: "Joint resolution disapproving the recommendations of the National Commission on Executive Organization and Structure."

(c) REFERRAL.—A resolution described in subsection (a), introduced in the House of Representatives shall be referred to the Committee on Government Reform and Oversight of the House of Representatives. A resolution described in subsection (a) introduced in the Senate shall be referred to the Committee on Governmental Affairs of the Senate.

(d) DISCHARGE.—If the committee to which a resolution described in subsection (a) is referred has not reported such resolution (or an identical resolution) before July 15, 2001, such committee shall be, as of July 15, 2001, discharged from further consideration of such resolution, and such resolution shall be placed on the appropriate calendar of the House involved.

(e) CONSIDERATION.—(1) On or after the third day after the date on which the committee to which such a resolution is referred has reported, or has been discharged (under subsection (c)) from further consideration of, such a resolution, it is in order (even though a previous motion to the same effect has been disagreed to) for any Member of the respective House to move to proceed to the consideration of the resolution (but only on the day after the calendar day on which such Member announces to the House concerned the Member's intention to do so). All points of order against the resolution (and against consideration of the resolution) are waived. The motion is highly privileged in the House of Representatives and is privileged in the Senate and is not debatable. The motion is not subject to amendment, or to a motion to postpone, or to a motion to proceed to the consideration of other business. A motion to reconsider the vote by which the motion is agreed to or disagreed to shall not be in order. If a motion to proceed to the consideration of the resolution is agreed to, the respective House shall immediately proceed to consideration of the joint resolution without intervening motion, order, or other business, and the resolution shall remain the unfinished business of the respective House until disposed of.

(2) Debate on the resolution, and on all debatable motions and appeals in connection therewith, shall be limited to not more than 10 hours, which shall be divided equally between those favoring and those opposing the resolution. An amendment to the resolution is not in order. A motion further to limit debate is in order and not debatable. A motion to postpone, or a motion to proceed to the consideration of other business, or a motion to recommit the resolution is not in order. A motion to reconsider the vote by which the resolution is agreed to or disagreed to is not in order.

(3) Immediately following the conclusion of the debate on a resolution described in subsection (a) and a single quorum call at the conclusion of the debate if requested in accordance with the rules of the appropriate House, the vote on final passage of the resolution shall occur.

(4) Appeals from the decisions of the Chair relating to the application of the rules of the Senate or the House of Representatives, as the case may be, to the procedure relating to a resolution described in subsection (a) shall be decided without debate.

(f) CONSIDERATION BY OTHER HOUSE.—(1) If, before the passage by one House of a resolution of that House described in subsection (a), that House receives from the other House a resolution described in subsection (a), then the following procedures shall apply:

(A) The resolution of the other House shall not be referred to a committee and may not be considered in the House receiving it except in the case of final passage as provided in subparagraph (B)(ii).

(B) With respect to a resolution described in subsection (a) of the House receiving the resolution—

(i) the procedure in that House shall be the same as if no resolution had been received from the other House; but

(ii) the vote on final passage shall be on the resolution of the other House.

(2) Upon disposition of the resolution received from the other House, it shall no longer be in order to consider the resolution that originated in the receiving House.

(g) RULES OF THE SENATE AND HOUSE.—This section is enacted by Congress—

(1) as an exercise of the rulemaking power of the Senate and House of Representatives, respectively, and as such it is deemed a part of the rules of each House, respectively, but applicable only with respect to the procedure to be followed in that House in the case of a resolution described in subsection (a), and it supersedes other rules only to the extent that it is inconsistent with such rules; and

(2) with full recognition of the constitutional right of either House to change the rules (so far as relating to the procedure of that House) at any time, in the same manner, and to the same extent as in the case of any other rule of that House.

PREPARED STATEMENT OF HON. TRENT LOTT

Welcome, Mr. Rossotti. You are undoubtedly a brave man for taking a job as IRS Commissioner. I will be honest with you—you run an agency that I don't like, and that I wish did not exist. Some call the IRS a "necessary evil." I know I agree with the second part of that description. I have not yet made up my mind about the first part.

You are in the unenviable position of attempting to restructure an agency within an Administration that is out of touch with our citizens' feelings about taxes. Your bosses don't understand Americans' fear and distrust of the Internal Revenue Service.

I look forward to studying your reorganization plan, and I know that you have both professional training and experience as a successful business manager. Until I have evaluated your proposal, I will not deem it as "too little." I will, however, say here to your superiors that it is certainly "too late."

This Administration seems to delight in spending its citizens' money. Last night we heard another laundry list of new government programs and expansions. If this Administration spent one-tenth the time and effort on taxes as they do on creating new government programs, our tax system and your agency would be in much better shape.

We need to cut the taxes Americans pay, to reduce the economic burdens of those taxes on the taxpayers, and the manner in which they collect them. We also need Americans to *know how much they pay*—billions of dollars pass into your agency's hands through hidden taxes. I always remember one simple rule: ultimately, **people pay taxes.** Every tax dollar comes from a person, either as a worker, as a consumer, or as an owner of capital. We must never forget that the function of government is to serve the American people, and that we the people, through the engine of a competitive market economy, pay for all the services we receive.

Last night I gave my word to the American people that we would stop the abuses the IRS is inflicting on the American taxpayer. We took several small steps last year, and will do much more this year. Chairman Roth, you did a fine job last year in constructing the Taxpayer Relief Act, and I look forward to working with you again this year as we jointly attack the serious problems this agency faces.

PREPARED STATEMENT OF HON. CONNIE MACK

Mr. Chairman, I thank you for holding these hearings on the most important of subjects, cleaning up the IRS. I look forward to participating in this bipartisan effort to restructure this agency. The IRS interacts with more Americans than any other government agency or private business in America. Therefore, it is critical that the word "service" in Internal Revenue Service returns as a top priority.

Unfortunately, our hearings last September confirmed that we have a big job ahead of us. Those hearings exposed a rogue agency that was literally out of control. We learned about the illegal use of enforcement statistics to evaluate IRS employee performance—in other words, judging employees based on how much they say the taxpayers owe. We heard testimony that IRS management encourages IRS employees to mislead and lie to taxpayers about their rights, and to fabricate evidence against taxpayers and fellow employees. We learned that IRS management encourages IRS employees to ignore tax code provisions that would result in a favorable adjustment to taxpayers, and to violate the laws concerning taxpayer privacy and the commencement of liens, levies, and seizures This was shocking. Taxpayers who spend $8 billion to run the IRS deserve at least honest service.

But the September hearings revealed that the IRS views itself more as a law enforcer rather than a service provider. We heard that many IRS managers believe that all tax debtors are tax cheats that must be punished. This is hard to accept.

IRS employees, of all people, should recognize that our complex tax code can easily lead to innocent mistakes on the part of well-meaning taxpayers. The attitude of antagonism toward the taxpayer must end.

I am encouraged by the early efforts by Commissioner Rossotti to turn things around at the IRS. But he needs our assistance.

Just like taxpayers are subjected to an audit, I think it is time we *audit the IRS*. We need to do a top to bottom inspection of what works and what doesn't—no stone should be left unturned. The restructuring bill passed by the House is an important first step in this process. I trust these hearings will further our understanding of what needs to be done to make the IRS taxpayer-friendly. This requires both restructuring and a renewed emphasis on taxpayer protections—including increased taxpayer confidentiality, correcting the presumption that the IRS is always right and the taxpayer always wrong, and treating the Service as it treats the taxpayer by making it pay for its mistakes.

The IRS cannot operate in a vacuum and disregard the rights and needs of taxpayers. Fiscal mismanagement and negligence only undermine taxpayers' faith in the fairness of any tax system. Outright abuse and harassment destroy this faith.

I'm glad this committee has the chance over the next few weeks to hear from witnesses that will help us in our efforts to end the culture of waste, fraud, and abuse at the IRS.

PREPARED STATEMENT OF MICHAEL E. MARES

Mr. Chairman and members of the Committee: Thank you for inviting the American Institute of Certified Public Accountants ("AICPA") to testify before you today. I am Michael Mares, Chair of the AICPA's Tax Executive Committee. The AICPA is the national, professional organization of more than 331,000 certified public accountants. The Institute's members advise clients on Federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's largest businesses. It is from this base of experience that the AICPA offers its comments.

The AICPA actively participated in the work of the National Commission on Restructuring the Internal Revenue Service ("National Commission") during the past year, testifying at several hearings of the National Commission, attending numerous meetings, and providing written and oral comments and suggestions. We also testified before the House Ways and Means Committee and its Oversight Subcommittee on the National Commission's report, *A Vision for a New IRS*, and on H.R. 2292, the legislation introduced to implement that report and the predecessor to H.R. 2676, the *Internal Revenue Service Restructuring and Reform Act of 1997* as passed by the House of Representatives.

Overall, the AICPA supports the Commission's report, H.R. 2292, and H.R. 2676. Set forth below are our comments on some of the most significant provisions and topics in H.R. 2676 and H.R. 2292. Upon request, we will be happy to provide you with comments on any additional issues.

TITLE I—EXECUTIVE BRANCH GOVERNANCE AND SENIOR MANAGEMENT

Independent Oversight Board

The IRS is a large, complex organization; the structure and governance processes which have served it well in the past will not do so in the future. The Institute believes a fundamental change in the governance of the IRS is needed to provide the IRS with consistent direction and to enable the IRS to benefit from private sector experience and expertise. Thus, the AICPA supports the H.R. 2676 proposal to create an independent Internal Revenue Service Oversight Board ("Board"). We take exception, however, with some of the criteria for selection of members, as discussed later.

There is a need for changing the way the IRS is governed. There is public consensus, agreement within Congress and the Administration, among tax professionals and, importantly, within IRS management, that the agency requires revitalization and renewal. The expertise needed to govern the IRS can no longer be easily categorized into the two broad components, tax policy and tax administration. Instead, IRS Commissioners now wrestle with massive information systems projects, the need to dramatically improve financial management, re-engineering IRS work processes and providing dramatically improved customer service. At the same time, the traditional expectations of increasing voluntary compliance, handling non-compliance and collecting tax revenues must still be met. This must all be done with

smaller budgets. Thus, the need for additional and different perspectives on managing these broad challenges is very clear. This is not an indictment of the present structure. It is, however, a recognition that the unprecedented challenges facing the IRS require a different approach and new mix of governance skills and abilities.

Creating more independence for the IRS will improve tax policy deliberations. While concerns have been expressed that separating the IRS from Treasury will undermine tax policy effectiveness, we believe it will actually have the opposite effect. Independence will provide the IRS with the ability to provide needed input into the impact of tax policy and legislative proposals on compliance. We understand that this input will be limited to taxpayer burdens and administrative complexity inherent in such changes. This is important information, however, which should be, but currently is not always, made available to Congress or the public. The current relationship between the IRS and Treasury does not give the IRS an independent voice on such issues.

For example, IRS tax administrators were extremely concerned about the difficulty and complexity involved in administering the earned income tax credit when the concept was first introduced. Those concerns were not expressed to Congress because the IRS was limited in its ability to discuss the impact of tax policy on administration, except with Treasury's guidance. It was several years before Congress and Treasury took notice of IRS's concerns. Creating more independence for the IRS would allow the IRS to more clearly articulate its views when such debate is underway, thus reducing the practical problems in implementing specific provisions.

A Board of presidential appointees specifically assigned for a fixed term to govern the IRS will increase continuity of oversight as well as accountability. Under the proposal in H.R. 2676, the Board members (other than the initial Board members) would serve five-year staggered terms. This structure would provide much-needed continuity in the overall governance of the IRS and contrasts markedly with the very limited governance continuity under the current system. Further, since Board members would be appointed by the President, confirmed by the Senate and could be removed at will by the President, there would be controls in place to ensure integrity and accountability.

A properly constituted and managed Board, focused on overall governance of the IRS, not specific law enforcement matters, can avoid conflict of interest problems. Much has been written and said about the potential for conflicts of interest if there is a primarily private sector Board for the IRS. We believe the proposal adequately addresses these concerns. The Board is to focus on the overall governance of the IRS, not to deal with day-to-day decisions or specific law enforcement matters in the IRS, so conflicts should not arise. The Board members will be "special government employees" subject to conflict of interest rules in Title 18 of the United States Code. It thus appears that there are adequate statutory safeguards. If not, we believe that additional safeguards could be drafted to prevent conflict of interest problems.

It also should be noted that the conflict of interest discussions seem to be concerned with potential members of the Board who would serve as executives of business enterprises at the same time they serve on the Board. Even if it were determined that potential conflict of interest problems could not be adequately addressed with respect to such individuals, we believe there is a large pool of highly qualified individuals who could serve on the Board, for example, retired business executives, retired professionals, or educators, all of whom could meet the criteria for serving on the Board, without raising the specter of a potential conflict.

Board members should be selected for their expertise, not for their representation of special interest groups. H.R. 2676 specifies that the private sector members of the Board are to be selected "solely on the basis of their professional experience and expertise" so that collectively, the members can contribute to the Board expertise in management of large service organizations, customer service, federal tax laws (including tax administration and compliance), information technology, organization development, and the needs and concerns of taxpayers. The AICPA strongly supports the concept of stated areas of required expertise for the current Board, especially the need for individuals with practical experience and expertise in tax compliance and the needs and concerns of taxpayers. The AICPA also strongly believes that all Board positions, other than the positions reserved for the Commissioner and for the Secretary or Deputy Secretary of the Treasury, should be filled based solely on the qualifications of the individuals and the needed expertise of the Board. The AICPA, therefore, believes no position on the Board should be reserved for representatives of special interest groups such as the IRS employees union.

Public confidence must be restored in the Internal Revenue Service. The professional men and women who manage and work for the Internal Revenue Service have been the subject of unprecedented criticism over the past three years. Some of the criticism is valid, but much is not. Obviously, there have been operational

problems such as the documented difficulties with the Tax System Modernization program and the taxpayer abuse cases disclosed in your Committee's hearings last Fall. While problems such as these need to be addressed, the AICPA believes it is time to focus on the future direction of the IRS as well. The proposed Board would serve as the catalyst to do so.

The tax system and the IRS are a part of this nation's infrastructure, just like the highways and airports. The tax administration infrastructure is in need of attention, repair and reconstruction. A part of the renewal of the infrastructure is a restructured IRS. The proposed Board provides a focused direction critical for this effort, undistracted by the broader issues that the Treasury Department must address daily. The Board would also recreate credibility about the governance of this vital effort.

Commissioner

Just as there is a need for stability and continuity in the overall governance of the IRS, there is a need for stability and continuity in its senior management. The current system, with no fixed term of office for the Commissioner and the possible appointment of a new Commissioner with each new Administration, does not provide the stability required for such a vitally important leadership position. The AICPA, therefore, supports the H.R. 2676 proposal for a fixed five-year term for the Commissioner.

Executive Leadership

The IRS has been a very closed organization, with its executive leadership consisting almost exclusively of IRS career employees. People with varied backgrounds and expertise need to be added to the executive leadership to provide the IRS with different insights and to help generate innovative approaches to the many challenges confronting the IRS. Also, steps need to be taken, such as providing flexibility in compensation, to encourage qualified IRS career executives to remain with the IRS so that their knowledge and expertise is not lost to the IRS.

To facilitate broad approaches and thinking on issues, AICPA recommends that some positions now reserved for career civil service employees be open for "professional appointees." These professional appointees should be selected based on their professional and managerial competence rather than political affiliation and should be appointed by the Commissioner with the approval of the Board.

Emphasis should be placed on using professional appointees in positions managing program execution rather than solely in policy-making positions. To prevent such appointees from dealing directly with specific taxpayer cases, no such appointments outside the National Office should be for positions below the Regional Commissioner level.

Taxpayer Advocate's Office

Section 7802(d)(2)(A) of the Internal Revenue Code assigns the Taxpayer Advocate's Office the responsibility to:

1. Assist taxpayers in resolving problems with the IRS;
2. Identify areas in which taxpayers have problems in dealings with the IRS;
3. To the extent possible, propose changes in the administrative practices of the IRS to mitigate such problems; and
4. Identify potential legislative changes which may be appropriate to mitigate such problems.

The Taxpayer Advocate's Office is in the unique position of being inside the IRS, yet having the specific charge of representing the interests of American taxpayers, scrutinizing the Service's activities, and serving as the advocate of taxpayers in recommending changes that will improve taxpayer services and the IRS's responsiveness to taxpayers. Given that role, the Taxpayer Advocate's Office must be a zealous advocate of taxpayers.

For the Taxpayer Advocate's Office to fulfill its responsibilities, it must have the trust of taxpayers. The fact that it is a part of the Internal Revenue Service may taint its objectiveness in the minds of taxpayers. It is, therefore, crucial that the Taxpayer Advocate's Office be regarded by taxpayers as being independent, both in fact and in appearance. We urge your committee to incorporate into the IRS reform legislation measures that enable the Taxpayer Advocate and his office to act in such a manner that they are regarded as independent from the IRS both in fact and in appearance; for example, have the Taxpayer Advocate appointed by and report directly to the Board instead of the Commissioner or have the Taxpayer Advocate's Office removed from the IRS and operate out of the Department of Treasury.

Director of Practice

Currently, the Director of Practice is appointed by the Secretary of the Treasury. The Director of Practice acts upon applications for enrollment to practice before the IRS, institutes and provides for the conduct of disciplinary proceedings relating to attorneys, certified public accountants, enrolled agents, enrolled actuaries and appraisers, makes inquiries with respect to matters under the office's jurisdiction, and performs such other duties as are necessary or appropriate to carry out the functions of the office as described above or as prescribed by the Secretary of the Treasury.

We recommend that the Secretary of the Treasury be required to obtain input regarding the selection of the Director of Practice from the Board and that a candidate for the position should have either substantial experience as a tax practitioner representing taxpayers before the IRS or substantial experience within the IRS working with tax practitioners. The primary source of candidates should be from outside the IRS.

We also recommend that the Director of Practice's responsibilities be expanded to include monitoring the leading causes of disciplinary action against tax practitioners and developing recommendations for reducing the occurrence of such causes, developing criteria for the process and types of cases where referral of tax practitioners is appropriate, and maintaining close relationships with tax administration and professional organizations. The Director of Practice should also work closely with the IRS chief compliance office in establishing standards for ethical behavior on the part of IRS employees.

TITLE II—ELECTRONIC FILING

The AICPA has supported for many years the concept of electronic filing and strongly agrees the use of electronic filing needs to be increased. CPAs have not embraced electronic filing because: all forms cannot be filed electronically; there is no ability to attach white paper schedules, disclosures or elections electronically; the required Form 8453 (Jurat form) disrupts the normal processing of the returns in a CPA office; the procedures for registration and the annual registration cutoff in early December are less desirable than a rolling acceptance date; and the registration is cumbersome for firms with multiple offices. Further, since it costs taxpayers more, not less, to file electronically, there currently is no perceived benefit to filing electronically for those taxpayers who have a balance due.

The AICPA supports the provisions in Title II of H.R. 2676 that call for the removal of the barriers to, and for promoting the use of, electronic filing. We are concerned, however, that the language of section 203 of the current H.R. 2676 is weaker than that of the comparable provision (section 203) in H.R. 2292, the predecessor to H.R. 2676.

With respect to electronic signatures, section 203 of H.R. 2292 provided that, until procedures are established for the acceptance of signatures in digital or other electronic form, the Secretary "shall accept" electronically filed returns and other documents on which the required signatures are typed, provided the filers retain a signed original of each and make them available for inspection by the Secretary. In contrast, section 203 of H.R. 2676 merely provides that the Secretary "may waive" the required signature or provide an alternative means of subscribing during that time period.

Similarly, section 203 of H.R. 2292 provided that "[n]ot later than December 31, 1998, the Secretary . . . shall establish procedures to accept, in electronic form, any other information, statements, elections, or schedules, from taxpayers filing returns electronically, so that such taxpayers will not be required to file any paper." In contrast, section 203 of H.R. 2676 qualifies that statement with the phrase "to the extent practicable" and extends the effective date of the requirement by making it apply for "taxable periods beginning after December 31, 1998."

The National Commission, the House Ways and Means Committee, Treasury, and the IRS all have indicated the importance of promoting the use of electronic filing. The AICPA agrees and feels that removing the barriers to using electronic filing should be given a high priority. For this reason, we support the stronger, more time sensitive approach contained in section 203 of H.R. 2292 than that in section 203 of H.R. 2676.

TITLE III—TAXPAYER PROTECTION AND RIGHTS

The following discussion of taxpayer protection and rights issues is divided into five sections: H.R. 2676 provisions supported by the AICPA; H.R. 2676 provisions not supported by the AICPA; H.R. 2676 provisions supported by the AICPA, but

with revisions or additional recommendations; H.R. 2292 provisions supported by the AICPA which are not in H.R. 2676; and additional AICPA recommendations.

A. H.R. 2676 Provisions Supported by the AICPA

The AICPA supports, without reservations, the following provisions in H.R. 2676:

- **Expanded Authority to Award Fees and Costs** (Section 311), expanding the authority of courts to award fees and costs under IRC section 7430 by: (1) allowing courts to consider the local availability of practitioners with tax expertise when determining whether to allow more than the $110 hourly rate for attorney's fees; (2) permitting an award of costs beginning from the date of the notice of proposed deficiency—i.e., the 30-day letter; (3) clarifying that fees can be allowed for pro bono services; and (4) providing that, in determining if the position of the IRS was substantially justified, the court should take into account if the IRS has lost in courts of appeals in other circuits on substantially similar cases.
- **Disclosure of Criteria for Examination Selection** (Section 353), requiring the IRS to include in Publication 1, "Your Rights as a Taxpayer," the criteria and procedures used in selecting returns for audit.
- **Disclosure of Records to National Archives** (Section 373), allowing the IRS to disclose tax records to the National Archives for purposes of determining which records should be destroyed and which should be retained in the Archives.
- **Study Regarding Confidentiality of Tax Return Information** (Section 382), directing the Joint Committee on Taxation to establish a study of present protections for taxpayer privacy, the need for third parties to use tax information, and the ability to achieve greater levels of voluntary compliance by allowing the public to know who does not file tax returns.
- **Taxes Made Payable to U.S. Treasurer** (Section 374), requiring tax payments be made payable to the Treasurer, United States of America.
- **Tax Court Jurisdiction** (Section 313), increasing the jurisdictional limit under the small case procedures from $10,000 to $25,000.
- **Explanation of Joint Liability** (Section 351), requiring the IRS to insert a notice on all tax forms, publications, and instructions to alert taxpayers of their joint and several liabilities.
- **Procedures Relating to Extensions of the Statute of Limitations by Agreement** (Section 345), requiring the IRS to notify taxpayers on each occasion they are asked to consent to an extension of the statute of limitations, that they have the right to refuse to execute such consent or to limit their consent to particular issues.
- **Low Income Taxpayer Clinic** (Section 361), allowing the IRS to make grants for low income taxpayer clinics.
- **Suspension of Statute During Disability** (Section 322), suspending the statute of limitations for filing refund claims for an individual during any period the individual is unable to manage his or her financial affairs because of a physical or mental impairment expected to cause death or last at least twelve months and who does not have a spouse or other individual who is authorized to act on the taxpayer's behalf in financial matters.
- **Increase in Overpayment Interest Rate** (Section 332), eliminating the differential between the overpayment and the underpayment interest rates for noncorporate taxpayers.
- **Limitation on Financial Status Audit Techniques** (Section 343), prohibiting use of financial status audit techniques unless the IRS has "a reasonable indication that there is a likelihood of such unreported income."
- **Limitation on Authority to Require Production of Computer Source Code** (Section 344), prohibiting the IRS from summoning third-party tax-related computer source code, with some exceptions.
- **Notice of Deficiency Procedures** (Section 347), requiring the IRS to include on every deficiency notice the date determined by the IRS as the last day on which the taxpayer may file a petition with the Tax Court.
- **Refund Procedures** (Section 348), allowing the refund of that portion of any overpayment determined by the Tax Court to the extent the overpayment is not contested on appeal.
- **Directive Regarding Tip Reporting Program** (Section 349), requiring the IRS to instruct its employees that they may not threaten a taxpayer with an audit in an attempt to coerce the taxpayer into entering into a Tip Reporting Alternative Commitment Agreement.
- **Explanations of Appeals and Collection Process** (Section 354), requiring that an explanation of the appeals and the collection processes with respect to

a proposed deficiency be included with the first letter of proposed deficiency sent to the taxpayer that allows the taxpayer an opportunity for administrative review.

- **Jurisdictional Changes Regarding Estate Tax Refund Claims** (Section 371), granting the U.S. Court of Federal Claims and the U.S. district courts jurisdiction to determine the estate tax liability (or refund) in actions brought by taxpayers that have elected the installment method of payment, provided certain conditions are met.
- **Clarification of Authority of the Secretary Relating to Making Elections** (Section 375), indicating that, except as otherwise provided, the Secretary may prescribe the manner of making the election by any reasonable means.

B. H.R. 2676 Provision Not Supported by the AICPA

Burden of Proof

The AICPA does not support section 301 of H.R. 2676, which would shift the burden of proof from the taxpayer to the IRS in court proceedings in certain circumstances. If the provision were adopted, we are concerned agents might feel compelled to make overly broad document requests during examinations in order to have a complete file prepared for trial prior to the time the burden shifts to the IRS. Also, since the burden is to shift from the taxpayer to the IRS only if the taxpayer has "fully cooperated," the provision might induce an agent to intentionally make overly broad document requests so that the taxpayer will not comply and, therefore, will not be deemed to have "fully cooperated." Thus, we believe that the provision could actually result in more intrusive behavior against taxpayers by the IRS during the examination function.

Since only a small percentage of tax disputes actually are litigated, it is our concern that the provision may potentially result in subjecting many taxpayers to unnecessary, burdensome, and intrusive behavior from the IRS, for the possible benefit of only a small number of taxpayers. We, therefore, oppose this provision.

C. H.R. 2676 Provisions Supported by AICPA, But With Revisions or Additional Recommendations

Privacy in Tax Matters

The complexity of the Federal income tax laws and the often surprising ways in which income tax statutes and regulations may apply to taxpayers with moderate or sophisticated financial affairs means that millions of taxpayers must choose or elect to choose tax advisors. Advisors become privy to much private information about their clients in the course of forming recommendations; for individuals, this may include information about lifestyle, family, and habits; for businesses, it may include trade secrets and competitive factors.

The recommendations or tax advice given to clients may be based in part on such private information and also may involve professional opinions and judgments, and even pure speculation as to the outcome of financial transactions and events over time. Taxpayers expect privacy and confidentiality in discussing tax matters with their advisors. As a matter of public policy, a taxpayer has the right to expect that if the tax advisor selected is authorized to practice before the IRS, all information the advisor has regarding the taxpayer's tax matters will be accorded the same protection of privacy, regardless of the specific professional classification of the advisor.

Section 341 of House-passed H.R. 2676 affords taxpayers needed confidentiality protection in noncriminal proceedings before the IRS for tax advice from any Federally-authorized tax advisor to the same extent such advice would be protected under the attorney-client confidentiality privilege. The AICPA supports the section 341 proposal but we believe some modifications are needed to clarify the appropriate taxpayer protections. The language should be clarified to apply in court proceedings regarding matters previously before the IRS. Otherwise, the IRS would have an incentive to litigate these matters in court. Also, clarification is needed to ensure uniform application to all tax practitioners who are authorized under Federal statutes to practice before the IRS. The key in this situation is recognizing the disparate treatment of taxpayers based on their choice of tax advisor and providing them the needed privacy protections.

Expansion of Authority to Issue Taxpayer Assistance Orders

IRC section 7811 authorizes the Taxpayer Advocate to issue Taxpayer Assistance Orders ("TAOs") if the Taxpayer Advocate determines that the taxpayer is suffering or about to suffer a significant hardship. 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. Section 342 of H.R. 2676 would expand the authority to issue TAOs by directing the Taxpayer Advocate to consider

whether there is an immediate threat of adverse action, an unreasonable delay in resolving taxpayer account problems, the prospect that the taxpayer will have to pay significant fees for representation if relief is not granted, and irreparable injury or long-term adverse impact if relief is not granted. Further, if the IRS employee is not following applicable published guidance (including the Internal Revenue Manual), the Taxpayer Advocate shall construe the factors in the manner most favorable to the taxpayer.

The AICPA supports this provision; however, we believe that the provision does not go far enough. The AICPA recommends that the Taxpayer Advocate's authority under section 7811 be further expanded by eliminating the qualifiers "undue," "significant," etc., thereby allowing the Taxpayer Advocate to take action when deemed necessary to assure that taxpayers do not suffer unfairly. This recommendation is consistent with Congress' goal that the Taxpayer Advocate take a more assertive role on behalf of taxpayers when addressing the IRS' shortcomings.

Increased Damages for IRS Negligence in Collection Actions and for Wrongful Liens

Section 312 of H.R. 2676 includes a provision which would allow taxpayers to recover up to $100,000 for damages incurred as a result of the IRS' negligence in unauthorized collection actions; to qualify for this relief, the taxpayer must exhaust all administrative remedies. The AICPA supports this provision, but is concerned that taxpayers may not be aware of all procedures to be followed to obtain relief. To protect taxpayer rights in this area, we recommend that when an assessment notice is mailed to a taxpayer, it be accompanied by a notice detailing the relief available and how to apply for it, along with a form for use in appealing the assessment. Further, although, the AICPA supports this provision, we believe that it, alone, is insufficient because it does not provide jurisdiction where the IRS has wrongfully filed tax liens. Accordingly, we recommend that this provision be amended to provide a cause of action against the IRS for wrongful liens and for federal tax liens filed in violation of the automatic stay provisions of the Bankruptcy Code (11 USC section 362).

Offers in Compromise

Section 346 of H.R. 2676 would require the IRS to develop and publish national and local allowance standards to ensure that taxpayers who enter into compromise agreements have adequate means to provide for their basic living expenses. In addition, the provision would require Treasury to prepare a statement describing the rights of taxpayers and the obligation of the IRS regarding offers in compromise. The statement is to (1) advise taxpayers to promptly notify the IRS of change of marital status or address and (2) notify taxpayers that if a compromise agreement is terminated due to actions of one spouse or former spouse, the IRS will, on application, reinstate the agreement for the spouse or former spouse who remains in compliance with the agreement.

The AICPA supports this provision, but recommends the legislation be amended to reflect that revenue officers are encouraged, not just allowed, to use the discretion contained in the Internal Revenue Manual to permit variances from national and local standards when circumstances justify the variance. The standards should generally be followed but exceptions should be made if documented by the taxpayer or the IRS. In many cases, justifiable exceptions currently are not being allowed. We also recommend that legislation provide that the standards should be updated and adjusted for inflation annually and that the standards be adjusted by moving the cost of food from a national to a local standard, by localizing the cost of housing by zip code rather than by county, and by taking into account the taxpayer's income and the size of the family in determining the housing standard.

In addition, we recommend that a study of the offer program be made to determine the reason for the declining acceptance rates, the increasing number of unprocessable offers, and other issues related to uniformity and fairness.

Innocent Spouse Relief

Section 321 of H.R. 2676 generally makes innocent spouse relief easier to obtain. It eliminates the understatement thresholds, requires only that the understatement be attributable to an erroneous (not just a grossly erroneous) item of the other spouse, and allows relief on an apportioned basis. The provision also grants the Tax Court both jurisdiction to review any denial of relief (or failure to rule) by the IRS and authority to order refunds if it determines the spouse qualifies for relief and an overpayment exists as a result of the spouse so qualifying. The provision requires the development of a form and instructions for use by taxpayers in applying for innocent spouse relief. The provision is to be effective for understatements with respect to taxable years beginning after the date of enactment.

The AICPA supports this provision but urges that the relief being granted be made retroactive to apply to returns for the last three taxable years provided the specific issue has not already been addressed by a final court determination rendered with respect to the taxpayer.

Elimination of Interest Differential on Overpayments and Underpayments

Section 331 of H.R. 2676 would eliminate the differential in interest rates for overpayments and underpayments. The AICPA supports this provision, with additional recommendations, as set forth later in our discussion of various issues concerning interest.

Limitation on Failure to Pay Penalty

Section 376 of H.R. 2676 limits the failure to pay penalty to a maximum of 9.5% while an installment agreement is in effect. H.R. 2292 would have eliminated the penalty completely while the agreement remains in effect. While we believe it appropriate to, at a minimum, limit the penalty, we feel the provision in H.R. 2676 does not go far enough and instead support the provision in H.R. 2292 that would impose no penalty while the installment agreement is in effect.

Review of Penalty Administration and Development of Recommendations

Section 381 of H.R. 2676 would require the Joint Committee on Taxation to review the administration and implementation of penalty reform recommendations made by Congress in 1989 and provide a report to the House Committee on Ways and Means and the Senate Committee on Finance, containing legislative and administrative recommendations to simplify penalty administration and reduce taxpayer burden. The AICPA supports this provision; however, we believe the review and recommended legislation should also address all other penalty issues, particularly penalty assessment and abatement practices of the IRS.

The IRS assesses numerous penalties, thus requiring taxpayers to spend a great deal of time documenting reasonable cause in order to have the penalties abated. The process is both time consuming and expensive. Through reasonable cause and because of IRS errors, however, the IRS abates up to 50 percent of some types of proposed penalties. Unfortunately, taxpayers without representation are often unaware of the opportunities for abatement. It may be possible to achieve a more cost-effective and equitable outcome by establishing criteria for reducing assessments that are likely to be abated.

To reduce the burden on both the IRS and taxpayers, we recommend that the IRS establish safe harbor provisions for a variety of penalties which would automatically be deemed to be reasonable cause for abatement. This could be confined to late filing, late deposit, and certain information return related penalties. The object would be to concentrate on those penalties that are regularly assessed and abated. Safe harbor provisions could take the form of:

- No penalty assessments for an initial occurrence; however, the taxpayer would receive a notice that a reoccurrence will result in a penalty;
- Automatic non-assertion or abatement based on a record of a certain number of periods of compliance; or
- Voluntary attendance at some type of educational seminar on the issue in question, as the basis for non-assertion or abatement.

Use of the safe harbor approach would encourage and create a vested interest in compliance, since a good history of compliance could automatically result in relief. Additionally, the likelihood of future abatements would diminish if the taxpayer has a history of non-compliance. Furthermore, a system of automatic abatements would reduce the time spent by the IRS and taxpayers on proposing assessments, initiating and handling correspondence, and subsequently abating a high percentage of penalties. The ability to abate a penalty for a reasonable cause other than those used for automatic abatements would exist; however, reasonable cause abatements requiring independent evaluation may be reduced.

Cataloging Taxpayer Complaints of IRS Misconduct

Section 372 of H.R. 2676 would require the IRS to establish procedures for cataloging and reviewing taxpayer complaints of misconduct by IRS employees. The AICPA supports such procedures. We have reservations, however, about how such complaints should be registered with the IRS.

We are concerned that establishing yet another toll-free telephone number, given the IRS' limited resources and its current inability to handle the volume of calls it receives on its taxpayer assistance toll-free lines, could drain resources and further erode the level of service provided. As an alternative, an electronic means of registering complaints might be considered to minimize the burden on the IRS. Further, a better approach might be to use existing avenues for registering complaints,

such as the Problem Resolution Program or the IRS Inspection Service, that currently receive, handle, and catalog such complaints; however, the public should be made aware of the existence of such forums and of the procedures for filing complaints. Taxpayers should also receive a positive response, in some fashion, from the IRS indicating the resolution of their matter. Adequate safeguards should be added to protect taxpayers from reprisals when a complaint has been filed.

Procedures Involving Taxpayer Contacts and Interviews

Section 352 of H.R. 2676 would require that, before conducting an initial in-person interview relating to the determination of tax, IRS personnel must: (1) explain to the taxpayer the audit process and the taxpayer's rights under the process; (2) inquire as to whether the taxpayer is represented by an individual authorized to practice before the IRS; (3) explain that the taxpayer has the right to have the interview take place at a reasonable location, and that the location does not have to be the taxpayer's home; (4) state the reasons why the taxpayer's return was selected for examination; and (5) provide the taxpayer with a written explanation of the applicable burdens of proof on taxpayers and on the IRS. The section also would require that, before conducting an in-person interview relating to the collection of any tax, IRS personnel must explain to the taxpayer the collection process and the taxpayer's rights under the process. The AICPA supports these provisions.

a. Taxpayer Interviews

The AICPA also recommends an additional provision concerning taxpayer interviews, to inform taxpayers of their rights to representation. IRC 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." We are aware of many instances where the IRS appeared to demand that a taxpayer personally appear at an 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 handled in its entirety by a representative. We believe stronger legislation is needed to ensure that taxpayers are notified of their rights under section 7521 and allowed appropriate representation.

b. Place of Examination

Currently, IRC 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." Treas. 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 the convenience of the taxpayer with the requirements of sound and efficient tax administration.

Unfortunately, the IRS placed unnecessary limitations on their field personnel through the Internal Revenue Manual. Parts 320:(1) and (2) of IRM [4235], the Techniques Handbook for In-Depth Examinations, provide 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. This guidance also 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. This often places an undue burden on small taxpayers with limited space. It also may result in a denial of a taxpayer's privacy if the taxpayer does not want others to know an audit is being conducted. Thus, the IRM guidelines are inappropriate in certain circumstances; the place of examination standard needs to be clarified legislatively. We recommend that IRC section 7605(a) be amended to state 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."

c. Notice of Examination

The IRS 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 by a letter to present the taxpayers' rights in written form. The process of allowing initial contacts to be made by telephone, however, creates many problems in ensuring taxpayers their rights. The revenue agent may request an appointment with taxpayers in initial calls. As previously noted, sometimes taxpayers be-

lieve they must personally be at the appointment and do not understand that they have a right to representation.

In order to protect the rights of taxpayers, we recommend that IRC section 7605 be amended to require that the initial notification of an examination be made in writing. This requirement should extend to all examinations. The rights accorded to taxpayers under IRC section 7521 (explanation of examination process, right to be represented, etc.) should attach when taxpayers receive a notice of examination.

D. H.R. 2292 Provision Supported by AICPA But Not in H.R. 2676

Safe Harbor for Qualification for Installment Agreement

Section 311 of H.R. 2292 created a safe harbor for paying taxes by means of an installment agreement, provided the taxpayer does not owe more than $10,000, has not failed to file any tax return in the prior five years, and has not previously used this safe harbor provision. The AICPA supports this provision and recommends its adoption.

E. Additional AICPA Recommendations

The AICPA recommends that any taxpayer rights legislation also address the following issues:

Consistent Standards for Raising an Issue in an IRS Examination

Treasury Department Circular No. 230, IRC section 6694, and professional ethics guidance of the AICPA and the American Bar Association ("ABA") provide that tax advisors may not recommend a position in a return that lacks a realistic possibility of being sustained on its merits. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

Although the AICPA and the ABA prefer not to assign mathematical probabilities to the realistic possibility standard, nevertheless, both professions subscribe to the standard. Unfortunately, the IRS has not chosen to instruct revenue agents to apply the same "realistic possibility" standard before raising issues in examinations.

For example, in a recent IRS examination, a revenue agent asserted in his Revenue Agent's Report ("RAR") that a taxpayer corporation must switch from the cash method of accounting to the accrual method of accounting based on an IRS Industry Specialization Paper for Health Care. Although the taxpayer was a personal service corporation (with no inventories) that is entitled by statute (IRC section 448) to be on the cash method of accounting, the revenue agent did not feel constrained from raising the method of accounting issue. When the taxpayer protested this issue to the Appeals Office, the Appeals officer consulted with the industry coordinator and dropped the issue. The taxpayer incurred the expense of protesting the revenue agent's adjustment to the Appeals Office even though there was no realistic possibility of the IRS prevailing on the issue.

As a matter of fairness and consistency, we recommend that the IRS require revenue agents to have concluded that there is at least a realistic possibility of success before proposing an adjustment against a taxpayer. One method of ensuring that a position contained in a RAR has a realistic possibility of success could be to require that each RAR be signed by an individual at the group manager or higher level, attesting to the fact that the proposed adjustments set forth therein meet the realistic possibility standard. Implementing a policy such as this would be consistent with tax administration principles for the IRS, set forth in Rev. Proc. 64-22, 1964-1 C.B. 689

Rev. Proc. 64-22 provides, in part:

> The Service . . . has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Timely Case Resolution

Currently, there is no incentive for the IRS to complete an examination within the statutory period (without regard to extension). Furthermore, taxpayers faced with the prospect of a notice of deficiency are, in essence, forced to grant extensions of the limitations period as a matter of course. This practice defeats the general purpose of a limitations period: finality.

Too frequently the Internal Revenue Service initiates an examination of a taxpayer's return when there is insufficient time remaining within the statue of limitations (without regard to extensions) to complete the examination and make a correct determination of the taxpayer's liability. In such a case, the IRS must either seek a consent to extend the statute of limitations or issue a statutory notice of deficiency. Ultimately, the choice falls upon the taxpayer; if the taxpayer extends the assessment period, a more accurate determination can be made; if the taxpayer fails to extend the assessment period, a notice of deficiency may be issued. In such a case, the notice of deficiency may be speculative or arbitrary, because the IRS failed to complete a thorough examination of the taxpayer's books and records.

In response to a notice of deficiency, a taxpayer has two options: file a petition for redetermination with the United States Tax Court or pay the deficiency. Either alternative can result in substantial expense to the taxpayer. Furthermore, a notice of deficiency receives a presumption of correctness before the Tax Court. As a result of the consequences of the issuance of a notice of deficiency, taxpayers generally are forced to agree to an extension of the limitations period.

In complicated audits, such as those involving large corporate returns, it may not be feasible for the IRS to complete an examination within the statutory period. Accordingly, in such cases, it may be reasonable for the government to request a consent to extend the statute. However, in audits of individual taxpayers, the government should complete its examination in the time prescribed by statute, without the need for extensions. Administrative or legislative changes should be made to provide a disincentive to the IRS for seeking extensions.

Safeguard for Divorced or Separated Spouses and Married Persons in Community Property States

Taxpayer Bill of Rights 2 ("TBOR2") provided for the disclosure of collection activities with respect to joint returns. However, we believe additional safeguards 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. The root of the collection problem is in the examination procedures that do not require both spouses be involved in an audit. We recommend legislation be enacted that would require, at the initiation of an examination, the absent spouse acknowledge by signature whether the other spouse may, or may not, represent the absent spouse (as well as procedures to deal with situations where a spouse refuses to sign such a statement or cannot be located). 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.

Elimination of Interest Differential on Overpayments and Underpayments and Interest Netting

Currently, there is a differential between the interest rate a taxpayer pays on a deficiency and the interest rate the government pays to a taxpayer on an overpayment; the differential rate can vary from 1 percent to 4.5 percent. Situations often arise when a taxpayer is indebted to the government at the same time that the government is indebted to the taxpayer. Absent netting, a taxpayer who owes the government the same amount that the government owes the taxpayer would incur an interest obligation in favor of the government.

As noted earlier, section 331 of H.R. 2676 would eliminate the differential in interest rates for overpayments and underpayments. On a "going-forward" basis, the elimination of all interest rate differentials for purposes of determining interest on overpayments and underpayments effectively eliminates the economic detriment for some taxpayers who are both creditors and debtors during the same period of time. (However, it generally does not eliminate it for individuals who will be taxed on interest income and not be allowed a deduction for interest expense.)

With interest rate equalization, there is not an economic detriment for some taxpayers caused solely by the timing of payment and refunds (for interest periods after date of enactment). In addition, the use of a single rate will ease the administrative burden of the IRS, encourage prompt payment of even partial deficiencies, and simplify the overall computation process. It is certainly a first step in the overall simplification process.

Given the recent court decisions in cases such as *The May Department Stores Co. v. United States,* 36 Fed. Cl. 680, 96-2 USTC Para. 50,596 (Nov. 4, 1996) and *Fluor Corporation and Affiliates v. United States,* 97 TNT 162-9, however, the IRS should also take this opportunity to review the overall interest scheme and analyze the existing rules given the "use of money" principles long advocated by taxpayers and the courts. In addition, for interest accruing after 12/31/86 and before date of enactment, IRS should allow taxpayers to provide supportable interest computations

which reflect interest netting to eliminate the economic detriment to such taxpayers currently resulting from the existing rate differential of up to 4½%.

The Service's current policy with respect to interest netting is fundamentally unfair, both because of the manner in which the Service makes interest netting calculations and also because of the Service's inconsistent application of netting principles, resulting in similarly situated taxpayers receiving disparate treatment.

Interest provisions in the Code are intended to compensate the government or the taxpayer for the use of the money. (Rev. Proc. 60-17, 1960-2 C.B. 942) Interest applies only if there is an amount that is both due and unpaid. (See, e.g., IRC Sec. 6601(a); and *Avon Products, Inc. v. United States,* 78-2 U.S.T.C. (CCH) Para. 9821 (2d Cir. 1978).) To the extent there is a "mutuality of indebtedness" between the taxpayer and the government (i.e., to the extent the government and the taxpayer owe each other the same amount of money over the same period of time), there is no unpaid balance and, therefore, no amount on which interest should accrue.

The Service's current policy (See Treas. Reg. *301.6402-1.) of only netting outstanding overpayments against outstanding liabilities for both computational and collection purposes is unfair to taxpayers that promptly pay contested amounts of tax and, therefore, have no "outstanding" liabilities. This is illustrated by the recent case of *Northern States Power,* in which the company's prompt payment of alleged deficiencies cost it $460,000 more in interest than it would have had to pay if it had delayed in making the payment. (See *Northern States Power Co. v. United States,* 73 F3d 764 (8th Cir. 1996), cert denied 117 S.Ct. 168.)

Finally, and of significant import, despite the Service's stated policies toward interest netting (i.e., that netting can legally occur when both deficiencies and overpayments are outstanding and unpaid, see, e.g., Notice 96-18), netting continues to be performed on an ad hoc basis. A revenue agent's decision to deny a taxpayer netting is supported and justified by language in the Eighth Circuit's opinion in Northern States Power, which states that such netting is discretionary. However, the Service's discretionary application of the law without any formal or enforced guidelines, policies or procedures is inherently unfair to taxpayers. The virtual absence of any clear legal standards for interest netting also is unacceptable from a systemic standpoint, because it affords the IRS unfettered power to convert a taxpayer from a creditor to a debtor, with the size of a potential interest debt quickly becoming astronomical.

Further, viewing comprehensive netting as entirely within the discretion of the Service interjects serious fairness concerns into the settlement process. The Service has used the netting issue as a bargaining chip in negotiations to extract concessions from taxpayers on issues under examination. This inappropriately distances negotiations from the merits of the underlying issues. It also has the inappropriate effect of using netting (or the absence of netting) as a tool to raise revenue, rather than as a means to compensate for the use of money.

The Service counters taxpayer criticism of unfairness with the argument that netting in all situations is not administratively feasible. While comprehensive interest netting raises concerns of administrative feasibility, more progress must be made in balancing these concerns with taxpayer fairness.

For these reasons, we recommend that Congress mandate that: (1) within 90 days, guidance be issued to implement comprehensive netting in all situations; and (2) as an interim measure, guidance be issued to require the Service to net comprehensively at the request of the taxpayer, provided the taxpayer furnishes the Service with relevant information and interest computations. We also recommend that the mandated guidance in this area be issued in the form of proposed regulations, so that all interested persons will have an opportunity to comment on the technical details.

By "comprehensive netting" we mean netting for all interest accruing after December 31, 1986 for all types of taxes and all years (open or closed) to the extent necessary to compute interest accurately for a refund or an assessment in an open year. The interim recommendation is similar to the elective approach previously recommended by the House Ways and Means Subcommittee on Oversight, as well as the approach of a draft revenue procedure submitted by the Compliance Subgroup of the Commissioner's Advisory Group at its January 1995 meeting.

As stated by House Committee on Ways and Means Chair Bill Archer in his letter to Treasury Secretary Rubin dated September 26, 1996: "In my view, Congress has given Treasury and the IRS both a clear mandate and clear authority to implement comprehensive procedures to net underpayments and overpayments before applying differential interest rates." Chairman Archer concluded that interest netting is a problem "Congress has long expected would be resolved administratively and I certainly hope that Treasury will reexamine its position on this issue." No further

delays are acceptable. The time has come for the IRS to implement these procedures.

Detailed Interest Computations

The AICPA is of the opinion that the IRS should provide interest computations, as a matter of course, to taxpayers when adjustments involving interest are made. Currently, a 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 taxpayers as 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 amount 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 less than $50 or $100. If providing this information still would constitute a significant burden on the IRS, at a minimum, this information should be made available to taxpayers upon request and notice of the availability of the information should be communicated to taxpayers.

Payroll Tax Collection

The Taxpayer Bill of Rights 2 made a number of changes in the procedures under IRC section 6672 for the assessment against and collection of unpaid payroll taxes from owners, officers, and others known as "responsible persons." We recommend additional legislation be enacted to prohibit the IRS from attempting to collect the trust fund recovery penalty (also known as the 100 percent penalty) from any alleged responsible person during the pendency of any administrative proceeding or judicial action brought to contest the merits of the trust fund recovery penalty liability.

Disclosure Changes (PIN/POA)

IRS statistics indicate approximately 50 percent of all individual returns are prepared by paid preparers. We believe, especially because of the increasingly complex nature of the tax 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 that 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 a preparer "do what the preparer is being paid to do"—i.e, prepare the return, solve any processing problems, and appropriately interact with the Service.

We believe changes in the disclosure rules would reduce taxpayer burden, reduce IRS correspondence in dealing with ineffective contacts by preparers without a power of attorney, and support the taxpayer's rights to be represented. Specifically, we recommend that third parties be allowed to discuss a notice and its related account with the IRS by use of a Personal Identification Number ("PIN") on the notices sent to taxpayers.

The use of a PIN was under active discussion between the AICPA Tax Practice and Procedures Committee and the IRS in the past, but we were unable to reach agreement with the Service regarding implementation of such a procedure.

The ability of a practitioner, parent, child, or neighbor to assist a taxpayer who does not understand, see well, hear well, etc., in handling his or her business affairs with the IRS immediately (i.e., a telephone reply or discussion), would reduce the time spent, frustration, and cost for the IRS, taxpayers, and preparers. Telephonic interaction with the IRS is the future of "one-stop" service and efficiency in a modern-day tax system. Two-way conversations between taxpayers, their representatives, and the IRS discussing notices, payments, penalties, errors, missing information, etc. must be distinguished from representing taxpayers before the Service and entering into binding agreements on their behalf, for which there is a need for a formal power of attorney.

Consistency When Implementing IRS Policies

Often, the IRS will institute policies designed to assist taxpayers or clarify the application of particular Code sections. However, when the Service institutes policies that impact taxpayers, it can be unfair when those policies are applied only to some taxpayers. In certain instances, the policies are designed to apply only to particular taxpayers, and those instances are not at issue. But, when a benefit is intended to apply to a taxpayer, and through ignorance or capriciousness, an agent fails to give the taxpayer the benefit of those policies, it is detrimental to both the taxpayer and tax administration. One such example is the IRS' inconsistent application of interest netting principles. Other examples exist. On June 3, 1996, the Assistant Commissioner (Examination) issued a memorandum to all regional compliance officers regarding overly broad Information Document Requests ("IDRs"). The memorandum was, in part, in response to complaints from taxpayers and practitioners about revenue agents initiating an examination and immediately requesting an array of documents, many of which prove to be irrelevant to the examination. The well-reasoned memorandum of the Assistant Commissioner (Examination) set forth a standard for issuing document requests: an IDR should be issued for specifically identified issues or specifically identified reasons. The memorandum made it clear that "kitchen sink" or "boxcar" IDRs are inappropriate.

The experience of many tax practitioners is that the guidance issued by National Office is sometimes disregarded and, in this instance, many agents are unaware of the memorandum. As a result, taxpayers continue to receive these overly broad, burdensome document requests. From the standpoint of an advocate, it is imprudent to bypass the revenue agent, and taxpayers thus frequently comply with these broad IDRs. As a general principle, the Service must strive to communicate its policies more uniformly throughout the organization. Policies should be meaningful, and there should be consequences when an agent or Appeals officer disregards a policy set forth by the National Office.

Notification of Intention to Offset

Current IRS procedures require that before any overpayment is refunded or credited to estimated tax, as requested by the taxpayer, there must be a review of a taxpayer's account for any balances due. If a balance due is showing for the taxpayer on another account or module, the overpayment will be offset and the remaining balance, if any, refunded or credited. The taxpayer is not given an opportunity to verify the correctness of the IRS data before this action is taken. We believe the IRS should provide taxpayers with notification of its intention to offset an overpayment from one account to a balance due on another account or module. We recognize the IRS' authority to credit amounts due the taxpayer to any other liability of the taxpayer, in accordance with IRC section 6402. However, the taxpayer should be notified of such credit application before the action is taken. In many instances, the balance due is erroneous 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' current system, the taxpayer's overpayment of income tax will be applied to the outstanding assessment for the employment tax penalty. The remaining amount applied to the first quarter estimated tax payment for the subsequent year may then be insufficient to cover the required quarterly payment and cause the taxpayer to be subject to an estimated tax penalty on the subsequent year. If the employment tax penalty is subsequently abated, the amount credited to the account will then be refunded to the taxpayer from the employment tax account; the estimated tax penalty will not be abated automatically.

To remedy this and similar situations, we recommend that taxpayers be notified prior to the application of overpayments to balances due on other accounts or modules. 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.

Protection from Retroactivity

The Taxpayer Bill of Rights 2 ("TBOR2") provided relief from retroactive application of Treasury Department regulations by providing that temporary and proposed regulations must have an effective date no earlier than the date of publication in the Federal Register or the date on which any notice substantially describing the expected contents of such regulation is issued to the public, with some limitations. The revision also allowed Treasury to provide that taxpayers may elect to apply a temporary or proposed regulation retroactively from the date of publication of the regulation. However, to date, Treasury has not provided taxpayers with the option of retroactive application.

In addition, the changes by TBOR2 did not address the issue of proposed regulations that are not finalized in a timely manner. For example, many proposed regulations have existed for ten years or more and have yet to be finalized. Even with the TBOR2 changes, such changes would apply retroactively to the date the proposed regulations were first issued. We recommend a time limit of no more than eighteen months be added for the period between the date proposed regulations are issued and the date they are finalized, for purposes of retroactive application.

Rounding

We believe requiring the rounding of numbers on most tax returns would decrease the number of errors in tax return preparation and processing. It could greatly enhance efficiency in processing tax returns and does not affect the rights of individual taxpayers.

Technical Advice in Employee Plans and Exempt Organizations

Currently, if technical advice is sought with regard to an exempt organization, and the determination by the National Office is in favor of the Service as to a tax-related issue (i.e., liability for or amount of tax), Examination is bound by that determination; however, the taxpayer may take the issue to Appeals. If already in Appeals (or once appealed), Appeals may settle the issue, but must accept the underlying legal analysis of the National Office. In other words, Appeals could settle the issue based on litigation risks, but could not "give away" the issue. However, if technical advice is sought with regard to an exempt organization and a determination is made by the National Office that the entity does not qualify as an exempt organization (or has engaged in activity that should result in the termination of the entity's exempt status), both the Examination Division and Appeals Office of the Service are bound by this decision.

Generally, technical advice may be reviewed on appeal, and the IRS Appeals Office may settle an issue, regardless of technical advice. The reason for this is that Appeals specializes in, and is trained to look at factors other than the "Service's position" as to an issue. Appeals is intended to give the issue a "fresh look" and can make independent determinations. One important factor considered in Appeals is the risk of litigation. Generally, issues may be settled for some dollar value despite the fact that one (or both) of the parties believes that its position is correct. However, the unique rules established in the limited circumstances of EP/EO deny taxpayers a "fresh look" other than by a court, which necessarily involves the expenses of litigation. We recommend that the legislation address this issue.

IRS "Test" Programs

In an effort to enhance taxpayer service, the IRS has implemented several test programs or other programs that are limited to select groups of taxpayers. Generally, it is the intent of the Service to expand test programs to other groups of taxpayers. Unfortunately, expanding the scope of taxpayers who may avail themselves of some of these programs often takes years, if ever. Some of these programs are naturally suited to be expanded into other areas.

For example, in Fiscal Year 1996, the Service began a one-year test of mediation with certain types of cases in the Coordinated Examination Program. The Service has now announced that the "test" will continue for another year. To the extent that mediation has been used, it has been an unmitigated success. Furthermore, there are other taxpayers and subject matters that would be particularly well suited to mediation—such as valuation cases—that could benefit from the expansion of the mediation program rather than continuation as a "test." Other programs that could be evaluated for expedited expansion include accelerated issue resolution, early referral, and the delegation of more settlement authority to the Examination Division.

Allowing Taxpayers in "Small Cases" in Tax Court to be Represented by CPAs

The vast majority of small cases in Tax Court are "pro se." In such instances, the taxpayers do not have the benefit of representation and the Tax Court, in trying to determine a just resolution of the tax controversy, does not have the benefit of

having the facts and applicable tax authorities presented to it by an individual knowledgeable in the area.

The need for greater access to representation of taxpayers in the Tax Court apparently is recognized by the court itself, by permitting students enrolled in certain tax clinic programs to practice before the Tax Court. The need also is apparently recognized by the National Commission on Restructuring the Internal Revenue Service and the drafters of the H.R. 2676, based on the proposal to fund tax clinics where students may practice before the Tax Court.

To provide taxpayers with greater access to representation with respect to their controversies, it is recommended that legislation be enacted to designate all CPAs as being authorized for small case practice before the Tax Court.

TITLE IV—CONGRESSIONAL ACCOUNTABILITY FOR THE INTERNAL REVENUE SERVICE

Coordinated Congressional Oversight

H.R. 2676 calls for two joint hearings a year, to be attended by representatives of the six Congressional committees/subcommittees having oversight responsibility with respect to the IRS. One of the purposes of the proposal is to eliminate overlapping investigations and inquires. Nevertheless, there is no language in H.R. 2676 that would reduce or limit the number of hearings each of the six committees/subcommittees can hold. Some restrictions should be provided so that the result of the two new joint hearings is not an increase, but rather a decrease, in the overall number of hearings with respect to the IRS.

Tax Law Complexity

The problem of tax law complexity originates with complex statutes, not administration. The IRS can be restructured over and over again but the basic frustration taxpayers experience with the IRS will remain until the issue of complexity has been addressed.

At the National Commission's November 8, 1996 hearing, we presented a detailed discussion of the complexity issue and the AICPA Tax Complexity Index; we would be happy to provide you with a copy of that testimony at your request. Further, in the AICPA's overall recommendations to the National Commission, we submitted the following proposals to address the complexity problem:

- *Establish a Complexity Analysis Process for Hearings.* Hearings on all tax proposals before either the House Ways and Means or the Senate Finance Committees should require disclosure of the proposals' effect on complexity. Analysis of such effects by the staffs of both the Joint Committee on Taxation and the Tax Legislative Counsel should be published and discussed. The staff of the Joint Committee on Taxation should be required to adopt a methodology for evaluating the complexity aspects of a proposal and to discuss the results in any hearing pamphlets or other published documents. In addition, simplification options, with respect to the proposals under consideration at the hearing, should be discussed. Testimony by representatives of the Treasury Department should include an independent analysis of the effect of any proposals on complexity, as well as evaluation of the published comments of the staff of the Joint Committee on Taxation.
- *Establish a Complexity Review Process for Legislative Markup.* All proposals considered during the legislative markup process should also be evaluated to determine their effect on complexity. If the markup begins with acceptance of a Chairman's Mark or other basic document, a complexity analysis should be required for each item in the mark. Amendments must include analyses of their effect on complexity before being considered. At each step, the staff should be prepared to offer alternatives to the items included in the mark or offered as amendments that could make greater contributions to simplification.
- *Study Revising the Legislative Drafting Process.* The staffs of the House and Senate Legislative Counsel's Offices should be instructed by the members to undertake a study of drafting procedures and techniques that would contribute to simplification, such as requiring IRS input on complexity (including comments re administrative complexity) during the drafting process and using horizontal drafting. Candidates for horizontal drafting include the constructive ownership rules and the provisions governing pass-through entities and their owner or beneficiaries. The respective Legislative Counsel's Offices should be required to publish the results of their study within a reasonable period of time.
- *Establish a Complexity Review Process for Regulatory Action.* The Treasury Department and the IRS should be required to include an analysis of the effect of any proposed, temporary, or final regulations on complexity, along with a discussion of alternative approaches.

- *Mandate Periodic Simplification Initiatives.* Appropriate governmental staff (Treasury, IRS, Ways and Means, Finance, Legislative Counsel, and/or Joint Committee on Taxation) should be required periodically to publish simplification initiatives that could form the basis of future legislation. Such initiatives could include:
  - A review of the Internal Revenue Code for "deadwood" provisions;
  - A review of the Code and regulations for complex rules that should be withdrawn or substantially simplified;
  - Analyses of various rules to determine where horizontal consistency is lacking (proposals to enhance horizontal consistency would be expected) and development of a tax term glossary to ensure consistent use of terms across different sections of the Code; and,
  - Analyses of specific subjects in the Code to determine the level of complexity present and to make proposals for the reduction of complexity.

Although section 422 of H.R. 2676 constitutes some attempt to address the complexity problem, it does not go far enough. We urge you to give serious consideration to the proposals set forth above. At a minimum, we ask you to adopt section 422 of H.R. 2292 instead of the much weaker section 422 of H.R. 2676. H.R. 2676 requires a complexity analysis only if legislation is determined by the Joint Committee to add significant complexity or provide significant simplification; H.R. 2292 required a complexity analysis for all legislation that would amend the Internal Revenue Code. Further, H.R. 2676 does not set forth the basis to be used in determining complexity; H.R. 2292 detailed specific factors to be considered in the complexity analysis.

III. CLOSING COMMENTS

The AICPA appreciates the opportunity to offer comments at today's hearing and is willing to provide your committee with additional assistance and comments as requested. Thank you for your attention.

ADDITIONAL COMMENTS REQUESTED BY SENATOR ROTH

March 25, 1998

Hon. WILLIAM V. ROTH, JR.,
Chairman, Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Senator Roth: Thank you for requesting additional comments from the AICPA on certain IRS restructuring issues. Our responses to the questions you raised on your March 5, 1998 letter to us are set forth below, in a slightly different order from that of your questions. We will be happy to discuss these and other issues with you if you so desire.

OVERSIGHT BOARD/STRENGTHENING OVERSIGHT

1. Oversight Board's Powers and Responsibilities

We believe the proposed IRS Oversight Board should have powers and responsibilities similar to those of a corporate board of directors, it should not be merely another advisory group. The Board should provide direction, oversight, and support for the IRS management and make policy decisions regarding IRS operations. Tax policy decisions should remain the responsibility of Treasury.

The IRS Oversight Board's responsibilities should include providing input on long range strategic planning, approving the IRS strategic plan, monitoring organizational performance, and evaluating compensation for the Commissioner and the top-level IRS managers. Similar to a corporate board of directors, the Oversight Board's activities should remain at the programmatic management level and address systemic problems, but not, for example, specific instances of employee misconduct, although the Board should be advised of generic employee misconduct problems in order to evaluate the systemic response and devise corrections.

2. Board's Relationship to Commissioner

The Commissioner and the senior management of the IRS should have powers and responsibilities similar to the president and senior management of a corporation. They should have responsibility for directing the day-to-day activities of the IRS in a manner consistent with the management policies established by the Oversight Board and be answerable to the Board for those activities. We do not believe it would be appropriate for the Board to have legal authority to direct the actions

of the Commissioner. If the actions of the Commissioner are inconsistent with the Board's policy decisions for the IRS, however, the Board should have the authority to recommend to the President that the Commissioner be removed from office.

3. Sunsetting Oversight Board

The AICPA believes the Oversight Board should not be subject to a sunset. The Board would be established to provide the IRS with consistent direction and enable it to benefit from private sector experience and expertise. These are ongoing, systemic needs of the IRS. The Board should remain in place to meet those needs, not subject to termination because the perceived problems that caused the Board's creation are resolved.

4. Prohibition on Board's Authority Over Law Enforcement Activities

As noted above, the Oversight Board should focus on the overall governance of the IRS and not deal with day-to-day activities. Thus, it should not be involved in specific law enforcement cases. In its policy-making and oversight roles, however, the Board should have authority over policies regarding how the IRS carries out its law enforcement responsibilities.

5. Board vs. Inspector General Oversight

We believe both the Board and the Treasury Inspector General should work together on oversight of the IRS. The Inspector General should provide oversight with respect to specific activities or problems and should report its conclusions regarding problems to the Board. The Board should keep itself apprised of the Inspector General's activities and conclusions and, to the extent that systemic problems are discovered, should take action to correct them.

6. Oversight Board Within Treasury

The AICPA believes that the Oversight Board should be independent of Treasury. If, however, the final restructuring legislation provides for an IRS Oversight Board similar to that previously proposed by Treasury, we recommend that the members of the Board serve only on a part-time basis and that a majority of the members of the Board be from outside Treasury and the IRS.

PROTECTING THE TAXPAYER

1. Penalty and Interest Reforms

The AICPA believes major revisions to the penalty and interest provisions are critically necessary, but feel they should be made only pursuant to a comprehensive study of the current system and a detailed analysis of the impact the proposed revisions would have on taxpayers, tax practitioners and tax administration. We would welcome the opportunity to participate in such an undertaking. Please see the enclosed March 17, 1998 letter to staff of the Senate Finance Committee regarding this matter.

2. Independence of Taxpayer Advocate

The Taxpayer Advocate's Office is in the unique position of being inside the IRS, yet having the specific charge of representing the interests of American taxpayers, scrutinizing the Service's activities, and serving as the advocate of taxpayers in recommending changes that will improve the IRS's service and responsiveness to taxpayers. Given that role, the Taxpayer Advocate must zealously represent taxpayers, not serve as a spokesperson or apologist for the IRS.

For the Taxpayer Advocate's Office fulfill its responsibilities, it must have the trust of taxpayers. We recognize that, from a realistic point of view, it is probably necessary to have the Taxpayer Advocate's Office be part of the IRS, so that the employees of the Advocate's Office can have access to taxpayer information. The fact that the Office is organizationally a part of the Internal Revenue Service, however, may taint its objectivity in the minds of taxpayers. It is, therefore, crucial that the Taxpayer Advocate's Office be structured and operated in such a manner as to maximize the independence of its advocacy. For example, the Taxpayer Advocate should be appointed by and report directly to the independent Oversight Board instead of to the Commissioner.

While we recognize the many contributions already made by the Advocate's Office, based on the Taxpayer Advocate's annual reports to Congress in 1997 and 1998, it appears the Taxpayer Advocate's view of issues is too heavily weighted from the IRS' perspective rather than that of the taxpayers. The weighted IRS perspective, unfortunately, sends the message to the taxpaying public that the Advocate may not be independent. This image must be changed.

3. Offer in Compromise Program

In an October 9, 1997 letter to the Assistant Commissioner (Collection), we set forth our concerns about the offer in compromise program; a copy of that letter is enclosed for your reference. It is our understanding that an IRS task force currently is addressing some of the issues in that letter. We are pleased that the IRS is working to improve the offer in compromise program. We urge your committee to also address the problems of the current system.

4. Illegal Tax Protester

We concur with the need to protect both the rights of innocent taxpayers and an individual's right to freedom of speech. Currently, the Internal Revenue Manual sets forth guidance on what constitutes grounds for classifying an individual as an "illegal tax protester" and describes how returns filed by illegal tax protesters are to be processed. Classification of taxpayers as illegal tax protesters is done by the IRS with no input, notice, or review by affected taxpayers. To provide taxpayers with protection from an unjust classification, we recommend that the illegal tax protester classification should apply only after the initial determination of such status by the IRS has been reviewed and approved by the Taxpayer Advocate's Office.

An individual's exercise of the right to free speech, such as advocating a change in the tax system or even advocating a protester position, should not be grounds for classification as an illegal tax protester. Clearly, the IRS should bear the burden of proof in classifying someone as an illegal tax protester, and any review should be particularly critical of evidence presented by the IRS to ensure that a taxpayer's rights are fully protected.

5. IRS Employee Contact Information

We agree that IRS employees should be held accountable for their actions and, therefore, agree with the concept of having each employee sign correspondence coming from him or her. Also, to the extent practical, we agree with the concept of putting the name and phone number of a contact person on notices; we are concerned, however, that this may not always assist the taxpayer because of varying work hours, notices relating to returns with several issues under consideration and thus requiring different areas of expertise, etc. Further, this may not always be practical, such as on computer-generated notices of math errors.

CHANGING THE CULTURE

1. Personnel Management/Employee Morale

Recruitment and Retention of the Best for the IRS. Employment at the IRS has always been viewed as a professional career. In the past, the IRS successfully recruited entry level personnel who not only grew with the organization, but who today are leaders in the tax field both inside or outside the IRS. Ensuring the continuity of this succession of leaders will require improvements in recruitment, training, and compensation, as well as clarification of career paths for IRS employees. The IRS's strategic plan needs to focus on accomplishing these objectives. We make the following recommendations in this area:

- *Pay Competitive Salaries.* In many geographic locations, IRS salary levels are woefully uncompetitive. The IRS must be capable of paying competitive salaries in order to recruit and retain qualified employees If this raises issues of equity among governmental agencies, we would note that no other agency so touches the lives of the U S. public, and no other agency is charged with raising over $1.5 trillion a year.
- *Provide Superior Training.* Superior training has been one of the attractions of a career with the IRS. Obviously, better trained IRS employees work more efficiently and taxpayers have a better experience dealing with properly trained IRS employees. Conversely, for taxpayers and tax professionals, dealing with ill-informed auditors often results in wasted time resolving needless issues and promotes negative attitudes toward the IRS.
- *Set High Educational Standards.* High educational standards must be set for IRS employees. These standards should require both a quality accounting education as a prerequisite to hiring and dismissal of agents who cannot pass training. .
- *Increase the Number of CPAs in the IRS.* To increase the depth of knowledge and practical experience of IRS employees, it is recommended that the practice of hiring CPAs in the Office of IRS Chief Counsel be reinstated and that continuous and active recruiting of CPAs in the Examination Branch be undertaken. Further, in connection with continuing education for IRS employees, non-CPA employees should be encouraged to become CPAs.

Professionalism and Image. The "Forward" to the IRS *Rules of Conduct* notes that public confidence in the Service "can be instilled and maintained only if every contact with the public reflects high ethical standards and [the] commitment to perform [the] work conscientiously, courteously, and effectively." The professionalism that is present in the executive ranks of the IRS must be passed down to employees at all levels. We make the following recommendations regarding these issues:

- *Codify Professional Standards.* The IRS should codify and enforce its professional standards. Due to the interdisciplinary nature of tax standards, the IRS and professional tax organizations should form a working group to collegially develop such standards of professionalism.
- *Measure Job Performance Based on Professionalism.* In testimony before the National Commission on Restructuring the Internal Revenue Service and in a July 7, 1997 letter to the IRS, the AICPA objected to the measurement standards applied to job performance of IRS employees and encouraged measurement based on professionalism. Better performance measures must be devised to reward performance that furthers the mission of the IRS rather than encourage overly aggressive and unjustified proposed adjustments and collection actions. We are pleased with the actions taken thus far in this area and hope the process of improving the measurement system is continued.
- *Engage in a Public Relations Campaign.* As a means of increasing employee morale as well as aiding compliance and reducing negative ratings, the IRS should communicate to the public that it works in the public interest carrying out the mandates of Congress.

2. Doing Away with the IRS

Currently the IRS processes over 200 million tax returns and collects over $1.5 trillion of revenue in a year. For the majority of taxpayers, a "successful" filing of their returns is the only contact they have with the IRS. To the extent they have criticisms of the IRS it its likely the criticisms relate more to the complexity of the tax law, rather than to specific acts of the IRS.

Further, the IRS recently has been the subject of much criticism, both warranted and unwarranted. Such criticism tends to gain momentum on its own; in the case of the IRS, this is exacerbated by the natural tendency of individuals to dislike paying taxes and by the common misunderstanding that the IRS is responsible for the complexity of the tax law and related forms.

Realistically, some institution needs to administer the tax law and collect the revenue needed for our country to operate. This is true regardless of the type of tax system used to fund the government. Further, as is pointed out in Changing America's Tax System: A Guide to the Debate, a 1996 AICPA study on alternative tax systems, there also are collection problems in all of the alternative tax systems being discussed.

There is no easy solution. People who would do away with the IRS are doing this nation a disservice. Rather, the energy would be better spent in revitalizing and improving the IRS. It is disingenuous to maintain that the federal government can continue to raise needed revenues on the scale to which it has become accustomed without significant administrative, collection and enforcement efforts.

3. IRS Employee Adherence to IRS Procedures

Consistency When Implementing IRS Policies. Often, the IRS will institute policies designed to assist taxpayers or clarify the application of particular Code sections. (In certain instances, the policies are designed to apply only to particular taxpayers, and those are not at issue.) But, when a benefit is intended to apply to all taxpayers, and through ignorance or capriciousness, an agent fails to give a taxpayer the benefit of those policies, it is detrimental not only to the taxpayer, but also to tax administration in general.

One such example involves document requests. On June 3, 1996, the Assistant Commissioner (Examination) issued a memorandum to all regional compliance officers regarding overly broad Information Document Requests ("IDRs"). The memorandum was issued, in part, in response to complaints from taxpayers and practitioners about revenue agents initiating an examination and immediately requesting an array of documents, many of which prove to be irrelevant to the examination. The well-reasoned memorandum of the Assistant Commissioner (Examination) set forth a standard for issuing document requests: an IDR should be issued for specifically identified issues or specifically identified reasons. The memorandum made it clear that "kitchen sink" or "boxcar" IDRs are inappropriate. The experience of many tax practitioners, however, is that the guidance issued by National Office is sometimes disregarded and, in this instance, many agents are unaware of the memorandum. As a result, taxpayers continue to receive these broad IDRs. Out of

fear of reprisal, taxpayers frequently comply with these overly broad, burdensome document requests rather than attempt to bypass or confront a revenue agent regarding this memorandum.

As a general principle, the Service must strive to communicate its policies more uniformly throughout the organization. Policies should be meaningful, and there should be consequences when an agent or Appeals officer disregards a policy set forth by the National Office.

Consistent Standards for Raising an Issue in an IRS Examination. Treasury Department Circular No. 230, IRC section 6694, and professional ethics guidance of the AICPA and the American Bar Association ("ABA") provide that tax advisors may not recommend a position in a return that lacks a realistic possibility of being sustained on its merits. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

Although the AICPA and the ABA prefer not to assign mathematical probabilities to the realistic possibility standard, nevertheless, both professions are bound to abide by the standard, as prescribed by regulations under section 6694. Unfortunately, the IRS has not chosen to instruct revenue agents to apply the same "realistic possibility" standard before raising issues in examinations.

As a matter of fairness and consistency, we recommend that the IRS require revenue agents to have concluded that there is at least a realistic possibility of success before proposing an adjustment against a taxpayer. One method of ensuring that a position contained in a RAR has a realistic possibility of success could be to require that each RAR be signed by an individual at the group manager or higher level, attesting to the fact that the proposed adjustments set forth therein meet the realistic possibility standard. Implementing a policy such as this would be consistent with tax administration principles for the IRS, set forth in Rev. Proc. 64-22, 1964-1 C.B. 689.

Rev. Proc. 64-22 provides, in part:

> The Service . . . has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

SIMPLIFYING THE CODE

The AICPA believes the IRS can be restructured again and again but the basic frustration that taxpayers experience in dealing with the IRS will remain until the issue of complexity has been addressed. Enclosed for your reference are tax simplification proposals we have submitted to Members of Congress during the past year. Also enclosed for your consideration is the AICPA Tax Complexity Index. The Index is intended to be used as a tool to analyze the complexity of any proposed legislation.

PREPARED STATEMENT OF MARJORIE A. O'CONNELL

Mr. Chairman, Members of the United States Senate Committee on Finance. Thank you for the opportunity to testify before you today about proposals to reform the innocent spouse tax rules.

My name is Marjorie O'Connell, I have practiced law in Washington, D.C. for 25 years. I am a tax attorney, my specialty in practice is family taxation, particularly divorce taxation. I have authored numerous articles, several books, and a tax service supplemented monthly since 1982 about divorce taxation. I have served in the American Bar Association's various Sections as a specialist, leading committees and task forces that have addressed the subject about which I testify before you today. I have provided my professional credentials as the last page of my written testimony.

Through my law practice experience, my work as a author and lecturer, and significant involvement in professional organizations' efforts to improve tax law, I have encountered hundreds of spouses innocent of tax liability, yet confounded by the tax code's current provisions to relieve them from that liability. I am here today to tell you from these experiences why current law does not work and why even as current law is improved in the House-passed Taxpayer Bill of Rights 3, the law still would

not work. I choose to do this only briefly because the panel who appeared before me has told you their tales. There are more stories in legion which I know you have read in letters from stricken constituents who have squarely put the problem on your desks.

In short, current law in its overwhelming complexity has proven itself no relief but a waste of time and money for many innocent spouses. The Internal Revenue Service as you heard from Professor Beck frequently pursues the perceived lesser empowered of spouses who signs a joint return and succeeds in overwhelming that spouse through perfectly legal collection mechanisms. For those few spouses who can afford and are well enough informed to allege an innocent spouse defense, even early in the audit process, conflicting administrative rulings and court decisions defeat them. Under current law and even under the revision proposed in TBR 3, an innocent spouse must prove, among other things, that he or she did not know and had no reason to know of the item on the return which caused the tax understatement. That spouse must also prove that it will be inequitable to hold him or her liable for the tax. Inequitable is defined to mean that the party alleging the innocent spouse status must prove that he or she did not benefit from the tax understatement. It is rare that innocent spouses can meet these two extremely difficult "negative" burdens of proof. Even in cases like those you heard this morning, and others numbering in the thousands, some decision makers will always find a basis to suspect "reason to know" (in cases in which a spouse is simply employed in the market place) or a basis to find "benefit" (in cases in which a spouse receives any portion of a marital estate after a long-term marriage).

We can have a system that is fair for taxpayers, easier to administer for the Internal Revenue Service and simpler for all. This system could work without jeopardizing tax collections.

Let us simplify the problem. What don't we like about everything we heard today? It is that a spouse is held liable, who is not responsible for the tax mistake: liable up to 100 percent of the taxes owed, plus penalties and interest; when not responsible simply because it is not the innocent spouse's income or his or her business or investment; for a reporting mistake when that spouse was not even involved in deciding how to report the item that caused the understatement.

What is the path to a solution? Well, how do we cause the problem? When spouses sign joint returns, they undertake joint and several liability becoming fully responsible for mistakes in which they are not involved.

What's the solution? It could not be simpler, disassociate joint return signing from tax liability.

How would that work? What would happen under various systems of doing that? Professor Beck has given you some of the history and alluded to our projects principally through the American Bar Association to address this problem. Almost 15 years ago, those of us who had participated in a five-year effort to reform domestic relations taxation, thought we had truly invented a "rounder wheel" for joint return liability. Compared to then existing law, indeed, we had. But, as if sent rolling down pothole- ridden streets of Washington, D.C., this wheel has taken the blows of uneven IRS administration and inconsistent court decisions. Today, the misshapen wheel is no longer able to roll the wagon of tax equity forward.

In 1994 and 1995, 10 years after the last major legislative relief in this area, I participated with the American Bar Association to design a solution that would disassociate joint return signing from tax liability. The ABA recommendation also addresses the circumstance of the spouse in a community property state who does not sign a joint return but who might nonetheless be held liable for the tax mistake of a spouse in whose economic activities the innocent spouse had no involvement. As is our policy in the ABA, we adopted a recommendation. Those of us who worked on the project also prepared an extensive report in support of it and drafted proposed statutory language. All of these materials are provided to the Committee in my written testimony.

It is recommended that all married persons be taxed only on their own individual incomes, without liability for tax on the income of their spouses, even when they file joint returns or are residents of a community property state.

There is ordinarily no difficulty in determining each spouse's gross income on a joint return. The difficulty, if any, results from the necessary allocation and apportionment of deductions. However, allocation and apportionment of deductions between related taxpayers is routinely required in other circumstances, and the audit process almost necessarily reveals the source of any asserted deficiency. Most deficiencies are assessed as result of matching the return with information forms W-2, 1099, K-1 and the like, which reveal the source of income.

It is important to emphasize that, in order to separate the liability of married persons for payment of income tax on a joint return, no other changes would be re-

quired. The current rate structure and filing status system would remain unchanged, and the benefits of income-splitting for joint filers would be preserved. The basic formula for determining the separate liability of each spouse on a joint return is as follows: First, each spouse's tax would be calculated as if he or she filed a separate return of a married individual, second, the ratio of a spouse's separate tax to the sum of both separate taxes would be applied to the total joint tax due. In this way, the benefit of the income-splitting rate structure is preserved, but each spouse is liable only for the portion of the joint tax which is due to his or her separate income. The 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 one spouse.

Determining liability for subsequently assessed deficiencies may be thought of as an "item" approach, in which liability for the tax follows responsibility for the item, and represents a departure from strictly proportional liability.

Poe v. Seaborn, 282 U.S. 101 (1930), construed family property law in the community property states to create a separate liability on each spouse for the tax on one-half of 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, but results automatically from residence in a community property jurisdiction. *Seaborn* should be legislative overruled, as has already occurred in limited contexts. In 1976, Congress in effect repealed the *Seaborn* rule for couples one or both of whom are nonresident aliens. It is this rule, codified under Internal Revenue Code section 879(a), which our recommendation would extend to all taxpayers, modified, as explained below, with respect to the treatment of investment income. As under section 879(a), the earned income of couples would taxable to the earner alone. Items of income and deduction from a trade or business would be treated as items of the spouse who exercises substantially all the management and control of the trade or business. Income and deductions from a partnership distributive share would be taxable entirely to the spouse who is the partner. Income from separate property would be the separate income of the spouse, notwithstanding the law of some states which treats such income as community property. Tax liability would be incurred solely by the titleholder(s) of investment property just as in common law states. The sole titleholder can usually control and dispose of investment income without consent of the other spouse, often, as a practical matter, without incurring any accounting or other liability for the non-titleholding spouse's community interest in the income.

In conclusion, we recommend that the Committee approve legislation that would (i) eliminate joint and several liability of a taxpayer who has signed a joint return with his or her spouse for tax on income properly attributable to his or her spouse, (ii) substitute separate liability for tax shown to be due on the joint return, and (iii) repeal innocent spouse relief from liability for tax on the joint return when the liability arises from erroneous items of the taxpayer's spouse; and would (iv) overrule the holding in *Poe v. Seaborn*, 282 U.S. 101 (1930), so that married taxpayers who live in community property states would not be individually liable for income tax on any portion of the income earned by their spouses; (v) refer to section 879(a), with modifications, for the purpose of attributing income to a spouse in a community property state for income tax purposes; and (vi) repeal the provisions granting relief from tax on income attributed to the taxpayer as the taxpayer's share of community income earned by the taxpayer's spouse.

Thank you for your consideration of these recommendations.

PREPARED STATEMENT OF NINA E. OLSON

Mr. Chairman and Members of the Committee:

Thank you for providing me the opportunity to testify on the topics of IRS restructuring and taxpayer rights. I comment in my capacity as the Executive Director and staff attorney of The Community Tax Law Project (CTLP). CTLP is a 501(c)(3) organization founded in 1992 for the purposes of (1) providing low income Virginia residents with pro bono legal representation in federal, state and local tax disputes; (2) educating low income individuals about their rights and responsibilities as U.S. taxpayers; and (3) increasing public awareness of and encouraging informed debate about policy and practice issues impacting on low income taxpayers.

CTLP accomplishes its goals in a variety of ways, including in-house legal representation and a statewide pro bono referral panel of volunteer attorneys, accountants and enrolled agents. The Project provides back-up training and technical support for its volunteers and maintains a research library. It sponsors continuing legal

education programs, including one coming up in March, 1998, on representation before the United States Tax Court. I frequently address groups of low income parents and workers about tax issues impacting on their families and their businesses.

In January, 1996, CTLP became the first independent nonprofit clinic to enter into an agreement with the United States Tax Court, whereby letters from CTLP are included in trial notices to pro se petitioners scheduled for the Richmond or Roanoke court calendars. These letters advise the pro se petitioner that the Project may provide him or her with legal advice or representation if eligibility guidelines are met. The Tax Court has similar agreements with student tax clinics at law schools throughout the United States. Such agreements permit law students to argue cases before the Court.

CTLP attorneys also attend calendar call at all Tax Court dockets in Richmond and Roanoke. The presiding judge makes an announcement from the bench, pointing out the availability of volunteer attorneys for consultations prior to trial. These efforts are uniformly a success from the point of view of all parties involved.

The Virginia-West Virginia District of the Internal Revenue Service recently agreed to publicize CTLP's services by displaying brochures and posters in walk-in taxpayer services offices and waiting rooms throughout Virginia. The District further agreed to include letters from CTLP in exam notices and 30-day letters issued from the Richmond field office.

In response to our pro bono panel's need for training, CTLP publishes a national quarterly newsletter about low income tax practice and policy. *The Community Tax Law Report's* target audience includes attorneys and accountants, economists, lawmakers and community services workers having an interest in low income and/or tax issues. Since its first issue in October, 1996, *The Report* has published articles about tax reform, IRS collections (including outsourcing of collections), innocent spouse relief, dividing pensions at divorce, the taxation of workfare, social security and child care reform.

My remarks today are informed by my experiences as a taxpayer advocate, one who has daily contacts with all levels of the Internal Revenue Service on behalf of low income taxpayers. Perhaps even more important, I am the attorney who answers taxpayers' calls for assistance and screens cases for acceptance by the Project. I hear directly from low income taxpayers about their own efforts in resolving tax disputes and their treatment by IRS employees.

COLLECTIONS

In General

Collections is the branch of the IRS with which low income taxpayers have the most contact. Many low income taxpayers attempt to bring up substantive issues in Collections because they have not understood their opportunities to dispute a proposed assessment at earlier stages of the examination process. Collections is, of course, a most inappropriate place to attempt to clear up matters of substantive tax law. My clients do not understand why the revenue officer is not willing to listen to their protestations that they do not owe the tax being collected. A recognition of this misconception is fundamental to an understanding of the problems low income taxpayers have with the collections branch and their resentment toward the Internal Revenue Service. This resentment goes beyond the general feeling of not wanting to pay over any of one's hard-earned money; rather, it generates from the belief that noone is interested in learning whether the tax was correctly assessed.

Collection employees—revenue officers, managers, ACS employees—all must be trained in basic customer relations approaches to taxpayers. They must learn to view the taxpayer as someone who is trying to work out a way to pay his tax debt and not as someone who automatically warrants the institution of harsh collection techniques. The RO can easily use those methods when the situation calls for them.

All too often today the taxpayer is told of only one option—pay up or else dire steps will be taken. The taxpayer develops an attitude of resentment and suspicion, which in turns feeds the RO's perception that the taxpayer is a "deadbeat." This unfortunate scenario might be avoided if, when a taxpayer initially contacts Collections, the interviewer outlines to the taxpayer his or her options for payment. By this I mean ALL of the options—payment in full, payment within 12 months, other installment plans, and the offer in compromise procedure (including those based on doubt as to liability).

If a taxpayer is willing to pay and has not demonstrated to the IRS that he is trying to delay payment in hopes of evading the tax entirely or that he has willfully not honored prior payment agreements, the Service should be willing to work out with the taxpayer reasonable payment arrangements. The public fisc will be protected by the imposition of interest and late payment penalties.

Late Payment Penalties (Section 376)

I do not support the abatement of the late payment penalty during the term of an installment agreement. Nor do I support a percentage cap on additions to tax for late filing or paying. As a rule, taxpayers who fail to timely pay their taxes should be penalized. In general, the combined rate of interest and penalty charged by the government should be greater than that for a commercial installment loan, a mortgage, or a credit card. The government should not get in the business of competing to be a money lender to taxpayers. Rather, the government should be a lender of last resort. Revenue officers should encourage taxpayers to find alternate loan sources at lower interest as well as explain the payment options available from the Service.

Collection employees should explain that the price of working out a deal with the government is the combined interest/late payment charge. Most taxpayers can recognize the sense behind this policy, even if they don't like its application in their individual cases. Any other approach will seriously erode taxpayer confidence.

I do support, however, the imposition of a cap on civil penalties equal to 100% of the underlying tax. This limit will still retain the disciplinary nature of civil penalties while not creating a hopeless situation from which the taxpayer feels she will never extricate herself. Rather than discouraging compliance, a 100%-of-tax limit on penalties may actually encourage taxpayers to continue paying, since they will be able to see the light at the end of the tunnel.

Trust Fund Recovery Penalty

One area where taxpayers need additional information involves the assessment of the IRC § 6672 trust fund recovery penalty (aka the "responsible person penalty"). Often the taxpayers involved in a failing business have lost all they own in the process of keeping the business afloat. The arrival of an IRS revenue officer on the scene produces fear in an already anxiety-ridden situation. All too frequently the RO does not explain to the taxpayer the concept of a "responsible person." He does not explain the underlying purpose of the inquiry into responsibility for payment and the possible results of a finding of responsibility. I have represented taxpayers in several cases where the RO simply explained that they had no choice but to agree to the assessment of the trust fund tax against them. They were not advised that they have the right to disagree with the RO and obtain further review of the proposed assessment. They were not told that by agreeing to the assessment and signing Form 2751, Proposed Assessment of 100 Percent Penalty, they waive their right to claim a refund or abatement of tax.

Given that taxpayers in these situations are hesitant about spending any funds for legal counsel (and if they do have counsel, the taxpayers are often questioned by the RO as to why they are spending money on legal representation when they can't pay their taxes), it is vitally important that revenue officers be required to provide the taxpayer with a separate statement outlining the requirements for making a 6672 assessment, the taxpayer's rights pertaining to the responsible person penalty assessment, and an explanation of the effect of consenting to an assessment. It should also be explained that these taxes are often not dischargeable in bankruptcy and will be vigorously collected. Further, the RO should explain to the taxpayer his payment options in the event he does agree to the assessment.

Explanation of Rights and Procedures (Sections 352 and 354)

Requiring revenue officers and other collection employees to review taxpayer rights and options at every contact will daily serve to remind IRS employees that these are not empty statements. They must be taken seriously if taxpayer confidence in the system is to be restored and maintained. Employees should be provided with a standard statement of rights in collections and another statement for 6672 investigations. Failure to cover this material with the taxpayer would result in some type of demerit to be considered in the employee's performance reviews. Such failure would also constitute grounds in support of a Taxpayer Assistance Order granting relief from proposed collection activities.

Taxpayers in collections must receive a meaningful review of collection activities by supervisors. In my experience, any complaint to a supervisor has been answered by the offending rvenue oficer, i.e., after I speak with the supervisor, the supervisor instructs the revenue officer to respond to the taxpayer with the results of the review. This is inappropriate because it leads to the perception that the supervisor has given only a perfunctory review of the revenue officer's actions. It also cuts off the taxpayer's ability to respond and provide to a third party additional supporting information about the RO's actions or proposed actions. Supervisors should be required to explain the results of their decisions to the taxpayers or their representatives and not delegate these explanations to the revenue officer involved. Super-

visors should also be more willing to reassign cases where there is a clear personality clash between the taxpayer and the RO. (Such reassignment would only be available where the taxpayer has not sought to avoid or unreasonably delay paying the tax due.)

When a taxpayer objects to the payment of the tax on the ground that there is an error of law, revenue officers should be trained to explain their role as tax collectors, not tax adjudicators. However, the RO should also receive training in the various avenues of substantive relief available, including refund claims, the problem resolution officer, and offers in compromise based on doubt as to liability. Although Collections employees do not need to know all the details of such procedures, they should be required to provide taxpayers with information about possible avenues for resolution of the substantive issues.

Absent evidence indicating evasion of payment, collections activity should cease pending any of the above procedures. Taxpayers should be reminded that penalty and interest continue to accrue. The possibility of making a deposit to stop the running of penalties and interest should be discussed with the taxpayer.

All collections employees should be provided with a list of Low Income Taxpayer Clinics accepting referrals of collection problems. Collection employees should encourage unrepresented taxpayers to contact these clinics.

EARNED INCOME CREDIT EXAMINATIONS

As a result of Congress' concern about taxpayers' erroneous claims for the Earned Income Credit, the IRS is conducting frequent examinations of such claims. The Community Tax Law Project receives at least one call a week from a distraught taxpayer who has been denied the credit, dependency exemptions and/or head of household status even though she is clearly eligible. We have found that the correspondence "audit" is superficial at best. It is also not clear, where two individuals have claimed the same child, whether both individuals are being examined or only the last to file. It is my experience that the last to file is generally the one entitled to the credit.

Examiners do not appear to allow for the fact that low income taxpayers eligible for this credit often (usually) do not have checking accounts. In fact, until recent changes in the welfare laws, AFDC recipients were not permitted to maintain checking accounts and continue to receive benefits. Thus these taxpayers are often unable to document purchases for food or clothing. The Service's employees have not attempted to suggest alternate forms of proof more relevant to these taxpayers' life circumstances. The review process is thus biased against the taxpayer. There is no reason why the Service cannot attribute reasonable standard allowances for food and clothing to taxpayers who are otherwise able to demonstrate that they are the sole or primary source of the dependent's support or of household maintenance.

We have also noticed what appears to be automatic assessment of the IRC § 6662(a) accuracy-related penalty on returns prepared by tax professionals. There does not appear to be any attempt to determine whether the taxpayer relied on professional advice before applying the penalty.

The IRS should be instructed to develop procedures for determining eligibility that reflect the recordkeeping methods available to taxpayers in this income class; alternative documentation procedures should be explored and the revenue agents conducting such reviews should be trained to assist taxpayers in obtaining the information from a variety of sources. Although the burden of proof remains with the taxpayer, the revenue agents can adopt a helpful approach toward the taxpayer in arriving at a correct answer.

Further, the revenue agents should be instructed not to automatically impose the § 6662(a) penalty in all cases where the dependency exemption or earned income credit is disallowed. Where the penalty is imposed, revenue agents should also inform the taxpayer about the grounds available for abatement. Revenue agents must be trained to view earned income credit/dependency exemption examinations as opportunities to educate the taxpayer about these complicated code sections. Often these examinations are the taxpayer's first contact with an IRS employee and will influence the taxpayer's attitude toward future compliance.

It should be noted that of the nine EIC cases I have personally taken to Tax Court or to Appeals over the last 18 months, the taxpayer has ultimately prevailed and the examining agent's proposed deficiency defeated. I am confident we will prevail in the five cases presently in-house or referred to our pro bono attorneys.

OFFERS-IN-COMPROMISE AND "ORDINARY AND NECESSARY EXPENSES"

I support the "reasonable living expenses" approach ennunciated in H.R. 2676 Section 346. This provision should be extended specifically to the determination of

installment payment amounts. The impact of the current standards is illustrated by a recent case in which I represented an individual who lived in a blighted inner-city neighborhood and used public transportation. The ACS employee refused to allow his busfare for travel to a grocery store at the shopping mall, although he needed to go there in order to keep his food expenses within the IRS guidelines. This "catch-22" approach to necessary expenses is completely indefensible in situations where the taxpayer is making efforts to pay the tax and is subject to interest and late payment penalties for failure to pay.

The national and local guidelines developed by the Service should be adjusted annually with respect to inflation and other factors. Revenue officers must be trained to apply national and local standards as guidelines, not rigid categories.

Low income taxpayers are unable to qualify for offers-in-compromise because they cannot raise a sufficient amount of funds to interest the Service in processing the offer. In my district, I have been advised that an otherwise acceptable offer would be immediately rejected as "frivolous" if it were to come in between $500 and $1,000, on the the ground that it costs the Service more than that amount to process the offer. Such a policy has the effect of permitting only affluent taxpayers to "buy" relief from tax liabilities through offers-in-compromise. Congress should make clear that there is no minimum offer amount required for consideration of an offer.

Practitioners have long reported confusion on the part of IRS employees regarding the processing of offers-in-compromise based on doubt as to liability. Most offer specialists insist on processing an offer asserting doubt as to both liability and collectibility from the aspect of collectibility first, although reviewing the liability basis might in fact reduce the tax down to an amount which the taxpayer could full-pay. Admittedly, processing a "liability" offer requires a more detailed analysis than a "collectibility" offer. However, given the amount of time offers take to process, it would seem appropriate to begin the analysis at the place most likely to yield the correct answer. If the liability offer is accepted, there will be no need to process the collectibility offer. By processing the collectibility first, the Service may be collecting more than the correct amount of tax from the taxpayer.

Many offer specialists refuse to review offers based solely on doubt as to liability without an accompanying offer of payment or an attached financial statement. This is a peculiar requirement where the taxpayer is saying that he or she does not owe any tax at all. The Service simply must do a better job alerting its offer specialists and managers to the Internal Revenue Manual provisions governing offers in compromise based on doubt as to liability. As in so many cases, no new statute or rules are required. Rather, the Service needs a directive that it follow the provisions already in place.

WAGE LEVIES

It has never been adequately explained to me why, when the IRS is given proof of a taxpayer's inability to pay the tax, the IRS will not release a previously filed wage levy until one wage payment is levied upon. This is the case where the Service and the taxpayer agree that the taxpayer is "currently not collectible" and yet the Service still collects one period's wage levy before releasing the levy. The taxpayer should not be forced to seek a Taxpayer Assistance Order if all parties agree that the taxpayer cannot afford to pay any amount toward the tax.

BURDEN OF PROOF (SECTION 301)

I find the burden of proof provision, Section 301, unhelpful and quite possibly harmful to low income taxpayers. First, most problems of low income taxpayers involve substantiation issues, an area specifically excluded from the provisions of burden-shifting. This point has not been made clear in all of the pronouncements and announcements about this particular provision. Since the passage of HR 2676, CTLP has received phone calls from prospective clients who are under the misunderstanding that (1) the law has already changed; and (2) they don't need to keep records any longer because the IRS must prove they owe more.

Secondly, low income taxpayers are least likely to have representation and are therefore most likely to not respond satisfactorily to IRS "reasonable" requests for documentation or witnesses within a "reasonable" period of time. However, they are the most vulnerable targets of aggressive examination procedures that the Service is sure to adopt in the wake of any change in the burden of proof. One wonders (or dreads) how the Service will be forced to investigate a claim for innocent spouse relief once the burden shifts to the government.

I believe that most taxpayers are generally able to understand the burden of proof and need only to be reminded on a regular basis that they must retain records to support their returns. Alternate procedures exist and could be expanded for cir-

cumstances where proof is unobtainable or destroyed. Rather than changing the burden of proof, the Service needs to train its employees to assist taxpayers in meeting the necessary burden as well as to better determine when the necessary quantum of proof has been offered.

INNOCENT SPOUSE RELIEF

The most appropriate solution to the problems raised by joint and several liability would be to establish proportional liability for additions to tax as proposed by the ABA Tax Section. In fact, I am leary of creating yet another procedure for taxpayers to navigate through. However, I support legislation providing a remedy to a spouse that learns of a liability arising from a joint return only after assessment of the tax. The procedure outlined in Section 321 will afford that taxpayer with access to the Tax Court.

Section makes several major improvements to current IRC δ 6013(e). It removes any numerical floor for unreported income items as well as the percentage of income test for overstated deductions. The legislation also drops the requirement that an overstated deduction have no basis in law or fact.

I would like to propose some revisions to this section. As a jurisdictional matter, the petitioner should be required to prove that he did not receive notice of and participate in any examination or appeals conference with regard to the assessment from which he is now seeking relief. This will preclude the circumstance of a spouse simply ignoring the notice or deferring to the other spouse's handling of the matter, only later deciding that he is an innocent spouse when an unfavorable assessment results from audit. This threshold, along with the consent to representation discussed below, will protect the Court from taxpayer abuse.

Further, taxpayers are likely to miss their window of opportunity for filing in the Tax Court under this provision if the petition deadline is the earlier of (1) 90 days from the six month anniversary of filing the innocent spouse claim form or (2) 90 days from the date of the IRS notice of disallowance by certified/registered mail. Taxpayers have a hard enough calculating the 90-day filing deadline for Tax Court petitions (and in fact H.R. 2676 requires the IRS to specify the filing date on the statutory notice of deficiency because of this confusion). The section should be amended to provide for a permissive filing deadline of six months from filing the claim for relief and a mandatory deadline of 90 days from the date of the IRS notice of disallowance. These provisions track the filing scheme of IRC § 6532. To further protect taxpayers from missing the deadline, the notice of disallowance should specify the final date for filing a petition in Tax Court.

The statute should clearly state that the new timeframes apply only to the new Tax Court jurisdiction and do not override any avenues of relief available under other Code sections.

I am also concerned about the provision in Section 321(d)(3) providing for removal of the Tax Court action where a refund suit is filed for the same tax year in a refund forum. The refund fora involve different opposing attorneys (Dept. of Justice instead of District Counsel); they employ much more extensive discovery; they do not settle out cases as frequently as the Tax Court; and they follow a more formal application of the Federal Rules of Evidence. All of these differences work against the taxpayer who has chosen the taxpayer-friendly forum of the Tax Court in which to litigate her claim. It is unfair for the taxpayer to be removed from this taxpayer-friendly forum into a more formal tribunal such as the district court not by her own actions but by someone else's. Such a provision only compounds the injustice that brought the taxpayer to the Tax Court in the first place.

This provision also raises serious questions of limitation on the Tax Court's jurisdiction. Heretofore, the Tax Court has been viewed as the tribunal most favorable for the taxpayer to litigate tax claims; for example, if a refund suit is filed in a refund forum while the statute of limitations for assessment is still open and the IRS subsequently issues a statutory notice of deficiency, the taxpayer may then petition the Tax Court. In this case, it is the refund case that is removed to the Tax Court.

Thus, Section 321(d)(3) should be amended to provide that the filing of a refund case in a refund forum by the other spouse should not impact on the Tax Court's jurisdiction over the first spouse's case. The mere fact that two different taxpayers would have two different results for the same tax year is not a serious problem. In the event that the innocent spouse wishes to bring a refund suit in a refund forum raising other issues while the Tax Court innocent spouse case is pending, then it is appropriate to remove the case to the refund forum, since the Tax Court jurisdiction over the innocent spouse claim is a limited one and should extend to only those situations where no other relief is available.

JOINT AND SEVERAL LIABILITY

Section 351 of HR 2676 provides for taxpayer education about the effect of joint and several liability. This explanation should include a reference to innocent spouse relief under proposed IRC § 6015. I would extend section 351 a bit further and require the Service to specifically highlight an explanation next to the Form 1040 check-off box for joint return status. A similar reminder should be included in the boilerplate language above the signature line.

I would also require revenue agents and appeals officers to attempt to obtain the consent of an absent spouse to representation by the present spouse. This can be done by communicating directly with the absent spouse and by providing him with the explanation of joint and several liability and a power of attorney for the present spouse. This information should be delivered in person or by certified mail, return receipt requested. If the absent spouse fails to agree to such representation and also fails to appear, then a deficiency notice would be issued to the absent spouse based on the results of the present taxpayer's audit or appeals (even where the present spouse agreed to the results). This procedure would give the absent spouse one more opportunity to contest the results.

Further, if the absent spouse refused to authorize the present spouse to represent him, failed to appear at the exam/appeals conference, and did not file a Tax Court petition in response to the Notice of Deficiency, the Service could use such facts in a Section 321 Tax Court innocent spouse claim as evidence of knowledge of the deficiency and thus protect the jurisdiction of the Tax Court. The taxpayer could overcome the weight of these facts by showing that he never received the notices, etc.

Note that I am not suggesting here that the IRS become involved in marital disputes. The proposed explanation/notification is designed to notify spouses about the impact of joint and several liability at the exam and collections level. It offers the spouses an opportunity to consider all possible defenses in a tax dispute and it attempts to raise the innocent spouse issue at the earliest stages of the dispute process.

The above-described procedure should in not be interpreted to deprive a married taxpayer of their right to be represented individually by counsel or other tax professional. Every practitioner has encountered at least one IRS employee who refuses to communicate with the representative unless she represents both spouses. All IRS employees must be educated about possible conflicts of interest inherent in joint representation and must follow the Treasury Regulations and Internal Revenue Manual provisions regarding powers of attorney.

ATTORNEYS FEES AWARDS

Section 311 provides for the award of attorney fees under IRC δ 7430 where the attorney represents the client on a pro bono basis or for a nominal fee. This section should be clarified to provide that where an attorney is a volunteer with a qualified nonprofit Low Income Taxpayer Clinic, then that clinic will be deemed the attorney's employer for the purposes of receiving the award granted under this section. As currently drafted, an attorney wishing to donate his award to the referring Low Income Taxpayer Clinic will have taxable business income (and self-employment income, where applicable) and then may not be able to offset the (self-employment) income with a charitable contribution deduction. Such a result would penalize both the attorney and the clinic, where in fact the reverse is intended.

LOW INCOME TAXPAYERS CLINICS

I view Section 361 as the single most helpful provision of TBOR3. All of the problems discussed above will be lessened if not eliminated when low income taxpayers are able to obtain representation. The provision of federal funding on a matching grant basis is an appropriate incentive for the establishment of clinics.

I am concerned, however, that one of the factors given special consideration in the awarding of grants is the level of service to individuals for whom English is a second language. I would add to this category a second targeted population, namely participants in welfare-to-work programs. These individuals are being thrown into the workforce without appropriate training in the matter of tax responsibilities and without access to representation. As a result, they are sure to face problems in a few years arising from dependency exemption claims and EIC audits.

The section should also make clear that faculty salaries will only be considered as matching support to the extent that they are attributable to operation of the clinic. Further, some provision should be made for in-kind contribution of pro bono attorney hours. A program in an impoverished rural area may not be able to raise significant cash funds but may have the full support of its local attorneys by way

of volunteer hours. A maximum in-kind contribution allowance for attorney time could be established. Pro bono involvement keeps overhead costs at a minimum for these programs and should be encouraged by Congress.

Further, the maximum aggregate amount of funding should be increased from $3 million per year to $5 million. This will allow at least one clinic to operate in each of the fifty states, although in practice some states will need more than one clinic, based on population density and demographics.

CONCLUSION

Thank you for inviting me to share my thoughts with you about this important piece of legislation. I hope that these comments are helpful to you as the Senate Finance Committee begins work on its version of H.R. 2676. True tax system restructuring not only protects taxpayer rights but also assists taxpayers in understanding the vital role that tax collection and compliance play in the proper functioning of our society. IRS employees must learn to see themselves as part of a process, in which they serve the two goals of taxpayer compliance and taxpayer education. Congress, in exercising its oversight function, must be careful to not send the Service contradictory messages, linking funding increases to greater tax collections. And tax professionals must volunteer to undertake representation of those unable to pay for their services in order to protect the overall fairness of the system.

We must all begin to think in a new paradigm: that for the vast majority of taxpayers in this country there is no conflict between taxpayer compliance and taxpayer rights. The latter enhances the former. Access to justice and representation within the tax system brings these two goals into harmony.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

30 June 1998

Hon. WILLIAM V. ROTH, JR.,
U.S. Senate,
Committee on Finance,
Washington, DC.

Dear Senator Roth: Thank you for providing me with the opportunity to testify before your committee in February of this year on the subject of taxpayer rights. I am delighted to be able to respond to your request for my views on your additional questions, set forth below.

Question 1. Do you believe that taxpayers are afforded proper due process in the collection process as implemented by the IRS? If not, what are your suggestions that would protect the taxpayer while not harming our tax system?

Answer. I believe that there are several mechanisms in place that, if applied in the spirit with which they were developed, would protect taxpayers' due process rights. At present, the Collection Appeal Request (Form 9423) provides an independent Appeals review of proposed collection actions. This method is utilized infrequently. The fact that it is an option is not clearly identified in publications or in conversations with IRS employees. Thus, the Service should much more aggressively inform taxpayers about the right to such a collections appeal.

I do not, however, believe that a new layer of administrative review should be inserted into the collections process. For example, I do not think an "administrative law judge" proceeding pre-seizure, -lien, or -levy, is necessary; it would only further confuse the taxpayer.

Revenue Officers should be required to orally inform the taxpayers of their rights to appeal a proposed collection action, even if the taxpayer does not protest it (some taxpayers may be afraid to protest). A simple card bearing a statement of taxpayer rights in collection actions could be inserted in each collections communication; this card need not be enormously detailed. Rather, it should be a checklist, providing the taxpayer with a "heads-up" about their rights. Revenue Officers should also be required to inform taxpayers about the availability of low income taxpayer clinics. Finally, they should be prohibited from discouraging the taxpayer from seeking representation by an authorized representative.

Question 2. I am also concerned that the IRS targets low income and disadvantaged taxpayers for audit. What can be done to ensure that these taxpayers who are attempting to comply with the complex tax laws are afforded protection from being targeted by the IRS?

Answer. The single most effective tool to combat targeting (intentional or unintentional) of low income and disadvantaged taxpayers is access to representation. Representation levels the playing field in audits, collections and litigation. It is impera-

tive that funding be available for the establishment and operation of low income taxpayer clinics in every major city in each IRS district.

Certain audit issues will of necessity "target" low income taxpayers. The most obvious example is initiatives directed toward better compliance with the Earned Income Credit. General substantiation requirements will also cause problems for low income taxpayers, many of whom live marginal existences and do not use checking accounts or have a mechanism for keeping records or saving receipts. They often live in multi-generational households and care for informal "foster" children. They do not understand the complex and often contradictory laws governing dependency exemptions; head of household vs. married filing separately status; and the EIC "qualifying child."

Similarly, self-employed low income persons do not retain receipts for otherwise deductible business expenses.

During the course of a typical correspondence audit, the taxpayer is given thirty (30) days to respond to the Service, providing documentation supporting the taxpayer's position. This is too short a period of time for low income persons to gather the necessary information, since many low income persons do not have a telephone in their home; nor can they take off work to gather documents. Often the 30 days elapse, the deficiency notice is generated and the 90-day window to Tax Court expires while the taxpayer is still gathering evidence.

When taxpayers do call the IRS or submit some documentation, it is often insufficient because the taxpayers do not understand how to prove a specific deduction or credit. Correspondence audit workers often review the documentation superficially and do not work with the taxpayer to obtain more appropriate evidence. It is easier to close the case than it is to write a clear letter to the taxpayer suggesting additional documentary support.

Low income taxpayers are not provided with a satisfactory explanation of the difference between the Audit and Appeals functions. Many taxpayers do not appeal their audit results because they think that Appeals will not give a fresh look at the documents. The pro forma letters explaining appeal rights are not eye-catching or informative enough to make someone think he will have a real second chance to present his case.

Finally, unscupulous, untrained, or unregulated return preparers are a real problem for this population. Even the measures targeting due diligence are only effective if the preparer signs the return. In many low income communities today, inexpensive but unqualified preparers are setting up low income taxpayers for future audits.

Thus, I would suggest the following initiatives:

- Fund low income taxpayer clinics. Require the exam branches of district offices and service centers to insert into audit and 30-day letters a list of all qualified low income taxpayer clinics eligible to receive federal funding under proposed Section 2576.
- Lengthen the response time period for correspondence audits, particularly in audits covering issues likely to affect low income taxpayers, e.g., the earned income credit.
- Train auditors to ask for specific additional information that might be helpful to the taxpayer, rather than assume the taxpayer is withholding information or cannot substantiate his or her position.
- Develop clear and easily understandable explanations of the audit process.
- Train auditors to show flexibility and sensitivity to the taxpayer's life situation, including her current financial status.
- Develop creative and helpful suggestions for establishing certain deductions, credits, filing status, other than through traditional methods such as cancelled checks.
- Provide clear and easily understandable explanations of the Appeals process. Require oral explanations of the Appeals process as a possible alternative for a taxpayer unhappy with the result at the exam level.
- Order a study of unregulated return preparers. The IRS should launch an initiative throughout the tax preparation community regarding return preparer requirements and need for self-monitoring by the profession.

Question 3. Are the Taxpayer Advocate and Problem Resolution Officers effective in quickly solving taxpayer problems?

Answer. I have had general success in resolving issues at the Taxpayer Advocate/Problem Resolution Officer level once the matter is referred to these offices. The difficulty lies in obtaining the referral. Often a case bounces around between collections and PRO. The taxpayer receives a letter from the PRO asking him or her to send the PRO all sorts of information supporting his position. Often the problem is that very lack of information. That's why the case is in PRO: to ferret out the infor-

mation. If the taxpayer gives this response to the PRO, the case is sent back to collections.

Many PROs are unwilling to use the tools currently at their disposal. This is particularly true with Taxpayer Assistance Orders (TAOs). It is my experience that the taxpayer has to be in extremely dire circumstances for such an order to be issued. I find myself requesting TAOs for clients most frequently when the system has failed to respond to earlier attempts at resolving an issue. Yet PROs are hesitant about using the TAO in such situations. This hesitancy is contrary to the purpose for TAOs.

The only solution to this problem is a strong Taxpayer Advocate at the National Office level and strong Taxpayer Advocates in each region and district. Only with excellent leadership will a timid workforce fulfill their true function. Strong leadership will also encourage those demoralized members of the PRO staff who are out there in the field really trying to assist taxpayers.

Question 4. The current offer in compromise program does not seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they get out they are socked with horrendous interest and penalties. Is this program broken? How would you improve it?

Answer. I believe that the offer in compromise program is an excellent solution to the nagging problem of unproductive collections. However, the system does not work well or fulfill its potential because of a lack of flexibility in the rules governing the program, which is further reflected in the actions of the employees governed by these rules. Specifically, the national standards for allowable and necessary expenses are taken as rigid restrictions rather than guidelines.

Further, there is little, if any, emphasis on the equities and reasonableness of the tax debt. For example, where a taxpayer has paid all of the underlying tax and is seeking to compromise penalties and interest, this fact should be relevant in the determination of the offer's acceptance. Offer examiners should weigh intangible factors such as the likelihood of repeat arrearages and the likelihood of bankruptcy. Is this a responsible person penalty arising from a business that is no longer in existence? Is the taxpayer 80 years old and disabled? These facts should weigh in favor of offer acceptance.

The Service must undertake a significant commitment to keeping taxpayers within the system and helping them remain within it. I can only do so much as an attorney to convince my client to come forward and become compliant. I will be unsuccessful in convincing him to reenter if I cannot offer some sort of resolution to his back tax debts. To do this, I must have the Service's cooperation: it should attribute a high value to a promise of continued compliance.

The Service should also remove the requirement of a minimum offer amount. A low income taxpayer may offer $500, which he has borrowed from family and friends, to pay a tax debt. Refusing this offer on the grounds that it is too little to cover even the costs of processing the offer is a complete distortion of the offer in compromise program's purpose. It limits participation in the program and the program's remedy to affluent taxpayers alone.

The offer in compromise program could be a very successful vehicle for challenging the validity of the underlying tax liability. It is the only avenue available when all statutes of limitation (other than collections) have run. The Service in our district requires financial statements to be filed with doubt-as-to-liability offers. Financial status is irrelevant where the underlying tax is being challenged. Further, the Service should not expect any payment for this offer; the taxpayer is paying a significant price in submitting the offer because the statute of limitations on collections is extended upon submission. That fact alone, if publicized, will discourage meritless offers.

Finally, tax practitioners need to be more careful about submitting offers and not abuse the process. The offer in compromise program is not the end-all panacea. I am aware of at least one organization that checks federal tax lien filings and contacts taxpayers about possible tax relief. I have represented clients who have paid this group $500 up front for IRS representation (by mail) only to receive (by mail) a copy of Form 656 (Offer in Compromise) and Form 433-A (Individual Financial Statement). The taxpayer is instructed to fill these forms out and return them to the company, which will in turn submit them to the IRS. Of course, the taxpayer could have done this themselves, for free. The Service, Congress and professional tax practitioners need to do a better job of policing the tax profession in the collections arena.

Question 5. Last September, one of our witnesses, Father Ballweg, indicated to all of us the importance of a system that is customer friendly. Shouldn't most correspondence be signed so that agency personnel are accountable? At some stage in

the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. I think it is vitally important that the IRS becomes more customer friendly. Employees must learn to adopt the attitude that the taxpayer is sincere in attempting to resolve a matter, even if they are incorrect. Employees must see their role as non-adversarial (with the exception of litigation personnel).

I believe front-line people who have direct contact with the taxpaying public should be paid extremely well. These are the people most taxpayers have contact with and identify with the "Government." Respectful contacts at this level are vital to ensuring ongoing taxpayer compliance with the tax system. The Service should develop incentive awards for politeness, not collections levels. Because of the stress inherent in customer service jobs, split shifts and part-time shifts may be the most appropriate staffing approach. Private industry has worked with this problem for decades; the Service should study its methods and adapt them to the government function.

I do not think collections employees should sign their full name to correspondence on a routine basis. There is a level, at correspondence audit, where contact employees are identified, and I believe this is an appropriate procedure given the nature of the cases. At the ACS level of collections, assigning one employee to a given case would work against current initiatives to provide customer service during extended office hours. This latter effort is a very important customer service feature.

It is important, however, that IRS employees be held accountable. In telephone conversations, particularly in collections, not only should employees identify themselves by their last names but also by their employee numbers so that erroneous statements or advice can be traced to the responsible employee.

Finally, I believe that the Service could benefit greatly from outsourcing its graphic design and communications efforts. Government publications do not need to be arcane, nor do they need to look like standard issue government documents. Particularly with the population I represent, visual elements and legibly displayed materials are key to getting any message across.

Question 6. I have a constituent who owns a small business in Delaware. . . . If the IRS audits or attempts to collect from a taxpayer and the taxpayer prevails either in court or in appeals, should the IRS pay the taxpayer's costs and attorney fees?

Answer. Two improvements should be made to current statutory scheme for recovery of attorney fees under IRC § 7430. First, recovery should be extended to cover the cost of representation commencing with the 30-day letter advising the taxpayer of his or her right to an Appeals conference. Second, the statute should provide for recovery of (imputed) attorney fees and costs when a taxpayer is represented on a pro bono basis.

I do not think that § 7430 should be extended to the examination level, since it may limit legitimate inquiries into a taxpayer's return. Any society with a system of taxation must accomodate reasonable differences of interpretation between the taxpayer and the taxing agency. The key word here, of course, is "reasonable." There are other methods available, including performance evaluations, that can increase "reasonable" positions at the audit level.

When someone with settlement authority (Appeals) has a chance to look at the case, it should be that person's responsibility to identify any positions that are not substantially justified. Making Appeals subject to IRC § 7430 will reinforce the independence of Appeals. Further, if an issue raised at audit is determined by Appeals to be not substantially justified, it should be taken into consideration during the revenue agent's personnel evaluation. If Appeals and the taxpayer cannot agree as to the applicability of IRC § 7430, then the taxpayer should have an opportunity for review by an Appeals Officer not previously involved in the case.

Question 7. During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures? If IRS personnel do not follow IRS policies and procedures, what should happen to the taxpayer's case?

Answer. We as practitioners rely upon the Internal Revenue Manual (IRM) as a roadmap for what we can expect during IRS communications and proceedings. Indeed, the Service often justifies its actions by reliance on IRM provisions. I have had some second thoughts, however, about requiring the IRM be followed in all cases, since in a bureaucracy like the IRS, procedural guidelines tend to become set in stone (see, for example, the above discussion of the offer in compromise program).

Rather than requiring IRS employees to follow the IRM, they should be required to explain and document why they are deviating from the Manual. The taxpayer should be provided access to this explanation upon request. This will still afford the

employee the chance to deviate for good reason but will provide the taxpayer with some justification for the deviation from established and expected procedures. Adherence to IRM procedures (or adequacy of explanations for deviation) should be an element of performance reviews. Deviations may point to a need for changes in the IRM; for this reason, some mechanism for cataloging deviations should be developed.

I hope the above responses prove helpful to you. Thank you again for your keen interest in IRS Restructuring and your particular interest in taxpayer rights and low income taxpayers. It has been a privilege to work with you and your staff in the development of this significant legislation.

Yours very truly,

NINA E. OLSON,
Executive Director,
The Community Tax Law Project

PREPARED STATEMENT OF SVETLANA PEJANOVIC

Thank you Chairman Roth and members of the Committee for this opportunity to tell you my story. Please excuse my English—I will do my best to be clear.

My name is Svetlana Pejanovic. I came to the United States from the former Yugoslavia in 1980 on a student exchange program. I was only 23 and spoke no English. Now, 18 years after my arrival in this great country, I am on the verge of losing everything that I have ever worked for. My salary has been garnished, and the Internal Revenue Service (IRS) has placed a lien on my home. One evening just last month, an IRS collection officer came to my home, unannounced, wanting to seize all of my personal belongings.

I will now provide you with some background on me and how I arrived at this point. I married an American citizen in March of 1982. For the 4 years I was married to him, my husband asked me to sign joint income tax returns. Because this type of tax did not exist in Yugoslavia. I relied on my husband to do the correct thing since he was familiar with such requirements in the United States. Our marriage did not last and we separated in 1986. I did not receive any financial help, at all, from him after the divorce.

After that experience, I filed my own tax returns under the guidance of my former husband's accountant. I was able to purchase a modest apartment for myself and worked hard to pay my mortgage.

At the end of 1993, I received a phone call from the IRS telling me I was in serious trouble as I owed over two hundred thousand dollars for back taxes from over a decade before when I was married to my husband. I was absolutely shocked. I was totally honest with the IRS officer during this telephone call and provided both my home and work address, and stated to him that I owned the condominium in which I lived.

Immediately after this phone call a lien was placed on my home. I called my former husband about all that had taken place and he assured me that he would take care of the problem. I still trusted him since he was the one who handled all our finances while we were married. Roughly 3 months after he assured me the problem would be resolved, I received an extremely embarrassing call from my company's payroll department informing me that my pay would be seized within 2 days unless I could make a "deal" with the IRS. It was only after I informed my former husband of this problem that he confessed that he had, in fact, been receiving mail from the IRS—addressed to both of us—for years.

My former husband, the accountant we both had retained, even others at my former husband's company, all knew about this problem. They never told me! My former husband even admitted to me that he really did not think the IRS would ever go after me. He claimed he had no money for lawyers and that I was the stupid one for co-cooperating and being open and honest with the IRS! At this point he had now gone back to his former wife and had placed all his assets in both her name, and his children's names.

Gentlemen almost 16 years after my failed marriage, my former husband is of no interest to the IRS for actions he alone is responsible for. Yet as his former wife—not current but former—I continue to be the target of the IRS' collection effort for the taxes he owes. In fact, as recently as 3 weeks ago this past, Monday, the IRS seized my checking account as well as my personal retirement account! Is it my fault that my former husband was faster at disposing of his assets than the IRS was in collecting from him? Am I to continue to be the victim of the IRS' rage? Senators, my former husband is living in a home with his family and has an income.

Why doesn't the IRS go after him for the taxes he owes? Are they coming after me because I can't fight? Maybe I am just an easy target.

I contacted a lawyer who advised me that I had 3 options to choose from given my situation (1) bankruptcy; (2) an offer in compromise; or (3) filing an innocent spouse petition. He claimed bankruptcy was the easiest and cheapest way to resolve the problem I responded, ". . . but I'm not guilty of anything!" I told him I would NEVER declare bankruptcy—to do so was against my principles' He then suggested I should stop working altogether until I solved this problem. After the lawyer charged me thousands of dollars and provided no solution. I turned to an accountant who was a former IRS employee. For years he argued with the IRS that I should be "let off the hook" since I had never received, seen or known about any IRS notices that had been sent to my former husband, and he insisted the statute of limitations had run out. Regrettably this argument went nowhere. Friends and colleagues urged me not to fight the system. They told me not to fight the IRS but simply declare bankruptcy and to get on with my life.

Just last year a lawyer informed me that the facts of my case made me a "classic" innocent spouse but, in order to prove this in court, I was told I would have to put up the entire amount of money the IRS claimed I owed based on my former husband's bungled finances. Senators, the amount by then was roughly $300,000 doubt if any of you can tell me how I can defend myself against the IRS. Alone, I am no match emotionally, or financially. against their power.

Senators, I left a communist country in Eastern Europe many years ago to study in the United States and enjoy, even for a short time, the freedoms democracy bestows on its citizens. Today, I am still thrilled to be able to live and work in this great nation. However, I must tell you that the actions of the IRS against me were not unlike actions that took place in my former communist homeland. To me, the IRS is too powerful and is responsible to no one. They do not care who they hurt, or how they get their money. Do not be mistaken. I am willing to pay taxes—as I have been for all these years—to support this great nation but the way the IRS has gone after me for them is simply not fair.

I am so grateful to be able to appear before the United States Senate to tell my story. My hope is that by doing so will be, in some small way, helpful to you as well as the many women who may be watching this today who, themselves, have been overpowered by the IRS.

Thank you.

PREPARED STATEMENT OF HON. ROB PORTMAN

Thank you, Chairman Roth and Members of the Committee, for allowing me to testify today. As you know, I served as co-chairman of the National Commission on Restructuring the IRS along with your colleague and a respected Member of this Committee, Senator Bob Kerrey. His vision, creative ideas and commitment to reform were key to producing the comprehensive Commission recommendations and the legislation to implement them. And, another distinguished Member of this panel, Senator Charles Grassley, was an active member of the Commission and made valuable contributions to our work and final report, especially in the area of taxpayer rights.

The Restructuring Commission was created by Congress and charged with "auditing the IRS" for the first time since 1952. We rolled up our sleeves, spent a year looking at the problems of the agency, conducted an extensive series of public hearings, and, last June, came up with a comprehensive plan to create a new IRS—more responsive to taxpayers and more respectful of their rights. In July, Senators Kerrey and Grassley and Congressman Ben Cardin and I introduced legislation to implement the major reforms embodied in the Commission's recommendations—legislation that was the subject of extensive hearings before the Ways and Means Committee and that passed the House by a vote of 426 to 4. But it was this Committee's hearings last September that focused all of America on the need to fundamentally reform this troubled agency, and for that, Mr. Chairman, this Committee deserves the gratitude of the Commission members, the Congress and, most importantly, the American taxpayer. I commend this panel for using the House-passed bill as the foundation for your reforms. I know I speak for Chairman Archer, Congressman Cardin and others in the House in saying that we are eager to work with you as partners in improving our bill and getting this legislation to the President as soon as possible this year.

A number of questions were raised yesterday regarding the House-passed legislation, and I would be happy to try to respond to them. But first, I would like to discuss briefly a couple of the difficult issues that this Committee will be considering.

As you have rightfully pointed out, Chairman Roth, we'll only have one shot at IRS reform in this Congress, so it's important to ensure that the IRS reforms we enact are comprehensive and sustainable. That's why the IRS Oversight Board we have proposed is so important. Long after these important hearings have ended, and the cameras and reporters have gone on to other stories, Congress and the American taxpayer should know that there is a mechanism in place to hold the IRS' feet to the fire—a mechanism that provides ongoing oversight with expertise, continuity and accountability.

The Oversight Board's role, simply put, is to guide the development and oversee the implementation of long-term strategies at the IRS—a function that is sorely lacking now—and to hold IRS management accountable for its performance. In my view, to be effective, the Board must focus on the "big picture" strategic issues and allow the Commissioner to be responsible for the day-to-day operations of the IRS. The Oversight Board's job is to ensure that the train is running in the right direction and on time, not to micromanage the conductor. As envisioned by the House-passed legislation, the Oversight Board is focused on strategic tax administration—it is not intended to get into specific tax cases.

The withholding of Section 6103 authority from the Board was deliberate, and it was done for two reasons. First, it serves to prevent actual or perceived conflicts of interest for board members. This is important for a number of reasons, but one of my concerns is that the potential for such problems may make it difficult to attract the kind of people we would want to serve on the Board.

Second, the lack of 6103 authority will also keep the Board focused on the big picture problems of the IRS and prevent it from becoming mired in individual tax matters. There may be a way to grant something short of blanket 6103 authority to the IRS Oversight Board, without permitting access to individual taxpayer information.

Finally, I would like to commend Chairman Roth and the Members of this Committee for their strong endorsement and confirmation of Charles Rossotti as Commissioner of the IRS. As I believe you witnessed in this hearing room yesterday, he brings the kind of credibility, expertise and new ideas that are clearly needed to guide the IRS out of these troubled waters.

The plans he unveiled before this Committee yesterday for a comprehensive modernization of the IRS—focusing on helping people comply with the tax laws and ensuring fairness of compliance—are exciting and entirely consistent with the House-passed bill. Essential to this concept is designing, organizing and measuring the work of the IRS around major taxpayer groups with similar needs. I support this concept, which was recommended by the Restructuring Commission, and Mr. Rossotti deserves credit for moving forward to implement it. But, in order to be truly successful in his task, Commissioner Rossotti must have the expanded authority and the personnel flexibilities that the restructuring legislation would give him, and a strong Board to enhance and support the bold reforms that must be driven all the way through this agency.

The era of big government may be over, Mr. Chairman, but we must now redouble our efforts to create more efficient and responsive government. The IRS, in its current form, represents the worst of impersonal, antiquated and inefficient Washington bureaucracy. Meanwhile, the private sector has redefined the standards of customer service over the last two decades, delivering world class products and responsiveness while achieving new levels of efficiency. We should expect no less of the IRS as we enter the 21st Century. Congress has a responsibility to give the IRS the tools and oversight it needs to get the job done. I commend you again for moving legislation forward to do just that, and look forward to working with you in the weeks ahead to provide this needed relief to taxpayers as soon as possible.

PREPARED STATEMENT OF MARGARET MILNER RICHARDSON

Chairman Roth and distinguished members of the Committee. I appreciate the opportunity to join you today to share some of my thoughts about restructuring the operations of the Internal Revenue Service, as well as some of my thoughts about the provisions in the Internal Revenue Service Restructuring and Reform Act of 1997 (H.R.2676) passed by the House last fall. I commend you and your Committee, Mr. Chairman, for carefully considering the issues and various proposals for restructuring and reforming the Internal Revenue Service. I believe it is important to take the time to weigh the potential impact of these proposals on the future of tax administration and on our self-assessment tax system.

I am currently a partner at Ernst & Young, LLP. From 1993 to 1997, I served as Commissioner of Internal Revenue. Those four years marked a period of great change as well as significant accomplishment at the Internal Revenue Service, al-

though I would be the first to tell you that there was more that needed to be done. We set ambitious goals to improve service to taxpayers by providing more ways for them to obtain accurate and timely information, file returns and make payments. We were also addressing concerns expressed by many of you and your colleagues in the House of Representatives about eliminating refund fraud, particularly in the Earned Income Tax Credit program, closing the so-called "tax gap," decreasing the accounts receivable, and improving compliance levels. In other words, the IRS tried to improve service to taxpayers, while at the same time improving compliance—not an easy task at any time, but especially not during a period of shrinking resources.

I began my career in the Chief Counsel's Office of the Internal Revenue Service in 1969. At the time I left for the private sector in 1977, I held the highest management position in the Chief Counsel's Office. Managing at that time in the public sector was often challenging and sometimes frustrating, largely because of a budget process that inhibited long range planning and personnel rules that did not always permit an agency to hire the best person for the job nor provide the flexibility to reward those who performed well.

When I returned to the IRS as Commissioner almost 25 years later, I found some of the same people, some of the same systems and many of the same issues. Managing in the public sector was still challenging, but even more frustrating. Not only had the Internal Revenue Code grown lengthier and more complex, but the Internal Revenue Service had also been asked to shoulder responsibilities beyond just collecting taxes. In addition, everyone attempting to manage in the federal sector was struggling with the sometimes conflicting requirements of the Federal Managers' Financial Integrity Act, the Chief Financial Officers Act, the Government Performance and Results Act, the Paperwork Reduction Act, the Debt Collection Improvement Act, and the 1974 Congressional Budget Act (to name a few).

It was also clear that the resources available to the IRS would not continue to expand as they had throughout the 1980's and that significant change in the way the IRS was organized and did business would be essential in order to provide efficient, effective, high quality tax administration. I found a number of employees who were concerned about finding ways to provide better service to taxpayers. They wanted to be better trained and better resourced so they could provide better service while enhancing compliance levels.

Although there was a desire to implement change and many at the IRS spoke the language of change, often they did not have the training, tools, and resources to implement change. There was also a certain skepticism, and at times even cynicism, about whether or not change could be effected or that a consensus among the overseers could be reached on what kind of change should be undertaken. That was why many of us at the IRS welcomed the creation of the National Commission on Restructuring the Internal Revenue Service and looked forward its report. We believed that the Commission could examine a number of issues in a bipartisan atmosphere and that the recommendations would be taken seriously because of the stature of the Commission members.

One of my privileges as Commissioner was to participate as an ex officio member of the Commission. The Commission examined many aspects of the IRS and its operations; the IRS provided extensive material to the Commission and unlimited access to IRS employees. The work of the Commission and its Report issued in June, 1997, formed the basis for H.R. 2676 and its Senate companion S. 1096.

IRS Mission and Governance

The subject that has captured the most attention in connection with discussions about restructuring and reforming the IRS has been that of governance. The specific focus has been whether or not there should be an Oversight Board with private sector members, and, if so, what authorities and responsibilities such a body should have.

I do not believe that there is any one form of organization or governance that is perfect—whether it be for the Internal Revenue Service or any other organization. Nor do I believe that there is any one form of organization that will cause all of the concerns about the IRS—real and/or perceived—to evaporate. We have all heard repeatedly during the past year about the "problems" of the IRS, that they were a long time in the making, and that those problems would take a long time "to fix." What those "problems" are must be identified with enough specificity so that the steps necessary to "fix" them can be specifically identified. Some of the problems at the IRS are no doubt present in any large organization; some of the same problems are present in many other government agencies; and some of the problems relate to the complexity of the Code that the IRS is charged with administering. You in the Congress—the elected representatives of the American people—must decide what you want to achieve through any reform and restructuring of the IRS. Your

task is to identify those problems which can be fixed and try to identify the organizational structure and the changes that will most likely produce the fixes.

It is also imperative that there be agreement among all of the various interested parties, particularly in the Executive branch and the Congress, what the mission of the IRS should be. The current Mission Statement of the IRS provides:

> The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

If you as our elected representatives are not satisfied that this statement properly reflects the mission of the Service, then you should change it. Once there is agreement about the mission of the IRS, then there must be agreement about the governance and organizational structure most likely to accomplish that mission. Ideally, such a structure would be so streamline that there would be clear lines of authority and accountability throughout the organization, from the top all of the way to the front line employee.

The goal of the proposal that Commissioner Rossotti discussed with this Committee yesterday for restructuring the IRS is intended to do just that. That proposal deserves very careful consideration—something I am certain the Congress will give it. The Commission considered such an approach, but did not have time to fully explore it, and recommended that it be given further consideration. Obviously, without more details about the Commissioner's proposal, it is difficult to predict whether that proposal will accomplish its intended goals. What I can predict with reasonable certainty is that any new organizational structure without the right kind of talent to perform the organization's mission will have little chance of success. Without maximum personnel flexibilities so that the best qualified people can be recruited, trained, and retained, any new structure will fail. In addition, without stable funding and focused, consistent, and constructive oversight, a new organizational structure will have little success.

For those reasons, I strongly support the provisions in the House bill that would provide stable funding and coordinated Congressional oversight. There is also a provision that restricts GAO audits and investigations so that there will be close coordination of all GAO audits to prevent duplicate and overlapping investigations. Those restrictions should also apply to GAO audits that are ordered by Committee and Subcommittee Chairs and Ranking Members. In addition, section 7217 of the House bill prohibiting certain Executive branch employees from requesting the IRS to conduct or terminate an audit or investigation of any particular taxpayer should be expanded to cover the Legislative branch as well.

IRS Governance and Organization

Under H.R. 2676, the IRS would continue as a bureau of the Treasury Department, but the legislation provides for the establishment of an IRS Oversight Board comprised of 11 members, eight of whom would not be federal government employees. The remaining Board members would be the Secretary of the Treasury (or Deputy Secretary, if designated by the Secretary), the Commissioner of Internal Revenue, and a representative of an organization that represents a substantial number of IRS employees, currently the National Treasury Employees Union (NTEU).

Under the House bill, the Board would have no responsibilities or authority with respect to the development of federal tax policy, IRS law enforcement activities, and specific IRS procurement activities. The Board would have specific authority to:

- review and approve IRS strategic plans, including the establishment of mission and objectives;
- review the operational functions of IRS, including plans for modernization of the tax system, outsourcing or managed competition, and training and education;
- review (but not approve) the Commissioner's selection, evaluation, and compensation of senior managers;
- review and approve the Commissioner's plans for major reorganization of the IRS; and
- review and approve the Commissioner's budget request and ensure that the request supports the annual long-range strategic plans of the IRS.

The Commission originally recommended a seven-member Board with more authority than that provided in the House Bill. The Commission envisioned a Board with broad general powers to "oversee the IRS in the management, administration, conduct, direction, and supervision of the execution and application of the internal revenue laws." In addition, the Commission would have charged the Board with certain specific powers, including the power to select, appoint, evaluate, and remove

the IRS Commissioner and to review and approve the selection, evaluation, and compensation of senior IRS managers.

While I agree with the change made to leave the power to appoint and remove the Commissioner with the President, I hope that in addition to carefully considering Commissioner Rossotti's proposal for reorganizing the IRS that this Committee will carefully focus on what the governance structure of the IRS should be. One approach considered by the Restructuring Commission, but not pursued because of concerns about its political feasibility, was whether the IRS should be an independent agency, perhaps like the Social Security Administration, with the Commissioner reporting to a governing board overseeing the agency's operations. In my opinion, such an approach could provide the most effective and least cumbersome governance structure for the agency. Such a structure, coupled with oversight, budget, and personnel reforms could make a significant improvement in the ability of the Service to carry out its mission more effectively and efficiently. An independent agency with cabinet-level status would also provide an advantage in recruiting and retaining top quality personnel.

The IRS performs a unique function and should be treated uniquely. It is in effect the government's "profit center," but currently it is subject to the discretionary budget caps. In the appropriation process, the IRS is often treated as "just another spending program" where it is forced to compete for resources with other programs that have far more political appeal.

I cannot overemphasize the importance of stable funding sufficient to carry out the IRS mission. The IRS is responsible for collecting 95% of all federal revenues and for enforcing the nation's tax laws. In addition, the IRS has been charged in recent years with other, non-tax responsibilities ranging from enforcing child support payments to money laundering statutes. The lack of stable and sufficient funding directly affects the IRS's ability to provide quality service to taxpayers and directly affects the IRS's ability to enforce the tax laws. Providing quality service to taxpayers, while continuing to enforce the tax laws is vital to our self assessment system.

Making the IRS an independent agency also would allow the IRS Commissioner to be an independent voice for tax administration concerns. The Treasury Department has an Assistant Secretary for Tax Policy who serves as the chief advocate for tax policy views, but there is no equivalent advocate for sound tax administration. I am convinced that the lack of such high level attention to tax administration concerns has contributed to the high degree of complexity in our current tax system. For that reason, I wholeheartedly support section 421 of the House bill which indicates that the IRS should provide an independent view of tax administration to Congress about the administrability of proposed tax law provisions.

I realize that establishing the IRS as an independent agency may not be politically feasible at this time, but I urge this Committee to give serious consideration to that approach. Short of making the IRS an independent agency, and if you determine that an Oversight Board is an appropriate form of governance to improve the efficiency and quality of tax administration, then I believe that the responsibility and authority of the Board cannot be ambiguous. As I read the House bill, the authority and responsibility of the Oversight Board is ambiguous and appears to overlap the authority and responsibility of the Commissioner. The Board has no authority to run the IRS and would have insufficient powers to hold the IRS Commissioner and senior IRS executives fully accountable for achieving the IRS's strategic goals. The only real authority bestowed on the Board appears to be to review and approve the annual strategic plan and any major IRS reorganization.

It is vital for Congress to be clear about what it wants the role of the Oversight Board to be. If you want an Oversight Board to run the agency, you should expressly give it the authority it needs. If you want a Board to serve an advisory function, then you should be explicit that its role is merely advisory. The most difficult situation from the standpoint of the agency would be to provide a Board with an ambiguous role. The Board can be effective only if its role is clear.

One issue not covered by the House bill that I think should be addressed by this Committee involves the Office of the Chief Counsel. Currently the Chief Counsel is an Assistant General Counsel of the Treasury Department, and the Office of the Chief Counsel is not a part of the IRS organization, although the funding for the Office comes from IRS appropriations. The Office of the Chief Counsel should be a formal part of the IRS organization and report to the Commissioner. It is an anomaly for an organization's lawyer not to be responsible to its client. That is the norm in the private sector, and, except for the IRS, I believe it is the norm in the federal sector. If a reorganization such as that suggested by Commissioner Rossotti were to proceed, then it would be even more important for the Chief Counsel's Office to

be part of the IRS organization, so the organization could be aligned with each of the IRS' major business units.

Appropriate Oversight

Intertwined with consideration of how the IRS should be governed are questions about the appropriate form and amount of oversight. The IRS is currently subject to both external and internal oversight. The Office of Management and Budget and the Department of Treasury provide oversight within the Executive branch, while in the Legislative branch oversight is provided by three Committees in the House (the Ways and Means Committee; the Subcommittee on Treasury, Postal Service and General Government Appropriations; and the Committee on Government Reform and Oversight) and three committees in the Senate (the Finance Committee; Subcommittee on Treasury, General Government, and Civil Service Appropriations; and the Governmental Affairs Committee), as well as the Joint Committee on Taxation. Congressional committees also provide oversight from time to time, and the General Accounting Office routinely provides oversight on behalf of the Congress. The Restructuring Commission undertook a comprehensive review of the IRS, and the press, practitioners, and the general public perform oversight as well.

To give you some idea of the levels and types of oversight the Service regularly receives, during my four years as Commissioner, the IRS testified at 60 hearings and was the subject of more than 140 GAO reports. Internally, the IRS' Internal Audit Function under the Chief Inspector, who reports directly to the Commissioner, initiates its own studies and audits. The results of these studies and audits are reported to IRS management and to the Treasury's Department's Inspector General, who, in turn, reports them to Congress. In addition, the Taxpayer Advocate, who also reports to the Commissioner, is required to submit a "report card" for the IRS and Congress each year.

I am a strong supporter of constructive oversight. I believe such oversight is absolutely essential for all government agencies, but particularly for the IRS, since our self-assessment system relies heavily on taxpayers' confidence in how that system is run. I urge this Committee to seriously examine what level of oversight would be appropriate.

The Committee also should be mindful when fashioning the role of the Board that when there is more than one overseer, conflicting priorities and direction are inevitable. Establishing priorities is made more difficult when the various oversight bodies do not agree. For this reason, I believe that the provisions in the House bill designed to better coordinate Congressional oversight of the IRS are critically important. While each of the Congressional committees responsible for IRS oversight has a shared interest in improving IRS operations, they typically act independently and frequently establish conflicting priorities for specific IRS actions.

The challenge that this creates for the IRS is exemplified by the way various Committees responded to the growth in the IRS's Accounts Receivables Dollar Inventory, the inventory of accumulated delinquent taxes owed by individuals, corporations and other taxpayers.

Over the period from 1990 to 1995, the IRS accounts receivables inventory grew from about $90 billion to $200 billion. (It is important to note that a large portion of this rapid growth was attributable to specific causes, such as the increase in the statute of limitations on tax collections from six to 10 years, the crisis in the savings and loan industry in the late 1980s and early 1990s, and provisions in the Chief Financial Officers Act of 1990 which mandated the IRS to include accrued interest and penalties in the inventory beginning in 1991.)

Concerns about this rapid growth prompted both the General Accounting Office and the Office of Management and Budget to identify accounts receivables as a "high risk" area for the IRS. In response, the FY95 Treasury, Postal Service and General Government appropriation included $405 million in funds for the IRS to hire additional collection personnel for what was to have been a 5-year $2 billion "compliance initiative" designed in part to increase collection of delinquent taxes.

During the first year of the initiative, the IRS collected an additional $803 million in taxes, more than double the amount expected. Despite this successful beginning, the compliance initiative was canceled the following year, and IRS budget resources were also reduced from the previous year. In addition, the FY 1996 appropriation directed the IRS to use $13 million to conduct a pilot project using private collection agencies to secure delinquent tax debt. During this same period, however, other Congressional committees were increasingly concerned about service to taxpayers particularly telephone service (although no monies for expanded service were appropriated). I cite this to illustrate how the IRS can be whipsawed between the conflicting priorities established by the various Congressional committees with IRS oversight jurisdiction.

If the effort to reform the IRS is to succeed, Congress must better coordinate and rationalize the demands that it places upon the Service. The House bill would address this issue by requiring two annual joint IRS oversight hearings consisting of two majority and one minority member from each of the Senate Committees on Finance, Appropriations, and Government Affairs, and the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight. The purpose of the first hearing would be to review IRS strategic plans and budget resources. The purpose of the second hearing would be to review the IRS's progress in meeting its strategic objectives, the improvement in taxpayer service and compliance, its progress on technology modernization, and the annual filing season.

I think it would be beneficial to the oversight process to assemble the senior members from each of the appropriate Committees twice a year in the same room at the same time to hear the same information and have an opportunity to question the Commissioner and IRS representatives about IRS programs and operations. In the long run, I believe this will reduce the risk of the IRS being subjected to conflicting priorities and facilitate discussion and better coordination among the Congressional Committees.

Ethics Restrictions on Board Members

Another issue the Committee should consider carefully is the ethical and conflict-of-interest restrictions that would be applied to the private sector members of the Oversight Board. While it is vitally important to include measures that are designed to avoid potential conflicts of interest, it is also important that the ethics standards that come with service on the Board be commensurate with the Board's actual authority.

Under the House bill, the private sector members of the Board would be treated as "special government employees" under Title 18 U.S. Code sec. 202, but with an important exception. The Board would be treated as serving continuously for 365 days a year. This apparently means that the private sector members of the Board would be prohibited from representing clients on specific matters before the Treasury Department and the IRS and from representing clients in litigation against the Treasury and IRS. My understanding is that the private sector members of the Board would also be subject to a one-year post-employment ban on contacting Treasury or the IRS, and would be required to make public financial disclosure.

While these ethics requirements would be entirely appropriate for a Board which is fully empowered to govern the IRS and hold the Commissioner and senior executives accountable, they may not be appropriate to apply to members of an Oversight Board whose powers are only advisory in nature. Thus, the decisions that you make about what level of authority to give the Board with respect to IRS governance should be accompanied by thoughtful consideration of what ethical restrictions are appropriate to the Board's actual level of authority and the perceived risk of conflicts of interest.

The Oversight Board's ability to effectively guide the IRS through the difficult changes to come will directly depend on the quality of its members. If there is a significant mismatch between the authority the Board would wield and the ethical restrictions imposed on the private sector members, this could potentially affect the willingness of high quality people to serve on the Board. I worry whether individuals with the skills and expertise to make a real contribution to the IRS would be willing to subject themselves to high level ethical restrictions and public financial disclosure in order to serve on a Board without any.

I would also suggest that you make explicit whether the proceedings and activities of the Oversight Board are covered by the Freedom of Information Act, the Government in Sunshine Act, and the Federal Advisory Committee Act. The House bill's silence with respect to this issue has created some confusion as to whether the House intended for these statutes to be applicable.

Personnel Flexibilities

One of the most critical issues facing the IRS is how to recruit and retain a workforce with the competencies and skills to accomplish the mission it is and will be asked to perform.

The Commission recommended that Congress, the IRS and the proposed Board of Directors make training, skills, and support of IRS personnel a priority. Further, the Commission recommended that the IRS place as high a priority on employee training and skills as it places on the filing season. The House bill contains a package of personnel flexibilities which help somewhat in this regard, but their effectiveness will be limited by the fact that members of the union, probably seventy-five to eighty percent of the workforce, are exempt from the bill's personnel flexibilities provisions. This is a major shortcoming which I urge the Committee to correct.

Taxpayer Bill of Rights 3

There are a few points about the proposals in the Taxpayer Bill of Rights 3, which was part of the House passed legislation about which I would like to comment.

Burden of Proof

The House bill includes a proposal that would shift the burden of proof to the government in any court proceeding with respect to any factual issue if the taxpayer asserts a reasonable dispute with respect to such issue, and if the taxpayer has fully cooperated with the Secretary, including providing within a reasonable amount of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the Secretary. Under this proposal one necessary element of "fully cooperating" is that the taxpayer must exhaust his or her administrative remedies. Also, the taxpayer must meet certain net worth limitations that apply under current law for purposes of awarding attorney's fees.

I am in full agreement with the comments that the Chief Judge of the Tax Court, Mary Ann Cohen, made in a December 19 letter to Sens. Roth and Moynihan. Judge Cohen commented that the proposed change could encourage duplicate proceedings, where the Tax Court would have to decide whether the taxpayer is asserting a reasonable dispute, whether the taxpayer fully cooperated with the Secretary within a reasonable amount of time, and whether the taxpayer met the substantiation requirements. She rightfully pondered what this change might mean in terms of time and resources expended by the parties involved and by the Court.

I do not disagree with the fundamental fairness of asking the IRS to prove its case against a taxpayer—provided, of course, that the Service has full access to all of the documentation in the taxpayer's control that would be necessary to determine the accuracy of the tax return. However, I seriously question whether the formulation of the shift in the burden proposed in the House bill will be of sufficient benefit to taxpayers to warrant the significant added complexity and costs associated with requiring the Tax Court to make a whole new set of factual determinations.

The Committee should look carefully at all the implications that could result from making such a change. It might be prudent for this Committee to dedicate a separate hearing to this proposal, with a discussion of the cumulative effect on tax administration and on taxpayer burden of making this change in conjunction with other proposals contained in the bill.

Extension of Privilege

The House bill provides that the present law attorney-client privilege be extended to cover tax advice that is furnished by an individual who is authorized to practice before the IRS. The government has historically not supported the expansion of privilege in civil tax proceedings, because the IRS wants to maintain the ability to access all memos, records, and documents. A position I also supported as Commissioner.

I understand that some taxpayers, however, may look at privilege as an issue of fairness. They cannot understand why tax advice provided by one tax advisor is treated differently from tax advice provided by another advisor. The Committee will have to weigh competing concerns. On the one hand the IRS has a strong interest in having access to any information that might be relevant to the taxpayer. On the other hand, taxpayers understandably want to provide the IRS only the information necessary to ascertain the correctness of their returns. They also want to choose their tax advisors without worrying about whether the advice they receive is protected by privilege.

Study of Penalty Administration

The House bill would require the Joint Committee on Taxation staff to conduct a study reviewing the administration and implementation of the overall civil penalty structure, which was reformed in 1989. The study would review the administration and implementation of the 1989 penalty provisions and make any legislative and administrative recommendations as appropriate to simplify penalty administration and reduce the burden on taxpayers.

The civil penalty structure is in need of serious review and simplification. I expressed concerns as Commissioner, concerns I believe you share Mr. Chairman, about the complexity of the civil penalty regime. I commend the House for including this in the bill, and I urge its support in the Senate.

Electronic Filing of Tax and Information Returns

The House bill contains a provision that requires the Treasury Department to establish a plan to promote electronic filing of tax and information returns, with a goal of limiting paper returns to 20% of all returns by 2007. The proposal requires

that the Secretary establish a plan to eliminate barriers, provide incentives, and use competitive market forces to increase taxpayer use of electronic filing.

As I did when I was Commissioner, I fully support the effort to promote electronic tax administration, and I continue to encourage any steps that would enhance completely paperless electronic filing and paperless tax administration. While I was Commissioner, the service issued Rev. Proc. 97-22 which provided for electronic maintenance of books and records. I suggest that the Committee consider eliminating the current barrier that exists with respect to electronic document and retention requirements.

The current IRS document retention requirements will not allow complete conversion to an electronic system because the regulations require retention of paper tax returns with the original preparer destruction of the original hard copy of books and records, provided they are electronically stored, but the tax return itself and attachments still must be retained in hard copy. This seriously hinders a move to a completely electronic filing system for no apparent purpose.

This road block can be easily removed by legislation that allows a scanned or electronically maintained copy of the originally signed tax return to meet the document retention requirements that already apply to electronic storage of records.

Conclusion

I doubt that I need to remind you that tax collectors have never been popular—at least in recorded history. As long as there is a need to raise federal revenue, I believe that there will be a need to have an agency to perform that vital government function.

There is every reason to have serious discussions about what our tax collection agency should be like, and I hope that I have added to that discussion today. I want to leave you with one final thought: the type of tax system we have affects what the tax administration agency looks like. The issue at the top of everyone's list when discussing the tax system is the ever growing level of complexity. As our society and the economy have grown more complex, so has the Internal Revenue Code. The agency and its personnel should not bear the blame for complexity in the law. I urge the Congress to continue examining the causes for complexity and to seriously pursue legislative simplification of the Internal Revenue Code.

Thank you for the opportunity to present my views. I would be happy to respond to any questions.

RESPONSES TO QUESTIONS SUBMITTED BY SENATOR ROTH

STRENGTHENING OVERSIGHT

Question 1. Should the Inspection Division be more independent? Should the IRS Inspections Division be transferred to the Treasury IG?

Answer. I am not certain what is meant by "more independent," but any change in the organizational placement of the Inspection Division should be given careful consideration. At the present time, the Chief inspector reports to the Commissioner, and the Inspection organization froth Internal Audit and Internal Security) in that sense is independent of the rest of the IRS organization. The question that I believe needs to be asked and answered is what role the Inspection organization should play in the IRS. by the answer is that Inspection should provide the Commissioner with the requisite information and insights to oversee and evaluate programs and to promote employee integrity, then the salient issue is not the "independence" of Inspection, but its ability to attract and retain high quality employees. Transferring Inspection to Treasury will not enhance its ability to attract and retain high quality employees.

Question 2. One of the most important lessons learned from the Committee's oversight hearings last September is the need for greater oversight of the IRS. The Congress needs to do more oversight—which we intend to do. But also there must be more oversight of the IRS in the Executive Branch. There are, at least, two ways we can improve that oversight. The first is to vest significant oversight responsibility with the Oversight Board that is created in the House-passed bill. The second way is to substantially increase the power of the Treasury Inspector General. What are your views on both of these ideas?

Answer. In my opinion, the problem is not that there is too little oversight of the IRS. The problem is that the oversight that does occur is uncoordinated and frequently ineffective. As I pointed out in my prepared testimony to the Committee, the IRS is currently subject to both external and internal oversight. The Office of Management and Budget and the Department of Treasury provide oversight within the Executive branch, while in the Legislative branch oversight is provided by three Committees in the House (the Committees on Ways and Means, Appropriations

(Subcommittee on Treasury, Postal Service and General Government, and Government Reform and Oversight) and three committees in the Senate (the Committees on Finance, Appropriations Subcommittee on Treasury, General Government, and Civil Service, and Governmental Affairs), and the Joint Committee on Taxation. Other Congressional committees also provide oversight from time to time, and the General Accounting Office routinely provides oversight on behalf of the Congress. The Restructuring Commission undertook a comprehensive review of the IRS, and the press, practitioners, and the general public perform oversight as well.

During the four years I served as Commissioner, the IRS testified at 60 hearings and was the subject of more than 140 GAO reports. Within the IRS, the Internal Audit Function under the Chief Inspector, who reports directly to the Commissioner, initiates its own studies and audits. The results of these studies and audits are reported to IRS management and to the Treasury's Department's Inspector General, who, in turn, reports them to Congress. In addition, the Taxpayer Advocate, who also reports to the Commissioner, is required to submit to Congress each year a "report card" for the IRS.

I strongly support constructive oversight. Such oversight is absolutely essential particularly for the IRS, since this country's self-assessment system relies heavily on taxpayers' confidence in how that system is run. However, this Committee should focus on how to improve the coordination of oversight of the IRS and ways to assure more effective oversight rather than adding more layers of oversight.

Conflicting oversight priorities and direction are inevitable when there is more than one overseer. Establishing priorities is made more difficult when the various oversight bodies do not agree. For this reason, I believe that the provisions in the House bill designed to better coordinate Congressional oversight of the IRS are critically important and should be enacted.

The outside Board should not have additional oversight responsibility; its responsibilities should be limited to providing strategic guidance. (I suggest that "Oversight" be dropped from the Board's name and "Governance" be substituted.)

Question 3. Is the Oversight Board created in the House bill an executive board, or merely advisory? Does the Board have legal authority to direct actions taken by the Commissioner?

Answer. As proposed in the House bill, the Board is neither an advisory board nor an executive board. While it has some legal authority to hold the Commissioner accountable for certain aspects of IRS management, it does not have full legal authority to govern the agency. As conceived by the National Commission on Restructuring, the Board was never intended to be involved in the day-to-day management of the agency. Rather, the Board was to bring both expertise and consistency of direction to the IRS's long-term strategic planning process and to help ensure that the IRS both received sufficient resources to fulfill its strategic mission and deployed those resources appropriately. As the Commission noted, many of the key issues that need to be addressed in order for the IRS to better serve the needs of taxpayers (e.g. reengineering its business processes, modernizing its information technology, revamping performance measures, etc.) will require expertise, commitment and long-term focus. The Commission believed that a Board consisting largely of experts from the private sector would help focus the attention of senior executives, Congress and the Administration on the agency's long-term strategic needs. From this perspective, it seems immaterial to me whether the Board has actual legal authority over some IRS functions, or whether its authority is merely advisory. The point is to bring additional expertise to bear on the challenges facing the agency.

Question 4. If the Oversight Board is created and Commissioner Rossotti is able to turn the agency around, should the Board be sunsetted?

Answer. It is not clear how one would measure "turning the agency around" in order to judge whether the Board has fulfilled its mission. Therefore, I would reserve any judgment about the wisdom of sunsetting the Board.

PROTECTING THE TAXPAYER

Question 5. Our hearings have also indicated a need for the Committee to consider protection for the taxpayer in a number of very specific areas.

(a). What are your thoughts on changes the Committee ought to consider in the penalty and interest area?

Answer. Interest and penalties serve different purposes. Interest is a charge for the use of money; it is intended to compensate taxpayers or the government for money owed either to or by the taxpayer. It is not intended to penalize, although it is often perceived that way.

Penalties should be imposed to affect behavior and encourage compliance. In recent years, a number of penalties have been enacted or increased primarily by a de-

sire to raise revenue, rather than to encourage compliance. Penalties should be clear and understandable. Fundamental penalty reform has not been undertaken in almost a decade; the current penalty regime needs to be subjected to a thorough review with input from taxpayers, tax practitioners, and the IRS, which has to administer penalties.

(b). The Committee's oversight hearings showed considerable problems with the IRS's exercise of its lien, levy, and seizure authority. This has to be fixed. I'm concerned about taxpayers who do not receive real notice and wake up in the morning only to find that the IRS has taken their bank account, business or other assets. Should the taxpayer have a right to judicial hearing before seizure?

Answer. The current procedures governing liens, levies, and seizures contain a number of built-in protections for taxpayers, but adding judicial review of seizures of a personal residence or other significant assets certainly would be appropriate. It is important to distinguish between liens and levies. Currently, a lien for federal taxes arises as a matter of law upon assessment of tax. The primary purpose of filing a Notice of Lien is to establish the federal government 's priority vis-a-vis the taxpayer's other creditors. Therefore, it does not seem necessary or even appropriate to require judicial review before the IRS can file a lien.

(c). The current Offer in Compromise program doesn't seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they get out they are socked with horrendous interest and penalties. Is this program broken? How would you improve it?

Answer. Ironically, the Offer in Compromise program works better today than it has in its many-year history, although that is not to say that some changes are not needed. Considering the time and attention the IRS and various advisory groups have spent looking into the OIC program in the past two years, I recommend that this Committee have the IRS and these advisory groups report on their recommendations before trying to legislate specific changes.

(d). The IRS has the power to label a taxpayer as an "illegal tax protester." Such a label is important for the IRS in its efforts to protect its agent. But such a label also brings serious consequences for the labeled taxpayer. It is important to protect IRS employees. However, our investigation has revealed that some taxpayers may have been labeled as illegal tax protesters merely because they wrote an article in a newspaper. Should there be a review of such labeling to prevent abuse of the labeling system to the detriment of law abiding taxpayers?

Answer. There is a section of the Internal Revenue Manual that discusses "Potentially Dangerous Taxpayers" (PDT), but I am not aware of any official designation of "Illegal Tax Protester." The PDT system has been operated by the Inspection Division since 1984. It involves information gathering on potentially violent taxpayers, a streamlined reporting system enabling employees to make referrals by telephone, and immediate notification to all unctions once a complaint is received. The PDT indicator appears on documents generated to Collection, Examination, Taxpayer Service, and Criminal Investigation personnel. The system provides access to a national database containing details on PDTs, has information based on specific assaults and threats, and has information from other federal agencies and from undercover information about tax protester groups.

The designation of a taxpayer as a PDT must be based upon verifiable evidence or information. It is not subjective. Among the specific criteria are a physical assault against an IRS employee, a threat of bodily harm, intimidation with a show of weapons, and active participation in tax protest groups that advocate violence against IRS employees. Taxpayers who write critical articles in the newspaper are not designated as a PDT by the IRS. Designation as a PDT means that there is a verifiable reason to believe that IRS employees—or other federal law enforcement personnel—who come into contact with these taxpayers could be in physical danger.

After a taxpayer has been designated a PDT for five years, a review is done to determine if the designation should be removed. Taxpayers who have assaulted employees remain in the system until they are deceased. A taxpayer who originally made a threat will be removed if there has been no subsequent incident.

(e). The case of Father Ballweg indicated to all of us the importance of a system that is customer friendly. Shouldn't most correspondence be signed so that the agency personnel are accountable? At some stage in the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. I agree that all individually prepared correspondence should be signed by an IRS employee; the Internal Revenue Manual already contains such a requirement. However, I strongly question whether adding a signature requirement to computer generated notices would be in the best interest of either taxpayers or the IRS. The Service generates in excess of 1 million computer notices each year. Reprogram-

ming IRS computers to include the name and telephone contact of an IRS employee would impose a monumental computer reprogramming burden on the IRS. More importantly, over the past several years, the IRS has invested hundreds of millions of dollars in a telephone call routing system that allows taxpayers with questions to be routed to the next available telephone assistor. This investment was made to improve telephone access for taxpayers and to emulate the best practices in the private sector, where the trend in customer service has been to increase the speed of response to customers. Placing the name and telephone number of a specific IRS employee on every computer generated notice would run in exactly the opposite direction and lead taxpayers to believe that the only person in the IRS who could answer their questions with regard to the notices they receive is the person listed on the notice.

I do agree that at some appropriate point, before a case gets "too old," a "caseworker" should be assigned to resolve it and the name and phone number of that caseworker should be made available to the taxpayer.

Question 6. Should the Taxpayer Advocate and problems resolution officers be independent from the IRS?

Answer. The effectiveness of the Taxpayer Advocate program does not depend on whether Taxpayer Advocate personnel are independent, but rather depends on the quality and attitude of the individuals who serve in those positions.

Question 7. Are you aware of any instances of IRS employees who were abusive to taxpayers or retaliate against other employees who were not disciplined because management believed the disciplinary process is too burdensome?

Answer. I am not aware of any specific situations where employees were not disciplined because the disciplinary process was viewed as too burdensome. However, I am aware of instances involving unauthorized access of taxpayers' accounts (sometimes referred to as "browsing") where management was frustrated in its attempt to discipline employees. Although a clear policy, communication, training, and effective detection are important ways of institutionalizing a policy against unauthorized access, strong disciplinary and judicial support are essential to reinforce the seriousness and consequences of violating the policy. However, in pursuing strong disciplinary actions before administrative tribunals, the results have been mixed, such as with the First Circuit's reversal of an IRS employee's conviction on wire and computer fraud charges because the employee did not intend to deprive the IRS of property and obtained nothing in of value from the browsing (See *United States v. Richard W. Czubinski,* No. 96-1317).

Question 8. The Committee's hearings last September dramatically demonstrated the need to institute greater taxpayer protection. I think we were all very disappointed by the poor performance of the taxpayer advocate's office. The idea, though, of a tax ombudsman-someone who has the knowledge to guide taxpayers and the power to resolve snafus-seems to me to be a good one. On the other hand we should be striving for an IRS where problems are solved right for the first time by the front line agency personnel that deal with the public.

Until we achieve such a happy state, one avenue open to the Committee is to increase the resources devoted to the advocate's office, develop a separate professional career path for the people who work in it, and have the office report to both the Commissioner and the Oversight Board. What is your reaction to that?

Answer. Increasing the resources devoted to the Advocate's office is an excellent idea. Before making any changes to the career path of the people working for the Taxpayer Advocate function, though, I suggest that this Committee assure that any changes are coordinated with other IRS reorganization plans.

CHANGING THE CULTURE

Question 9. Improving oversight and protecting the taxpayer are not the only things we need to be doing to respond to the problems uncovered by the IRS. We need to change the very culture of the agency itself. That will require a complete new look at its organizational structure, its managerial rules, its performance measures, and its training programs.

(a). One of the surprises of the Committee's investigation into the IRS is how fearful many employees are at how they are managed. They paint a picture of the IRS as a vindictive and unhappy place to work. What changes would you like to see in personnel rules and other procedures to change the culture of this organization?

Answer. One of the most critical issues facing the IRS how to recruit and retain a workforce with the competencies and skills to accomplish the mission the agency is and will be asked to perform. The Commission recommended that Congress, the IRS, and the proposed Board of Directors make training, skills, and support of IRS personnel a priority. Further, the Commission recommended that the IRS place as

high a priority on employee training and skills as it places on the filing season. I urge this Committee to study how the personnel rules could be changed so that the people best suited for the job can be recruited and retained. I also believe that this Committee should look into the role the union plays in the culture of the organization. Unfortunately, the Commission did not have time to examine this issue; however, with almost three quarters of the workforce represented by the union, its role in the agency needs to be examined.

(b). There are a considerable number of people who feel that it is not possible to reform the culture of the IRS without dismantling the agency. For these people, a whole new tax system that isn't dependent on a collection agency is the way to go. What is your response to people who, because of their experiences with the IRS, believe this is an agency beyond saving?

Answer. To my knowledge, there has never been a tax system in the history of the world that has not had some agency or body to collect the revenues. Despite the criticisms and concerns and the need for some improvements, the IRS is one of the most efficient agencies of the federal government, collecting more than $1.7 trillion dollars in taxes each year on a budget of approximately $7 billion. If any other organization (government or private sector) had received the same level of scrutiny the IRS has in recent years, I doubt that many of them would measure up as well. During my time as Commissioner, the organization took very seriously the concerns expressed by its critics. For example, when the CFO Act imposed the requirement on federal agencies to prepare financial statements that could be audited and the IRS as a pilot agency did not "pass" its first audit, a serious and thus far successful effort to address the issues raised by the GAO was undertaken. The good news is that the IRS has made substantial progress in meeting the GAO's criticisms; the unfortunate fact is that the agency gets no credit for the many things that it does right. The vast majority of taxpayers have little to no contact with the agency outside of their annual filing requirement. In other words, millions of contacts with taxpayers take place without any problems.

(c). In 1994, Congress passed the Government Performance and Results Act (GPRA). This was an effort to get the Congress and the Executive Branch to focus on performance standards. Do you support such standards for the IRS? If you do, what do you think the performance standards should be?

Answer. There should be performance measures, but great care needs to be taken to assure that those measures do not produce undesirable behavior. However, it is important to recognize that accurate measures for assessing customer satisfaction in an agency with the mission of collecting taxes will not be easy to develop.

(d). During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures?

Answer. Of course, employees should generally follow the Internal Revenue Manual and be subject to appropriate disciplinary actions for noncompliance. I would caution the Committee to consider carefully, however, what those sanctions should be. Any disciplinary action taken against an employee should affect that employee, not taxpayers.

OVERSIGHT BOARD QUESTIONS

Question 10. The House bill establishes a board "to oversee" the IRS in its "administration, management, conduct, direction, and supervision" of the administration of the tax laws. What does "oversee" mean to you? What should be the relationship between the Commissioner and the Board?

Answer. As I said in my written testimony to the Committee, one approach considered by the Restructuring Commission, but not pursued because of concerns about its political feasibility, was whether the IRS should be an independent agency, perhaps like the Social Security Administration, with the Commissioner reporting to a governing board overseeing the agency's operations. In my opinion, such an approach could provide the most effective and least cumbersome governance structure for the agency.

Short of making the IRS an independent agency, and if Congress determines that an outside Board is an appropriate form of governance to improve the efficiency and quality of tax administration, then I believe that the responsibility and authority of that Board cannot be ambiguous. The authority and responsibility of the Board should be clear and should not overlap the authority and responsibility of the Commissioner.

It is vital for Congress to be clear about what it wants the role of the Board to be. If you want the Board to run the agency, you should expressly give it the author-

ity it needs. If you want a Board to serve an advisory function, then you should be explicit that its role is merely advisory. The most difficult situation from the standpoint of the agency would be to establish a Board with an ambiguous role. The Board can be effective only if its role is clear.

Question 11. I am troubled that the bill prohibits the board from exercising any authority over "law enforcement activities" such as collections—an area which our hearings have shown to be rife with taxpayer abuse.

Answer. The Board should not have specific oversight responsibilities with regard to collection functions. As I previously indicated, I believe that the role of the Board is to bring both expertise and consistency of direction to the IRS's long-term strategic planning process and to help ensure that the IRS both receives sufficient resources to fulfill its strategic mission and deploys those resources appropriately.

Question 12. If an IRS Oversight Board is established within Treasury, should Board members be part-time or full-time employees?

Answer. I believe that the Board's members should be part-time.

Question 13. What is your opinion regarding who should serve on the proposed IRS Oversight Board? Should a union representative be guaranteed a slot on the Board? Should the Commissioner and Secretary of Treasury be on the Board?

Answer. I think that an advisory board with no more than seven members to advise the Commissioner and Secretary would be the most effective. I see no reason to guarantee Board membership to a union representative, and I understand that such membership would raise significant conflicts with government ethics rules. There is no reason for the Secretary or the Commissioner to be official members of the Board.

SIMPLIFYING THE CODE

Question 14. I think that we would probably all agree that a significant part of taxpayers' problems with the IRS stem from the complexity of the Code. What parts of the Code do you think are prime candidates for simplification?

Answer. The prime candidates for simplification are the penalty provisions; the capital gains rules; rules relating to dependents, qualifying children and other rules relying on relationships, which could be standardized; rules relating to IRA's and pensions, both contributions and distributions; and worker classification rules—the provisions that probably produce the most controversy with small business owners.

These provisions were simplified, the lives of many individual and small business taxpayers would be much less complicated.

PREPARED STATEMENT OF HON. CHARLES O. ROSSOTTI

Mr. Chairman and Distinguished Members of the Committee:

When I appeared before this Committee in October, I had already confirmed for myself two things: that the IRS must do a far better job of serving taxpayers, and that achieving a goal of consistent first rate service would require a major shift in the IRS's focus. I committed to you that I would improve the work of an agency that directly affects so many people and do so to the best of my ability.

Since my appearance here in October, I have read thousands of pages of studies and reports, met with over 500 IRS employees, reviewed the ongoing audits conducted by the IRS Chief Inspector, visited offices all across the country, spoken with taxpayers at Problem Solving Days and met with all of the practitioner and professional groups who will testify before you tomorrow. I have learned a great deal from the work of this Committee and from the work of the Committee on Ways and Means. Drawing upon these sources, the report and recommendations of the National Commission on Restructuring the IRS, and my own 28 years of experience as a manager, I have reached a clear and inescapable conclusion: the IRS must shift its focus away from its own internal operations and think about its job from the taxpayers' point of view.

I am pleased to be here today to outline for you how I plan to do what I said I would do back in October, how the legislation you are considering will help in this endeavor, and how concrete measures will be taken to address the kinds of problems you, Mr. Chairman, brought to light in your hearings in September.

But, before I outline my concept of a new IRS, let me discuss two important issues of concern to this committee. First, the hearings you held in September prompted the IRS to take stock of itself in a number of key areas, and I'd like to take this opportunity to review the actions the agency has taken since. Second, I'd like to make a few points with regard to the restructuring legislation that has passed the House and that will soon be marked up in the Senate.

ACTIONS SINCE FINANCE COMMITTEE HEARINGS

Mr. Chairman, your September hearings were a call to action and have caused the IRS to begin a period of self-examination on a number of fronts. We have initiated internal audits on the use of statistics in Examination and Collection and begun reviewing the conduct of managers and employees so that we can detect and correct abuses. In addition to these specific actions, I want to take a moment to review some of the other major commitments we have made to improve our treatment of taxpayers. I would also like to assure you that we will continue to fulfill our current commitments and for the longer term strive to prevent these situations from occurring in the first place.

Both before and after the hearings last September, the IRS worked closely with the Finance Committee staff and the Treasury Department to identify the problems that must be resolved in order to end abuses, protect taxpayers' rights, and make the IRS more customer focused.

The IRS and the Treasury Department have jointly developed action plans to address each of the problem areas which have surfaced over the last few months. The issues that could be resolved quickly have been. Others will take more time. There are approximately 100 detailed actions being taken by the IRS to honor commitments made during and after the September hearings, and just last week we delivered our second progress report to the Committee. There are three general categories of actions that I highlighted in my report to you and also would like to address today:

- Resolution of problem cases;
- Enforcement statistics and employee misconduct; and
- Employee education.

Resolution of Problem Cases

IRS staff, both at the National Office and in the field, have been working on several efforts related to resolving problem cases. Some of these efforts are direct consequences of the Senate hearings, whereas others are more proactive steps to identify and solve taxpayer concerns before they become intractable problems.

We have completed a comprehensive review of the cases involving the four taxpayers which testified at Septembers hearings. Our findings and the reports prepared by the responsible field office executives were sent to you last week.

In addition to addressing the cases for these four taxpayers, the IRS has established new procedures to monitor complaints received as a result of the hearings. The Chief Inspector is also tracking any complaints generated by the hearings. The Taxpayer Advocate has been working closely with field executives to review correspondence received by the IRS in the first quarter of this fiscal year (October 1, 1998 through December 31, 1998). In this review, field offices analyzed roughly 25,000 pieces of correspondence and provided a summary of those results to your staff last week. We are currently undergoing a similar review for the second quarter. Through these types of extensive reviews, we will be are able to better understand the types of correspondence we are receiving and more readily identify potential systemic and individual problems early on.

Problem Solving Days

On September 25, 1997, Deputy Commissioner Mike Dolan announced that each IRS district would begin holding monthly Problem Solving Days to provide taxpayers an opportunity to meet with Service personnel to resolve special tax problems they might be encountering. On Saturday, November 15, 1997, we held our first Problem Solving Day. Since then, we have held many more Problem Solving Days throughout the country. I was pleased to spend time with you, Mr. Chairman, in Wilmington, Delaware, and with you, Sen. Grassley, in Des Moines. As of January 16, 1998, more than 16,200 people have been assisted during Problem Solving Day events throughout the country.

We are pleased with the initial success of Problem Solving Days. According to the customer satisfaction survey distributed at the November Problem Solving Day, taxpayers were extraordinarily pleased with the quality of service they received. With a 55 percent response rate, customers gave the day an average rating of 6.46 on a scale of 1 to 7, with 7 being "completely satisfied." Approximately 75 percent of respondents gave the IRS the top rating of 7 for "overall service." The highest overall rating of 6.66 was for employee courtesy.

In our second round of Problem Solving Day events, held in December, the IRS received even higher ratings for "overall service." For "overall service," the IRS received an average rating of 6.54 as compared to the November rating of 6.46. Again, our highest overall rating was for "employee courtesy;" however, the rating improved (from 6.66 to 6.81).

During the two Saturdays prior to April 15, 1998, IRS will hold "Problem Prevention Days." Local offices will assist taxpayers in preparing returns and in voluntarily complying with tax laws.

Problem Resolution Program

The IRS is increasing the National Office Problem Resolution staff by one-third and is conducting a workload review to determine how many additional resources are needed in field offices. Additionally, the IRS has begun a national search, using a well known executive search firm, for a new Taxpayer Advocate with experience representing and advocating for individuals and small business taxpayers. I also plan to expand the position to include significantly increased opportunities for educating the public about the Taxpayer Advocate program and the remedies it offers.

Improve Written Communications With Taxpayers

During fiscal year 1997, the IRS issued roughly 10 million letters and 111 million notices to taxpayers. Letters are issued by a specific employee to provide detailed information regarding a taxpayer's account. Notices are standardized forms which are categorized by issue and sent to taxpayers which require that type of notification. To improve the taxpayer's ability to respond to letters we have issued a reminder alert to field offices to emphasize that all letters must be signed by the appropriate contact person.

We also have been working to redesign our notices, and plan to procure the services of an outside contractor, in an effort to increase their clarity. These improvements should help taxpayers understand more clearly why they have received a notice and how they need to respond to that notice without the need for further explanation. Many of our generated notices already include names.

Although we continue to evaluate the viability of adding names to more notices, we have reservations. For example, the IRS has invested considerable resources to emulate private sector best practices by enhancing customer access to toll-free telephone services. To improve access, we have implemented systems that enable us to route incoming calls to the next available assistor located in any of our call sites across the nation. We are concerned that a taxpayer, calling the employee identified on a notice, may have to stay on hold for longer than if he or she had been transferred to the first available employee. We are continuing to explore ways to make employees more accountable for solving problems while ensuring that taxpayers get the most efficient service we can deliver.

Provide Better Telephone Service

On January 2, 1998, the IRS expanded telephone service over one third—from 5 days a week, 12 hours a day to 6 days a week, 16 hours a day. In addition to increasing our hours of operation, the IRS has several key initiatives designed to improve the Level of Access to our telephone service to 70% during the 1998 filing season.

Enforcement Statistics and Employee Misconduct

Last September's Finance Committee hearings raised a number of questions about how the IRS uses enforcement statistics. Since the hearings, senior IRS executives have made a determined effort to communicate to the entire organization that enforcement statistics are not to be used in evaluating employees. We have stopped ranking the 33 district offices and 10 service centers on revenue and enforcement results and stopped issuing these kinds of performance goals to regions, districts, and service centers. Because of concerns that including penalties in our examination assessments created incentives for our employees to propose unwarranted taxpayer penalties, we have also decided to exclude all penalty data from the statistics used for examination assessments.

IRS Seizures

On December 2, 1997, the IRS announced an interim policy requiring higher level management approval before an employee can seize tangible property. This higher level of approval is a prudent step to ensure that, while we complete our analysis of the use of these enforcement authorities, collection enforcement tools such as seizures are only used in appropriate cases.

Internal Audit Reports

Subsequent to the Committee's September hearings, in which allegations of violations of taxpayers' rights surfaced, the Inspection Service and the General Accounting Office (GAO) were asked to investigate the IRS's use of enforcement tools and statistical indicators. To date, two Internal Audit reports have been issued. The first audit report focused on the Arkansas-Oklahoma district and concluded that the dis-

trict permitted, and in some cases encouraged, inappropriate use of enforcement statistics and tools. The second report reviewed the use of enforcement statistics in the Collection function at the national and regional levels, and in 12 districts. On January 13 this report was issued and concluded that the IRS created an environment driven by statistical accomplishments that placed taxpayer rights and a fair employee evaluation system at risk. In response to both audit reports, the IRS has taken the following steps:

- On December 16, 1997, the Deputy Commissioner initiated a review of the lien and levy procedures currently being followed by field offices. This review will result in recommendations for improving current processes with a particular emphasis on ensuring that these collection tools are utilized in a way that correctly balances the individual rights of taxpayers with the organization's responsibility to collect the correct amount of tax.
- On December 22, 1997, Deputy Commissioner Dolan recalled Document 9429, *Managing Statistics Within the Collection Function*. Collection personnel were directed to rely on the overall guidance contained in Document 7300, *Managing Statistics* (1992). New guidance revisions are scheduled to be available by March 30, 1998.
- At the request of the IRS, GAO is currently conducting an overall review of the quarterly certification process.
- The IRS will expand its longstanding policy prohibition on the use of enforcement statistics to bar their use in evaluating front-line managers of enforcement officers and apply the TBOR Certification process to all enforcement activities, not just collection.
- The procedures that govern the clearance of documents containing reference to interpretation of Service policy will be strengthened so that any legal concerns raised by Chief Counsel will be adequately addressed.

Additionally, I announced on January 13, a panel will be created to objectively determine disciplinary actions to be taken in cases arising from the Chief Inspector's investigation.

Employee Education

Finally, during the September hearings, a commitment was made to engage the IRS in discussions about the organization's obligation to provide high-quality customer service to taxpayers. IRS management has conducted several video conferences with employees to discuss lessons learned from the hearings; conducted meetings with all IRS executives and field office division chiefs; issued several formal statements to employees announcing corrective actions being taken; and this week we will be conducting focus group interview sessions with over 2,000 employees to solicit employees' concerns regarding barriers to proper treatment of taxpayers and to offer suggestions for improving taxpayer treatment.

The IRS is working on other initiatives to formally educate employees. One of these initiatives is titled "Working with Taxpayers" and is designed to help employees throughout the organization understand how to treat taxpayers fairly and courteously. Another critical aspect of providing the proper level of customer service is accurate technical knowledge. There have been several significant changes to the tax code over the last year, the most significant being the Taxpayer Relief Act of 1997 (TRA 97). The IRS is currently providing training to Customer Service personnel on TRA 97 issues that impact the 1998 filing season.

RESTRUCTURING LEGISLATION

Mr. Chairman, this hearing marks the start of the Finance Committee's deliberations to draft its own version of IRS restructuring legislation. As Secretary Rubin stated earlier, we support the Internal Revenue Service Restructuring and Reform Act of 1997, as passed by the House of Representatives, and are committed to working with the Congress, along with the Department of Treasury, to implement it. As currently drafted, the Act provides for, among other things, additional taxpayer rights, more effective oversight of the IRS and greater continuity of leadership at the agency. This Act can be the impetus for bringing additional change to the IRS—change that will help to accomplish the shift in focus that I have mentioned. I would like to take this opportunity to comment on some of the key provisions.

Taxpayer Rights

The House-passed bill includes a number of taxpayer rights provisions that we support including:

- relief for innocent spouses,
- the expansion of our authority to issue "taxpayer assistance orders,"

- providing taxpayers with additional information on a variety of matters, including a taxpayer's rights in interviews with the IRS,
- equitable tolling of the statute of limitations for refund claims of disabled taxpayers, and
- matching grants for the development, expansion or continuation of certain low-income taxpayer clinics.

We also support the provision which would allow taxpayers to sue the government for up to $100,000 in civil damages caused by IRS employees who disregard provisions of the Internal Revenue Code or Treasury regulations in connection with collection Federal tax with respect to taxpayers, but believe the standard should be "gross negligence."

The House-passed bill also contains two provisions that cause us concern. As currently drafted, the section on burden of proof could have the unintended consequence of providing taxpayers with an incentive not to keep records that support their tax return positions and could make audits more intrusive. We are also concerned that the provision extending a privilege to accountants could give rise to disputes and interfere with our efforts to resolve issues quickly and correctly. These are highly technical issues that we would like to have our staff work with the Committee staff to resolve.

Electronic Filing

The expansion of alternative methods of filing is of vital importance to America's tax system and the House-passed bill establishes a long-range goal for electronic filing. While IRS's electronic filing programs have been successful to a degree, the public's use and acceptance of electronic alternatives to paper has not grown as rapidly as once hoped. For these reasons, the encouragement provided under the House-passed bill is important. As the Committee knows, current law already authorizes paperless filing, but the policy statement in this bill could be the catalyst for its successful expansion.

The legislation also provides us with needed authority to pursue such developments as the ability to accept taxpayers' signatures in a digital or other electronic format. During 1998, the IRS will be formulating a broader strategy for electronic service delivery through partnerships with private industry. Priorities for 1999 include implementing paperless filing, accepting electronic payments, and continuing to increase taxpayers' and practitioners' understanding of the benefits of electronic filing.

Governance Arrangements

As Secretary Rubin indicated to the Committee, the bill contains new governance arrangements that will ensure critical input from the private sector, provide for outside oversight, and maintain authority and accountability with respect to the IRS within the existing structure of the federal government. We support the provisions in the final bill that retain executive branch accountability under the Constitution, as well as the Secretary's authority to administer and enforce the internal revenue law. We also support granting the Oversight Board the authority to consult on strategic plans and review operational functions.

I should also note that I believe it is critical that we are able to attract the right people to fulfill the Board's important role. To avoid a prohibitive time commitment that an attractive candidate might not be able to fulfill, or, conversely, not allow for enough time to make a substantial contribution, I encourage a change to the legislation that would allow the Chairman of the Oversight Board maximum authority concerning the functioning of the board on matters such as the frequency of meetings and the possibility of appointing subcommittees. In addition, I support the technical changes to the conflict of interest provisions applicable to the Board. The current provisions are unclear and may inadvertently discourage service on the Board. We understand that the Office of Government Ethics is willing to work with Committee staff to ensure that these provisions are clear and fair.

Personnel Flexibilities

Mr. Chairman, critical to achieving the goals that I will lay out for you today is my ability to recruit and retain a top notch leadership and technical team, and to re-tool the existing workforce for the new challenges that await them. Therefore, we will be seeking your support for several additional flexibilities, particularly in the areas of compensation and workforce restructuring. Also, so that our employees may make the best choices for their futures, we seek reauthorization of the buyout authority that expired in December. Flexibility to reposition the current IRS workforce will be critical to implementing a new organization that is designed around the needs of the taxpayers. The Committee's support for these changes will be appreciated.

Mr. Chairman, the actions we have taken since your September hearings and the ongoing discussion of the restructuring legislation point the direction for the IRS into the next century. Let me now turn to my concept for modernizing the nation's tax agency.

CONCEPT TO MODERNIZE THE NATION'S TAX AGENCY

Mr. Chairman, I noted at the outset that your hearings were a call to action for the IRS. As you begin to consider restructuring legislation, I want to lay out my concept of how we can modernize the IRS. Let me stress at the beginning that enactment of restructuring legislation is crucial to the effort I am about to outline. The legislation is a necessary and critical enabler of the change that the IRS must undertake.

How can the IRS shift its focus and become the customer-oriented agency it must become?

I have carefully reviewed the work done by the National Commission on Restructuring the IRS, read many thousands of pages of internal studies of IRS business practices, technology and organization, and have met with hundreds of IRS employees as well as others who are vitally interested in our tax system. I have consulted with the Secretary of the Treasury and benefitted by the work of the Treasury and National Performance Review task force on customer service.

A clear sense of direction has emerged from this work and from the problems brought to light by this Committee. The IRS must shift its focus from its own internal operations and think about its job from the taxpayers point of view.

The IRS today does a remarkable job of processing 200 million tax returns, collecting with great integrity over $1.5 trillion and providing service to millions of taxpayers. These capabilities represent great strengths for our country.

To meet the public's legitimate expectations in the future, however, we in the IRS must fundamentally change the way we think about our agency. We must become fundamentally committed to customer service. We must shift our focus, as many large companies have already done, from expecting our customers, the taxpayers, to understand and navigate the IRS according to our internal operations, to thinking about everything from the taxpayers's view. We must gain a greater understanding of taxpayers' problems and how we can best help them meet their obligations under the tax laws.

From the taxpayer's viewpoint, we provide service in two ways.

We serve each taxpayer with whom we deal directly, one at a time. These interactions with taxpayers range from the routine, such as providing forms and information, to the complex, such as when a taxpayer may be thought to owe more money as a result of an examination. In each and every one of these interactions with taxpayers, we should provide first quality service and treatment that is prompt, professional and helpful based on what we know to be their particular needs.

Secondly, we serve all taxpayers by ensuring that compliance is fair. Our tax system depends on each person who is voluntarily meeting his or her tax obligations having confidence that his or her neighbor or competitor is also complying.

I believe that the IRS, over time, can greatly improve both kinds of service to the public. Furthermore, I believe that we can accomplish this, while also processing an increasing workload with the workforce we have. Our workforce is competent and dedicated, but handicapped by outdated practices and technology.

In the near term, we are taking action to move forward toward these goals.

As I mentioned earlier, the Problem Solving Days that we have been holding monthly across the country are excellent examples of the way we should be serving taxpayers. We are extending the hours of telephone service this filing season to 16 hours a day 6 days a week. We are setting up a special process to resolve the particularly difficult taxpayer cases that we are identifying through your Committee and our internal programs. We have taken steps to raise the level of management review on enforcement actions such as seizures and to see that inappropriate use of enforcement statistics is ended. These are only a few of the hundreds of actions we are taking this year to improve service and provide proper treatment to taxpayers.

We are also closely managing our enormous and challenging program to update our computer systems for the century date change and the tax law changes required by the 1997 Taxpayer Relief Act. Most of this work must be completed in the next 12 months prior to the 1999 filing season.

As important as these steps are, they will not enable us to meet our goals unless we make more fundamental changes to our way of doing business. These changes will take time but are essential for the IRS to meet the public's legitimate expectations for service from its tax agency.

Five Key Elements

The concept that I will outline today includes a renewed mission with emphasis on service and fairness to taxpayers and practical goals and guiding principles which define the path forward. We will reach our goals of service to each and to all taxpayers through changes in five key areas, each complementing the others. These five areas, along with the goals and guiding principles are summarized on Chart C.

Revamped IRS business practices that will focus on understanding, solving and preventing taxpayer problems

Each of the IRS's business practices, from customer education to filing assistance to collection, holds great promise for improvement by our gaining a greater understanding of the particular problems that taxpayers have and focusing continuously on solving them. In most cases, there are very close parallels in the private sector that we can draw on.

For example, our business practices should make filing easier for all taxpayers by providing easily accessible high quality assistance to those taxpayers who need help in filing and by having more returns filed electronically. Just as companies develop very particular marketing programs to reach customers with differing needs, we can help taxpayers more effectively by tailoring our publications, education, communications and assistance programs to taxpayers with particular needs. College students who often can file with a simple 1040EZ form and a 10 minute phone call have very different needs from senior citizens with social security and investment income who may be best served through a network of volunteers who specialize in the needs of seniors.

This principle of tailoring our services to the needs of particular groups of taxpayers is a cornerstone of how we can dramatically improve our service to taxpayers as well as our internal productivity.

As another example, some of our most difficult interactions with taxpayers occur when additional money may be due and collection activity is required. Today, 90 % of the active collection activity by the IRS telephone and field collectors is on accounts that are more than 6-months old, and most are much older than that. This is the reverse of practices in the private sector. The proven keys to effective collection are to identify as promptly as possible customers who may present risk of nonpayment and to work out a payment program that addresses the particular payment problem of that customer. This helps the customer as well as the collecting agency and minimizes the need for enforcement actions.

Organizational structure built around taxpayer needs

The IRS organizational structure no longer enables its managers to be knowledgeable about and take action on major problems affecting taxpayers nor is it capable of modernizing the business practices and technology needed to achieve our goals. The principal IRS organization today, as shown in Chart A, is built around 33 districts and 10 service centers. Each of these 43 units is charged with the mission of serving every kind of taxpayer, large and small, with simple or complex problems, in a defined geographical area. If a taxpayer moves, the responsibility moves to another geographical area. Further, every taxpayer is serviced by both a service center and a district and sometimes more than one. Service centers and districts each perform customer service, collection and examination activities for the same taxpayer.

For example, in the collection area, there are three separate kinds of organizations, spread over 43 organizational units, that use three separate computer systems to support collection. Each of these three types of units collects from every kind of taxpayer, from small businesses to wealthy individuals.

There are 8 intermediate levels of staff and line management between a front line employee and the Deputy Commissioner, who is the only manager besides the Commissioner who has full responsibility for service to any particular taxpayer. Although important improvements have been made in this structure over the last few years, notably the reduction in the number of districts, the fundamental problem remains: the structure is far too complex and accountability is weak.

Fortunately, there are solutions to this organizational problem which are widely used in the private sector and may enable us to better serve the American taxpayer. The approach I am discussing today is to organize around the needs of our customers, the taxpayers. Just as many large financial institutions have different divisions that serve retail customers, small to medium business customers, and large multinational business customers, the taxpayer base falls rather naturally into similar groups. This fact simply reflects the structure of the US economy.

Therefore, as shown in Chart B, one logical way to organize the IRS is into four units, each charged with end-to-end responsibility for serving a particular group of

taxpayers with similar needs. These units could replace the four regional offices and a substantial part of the national office, allowing the national office to better fulfill its responsibilities of oversight and broad policy rather than operations. As I noted at the outset, this is a concept—a concept that will require outside validation. I am initiating a review of this concept because I believe we need to refocus and realign the efforts of the IRS on our customers—the American taxpayers. Of course, during and after the review, we may need to revise this proposal, depending on the results.

By organizing in this way, the management teams for each unit could learn a great deal about the needs and particular problems that affect each group of taxpayers. The tax code is extremely complex but most of it does not apply to each group of taxpayers.

There are 100 million filers, comprising about 140 million taxpayers, who have only wage and investment income. For this very large group, almost 80% of all taxpayers, the primary needs are improved assistance in filing or in getting information about an account or a refund. Collection problems are relatively limited since most of their taxes are paid through withholding by employers. Compliance problems are concentrated in the area of dependent exemptions, credits, filing status, and deductions, many of which can be addressed in part by better education of taxpayers with the assistance of volunteer groups and preparers. Improved phone service and more walk-in "retail" sites where taxpayers can get quick, in-person assistance are also important.

Another very important group of taxpayers are small businesses, including sole proprietors and small business corporations. There are about 25 million filers in this category. Compared to other individual taxpayers, this group has much more frequent and complex filing requirements and pays much more directly to the IRS, including tax deposits, quarterly employment returns and many other types of income tax returns and schedules. Providing good service to this group of taxpayers is more difficult than wage and investment filers, and compliance and collection problems are also much greater. Small start-up businesses in particular need special help. By dedicating a fully responsible unit to providing all IRS services for the self employed and small business, this unit will be able to work closely with industry associations, small business groups and preparers to solve problems for the benefit of all.

Larger businesses, although few in number, pay a substantial share of their tax in the form of withholding, employment and excise taxes, and corporate income taxes. Complex tax law, regulatory and accounting questions, including many issues arising from international activities, dominate the work of the IRS in serving this group. A management team and unit dedicated to serving these taxpayers will be able to understand and solve these problems more effectively than at present.

Finally, the tax exempt sector, including employee plans, exempt organizations and state and local governments, represents a large economic sector with unique needs. Although generally paying no income tax, this sector pays over $190 billion in employment taxes and withholding for employees and manages $5 trillion in tax exempt assets. This huge sector will benefit from a dedicated unit that understands its special problems.

Management roles with clear responsibility

Since each unit will be fully responsible for serving a set of taxpayers with like needs, the management teams responsible for each of these units will be able to become knowledgeable about the needs and problems of their customers, and be held fully accountable for achieving specific goals in serving them. Furthermore, having learned about problems, managers can cut dramatically the time required to communicate with the workforce and implement solutions. Because the organization would be "flatter," there would be fewer layers of management. Front-line employees and first-line managers would have a much closer identification and communication channel to people with general management responsibility.

For each unit, a cohesive management team will be established which will be able to organize internally in ways that are appropriate to the particular needs of the taxpayers they are serving. I believe that highly qualified managers, from internal or external sources, will be far more attracted to these kinds of management jobs than those in today's complex structure .

Balanced Measures of Performance

It is essential to have measures of organizational performance that balance customer satisfaction, business results, employee satisfaction and productivity. It is particularly important that performance measures do not directly or indirectly cause inappropriate behavior toward taxpayers, and that they provide incentives for service-oriented behavior.

The establishment of management teams with clear responsibility for serving large groups of taxpayers with reasonably common characteristics and needs will help make it possible for the first time to develop realistic and meaningful measures of organizational performance in the areas of customer satisfaction and overall compliance on a continuing basis. This will help eliminate the problem that has plagued the IRS for decades, namely the use of "enforcement" results as a key measure of success.

New Technology

One of the limiting factors in our ability to modernize our business practices at the IRS today is our computer systems, which are extremely deficient in their ability to support our missions and goals. But computer systems essentially represent a detailed codification of the business practices and organization structure that exist. Building new computer systems to support the old business practices and complex organization structure will not work.

The recently issued technology modernization blueprint and the new CIO organization provide an outstanding and professional basis for managing the evolution of our technology. The revamped business practices and rationalized organizational structure I discussed earlier will provide a sound basis for completing and implementing the modern systems envisioned in the blueprint.

The management teams in each unit will be able to act as knowledgeable and responsible business owners to work with the centralized professional information systems organization and outside contractors. For the first time, this will establish all the critical elements needed to manage a large-scale technology/modernization program successfully.

SUMMARY

The comprehensive modernization concept I have outlined includes a renewed mission with emphasis on service and fairness to taxpayers, practical goals and guiding principles which define the path forward, revamped business practices that focus on solving taxpayer problems, a new organizational structure built around serving groups of taxpayers with like needs, more accountable and attractive management roles, balanced measures of performance tied to achievement of goals, and a workable way of modernizing our technology. All this is summarized on one page in Chart C.

I want to emphasize that much study is required to validate this concept and to decide on hundreds of details. Much consultation will be involved, internally and externally, during this study process which we hope to complete by early summer. While an enormous job is ahead of us, I am confident that, given time and support from Congress and the public, this path will lead us to the goal we all seek: an IRS which provides consistently first quality service to taxpayers.

Let me also stress that this concept is fully consistent with and, in fact complements, the Oversight Board that is created in the Restructuring Bill. Under the structure proposed, the Commissioner and the National Office will be better able to fulfill their appropriate top management roles and will be able to be accountable to the Board for the achievement of overall organizational goals as approved by the Board.

In conclusion, I want to assure the Committee that it is a new day at the IRS. The agency is committed to moving forward in ways that keep up with a changing world and the increased expectations of the American taxpaying public. Restructuring legislation will help us get there, and the work of your Committee has served as one of our catalysts for change. Thank you, Mr. Chairman, and I will be happy to answer any questions.

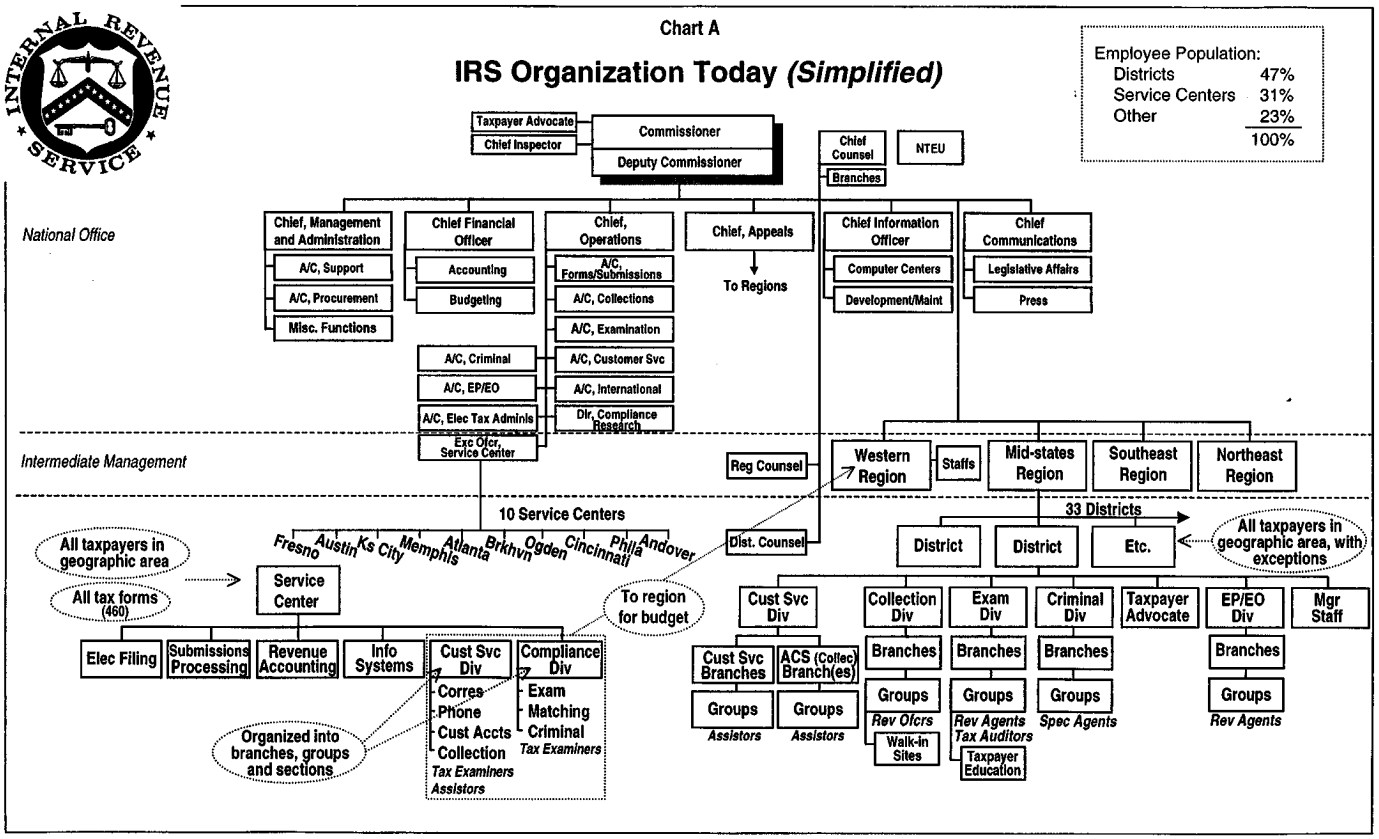
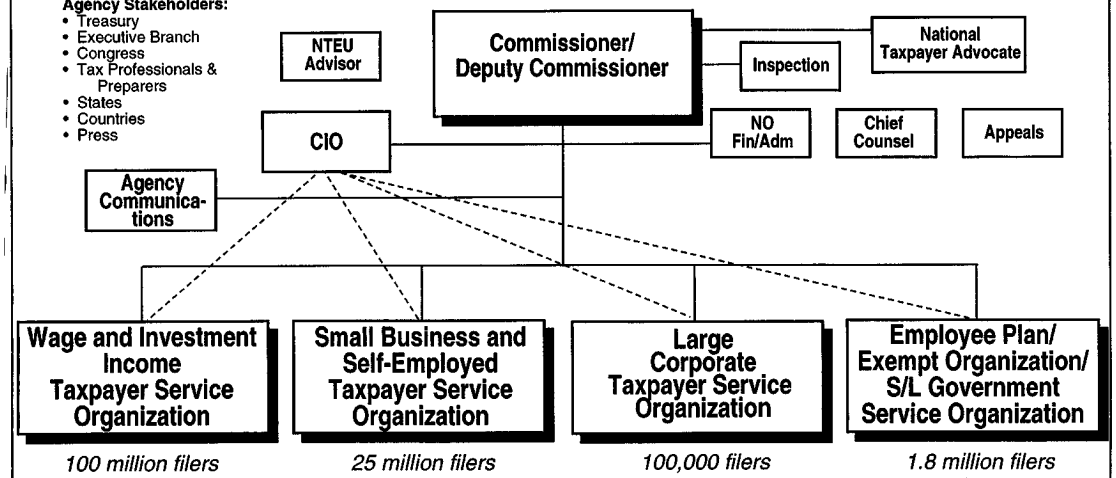


Chart A
IRS Organization Today (Simplified)
Employee Population:
Districts 47%
Service Centers 31%
Other 23%
100%
National Office
Intermediate Management
Taxpayer Advocate
Chief Inspector
Commissioner
Deputy Commissioner
Chief Counsel
Branches
NTEU
Chief, Management and Administration
A/C, Support
A/C, Procurement
Misc. Functions
Chief Financial Officer
Accounting
Budgeting
Chief, Operations
A/C, Forms/Submissions
A/C, Collections
A/C, Examination
A/C, Customer Svc
A/C, International
Dir, Compliance Research
A/C, Criminal
A/C, EP/EO
A/C, Elec Tax Adminis
Exc Ofcr, Service Center
Chief, Appeals
To Regions
Chief Information Officer
Computer Centers
Development/Maint
Chief Communications
Legislative Affairs
Press
Reg Counsel
Western Region
Staffs
Mid-states Region
Southeast Region
Northeast Region
10 Service Centers
Fresno
Austin
Ks City
Memphis
Atlanta
Brkhvn
Ogden
Cincinnati
Phila
Andover
Dist. Counsel
33 Districts
District
District
Etc.
All taxpayers in geographic area, with exceptions
All taxpayers in geographic area
All tax forms (460)
Service Center
To region for budget
Elec Filing
Submissions Processing
Revenue Accounting
Info Systems
Cust Svc Div
Compliance Div
Corres
Phone
Cust Accts
Collection
Tax Examiners
Assistors
Exam
Matching
Criminal
Tax Examiners
Organized into branches, groups and sections
Cust Svc Div
Cust Svc Branches
ACS (Collec) Branch(es)
Groups
Assistors
Collection Div
Branches
Groups
Rev Ofcrs
Walk-in Sites
Exam Div
Branches
Groups
Rev Agents
Tax Auditors
Taxpayer Education
Criminal Div
Branches
Groups
Spec Agents
Taxpayer Advocate
EP/EO Div
Branches
Groups
Rev Agents
Mgr Staff

Chart B

Top Level Organization Concept

Agency Stakeholders:
- Treasury
- Executive Branch
- Congress
- Tax Professionals & Preparers
- States
- Countries
- Press



All line operations conducted by 4 major operating units, each serving a major group of taxpayers with like needs. These replace 4 regions and part of NO. Technology management is centralized, but each operating unit is the business owner for systems that support it. NO becomes much smaller corporate headquarters. Each operating unit is internally organized differently, tailored to specific needs of its market.

Chart C

Modernizing America's Tax Agency

Internal Revenue Service

Help People Comply with Tax Laws, Ensure Fairness of Compliance

Guiding Principles
- Understand and solve problems from taxpayer's point of view
- Expect managers to be accountable - knowledge, responsibility, authority, action
- Use balanced measures of performance
- Foster open, honest communication
- Insist on total integrity

Goals

Service to Each Taxpayer:
- Make filing easier
- Provide first quality service to each taxpayer needing help with his or her return or account
- Provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due

Service to All Taxpayers:
- Increase fairness of compliance
- Increase overall compliance

Productivity Through a Quality Work Environment:
- Increase employee job satisfaction
- Hold agency employment stable while economy grows and service improves

Revamped business practices aimed at understanding, solving and preventing taxpayer problems
- Customer education - work with preparers, volunteers and industry groups - tailored services
- Customer service - easier access; clear responsibility for each account; more attractive electronic filing
- Collections; early help for people with payment problems
- Compliance - more focus on identifying and preventing recurring problems

4 Operating Units

Each dedicated to helping taxpayers with like needs:
Wage and Investment Income
Small Business/Self Employed
Large Business
Employee Plans/Exempt Orgs.
- Services tailored to needs of taxpayers
- Knowledgeable management team who can act to solve problems
- Many fewer layers
- Makes it clear who's responsible
- Pattern similar to private sector
- More independent taxpayer advocates

Management roles with clear responsibility
- Jobs defined in manner similar to private sector
- Broader range of experience, external as well as internal
- Management teams
- Jobs more attractive to internal and external candidates

Balanced measurement of performance
- Tied to goals
- Externally validated
- Financial management tied to plans and goals

New technology
- Central, professional management
- Common standards and architecture
- Partnership among business owners, CIO and private sector contractors
- Flexible evolution driven by business goals

PREPARED STATEMENT OF HON. ROBERT E. RUBIN

Mr. Chairman, distinguished members of this Committee, it is a pleasure to speak with you today. Soon after becoming Secretary of the Treasury, I began to see that the IRS was greatly in need of change. Just as many of you in this committee have been strongly focused on IRS reform, I became involved out of my concern that there were deep problems at the IRS, problems that developed over years, even decades, and problems that will take years to fully solve. The phones weren't being answered, the computers didn't work, and American taxpayers were too often being treated improperly and too seldom getting appropriate service. As a consequence, we started a highly intensified process of reform and change about two years ago. Though we have begun to make progress in some areas, there is an enormous challenge ahead including internalizing the commitment to change and reform. We must all work together constructively to meet this challenge.

Many have already contributed to the irreversible process of change under way at the IRS. We at Treasury are committed to continuing to provide our full assistance and support. The Vice-President's National Performance Review, in conjunction with Treasury and the IRS, produced an important set of recommendations on customer service. The Commission on IRS Restructuring, co-chaired by Senator Kerrey of this Committee and Congressman Portman, has been an important forum for analysis and an effective catalyst for IRS reform. And this Committee, in its hearings last fall, brought to light serious and intolerable abuses at the IRS—abuses that have now been vigorously explored in the IRS' two recent reports, and will be further explored in one report not yet completed.

I am deeply troubled by the reports' conclusion that the inappropriate use of enforcement statistics has put taxpayer rights in jeopardy in districts around the nation. This is an unacceptable situation and strong steps have been taken by the IRS to end this practice. We at Treasury and Commissioner Rossotti are committed to fundamentally changing the agency to one that respects taxpayer rights while collecting the taxes due. And in recent months, significant steps have been taken to address these problems, including stopping the use of revenue goals in field offices, beginning to develop a new set of performance measures that address customer service and taxpayer rights, establishing more independent reviews of each district's compliance with the taxpayer bill of rights, and initiating monthly Problem Solving Days.

Despite the many, far-reaching problems, and fully recognizing the immensity of the challenge, I think there is good reason to expect substantial progress in the years ahead. The IRS is now guided by the firm hand of its new Commissioner, Charles Rossotti—an individual quite unlike any previous Commissioner—who brings with him 28 years of private sector management experience in the area of information technology and who has already begun to bring changes at the IRS. Our reform efforts over the past two years—in addition to producing Commissioner Rossotti—have resulted in setting technology on a new course, increased electronic filing and telefiling, and improved telephone service. The GAO recently released a report that praised the IRS' performance during the 1997 filing season, citing "substantial improvement" in two critical areas: telephone accessibility and the use of alternative filing methods. And the legislation passed with bipartisan support in the House last November promises to help bring the IRS into a new era.

Congress can continue to contribute vitally to reforming the IRS through adequate funding, effective oversight, and, most immediately, through passing the bill passed by the House as soon as possible.

This bill contains important measures that will help build the IRS we all want to see:

- it provides for increased continuity and leadership at the IRS, by providing that the Commissioner serve a fixed five-year term, and it provides a range of personnel management reforms, although we would like to go further in improving managerial flexibility in selecting and managing personnel;
- it contains additional steps to strengthen taxpayer rights, including many of the President's taxpayers' rights proposals announced last year;
- it has important measures to expand electronic filing, which will decrease paperwork, increase efficiency, and save money;
- finally, the bill contains new governance arrangements providing for valuable input from the private sector and effective outside oversight, while maintaining the authority and accountability with respect to the IRS within the existing structure of the federal government, with the on-going oversight and synergies that that can provide. We would also recommend semi-annual testimony be required of the Secretary and Deputy Secretary of the Treasury, on the IRS, to use public accountability to see to it that future Secretaries and Deputy Sec-

retaries take their responsibilities with respect to the IRS with the greatest seriousness.

In short, Mr. Chairman, this bill will help continue the process of change at the IRS in the months and years ahead, including an intense focus on eliminating the abuse of taxpayers that has been brought to light in recent months. It is clear that the IRS must focus more on taxpayer rights and quality customer service, while at the same time collecting the revenue due. In that regard, we must remember that those who cheat on their taxes increase the burden on all the rest of us.

Mr. Chairman, IRS reform is an issue of immense national importance, and one which we take with the utmost seriousness. We can debate whether to continue with the current progressive income tax system, or change to some other system, but we should not let that debate affect our support for the absolutely vital task of serving the American taxpayer and collecting the revenue due. Our society depends on effective tax collection to fund 95 percent of the services of the Federal Government, from defense to Social Security, and there are large numbers of hard-working employees at the IRS who are committed to doing the job properly—as was demonstrated to me when I visited one regional office on the first nationwide Problem Solving Day last November.

The new IRS will need to be the work of many hands. As we go forward we must all work together in a constructive spirit in helping the IRS meet the many serious challenges it faces, including each years tax collection, the fundamental transformation now underway, and dealing with the year 2000 conversion, a subject which I know is of particular interest to members of the Committee.

I believe that in Charles Rossotti we have a Commissioner who both symbolizes the transformation under way and is exceedingly well-suited to provide transforming leadership. He needs your constructive engagement to get the required tools—and I believe an important step would be to adopt IRS reform legislation that will shortly be before you. I look forward to working with you, Mr. Chairman, the members of this Committee, the men and women of the IRS, the National Treasury Employees' Union, and all other interested parties as we take the steps necessary to transform the IRS into and institution that meets the needs of the American people. I would now welcome any questions.

PREPARED STATEMENT OF MICHAEL I. SALTZMAN

Mr. Chairman and Members of the Finance Committee: I am pleased to appear before you today at your request. I have been asked to give you my views on the Report of the Restructuring Commission on the Internal Revenue Service, S. 1096, the "Internal Revenue Service Restructuring and Reform Act of 1997," and H.R. 2676, the "Internal Revenue Service Restructuring and Reform Act of 1997" passed by the House of Representatives. My testimony represents my own views and is not on behalf of any client, nor my law firm.

My experience is as a practitioner and tax lawyer with over thirty three years of experience in handling all kinds of tax disputes, from civil to criminal cases, from collection cases to sophisticated substantive tax cases, from representing individuals and corporations before the IRS, to appearing in the U.S. Tax Court, federal district courts, bankruptcy courts, the Court of Claims, and circuit courts of appeals. I have been a government attorney, a sole practitioner for more than 10 years, as well as a member of a large international law firm. I have worked as a Justice Department Tax Division trial attorney (1964-69), and an Assistant U.S. Attorney in charge of tax cases in the Southern District of New York (1970-1972). I also am the author of a treatise on IRS procedures as well as the law of tax procedure, entitled "IRS Practice & Procedure," which was first published in 1981, with a second edition in 1991. I supplement that treatise three times a year to keep subscribers abreast of developments in the IRS's procedures and court decisions. For about 18 years, I have also been teaching courses in tax procedure at the New York University Law School's Graduate Tax Program. I have also been active for many years in the American Bar Association's Tax Section, and during my tenure as Chair of the Tax Section's Civil & Criminal Penalties Committee was one of the principal drafters of a 1989 Report on Civil Penalty Reform. This report became part of the proceedings before the House of Representatives Ways & Means Committee's Oversight Subcommittee. In that capacity, I participated in various groups Chairman Pickle selected to study civil penalty reform. This effort led to the important civil penalty reforms enacted in 1989.

There are several issues on which I would appreciate your considering my views.

THE GOAL OF REFORM AND AN APPROACH TO ACHIEVING IT

In setting about reforming the operations of the Internal Revenue Service, it is worth keeping in mind, as one historian has observed, that taxes, including penalties, "must not merely be imposed; they must be justly imposed. Their efficient, comprehensive, and equitable collection is the foundation of a healthy and stable government." P. Johnson, *A History of the English People,* p.47 (1989). It is not enough that taxpayers subject to various tax obligations, penalties, and interest, are also protected by a range of remedies in an effort to ensure that the IRS treats them fairly. Unless structural reforms and protections added to the Code result in taxpayers' feeling that they have been treated fairly, popular attitudes toward the IRS will not change and statutory changes will do nothing more than add sterile complexity to an already complex law. I suggest that if the IRS shares the goal of fostering taxpayer trust that the IRS will treat them fairly, the need for structural reforms of the IRS will be reduced.

One way to make statutory changes more effective, however, is to view them as part of a coordinated strategy. Statutory reforms should not be made in isolation. Changes to the penalty provisions of the Code are related to the interest provisions and to collection procedures. Burden of proof changes must be seen in the context of the IRS's summons authority. The proposed protection of tax advice non-attorneys give to taxpayers should be considered in relation to the reasonable cause defense, which a taxpayer has to an accuracy-related penalty when the taxpayer proves reliance on the advice of a tax advisor.

With this approach to IRS reform in mind, I offer the following comments regarding certain provisions in H.R. 2676 and S. 1096, as well as certain other recommended reforms.

I. COMMENTS ON S. 1096 AND H.R. 2676

A. Privilege of Confidentiality extended to taxpayer's dealings with non-attorneys authorized to practice before the IRS (sec. 341 of H.R. 2676).

Present Law

Under common law, the privilege of confidentiality exists for confidential communications between an attorney and client made during the course of the attorney's representation that have not been revealed to a third party. This privilege is limited to communications between clients and attorneys. This privilege is not extended to communications between a client and other professionals, such as CPAs or enrolled agents authorized to practice before the IRS.

Proposed Change

Under the bill, the present common law privilege of confidentiality will be extended to tax advice given to a client-taxpayer (or potential client-taxpayer), in a noncriminal proceeding before the IRS, by an individual who is not an attorney but who is authorized to practice before the IRS.

Comments on Proposed Change

In the explanation of this provision, it is stated that extending the confidentiality privilege in this context will allow taxpayers to consult with other qualified tax advisors in the same manner they currently may consult with tax advisors who are licensed to practice law.

Confidentiality for communications made to non-attorneys is not necessary. As a practical matter, the attorney-client privilege is not as broad in the tax area as many lawyers believe. The new provision assumes that the attorney-client privilege protects all information a client provides to the attorney. However, when an attorney either prepares or assists in preparation a tax return, the attorney's tax advice is not privileged where the advice is disclosed on the tax return in the form of a return position. This results in the waiver of the attorney-client privilege by disclosure. Thus, the new privilege for non-attorneys would also be waived in this circumstance.

Suppose an attorney gives advice to a client, and the client later claims that he or she relied on this advice to avoid an accuracy related penalty. Again, the client-taxpayer has waived the attorney-client privilege because the advice has been disclosed. The same waiver will occur if this privilege is extended to non-attorneys.

Attorneys and accountants also differ in their roles. An attorney, representing a taxpayer, and acting within the bounds of law, owes a duty of loyalty to a client when providing tax advice. A full-service accounting firm, which attempts to provide

both auditing services (where a duty of independence is owed) and tax services (where a duty of loyalty is owed), will have conflicting duties.

In short, the problem with this "protection" is that it may delude taxpayers into believing that greater confidentiality exists in their dealing with non-attorneys than presently exists with attorneys.

B. Offers in Compromise (sec. 346 of H.R. 2676 and sec. 308 of S. 1096)

Present Law

Section 7122 of the Code permits the IRS to compromise a taxpayer's liability for all types of federal taxes, including penalties and interest. An offer-in-compromise is a proposal by the taxpayer to settle its tax liabilities for less than the full amount of the assessed balance due on the basis that there is doubt as to the fact of the liability or doubt as to the taxpayer's ability to pay in full. If a taxpayer proposes an offer-in-compromise on the basis of doubt as to his or her ability to pay, the taxpayer must make certain financial disclosures concerning assets and liabilities and must observe all IRC provisions relating to the filing of returns and paying taxes for five years from the date the IRS accepts the offer. Failure to obey this requirement permits the IRS to begin immediate collection efforts for the original amount of the unpaid assessment.

Proposed Change

Both S. 1096 and H.R. 2676 will require (1) that the IRS develop and publish schedules of national and local allowances designed to provide taxpayers entering into offers-in-compromise adequate means to provide for basic living expenses and (2) the IRS to prepare a publication or statement providing taxpayer guidance regarding the rights and obligations of both taxpayers and the IRS in entering into an offer-in-compromise, including an explanation of the rights of married taxpayers should their marital status change. In addition, H.R. 2676 will require that if an offer-in-compromise is terminated due to the actions of one spouse or former spouse, the complying spouse may apply for reinstatement of the offer.

Additional Suggested Changes

I am concerned that national and local expense standards will complicate the process of obtaining financial information in order to evaluate installment payment agreements and offers-in-compromise. National and local expense standards will not eliminate confrontations between revenue officers and taxpayers who inevitably believe that the government is telling them how to live their lives.

Recognizing that there is no panacea for this issue, I recommend several approaches. First, a third party should be interposed in the process to help the taxpayer pay and the IRS to receive as much of the taxes owed as is practical. The problem with the current system and the proposal is that taxpayers who are unable to pay their tax obligations need financial planning advice, not instructions from revenue officers on how much they can spend for what taxpayers consider to be necessary expenses. By the very nature of their role with the IRS, revenue officers are not equipped to give that advice. The third party should have a background in financial planning and should have as his or her objective, the development of a practical and attainable plan to pay as much of the tax as possible. The individual who serves in this capacity as financial advisor/mediator may come from a specialized group in the IRS's Appeals Division, the Taxpayer's Advocate Problems Resolution function, or outside private practitioners, who have these skills. I believe that retired professionals and business people should be considered to serve in this role.

Second, there must be recognition that, under an offer-in-compromise or installment payment agreement, the IRS will not receive full payment for tax, penalties, and interest. The focus should be on the collection of the unpaid tax. In a significant number of cases, full or even substantial payment of the tax is all that can reasonably be expected. Because interest is market sensitive and compounded daily (therefore often twice or three times the amount of tax), the failure to collect interest should not be an obstacle to agreement. Penalties, such as the failure to pay penalty, should not be imposed when a taxpayer is complying with the terms of an installment payment agreement or offer-in-compromise.

I recognize that some will say that this approach will reward delinquent taxpayers and be unfair to taxpayers who are compliant. I agree with this criticism. However, my experience tells me that it is no reward to have to deal with the tax collector and that it benefits the tax system as a whole to avoid the taxpayers' return to a system full of past tax debts and the IRS' having ever-increasing,

uncollectible delinquent accounts. Some radically reduced expectations are necessary if this is to happen.

C. Burden of Proof (sec. 301 of H.R. 2676 and sec. 321 of S. 1096)

Present Law

Under present law, the IRS Commissioner's determination of a tax deficiency is presumed correct, and the taxpayer bears the burden of proving that the Commissioner's determination is erroneous. This general rule recognizes (1) that the taxpayer who engaged in a particular transaction, which is the subject of the Commissioner's determination, is in the best position to produce evidence relating to the transaction and (2) that the taxpayer is required to maintain adequate books records to substantiate any position taken on a tax return. Under specific circumstances, however, including the imposition of the fraud penalty, a determination of transferee liability, untimely assertion of new matters, worker status, etc., the burden of proof is placed upon the Commissioner.

Proposed Change

Proposed Code section 7491 provides that the Commissioner shall have the burden of proof in any court proceeding with respect to a factual issue if (1) the taxpayer asserts a reasonable dispute with respect to any factual issue relevant to ascertaining the taxpayer's income tax liability, (2) the taxpayer fully cooperated at all times with reasonable requests from the IRS, including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer, (3) the taxpayer meets all applicable substantiation requirements, and (4) the taxpayer meets the net worth requirements that are currently in place as a prerequisite to an award for attorney's fees.

Comments on Proposed IRC § 7491

Proposed Code section 7491 was based on the concern that individual and small business taxpayers frequently are at a disadvantage when forced to litigate with the IRS, and that all other things being equal, facts asserted by individual and small business taxpayers, who fully cooperate with the IRS and satisfy all relevant substantiation requirements, should be accepted.

First, as a practical matter, cases that turn on the burden of proof generally do not involve taxpayers who have fully satisfied the substantiation requirements; most of these cases are settled with the IRS prior to litigation. In making factual findings, courts generally do not consider what occurred during examination, before the issuance of the notice of deficiency to a taxpayer. Rather, courts render decisions based upon the evidence produced and offered at trial. In this context, cases where taxpayers lose on the burden of proof are cases in which a taxpayer is either (1) relying on evidence other than substantiating books and records, such as his or her own testimony, or (2) is pro se (representing himself or herself) and simply does not know what evidence to put forward or fails to put evidence forward on every issue presented, as a consequence of being unrepresented. For example, a taxpayer may be facing a number of issues including asserted penalties for negligence. The taxpayer may come to court prepared to present evidence on the primary issue of the underlying deficiency and simply fail to present evidence with respect to the penalties. In this case, with no evidence in the record, the Commissioner will be sustained on the burden of proof. It is respectfully suggested that in these cases, and in fact all cases, the Commissioner should not be permitted to simply rest its case on the burden of proof with respect to any issue until and unless the Commissioner's position on that issue is set forth, and the taxpayer is alerted to his or her responsibility to rebut that position with sufficient evidence.

Secondly, it can be reasonably anticipated that proposed section 7491 will significantly increase the scope of litigation necessitating the need for mini trials on statutory interpretation issues in order to determine if the taxpayer has met the statutory predicate to shifting the burden of proof to the Commissioner, including the meaning of "full cooperation," "reasonable period of time," and what is a "reasonable request" on the part of the IRS. These inquiries will prolong the length of the trial process and necessarily increase the cost of litigation to both the government and the taxpayer.

Finally, it is unclear the effect that this legislation will have on the audit and settlement process and how this legislation may affect situations where the burden of proof is currently on the Commissioner.

II. OTHER COMMENTS AND SUGGESTED CHANGES

A. Penalties.

1. The Failure to Pay Penalty.

Present Law

Under current law, unless reasonable cause is shown, a delinquency penalty is imposed by Code section 6651 for failure to pay an amount of tax shown on a return when due. Section 6651(a)(2) of the Code imposes a penalty in an amount equal to 5 percent of the amount of tax per month if the failure is not for more than one month, with an additional 5 percent for each month or fraction thereof for which such failure to pay continues, not to exceed 25 percent in the aggregate.

Comment on Present Law

The current failure to pay penalty was added to the Code in 1969 to discourage taxpayers from "borrowing" from the Government because at the time the cost of borrowing money was "substantially in excess of the 6 percent interest rate provided by the code, [and] it [was] to the advantage of taxpayers in many cases to file a return on the due date but not to pay the tax shown owing on the return." Senate Report 91-552, Tax Reform Act of 1969, PL 91-172, 1969-3 C.B. 429, 611. In other words, by delaying the payment of tax, taxpayers before 1969 could "borrow" from the Government at 6 percent simple interest, when the prevailing market rates were in excess of that 6 percent interest rate.

Under the current interest provisions in the Code, interest rates are market sensitive and adjusted quarterly, and interest is not calculated as simple interest, but is compounded daily. Sections 6621, 6622(a). Despite changes in the rate and computation of interest, that eliminate the interest rate differential incentive for a taxpayers' failing to pay the reported tax, the failure to pay penalty of up to 25 percent of the net unpaid amount remains in the Code. Although the failure to pay penalty no longer serves as a disincentive for taxpayers who can pay their reported tax from playing a tax arbitrage game with their taxpaying obligations, the penalty has serious adverse consequences for taxpayers, especially individual taxpayers who simply do not have the funds to pay their taxes. For individual taxpayers, interest on the unpaid tax is nondeductible, and so the failure to pay penalty operates as a second penalty on taxpayers who cannot timely pay their tax obligations. These taxpayers are not taking advantage of low delinquency interest rates. When a financially-pressed taxpayer files a return reporting a tax due, but does not include full payment, the failure to pay penalty is automatically imposed. If the taxpayer attempts to work out a part-payment agreement, the amount the taxpayer will have to pay is not only the unpaid tax, plus interest compounding at a daily and market sensitive rate, but the taxpayer will also face a 25 percent failure to pay penalty, which itself draws interest. When the 25 percent failure to pay penalty is added to the already overwhelming tax bill (and that penalty itself draws interest), these taxpayers feel that they are unfairly punished for their inability to pay, locked in a kind of IRS prison for debt.

There are at least three types of conduct that follow from this situation. First, it should come as no surprise that taxpayers in this predicament find it difficult to deal with collection officers, and thus meetings between them can be explosive. Secondly, feelings that there will be no way to pay off a tax debt increases taxpayers' recourse to bankruptcy. For those who calculate the potential tax bill in advance of filing a return, the third course of conduct can be the failure to file a return and to start down the road to criminal conduct.

Suggested Change

One way to make the penalty provisions reflect the reality of failure to pay situations is to eliminate the failure to pay penalty. To reflect the reality of the interest rate and computation, instead imposing a penalty for failure to pay a reported tax, the taxpayer should be subject to a higher than normal interest rate. The additional interest rate should not be equivalent to the failure to pay penalty. It should be intended to strike a balance between encouraging taxpayers to timely pay and recognizing that the taxpayer who files a return reporting tax due, but who cannot pay the full amount is attempting to comply with the tax system. In other words, the taxpayer should not be punished and feel as though he has engaged in misconduct merely because financial hardship prevents timely payment.

If, on the other hand, the taxpayer intentionally fails to pay or the taxpayer refuses to act as a reasonably responsible taxpayer would, which results in a deter-

mination of a deficiency, then the taxpayer may be punished by the 20 percent penalty for negligence or intentional disregard of rules or regulations under section 6662 on the portion of the underpayment attributable to such conduct.

2. The Substantial Understatement Penalty.

Present Law

The substantial understatement penalty is one of the accuracy-related penalties (§ 6662), which subjects a taxpayer to a 20 percent penalty of the underpayment. A taxpayer is liable for this penalty if the taxpayer understates income tax by the greater of 10 percent of the tax the taxpayer is required to pay, or $5,000 ($10,000 in the case of corporations). In other words, the penalty is automatically imposed when there is a relatively small error in the return.

The taxpayer may attempt to avoid the penalty by showing that there was "substantial authority" for the treatment of the item on the return, or make a disclosure to the IRS of the basis for the treatment of the item by attaching a disclosure statement to the return. When this penalty provision was adopted, the term "substantial authority" was said to be a new one, the meaning of which was to be articulated by the courts. Regulations define "substantial authority," and set out rules regarding what is and what is not qualifying authority. Tax professionals do not necessarily agree with the limitations the regulations impose, however. The IRS also believes that substantial authority is a quantitative term (meaning a one-in-three chance of success), not a qualitative term.

Comment on Present Law

The substantial understatement penalty was added to the Code in 1982 in order to combat the spread of investments in tax shelters. S. Rep. No. 97-494, vol. 1, at 272-274 (1982), reprinted in 1982 U.S.C.C.A.N. 781, 1019-1021. Taxpayers were taking advantage of the IRS's difficulty in identifying tax shelter returns and playing the audit lottery. Id. Also, when the IRS selected a tax shelter return for audit, taxpayers were said to be claiming that they were avoiding negligence penalties because they had relied on so-called reasonable basis opinions of tax professionals. Id.

The substantial understatement penalty, however, applies broadly to all taxpayers, not just tax shelter investors. This penalty presents serious difficulties and uncertainties for taxpayers in general. Because of the uncertainty about the meaning of the term "substantial authority," the substantial understatement penalty can easily be abused by IRS agents and be frustrating to taxpayers. Since substantial authority is a unique term, it sets up a standard, which is difficult for the IRS to articulate and for taxpayers to follow. The penalty is imposed on the taxpayer, but the misconduct of failing to have sufficient authority really applies to the taxpayer's return preparer, unless the taxpayer is supposed to second guess the preparer. Moreover, it is hard to understand just how and why taxpayer conduct amounting to negligence or intentional disregard of rules and regulations differs from an absence of authority of substance for the taxpayer's position.

In practice, the penalty has become a penalty for "being wrong" in the opinion of the revenue agent. Many practitioners also believe that the penalty is asserted at the district level solely to gain some bargaining advantage at the Appeals level. This creates additional expense for taxpayers in fighting the penalty when all that may truly be in dispute is a frank difference of opinion as to what the law requires.

Suggested Change

Accordingly, I respectfully recommend the elimination of the substantial understatement component of the accuracy-related penalty. Misconduct amounting to negligently taking a return position, or intentionally disregarding rules and regulations, can be punished under the negligence and intentional disregard component of the accuracy-related penalty. Particularly abusive intentional disregard misconduct should be punished by an increased penalty. I also believe that taxpayers should be encouraged to disclose return positions, not discouraged by limiting qualifying disclosures to those having a reasonable basis. Accordingly, I would permit a disclosure statement to avoid a penalty if it is supported in fact and law or by a good faith extension of existing law.

3. Reasonable Cause.

Present Law

One of the contributions of the 1989 penalty reform was a uniform waiver standard for reasonable cause and good faith. Section 6664. If the taxpayer can establish reasonable cause and good faith, the accuracy-related penalty is not due. Reasonable cause is a concept which has its roots in the tort law. It exists when a taxpayer acts in a way that a reasonably prudent taxpayer would under the circumstances. See Restatement (Second) of Torts § 283 (1965). Similarly, the Supreme Court in Boyle defined reasonable cause and an absence of willful neglect as "ordinary business care and prudence."

Comments on Present Law

Despite these relatively simple statements of the standard, the IRS and Treasury have defined and re-defined when the IRS will consider reasonable cause to exist. The regulations under the reasonable cause provision even define what form a tax professional's advice must take to permit a taxpayer to rely on that advice to avoid the penalty. Moreover, the term reasonable cause has been given a special meaning for IRS regulations purposes, a somewhat different meaning in the IRS's Consolidated Penalty Handbook for its personnel, and still another meaning by the courts.

Suggested Change

Accordingly, I respectfully recommend that the reasonable cause exception be restated to recognize the Supreme Court's definition of the term as ordinary business care and prudence. I also recommend that the statute specifically list the recognized defenses, such as reliance on a competent tax advisor's advice, mistake, and physical or mental disability.

4. Interest on Penalties.

Present Law

Generally, under Code section 6601(e), for tax returns due after December 31, 1996, interest begins to run on penalties and additions to tax on the date the IRS makes "notice and demand," i.e., when the IRS gives the taxpayer notice of an assessment and makes demand for payment of the amount assessed. This general rule does not apply to all penalties, however. For example, on penalties for failure to file (§ 6651), fraud (§ 6653), negligence (§ 6662(b)(1)), substantial understatement of tax (§ 6662(b)(2)), and others, interest is imposed from the date the tax return is required to be filed until the date of the payment of the penalty.

Comments on Present Law

The purpose of imposing interest on amounts due and owing to the IRS is to compensate the IRS for the loss of the use of money, not to impose a penalty. As the IRS itself has put it, "the underlying objective [of the interest provisions] is to determine in a given situation whose money it is and for how long the other party had use of it." Rev. Proc. 60-17, 1960-2 CB 942, modified by Rev. Proc. 84-66, 1984-2 CB 637. It should be recognized that this rationale fails when applied to interest on penalties, which in effect creates a penalty on a penalty. It should also be recognized that taxpayers are often crushed under the financial burden of owing the tax due, interest on the tax, penalties, and interest on penalties, a reality which results in a taxpayer's inability to pay amounts owed. The goal of interest and penalties is to make the government whole. Interest is due in order to compensate the government for the loss of the use of money. Penalties are due in order to punish a taxpayer and create a deterrent effect. The deterrent effect of penalties is diluted if the burden is so great that taxpayers cannot pay.

Suggested Change

Accordingly, I respectfully recommend that, if interest on penalties remains in effect, the interest should begin to run, for all penalties, no earlier than the date the IRS makes notice and demand. In many cases, it can be many years after a taxpayer has filed a return that a determination as to the imposition of penalties is made. A taxpayer should not pay interest on a penalty from the date the return is required to be filed. It is simply inequitable from the standpoint of the taxpayer,

that interest on the penalty is imposed before notification of the imposition of the penalty is made, i.e., when the debt for the penalty is created.

B. Taxpayer Protections: Seizures and Disclosure Cases.

Present Law

Section 6331(a) generally authorizes the IRS to levy on all property and rights to property of a taxpayer who neglects or refuses to pay tax. Sections 6331(b) and 7701(a)(21) define the term "levy" as including "the power of distraint and seizure by any means." In *G.M. Leasing Corp. v United States*, 429 U.S. 338 (1977), the U.S. Supreme Court held that, in the absence of valid consent and exigent circumstances, a warrantless entry into a taxpayer's premises for the purpose of seizing property pursuant to section 6331(a) violated the Fourth Amendment's prohibition of unreasonable searches and seizures.

Following the Court's decision in *G.M. Leasing Corp.*, the IRS adopted procedures for obtaining a writ of entry ex parte. Section 56(12)4.5 of the Internal Revenue Manual provides that the revenue officer who seeks the writ must prepare an affidavit, which is to be reviewed by District Counsel and forwarded to a U.S. Attorney for handling. Generally, a district court judge or magistrate judge will issue a writ of entry upon a showing of "probable cause."

Comments and Suggested Change

The IRS should not be permitted to obtain an order of entry from a magistrate judge ex parte, which permits the IRS to enter the taxpayer's residence or business in order to seize and sell property. The taxpayer should be able to have a pre-deprivation hearing, or at least a prompt post-deprivation hearing before any sale of property. The hearing would be similar to a jeopardy assessment review proceeding (§ 7429) before some subordinate judicial officer who would be empowered, not only to review the IRS's prospective seizure, but to order the taxpayer not to transfer property.

Section 7431 of the Code permits a taxpayer to institute a civil action for damages if an officer or employee discloses the taxpayer's confidential return information in violation of the tax return confidentiality protections of section 6103. My experience is that this civil action is an incomplete remedy. Although attorney's fees may be received, the cost of litigation has been greater that the taxpayer can bear. Litigation also raises the prospect of repeating the disclosure in court papers and raises the possibility of publicity.

I recommend that the taxpayer, the IRS, and its attorneys in the Justice Department, be required to use alternative dispute resolution procedures in these cases. Mediation, because of its confidentiality and low cost, appears to me to represent an appropriate ADR procedure in these cases. Only if resolution cannot be achieved without a trial, should further discovery and trial proceedings be permitted.

C. Proposed Study

If taxpayer remedies, such as review of jeopardy assessments and seizures are to be effective, some court other than federal district court must handle them. In my experience, federal district courts are so overburdened by criminal cases that expedited review in certain types of tax cases is unlikely to occur.

Accordingly, I respectfully recommend that a study be conducted with respect to the efficacy of pre-deprivation administrative review of significant seizures of taxpayer property. This could be accomplished by establishing field offices where administrative judges or U.S. Tax Court special trial judges could make determinations as to whether seizure of significant taxpayer property in any given situation is an appropriate remedy. In addition to this task, many other actions could be heard in these field offices, such as issues surrounding jeopardy assessments, John Doe summonses, and similar matters. This alternative will allow for the quick handling of these issues at a local level and at a considerably lesser expense than resort to the district courts.

CONCLUSION

I thank the Chairman and the Members of the Finance Committee for giving me the opportunity to express my views on these important matters. I hope my comments will assist the Committee in its consideration of the provisions affecting taxpayer rights and protections.

RESPONSES TO QUESTIONS FROM SENATOR ROTH

Question 1. You have asked whether I believe that taxpayers are afforded proper due process in the collection process, as implemented by the IRS, and if not what my suggestions I might have that would protect the taxpayer without harming our tax system.

Answer. The simple answer to your question is that as implemented by the IRS, taxpayers are not afforded proper due process in the collection process because, in general, a taxpayer has no or little opportunity for independent review of IRS collection actions. Taxpayers may be denied due process at both the service center and at district levels in the collection process.

1. IRS Service Center Collection Action.

The IRS's collection process begins at its regional service centers, where, using a computer-driven system called the Automated Collection System ("ACS"), the IRS will generate levies and liens to collect an unpaid tax assessment. Taxpayers do not have direct access to IRS personnel at service centers, who control the collection process. They must attempt to communicate with IRS service personnel by letter or telephone to resolve a problem. While the IRS has procedures intended to assist taxpayers having difficulties in dealing with the service center collection action, such as Taxpayer Service and Problems Resolution personnel, there is no statutory procedure for the IRS to suspend collection action while the propriety of the collection action is independently reviewed. Instead taxpayers have the burden of attempting to convince IRS personnel to halt the process. Taxpayers find this burden difficult, time-consuming, and frustrating. In the meanwhile, taxpayers fear that the IRS will take collection action and find, that for one reason or another, the computerized collection process works inexorably against them and defeats their ability to stop it. Thus, because the IRS's initial collection actions are computer-driven at inaccessible service centers, if a taxpayer believes that an IRS assessment notice is erroneous, or wishes to resolve a liability without the IRS's taking collection action, the taxpayer runs a race with the ACS computer program.

The service center collection process starts with the assessment of a tax. After an assessment is made, if the taxpayer has failed to remit the amount assessed, the service center is required by law to send a notice of the assessment and a demand for its payments (a "notice and demand"). If in response to the notice and demand, the taxpayer fails to make full payment to the service center, service center computers are programmed to send one or more notices to the taxpayer, and if no payment is received and credited, an ACS-generated notice of intention to levy is sent to a levy source.

Once this computer-driven collection process has begun, the taxpayer's only recourse is to attempt to correspond with or to telephone the service center. If the taxpayer reaches a service center representative, the taxpayer may be able to resolve the issue, succeed in securing a hold on collection, or be unable to stop the collection process. In any event, the taxpayer has the burden of reaching some service center employee and succeeding in persuading that employee to take some action to stop the collection process or the collection process will continue.

In the usual case, the taxpayer attempts to correspond with the service center about a notice, but does not include full payment of the amount billed. The correspondence is not acted upon and the automated collection process continues. Accordingly, the service center computer generates another notice threatening collection action, and the taxpayer, now frustrated and fearful that the IRS will levy on a bank account or other property, writes another letter. Service center personnel either fail to act on this correspondence, or act on it by contacting the taxpayer, but they sometimes fail to see to it that a hold on collection is input. As a result, a levy is sent to the bank or even to an employer.

Taxpayers can also become frustrated when they attempt to telephone the service center at the general number indicated on dunning notices. When the taxpayer telephones the service center, the taxpayer listens to a menu of possible extensions linked to particular problems, but the taxpayer then must have the patience to stay on the line for long periods before a representative becomes available. Even when the taxpayer reaches a service center representative, the service center representative may unilaterally reject the taxpayer's request, the taxpayer may have to provide correspondence or substantiating data before collection is suspended, or the representative fails to input a hold on collection in time to stop further collection action.

The IRS's Problems Resolution Program ("PRP") can assist the taxpayer in resolving a service center problem, however, the assistance is provided in only in cases involving limited criteria. Problems Resolution has the authority to issue a Tax-

payer Assistance Order, a kind of administrative injunction, to halt the collection process. But the Problem Resolution Program's criteria for accepting a taxpayer's case have been based on the premise that jurisdiction is limited to instances where the taxpayer is unable to resolve the problem with the appropriate function. Although the IRS relaxed the PRP's restrictive criteria in 1995, taxpayers still must persuade the problems resolution officer that they will suffer significant hardship if the collection action continues.

Computer foul-ups cannot be legislated away, but there are a number of possible changes that can be made:

a. The IRS should provide more complete information to taxpayers about the alternative procedural solutions available to them to resolve problems they may have with a notice. The information should have a checklist of problems, specific solutions (and alternative solutions where appropriate), the specific requirements to be met in order for the solution to be available, telephone numbers of IRS offices, and the data that the IRS office will require. A preprinted envelope(s) should be provided, which is designed to permit taxpayers to complete the service center address with the code or stop number for specific problems.

b. Procedures the IRS already has in place to deal with taxpayer problems should be expanded to permit greater taxpayer access. This means restrictive criteria should be eliminated or revised. Furthermore, taxpayers should be permitted to request that a manager review a problem.

c. Taxpayers should be given easier access to taxpayer assistance personnel and the PRP. Specifically, taxpayers should not have to wait until the service center or other collection office fails to respond to taxpayer inquiries or requests before PRP intervenes. The PRP should be given statutory authority to temporarily stop the collection process as soon as the IRS fails to respond to a taxpayer complaint.

d. Once contact has been made with a service center employee, correspondence should include the particular employee's name and telephone number.

2. District Office Collection Actions.

As your hearings have confirmed, revenue officers in IRS district Collection Divisions have enormous discretion in taking collection action against taxpayers, including the filing of notices of federal tax liens against their property, serving levies, and seizing and selling their property. Taxpayers are deprived of their property without due process because there is no statutory procedure for any independent review of the revenue officer's collection decision.

Under the Collection Appeals Program, a taxpayer may obtain review of certain collection actions, proposed levies, seizures, and the filing of notice of lien. However, it is not clear that taxpayers are informed of their opportunity to appeal proposed collection action, and I suspect that revenue officers do not explain the procedure to delinquent taxpayers.

Accordingly, I recommend adoption of the following procedures:

a. There should be a statutory procedure for the review of IRS collection action.

b. The model for this review procedure should be Section 7429, which permits a taxpayer to obtain administrative and judicial review of a jeopardy assessment or jeopardy levy. The IRS must give the taxpayer notice of the jeopardy assessment or jeopardy levy New York within 5 days after the date of the assessment, after which the taxpayer has 30 days within which to request administrative review of the jeopardy assessment. In part, the purpose of the administrative review is to determine whether the making of the jeopardy assessment or levy was reasonable under the circumstance. The taxpayer may also obtain judicial review in a federal district court or the Tax Court. If the court determines that the making of the levy was unreasonable, the court may order the IRS to release the levy or to take such other action the court finds appropriate. The Code already provides a civil remedy (Section 7432) if the IRS erroneously fails to release a lien, and this statutory provision requires the taxpayer to exhaust his administrative remedies. The new lien and levy review procedures can provide this administrative remedy.

c. I believe that threatened liens and levies should be reviewed by an Appeals officer. Unlike the jeopardy levy review procedures, I recommend that judicial review be conducted by special trial judges of the Tax Court, who will hear the case on an expedited basis.

Question 2. The IRS targets low income and disadvantaged taxpayers for audit. You asked how these taxpayers can be given adequate protection from being targeted.

Answer. The IRS has misallocated its examination resources by targeting low income taxpayers. For example, individual taxpayers filing income tax returns, with Schedule Cs reporting less than $25,000, are audited far more frequently than the overall audit coverage percentage. I suggest the following steps might be taken:

a. Because targeting low income taxpayers is a management problem, at least one way to deal with the unfair audit coverage of low income taxpayers is to require that the Taxpayer Advocate be given the opportunity to review and object to the IRS annual audit plan to prevent the targeting.

b. Another way to protect low income taxpayers, whose returns have been selected for audit, is to require IRS Examination personnel to refer these taxpayers to legal clinics and available professionals supplied by state bar associations, state societies of certified public accountants, and enrolled agents so that they may have adequate representation during an examination.

Question 3. Are the Taxpayer Advocate and Problem Resolution Officers effective in quickly solving taxpayer problems?

Answer. I recognize that the Problems Resolution Program handles a substantial number of taxpayer complaints, over 300,000 in fiscal year 1996, according to the Taxpayer Advocate. However, I believe that the usefulness of the PRP to taxpayers is reduced by the restrictive criteria it uses in deciding whether to accept a case. Merely because a taxpayer cannot convince a problem resolution officer that collection action will cause the taxpayer significant harm does not mean that the taxpayer should be subjected to erroneous collection action.

Even if PRP takes a case, it frequently resolves the problem merely be seeing to it that the taxpayer's problem is or has been assigned to the appropriate office. The problems resolution officer does not determine whether the action of the office is proper or reasonable. In short, I do not believe that the PRP solves taxpayer problems. It merely acts as a gate keeper.

Furthermore, whether because of restrictions on their actions or possibly the incompleteness of their training, problem resolution officers often seem more intent on closing a case than in solving taxpayer problems.

Question 4. You have asked how the current offer and compromise program can be improved.

Answer. Recognizing that there is no panacea for this issue, 1 recommend several approaches.

a. A third party should be interposed in the offer in compromise process to help the taxpayer and the IRS collection officer work out an agreement. The problem with the current system and the proposal is that taxpayers who are unable to pay their tax obligations need financial planning advice, not instructions from revenue officers on how much they can spend for what taxpayers consider to be necessary living expenses. By the very nature of their role with the IRS, revenue officers are not equipped to give that advice. The third party should have a background in financial planning and should have as his or her objective, the development of a practical and attainable plan to pay as much of the tax as possible.

b. The individual who serves in this capacity as financial advisor/mediator may come from a specialized group in the IRS's Appeals Division, the Taxpayer's Advocate Problems Resolution function, or outside private practitioners, who have these skills. I believe that retired professionals and business people should be considered to serve in this role. However, because many offers in compromise are agreed upon at Appeals offices already, I recommend that taxpayers be given the statutory right to have an Appeals officer assist in the offer in compromise process, and that Appeals officers be detailed to local district offices to deal with offers.

c. There must be a different approach to the evaluation of the taxpayer's financial condition as part of the offer in compromise process. At the present time, the IRS Collection Division will not agree to an offer in compromise unless the taxpayer demonstrates that there is doubt as to collectibility; that is, doubt that the liability can be collected from the taxpayer.

However, doubt as to collectibility is determined to exist only after the taxpayer pays the maximum amount that can be paid. The IRS's financial analysis forces the taxpayer to pay an amount which approximates the liquidation value of the taxpayer's property before the IRS will agree to the offer in compromise. This makes the offer in compromise process similar to a liquidating bankruptcy under Chapter 7 of the Bankruptcy Code. It is unrealistic to expect that taxpayers will sell their assets and pay the IRS the net proceeds in order to obtain an offer in compromise. I suspect that one of the reasons that the number of taxpayer bankruptcies has increased, with the IRS as the single or major creditor, is the IRS's approach to an acceptable offer. Taxpayers simply choose to go

through a reorganization proceeding under Chapter 11 or wage earner's plan under Chapter 13 of the Bankruptcy Code, rather than an offer in compromise, which will require them to liquidate their property. It should be noted that under Chapter 13 a debtor has 6 years to pay a tax debt. Accordingly, I recommend that the offer in compromise procedure be coordinated with Chapter 13 of the Bankruptcy Code with the ultimate objective of giving the delinquent taxpayer the fresh start that the Bankruptcy Code contemplates for all debtors.

d. The focus of the offer in compromise procedure should be on the collection of the unpaid tax. In a significant number of cases, full or even substantial payment of the tax is all that can reasonably be expected. Because interest is market sensitive and compounded daily (therefore often twice or three times the amount of tax), the failure to collect interest should not be an obstacle to agreement. Penalties, such as the failure to pay penalty, should not be imposed when a taxpayer is complying with the terms of an installment payment agreement or offer-in-compromise.

e. I do not believe that standardized expenses will help the compromise process. Revenue officers will apply standardized expenses inflexibly, and taxpayers will perceive them as the revenue officer's way of intruding into their personal affairs. For this reason, I believe the focus should be on assisting the taxpayer to develop a financial plan to pay off the delinquent tax debt (principally the tax) while paying timely current obligations. The Appeals officer should help the taxpayer in this process, or volunteer assistance should be provided.

I recognize that some will say that this approach will reward delinquent taxpayers and be unfair to taxpayers who are compliant. I agree with this criticism. However, my experience tells me that it is no reward to have to deal with the tax collector. It benefits the tax system as a whole, moreover, if the delinquent taxpayer, who honestly is unable to pay to the full amount of past tax debts, is given a fresh start, and the IRS is relieved of ever-increasing, uncollectible delinquent accounts. Some radically reduced expectations are necessary if this is to happen.

Question 5. You have asked whether, for purposes of accountability, all IRS correspondence should be signed by IRS personnel, and whether an IRS employee should be assigned to taxpayer when problems arise.

Answer. I agree that to have a specific IRS employee contact a taxpayer may be helpful. However, many IRS notices already have a contact person and a telephone number. Some IRS notices have the names of a non-existent person with a contact number. My understanding is that the reason why a non-existent person is used is to protect IRS personnel from tax protesters or other problem taxpayers who might contact an IRS employee personally. I recognize that this may be a legitimate concern.

One way to reconcile the taxpayer's need for speedy resolution of a problem and the IRS employees' personal interests is to require the assignment of a single IRS employee after the first contact with a taxpayer. The expectation would be, that in the first contact, the bona fides of the taxpayer's problem could be determined and an appropriate assignment made.

Question 6. You have asked whether taxpayers should be entitled to attorney's fees and costs if they prevail in Appeals.

The award of attorney's fees to taxpayers who prevail in Appeals seems appropriate because a taxpayer necessarily is forced to incur expense to establish that the district's adjustment was improper. On the other hand, I am concerned that the settlement process in Appeals will be undermined if an Appeals officer knows that he or she will be exposing the IRS to the cost of attorney's fees if an adjustment is substantially reduced. This may cause the Appeals officer to be more reluctant to concede an issue or settle it substantially in the taxpayer's favor.

Also, the limitations on the benefit of awards of attorney's fees under Section 7430 should be recognized. First, there must be a determination as to whether the taxpayer has substantially prevailed, and whether the IRS's position is substantially justified. Secondly, litigation over the entitlement to fees is not a satisfying remedy to a taxpayer who has been successful, but must chance further expense to secure only partial reimbursement for any fees.

Accordingly, I do not recommend further enhancing the recovery of reasonable administrative costs.

Question 7. You have asked whether IRS employees should be required to follow the Internal Revenue Manual, and if so what remedies a taxpayer should have if these procedures are not followed.

I believe that IRS personnel should be required to follow the Manual. As a general matter of administrative law, an administrative agency is required to follow its own procedural rules. While a number of courts have held that the IRS's Procedural Regulations and Manual are directory and not mandatory, these courts have failed to

recognize decisions of the Supreme Court that have held that an agency is bound by its own procedural rules when some personal interest of an affected person is involved. In general, a taxpayer should have the same right he or she would have had if the IRS employee had followed its Manual, and the IRS should be required to return the situation to the status quo ante; that is, the situation before the violation of the Manual provision.

For example, if the IRS makes an assessment of a penalty before the taxpayer has had an opportunity to appeal the penalty in pre-assessment status, the IRS should be required to abate its assessment and permit the taxpayer to appeal the proposed penalty to the Appeals office. Similarly, if the IRS sends a notice of deficiency without giving the taxpayer an opportunity to appeal the district's deficiency determination, the IRS should be required to rescind the notice so long as there is sufficient time remaining on the statute of limitations to permit the administrative appeal. If there is insufficient time on the statute to permit the taxpayer's appeal, the IRS should not be required to rescind the notice unless the taxpayer agrees to extend the statute. Also, if the IRS takes collection action in violation of the Manual, it should be required to release a levy or lien and follow the procedure the Manual requires.

PREPARED STATEMENT OF DR. RONALD P. SANDERS [1]

I. INTRODUCTION

Mr. Chairman, I appreciate the opportunity to appear before the Senate Committee on Finance to discuss proposed legislation to restructure the Internal Revenue Service (IRS). While the Service has a long and venerable history, nearly everyone agrees that the time has come for major changes in the way the agency does business with the American taxpayer, and both Houses of the Congress have responded with multifaceted legislation designed to usher the IRS into the 21st century. At the request of your staff, I would like to concentrate on two major aspects of that legislation this morning: (a) the proposed establishment of a new management and oversight structure for the IRS; and (b) proposed "upgrades" to the various internal management systems that are critical to the agency's mission—especially its human resource management system. In each instance, I will use the various provisions of the Senate bill (also known as the Kerry Substitute) as a benchmark.

II. MANAGEMENT AND OVERSIGHT

First, with respect to the management and oversight structure of the IRS, the President and the Congress now seem to agree that some sort of Oversight Board, variously composed of internal and external stakeholders, is necessary. As first stated in the Report of the National Commission on Restructuring the Internal Revenue Service—hereafter referred to as the National Commission—such a body (it was initially to be called a Board of Directors) was to " . . . guide the direction of long-term strategy at IRS, appoint and remove its senior leadership, and hold IRS management accountable," and its "experience, independence, and stability . . . (would) give Congress more confidence in IRS operations." [2] These are all laudable objectives, but as presently configured, the Oversight Board may not be up to achieving them.

Oversight or Operations? First, there is the fundamental question of its role. Is it one of oversight or operations? In both House and Senate versions of the legislation, the Board's title is clear, but its reach and responsibilities are not at all. Is it truly to be an oversight body, as its name implies, a surrogate of the Congress, standing apart of the Service and sitting in judgment of its managerial efficacy? Or is its function principally operational, adding yet another layer in an organization that already has too many (seven at last count), further attenuating the accountability it was expressly designed to improve? As it now stands, the Board seems to be a little of both—at best its responsibilities in this regard are unclear; at worst, they are schizophrenic, with the Board forced to blend and balance potentially conflicting and confusing responsibilities. This ambiguity has all sorts of implications for the Board's jurisdictional purview and efficacy, as well as the size and composition of its membership.

Nowhere is this schizophrenia more evident than in the Board's jurisdictional charter. The Board's title notwithstanding, that charter suggests a body (albeit a part-time one) deeply involved in the day-to-day minutiae of running an agency, approving the Service's strategic plans and internal reorganizations, even determining—and thereafter submitting—the agency's annual budget request. Thus, instead of clarifying the Commissioner's accountability in this regard, the Board's presence

clouds it. Does it advise or approve? In the case of the agency's strategic plan, or its budget, who does the Congress hold responsible for their ultimate execution? What happens if the Board and the Commissioner disagree, say on priorities within the Service's various business plans, or on matters of resource allocation within its overall operating budget? Who decides? One could easily envision this Committee becoming embroiled in such operational questions, and they are best handled up front—decide whether the Board's mission is oversight or operations, one or the other.

In my view, the Oversight Board should stick to oversight. It should review, not approve; advise, not decide. Any other path is slippery. For example, take the issue of Board access to individual taxpayer information. The legislation suggests that the Board should have such access (to taxpayer and employee files and records, internal audits, etc.) on grounds that it is essential to its oversight role—that is, that access would prevent just the sorts of abuses uncovered by this Committee several months ago. This is fine in theory but difficult in practice, where the Board will be tempted to correct what it finds, and in so doing, become a de facto court of first resort for taxpayers, one more administrative appeal procedure. The IRS already has plenty of investigatory, advocacy, and appellate avenues, and while we could debate their effectiveness, the point is that providing one more is hardly the answer. Thus, access to individual files and records, sanitized where appropriate to accommodate privacy interests, should be for the purpose of identifying adverse or abusive patterns and practices. And where such patterns are identified, the Board should direct the IRS to correct them, rather than intervene in its own right.

Advise or Approve? The Board's somewhat ambiguous role also bears on the issue of its membership. To the extent that the Board takes on a greater role in the day-to-day management of the Service, its proposed composition is problematic, particularly with respect to two of its principal prospective members: the Commissioner and the representative of the National Treasury Employees Union (NTEU). As it now stands in the Senate bill, the former is not a member of the Board, presumably on the theory that the latter must remain independent of the Service's chain of command. This "separation of powers" approach has historic legitimacy, but it works only if the Board remains an oversight body, deliberately detached from the day-to-day executive functions of the Service. To the extent that it begins to suffer from "mission creep"—that is, a gradual but greater intrusion into the administrative and management operations of the IRS—that separation may come to undermine the Commissioner's authority, as well as the Board's.

In short, the Board (and the Congress) must maintain a clear distinction between management oversight and management operations. Otherwise, who exactly will be in charge? If the Board disagrees with an operational decision of the Commissioner, say in the delicate area of personnel, will it overrule—or will the Board let the Commissioner act, holding him or her accountable after the fact? One is operational, the other oversight, and it is difficult to mix the two. Indeed, we are all familiar with the old expression "going native"—applied to those administrative reformers who come to be captured by the very bureaucracies they were intended to tame—and there is some risk that an operationally-oriented Oversight Board would fall into this trap. After all, to the extent that it becomes part of the Service's internal decision-making process, it will (and should) take responsibility for those decisions—even as it is charged with independently determining their efficacy.

In my view, the answer here is straightforward, an either/or choice for the Congress: if the Oversight Board is to have any operational authority whatsoever, the Commissioner should be a full-fledged member—perhaps even its chair. At least then, there would be a single chain of command and accountability (albeit by committee). On the other hand, if the Board is to remain an oversight body, independent of the IRS, then the Commissioner should not be a member; rather, he or she should answer to the Board on management matters, much as the Secretary of the Treasury and the Commissioner must answer to the Congress on matters of tax policy. The boundary here must be drawn clearly, on the difference between advise and approve, one or the other. Is it to be an Oversight Board, or an Operations Board?

This critical distinction between operations and oversight would seem to bear on other administrative issues involving the Board, such as its size and structure. I have no views on the number of Board members—the more the merrier—so long as the Board remains focused on management oversight. A Board involved in management operations, however, is another thing altogether; here, "size does matter." We all know how hard it is for a committee to make operational decisions, and according to the Commission, this is especially the case with the IRS and its Executive Committee.[3] This difficulty would only be compounded by a large Oversight Board involved in approving major management decisions. I would view questions concerning the Board's authority to constitute subcommittees much the same way: where

such appendages may be necessary for oversight, they would impede operational effectiveness, complicating an already-far-too-complex management structure. It all turns on clarity of mission and function.

Union Representation. The distinction between oversight and operations also bears on the controversial question of union representation on the Board. I would urge the Congress to apply the same rule of thumb here: that is, if the Oversight Board is to become involved in day-to-day management decisions, then NTEU representation on the Board is redundant—and may even constitute a potential conflict of interest:

- Redundant in the sense that the union presently enjoys exclusive recognition for most of the Service's 100,000 employees, entitling it to speak for (and bargain on behalf of) their collective interests; it also enjoys one of the most effective labor-management partnerships in the Federal government. Thus, by law and custom, NTEU would be intimately involved in any matter affecting IRS employees long before it ever reached an operationally-oriented Oversight Board. And to the extent that those matters that may require Board review (or approval) , the union ought to be going with the IRS Commissioner to seek it—as a partner—rather than sitting in judgment of the Commissioner on the Board itself. In this regard, union membership constitutes a "second (or maybe even third) bite of the apple."
- A potential conflict of interest, in that a union representative on an operationally-oriented Oversight Board would be privy to information adverse to the interests of his or her constituency—for example, a confidential Board decision to close a facility or conduct a reduction-in-force (RIF). What does the union representative do with that information? On the one hand, as a Board member, he or she would be obliged to maintain the confidentiality of that information until it is released. On the other, that union official has a statutory duty to represent employee interests, and that duty may argue for disclosure. If my friend Mr. Tobias is to be the NTEU representative on the Board, I do not envy him in this position.

In my view, union representation on the Board is particularly problematic when it comes to personnel decisions involving individual IRS executives and employees. First of all, I believe that an Oversight Board should not become embroiled in that level of detail. It is one thing to oversee and assess the overall performance of business lines and units within the IRS—that is clearly within an Oversight Board's purview—but it is quite another to deal with individual personnel actions that may derive from those assessments. By definition, such matters are strictly confidential, and while the Board may review them in the aggregate (in order to determine pattern or practice, or even to appraise the Commissioner's performance in this regard), I do not believe a true Oversight Board—with or without union representation—should be in the business of making, or even reviewing, those decisions. Add a union official to that mix, even in the context of the IRS-NTEU partnership, and you make an already "risk-averse"[4] management culture even more so. Can you picture a union official bargaining with the Commissioner's senior staff one day, and then as a Board member, judging their performance the next?

In matters involving IRS personnel, let me suggest another general rule of thumb here: if the proposed Oversight Board is to be concerned with such personal matters—that is, if individuals can be identified—then the union should not have a seat on it. On the other hand, if the Oversight Board is to be strictly concerned with management oversight, in a programmatic sense, I believe that union membership is permissible, potentially giving the Board access to a point of view that it needs to accomplish its mission. Indeed, in many respects, Federal employee unions generally (and NTEU in particular) have traditionally played an effective role in government oversight, so formalizing that role in this particular case is not particularly problematic—and entirely compatible with the Board's oversight responsibilities. However, to belabor the point, insofar as those oversight responsibilities are diluted and diverted by extensive operational involvement, union membership should be carefully considered—by the Congress and the NTEU.

III. MANAGEMENT SYSTEMS

If the IRS is to be transformed, it needs more than a new vision and management structure; while these are no doubt crucial, it also needs new management systems—human, information, financial, etc.—that give its leadership the wherewithal to realize that vision and structure. In my view, the most important of these is the Service's ability to manage its human resources more effectively, for without the right people in the right places, the vision of the Commission and the Congress will remain just that. Accordingly, I would like to spend the remainder of my time ad-

dressing the various personnel flexibilities proposed for the IRS by the Administration and the Congress. They come in two types—those dealing with the Service's senior executive corps, and those that address its civil service work force more generally—and I will take each in turn.

New Tools at the Top. It is clear that the IRS needs an infusion of new leadership at the top. This is not to say that the present corps of senior career executives is somehow deficient or lacking in this regard. To the contrary; as a general matter, Senior Executive Service (SES) members in the IRS are among most respected in the Federal government, and the Service has long had one of the most effective executive development strategies anywhere. However, like most Federal agencies, senior executives in IRS tend to come "up from the ranks" and may need to be augmented with outside talent and experience from time to time. This is one of those times—it is often hardest for those who have grown up in an organization to see the way clear to radically transform it—and nothing less than a paradigm shift is required among the agency's senior executive, technical, and professional leadership.

The Congress and the Administration propose a number of provisions that would help bring that paradigm shift about. For example, one such proposal would give the Commissioner "fast track" authority to establish and fill up to 40 critical technical, professional, and managerial positions for up to four years apiece—and pay those who occupy them (by law, from outside the IRS) up to $172,000 per annum.[5] Other proposals would (a) expand the Treasury Secretary's discretion, on behalf of IRS, to request similar compensation for other senior executive and equivalent positions under existing "critical pay" authority; (b) eliminate certain limitations (in the total amount, as well as in the method of payment) on existing authority to pay recruiting, relocation, and retention allowances; (c) increase the number of emergency and limited-term SES appointments the Service could make—up to 10% of its total SES allocation (not just its career-general allotment)—and permit extensions of those appointments for up to two additional three-year terms; and (d) increase the amount of bonuses payable to the Service's top senior executives, where they manage to meet pre-established performance goals.

I would urge the Senate to include all of these in its final bill. They offer just the kind of targeted tool kit that the IRS needs to reinvent and revitalize its senior leadership cadre. None of the tools represent such a radical departure from current law, and in some cases, the proposals follow precedent already established in other agencies by the Congress. Absent such tools—especially those dealing with compensation—the Commissioner will have a difficult time attracting and motivating the kind of "cutting edge" executive, professional, and technical talent that he needs, talent that is essential to the transformation of the IRS. And while some may suggest that now is not the time to be so generous to IRS executives, or that such generosity will inevitably be subject to abuse, this is precisely the reason for having an Oversight Board: not to review individual salaries and bonuses, but to ensure that overall, IRS executive compensation is justified by its bottom line performance.

An Alternative Personnel System. A similar case may be made for the more general human resource management (HRM) flexibilities proposed by both the House and the Senate. Here again, there is nothing very radical—indeed, the proposals generally track a model Congress first applied to the Federal Aviation Administration in 1995—that is, they authorize the IRS to develop and deploy an alternative personnel system customized to meet its unique circumstances and needs, but presumably within the broad principles and guidelines of Federal civil service law[6]—in effect, a "system within a system." There is ample precedent for this. According to a 1996 General Accounting Office report on the state of the Federal civil service, the Congress has approved similar, customized HRM arrangements for over half of all Federal employees—without any apparent ill effects—and this proposal is no more than the latest chapter in that larger trend away from a unitary, "one size fits all" Federal civil service.

As part of that alternative system, the Senate would grant IRS expanded personnel demonstration project authority, without regard to the numerical limitations currently established by chapter 47 of title 5; however, the IRS would still be subject to existing restrictions on the content of such demonstrations (for example, the agency could not experiment with employee health benefits). That same provision would allow such projects to become permanent—that is, statutory—upon notice to the public and the Congress, and would also eliminate a proposed House requirement to consult with the Office of Personnel Management in project design; however, agencies with similar expanded demonstration authority have not found OPM consultation especially onerous, particularly where statutory waivers are involved; moreover, it is not clear that such a waiver, once granted under such authority, could automatically become law without congressional action. Accordingly, the Senate may wish to reconsider these provisions.

In addition, the Senate would grant IRS authority to establish a paybanding job classification and compensation system, so long as it meets general OPM criteria.[7] While I caution against the level of detail contained in the legislation (any fine-tuning would literally require an act of Congress!), in concept, such a system would provide the Service with the kind of flexibilities it needs—in how it structures work and jobs, and how it pays people to restructure, this in sharp contrast to the rigidities engendered by the Federal government's half-century old General Schedule classification scheme. In this regard, most experts agree that that GS system is obsolete, out of step with the requirements of a more team-based, customer-focused government, and paybanding has long been identified as its most feasible heir apparent. Indeed, the concept is not new—the Department of the Navy's China Lake demonstration project first pioneered paybanding in the early 1980's,[8] and several years ago, the Congress authorized DoD to expand its use to other research and development facilities; FAA is also in the process of implementing its own paybanding system, under authority comparable to that contemplated by the Senate.

Impasse Resolution. The design and deployment of an alternative personnel system in the IRS requires some discussion about the extent of union involvement in that effort—that is, in the form of formal collective bargaining, as opposed to more informal, interest-based partnership discussions. Under normal circumstances, existing bargaining rights and obligations have worked reasonably well in this regard. When it comes to standard demonstration project authority, those rights and obligations (generally established by 5 USC chapter 47) have heretofore required labor and management to agree on the substantive aspects of the project before it is allowed to proceed. This provides a necessary safeguard, given the fact that such projects typically involve exceptions to governing personnel laws and regulations that are otherwise beyond the power of either of the parties to amend. Does this give the union a potential veto? Perhaps, but the same applies to the agency, and the general assumption is that both have a compelling motivation to find common ground.

However, these are not normal circumstances. By some accounts, the IRS is in a state of crisis—it is certainly in need of some restructuring—and if left to the legislation and the law as they now stand, the agency's restructuring efforts (not to mention the intentions of Congress) could be impeded if labor and management cannot reach agreement on the parameters of an alternative personnel system. Such a laissez faire approach may suffice when the only objective of a demonstration project is research, but here the consequences of impasse—that is, inaction and the status quo—are much more serious. Accordingly, in the event that the IRS and NTEU cannot come to terms on an alternative personnel system for the agency, the Senate should give either party access to the Federal Service Impasses Panel (FSIP); the Panel, established by the Federal Labor-Management Relations Statute (5 USC chapter 71), has a long and effective history of resolving bargaining impasses, and its expertise should be available in a matter as important as this.

Reshaping the Work Force. Separately, these approaches (including those dealing with collective bargaining) should be made an integral part of the Service's restructuring legislation. Taken as a whole, they would provide the IRS with a state-of-the-art human resource management system better fitted to the requirements of its intended transformation. However, getting there is easier said than done, and this maxim suggests that one additional tool is necessary—buyout authority. By providing the IRS with standard Voluntary Separation Incentive Pay (VSIP) authority through 2002—perhaps subject to an OMB-approved strategic plan—the Senate would go far to ease the organizational pain that will most certainly be engendered by this effort. Thus, even while the IRS may be able to keep its promise of relatively stable employment level throughout the transformation process, that "flat line" masks the need for massive internal displacements and redeployments (functional as well as geographic), as the existing work force is retooled to the Service's new structure and culture.

VSIP can ease the trauma of these redeployments, for employees and the organization alike. Obviously, buyouts offer those retirement-eligible workers and managers who cannot (or will not) change an easy way out, but significant advantages accrue to the IRS as well. If properly targeted at surplus skill areas, they can provide an extremely effective way to "reshape" the agency's work force; only reductions-in-force are more effective at such surgery, but most consider their price too high. In this regard, buyouts are also quite cost-effective; compared to the costs of retraining, relocating, or RIFing surplus employees, it is often much less expensive to "buy them out" and hire new ones. And this infusion of new skills and talent hastens the transformation process. In sum, when it comes to the sort of restructuring envisioned for the IRS, VSIP authority is more than worth the price—it is an essential means to the end that Congress and the Administration both seek.

Mr. Chairman, the challenges associated with restructuring the Internal Revenue Service are considerable, but they are neither unprecedented nor insurmountable. Other Federal agencies have faced similar challenges, and they have successfully transformed themselves. However, they required a compelling vision, a solid implementation strategy, congressional support, and the right tools. From my vantage, the Senate bill seems to have these just about right (indeed, in some cases, the IRS would enjoy advantages over those agencies that have come this way before) and with some clarification and modification, your legislation will serve the Service—and the American public—well.

I would be pleased to answer any questions the Committee may have.

ENDNOTES

[1]: Not for release until February 25, 1998. The statements contained herein reflect the personal views and opinions of the witness and do not constitute or represent the official position of the University or any other organization
[2]: Report of the National Commission on Restructuring the IRS (Washington, DC; June 1997—page 5)
[3]: ibid; Commission Report, page 7
[4]: ibid; Commission Report, page 12
[5]: Note that incumbents would not be entitled to normal civil service protections under 5 USC chapter 75
[6]: For example, the merit principles set forth in title 5, United States Code
[7]: Note that while the House does not provide for paybanding, the Kerry Substitute bill would
[8]: Congress subsequently made the system permanent there

Ronald P. Sanders

Dr. Ronald P. Sanders (DPA 1989) is an Associate Professor of Public Administration with the George Washington University's School of Business and Public Management. In that capacity he also serves as Director of the School's new multi-million dollar Center for Excellence in Municipal Management, a unique public-private partnership with the District of Columbia and the area's business and professional communities chartered (by mayoral proclamation) to help Washington, DC rebuild its leadership and management capacity. Prior to returning to GWU, Dr. Sanders held a faculty appointment as Eminent Professor of Public Administration Practice with Syracuse University's Maxwell School of Citizenship and Public Affairs, where he also founded and directed Maxwell's Washington, DC Center for Advanced Public Management. He has been an elected member of the Board of Directors of the Senior Executives Association since 1990, and an officer (Secretary) from 1995-1997. He is also Faculty Chair of the Brookings Institution's Government Affairs Institute and a Principal with the Council for Excellence in Government.

In his present capacity, Dr. Sanders conducts research, teaches, and consults on government reinvention and change, civil service reform, public human resource management, privatization, and public-private competition. He has worked with public organizations at all levels of government in the US and abroad. He has testified before Congress on numerous occasions—most recently in 1997 on civil service reform—and has been appointed co-chair of the District of Columbia's Council on Privatization and Managed Competition; he is also a member of its Personnel Reform Advisory Committee and co-chairs the National Performance Review's Privatization Roundtable. In addition, he is a regular lecturer at the Peoples Republic of China's National School of Administration and has provided expert advisory services for such foreign governments as the Ukraine, Korea, and the Kingdom of Jordan.

Dr. Sanders is the co-author of Civil Service Reform: Building a Government That Works (Brookings Institution Press, 1996), as well as Transforming Government: Lessons from the Reinvention Labs (Jossey-Bass, 1998). He has also been published in several professional and academic journals—most recently in the Public Productivity and Management Review ("Strategies for Reinventing Federal Agencies")—and is a regular contributor to Government Executive Magazine and The Public Manager, where he serves as an associate editor. He has also contributed chapters to several books, including "Gainsharing in Government: Group-Based Performance Pay for Public Employees" in New Strategies for Public Pay (Jossey-Bass, 1997) and "Reinventing the Senior Executive Service" in New Paradigms for Government; (Jossey-Bass, 1994). In addition, his doctoral research, "The Best and Brightest: Can the Public Service Compete?" was published as part of the Volcker Commission's final report, Leadership for America: Rebuilding the Public Service (1989).

A career member of the Federal Senior Executive Service, Dr. Sanders was awarded the Presidential Rank of Meritorious Executive in 1994. From 1990 to 1995, he

served as the U.S. Defense Department's senior career human resource management (HRM) executive, with responsibility for personnel and equal employment opportunity policies and programs covering the Department's one million civilian employees. Dr. Sanders also founded the Defense Civilian Personnel Management Service (DCPMS), a $46M organization employing 360 people worldwide, and he served as its first Director and CEO. While at DoD, Dr. Sanders led the Department's historic civilian drawdown, pioneering the use of civilian separation incentives ("buyouts") in the Federal Government and using them to reduce the Department's employment rolls by over 230,000 people in four years—with less than 12,000 involuntary separations; he also spearheaded a landmark restructuring of DoD's HRM business area, automating and regionalizing world-wide operations to achieve projected savings of over $100M annually. Prior to his appointment in the Office of the Secretary of Defense, he served as Deputy Director of Civilian Personnel (SES) for the Department of the Air Force.

PREPARED STATEMENT OF ROBERT S. SCHRIEBMAN

Mr. Chairman, Senator Moynihan, and members of the Committee, thank you for opportunity to be of service and to express my views on restructuring the Internal Revenue Service. I am a practicing tax attorney in the City of Rolling Hills Estates, which is a suburb of Los Angeles. For the past 20 years, my practice has been primarily limited to matters of tax collections, audits and tax litigation.

I am the author of several books on IRS practice and procedure with emphasis on audit and collection practices of the IRS. I wrote the first practitioner's manuals on IRS and California collection defense practice. I taught IRS practice and procedure at USC's Graduate School of Accounting. I wish to emphasize, however, that I am not an ivory tower academic, but a full-time practicing tax lawyer. I come in daily contact with both the IRS' Audit and Collection Divisions.

OVERSIGHT HEARINGS OF SEPTEMBER, 1997

Last September, this Committee heard three days of IRS horror stories ending with an apology by then Acting Commissioner Michael Dolan. We learned that an IRS District Director can take a taxpayer's home with a stroke of a pen; it's in the Internal Revenue Code. We learned of the complete absence of taxpayer due process when the IRS takes a taxpayer's home; and an absence of due process when the IRS takes a taxpayer's business. We learned that IRS collectors, with the blessings of management, can and do, commit perjury before federal judges when seizing taxpayer's assets. These people believe that they are above the law and that there is no day of atonement. We learned how the IRS forces productive taxpayers into bankruptcy because of unrealistic expense allowances. We learned that there is an "us versus them" mentality at the IRS. "Just scratch any taxpayer hard enough and you will find a tax cheat." We learned that the collection and audit quota system is alive and well despite prohibitive legislation in the first Taxpayer Bill of Rights.

Sadly, we learned that there is an absence of accountability within the system to the targeted taxpayer and to the American people—an institutional arrogance. Taxpayer abuse is so pervasive as to be perversive.

CONGRESS RESPONDS

Last October the House passed H.R. 2676 entitled "IRS Restructuring and Reform Bill of 1997." This Committee wisely waited until further hearings and investigations could be conducted before coming up with its own version of IRS reform. It is now clear that H.R. 2676 was much less than meets the eye. When all is said and done, a lot was said, but very little was done.

In my opinion, there isn't more than a handful of provisions in the Taxpayer Bill of Rights 3 (TBR3) that truly protect a taxpayer from IRS overzealousness or an attempt to provide a level playing field. In other words, if TBR3 passes, it will he business as usual at the IRS.

PROPOSALS FOR IRS REFORM AND TBR3

After practicing law in the area of IRS tax controversies for over 25 years, together with writing books, teaching at the university level and lecturing on IRS audit and collection procedures, I have made the following observations:

1. When a taxpayer has a problem within the IRS, about the only place to go to resolve the matter is within the IRS. History has shown that the Problem Resolution Program doesn't work most of the time and the Taxpayer Advocate

is a "weak sister." This leads to taxpayer frustration, anger and a loss of faith in the system.

2. On many types of assessments and penalties, the IRS is the sole judge, jury and executioner. This generates a conflict of interest. You are guilty until proven innocent. The taxpayer doesn't get a fair shake.

3. There is virtually a complete absence of basic due process when it comes to IRS liens, wage garnishments, and seizures of assets. Basic due process consists of giving the taxpayer notice and an opportunity to be heard prior to enforced collection, not afterwards in super expensive court proceedings. In other words, basic due process means basic fairness.

You don't need a psychiatrist to tell you that you can't change the next guy—you must be the one to change. IRS taxpayer abuse is inborn, inbred, and systemic. It's not going to change with an apology from Michael Dolan or promises from new IRS Commissioner Rossotti—no matter how sincere or well-meaning. Within a few months after these hearings are over, it will be "business as usual at the IRS." IRS representatives will tell this Committee, members of Congress, and the American people anything they want to hear to avoid stronger taxpayer rights.

IRS monthly open houses are good "PR" and may represent a positive step in the right direction, but what is needed is the elimination of internal conflicts of interest, the establishment of real due process, and a realistic business-like approach to collecting the billions of outstanding, dollars known technically as the "tax gap."

SPECIFIC PROPOSALS

I submit to you four specific proposals for your consideration:

1. Creation of an Outside Independent Forum to Hear Taxpayer's Complaints of IRS Field Level Audit and Collection Problems

I recommend the creation of an outside independent forum to hear taxpayer complaints of IRS field-level audit and collection abuses without the taxpayer first having to first pay what the IRS alleges is owed.

We currently have in place two judicial forums available to hear taxpayer complaints. These are the United States Tax Court and Federal District Court Magistrates. To increase the jurisdiction of either or both of these forums would be the most cost-effective with minor systemic changes.

Tax Court Judges, for the most part, are headquartered in Washington, D.C. There are only one or two Special Trial Judges permanently stationed in major cities such as Los Angeles. Senior Trial Judges travel circuits around the country. This proposal would hire more Special Trial Judges to be permanently located in federal buildings in most major cities or in the capitals of the several states.

Ideally however, it is my recommendation that a system of administrative law judges (ALJs) be created with a chief administrative law judge headquartered in Washington. DC. This will provide taxpayers a low cost and informal forum where lawyers and other highly paid professionals will not be necessary as they would be in the Tax Court and other federal courts.

2. Guarantees of Due Process for the Following IRS Activities:

(a) Liens, levies, wage garnishments and seizures.

(b) Accusations of alter-ego and transferee liability.

(c) Trust Fund Recovery Penalty. This is really not a penalty. It is a tax. Currently, the IRS uses a "shot gun approach" to assessing this penalty within an organization. It's something like the old Army joke. "I need volunteers—you, you and you." Field cases are not properly and thoroughly developed. Many targeted taxpayers are innocent. Taxpayers wishing to contest this assessment have to plead their case before the IRS. The IRS is the sole judge, jury and executioner. The IRS knows that most targeted taxpayers cannot afford to go to court, so the IRS sticks them with the assessment, guilty or not. The botton line is an economic life sentence.

3. Realistic Approaches to Accepting Offers in Compromise

The offer in compromise process could be a highly effective vehicle for bringing taxpayers back into the system and collecting delinquent taxes. The IRS, however, changes the rules every few months making it more difficult for taxpayers to take advantage of a procedure that has been part of American taxation virtually since the War of 1812. It is my recommendation that specific legislation be introduced encouraging the IRS to adopt liberal acceptance procedures for offers in compromises.

In 1996, the GAO estimated that approximately $200 billion was owed by taxpayers having delinquent accounts. If the truth were known, it would be probably more like $400 billion. The Treasury is losing tens of thousands of dollars per sec-

ond in uncollectible accounts, because of the expiration of the ten year statute of limitations for collection.

The IRS is willing to force an otherwise productive taxpayer into bankruptcy rather than accepting a fair offer in compromise. This is the biggest scandal in American taxation today.

4. Expansion of the Award of Civil Damages for Unauthorized Collection Activities

Historically, taxpayers have been allowed to go to court to recover damages for violations of the tax law. This means violation of the Internal Revenue Code. This does not go far enough. The IRS doesn't pay. The IRS wears down the taxpayer. The IRS keeps appealing because it has the free use of the Department of Justice—the largest and best law firm in the country. I propose the following:

(a) Award civil damages including attorney's fees and related costs for intentional, reckless, or negligent violations of the Internal Revenue Code, the Internal Revenue Manual (the Bible of the IRS), and IRS national policies (which are also set forth in the IRS Manual).

(b) Once a judge awards a taxpayer damages, fees and costs, the IRS will not be allowed to appeal and the Treasury must pay the award in full within 90 days.

CONCLUSION

In summary, what I am proposing is the legislation of basic fairness and taxpayer respect. Both are absent from today's IRS and Internal Revenue Code. You are not going to have basic fairness and respect by naively trusting promises from the IRS no matter how sincere and well-meaning. There are those in the IRS who right now are laughing at what this Committee stands for and its lofty aims. These IRS employees are not taking you seriously. Strong legislation is the necessary bottom line.

Thank you for the opportunity to be of service.

PREPARED STATEMENT OF G. JERRY SHAW

Thank you for the opportunity to present the views of the career Senior Executive Service corps of the federal government.

The Senior Executives Association (SEA) is a professional association representing the interests of career members of the Senior Executive Service and other career executives in equivalent positions in the federal government.

SEA opposes the establishment of an Oversight Board at the Internal Revenue Service. We believe that the members of an Oversight Board, if composed of private citizens, would inherently be viewed by the tax paying public as having conflicts of interest, or as politicizing the operations of the Internal Revenue Service.

Having said that, we recognize that there is overwhelming support in Congress for such a Board. We will, therefore, confine our comments to the manner in which an Oversight Board could be constituted and to some ways that the appearance of conflicts of interest could be ameliorated.

IRS Oversight Board-Asset Disclosure

First, we believe that any person appointed to the Oversight Board should be required to make public disclosure of his/her assets. The Board, as proposed in the House passed Bill, HR 2676, as well as in the Senate alternatives that we have seen (S.1096 and S.1174), would be authorized to require the Commissioner of IRS to provide staff to the Board and would be allowed to hire staff from outside government. This staff will be interacting with the Internal Revenue Service, getting information for the Board and the Board members. It is imperative that the IRS employees and the public, as well as the Board's staff, know that the request by a Board member or by the Board generally to its staff for information is not a request for information that might be used for the personal benefit of the Board member or of the Board member's employer. The only way this assurance can be made is if the Board member is required to make a public disclosure of all his/her assets owned by the Board member, and disclosure of all his/her business relationships. Some have suggested that disclosure to the Administration and to Congress is part of the confirmation process and would be sufficient. We respectfully, but strenuously disagree. It is the public that must have absolute faith that the tax laws are being administered in a non-partisan and unbiased manner. The integrity of the entire federal tax system (of whatever kind) is at stake.

Composition of the Board

The House and Senate bills would provide that a representative of the IRS employees union hold membership on the Oversight Board. The IRS career executives unanimously believe that this would place them in an untenable situation in dealing with the union in normal day-to-day labor/management, matters as well as in labor/management contract negotiations. In addition, they firmly believe that any union representative on the Oversight Board would have a very real conflict of interest.

The union representative would sit on the Board for the sole purpose of representing the interests of his/her members. If he/she did not do so, he/she would not be a union representative for long. In addition, the Board has, under the various legislative provisions, the right to oversee the pay, bonuses, evaluations, promotions, and hiring and firing decisions regarding executives in the agency. This would give the union representative the opportunity to seek to take punitive action against a manager in the agency that he/she believes is not giving the union what it wants in negotiations or other labor/management issues. Finally, the union representative would be able to oppose the Commissioner on the Oversight Board and even seek to lead a movement to recommend to the President that a Commissioner that the union opposes be removed from his/her position.

This kind of power for a union is unprecedented in the federal or the private sector. The only analogy is the Saturn Corporation, where the organization's labor/management partnership was built from the bottom up when the organization was first begun, not imposed from the top down. In addition, in the one instance when the President of the UAW was on the Chrysler Board (because Chrysler needed the union's support for government bail-out loans), the union president left the Board as soon as possible. He publicly remarked that it had been a mistake for him to be on the Board because of the conflicting issues he had to deal with on behalf of his membership and the company.

We recommend that an Oversight Board subcommittee be established where the union representative, as well as representatives of the professional associations representing managers and executives, be given seats. The Oversight Board could then consult with this group as appropriate when input is needed on the impact of restructuring, and so on.

Union Veto on Personnel Reform

The House bill and the Senate Kerry/Grassley bill include provisions which grant the union absolute veto authority over any personnel reform initiated by the Oversight Board or the Commissioner. The provision stands the concept of labor/management relations on its head, granting the union veto authority over any proposal that could impact on bargaining unit employees. This could include proposals about performance, conduct, reassignments, promotions, pay banding systems, and anything else. This, too, is unprecedented in labor relations in both the federal government and the private sector. Under both the private sector Taft Hartley Act, and the public sector labor/management relations concept, management has certain rights which are not negotiable. In addition, if negotiations reach an impasse in the federal government, the matter is referred to the Impasses Panel, which makes a final decision. However, the provision in both the House and Senate bills would make the Impasses Panel provision not applicable to the IRS, and would thus give the union absolute veto authority, since the proposal states that nothing can be implemented which would affect bargaining unit employees without the union's written agreement.

Literally, the union could veto the implementation of any Oversight Board proposal unanimously adopted by the Board and by the Commissioner that would have any impact on bargaining unit employees.

This provision must be deleted from any final legislative enactment.

The 120-Day Rule

Section 9303(c) of HR 2676 makes inapplicable a provision of the Civil Service Reform Act requiring agencies to allow a "120-day get acquainted period" when a new political appointee takes over an agency. This means that a new political appointee cannot permanently reassign a career executive involuntarily during the first 120 days of his/her administration. This "get-acquainted period" was designed by Congress to ensure that new political leaders become familiar with the talents and experiences of incumbent career executives before making wholesale changes. We request that this provision making the 120-day rule inapplicable be dropped from the legislation. We have discussed this matter personally with Commissioner Rossotti, who stated that he has no problem with the 120-day rule being retained in effect at the IRS. We are unaware of any problems or complaints by other agencies or previous IRS Commissioners about this requirement.

Please note that a Commissioner can, of course, detail career executives and can voluntarily reassign during this 120-day period.

The Inspection Service in the IRS

There have been numerous allegations that the Internal Security portion of the IRS Inspection Service has not functioned in a manner which Congress has wished. While we believe the allegations are overstated, we again recognize that something will likely be done to deal with the reality of the perception. Our experience at IRS is that the Internal Audit function of the Inspection Service must remain under the authority and control of the Commissioner. It should, however, report directly to the Commissioner, and not through the Deputy Commissioner, giving the Commissioner absolute authority over the ability to direct internal audits within the agency. We would also prefer that Internal Security remain within the IRS reporting directly to the Commissioner (not through the Deputy Commissioner, as has been the case for the past 12–15 years) in order that no cases could be buried, as allegedly has occurred. We believe this direct reporting to the Commissioner would resolve any real problems that have occurred.

If, however, Congress decides that the Internal Security function must be moved, we strongly recommend that it not be placed in the Treasury IG's office, but that it be placed under the direction of the General Accounting Office. GAO is an arm of Congress, and serves the interests of the Congress and the people. GAO has routinely been involved in the audit of IRS operations and is extremely familiar with the functioning of this agency. It has personnel on site at IRS most of the time, doing audits of various kinds at the direction of Congress, and has a familiarity (even more so than the Treasury Department) with IRS operations. Thus, the Internal Security function of the IRS could maintain its present mission, but report to the GAO, as well as the Commissioner. Congress could then be assured by the leadership of the GAO that all cases are being adequately investigated and followed up on by the Internal Security function.

One caveat is that the Internal Security apparatus in IRS must remain available to the District, Regional and National offices in order to provide physical protection to employees when their life or property is threatened by tax protestors or others. This function has become an absolute necessity in today's environment and must not be overlooked when making a determination as to where Internal Security functions should be performed. The physical security of federal employees and their families should not be put further at risk.

In addition, the operations of the Inspection Service should not be subject to the authority of the Oversight Board, but report solely to the Commissioner, with the Internal Security function also reporting to GAO if Congress wishes. Obviously, the Commissioner is going to take the direction of the Oversight Board into consideration when assigning the Internal Audit or Internal Security functions to particular tasks, but there are limited resources within the Inspection Service. Inspection should not be subjected to the pulling and tugging of conflicting priorities that could take place between the Commissioner and the Oversight Board.

Demonstration Project Authority

Both the House and the Senate bills give the Commissioner the authority to establish demonstration projects without limitation in the IRS. In fact, the Commissioner could make the entire IRS a demonstration project under this authority. We support the Commissioner's ability to implement and test new and innovative approaches in IRS human resources management. However, we request that he not be granted authority to change (a) the current CSRS/FERS retirement systems, (b) the annual and sick leave regulations, or (c) deny employees the right to appeal adverse actions to the Merit Systems Protection Board.

While bargaining unit members have the protection of the union's ability to negotiate over changes to any of these subjects, supervisors, managers and executives do not. We believe that giving the Commissioner a broad grant of discretion is appropriate, but we request that these specific provisions be retained as they currently are in the law.

Taxpayer Advocate-Five-Year Moratorium

HR 2676 would restrict any IRS employee appointed Taxpayer Advocate from returning to another position in the IRS for five years after the end of the appointment. We believe that this five-year restriction should apply to any individual appointed to the position of Taxpayer Advocate, not just to an IRS employee.

Restrictions on Initiating or Terminating Audits, etc.

Section 7212 of HR 2676 prohibits certain political appointees in the Administration from requesting the initiation or termination of audits or other actions against

taxpayers. By naming the few, this legislative proposal empowers the many. Other than the President, the Vice President, their staffs and the Cabinet members, all other political appointees under this provision would be allowed to recommend the initiation or termination of tax audits. Obviously, this is not what Congress intended. We suggest that the language in this provision be changed to provide that only Executive Branch employees who are involved in the administration and enforcement of the Internal Revenue laws be allowed to request the initiation or termination of audits. All others would be precluded from doing so.

Political Executives at the IRS

HR 2428 and its companion bill S.1174 (the Rangel/Moynihan bill) propose to allow the Commissioner of IRS to hire up to 5% of the number of GS-15's through SESers (approximately 150) from outside the agency for term appointments of four years at salaries up to $200,000 per person. In addition, other similar alternatives have been discussed.

Our primary concern about such proposals is the danger that these appointments would turn into "political plums" which would be filled by the White House personnel office of whatever Administration was currently in power. Because these positions would be discretionary with the Commissioner, and would serve for a term commensurate with the Commissioner, there would be heavy pressure to place political supporters of the Administration in such positions. This would destroy the perception of non-partisan fairness that the public must have concerning IRS operations.

We do not, however, object to the Commissioner bringing people from outside Government into his administration, nor do we object to them being paid salaries exceeding those of current executives. However, we strongly recommend that they be required to meet the same test that any current applicant from outside government must meet in order to be hired as a "career" member of the Senior Executive Service. That is, their selection must not in any way be based on any political affiliation, but must be based strictly on "merit" and their "qualifications" for the stated requirements of the position, which are spelled out in a position description. In order for this to be enforced, we request that language be included in whatever bill is enacted requiring that the Commissioner's selection from outside government would have to be vetted through the Qualifications Review Board at the Office of Personnel Management. This vetting takes very little time and would not hamper the Commissioner's efforts. It would, however, ensure that unqualified, partisan political appointees were not being placed in these positions, thus politicizing the IRS and tax administration in general.

Personnel Flexibilities Generally

I. SEA believes that the personnel flexibilities granted to the Commissioner will be helpful in his efforts to restructure the agency. Career executives at IRS look forward to the possibility of being able to deal more expeditiously with poor performers and employees committing misconduct.

Contrary to popular views, however, we do not believe that the current systems for dealing with problem employees are broken. In fact, they are not generally used. This is because managers have no incentives to deal with problem employees and many disincentives.

If a manager even begins to take action against a problem employee, he/she can be assured of (a) an allegation against the manager by the employee to the IG's office of purported wrongdoing by the manager; (b) an EEO complaint alleging that the manager is really taking the action because of the employee's handicap, race, age, religion, national origin or gender; (c) if the employee is a female, the manager may well be accused of sexual harassment or creating a "hostile work environment" for the employee; (d) if the employee is in a bargaining unit, the union will file a grievance against the manager under the collective bargaining agreement and take it to an Arbitrator; (e) if the employee is a union official, the union will very likely file an "Unfair Labor Practice" charge against the manager at the Federal Labor Relations Authority, claiming the action is because the manager is anti-union; (f) the employee will also file an allegation at the Office of Special Counsel claiming that their allegation to the IG's office (see (a) above) makes them a "Whistleblower," and the OSC should investigate and take punitive action against the manager; (g) finally, as a last resort, the union and/or the employee will write the employee's member of Congress, seeking intervention on the employee's behalf. They will also seek press coverage of the employee's plight if possible. Thankfully, members of Congress and the press shy away from these stories if they can.

In the face of all these disincentives, the manager has only one positive incentive, and that is seeking to do his or her job by requiring the employee to work as necessary and appropriate and seeking to save the taxpayer's money by removing the employee if he or she doesn't. But, the manager must do this knowing that he or she will become the defendant, and the employee will not.

This is a system totally out of balance. The only way managers can manage employees in such an environment is to ignore most problem employees and only deal with the most blatant and egregious cases. To deal with problem employees, two things are needed:

1. A strong and cohesive exercise of management will and direction from the top of the agency to the bottom which makes employee "responsibility" as important as "empowerment" and a management process which provides support and assistance to managers, and;
2. Absolute assurances by agency political leadership that it will back up its managers who seek to deal with problem employees, especially against the counter attacks which will surely come from all directions.

Without "management will" and "management support," managers cannot and will not effectively take action against problem employees.

II. In addition to "management will" and "management support," the federal government, in all agencies, needs a single system for dealing with problem employees. As previously shown, employees have a number of forums that they can go to to make allegations against managers who are trying to deal with poor performance or misconduct. There should only be one!

We suggest that that one forum be the Merit Systems Protection Board for non-bargaining unit employees or an arbitrator for bargaining unit employees. However, in order for there to be consistency in the process, we recommend that arbitration decisions be subject to the review of the Merit Systems Protection Board on the basis that an arbitrator did not follow the law in his or her decision.

If the employee only had an appeal to the Merit Systems Protection Board, the employee must be able to raise all the defenses that he/she would raise against the manager in other forums. In other words, he/she could make whatever EEO, "whistleblowing," unfair labor practice or other allegations, or affirmative defenses that they wish to make in that single forum. The Administrative Judges at the Merit Systems Protection Board could rule on each and every issue in their decision, and the agency would only have to support the manager's decision before that single forum. The current multiplicity of forums costs the taxpayers millions of dollars for nothing except extreme confusion in federal agencies and undue protections to federal employees who seek to avoid their responsibilities. Under our proposal, the federal sector EEO program would be taken over by the Merit Systems Protection Board as would the unfair labor practice portion of the FLRA, if the ULP was raised in the context of a disciplinary or removal action.

This consolidation in the MSPB would still leave one remaining problem in the federal sector employee management relations arena. Federal employees, as do private sector employees, currently have the right to take any decision involving an allegation of a violation of the EEO law to federal District Court for a trial de novo, if they lose their claim in the administrative agency. Thus, the MSPB cases would be reviewable in Federal District courts around the country for those who had alleged that the action was taken because of an unlawful discrimination. This would result, as it currently does, in a plethora of varying decisions across the country from Federal District Courts and the 10 Federal Circuit Courts of Appeal. An alternative that would end this dilemma, and still preserve the EEO community's access to the courts for review of EEO problems, would be to establish either a separate Article 3 Federal Court (like the U.S. Tax Court) which would have the combined jurisdiction of the current administrative agencies and would have melded into that court the apparatus of the Merit Systems Protection Board. The EEO community would have retained the ability for federal court review of their EEO claim, however, the review by that court could only be appealed to the Federal Circuit Court of Appeals as is now the case from MSPB actions. This would result in the development of a consistent body of law as it applies to all Federal civilian employees.

Finally, a third alternative would be to meld the administrative agencies together and place all of them as part of the current U.S. Court of Federal Claims. This, too, would accomplish the same purpose and would result in an expansion of the U.S. Court of Federal Claims rather than an establishment of a new Court.

In sum, the current incentives for managers to deal with problem employees do not exist, but the disincentives are numerous and real. The result is that nothing will happen in this arena except by an extraordinary effort of "management will" in the Internal Revenue Service as well as at each of the other federal agencies. The

three alternatives cited above, i.e., a consolidated MSPB, a new Article 3 Court, or the placement of the consolidated MSPB functions within the U.S. Court of Federal Claims would insure due process for the employee, but would protect the managers from having their judgments attacked in a plethora of administrative forums as presently happens. Any of the three options would be an improvement and would, for the first time in recent memory, allow managers to deal effectively with problem employees.

Training

We strongly believe that. in order for an agency such as IRS to be "re-engineered," substantial training of all employees will be required, as well as clear, consistent direction from the agency head and the Congress. Employees need to be clearly told what the expectations are and how and why they are expected to change their workplace habits. Just telling them to do so won't accomplish the purpose. They must be trained, given the opportunity to ask questions and have those questions answered. All new employees must be given a similar orientation when they first come with the IRS.

The culture of the IRS is that of a law enforcement agency which exists to ensure that tax payers pay their proper tax in a timely manner. "Customer service" within this context should mean that all citizens will be treated fairly and with respect. It should not mean that taxpayers who have not complied with the tax law, or have not timely paid their taxes should be cut "slack" or "special deals" which are not authorized. The equal protection clause of the Constitution requires that the law be administered equally and fairly for all citizens. Common sense requires that the law be administered in a fair and respectful manner. The definitions that surround "customer service," "taxpayer rights" and similar concepts must be taught to all employees so that they understand the difference between being "nice" and "not enforcing the tax laws." Failure to do so will result in an agency not "re-engineered," but either rendered ineffective or unchanged, since it will continue, as in the past, to merely "ride out" the changing political winds of the time.

Attachment.

Attached is a letter of January 21, 1998, which SEA sent to Chairman Roth with point-by-point recommendations concerning the various legislative proposals under consideration. We request that this letter be included in the record along with this statement.

Thank you for the opportunity to testify. We will try to answer any questions you might have.

SENIOR EXECUTIVES ASSOCIATION,
Washington, DC.

January 21, 1998

Hon. WILLIAM V. ROTH, JR.,
Chairman, Senate Committee on Finance,
Washington, DC.

Dear Chairman Roth: Thank you for meeting with us recently. We appreciate your willingness to consider SEA's concerns regarding the provisions in H.R. 2676, The IRS Restructuring and Reform Act of 1998, and in S. 1096 the Kerrey/Grassley bill. We believe several provisions in these bills, as well as in S. 1174 would have a detrimental effect on federal management in general and on the operations of IRS in particular.

I. The following points reflect the Senior Executives Association's position on H.R. 2676:

A. *Section 7802:* We strongly recommend that all members of the IRS Oversight Board be required to publicly disclose their assets in order to prevent the appearance of conflicts of interest or actual conflicts of interest.

B. *Section 9303(c):* The "get acquainted period" which allows career SES employees an opportunity to prove themselves to a new Commissioner before being reassigned is rescinded for the IRS in this provision. We request that this provision of the bill be deleted.

C. *Section 7802:* We request that the activities of the Office of the Chief Inspector be included in this listing of law enforcement activities over which the IRS Oversight Board will have no authority. The Inspection Service is an arm of the Commissioner and carries out often sensitive investigations and audits at the direction of the Commissioner.

D. *Section 7803(c)(1)(B):* The 5-year moratorium on the Tax Advocate being able to accept subsequent employment in the IRS should apply to anyone ap-

pointed to that position, irrespective of whether their prior employment was from within or outside of the IRS.

E. *Section 9304:* We request that the IRS Commissioner's Demonstration Project authority be narrowed to prohibit the Commissioner from:

1. Altering the retirement systems (CSRS and FERS)
2. Changing the annual and sick leave regulations
3. Denying employees the right to appeal to the MSPB in adverse action cases.

F. *Section 7802(b)(1)(D):* Delete the provision making the NTEU President a member of the IRS Oversight Board because he would have a conflict of interest and such membership would prevent IRS management from effectively directing its workforce. Examples are:

1. *Section 9301(b):* The union president is given the power to exercise an absolute veto over the IRS Commissioner's or the Oversight Board's reform or restructuring initiatives affecting bargaining unit employees.

2. *Under Section 7802(d)(3)(A):* The union president could lobby among the Board members for the appointment or removal of a specific Commissioner if he is dissatisfied with the IRS stance in labor-management negotiations.

3. Under *Section 7802(d)(3)(B):* The union president could misuse, or give the appearance of being able to misuse his influence against IRS executives in labor negotiations because, as an Oversight Board member, he would be privy to reviewing their pay, bonuses, evaluations and promotions, as well as decisions on hiring or firing

4. As an Oversight Board member, the union president would be privy to management information not generally available to labor unions dealing with management authority and rights as set out in 5 USC Section 7106. He could use this information to benefit his union and its members in dealing with the IRS leadership on labor-management issues.

G. *Section 9301(b)(2):* We request that this entire provision be deleted. It grants the union absolute veto power over the Oversight Board and the Commissioner's ability to administer, reform or reorganize the IRS. It grants to the union the ability to stop any change merely by refusing to sign off on the change proposal. It completely abolishes the concept of non-negotiable management rights as set forth at 5 USC Section 7106. This grant of veto power to the union is unprecedented in the history of U. S. labor law. The National Treasury Employees Union (NTEU) could effectively control the IRS workforce, without the Commissioner or the Secretary of the Treasury being able to prevent it.

H. *Section 7212:* Expand the definition of "Applicable Person" in subsection (e) to include all political appointees in the Executive Branch, other than those directly responsible for administration and enforcement of the tax laws. This can be done by changing in (e)(2) the reference "in section 5312 of Title 5" to "in sections 5312 through 5317 of Title 5, and those positions designated Schedule C (political appointments) other than those directly involved in the administration and enforcement of the U.S. tax laws under Title 26 and related statutes."

II. The following points reflect the Senior Executives Association's position on S. 1096, the Kerrey/Grassley Bill:

A. *Section 7892(a)(1)(C):* Recommend deletion. (See our comments in I.F. above.)

B. *Section 7803 (d)1(C):* Recommend an amendment to apply to all appointees to this position. (See our comments in I.D. above.)

C. *Section 9301(b):* Recommend deletion. (See our comments in I.G. above.)

D. *Section 9304(c):* Recommend deletion. (See our comments in I.B. above.)

E. *Section 9305(a):* Recommend amendment to provide that retirement systems, leave provisions and appeal right to the MSPB as set forth in Title 5 of US Code are retained. (See our comments in I.E. above.)

III. H.R. 2428/S-1174 Rangel/Moynihan bill

A. *Section 9303:* Authorizes the Commissioner to hire up to 5% of SES and GS-15 positions in IRS into essentially 4-year term political appointments with pay set at whatever rate the Commissioner pleases up to nearly $200,000.

This would enable over 110 IRS positions to become political plums over time. If the Commissioner needs such authority, the positions should be restricted to career SES positions with expanded pay authority. The Commissioner can still hire the employees he or she needs from outside Government, but, to be hired as career SES employees, they would be required to be qualified for the positions, and partisan politics would be excluded from the hiring process.

B. *Section 9506:* Amend to exclude the authorization to place "limited emergency" and "limited term" SES appointees in career-reserved IRS positions. This provision would further politicize the IRS, since in neither case does an employee actually have to be qualified for the position. Thus, unqualified political appointees could quickly be hired and could effectively alter the nonpartisan administration and enforcement of the federal tax laws.

Suggestions:

- Establish an annual budget within which the IRS Oversight Board will operate and/or limit the number of staff assigned to the Oversight Board in order to deter a burgeoning bureaucracy.
- Provide training to all employees of the IRS about what is expected of them to bring about the "culture change" sought by Congress in the IRS.

Sincerely,

G. JERRY SHAW,
General Counsel.

PREPARED STATEMENT OF THOMAS H. STANTON

Mr. Chairman and Members of the Committee:

We appreciate your invitation to testify on H.R. 2676, the Internal Revenue Service Restructuring and Reform Act. My name is Thomas H. Stanton. I am Vice Chair of the National Academy of Public Administration's Standing Panel on Executive Organization and Management. Another panel member, Herbert N. Jasper, is accompanying me today.

The Academy was chartered by Congress and has a special obligation to investigate and report on subjects when called upon by Congress or the Executive Branch. We carry out our work both through project panels and standing panels, such as the one on whose behalf I am testifying today. This statement does not necessarily represent the views of the National Academy as an institution.

Standing panel members have extensive experience and knowledge about the relationship of organizational structure to the quality of federal management. The panel or its members have often testified on issues such as those presented by H.R. 2676, including those considered in connection with the governance structure for the Social Security Administration and the Resolution Trust Corporation.

The Congress has a vital stake in assuring that the Internal Revenue Service (IRS) carries out the law in an accountable, effective and humane manner. The country will always need an IRS. Whether we have some form of today's tax system, a flat tax or a consumption tax, issues of implementation and good management will always be important to the American taxpayer.

In our testimony today we would like to make four major points:

- *We support the recommendations of the National Commission on Restructuring the Internal Revenue Service and the provisions of H.R. 2676 to strengthen congressional oversight.* Greater involvement of the tax committees in oversight can help increase the accountability of the agency and offset some of the problems of an ingrown organizational culture.

More intensive oversight also can help to sensitize policy makers to the difficulty that the IRS faces in trying to administer the many complexities and compromises that find their way, almost annually, into the tax code.

- *The proposed Oversight Board will greatly limit the accountability of the IRS* to the Congress, the President and the Treasury Secretary, and will damage the professional independence of the agency.

H.R. 2676 gives the Oversight Board authority to approve strategic plans, reorganizations, and budgets of the IRS. The bill thus allows private parties to determine the deployment of the nation's tax collection apparatus and invites self-serving actions by the private board members, or invites a perception of such actions that could well lead to increased tax evasion. The Commissioner, individual board members, and the Secretary will all be able to point to others who hold partial responsibility for any actions that engender criticism.

- *These problems can be overcome if this Committee would turn the Oversight Board into an advisory board* that counsels the Secretary of the Treasury and the Commissioner, as the Senate wisely did with respect to the Social Security Administration and the Resolution Trust Corporation. An advisory board can help to infuse the IRS with fresh points of view on behalf of the private individuals and companies who must pay taxes, while trying to comply with an immense amount of instructions, paperwork, and arcane rules.

The advisory board could add its voice to those of the Taxpayer Advocate, and perhaps the Chief Inspector, to help inform the process of congressional oversight and raise timely issues of importance to taxpayers and lawmakers. To the extent that an advisory board gives sound advice, and has the ear of the Congress and the Secretary as well, its recommendations will very likely be persuasive to the Commissioner.

- *Management improvements must enhance rather than detract from the professionalism of the IRS.* We support the ideas of a fixed term and a performance contract for the Commissioner. Provisions of H.R. 2676 to strengthen prohibitions on executive branch influence over taxpayer audits might be strengthened, we respectfully suggest, by applying similar prohibitions to the legislative branch.

H.R. 2676 makes welcome additions to the flexibility of IRS personnel rules and provides that these shall be exercised in a manner consistent with merit system principles. We think it is not proper, however, to give veto power to the union representatives with respect to use of the personnel flexibilities.

We urge that Congress strengthen the provisions to assure that merit principles are applied to the hiring of all IRS employees below the level of Commissioner. Otherwise, over time, the agency is likely to be offered a remarkable array of politically well-connected but marginally, qualified people for special positions that were intended to be filled by experts.

At the end of the statement we summarize the nine principal changes that we believe need to be made in order to assure that the purposes of the legislation can be accomplished.

THE DILEMMA OF A TAX COLLECTION AGENCY

People do not like to pay taxes. Oliver Wendell Holmes said that taxes are the price we pay for a civilized society. Americans want much of what taxes fund—such as national defense, aviation safety, clean air and water, and national parks. At the same time, most would prefer to pay no taxes or to pay less taxes. Former Senator Russell Long described that sentiment as, "Don't tax me; don't tax thee; tax that fellow behind the tree." He went on to say, "but there is only you and me behind the tree."

This view of taxes—as a necessary but disliked part of reality—means that the IRS operates with conflicting goals. We ask our tax collection agency to be sure that people pay what they owe. After all, the more taxes that are evaded, the greater the burden on everyone else. At the same time, we ask our tax collection agency to be polite and treat taxpayers and tax evaders as "customers." Meeting both demands is hard; some people do cheat and there are estimated to be tens of billions of dollars in unreported income.

Lack of enforcement does lead to an increase in tax evasion. There are already concerns that the reduced incidence of audits in recent years may have led to an increase in noncompliance. We must remember that fairness in tax collection has two dimensions. Everyone wants to be treated decently, but no one wants to see others evade their taxes with impunity.

Treating taxpayers as customers has become an IRS objective, and the new Commissioner has strongly endorsed it. But calling taxpayers "customers" does raise some issues. The private sector customer model does not quite fit because taxpayers tend to be either reluctant or even unwilling customers. Unfortunately, some taxpayers may believe that their status as "customers" entitles them to lax enforcement. What both Congress and the Administration are searching for is a way to achieve effective collection of taxes owed while treating taxpayers fairly and decently.

The tension between these goals makes it easy to understand how the IRS may go too far in one direction or the other, depending on transitory congressional and executive priorities. For example, if the IRS feels heat about "uncollected taxes" or "the tax gap," it may pursue collection in a way that can be overzealous and unfair. If, however, "friendly customer service" becomes the primary performance goal, some citizens likely will be encouraged to believe that they can evade the taxes due to the government.

A leading challenge for managing IRS effectively—and certainly for setting performance standards—must be to strike the right balance between the two goals. We believe that Congress has actually been a significant factor in setting IRS' priorities and, thus, promoting its recent emphasis on collection and enforcement. Care must be taken not to overreact by pushing IRS toward lax enforcement and consequent evasion by taxpayers. As you know well, the American system is the envy of the world because of its successful reliance on voluntary compliance. But we must re-

member that voluntary compliance depends in large measure on the expectation or fear of being caught if one cheats.

The complexity of the tax code. Academy panels have many times noted situations in which the complexity or instability of the laws establishing federal programs has made it extremely difficult to assure their efficient or consistent administration.[1] For this reason, we suggest that many of the management shortcomings ascribed to the IRS in recent years are generated or, at a minimum, exacerbated by both the complexity of our tax laws and their frequent amendment.

We urge that this Committee and the Congress as a whole give special and urgent attention to the excellent comments and suggestions with respect to simplifying tax administration contained in the report of the National Commission, co-chaired by Senator Bob Kerrey and Representative Rob Portman. It is encouraging that a group led by members of Congress observed that, "While Congress often laments the complexity of tax forms and instructions, this complexity is a product of the laws written by the Congress."[2]

UNDUE EMPHASIS ON COLLECTION AND ENFORCEMENT

In recent hearings, this Committee revealed several examples of overzealous and unfair tax collection by some IRS officials. Needed are (1) a means of reducing the incidence of such actions; and (2) an avenue of prompt redress for taxpayers who may find themselves caught in an unfair situation.

The problem of IRS incentives relates to the need to set performance goals for the agency that relate to the quality of IRS taxpayer service, and not merely to the amount of tax revenue that the IRS collects. In enacting the Government Performance and Results Act of 1993 (GPRA), the Congress warned agencies about the problem of distorted performance goals. The Senate Governmental Affairs Committee stated in its report on the act that, "It is very important that annual performance plans include goals, not just for the quantity of effort, but also for the quality of that effort."[3]

In the face of congressional pressures to strengthen tax collection efforts, this warning was apparently disregarded. IRS provides a striking example of the importance of effectively balancing conflicting objectives. In congressional hearings, a report of the General Accounting Office, and appropriations for the 1995 compliance initiative, IRS was pushed to become more effective at raising significantly increased revenues, both from additional audits and through collections from delinquent taxpayers. This was seen to be an important part of the nation's efforts at deficit reduction.

Lost in this emphasis upon the performance goal of revenue-raising was the need to assure fair treatment of taxpayers. We recommend, therefore, that Congress and this Committee in particular take an interest in the balanced implementation of GPRA by IRS and the application of an even-handed set of performance goals. IRS must still be directed to collect the maximum amount of taxes owed, but consistent with the development and use of safeguards to protect innocent taxpayers from abuse, and to deal reasonably and equitably with those who do owe money to the government. GPRA, properly applied, can help to set a balanced agenda for IRS.

With a clear set of balanced goals from Congress, IRS should then carefully review its internal rules and procedures. It must assure that any guidance to staff, as well as performance standards, and evaluation and reward systems and practices are consistent with the desired combination of effective tax collection and fair treatment of taxpayers. Perhaps a new code of conduct should be developed to embody this balanced approach.

Congress could also strengthen a number of possible taxpayer safeguards. For example:

1. It is not clear that either taxpayers or IRS staff are sufficiently aware of the Problem Resolution process for removing cases subject to legitimate complaints from the ordinary flow of IRS action and providing for a prompt independent review of the case. Therefore, there ought to be more information and training about the process.

2. A system of performance goals could be established for IRS units and for individual officials that reflect the balanced GPRA goals, i.e., that reward fair treatment of taxpayers and not just effective collection and enforcement.

3. A system should be developed for identifying, retraining or otherwise dealing effectively with IRS officials whose actions result in unfair treatment of taxpayers.

There are models for this kind of process and incentive structure. For example, the Department of Education, concerned about fair treatment of those delinquent in

paying off student loans, has adopted such safeguards and applied them in its contracts with collection agencies.

Provisions in the bill to strengthen the Taxpayer Advocate function might also be helpful in gaining fair treatment for taxpayers. The Taxpayer Advocate has already undertaken to inform IRS personnel more fully about the Problem Resolution process. Consideration might also be given to broadening the focus of the inspections division so that it is concerned with such issues as the way taxpayers are treated, along with looking for violations of rules and procedures.

PROVISIONS THAT THE PANEL SUPPORTS, AND SUGGESTED MODIFICATIONS

Next, we will explain how many provisions of the bill would help set the tone for addressing current priorities. At the same time, however, we will point out how some of those provisions might be improved. Later, we will address some major features of the bill that we believe would be counter-productive.

This bill is based largely on a lengthy and comprehensive study by the National Commission. We believe that the study and its report provide an excellent example of how Congress can bring public attention to significant problems and pave the way for constructive action with a comprehensive and bipartisan approach.

We believe that the nine "key recommendations" summarized in the report constitute a well thought out and internally consistent set of objectives. However, as explained later, we strongly disagree with some of the implementing measures. We want to express our strong support for the following concepts in the House bill:

Strengthened congressional oversight of IRS. Like many large agencies, the IRS receives oversight from a large number of committees and subcommittees. Most of these tend to focus on particular aspects of internal revenue policies, and the managerial implications are often neglected. The Joint Committee on Internal Revenue Taxation has played a useful and continuing role in coordinating tax policies, but it has not taken a similar role in considering tax system operations and IRS management.

Title IV of the House bill requires that a twice-yearly joint hearing be conducted by representatives from three House and three Senate committees to review the strategic plans and budget of IRS. Further, the Joint Committee is directed to report annually to the six committees upon those matters, as well as on the state of our tax system, taxpayer service and compliance, and technology modernization, among other things. We believe those provisions would offer an opportunity for constructive oversight of IRS management, as well as for review of tax policies.

Prohibiting political influence in tax enforcement. This Committee is well aware that the nation's tax system must be administered by an impartial, non-political, and competent workforce. This has not always been the case. In the early 1950s, the American public was shocked by numerous reports of IRS employee embezzlement and bribery. To halt this corruption, the Finance Committee played a major role in enacting the 1952 congressional requirement that all of the IRS employees under the Commissioner be hired, trained, evaluated, and promoted under the merit system.

Experience since 1952 has demonstrated the wisdom of that congressional decision. The subsequent change in IRS' image was striking. For decades, IRS was viewed as one of the better-managed and professional agencies. The recent hearings of your Committee and the yearlong investigation of IRS by the National Commission have not shown—or even alleged—the kinds of employee embezzlements and bribery that precipitated the 1952 reforms. The abuses that your hearings revealed were related to overzealous efforts to collect money for the Treasury, not to put money in the employees' own pockets. So we urge that this bill continue to stress the importance of a non-political, highly qualified workforce.

We strongly support the prohibition in Section 104 of any attempt by some future President or other Executive Branch official to influence tax audits or investigations. Some of the recently released "Nixon tapes" reveal his anger and frustration over the fact that he had been unable to get the Internal Revenue Service career personnel to audit taxpayers whom he regarded as his political enemies, and that he wanted to get a new Commissioner who would bend the career people to his wishes. There have been reports suggesting that similar efforts were made by other presidents or White House staff as well.

We believe that the prohibition on influencing tax audits is so significant that you ought to extend it to cover all political appointees in the Executive Branch. In addition, we suggest that it be applied to all Members of Congress.

Merit principles and personnel flexibilities. H.R. 2676 provides an excellent opportunity to take further steps toward fulfilling the congressional intent of the Civil Service Reform Act of 1978, as we discuss below. As you know, the legislation was

designed, on the one hand, to encourage development of a far simpler civil service system which provided agencies and managers with the flexibility to modernize federal human resource management so the federal workforce could be more responsive to contemporary challenges.

On the other hand, the Congress also included among the 1978 reforms a series of provisions designed to prevent the new flexibilities from being manipulated in ways that undermine the principles of a professional workforce chosen on merit and protected from politicization. Such protection is of the utmost importance in administering our tax laws and, as we have noted, this has been successful in IRS since the 1952 reforms.

A set of merit principles was included in the 1978 law, together with a Merit Systems Protection Board (MSPB) and Special Counsel, to guard against violation of these safeguards as well as to prohibit discrimination. These provisions were included because of earlier experiences when the lack of safeguards permitted the positive steps of streamlining federal operations to be manipulated in ways that brought political intervention, resulting in scandal and lowered confidence of citizens in their government.

We note that the effort to shield IRS from politically-motivated actions would be strengthened by assuring that its personnel are not hired because of their own political connections. Since it is clear that the 1952 requirement that all employees below the Commissioner be hired on merit has worked well, we recommend that it be retained in this bill. We, therefore, urge that Section 7804(a) of the bill be amended to require that all such employees: (1) be selected on a non-political and non-partisan basis; and (2) be selected strictly on the basis of merit and qualifications.

In a number of panel reports, the Academy has urged that federal personnel rules be made more flexible, as contemplated in the civil service reform law.[4] Therefore, we were very glad to see that the House bill provides such flexibilities. And we strongly support the provision that these authorities must be exercised in a manner consistent with merit system principles.

We recognize that IRS needs, from time to time, to hire experts from the private sector in such fields of expertise as information technology and customer service. But many federal agencies, including IRS, itself, as well as NASA, FAA and the Defense Department have already demonstrated that such experts can and should be selected and hired on a merit basis. Indeed, some agencies have found that political pressures to hire marginally qualified or even unqualified people sometimes can be avoided only by requiring merit hiring. Since tax policy responsibilities will remain with Treasury Department officials, we think such new hires should, like all other IRS employees, be selected on a merit basis.

To be sure a proper balance is maintained between using the new flexibilities and observing merit principles, we urge that Section 9301(a) be revised. It must make clear that the organizations with responsibility for dealing with violations of merit principles through appellate and oversight processes under the 1978 civil service reform and earlier legislation (MSPB and its Special Counsel, as well as the Office of Personnel Management (OPM)) still retain this responsibility with respect to IRS.

Union veto. We were surprised to see that the House bill would give union officials veto power over the use of the personnel flexibilities in the organizational units that they represent. We believe that the unions should have full consultation rights, and perhaps bargaining rights, with respect to the use of these flexibilities. But veto power would make these union officials at least the equal of the Commissioner with regard to such matters. And it would give the union representative on the Oversight Board the ability to countermand decisions of the other ten members of the board.

Inevitably, there will be cases in which the public interest requires that an agency take actions that its employees dislike. Examples are downsizing, office relocations, and use of labor-saving equipment or processes, any of which might be facilitated by the use of the personnel flexibilities authorized in the bill.

The House bill would also prohibit the use in IRS of the Federal Impasses Panel to provide assistance in resolving labor-management disputes. We can see no reason to deprive the agency of this proven means for settling disputes. In order to equip IRS with the full range of methods for resolving disputes, while preserving the necessary prerogatives of management, we strongly urge two changes in Section 9301: (1) remove the union veto and include provisions to assure consultation or bargaining rights; and (2) preserve the role of the impasses panel.

A performance contract for the Commissioner. We were asked to comment on the utility of a performance contract for the Commissioner. Another Academy panel has reviewed the use of such contracts in connection with a study of the National Ocean Service in NOAA.[5] That panel concluded that a performance contract for the head of the new organizational unit that it recommended was both feasible and desirable.

It appears to us that the IRS Commissioner, likewise, is a good candidate for a performance contract.

Bringing In a New Team. When a new presidential appointee takes over a large agency, it is natural to want to put his or her own choices in some of the key jobs. In 1978, the designers of the Senior Executive Service were familiar with this tendency. Congress subsequently required that new appointees observe a 120-day get acquainted period before transferring career executives. The House bill would revoke this safeguard for IRS and revert to the older system in which new appointees unwittingly deprived themselves and the public of the value of many highly-experienced managers.

We are concerned about the bill's weakening of the Senior Executive Service (SES) goal of providing an executive personnel system able to meet the government's need for career leaders and managers. It can be damaged by piecemeal changes without any conscious decision or intent. For example, if a career executive who has earned advancement to SES rank by years of effective service can be suddenly moved to another city, or to a position with few or no responsibilities, by a new appointee who knows nothing about the incumbent's ability, and merely wants to bring in "his own team," that will damage morale and performance. Also, it could discourage many other outstanding people from accepting or remaining in SES jobs.

The congressional decision to require a get acquainted period seemed to be a practical compromise and we think it has worked well. However, if Congress now concludes that the Commissioner needs a little more leeway, we think that the Deputy Commissioner position, alone, might be excepted from the 120-day rule. We do believe, however, that the outright elimination of the rule, as provided in the House bill, would be a serious mistake.

Fixed term for the Commissioner. Historically, most executive officials have been appointed without fixed terms. A number of exceptions have existed for a sufficient time that we can assess the results. They include the Director of the National Science Foundation, the Director of the Office of Personnel Management, the Chairman of the Federal Reserve Board, the Administrator of the St. Lawrence Seaway Development Corporation, and the Comptroller General. The tenure of these officials was reviewed in connection with a 1991 study of the Federal Aviation Administration's (FAA) management problems.[6]

Experience showed that such officials generally served most of their statutory terms. This contrasted sharply with the average tenure of presidential appointees, which has approximated only two years. The 103rd Congress established a four-year term for the Commissioner of Social Security, and the last Congress established a five-year term for the head of the FAA. It should be noted that the Constitution generally assures that such appointees with fixed terms are removable by the President, as H.R. 2676 recognizes. In light of the favorable experience with fixed terms, we are pleased to endorse this provision in the House bill.

Multi-year funding. Agencies such as IRS, the National Weather Service, and FAA, that require significant capital investments to carry out their missions, would be best served by the availability of stable and predictable funding. Other agencies, such as NOAA, have long enjoyed multiyear funding. The Defense Department and NASA have had the benefit of full funding for multiyear projects. We believe that multiyear funding would greatly improve planning and management in IRS.

Updating the agency's technology. The need to modernize the agency's technology is closely related to the proposal for multi-year funding. While the agency's track record for managing its procurement of information technology may not have been exemplary, there is room for Congress, the Treasury Department, the Office of Management and Budget, and the General Services Administration to share the blame for a technology lag that resulted in part from inadequate and sporadic funding. We are hopeful that the consensus emerging on the agency's need for modern technology will make it possible for the new Commissioner, himself a management expert, to make rapid strides in effectively introducing such technology. A part of that should be the acceleration of plans and actions to facilitate paperless filing for most taxpayers, as recommended by the National Commission.

THE OVERSIGHT BOARD

The report of the National Commission strongly influenced the content of the bills now being considered by the Congress. Several Fellows of the Academy were consulted by commission members or staff because of their knowledge of either the IRS or the organization and management of large subcabinet agencies.[7] Since its release in June 1997, the report and the ensuing legislation have been discussed at length by Academy members.

To give independent advice on issues such as the role of an oversight board for IRS is precisely the reason that the National Academy was formed, and later chartered by Congress. The Executive Branch no longer has a staff of experts on such matters. The governance structure of agencies and the role of such boards are subjects upon which the advice of Academy Fellows has often been sought by Congress. For example, the proposed legislation to place a full-time board in charge of the Social Security Administration was revised in favor of a single administrator in 1994, as proposed in an Academy study. And the board was converted to an advisory board, as was stressed in the report on the bill by the Senate Finance Committee.[8] Similarly, the powers of the oversight board for the Resolution Trust Corporation were revised by the Senate in 1992 to make it strictly advisory, after testimony by two Academy Fellows, among others. We offer the following comments, recognizing that the National Commission proposed to vest IRS' functions in a Board of Directors with even stronger powers than those provided in H.R. 2676.

We are pleased that the House substituted an oversight board for a board of directors. But we do not think that the House went far enough. Experience shows that, except for independent regulatory agencies with quasi-legislative and quasi-judicial functions, programs are most effectively managed when a single head is responsible and, of utmost significance, held accountable for performance. We believe that the provisions regarding the board would seriously jeopardize accomplishing of some of the principal objectives of the legislation. Most important, the Oversight Board's powers would make it impossible to hold anyone accountable for IRS' performance.

There are, however, many potential benefits to establishing some sort of advisory board as a means to combat the natural insularity of a large government agency with a huge and recurrent workload, and difficult deadlines. As already noted, the frequent and extensive changes made by Congress in an already too complex tax code make it difficult for IRS to perform in a way that would engender widespread approval. There is a real danger that subjecting the IRS Commissioner to additional demands and disagreements generated by an oversight board may further compromise his ability to concentrate on effectively implementing the Taxpayer Relief Act of 1997 and to assure that the year 2000 problem will be resolved satisfactorily.

Much has been said about the difficulty of changing the "culture" of government agencies, especially that of a highly decentralized agency like IRS. But it should be noted that a well-established agency culture is a strength as well as a weakness. It conveys a sense of identity and professional pride in agency performance; it makes employees care about agency goals, about what they do and how well they do it; it orients and socializes new employees; and it helps present a coherent face to the customers.

But a strong culture also has disadvantages. It discourages hiring from outside for positions above the entry level; it leads managers and workers, alike, to cling to outdated ways of doing business and to view skeptically proposals for change, even when they are needed. It narrows the range of options surfaced and restricts the kinds of innovations that might get even fair consideration. It discourages questions about existing policies, procedures and values.

The challenge in changing an organization's culture is, first, especially with an inbred agency like IRS, to figure out how to change it at all. Second, one needs to preserve the benefits of a strong culture and commitment to the agency's mission, while opening the agency to new ideas.

We do think the basic concept of having a group of very well qualified persons to review IRS strategic planning, management and operations, and to provide informed advice, is sound and helpful. A board of advisors to the Commissioner and the Secretary of the Treasury could:

- assist them to assess how the agency is perceived by its customers
- help them to think outside of the box, by assuring that genuine innovations receive full and fair evaluation and are not rejected out of hand by the bureaucracy
- suggest new management, organizational or administrative ideas or approaches
- provide a sounding board for innovations or changes that the Commissioner is considering

All of these functions could be performed by an advisory board. Although the bill uses the term oversight to describe the board that it would establish, make no mistake about it: under H.R. 2676, the board would, in fact, be a governing board. Notwithstanding the Administration's endorsement of the House bill, the Commissioner has read it incisively. In his January 28, 1998 testimony before this committee (p. 15), he said " . . . the Commissioner . . . will be able to be accountable to the Board . . . ." We think it would be a serious mistake to make the Commissioner accountable to a part-time board dominated by eight private citizens.

A number of the bill's provisions would assure that the board will keep very busy in carrying out its functions. Specifically:

- Members of the board would receive substantial compensation, and the board would meet monthly.
- The chair's compensation would be two-thirds greater than that of the other private sector members, thus implying that the chair will spend a lot more time overseeing the Commissioner.
- The board chair could demand the detail of IRS personnel to the board.
- The board chair could procure temporary and intermittent services, apparently limited only by appropriations to IRS.
- Presumably, all or most of the board's staff would be full-time, with the result that they would no doubt be interacting with the Commissioner and other senior personnel on a regular basis between meetings of the board.

With those characteristics of the board in mind, we can now enumerate the provisions of the bill that would effectively give it power, rather than mere influence, over the Commissioner, as well as the Secretary of the Treasury:

- The board would not only review, but would approve, both strategic plans and the Commissioner's budget request. The Commissioner could well ascribe blame for failure to reach performance targets to the board because of its ill advised budget decisions.
- The board, and not the Commissioner, would submit the budget request to the Secretary, and both the Secretary and the President would be required to submit that budget to Congress.
- Any major reorganization of IRS would require the board's approval.
- The board could recommend removal of the Commissioner (although it could, of course, do so even without a statutory invitation).

A number of other functions of the board also seem inappropriate, such as ensuring that the budget request supports the strategic plans; approving the Commissioner's appointment of the Taxpayer Advocate, and selecting its own chair from among the nongovernment employees. The President could not hold the board accountable because he would not appoint the chair, and his power to remove board members would be eroded because of the sharing of authority and responsibility by the whole board.

The provisions stating that the Oversight Board shall have no responsibilities or authority with respect to tax policy and law enforcement activities would be compromised by the powers just described. That is because approving strategic plans, reorganizations and, especially, budgets for IRS is, in fact, setting tax policy and law enforcement policy.

Suppose, for example, the board adopted a budget that drastically restricts resources for collection and enforcement of corporate taxes, individual taxes, or excise taxes. That would send a strong signal to the affected sector that obstruction or evasion would become less risky. Similarly, suppose the board disapproved a proposed reorganization because it would likely lead to more effective enforcement and collection affecting the interests of board members.

To give a board with the preponderance of membership and the chair coming from the private sector such power over a federal agency is virtually unprecedented. To do so with respect to such a sensitive function as tax collection would be unfortunate. Among other things, we believe that new directions from the Congress could be frustrated by the board if it did not agree with those directions. We strongly believe that the bill's provisions relating to the Oversight Board would actually impede the attainment of the objectives of both the National Commission and Members of Congress for the following reasons:

- Neither the Congress nor the President could hold anyone accountable for IRS performance—not the Secretary of the Treasury, not the Oversight Board, and certainly not the Commissioner. All of them could pass the buck for whatever problems arise.
- Giving the board management functions would get it committed to agreed-upon courses of action with the result that it would lose its capacity to provide the fresh, outsider's perspective that we think you are seeking.
- The breadth of the board's powers would be an open invitation to employees and their union representatives, whether disgruntled or well-intentioned, to end-run the chain of command and take their problems or ideas directly to board members, or to their staff. The potentially large staff supporting the board would have a substantial incentive to develop and advance its own agenda.
- Members of the board from the private sector would have an extremely serious conflict of interest. Since they would be exempted from certain conflict of interest laws and from the Federal Advisory Committee Act, any actions promoting self interest could go undetected.

- The union representative would have an equally serious conflict of interest when the public's and employees' interests clash. Giving such a representative the power to vote for a recommendation to remove the Commissioner is fraught with possibilities for misguided actions. Unless the board is made advisory, as we strongly recommend, we believe that the provision for a union representative as a full-fledged, voting member must be deleted from the bill.
- Monthly meetings of a board supported by its own staff would likely intrude unduly on the time available to the Commissioner and his senior staff to manage the agency. There would also be preparations for the meetings, carrying out assignments from the meetings, and the need to meet many additional demands of the chair.

We believe that other features of the board's functions indicate a need for further consideration by Congress. For example, the board would add a new layer of supervision when we have been seeking to flatten our hierarchies; its supervisory duties might generate an adversarial and debilitating relationship with the Commissioner; the board's responsibilities would overlap with those of the financial management advisory group that the Commissioner is directed to establish by Section 412; and actions of the board that are perceived to favor one class of taxpayers might seriously erode the confidence of taxpayers at large in the fairness of the tax system.

We strongly believe that the board's powers should be revised so that it is clearly advisory, and not supervisory. Its reports to Congress could reflect any significant differences it might have with IRS or the Treasury Department.

Even if the board is made advisory, we would support the objective of Section 7802 which states that board members must be well qualified, and appointed solely on the basis of their professional experience and expertise. Certainly, the nation would be better served if we could find ways of ensuring that appointees to important positions of this kind do have appropriate experience and expertise for their positions. But, we should note that the executive branch has not been fully responsive to similar provisions calling for appointments based on specific expertise.

Based on experience with such bodies in the past, we can foresee that, sometime after the initial board has been appointed, a number of subsequent appointments will likely be based more on political expediency than expertise. This development could, of course, be overcome if the confirmation process focused more on enforcing provisions regarding qualifications.

We note that the bill recognizes that the President's appointment power under the Constitution cannot be restricted. So we can fully endorse the provision of Section 7802 that the board shall recommend to the President candidates for appointment as Commissioner. We all know that it has been difficult for the President to find well-qualified people for several hundred key federal appointments. Several Academy studies have dealt with that problem.[9] In order to strengthen the board's capacity to find the best candidates, we suggest that language be added to make it clear that the board be allowed use of federal funds to hire an executive search firm to aid them with this task.

EVALUATION

The changes being contemplated by the Committee would fundamentally change the IRS, and—it is hoped—the agency's performance. Therefore, an organized independent evaluation of these changes and their effectiveness should be planned. The evaluation should be conducted once the changes are in place, and sufficient time has elapsed to measure their effects, for two reasons.

First, it will be important to see whether the changes are achieving the objectives sought by the Congress—and if not, why not. The good intentions of the legislation may be thwarted by the unintended consequences that so often bedevil public administration. An evaluation would allow the Executive Branch and the Congress to take corrective action.

Second, several of the changes may provide lessons for other agencies. A thoughtful evaluation will allow the Executive Branch and the Congress to determine which lessons are specific to IRS and which could be generalized.

If a comprehensive evaluation is desired, it will be important to authorize it in the bill that you are considering. The evaluation needs to measure agency performance both now and after changes have been adopted, using a common set of metrics. Equally important, it must start with the objectives sought by the Congress, understood not in the imperfect mirror of hindsight but with the freshness and accuracy that only contemporary involvement can provide.

Finally, we urge that the provisions respecting the oversight board, be made subject to a sunset provision. Perhaps a five-year trial period would be appropriate since that is the term proposed for the Commissioner. Such a provision would en-

able the results of any evaluations to be more seriously considered in decisions related to the continued use of an oversight board.

CONCLUSION

We applaud the efforts of the National Commission, the House of Representatives and this Committee to reform the IRS. We note that the IRS is already undergoing substantial change, accelerated by this Committee's 1997 hearings. This Committee and the appropriations committee have recently heard testimony on what IRS has already changed, what changes it is working on, and the major reorganization that it is considering. We believe that you should give the agency and its new leader an opportunity to show what they can do. Creating a governing board at this time (regardless of what it is called) can only delay the pace of progress and confuse responsibility and accountability.

As we have noted, the Senate decided wisely to create advisory boards for the Social Security Administration and the Resolution Trust Corporation, instead of governing boards. We strongly believe that your reform efforts will be seriously compromised unless you make the same arrangement for IRS.

Following is a summary of the nine principal changes that we think need to be made in the bill in order to assure that the purposes of the legislation can be accomplished:

- Convert the Oversight Board to an advisory board by deleting each of the approval powers that we have noted, as well as the power to transmit IRS' budget.
- Eliminate the board's explicit power to recommend the Commissioner's removal.
- Vest in the President the power to name the board's chair.
- Require board meetings once a quarter rather than monthly.
- Make detailing personnel to the board subject to the Commissioner's discretion, and delete the board's authority to procure temporary and intermittent services.
- Restate the continued authority of today's oversight and appellate agencies to assure the preservation of merit principles for all personnel actions, not just those taken pursuant to the new flexibilities granted.
- Preserve the "120-day" rule for the Senior Executive Service, with an exception allowed for only the Deputy Commissioner.
- Provide that the board shall be terminated after five years unless extended by statute.
- Commission an independent evaluation of the functioning of the board and the other innovative features of the bill.

Only with such changes do we believe that IRS, even under a strong Commissioner with life-long experience as a manager, will be able to measure up to your expectations. We will be pleased to work with your staff in any further consideration of revisions in the bill.

This concludes our statement. We will be glad to answer any questions.

ENDNOTES

[1]: E.g., see "Renewing HUD," National Academy of Public Administration Panel Report, July 1994

[2]: Report of the National Commission on Restructuring the Internal Revenue Service, June 25, 1977, p.39

[3]: "Government Performance and Results Act," report of the Committee on Governmental Affairs, United States Senate, to accompany S. 20, Report 102-429, September 29, 1992, p. 15.

[4]: E.g., "Revitalizing Federal Management: Managers and Their Overburdened Systems," Report of an Academy Panel, 1983, and "The Role of the Office of Personnel Management," Academy Standing Panel on the Public Service, 1991.

[5]: "A Performance Based Organization for Nautical Charting and Geodesy," National Academy of Public Administration Panel Report, June 1996.

[6]: "Organizational Options for the Federal Aviation Administration," in Winds of Change: Domestic Air Transport Since Deregulation, Transportation Research Board of the National Research Council, by Herbert N. Jasper, 1991, see pp. 322 and 367.

[7]: E.g., Jonathan Breul, Sheldon Cohen, Alan Dean, Ronald Moe, and Edward Preston.

[8]: S. Report 103-221, to accompany S. 1560, January 25, 1994, p. 7.

[9]: E.g., "Leadership in Jeopardy: The Fraying of the Presidential Appointments System," National Academy of Public Administration, 1985.

NATIONAL ACADEMY OF PUBLIC ADMINISTRATION,
WASHINGTON, DC,
March 13, 1998.

Hon. WILLIAM V. ROTH, JR.,
Chairman, Senate Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Mr. Chairman: We appreciated the opportunity to testify at your February 25 hearing on H.R. 2676, the Internal Revenue Service Restructuring and Reform Act. Time did not permit us fully to respond to some of the questions that were posed, and we would like to supplement our remarks.

Why the Oversight Board Should Have Strong Oversight Authority But Not Decision-Making Authority

The bill would divide authority and, therefore, accountability. In October 23, 1991 testimony before the Senate Subcommittee on Consumer and Regulatory Affairs on restructuring the Resolution Trust Corporation, Academy Fellow Harold Seidman noted that "two heads are not necessarily better than one, particularly when they are on the same body." Congress, after hearing criticisms from a number of witnesses about the Administration's proposal for an Oversight Board with governing powers, changed the structure to have a single head of the RTC with a strong advisory board. By all accounts, the RTC went on to dispose of its business successfully and wind up its affairs.

The structure in H.R. 2676 would actually lead to even more difficulty in holding anyone accountable for IRS performance than if the management authority and responsibility were shared with merely two heads. In fact, the board's eight private members would all be autonomous, the chair would have certain additional powers but could not dictate positions of the board, and the union member would, in all likelihood, "march to his own drummer."

The kind of board that we are proposing would differ greatly from the current Commissioner's Advisory Group. We are recommending a board that would have substantially more status and authority than the existing advisory group. That group is appointed by the Commissioner and its members serve for a single, two-year term. It has no assured access to information, and it reports only to the Commissioner. By contrast, creating a board in statute would give its members more visibility and longer tenure and could guarantee them access to all pertinent documents and data. The provisions in H.R. 2676 could well be expanded and strengthened to assure the board's full access to information beyond the scope of strategic and operational plans, reorganizations and budgets, as now provided in H.R. 2676.

A statutory charter would also provide the new board a formal reporting channel to the Secretary, the Congress and the President. The board could be charged by law with such an important and sensitive function as exposing abuses, a responsibility not assigned to the existing advisory group.

The Congress would very likely pay as much attention to the views of a board with review and advisory functions as it would to a board that had decision-making authority. Indeed, the Congress could expect more candid views from such a board than from one that had already approved the decisions that the Congress might be inquiring about, or challenging.

In short, we are not proposing a toothless board. As our full testimony statement emphasized, we see many benefits flowing from a board that can provide the fresh view of outsiders. Those benefits can best be achieved without the dilution of accountability and the additional "layering" that would occur if the board is part of the decision-making process.

We think that the important issue to be resolved is whether the board retains the approval powers now included in H.R. 2676. If those few powers are deleted, as we strongly recommend, it could still be called an Oversight Board. However, other titles might be considered, such as Review Board or Advisory Board. The essential point is that the board must have full rights to receive all appropriate information and be able to provide meaningful review of IRS policies and actions.

Why the Union Representative Should Be a Voting Member of an Advisory Board, But Not of a Board with Decision-Making Powers

If the oversight board had all the review powers now proposed in H.R. 2676, but none of the approval powers that we have cited, we would strongly urge that the union representative be a full-fledged member. However, if the board continues to have authority in making the most significant management decisions of the agency,

then we believe that the union representative must not be a voting member. Following are our reasons.

Too many "bites at the apple." The union representative already has at least three sources of leverage with respect to IRS management. He is a member of the partnership council, he represents employees on bargainable issues, and he sits on the IRS Executive Committee. Those functions, alone, would likely make him the most knowledgeable and influential member of the board, even without a vote. With a vote, he will have to be negotiated with by the other members, rather than merely listened to.

Conflict of interest. Union representatives achieve and retain their positions by demonstrating that they put their members' interests first, and that they are effective in protecting those interests. That is an entirely constructive role, so long as the representatives are not placed in a position where they can usurp management's prerogatives.

It is entirely unrealistic, however, either: (1) to assume that there will not arise conflicts between the public interest and the interests of union members, or (2) to expect the union representative to vote against his members' interests when such a conflict arises. A union member of the board would not be obliged to support any board decisions that might be inimical to his members' interests and he could continue to represent those interests through his other roles on the partnership council and the Executive Committee, and his right to veto (along with the representatives of other bargaining units) the exercise of personnel flexibilities. He could be in a position to vote within the board to accept the union's position on a matter upon which he had failed to persuade IRS management. This would compromise the integrity of the review function.

* * * * *

We are writing on behalf of the Academy's Standing Panel on Executive Organization and Management. The panel would be pleased to provide further information or assist the committee in any way that you might ask.

Sincerely,

THOMAS H. STANTON, *Vice Chair*
HERBERT N. JASPER, *Panel Member*

Personnel Provisions in IRS Restructuring Bills

(March 16, 1998—Prepared by Several Fellows of the National Academy of Public Administration)

Subject	S. 1174 (Admin.)	H.R. 2676 (House)	S. 1096 (Kerrey/Grassley)	Comment
1. Merit principles[1] apply to flexibilities	Yes (33)[2]	Yes (31) ..	Yes (11) ..	Should apply to all personnel provisions
2. Union veto of flexibilities w/o resort to Impasses Panel.	Yes (34) ...	Yes (31) ..	Yes (11) ..	Substitute consultation for veto; preserve role of FSIP
3. New critical pay authority, n.t.e. Comptroller of Currency.	Yes (34) ...	No	No	Existing authority appears adequate
4. Streamlined critical pay authority, w/ new category of term appointments, n.t.e. 5% of GS-15 and above positions, not subject to merit principles.	Yes (35-6)	No	No	Unneeded; undesirable; a foot-in-the-door for politicization
5. Recruitment, retention and relocation incentives for 10 years.	Yes (37) ...	No	No	Desirable
6. Performance bonuses	Yes (37-8) for 10 yrs Compt'r of Curr'y ceiling.	Yes (36) up to 50% V.P. pay as ceiling.	Yes (13) Pres. pay as ceiling.	Permanent authority O.K.; 50% of pay probably excessive; Compt'r of Currency ceiling preferable
7. Career reserve SES appointments	Yes (39) ...	No	No	Unneeded, undesirable, if it remains, however, this would be the place to give authority to terminate freely (see #16)

Personnel Provisions in IRS Restructuring Bills—Continued

(March 16, 1998—Prepared by Several Fellows of the National Academy of Public Administration)

Subject	S. 1174 (Admin.)	H.R. 2676 (House)	S. 1096 (Kerrey/Grassley)	Comment
8. Streamlined demonstration	Yes (39-40) Permanent.	Yes (43-7) New authy.	Yes (16)	Reduced notice O.K., but 60 days authority preferred; termination waiver should have time limit and be fully justified
9. New performance mgt, retention, awards.	Yes (41-4) Authorized.	Yes (32-8) Required.	Yes (11-13) Required.	''May'' is far better than ''shall''
10. Broad-banding	Yes (44-6)	No	Yes (13-14)+ ''single band''.	Desirable; don't understand case for single band
11. Competitive promotions	Yes (46-8)	Yes (39) temporaries eligible.	No	Should be fully subject to merit principles; making tempies eligible is another risk of politicization
12. Categorical ratings for candidates	Yes (48)	Yes (40)	Yes (15)	Make certain that there are two or more categories of qualified candidates
13. Veterans preference incompetitive appointments.	Yes (48)	Yes (41)	Yes (16)	Placing veterans at top of category affords preference in excess of that currently required by law
14. Veterans eligibility in ''inside'' competition.	No	Yes (38)	No	Allowing veterans not in IRS to compete for positions to be filled from within the agency would greatly expand preference and set an undesirable precedent
15. Revoke 120 limit on details	Yes (49)	No	No	Unneeded, undesirable
16. Permit involuntary reassignments, removals, w/o current procedural protections.	No	Yes (42)	Yes (16)	A major threat to the preservation of ''merit principles;'' simplifying appeals process is preferable; 120 get-acquainted period for SES should be preserved, but could be shortened to, say, 90 days
17. Allow three years' probation	Yes (49)	Yes (42)	Yes (16)	O.K.
18. Alternative classification system	No	No	Yes (14-15).	Unneeded; undesirable; would further fractionate federal personnel system
19. No right of appeal for denial of step increase.	Yes (44)	Yes (38)	Yes (13)	O.K.
20. Change 30 days to 15 days for appeal of adverse action.	Yes (44)	Yes (38)	Yes (13)	O.K., but this will not materially shorten the months and years spent in appeals; better to consolidate appeals venues

[1] Merit principles as used herein includes prohibited personnel practices.
[2] Nos. in ( )'s refer to page nos. in bill.

Statement of Bruce A. Strauss

My name is Bruce A. Strauss and I am currently an Enrolled Agent licensed to represent taxpayers before the IRS. I have been President of the Enrolled Agents in our five county area in Florida for the past three fiscal years. I retired from the Internal Revenue Service after 31 years, the last 18 of which I held the position of Division Chief within the Collection Division. At the time of my retirement (April, 1992), I was Senior Division Chief and had received nine consecutive performance awards from 1983 through 1991.

I sincerely appreciate the opportunity to address this esteemed Committee. As you may recall, I had the privilege to testify before this Committee in September. 1997 regarding Internal Revenue Service practices, which generated ''abusive treatment of taxpayers'' and the ''resulting fear of the IRS'' by our citizens. This is of course, an unacceptable condition and must change. The reasons which are causing the cur-

rent IRS push for statistics and the resulting disregard for taxpayers and their rights were addressed during the September Hearings.

I would urge the members of this Committee to conduct a comprehensive and in-depth analysis of the issues which need to be addressed before writing proposed corrective legislation. It was less than two years ago, when the Taxpayer Bill of Rights 2 was passed. Obviously it did not address the core problem.

THE CORE PROBLEM IS THAT THE IRS WRITES THE REGULATIONS (THE LAW), DETERMINES THE RULES (THE INTERNAL REVENUE MANUAL) AND MAKES THE DECISIONS. CLEARLY, A PROBLEM DISPUTE SYSTEM MUST BE ESTABLISHED, INDEPENDENT OF THE IRS, WHICH HAS THE AUTHORITY TO DECIDE THE APPROPRIATE RESOLUTION FOR TAXPAYERS. THIS SYSTEM MUST BE PROVIDED AT MINIMAL COST.

The purpose of my testimony today is to recommend legislative and IRS organizational changes which should provide the citizens of this great nation:

1. A system in which taxpayers can be readily compensated for economic damages and reimbursed for expenses when the IRS exceeds its authority.
2. A system which guarantees an independent, timely, low cost, and highly skilled binding decision(s) when problems or disputes with the IRS require resolution.
3. A system which should provide continuous oversight of the IRS. laws.
4. A system which encourages taxpayers to voluntarily comply with the federal tax

These systems should restore the IRS to a "User Friendly," "Customer Service drive which seeks only the tax which is legally due. Major changes need to be accomplished in our current federal tax system in order to achieve these objectives. They are:

1. An entirely new system must be established outside of the IRS organizational structure that any tax payer with a dispute or a problem with the IRS would utilize. This system would replace the current Taxpayer Advocate Program. This system should have the authority to resolve all IRS issues and should be provided at a minimal cost to the taxpayer. This system should also have the ability/authority to economically compensate the taxpayer when the IRS exceeds their authority. In addition, it would make these awards to the taxpayer from the IRS District budget. The staffing and administrative costs of this system would be offset by the reduction of the IRS budget currently used to fund the Taxpayer Advocate Program. This system's management must be outside the IRS.
2. Congress must create a central "Clearing House" staff where all taxpayer complaints regarding the IRS are received and worked. This staff must be highly competent, having the ability to analyze the issues involved in any taxpayer complaint and to hold the IRS responsible to resolve these complaints fairly and objectively. This "Clearing House" staff would also advise Congress of potential legislative changes based on their analysis of the complaints and the IRS's ability to appropriately resolve these complaints. In essence, it would provide, in part, continues oversight of the IRS.
3. Congress must restrict the authority of the IRS to write tax regulations. It must also insist on Congressional approval prior to implementation of any new tax related regulations. The current ability of the IRS to write and implement regulations is one of the reasons for the complexity of the tax laws. The more immediate concern, is that federal law is being created by non-elected public employees.
4. Congress should conduct a review of existing tax regulations and the Internal Revenue Code and eliminate all current regulations and sections of the IRC which have little or no impact on tax revenue production or citizen's rights.
5. Congress should rethink the IRC, regulations, and Internal Revenue Manual concepts that control the IRS's approach to taxpayers who owe assessed unpaid taxes, taxpayers who have not filed legally due returns, and taxpayers who have filled incorrect returns. The objective should be, to have citizens, which fall in the above categories to become current with their legally due taxes; and ensure that they file and pay their future taxes in a timely manner. Currently, IRC Sections and many of the IRS policies create substantial financial barriers and are counterproductive in achieving this objective. For example, IRC Section 6222 assesses interest compounded daily, not only on the delinquent tax but also on the interest. For any other creditor, this is usury. The impact on the taxpayer, many times, is inability to become current with their taxes. As a result, for a period of 10 years or longer, the federal tax lien becomes a major problem in their ability to obtain credit, and live in a normal economic environment.

6. Conduct an "Amnesty Program" for all taxpayers who have not filed or have stopped filing legally due federal tax returns. This program must be conducted outside of normal IRS operations and must be designed to make the taxpayer whole. There is a mentality that taxpayers who have not met their tax paying responsibilities should receive significant punishment. I concur with the need for these taxpayers to experience some economic realities, but these realities must be reasonable and consistently applied. To continue with the current policies will only motivate these citizens to live with the fear of "getting caught" or find new methods to avoid their present and future taxes. In either situation, all of us lose.

7. Congress must legislate and the President must sign a law that specifically prohibits the IRS and all other federal agencies from establishing statistical operational goals and from including them in the IRS Executive annual evaluation process.

8. The "burden of proof" for establishing "INCOME," when the IRS disagrees with the taxpayer, must rest with the IRS. The current IRS practice of assigning income without a factual basis is a complete abuse of their power and of the taxpayer.

9. Internal Revenue Code, Section 7430–33, was passed as part of the first "Taxpayer Bill of Rights" in 1988. The concept is to restore taxpayers, and to cover certain expenses for the taxpayer. This section needs to be expanded to include all IRS actions and to remove the two year statute. In addition, all economic awards given to taxpayers should be paid from the current IRS District budget and would be included in the responsible IRS Executives annual evaluation The adoption of this recommendation would place "balance" regarding a goal for fair and objective treatment of all taxpayers along with an objective to ensure that all taxpayers pay their legally due taxes. This same section should also be expanded: (A) To prohibit all coercion tactics by the IRS; (B) to include the failure of the IRS to apply sections of the IRC which benefits the taxpayer.

10. The IRC must include provisions that all IRS decisions to prepare returns for taxpayers, recommendations to assess taxes on taxpayers; to file tax liens on third parties, to change taxpayer filing status, etc., must all be reviewed by an independent IRS quality review function prior to implementation of the decision. In addition, the IRS must provide the taxpayer a comprehensive written report, stated in layman's language, including an explanation of their rights to appeal the IRS decision.

11. Congress must recognize that the IRS needs a consistent long-term funding approach. Congress should determine what "Compliance Level" is acceptable and be prepared to fund the IRS to achieve this level.

12. Congress should return the collection statute to six years.

13. Congress should encourage the public to share their problems which they are having with the IRS.

14. Congress should require estimated income tax to be paid monthly, vs. the current requirement of four times a year.

15. Congress and the IRS must work on how they communicate. An adversarial relationship has no benefits to Congress or the IRS and certainly the citizens of this nation are not well served.

On December 9, 1997, I submitted 23 additional recommendations to the staffs of several members of this committee. I ask that these recommendations, along with my observations, also be given serious consideration and be included in the record. My primary objective is to create an environment within the IRS in that their only objective is to collect from the taxpayer what is legally due. This objective shall be achieved by treating all taxpayers in a respectful, courteous manner and by giving the taxpayer the benefit of the doubt.

Thank you Mr. Chairman for the privilege of testifying before this Committee.

Attachment—Dec. 9, 1997 Recommendations

December 9, 1997

PROFESSIONAL TAX STAFF,
Senate Finance Committee,
Washington. DC.

Please find attached my additional recommendations for legislative changes to the Internal Revenue Code. You have copies of my testimony and my initial recommendations which were attached to my testimony.

A significant issue/problem identified during the Senate Finance Committee's Oversight Hearings of the Internal Revenue Service was the setting of statistical

"goals" by the IRS. This is in direct violation of IRS Policy Statement P-1-20, dated 11-9-73, which, of course, is still in effect. As a result of the "Hearings", the IRS has stated that it will discontinue this practice.

The "bottom line" is that: TAXPAYERS ARE BEING ASSESSED TAX WHICH THEY DO NOT OWE. THE RESULTING ABUSE OF TAXPAYERS IS TOTALLY UNACCEPTABLE.

Now let's reexamine what has taken place: The IRS top executives violate a long standing IRS policy. This violation has major negative economic impact on the citizens of this country, and plays a major role in our citizens fear of the IRS. However, two months after the "Hearings" no one has accepted responsibility for this practice, nor has anyone been held accountable.

Hopefully, the current efforts by Congress will result in an Internal Revenue Service which is fair and objective. An environment must be achieved in which any law abiding citizen will be assured that their IRS tax issues/problems will be resolved in a timely, objective, fair, understanding manner. There is absolutely no excuse for any law abiding citizen to ever FEAR any governmental agency.

I look forward to discussing these issues with you.

Attachment.

1. IRC 6020[b] authority is being abused by the IRS. When, per IRS records, a tax return has not been filed by a taxpayer, the appropriate procedure is to issue a Summons for the books and records of the taxpayer to determine the proper tax liability. The practice that is currently in place by the IRS is to assess the tax using the authority of IRC 6020[b] in lieu of the summons procedure. The IRS Service Centers have been employing this tactic since the early 1980's. The IRS prepares the returns as a single taxpayer, with the standard deduction, even though the IRS records show that the taxpayer is married with legitimate dependents. Many times the income is overstated, but with certainty, the tax is almost always overstated. Then the collection pros is started with tax liens filed, etc. Many times, no tax is owed by the taxpayer.

The impact on the taxpayer is severe economic hardship. The impact on the IRS Collection Division is considerable additional staff hours being spent on correcting these assessments, when these cases are actually worked. Many of these cases are assigned to the IRS Que inventory and are not worked, thereby leaving the taxpayer with a tax assessment which is not resolved. The benefit to the IRS is, of course, the statistical reporting of substantial tax being assessed.

Solution: Except in "Jeopardy Cases," require a summons be issued for the taxpayer books/records for the IRS to determine the correct tax liability. If tax is owed, apply a 10% Penalty in addition to the current 5% per month (Max 25%) Penalty for non filing.

2. "Nominee Liens"/"Alter Ego Liens."

This process/procedure is not in the IRC but needs to be codified. IRS, when it suspects that a taxpayer has moved cash/assets to a third party, administratively files Federal Tax Liens in the name of the third party and proceeds to collect the taxes with the sale of these assets. The third party receives no appeal rights or even notice of IRS proposing the action.

Solution: Codify this process and give the parties effected normal appeal rights.

3. IRC Section 3402(d) often is being ignored by the IRS.

Solution: This can be rectified by giving it protection under IRC Section 7433.

4. IRC Section 3509 is also being ignored by the IRS in many cases. The solution is the same as #3 above.

5. Section IRC 7605(b) is being abused. I am repressing a case in which the taxpayer was changed from an independent contractor to an employer status. The IRS prepared the returns, after they looked at taxpayers records, and forced the taxpayer to sign. The taxpayer paid the tax, penalties and interest. Than she came try see me. We filed a claim to have the taxpayer refunded the money. The games that the IRS have played after the claim was filed are a classic example of abuse of power and of the IRS not admitting to their mistakes. The primary power play is their request to again examine the taxpayers records with the inherent threat of assessing more tax. Their are many additional issues in this case which even further weakens the IRS's position, but that doesn't stop the IRS from continuing to harass and abuse the taxpayer.

Solution: Change IRC Section 7605(b) which specifically prohibits the IRS from such abuse and bring it under the protection of IRC Section 7433.

NOTE: Recommendations 3, 4, 5 above are IRC Sections that were designed by congress to instill some fairness and to protect taxpayers. Why are they being ignored?

6. IRS Examination has a long standing practice of accepting the reported income but disallowing all expenses. This is typical for a business return (Ex. Sch. C) when the IRS deems the taxpayer not to be fully cooperative. They assess the tax and than tell the taxpayer the only method available for resolution is to pay the tax (which the taxpayer doesn't owe) and than file a claim for refund.

Solution: Codify: If the IRS is accepting the income than they must also accept reasonable business expenses which obviously were used to generate the income.

7. The IRS many times will take more than two years to complete an examination. Meanwhile any tax which is assessed as a result of the audit, accumulates compounding interest, interest compounds on the interest and penalties.

Solution: Codify maximum of one year to complete an examination and/or interest and penalties max out after one year.

8. Examination Proposed Assessments (30 Day Letter) are not being reviewed for Quality by the Quality Review Staff. This results in many examination tax assessments which are improper and many times overstated. Also, sections of the IRC which benefit the taxpayer are not being applied.

Solution: Require all proposed tax assessments by the IRS to be reviewed by an independent equality review staff.

Note: SEE ATTACHMENT 1: Only 28.65% Of taxes proposed to he assessed (Tax, Penalty and interest) were upheld by the Appeals Function during the five year period of F.Y. 92 thru F.Y. 96. Now consider the fact that less than 3% of proposed examination assessments were appealed in F.Y. 96. (The basis of this calculation is table 11-a from the FY1996 IRS Data Book)

The question than arises (regarding the abuse of taxpayers by the Examination Function in order to achieve Statistical Operational Objectives) as to the total of the Examination additional tax assessments, what is the actual percentage that are not legally owed?

9. The implementation of the Compliance 2000 initiative delegated the authority to approve a Compliance Project to the District Director Level, with ARC oversight. This authority must be moved back to National Office.

Solution: Codify that all compliance projects must be approved by IRS National Office.

10. The office of the Chief Inspector of the IRS, based on evidence at the Senate Finance Committee's Oversight Hearings and from my recent experience, appears to have abandoned least some of its responsibilities.

Solution: Have it report/be responsible to the "Independent Board of Directors."

11. The practice of establishing statistical operational goals and evaluating IRS personnel on achieving these goals is wholly unacceptable and is a (if not the) primary reason for the current environment within the IRS.

The primary objective for any taxpayer case being worked by the IRS is that it is completed in a timely, quality manner and stays within the constraints of the IRC, IRS regulations and the Internal Revenue Manual (IRM).

Solution: Codify Disciplinary/dismissal action(s) of IRS Personnel for utilizing.

12. Many taxpayer claims for taxes paid but not owed, are not completed by the IRS within six(6) months of receipt.

Solution: Codify: Failure to meet the six month date would result in automatic refunds of the amount claimed.

13. Many times taxpayers are due refunds/overpay their tax/determine that IRS owes them money but can not legally have their money paid to them due to the two year claim statute. This was a major issue the "Hearings."

Solution: Change IRC Section 6511 to Ten (10) years to allow for refunds due taxpayers when IRS actions play a role in creating the problem. Also, make it "Retroactive."

14. The concept of tax return preparer penalties needs to be reexamined. The return preparer primary obligation is to the client. It is the IRS's responsibility to insure that the federal tax laws are adhered to/enforced. The current preparer penalties, in effect, intimidate many preparers.

Solution: Study the effect impact of modifying/removing the tax return preparer penalties.

15. The "burden of proof" for determining unreported income must rest with the IRS.

Solution: Codify.

16. The IRC must identify/state the "Mission" of the IRS. The current IRS Mission Statement is contained in IRS Policy Statement P-1-1 dated 1-29-90. To authorize the Executives of the IRS to determine what their mission should be, is illogical and wholly inappropriate. This is a responsibility of Congress.

Solution: Codify the mission of the IRS. Certainly "to collect the proper amount of tax revenue" is inadequate. What does "proper" mean used in this context?

17. All IRS actions which impact a taxpayer should be subject to an "appeal" outside the IRS. The current "IRS Appeal Function" is part of the IRS. Also the Problem Resolution Function is part of the IRS.

Solution: Codify an "Appeal Process" independent of the IRS. I suggest that it be responsible to the Department of Justice or to the "Independent Board of Directors."

18. In recent years, the IRS has implemented a policy of charging "fees" (Ex. $1 for Pub. 17; $43 for an installment agreement). In my view this practice is highly questionable and is viewed as a tax.

Solution: Codify prohibition of such fees by the IRS.

19. In certain tax issues, the IRS has multiple authorities to resolve the same issue. An example is the Gift tax where the assets gifted can be pursued by the IRS (this is the IRS position) thru the Gift tax lien and/or a transferee assessment and/or a suit in Federal District Court. I represent a taxpayer where this process has been on going for more than twelve (12) years. A classic example of abuse.

Solution: Codify that a taxpayer can be perused for resolution of a IRS tax issue for no longer than six (6) years after the appropriate tax return has been filed and/or the tax has been assessed.

20. A favorite issue of the Examination Function is questioning the value of an asset, particularly real estate/land. Their approach is to place a value much higher than the taxpayer's and than place the burden on the taxpayer to prove the IRS position to be incorrect. Many times the IRS will not accept the valuation placed on the property by the county/city for their own taxation purposes although these values are kept current. The result, of course, is additional taxes being assessed by the IRS.

Solution: Codify that real estate/land values determined by the respective local taxing authorities will be the controlling value for IRS purposes.

21. The IRS, many times, will bypass a Power of Attorney and they will not follow their own IRM procedures in the bypass. It would appear their motivation is an attempt to intimidate the taxpayer.

Solution: Codify automatic disciplinary action.

22. The "Report of the National Commission on Restructuring the Internal Revenue Service" dated June 25, 1997, Appendix I "Taxpayer Rights Proposals" are on "target" and I support all of them. I would suggest that the proposal on "Offers in Compromise" be enlarged to include all payment agreements on delinquent taxes and IRS "Wage Levies"/attachments. The IRS unilaterally determined what living expenses and the amount of these living expenses they would allow a taxpayer(s) while repaying their delinquent taxes. I suggest these type of issues/decisions are legislative matters.

23. I have examples of FOIA requests for IRS records which are critical to challenging an IRS action/position. The IRS response is that the records are not available/or they cannot locate the records. The result is that the taxpayer is severely handicapped to resolve the issue.

Solution: Codify relief for the taxpayer.

SUMMARY

The fundamental issue is that there is not a level playing field when a taxpayer has a dispute with the IRS. In tact, a more accurate analogy is that when an ordinary citizen has a dispute with the IRS there is no playing field. The IRS makes significant portion of the law (Regulations, etc.), all of the rules (ex. IRM), and all of the decisions, unless someone has the financial recourses to eventually have the case heard before a court.

THE IRS DISPUTE/PROBLEM RESOLUTION SYSTEM MUST BE CHANGED AND IT MUST BE MOVED OUTSIDE THE IRS

Many current IRS staff years (Approximately 200) are committed to resolving taxpayer problems/disputes with the IRS (ex.; Problem Resolution and Appeals). Take these staff years and establish a legitimate, viable system outside the IRS with appropriate authority to resolve the problems and disputes and to restore the taxpayer where appropriate.

This system should include removal of at least some of the required administrative procedures currently included in IRC Section 7433.

Again, all IRS actions, must be brought under the protection of IRC Section 7433.

TABLE I–1. RECOVERY RATES IN APPEALS

	FY 1996	FY 1995	FY 1994	FY 1993	FY 1992	Five Year Total
Nondockted:						
Number of work units closed	43,731	42,281	41,576	43,281	44,347	215,216
Additional tax and penalties:						
Proposed ($1,000)	11,623,092	9,893,945	8,629,987	8,507,266	8,891,067	47,545,357
Revised ($1,000)	3,880,121	2,877,568	2,384,268	2,519,875	2,588,071	14,249,903
Percent recovered docketed	33.38%	29.08%	27.63%	29.62%	29.11%	29.97%
Number of work units closed	20,136	19,059	22,148	23,378	25,140	109,861
Additional tax and penalties:						
Proposed ($1,000)	2,043,079	2,341,895	2,939,049	2,492,774	3,194,118	13,010,915
Revised ($1,000)	435,602	615,915	768,859	447,616	832,348	3,100,340
Percent recovered total	21.32%	26.30%	26.16%	17.96%	26.06%	23.83%
Number of work units closed	63,867	61,340	63,724	66,659	69,487	325,077
Additional tax and penalties:						
Proposed ($1,000)	13,666,171	12,235,840	11,569,036	11,000,040	12,085,185	60,556,272
Revised ($1,000)	4,315,723	3,493,483	3,153,127	2,967,491	3,420,419	17,350,243
Percent recovered	31.58%	28.55%	27.25%	26.98%	28.30%	28.65%

TERMS:

Work units—Historically Appeals has tracked its inventory in ''works units''. A work unit generally involves one or more related taxpayers for one or more periods, for which the protests contain substantially the same primary issue. A work unit can, and often does, involve more than one tax return.

Additional Tax and Penalties—All of the docketed amounts and the bulk of the nondocketed amounts represent District proposed deficiencies (as defined in IRC Sec. 6211). However, the nondocketed figures also contain adjustments which are not subject to Tax Court jurisdiction. This includes cases referred to Appeals by Collection such as Trust Fund Recovery cases and Offer in Compromise cases.

SOURCE: Office of the National Director of Appeals, IRS.

RESPONSES TO QUESTIONS SUBMITTED BY SENATOR ROTH

Question 1. Do you believe that taxpayers are afforded proper due process in the collection process as implemented by the IRS? If not, what are your suggestions that would protect the taxpayer while not harming, our tax system?

Answer. I do not believe that taxpayers are afforded proper due process in either the IRS Collection or Examination process. My written testimony recommends several solutions to this problem which are recommendations #1, 7, 9, 10 and 11.

Question 2. I am also concerned that the IRS targets low income and disadvantaged taxpayers for audits. What can be done to ensure that these taxpayers who are attempting to comply with the complex tax laws are afforded adequate protection from being targeted by the IRS?

Answer. I am representing a number of taxpayers who are low income and/or disadvantaged citizens who have had additional taxes assessed. These cases are true "Horror Stories." The personal and economic price these citizens pay, due to IRS being driven by statistical goals and its incompetence, is unacceptable, and must change. The implementation of recommendations #1, 2, 3, 5, 7, 8, 9, 10, and 13 should eliminate this problem.

Question 3. Are the Taxpayer Advocate and Problem Resolution Officers effective in quickly solving taxpayer problems?

Answer. My recent experience with the IRS Taxpayer Advocate/Problem Resolution process demands that a new system be implemented to resolve taxpayer disputes. The incompetence is overwhelming. Implementation of recommendations #1, 2, 9 and 13 should eliminate this issue.

Question 4. The current offer in compromise program does not seem to work. In too many instances, people go into the program, nothing gets resolved, and by the time they get out they are socked with horrendous interest and penalties. Is this program broken? How would you improve it?

Answer. The reason the current IRS Offer in Compromise program does not work is the attitude by the IRS that they must "Protect the governments interest." As a result, the investigating IRS employee does to give proper consideration to the taxpayer needs, and the benefit to the government of making this taxpayer "whole." A taxpayer who does not have a federal tax lien on his credit report certainly has the potential to increase their earning capacity and thereby pay more federal taxes in future years. My recommendations to improve this program are:

Remove the automatic extension of the collection statute when an Offer in Compromise is submitted by a taxpayer. Also recommendations #1 and 12 attached.

Question 5. Last September, one of our witnesses, Father Ballweg, indicated to all of us the importance of a system that is customer friendly. Shouldn't most correspondence be signed so that agency personnel are accountable? At some stage in the process, where a problem arises, should the taxpayer be given an employee to whom the taxpayer may turn to resolve the case?

Answer. I concur with this recommendation. This recommendation should also include IRS executives.

Question 6. I have a constituent who owns a small business in Delaware. After settling his issue at the IRS appeals level, he asked whether he was entitled to his attorney's fees because he substantially prevailed on the merits. The IRS and it would get back to him. After nearly two years the IRS finally responded to this basic question. He was not entitled to his attorney fees. Because he did not pay the IRS at the time of settlement, he was responsible for interest during the IRS's two year delay. If the IRS audits or attempts to collect from a taxpayer and the taxpayer prevails either in court in appeals, should the IRS pay the taxpayer's costs and attorney fees?

Answer. My recommendation #9 addresses this problem along with recommendation #1.

Changing the Culture

Question 7. During the September hearings employee witnesses testified that many IRS employees ignore the Internal Revenue Manual and other official procedures with impunity. Should IRS employees be required to follow the Internal Revenue Manual and other official procedures? If IRS personnel do not follow IRS policies and procedures, what should happen to the taxpayer's case?

Answer. IRS employees are currently required to follow the Internal Revenue Manual. The reasons this problem exists is:

(A) The lack of concern/incompetence of IRS managers. When the "drive" is to achieve statistical goals, manual procedures and taxpayer rights (due process) tend to be ignored.

(B) The IRS has substantially reduced/eliminated the requirement for the "Quality Review" of cases in process and closed cases. Therefore, the built-in management "feedback" system as to the quality of the case work by the IRS employees has substantially been removed.

The implementation of recommendation(s) #1, 2, 7, should resolve this issue.

PREPARED STATEMENT OF ROBERT M. TOBIAS

Chairman Roth, Members of the Finance Committee, I am very pleased to be here today to discuss the IRS Restructuring and Reform Act of 1997. I have served as President of the National Treasury Employees Union (NTEU) since 1983 and have been associated with NTEU since 1968. NTEU represents approximately 150,000 federal employees, roughly 95,000 of whom work for the IRS.

I recently had the opportunity to serve with two very able Members of this Committee, Senator Kerrey and Senator Grassley, on the Commission to Restructure the IRS. The Commission's final report, which I supported, formed the basis of the legislation the Committee is considering today. I strongly support that legislation (H.R. 2676) and urge this Committee, the Senate and any Conference Committee that may be appointed, to move quickly to make it law.

The IRS has had many problems in recent years, including serious difficulties in acquiring and utilizing technology needed to allow employees to perform their jobs at levels that taxpayers rightly expect. Funding and training cutbacks have also created problems. Between 1992 and 1998 the agency has cut nearly 15,000 employees, leaving many functions, such as customer service, understaffed and woefully undertrained.

The IRS Restructuring Commission looked carefully into the many problems facing the IRS and the taxpayers who must interact with it. The Commission's thoughtful analysis of the problems and solutions provide a solid guide to getting the IRS back on track. But, the Commission's recommendations might have languished on a shelf without the impetus for action created by your hearings last September. Those hearings were very painful for the IRS employees I represent.

They were painful because the vast majority of IRS employees try very hard, despite antiquated computers, sometimes misguided managers and public disdain to do the best job possible for the taxpayers, yet the message of the hearings that filtered through the media all across the country was that most IRS employees were incompetent at best and evil at worst. I note and appreciate, Senator Roth, your repeated statements that most IRS employees do a good job and that your interest

is in correcting systemic problems and in protecting employees from management abuses.

The hearings were painful for IRS employees for other reasons as well. They were painful because many of the problems that were highlighted were problems that IRS employees knew could have been avoided. The most glaring of these problems, that of overly aggressive tax collection efforts, could have been avoided if the Field Office Performance Index, which has been suspended since the hearings, had never been adopted. NTEU had strenuously opposed the use of this system that measured and rated each IRS Field Office by the amount of collection revenue brought in. We knew that even though individual employee quotas had been outlawed, this system would have the same result by pushing district managers to push employees to emphasize collection statistics rather than fair treatment. And, in fact, your hearings and subsequent IRS internal investigations have found a number of managers who have done just that.

I believe that lack of training, outdated technology, low pay and the "stovepipe," compartmentalized structure of the IRS contributed to the inability of taxpayers to get their problems solved. I believe that Commissioner Rossotti's proposals to change the IRS structure to make it more responsive to taxpayers will make it easier for IRS employees to provide better customer service. I also believe that the institution of "problem solving days" has been helpful in providing IRS employees the means to solve taxpayers' problems and should serve as a model for how all of IRS's departments should work together to solve taxpayers' problems all the time. But much more needs to be done and the most important step to addressing the problems raised at your September hearings is enactment of H.R. 2676.

One of the provisions in H.R. 2676 that has received a great deal of attention is the establishment of an oversight board for the IRS. The board would be made up of private individuals, the Secretary of the Treasury, the IRS Commissioner and a representative of employees of the IRS. I believe that the board is necessary to restore credibility to the IRS and to ensure that the IRS becomes more responsive to taxpayers and does not fall into another disaster similar to its problems with Tax Systems Modernization.

There has been much consideration given to the powers and makeup of the board. With regard to the board's powers, I think H.R. 2676 strikes an appropriate balance that will allow the IRS Commissioner to manage the agency without undue interference, while ensuring that long term, broad based decisions are carefully reviewed. While some have proposed giving the board more powers, it should be noted that the IRS Oversight Board in H.R. 2676 has significant authority, especially as compared to other similar boards. The Social Security Advisory Board, for example, which was created by this Committee as part of the Social Security Independent Agency legislation, is charged with advising, analyzing, making recommendations and reviewing systems and policies at the Social Security Administration. Whereas, the IRS Oversight Board, in addition to similar duties, also approves strategic plans, major reorganizations and agency budget requests.

I know the issue of granting 6103 authority to the board is under consideration. My view is that such authority is not necessary to fulfill the board's role as broad policy advisor on tax administration matters.

The issue of the makeup of the board has also generated much interest. As you are aware, H.R. 2676 provides that one of the eleven members of the board be "an individual who is a representative of an organization that represents a substantial number of Internal Revenue Service employees." I am aware that representatives of IRS managers have raised objections to having an employee representative on the IRS Oversight Board. I believe that it is crucial for the board to have the input of the employees. I also believe that the concerns raised are unfounded.

First, the employee representative, would be nominated by the President, subject to Senate confirmation and removable at will by the President. If the representative were to wield the awesome power that some have suggested, interfering with the sound management and administration of the IRS, the President could remove the representative without the need to even provide a reason. Senate confirmation and Presidential removal at will provide adequate protection against inappropriate action by an employee representative.

Second, I currently serve as the employee representative on the IRS Executive Committee, which has performed many of the functions to be assigned to the board. I have served on this and predecessors of this committee for 6 years and I believe that while there have been times of disagreement, the IRS believes that it has not been a detriment to the accomplishment of agency objectives, but rather, an asset to have a representative of employees on these policy making bodies.

Third, an employee representative was put on the board because of, not in spite of, his or her role on behalf of IRS employees. Therefore, suggestions of a conflict

of interest due to the representative's role with regard to employees has no merit. In addition, the employee representative is prohibited from chairing the board and is in the minority even compared to the Secretary of the Treasury and the IRS Commissioner, who, I believe, are fully capable of and responsible for representing management concerns at the IRS.

Also, while the board has authority to review issues associated with senior managers' selection, evaluation and compensation, it has no approval authority in this area. I believe it is very appropriate for the board generally and the employee representative specifically, to be involved in such a review. Employees will have information that other board members will not. After all, it was employees who revealed to this Committee that some managers were employing abusive tactics against taxpayers and subordinates in order to beef up their collection statistics. The board should have regular access to any similar information.

Unlike the attention generated by the IRS Oversight Board, the Personnel Flexibilities provisions (Sec. 111) of H.R. 2676 have received little public attention, but I believe they are critically important to reforming the IRS. This section of the bill will allow the IRS to experiment with hiring, pay, classification, performance management and other personnel matters outside the restrictions of government wide civil service laws in order to find more effective ways of accomplishing its mission. The bill uses current law on "demonstration projects" as a model.

The purpose of demonstration projects is to allow agencies to waive statutory and regulatory personnel policies in order to test new and innovative approaches. Current law on demonstration projects, in effect since 1978, provides that:

> (f) Employees within a unit with respect to which a labor organization is accorded exclusive recognition under chapter 71 of this title shall not be included within any project under subsection (a) of this section—
>
> (1) if the project would violate a collective bargaining agreement (as defined in section 7103(8) of this title) between the agency and the labor organization, unless there is another written agreement with respect to the project between the agency and the organization permitting the inclusion; or
>
> (2) if the project is not covered by such a collective bargaining agreement, until there has been consultation or negotiation, as appropriate, by the agency with the labor organization.

(5 USC 4703)

While some have characterized the written agreement language of section 9301(b) in H.R. 2676 as an unprecedented approach, in fact, it is based on the above language, which has been used often and successfully in demonstration projects that have produced exactly the kind of enhanced effectiveness that is needed at the IRS.

The large majority of the demonstration projects that have been completed, made permanent, or are currently underway have involved employees represented by a labor organization and have involved a written agreement between the union and the agency before implementation, exactly as envisioned by the above referenced section of H.R. 2676. According to the Office of Personnel Management, these projects have increased effectiveness, produced cost savings and boosted productivity.

Nonrepresented employees have also participated in successful demonstration projects. Under current law on demonstration projects such nonrepresented employees have the same consultation rights as they have in other matters. H.R. 2676 could be clarified to ensure that those rights would continue upon enactment.

The idea behind both current law on demonstration projects and section 9301(b) of H.R. 2676 is that the employee representative and the agency will work collaboratively, in a consensus or partnership mode, to try new approaches. It provides a method for lifting many of the statutory protections afforded employees by the civil service laws, while providing a check against agency abuse by requiring agreement from recognized labor organizations before imposing new systems. While NTEU agrees that experimentation is a necessary part of positive change, allowing agencies to operate outside the civil service laws without such a check, could, I fear, lead to widespread abuses with no available recourse for employees. I believe that your September hearings provided ample evidence to support that fear.

Some have characterized the written agreement language in H.R. 2676 as providing the employee representative with a veto over agency proposals because it does not provide for appeal to the Federal Service Impasses Panel, which can impose a decision when an impasse is reached in other instances. While NTEU believes that this lack of appeal was intended and does, mirror current practice under demonstration project law, we would support a change that would allow appeals to the Federal Service Impasses Panel.

I would also like to correct an inaccuracy that I have seen in material discussing H.R. 2676 with regard to what laws can and can't be waived under the bill. I have seen statements indicating that basic benefits such as retirement and health insurance could be waived. That is not true. Section 9304(e)(2) of the bill states that subpart G of part III of Title 5 *cannot be waived*. Subpart G of part III of Title 5 covers workers compensation, retirement, unemployment compensation, life insurance and health insurance for federal employees.

Another inaccuracy I have seen states that prohibited personnel practices could be waived under H.R. 2676. That is also not true. H.R. 2676 states that, "any flexibilities under this chapter shall be exercised in a manner consistent with chapter 23, relating to merit system principles and prohibited personnel practices." (Section 9301(a)(1)). In addition, current law on demonstration projects prohibits waiving merit system and prohibited personnel practices law and is not amended by H.R. 2676. (See 5 USC 4703(c)(5) and section 9304 (b) and (c) of H.R. 2676.)

One change that we would like to see in the personnel flexibilities section of the bill would be to drop section 9304(e)(4), which prevents demonstration projects under the bill from permitting collective bargaining over pay or benefits, or requiring collective bargaining over any matter which would not be required under section 7106. Collective bargaining over pay is not prohibited under the current law on demonstration projects and Executive Order 12871, in effect since 1993, requires collective bargaining over certain subjects that are merely permissible under section 7106. I am unaware of any problems with these current law provisions and would recommend that these changes made by H.R. 2676 be dropped.

I would also like to address the issue of whether the flexibilities set out in H.R. 2676 will have the effect of bringing about needed change at the IRS and what kind of innovations might be pursued. I have spent a good amount of time with the new IRS Commissioner, Mr. Rossotti. I support his reorganization proposals and have joined with him to urge all IRS employees to do the same. In my role on the IRS Commission, I advocated the position that IRS needed to make customer service its number one priority. I believe Commissioner Rossotti agrees with that view.

Right now, customer service representatives at the IRS make on average around $28,000 a year, with an absolute maximum salary in the highest cost city in the country (San Francisco) of $36,027. The customer service representative is the person who is charged with answering every question that any taxpayer across the country may have when they call the IRS for help. This is the person charged with having intricate knowledge of the entire U.S. Tax Code, including the 9,000 pages just added last year. A law school graduate working as a first year associate at a tax law firm would laugh at that salary. Even customer service representatives at other federal agencies, like the Social Security Administration make more money. That must change and I believe it can by using flexibilities in the bill that will allow experimentation in the area of job classification with the goal of attracting, retaining and promoting individuals who will provide world class customer service.

I would note that Senator Gramm of Texas stated at the Committee's January 28th hearing that IRS employees needed to be paid more. I would like to second that sentiment and emphasize that not only the top technology people need to be paid more, but to ensure quality service to taxpayers front line employees need to be paid more as well.

Despite the monumental amount of knowledge required to perform the customer service jobs well, little and in some cases no training is provided. I have heard of many cases in which IRS employees who ordinarily perform other functions have been told to answer taxpayer calls and man walk in sites with no training at all. One IRS employee temporarily assigned to cover a taxpayer service window with no training recently told me that she felt terrible having to tell a taxpayer that all she could do was take her information and ask someone else to get back to her. She said she understood and sympathized with the taxpayer's anger over not being able to get an answer to her question, but that she was more afraid of giving the taxpayer the wrong answer. This also must change and I believe ensuring the availability of appropriate training can be addressed in the context of a new performance management system as required by section 9302 of the bill.

The personnel flexibilities section of H.R. 2676 also provides for rewarding groups of employees who work as a team and allows gainsharing, or the ability to reward employees by passing on savings that come about due to their successful efforts to improve work processes. The bill also specifically prohibits the use of cash awards based solely on tax enforcement results. I believe that all of these provisions will aid the IRS in achieving the culture change that is necessary to become a customer service oriented organization.

One issue critical to success for IRS reform that is not directly addressed in H.R. 2676 is adequate funding. Employees cannot provide quality service to taxpayers

without adequate pay, training, technology and facilities. I hope this Congress will provide the funding necessary to achieve the level of service taxpayers expect and deserve. I believe that the provisions of H.R. 2676 that call for more coordination between Congressional Committees with jurisdiction over IRS can help that process by limiting conflicting directives. I also believe that the tax complexity analysis provisions will at best lead to a simpler tax code and at a minimum raise the awareness of legislators as to any tax administration cost increases associated with new tax legislation.

Another issue that is not addressed in the bill, but that you have raised, Mr. Chairman, deals with the use of pseudonyms by IRS employees. Pseudonyms are rare, but sometimes extremely important to protect IRS employees from violent taxpayers. As you know, IRS employees are physically assaulted more than any other federal agency employees, including the FBI and DEA. In the past five years, approximately 3,200 threats and assaults against IRS employees have been reported. The main reason an IRS employee uses a pseudonym is to prevent a potentially violent taxpayer from finding out where they and their family live. In a small number of cases, I believe that is necessary.

I also believe, however, that taxpayers have a right to be able to know who they dealt with, in order to keep records or report inappropriate behavior, inaccurate information, nonresponsiveness, or yes, Mr. Chairman, even a problem solved, a helpful attitude or a job well done. (It does happen.) I believe that there should be a way to provide the protection that is sometimes necessary as well as the information that taxpayers require by instituting an employee identification number system. I would be pleased to work with you and the Committee staff to try to design such a workable system.

Mr. Chairman, thank you for this opportunity to present the views of the National Treasury Employees Union on the IRS Restructuring and Reform Act of 1997. And, again, thank you for continuing to point out throughout your hearings that most IRS employees do a good job. I certainly agree with that and would like to add that most IRS employees would like to be able to do a better job and that quick enactment of H.R. 2676 will further that goal. I would be pleased to answer any questions you may have.

PREPARED STATEMENT OF STEFAN F. TUCKER

Mr. Chairman and Member of the Committee:

My name is Stefan F. Tucker. I appear before you today in my capacity as Chair-elect of the American Bar Association Section of Taxation. This testimony is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

The Section appreciates the opportunity to appear before the Committee today to discuss various proposals to restructure the Internal Revenue Service. Because of the limited scope of today's hearing, our testimony focuses principally on issues of Executive Branch governance, Congressional oversight of the Internal Revenue Service ("Service" or "IRS") and certain other proposals contained in the House bill. When appropriate, we would be pleased to present our views on other issues to the Committee.

We have been privileged to consult with the Commission, members and staff of the tax writing committees, and representatives of the IRS and Treasury as they developed first the Commission's report and then the House bill. We particularly appreciate the courtesy that Senator Kerrey extended to us during this process and his willingness to consult with us.

In general, we support the House bill's approach to addressing crucial issues arising out of the Commission's report. While the Section does not agree with some important details of the solutions proposed by the Commission and the House, we believe the thoughtful way in which the issues have been presented will permit the Congress to fashion a workable framework for restructuring the IRS. We hope the testimony we present contributes to that goal.

I. GOVERNANCE AND OVERSIGHT

1. Governance

The House bill would create an IRS Oversight Board (the "Board) within the Treasury Department. The Board would be charged with oversight of IRS "administration, management, conduct, direction, and supervision of the execution and application of" the tax laws. Specifically, the Board would have the authority to: review

and approve IRS strategic plans, review operational functions of the IRS, provide for review of the Commissioner's selection, evaluation and compensation of senior managers, and review and approve the Commissioner's plans for major reorganizations.

a. Oversight Board

The Tax Section is concerned with the House proposal to vest in the management board direct approval authority over certain functions of the IRS. We believe the President is, and should remain, the ultimate authority over the IRS. Management of the agency charged with collection of virtually all of the revenues of the Federal Government is, fundamentally, an Executive Branch function. We believe this is consistent with the Constitutional notion of separation of powers and the management notion of accountability.

Moreover, we believe it is impossible, as well as unwise, to split the fiscal management of the Service from other issues involving tax administration, enforcement and policy. These functions should be retained by the only branch of government capable of carrying out both simultaneously—the Executive Branch—and should continue to be lodged in the Treasury Department, the Cabinet department charged with administering the Government's fiscal affairs.

We are concerned that a Board with substantive authority over IRS operations could be an impediment, rather than an aid, to better management. Much of the criticism directed at the Service in recent months has, at its core, been about lack of control and accountability. The Service is a huge organization which, like most bureaucracies, tends to function with or without top-down leadership. Any restructuring proposal should seek, as its principal goal, to enable those in charge to control the agency more effectively.

An independent oversight board with management authority will, we believe, hinder, rather than enhance, management accountability. Instead of a single head, operating within the Treasury chain of command, there would be separate power centers, each competing for its share of authority and each with different reporting relations. We see a Board with management authority as both a potential distraction to the Commissioner and, even worse, a rival. As a separate power center, the Board offers a potential for intrigue on the part of those seeking to undermine or circumvent the Commissioner. While this result is by no means a certainty, creating even the potential for such confusion is problematic. The Tax Section believes this development would run counter to the desired goal of enhancing the management of the Service.

The Section urges that day-to-day management functions remain within the Treasury Department Consequently, we do not support the House proposal to shift approval of certain management decisions to the Board. By retaining all such authority within the Executive Branch, clear management accountability will be maintained.

Having said this, we believe the creation of a Board without management authority could serve a useful purpose. Consistent with our view that private sector expertise should be made available to the Service's senior management and that such individuals should be involved in the oversight process, we recommend that Congress create an IRS Board of Review, made up exclusively of private sector members. No government officials would serve on the Board, either directly or ex officio. We suggest that the size of the Board be kept relatively small—five or six members would seem optimal. Their appointment, compensation, etc. would be as proposed by the House.

The role of the Board would be specified by Congress in the implementing legislation and would be somewhat similar to the role recommended by the Commission. For example, the Board would be expected to review and provide input to the Service's proposed budget, short-term and long-range strategic and operational plans, and major proposed management initiatives. In addition, the Commissioner would be expected to consult with the Board regarding the appointment, evaluation and compensation of the Commissioner's senior management team. The Board also would be expected to recommend to the President qualified candidates for the positions of Commissioner and Chief Counsel.

A Board constituted in this way would have the duty to make periodic (preferably semi-annual) independent reports directly to the President and the Congress concerning its assigned tasks.

Such reports would be expected to deal in a candid and uncensored fashion with the successes and problems of the Service, as well as any management initiatives which Congress must approve. Members of the Board would be available to consult directly with, and testify before, the Congress on the successes and problems of the agency. Rather than being involved in direct management of the Service, we con-

ceive of the Board's role as an extension of Congressional oversight. It would serve as the eyes and ears of Congress with respect to the Service, directly involved in reviewing the major management decisions affecting the Service without disrupting the normal Executive Branch authority.

Some might contend that a Board constituted in this manner would lack any authority. We clearly disagree. The authority that the Board would have would come not from direct management responsibility but, rather, from its reporting responsibility to Congress. The Board would have a direct link to the Congress that could not be circumvented by IRS or Treasury management. As a result, such management would, in all likelihood, seek to work with the Board.

As importantly, the Board would contribute the relevant expertise of private sector professionals as a consultative resource for the IRS and the Treasury on major management matters. This role should be specified in implementing legislation. A properly recruited Board could make considerable resources available to the IRS and could complement the management skills of the Commissioner and senior IRS officials by making available expertise in areas with which they may be less familiar.

We are convinced that a Board of Review, operating as we propose, would attract very high caliber members from the private sector. We are confident that ultimately these individuals would add substantial value to the analysis and review of management issues, and Congress would view the Board's role as an integral part of its oversight responsibility. Because of the important impact the Board of Review will have on improved management and oversight of the Service, we think there will be no shortage of top quality private sector individuals willing to serve.

b. Congress should establish the position of Undersecretary of Taxation

We concur in the assessment that Treasury oversight of the Service has been "limited and uncoordinated." We are concerned, however, that the House bill would not improve that Treasury oversight function. Therefore, we propose that this problem be addressed directly by creating within the Treasury Department a new Undersecretary of Taxation. The Undersecretary would be charged specifically with that responsibility, together with the task of coordinating the entire tax system, both tax administration and tax policy. The scope and importance of this new position dictate that it should be filled only with an individual having significant experience with the tax system.

The Undersecretary would report directly to the Secretary. In addition, the Undersecretary would be required to assure Treasury's participation with the Commissioner and other IRS management in the development of long-range planning for the Service. The Commissioner and the Assistant Secretary of the Treasury for Tax Policy would report directly to the Undersecretary. The Chief Counsel of the Internal Revenue Service, who currently reports directly to the Treasury Department General Counsel and has dotted-line reporting responsibility to the Commissioner, also would have dotted-line reporting responsibility to the Undersecretary[1] as would the Assistant Secretary for Management and others as deemed appropriate.

We believe that creation of such a position addresses more directly than does an outside Board the concerns expressed by the Commission concerning Treasury accountability. Such a position provides a person at the highest levels of Treasury whose sole responsibility would be to manage and coordinate the tax functions of the Administration. This is, in fact, what has been lacking in past Administrations, a point emphasized by the Commission. The Undersecretary would serve as the point of intersection between tax administration and tax policy, with the clear mandate to coordinate these functions.[2] In turn, the Undersecretary would report directly to the Secretary, the individual charged by the President with overall responsibility for the Treasury's tax function.

The Undersecretary would be required to make periodic reports to the Secretary, who in turn would be required to report regularly to the Congress. The Undersecretary and the Commissioner would be required to attend meetings of the Board at such reasonable times as the members of the Board determine, and would be responsible for reporting to and advising the Board about impending management proposals. The Undersecretary also would be available to the relevant Congressional committees to report and consult on matters relating to the Service.

The statutorily-mandated job description of the new Undersecretary that we have in mind differs from those of prior Treasury undersecretaries. For example, early in President Reagan's administration, an Undersecretary for Economic Policy had supervisory authority over the Assistant Secretary for Economic Policy and the Assistant Secretary for Tax Policy. We do not envision, and would not support, the proposed position as involving economic policy. Rather, the tasks assigned to the new Undersecretary should be limited to those relating to the management of the Service and tax policy.

Creation of the position of Undersecretary of Taxation would assure clear, continuing and coordinated accountability within the Treasury Department that, to date, has been absent or sporadic. This would not only avoid the prospect of management by committee, but also assure the greater coordination of fiscal management of the Service, tax administration and tax policy that we believe is essential. Together with a Board of Review reporting directly to Congress, the Undersecretary will provide a clear focus of responsibility, authority and accountability.

2. Personnel Policies

The Tax Section strongly endorses the recommendations of the Commission and the proposals in the House bill that give the Commissioner more flexibility with respect to IRS personnel. Historically, civil service rules have tied the Commissioner's hands, making it extremely difficult, if not impossible, for the Commissioner to hire the best people from the private sector and pay them at appropriate levels. The Service and, indeed, the Nation, can no longer afford such inflexibility. As an agency at a crossroads, it is imperative that the IRS, through the Commissioner, be able to bring into government the best and the brightest. That cannot and will not happen unless flexibility in hiring is increased and unless the Commissioner is given the ability to pay such individuals at levels that will attract them away from high-paying private sector jobs.

3. Independent Inspector General

The Tax Section also supports the creation of an independent Inspector General within the Internal Revenue Service. At present, the Treasury IG serves as the IG for the Service as well. This relationship suffers in many ways from the same problems as that of the Service to the Treasury generally. The Treasury IG is responsible for an entire Cabinet department, which makes it exceptionally difficult for that person to devote as much attention as necessary to the Service. This would be rectified by the creation of an IG position at the Service.

In addition, we believe an independent IG at the IRS would go far to address public perceptions about an agency out of control. While we do not share the view that the IRS is a rogue agency, recent revelations make it clear that abuses are not random or isolated and should be dealt with accordingly.

4. Congressional Oversight

We endorse the Commission's proposal to establish a single Congressional entity to coordinate IRS oversight. A joint panel, composed of members from the various committees of jurisdiction, would provide a focal point for examining the full scope of IRS management and budget issues. In addition, it would coordinate the sharing of information on IRS operations among the committees of jurisdiction. Finally, a joint entity could play a constructive role as a forum for enhanced communication among the various committees of jurisdiction and among the Congress, the IRS and Treasury.

5. Streamlining of Penalty and Interest Provisions

We note with interest Chairman's Roth's stated desire to streamline current law penalty and interest provisions. We are pleased that the Chairman has taken an interest in these provisions and wish to offer our technical assistance to him and the staff of the Finance Committee. There are many cases in which the application of penalty and interest provisions take on greater significance to taxpayers than the original tax liability itself. The Tax Section is concerned that individuals are often caught unaware by these provisions, and that the system lacks adequate flexibility to achieve equitable results. For example, there presently is little ability on the part of the Service to adjust penalties and interest after a statutory notice of deficiency has been issued. We would, therefore, support creation of such a review procedure as well as other changes to the penalty and interest provisions.

II. TAX SIMPLIFICATION

The Commission focused on tax simplification as a major step in improving the administration of the tax law. We strongly agree, and emphatically endorse its conclusions on the relationship between complexity of the tax law and administration. Unless there are meaningful legislative and administrative efforts to simplify the tax law, any changes in IRS governance will lose their effectiveness.

More specifically, tax law complexity and frequent changes in the Code mean more tax forms and instructions, more computer programming, more regulations and rulings, more training of IRS personnel, more taxpayers requiring assistance, and more disputes with taxpayers. They also mean greater compliance burdens for

taxpayers and an increased likelihood of taxpayer filing errors. Increased taxpayer errors, in turn, require the tax administrator to deal with correcting those errors.

Moreover, many of the amendments to the Code enacted since 1986 have particularly complicated tax administration and compliance. A significant reason for this is revenue considerations. The need for revenue has resulted in enactment of provisions that scale back the availability of tax benefits for taxpayers with incomes above certain levels. At the same time, revenue available for tax cuts has been limited, thus constraining the enactment of tax benefits with general applicability. Consequently, the tax benefits enacted have been carefully targeted to minimize the revenue impact. While the targeting of tax benefits may, in many cases, assist in carrying out laudable goals, the result is significantly increased complexity. The Taxpayer Relief Act of 1997 is replete with examples.

The Tax Section has long been a supporter of simplification. However, because change—even simplification—can be complicating, we recommend that simplification proposals only be adopted if they represent significant simplification, after they have received careful consideration, and then only if the changes are expected to remain in place for the long term.

With that background, we offer two proposals to the Committee.

1. Earned Income Tax Credit

The EITC affects approximately 15 million individual taxpayers and, according to the IRS, is the source of the most common errors made by taxpayers. Its purpose is to deal with a problem—regressive payroll taxes—by an indirect rather than a direct solution.

The EITC is incredibly complex. Eligibility alone is based on earned income, both taxable and non-taxable, adjusted gross income, modified adjusted gross income, and a number of other factors. The amount of the credit requires further difficult computations because it is dependent on different factors, including the number of qualifying children. This in turn depends upon whether the child lives with the taxpayer, the relationship of the child to the taxpayer, and the child's age. The test is more complicated than the test for dependency, and typically applies to a group of taxpayers who are generally unable to afford tax preparation assistance.

We have previously recommended that consideration be given to substituting the dependent child definition for the qualifying child definition. Although further improvements should be studied, this change alone would simplify application of the EITC and eliminate the need to twice determine whether a child can be claimed on a taxpayer's return.

2. Phaseouts

As noted above, many provisions of the Code are phased out over an income range. Phaseouts create a variety of computational difficulties that complicate forms and confuse taxpayers. This is magnified by the number of provisions subject to phaseouts, the different phaseout ranges, and the methods for computing the phaseouts. These phaseouts also create uncertainty for taxpayers as to whether they are eligible for certain tax benefits (and thus their ultimate tax liability). This uncertainty creates taxpayer frustration. For example, taxpayers cannot factor the Hope Scholarship Credit into their financial plans if they cannot determine whether they will be eligible for the credit.

The simple solution for this complexity would be to eliminate these phaseouts and adjust the tax rates to compensate. Short of this, we recommend a study of whether phaseouts could be standardized and simplified to minimize computational complexity and uncertainty.

3. Complexity Analysis

The House bill, based on the Commission's recommendation, proposed that a Tax Complexity Analysis be required as a formal part of the legislative process. The Section endorses the Commission's objective of providing relevant information with respect to the complexity of tax legislative proposals to those responsible for their enactment. Indeed, we suggested a similar process in our testimony before the Commission.

We are concerned, however, that the provision included in the House bill would have little effect on the legislative process. The House bill requires that such an analysis be provided as part of a committee's report on a bill, after the committee markup has already occurred. Thus, as presently envisioned, the complexity analysis would not be available at the very time when it would be most useful: the markup.

We believe a complexity analysis can have a meaningful effect on reducing complexity. In order for this to occur, however, the analysis must be available before members of tax writing committees consider proposals rather than afterward.

Therefore, we strongly encourage this committee to require a complexity analysis before a committee markup in order that it be available to members.

III. DISCLOSURE OF FIELD SERVICE ADVICE

The Court of Appeals for the D.C. Circuit recently held that field service advice memoranda issued by the IRS National Office are not exempt from disclosure under the Freedom of Information Act. Currently, there are no statutory procedures or administrative rules governing the disclosure of field service advice memoranda. The Section believes that legislation is necessary not only to provide clear guidelines to the IRS in determining the extent and timing of public disclosure but also to ensure that the process is fair to both taxpayers and the government and does not jeopardize taxpayers' privacy interests. We encourage the Congress to make clear, however, that the legislation is not intended to restrict the court's opinion.

1. Public Disclosure

The Section suggests that such legislation amend section 6110 of the Code to include written field service advice memoranda within the definition of a written determination, thus making such memoranda open to public inspection as provided in regulations. We do not believe it is advisable to constrain the ability of the field personnel to communicate orally with the National Office; however, we believe it is appropriate to adopt a rule that requires that any advice adverse to the taxpayer be rendered only in writing.

The legislation should clearly define the types information in field service advice memoranda that are subject to disclosure. For example, information providing guidance as to the interpretation of the internal revenue laws, including alternative legal theories, and the application of such laws to the facts of a particular case, should be subject to disclosure, while information that reveals the scope, direction, or emphasis of audit activity should not.

2. Taxpayer-Specific Provisions

The Section appreciates the usefulness of field service advice as a tool that permits field personnel to seek advice regarding the development of a case from the National Office at an early stage and in a relatively quick and efficient manner. We encourage the Congress to make clear that the legislation is not intended to jeopardize the efficiency of this process; however, we believe that certain safeguards are necessary to protect the interests of taxpayers and the government. We believe that an appropriate rule would provide that the taxpayer be notified that field service advice is being sought and provide the taxpayer the opportunity to request that such advice be obtained using the more formal technical advice process (if the facts are sufficiently developed and the issue is appropriate for such advice) or, if both the taxpayer and field personnel agree, through a joint informal consultation with the National Office. If the taxpayer does not wish to request technical advice (or technical advice is not appropriate), and a joint request for informal consultation is not acceptable by both parties, then the field personnel may proceed with the field service advice. Conversion to the technical advice process should be automatic, however, when a legal issue arises at a time when the facts and strategies of the case have been fully developed (e.g., at the appeals level). We encourage the Congress to direct, through Committee Report language, that these rules not be interpreted to preclude a request for both field service advice and technical advice in the same case, if both are appropriate. In addition, we recommend that the legislation require that a copy of the field service advice be promptly provided to the taxpayer.

3. Non-Substantive Tax Matters

We believe that one final point merits discussion. Neither the D.C. Circuit nor the legislative proposal that appeared in the Ways and Means Committee Chairman's mark explicitly addressed the disclosure of advice concerning non-substantive tax issues, such as collection, bankruptcy, and summons matters. We suggest that the legislation provide that the disclosure rules apply equally to information in field service advice memoranda regarding these general litigation matters.

IV. SHIFT IN THE BURDEN OF PROOF IN TAX CASES

The House bill provides that the IRS shall have the burden of proof in any court proceeding with respect to a factual issue if the taxpayer asserts a reasonable dispute with respect to any such issue relevant to ascertaining the taxpayer's income tax liability. The provision includes a number of "safeguards" that limit the scope of the shift in the burden of proof in order to create a "better balance" between the IRS and taxpayers, without encouraging tax avoidance. Taxpayers other than indi-

viduals must establish that their net worth does not exceed $7 million in order to be eligible for the benefits of this provision.

The provision specifically states that it should not be construed as overriding any requirement to substantiate an item under the Code or regulations. Accordingly, taxpayers must meet all applicable substantiation requirements, whether imposed generally or with respect to specific items. Taxpayers who fail to substantiate any item in accordance with the legal requirements of substantiation will not have satisfied all of the legal conditions that are prerequisite to claiming the item on the taxpayer's tax return, so will not be able to avail themselves of the provision's shift in the burden of proof.

The Tax Section continues to oppose any blanket shift in the burden of proof that would apply to all tax disputes. We have expressed concern that such a radical shift would provide a disincentive to adequate taxpayer recordkeeping; would result in some taxpayers being less forthright in preparing and filing their returns; would increase the incidence of taxpayers taking overly aggressive positions on their returns; and would encourage the IRS to be more aggressive in collecting information from taxpayers and third parties in the administrative audit stage. In our view, enactment of a proposal to shift the burden in all cases would have a significant adverse impact on tax administration and compliance.

In contrast, the proposal contained in the House bill is narrower and more reasonable in scope. We commend the House for recognizing that any changes to the burden of proof should be carefully crafted to ensure sound administration of the tax laws without compromising compliance. In particular, the requirement that the taxpayer cooperate fully during the audit process and exhaust administrative remedies within the IRS should eliminate most of the potential for abuse. Further, the House bill makes it abundantly clear that a taxpayer will not be relieved of either the general or specific substantiation requirements imposed by the Code and regulations. Thus, it appears that the government would not be placed in the fundamentally disadvantageous position inherent in earlier proposals.

It is hard to gauge what behavioral changes would occur as a result of the House bill's proposed burden shift. We strongly encourage this Committee to be guided by the counsel provided by the judges of the Tax Court by means of a letter to Chairmen Roth and Archer from Chief Judge Mary Ann Cohen. We share the concern of Chief Judge Cohen that controversies will, undoubtedly, increase as a consequence of this provision.

Thus, while we believe the House bill provision represents a substantial improvement over earlier legislative proposals, we strongly recommend that technical modifications be made to ensure that the safeguards provided in fact are effective to limit the problems about which we have previously expressed concern. For example, the meaning of the provision's requirement that the taxpayer assert a "reasonable" dispute is not clear. Does this mean that the taxpayer can simply assert an issue in his or her pleadings or that the taxpayer must present some evidence in support of the position? Does "reasonable" mean "not frivolous" or something more? We recommend that the Congress provide additional guidance as to the meaning of the foregoing provisions to narrow the disputes which likely will arise between taxpayers and the IRS on these matters.

V. EXTENSION OF PRIVILEGE TO OTHER TAX ADVISORS

The House bill includes a proposal to extend the common law attorney-client privilege of confidentiality to tax advice that is furnished to a taxpayer by any individual who is authorized to practice before the Internal Revenue Service.

As a preliminary matter, the Tax Section acknowledges the sensitivity of this issue. We recognize that anything that we say that raises concerns about the proposal may be dismissed by supporters as self-serving parochialism. We have attempted to put aside any self-interest and carry out our analysis from policy and technical points of view. In doing so, we have explicitly assumed that the House provision, or something similar to it, will be enacted.

First, we believe it is critical to examine the historical underpinnings of the privilege and the different roles that attorneys and accountants play in our society. The privilege developed directly out of the role of attorneys as zealous advocates for their clients. Without such a privilege, a client would never be willing to confide in the attorney. Since free and open communication between an attorney and his client is essential to zealous representation, privilege was an crucial element of that relationship. The attorney must remain free and independent of government coercion.

The privilege protects from disclosure communications to and from a client and his attorney. Where the privilege applies, it is absolute. It applies in all contexts: civil litigation, criminal litigation, administrative proceedings, and day-to-day advi-

sory functions. It applies in both state and Federal proceedings. The privilege belongs to the client, not the attorney. It may be waived by the client, in which case the attorney may not assert it on his own. The privilege does not extend to communications between an attorney and his client, where the attorney is acting in a capacity other than as an attorney, such as a tax-return preparer or a business advisor.

The client's privilege is generally available with respect to cases pending before the United States district courts and the United States Court of Federal Claims and with respect to tax-deficiency and other non-refund cases pending before the United States Tax Court.

In contrast, accountants have served an entirely different function in our society, one that is inconsistent with the concept of privilege. Indeed, accountants that serve as independent attestors of financial statements are required to maintain their independence from their clients, in order to act as protectors of the marketplace. In rejecting the creation of an accountant-client privilege, Chief Justice Burger, on behalf of a unanimous Court in *United States v. Arthur Young & Co.*, 465 U.S. 305 (1981), stated:

> [T]he independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.

We are concerned that extension of privilege calls this basic role of accountants into question. An accountant acting as both attestor and tax advisor faces a potential and fundamental conflict between those roles if, on the one hand, the accountant must maintain confidentiality while, on the other hand, the accountant's role as independent auditor compels or may compel disclosure of such information. We encourage this Committee to examine this conflict to determine if it may result in a weakening of the privilege and, thereby, harm to the public generally.

The Tax Section applauds Congress's attempt to broaden the number of tax professionals available to assist taxpayers in controversies before the IRS. We are concerned, however, that taxpayers who are unaware of the limited privilege being granted may be harmed. Taking a privilege that is absolute and that applies in all different situations, and engrafting on to it a new class of professional for whom the privilege will not be absolute and to whom it will apply in only limited circumstances, will, we believe, cause significant confusion.

Under the House bill, the privilege only applies to representation in civil tax cases, and then only during the administrative phase of such cases. Once any tax case reaches litigation, the privilege would disappear. That, alone, could subject the non-attorney tax advisor to being subpoenaed and the information, once confidential, being discovered. The common law attorney-client privilege, pervasive throughout the judicial system, far exceeds the breadth of any legislative privilege being granted.

Moreover, the privilege of confidentiality that extended in tax controversies would disappear once the information was sought for another purpose. Several examples will illustrate this point. By its own terms, the provision would not extend the privilege to criminal matters. Criminal tax controversies do not always begin as criminal cases. An individual may be surprised to learn that information given to his non-attorney advisor in the course of a civil tax case was not confidential once the case became a criminal one. While this would not be a common occurrence, the potential for mischief is apparent. A similar dilemma would arise in state tax cases, where the proposed privilege would not apply.

An even more likely situation is one involving domestic relations controversies. It has become increasingly common in today's world to find divorcing spouses using financial information in litigation over property settlements and alimony. We can easily envision that information disclosed to a non-attorney advisor for purposes of a tax controversy would be discoverable by one spouse or the other in divorce proceedings. No privilege would extend in that situation.

Finally, difficulties may arise in situations where an accountant is furnishing both tax advice and certified financial statements. For example, consider the situation where a small business seeks to obtain a loan or other financing. A non-attorney advisor to whom was given confidential tax information in the course of a tax controversy could not exercise the privilege to prevent disclosure of that information to

potential lenders requiring certified financial statements. The advisor's duty as an independent auditor appears to conflict with any claim of privilege.

Again, mindful of our self-interest, we have attempted in good faith to bring to the attention of this Committee issues that may create problems. We do not hold ourselves out as experts on the rules governing accountants and other non-attorney advisors. We encourage the Committee to examine these issues carefully.

VI. CONCLUSION

Mr. Chairman, thank you for the opportunity to appear before the Committee today. I will be pleased to respond to any questions.

ENDNOTES

[1]: The Chief Counsel would report to the Undersecretary on matters involving tax and compliance policy and legal interpretation of the tax laws. The Chief Counsel would continue to report to the General Counsel on litigation and personnel matters.

[2]: By this proposal, we do not advocate that the position of Assistant Secretary for Tax Policy be diminished in any way. The new Undersecretary position would, instead, focus on IRS management and coordination between that management function and tax policy.

AMERICAN BAR ASSOCIATION,
SECTION OF TAXATION,
April 23, 1998.

Hon. WILLIAM V. ROTH, JR.,
Chairman, Committee on Finance,
U.S. Senate,
Washington, DC.

Dear Mr. Chairman: On behalf of the American Bar Association's Section of Taxation, I am responding to your letter of March 5, 1998, requesting additional views concerning restructuring the Internal Revenue Service. In light of the Senate Finance Committee's subsequent markup of IRS restructuring legislation, this letter will address various aspects of the Senate Finance Committee bill as well.

We wish to compliment you and your committee for your work on IRS restructuring. While our views about certain aspects of the proposed legislation may differ, we are optimistic that, on balance, the ultimate product will strengthen the IRS.

As a general matter, the Section views with some concern the extent to which the Finance Committee bill seeks to impose statutory prescriptions for IRS organization and conduct of affairs. (In this regard, we note that our concern is not limited to the Finance Committee bill. More generally, the question of how far a legislative body should go in imposing management rules on an agency applies to all tax legislation and particularly taxpayer rights legislation.) We recognize that part of the motivation behind IRS restructuring has been the identification of past IRS abuses and the perceived need to ensure those abuses do not recur. While we agree with that goal, we are concerned that many provisions of the bill go too far. When Congress micromanages too many decisions for an agency as complex as the IRS, there will be unintended consequences, and the overall result may be to eliminate the flexibility the Commissioner needs to create an agency that performs in a fair and expeditious manner.

Discretion on the part of an agency is, without question, a two-edged sword. Discretion without appropriate management guidance and supervision often leads to the types of behavior Congress rightly seeks to curb. On the other hand, the complete elimination of discretion leads to rigidity in agency action, often to the detriment of taxpayers. In our view, it would be more advisable in such instances for Congress to identify problems that may exist, and then instruct the Commissioner to develop solutions to those problems. The Commissioner is the individual charged with management of the agency and, in most circumstances, the person best able to design solutions that address such problems without overly restricting the agency. Throughout this letter, we will identify particular provisions where this approach should work well.

GOVERNANCE

1. Board of Oversight

As we pointed out in our testimony before the Finance Committee in January, the Section believes that the creation of an IRS oversight board could serve a useful

purpose by providing independent, real world expertise and experience to an agency that has, in the past, suffered from excessive insularity. At the time, however, we also expressed concern about the possible risks that a board charged with actual management authority could pose.

As proposed by the Finance Committee, the new board of oversight would possess such direct management authority, particularly as it relates to the approval of strategic plans and budgets. While this authority is limited, we are nevertheless concerned that it may pose an impediment to improved management rather than any actual improvement in the same. A board so constituted could develop into a separate power center, actually competing with the Commissioner and the Secretary for authority. In short, it could become a rival to the Commissioner rather than an aid to better management.

A principal goal stated in the report of the Commission on Restructuring the Internal Revenue Service was to increase the accountability of those charged with managing the IRS. We believe strongly that any restructuring plan must be very explicit about where lines of authority and accountability run. New structures will only compound existing problems unless those structures simplify agency management. We remain unconvinced that an independent board with management responsibilities accomplishes that goal.

We compliment the Committee on the inclusion of a "sunset" for the new board of oversight. As Stefan Tucker indicated in his oral testimony before your Committee, such a sunset provides Congress with the ability to "go back" and adjust mechanisms that may not be working as well as planned. This is particularly useful in situations such as this where entirely new structures are being implemented.

2. Section 6103 Authority

The Finance Committee bill grants the new board limited access to confidential taxpayer information under section 6103. As we stated in January, the Section opposes any such authority on the part of the board. While the bill seeks to provide safeguards against abuses, we see no point in providing such access in the first place. We are not aware of any situation in which the new board should have access to confidential taxpayer information, and we think that a grant of access—no matter how limited in scope—can only create future problems.

3. Chief Counsel

We are concerned about the decision to remove the IRS Chief Counsel's reporting responsibility from Treasury. In view of the very substantial organizational changes proposed by the Commissioner, we think it is inadvisable to change the Chief Counsel's reporting responsibility without further consideration.

The most important benefit that we think derives from the current structure is that the Office of the Chief Counsel has some independence from its client and, therefore, is in a position to give the Commissioner and his vast compliance organization objective advice, even if that advice is not popular with the client. It has been suggested that the proposed change in reporting is more consistent with a corporate model and will assure accountability of the Office of Chief Counsel within the Service. We think it is very important to underscore the difference between the Internal Revenue Service and a private corporation. In a private corporation, a lawyer is charged with the responsibility of aggressively representing the position of his or her client as long as such representation is in accordance with the law and the rules of professional responsibility that govern a lawyer's behavior.

Unlike a private enterprise, the Internal Revenue Service is a law enforcement agency. Because of its extremely broad and significant powers, we should want the agency's lawyers to perform a different role. As we seek to further protect individual taxpayer's rights—a laudable goal of the Finance Committee -we should seek a structure in which the Office of Chief Counsel will be able to stand up to a revenue agent or collection officer, should the lawyer determine that the actions of the revenue agent or collection officer are improper. We are convinced that lawyers within the Office of Chief Counsel are better able to take positions that may be unpopular with others within the agency in a structure in which they ultimately report to an official outside the agency. If the same lawyer ultimately reported through the Chief Counsel to his or her client, we fear that the lawyer's effectiveness as a protector of taxpayer rights might be seriously undermined.

4. Treasury Inspector General

The Section is also concerned about the proposal to eliminate the IRS Office of Chief Inspector and transfer such functions to the Treasury Department in the form of a Treasury IG for Tax Administration. Our experience with the Treasury Department and IRS lead us to conclude that such a shift may actually result in less, rather than more, attention being paid to problems within the IRS. Removal of the IG

position from the agency does not, in and of itself, ensure greater success. Indeed, to move the function outside of the agency may result in a diversion of resources to other inspection functions. In addition, the fact the inspection function is removed from the agency may actually limit the inspector's ability to know the culture and weed out problems. To this end, we cite the successful tenure of Frederic Hitt, Inspector General of the CIA, as evidence that an independent IG within an agency is a workable model.

5. Ex Parte Contacts

The IRS offers one of the most highly developed systems of alternative dispute resolution (ADR) that exists today for resolving controversy without litigation. The various forms of ADR utilized by the IRS have been extraordinarily successful in minimizing the number of disputes that must be resolved by the courts through litigation. Forms of ADR function best when the ADR process is left flexible so that it can be adapted to fit the particular needs of the participants. For that reason, we urge caution in enactment of any proposals that would limit flexibility in the ADR process. Overlegalization of ADR is likely to harm, not help, the dispute resolution process. On the other hand, we encourage the Committee to make it clear to the Internal Revenue Service and the Treasury Department that it wishes to maximize the use of ADR as much as reasonably possible, including in disputes with foreign governments under our bilateral tax treaty network.

We would like to refer specifically to two proposals in the Finance Committee bill, the proposal to bar the participation of Examination personnel in the Appeals process and the proposal to bar field personnel from the taxpayer's conference of right in connection with a technical advice request.

We are aware that some taxpayers have found the participation of Examination personnel to have an adverse effect on the dispute resolution processes. Of course, this is not universally the case. In some instances, the participation of Examination personnel may speed the resolution of issues, and excluding them from the process may have an adverse effect on taxpayers.

In this regard, we are particularly concerned with the proposal that would prevent an Appeals Officer from communicating ex parte with Examination personnel. The Appeals process is heavily reliant on Examination personnel for the production of factual material and for mathematical calculations necessary to the disposition of the case. We think it would be a mistake to remove effectively the support of Examination personnel from Appeals Officers on an absolute basis.

On the other hand, we can understand how some taxpayers may be concerned when issues of disputed fact or law are discussed by an Appeals Officer ex parte with a revenue agent. In general, it is poor management strategy to permit examinations to remain uncompleted. Otherwise, the Appeals function will not be viewed as an independent review of the examination. We believe the Service should establish as its goal that examinations be carried through to completion. If the Committee is concerned with substantive ex parte discussions with Examination personnel on disputed issues of law or fact, then we suggest that the legislation direct the Commissioner to establish procedures for assuring that taxpayers have an opportunity to participate in such discussions.

With respect to the participation of field personnel in so-called adverse conferences in the technical advice process, we understand that the proposal does not automatically exclude field personnel, but only affords the taxpayer the right to exclude them. We also note that the proposal does not preclude the National Office from communicating with the field during its consideration of the technical advice request. We support preservation of this ability to communicate. However, we are concerned with trends in the technical advice process that have the perception of making the process less objective in resolving legal issues in dispute. Other examples include instances where the National Office has refused to advise the taxpayer of the status of the technical advice request, referring the taxpayer instead to the field, and the direction in the Internal Revenue Manual to refuse to supply the taxpayer with the written technical advice memorandum issued by the National Office if the field chooses to challenge a taxpayer-favorable decision.

We think it may be an appropriate time to reconsider the technical advice process and, in particular, the taxpayer's right to assure an even handed, objective determination of issues submitted to the National Office for resolution. Frankly, we would prefer for changes in the rules to be made by the Commissioner without the need for legislation, and if the Congress were able to obtain the Commissioner's commitment to do so, we would support that route.

Finally, we suspect that the proposals restricting field participation in the Appeals and technical advice processes may have been prompted, at least in part, by the behavior of particular Examination personnel who may become so vested in an

issue that they lose their perspective. For example, we understand that there have been referrals to IRS Inspection of cases where issues have been resolved favorably to taxpayers. Obviously, such a practice could have a severely chilling effect on the ADR processes that the IRS has employed so successfully. Accordingly, we recommend that the Committee make it clear to the Commissioner that it expects the Service to undertake efforts to further train employees in their responsibilities and supply appropriate disciplinary measures, if necessary.

6. Personnel Proposals

While many of the proposals with respect to IRS personnel purport to provide greater flexibility, others seemingly limit the Commissioner's discretion. In particular, we are concerned about the proposals that mandate dismissals of IRS employees for certain behavior. While it may often be the case that an employee should be dismissed for such behavior, there may also be situations in which dismissal would not be appropriate. It is simply too hard to know in advance of an actual case, or to adequately articulate which behavior is inappropriate so as to take account of changing mores and legal boundaries. Lack of flexibility on the part of the Commissioner to deal with such behavior in ways other than dismissal may become a deterrent to IRS employees who fear that proper, but aggressive pursuit of cases may place their jobs in jeopardy. Again, we believe it is the Commissioner who should be held responsible for balancing the competing interests of the agency.

TAXPAYER BILL OF RIGHTS III

1. Burden of Proof

We restate our opposition to a blanket shift in the burden of proof from taxpayers to the IRS. We recognize that the Senate Finance Committee's proposal is more limited, and should eliminate most of the potential for abuse inherent in a complete shift of the burden. On the whole, however, we are concerned that such a shift introduces tremendous uncertainty into a system that presently functions relatively well, though not perfectly. For example, the Finance Committee proposal requires, as a prerequisite to shifting the burden, that the taxpayer produce "credible" evidence with respect to a factual issue. Disputes as to what constitutes "credible" evidence will likely proliferate. Similarly, disputes as to whether the taxpayers have met their burden of moving forward generally will arise in many cases. We view these disputes as adding more complexity in cases, adding to the burdens on our courts, without any corresponding gain to taxpayers. For these reasons, we believe the burden of proof should remain where it is presently.

2. Innocent Spouse Relief

The Finance Committee proposes to allow spouses to elect to limit their liability for unpaid taxes on a joint return to the amount they would otherwise owe if they filed separately, unless the spouse had actual knowledge of the understatement of tax. This proportionate liability proposal would eliminate fairly severe restrictions that exist under present law, and represents a policy endorsed by the ABA.

The Section is pleased that the Finance Committee has seen fit to address the innocent spouse issue. The Section has, for some time, viewed the current limits on relief as overly restrictive and has attempted to develop alternatives that address concerns about fairness without allowing others to escape responsibility. While proportionate liability determinations can be difficult, we strongly encourage the Finance Committee to provide appropriate additional relief for the truly innocent spouse.

3. Interest Netting

We compliment the Finance Committee for addressing the vexing problem of interest netting. The Finance Committee bill goes far toward fixing this problem, particularly for individuals. Unfortunately, however, it does little to address the problem faced by corporate taxpayers. We urge that the Finance Committee eliminate any differential between interest rates for the underpayment and overpayment of taxes, irrespective of the type of taxpayer involved. Only by doing so can the problem be eliminated completely.

4. Suspension of Interest and Penalties After One Year

The Finance Committee bill includes a provision that would suspend the accrual of interest and penalties if the Service has not sent to the taxpayer a notice of deficiency within one year of the time the taxpayer filed their return. Interest and penalties would resume 21 days after receipt by the taxpayer of such notice.

We believe the rule being proposed is a goal toward which the Service should strive. We are concerned, however, that such a goal may be unattainable at present,

given the cutbacks in IRS budgets and the diversion of resources to address the Year 2000 problem.

Until and unless the Commissioner can bring new computer systems on-line, it will be virtually impossible, except in the simplest of cases, to issue notices of deficiency within a year of the return filing. The response could even result in the Service issuing far more notices than are issued at present, in order to protect the fisc in cases where it is suspected that a deficiency could arise. This would be a perverse result in view of the purpose of the provision.

We would prefer to see the Committee defer action on this proposal and, instead, direct the Commissioner to streamline procedures for the issuance of deficiency notices, with the goal that taxpayers receive notices within one year of return filing.

5. Due Process in IRS Collections Actions

The bill provides procedures by which taxpayers could challenge any levy and seizure actions by the Service. The proposal would allow administrative appeals to the IRS Appeals Office, followed by the right to challenge such actions in U.S. Tax Court.

The Section is concerned that this provision may unduly tie the hands of the Collection Division. During fiscal 1996, the IRS served 3.1 million notices of levy, filed 750,000 liens and conducted 10,000 seizures. If even a small portion of taxpayers challenged such actions with Appeals or in U. S. Tax Court, the system would stall. The granting of Tax Court jurisdiction would allow taxpayers to engage in long periods of delay during the collection process.

We believe a better approach would be to adopt statutorily the current administrative collection appeals system. The statute could provide specific standards for overruling overzealous collectors without resultant litigation. We would be pleased to work with the Committee staff to design such a proposal.

6. Low Income Taxpayer Clinics

We congratulate the Committee on its decision to authorize matching grants to fund clinics for low income taxpayers. The Section of Taxation has consistently supported the work of such clinics, both as an aid to taxpayers and as a means to allow the tax system to work more fairly and expeditiously. We look forward to continuing to work with these clinics to provide them with additional resources.

7. Pseudonyms

While the use of pseudonyms apparently has been abused in the past, it is clear that such use is appropriate in certain instances, such as the threats made by militants in certain IRS districts. We think the Commissioner is the individual best able to determine the appropriateness of their use.

TECHNICAL CORRECTIONS

The Section is pleased that the Finance Committee has acted expeditiously with respect to technical corrections. It is essential to the functioning of the tax system that mistakes be highlighted and corrected quickly, lest the system contain traps for the unwary. We hope that the speed with which Congress has adopted technical corrections this year becomes a model for the future.

In summary, Mr. Chairman, we appreciate the Committee's thoughtful approach to restructuring and hope we have provided useful suggestions. We would be pleased to assist you, your Committee and your staff as the process moves forward.

Sincerely,

PHILLIP L. MANN,
Chair.

PREPARED STATEMENT OF LYNDA D. WILLIS

Chairman Roth, Senator Moynihan, and Members of the Committee:

We are pleased to be here today to assist the Committee in its ongoing oversight of the Internal Revenue Service (IRS). As you requested, my statement today addresses four issues related to allegations of taxpayer abuse and employee misconduct. They are

—the adequacy of IRS controls over the treatment of taxpayers,
—the responsibilities of the Offices of the Chief Inspector (IRS Inspection) and the Treasury Office of Inspector General (Treasury OIG) in investigating allegations of taxpayer abuse and employee misconduct,
—the organizational placement of IRS Inspection, and
—the role of the Taxpayer Advocate in handling taxpayer complaints.

The statement is based on our past report on IRS' efforts to improve controls for ensuring that taxpayers are treated properly and preliminary information from work we have just started to assess the effectiveness of the Taxpayer Advocate.

In summary, my statement makes the following points:

—In spite of IRS management's heightened awareness of the importance of treating taxpayers properly, we remain unable to reach a conclusion as to the adequacy of IRS' controls to ensure fair treatment. This is because IRS and other federal information systems that collect information related to taxpayer cases do not capture the necessary management information to identify instances of abuse that have been reported and actions taken to address them and to prevent recurrence of those problems.

—Treasury OIG and IRS Inspection have separate and shared responsibilities for investigating allegations of employee misconduct and taxpayer abuse. IRS Inspection has primary responsibility for investigating and auditing IRS employees, programs, and internal controls. Treasury OIG is responsible for the oversight of IRS Inspection investigations and audits and may perform selective investigations and audits at IRS.

The two offices share some responsibilities as reflected in a 1994 IRS Commissioner-Treasury OIG Memorandum of Understanding. This involves investigating allegations of waste, fraud, and abuse by IRS employees. The investigations covered under this Memorandum encompass a wide range of misconduct allegations including taxpayer abuse. IRS Inspection is responsible for investigating allegations against IRS employees who are GS-14s and below and who do not work in Inspection. Treasury OIG Officials advised us that employees at this level are the ones most likely to have direct interaction with taxpayers and are most likely to be subject to allegations involving taxpayer abuse. Treasury OIG is responsible for investigating allegations against senior level IRS officials and IRS Inspection employees.

In the 1996 report on controls to ensure the proper treatment of taxpayers that we prepared at your request, Mr. Chairman, we noted that officials from both organizations thought that the arrangement was working well. However, more recent information indicates there may now be some concerns among those officials, particularly regarding timely referrals of allegations by both offices.

—In the Committee's September 1997 hearings, questions were raised about the independence of IRS Inspection. Subsequently, suggestions have been made to remove IRS Inspection from IRS and place it in Treasury OIG. We have historically supported a strong statutory Treasury OIG. We also believe that the IRS Commissioner needs an internal capability to review the effectiveness of IRS programs. Regardless of where IRS Inspection is placed organizationally, within IRS or Treasury OIG, mechanisms need to be in place to ensure its accountability and its ability to focus on its mission independent from undue pressures or influence. The Inspectors General Act as amended in 1988, provides guidance on the authorities, qualifications, safeguards, resources, and reporting requirements needed to ensure independent investigation and audit capabilities.

—In 1979, the Taxpayer Ombudsman was established administratively within IRS to advocate for taxpayers and assume authority for IRS' Problem Resolution Program. In 1988, this position was codified in the Taxpayer Bill of Rights 1. In 1996, the Taxpayer Bill of Rights 2 replaced the Ombudsman with the Taxpayer Advocate and expanded the responsibilities of the new Office of the Taxpayer Advocate. The Advocate was charged under the legislation with helping taxpayers resolve their problems with IRS and with identifying and resolving systemic problems. It is now nearly 20 years after the creation of the first executive-level position in IRS to advocate for taxpayers, and questions about the effectiveness of the advocacy continue to be asked. These questions involve the Advocate's (1) organizational independence within IRS; (2) adequacy of resource commitments to achieve its mission; and (3) ability to identify and correct problems with IRS processes and systems that adversely affect taxpayers.

ADEQUACY OF IRS' CONTROLS TO ENSURE FAIR TREATMENT OF TAXPAYERS CANNOT BE DETERMINED

The new IRS Commissioner and IRS management have expressed a commitment to ensure that taxpayers are treated properly. Even so, problems with current management information systems make it impossible to determine the extent to which allegations of taxpayer abuse and other taxpayer complaints have been reported, or the extent to which actions have been taken to address the complaints and prevent recurrence of systemic problems. That is because, as we reported to you in 1996, information systems currently maintained by IRS, Treasury OIG, and the Depart-

ment of Justice do not capture the necessary management information. These systems were designed as case tracking and resource management systems intended to serve the management information needs of particular functions, such as IRS Inspection's Internal Security Division. None of these systems include specific data elements for "taxpayer abuse;" instead, they contain data elements that encompass broad categories of misconduct, taxpayer problems, and legal and administrative actions.

Information contained in these systems relating to allegations and investigations of taxpayer abuse and other taxpayer complaints is not easily distinguishable from information on allegations and investigations that do not involve taxpayers. Consequently, as currently designed, the information systems cannot be used individually or collectively to account for IRS' handling of instances of alleged taxpayer abuse.

Information Systems Related to Taxpayer Abuse Allegations

Officials of several organizations indicated to us that several information systems might include information related to taxpayer abuse allegations—five maintained by IRS, one by Treasury OIG, and two by Justice. (See attachment for a description of these systems.)

The officials familiar with these systems stated that the systems do not include a specific data element for taxpayer abuse that could be used to easily distinguish abuse allegations from others not involving taxpayers. For example, officials from the Executive Office for the U.S. Attorneys stated that the public corruption and tort categories of their Case Management System may include instances of taxpayer abuse. But, they also said the system could not be used to identify such instances without a review of specific case files.

Systems Do Not Have Common Data Elements or Unique Identifiers

From our review of data from these systems for our 1996 report, we concluded that none of them, either individually or collectively, have common or comparable data elements that can be used to identify the number or outcomes of taxpayer abuse allegations or related investigations and actions. Rather, each system was developed to provide information for a particular organizational function, usually for case tracking, inventory, or other managerial purposes relative to the mission of that particular function. While each system has data elements that could reflect how some taxpayers have been treated, the data elements vary and in certain cases may relate to the same allegation and same IRS employee. Without common or comparable data elements and unique allegation and employee identifiers, these systems do not collect information in a consistent manner that could be used to accurately account for all allegations of taxpayer abuse.

IRS Has Adopted a Definition for "Taxpayer Complaints"

As we also reported in our 1996 report, IRS has not historically had a definition of taxpayer abuse. In response to the report, IRS adopted a definition for taxpayer complaints that included the following elements: (1) allegations of IRS employees' violating laws, regulations, or the IRS Code of Conduct; (2) overzealous, overly aggressive, or otherwise improper behavior of IRS employees in discharging their official duties; and (3) breakdowns in IRS systems or processes that frustrate taxpayers' ability to resolve issues through normal channels.

Also in response to the report, IRS established a Customer Feedback System in October 1997, which IRS managers are to use to report allegations of improper employee behavior toward taxpayers. IRS used this system to support its first required annual reporting to Congress on taxpayers' complaints through December 31, 1997. IRS officials acknowledged, however, that there were changes needed to ensure the accuracy and consistency of the reported data.

TREASURY OIG AND IRS INSPECTION ROLES FOR INVESTIGATING TAXPAYER ABUSE ALLEGATIONS

The 1988 amendments to the Inspectors General Act, which created the Treasury OIG, did not consolidate IRS Inspection into the Treasury OIG, but authorized the Treasury OIG to perform oversight of IRS Inspection and conduct audits and investigations of the IRS as appropriate. The act also provided the Treasury OIG with access to taxpayer data under the provisions of Section 6103 of the Internal Revenue Code as needed to conduct its work, with some recording and reporting requirements for such access.

Treasury OIG's Responsibilities

Currently, Treasury OIG is responsible for investigating allegations of misconduct, waste, fraud, and abuse involving senior IRS officials, GS-15s and above, as well as IRS Inspection employees. Treasury OIG also has oversight responsibility for the overall operations of IRS Inspection. Since November 1994, Treasury OIG has had increased flexibility for referring allegations involving GS-15s to IRS for investigation or administrative action. The need to make more referrals of GS-15 level cases was due to resource constraints and an increased emphasis by Treasury OIG on investigations involving criminal misconduct and procurement fraud across all Treasury bureaus.

In fiscal year 1996, Treasury OIG conducted 43 investigations—14 percent of the 306 allegations it received—many of which implicated senior IRS officials. Treasury OIG officials said that these investigations rarely involved allegations of taxpayer abuse because senior IRS officials and IRS Inspection employees usually do not interact directly with taxpayers.

IRS Inspection's Responsibilities

The IRS Chief Inspector, who reports directly to the IRS Commissioner, is responsible for conducting IRS investigations and internal audits done by IRS Inspection, as well as for coordinating IRS Inspection activities with Treasury OIG. IRS Inspection is to work closely with Treasury OIG in planning and performing its duties. IRS Inspection is also to provide information on its activities and results, as well as constraints or limitations placed on its activities, to Treasury OIG for incorporation into Treasury OIG's Semiannual Report to Congress. Disputes that the IRS Chief Inspector may have with the IRS Commissioner are to be resolved through Treasury OIG and the Secretary of the Treasury, to whom the Treasury OIG reports.

Reporting Responsibilities for Treasury Law Enforcement Bureaus

In September 1992, Treasury OIG issued Treasury Directive 40-01, which summarizes the authority vested in Treasury OIG and the reporting responsibilities of various Treasury bureaus. Treasury law enforcement bureaus, including IRS, are to (1) provide a monthly report to Treasury OIG concerning significant internal investigative and audit activities; (2) notify Treasury OIG immediately upon receiving allegations involving senior IRS officials, internal affairs employees, or IRS Inspection employees; and (3) submit written responses to Treasury OIG detailing actions taken or planned in response to Treasury OIG investigative reports and Treasury OIG referrals for agency management action.

Under procedures established in a Memorandum of Understanding between Treasury OIG and IRS Commissioner in November 1994, the requirement for immediate referrals to Treasury OIG of all misconduct allegations covered in the Directive was reiterated and supplemented. Treasury OIG has the discretion to refer any allegation to IRS for appropriate action, that is, either investigation by IRS Inspection or administrative action by IRS management. If IRS officials believe that an allegation referred by Treasury OIG warrants Treasury OIG attention, they may refer the case back to Treasury OIG, requesting that Treasury OIG conduct an investigation.

How Treasury OIG Handles Allegations Against IRS Employees

During our review for the 1996 report, Treasury OIG officials advised us that under the original 1992 Directive, they generally handled most allegations implicating Senior Executive Service (SES) and IRS Inspection employees, while reserving the right of first refusal on GS-15 employees. Under the procedures adopted in 1994, which were driven in part by resource constraints and Treasury OIG's need to do more criminal misconduct and procurement fraud investigations across all Treasury bureaus, Treasury OIG officials stated they have generally referred allegations involving GS-15s and below to IRS for investigation or management action. The same is true for allegations against any employees, including those in the SES, involving administrative matters and allegations dealing primarily with disputes of tax law interpretation.

Treasury OIG officials said that a determination is made by Treasury OIG after a preliminary review of the merits of the allegation as to whether it should investigate, refer to IRS to either investigate or take administrative action, or take no action at all. In fiscal year 1996, Treasury OIG received 306 allegations, many of which involved senior IRS officials. After a preliminary review, Treasury OIG decided no action was warranted on 40 of the allegations; referred 214 to IRS—either for investigation or administrative action; investigated 43; and closed 9 others for various administrative reasons.

Treasury OIG officials stated that, based on their investigative experience, most allegations of wrongdoing by IRS staff that involve taxpayers do not involve senior-level IRS officials or IRS Inspection employees. Rather, these allegations typically involve IRS Examination and Collection employees who most often interact directly with taxpayers.

How Treasury OIG Assesses IRS' Action in Response to Investigations or Referrals

Treasury OIG officials are to assess the adequacy of IRS' actions in response to Treasury OIG investigations and referrals as follows: (1) IRS is required to make written responses on actions taken within 90 days and 120 days, respectively, on Treasury OIG investigative reports of completed investigations and Treasury OIG referrals for investigations or management action; (2) Treasury OIG investigators are to assess the adequacy of IRS' responses before closing the Treasury OIG case; and (3) Treasury OIG's Office of Oversight is to assess the overall effectiveness of IRS Inspection capabilities and systems through periodic operational reviews.

In addition to assessing IRS' responses to Treasury OIG investigations and referrals, each quarter, the Treasury Inspector General, Deputy Inspector General, and Assistant Inspector General for Investigations are to brief the IRS Commissioner, IRS Deputy Commissioner, and Chief Inspector on the status of allegations involving senior IRS officials, including those being investigated by Treasury OIG and those awaiting IRS action.

In our 1996 report, we noted that officials from both agencies agreed that the arrangement was working well to ensure that allegations involving senior IRS officials and IRS Inspection employees were being handled properly. Even so, Treasury OIG officials expressed some concern with the amount of time IRS typically took to respond to Treasury OIG investigations and referrals. IRS officials acknowledged that responses were not always made within Treasury OIG time frames because, among other reasons, determinations about taking disciplinary actions and imposing such actions may have taken a considerable amount of time. Also, the IRS officials said some cases had to be returned for additional development by Treasury OIG, which may have prolonged the time for completion. The IRS officials, however, also suggested that actions on Treasury OIG referrals were closely monitored, as evidenced by the referrals inclusion in discussions during quarterly Inspector General briefings with the IRS Commissioner.

Since 1996, there has been some indication of problems between the two offices. Specifically, in its most recent Semiannual Report to Congress, Treasury OIG concluded, after reviewing IRS' compliance with Treasury Directive 40-01, that "both IRS and Treasury OIG need to make improvements, particularly in the area of timely, prompt referrals." It is not clear what steps Treasury OIG officials plan to take to resolve the problems.

ORGANIZATIONAL PLACEMENT OF IRS INSPECTION REMAINS SUBJECT OF DEBATE

At the Committee's September 1997 IRS oversight hearings, some IRS employees raised concerns about the effectiveness of IRS Inspection and its independence from undue pressures and influence from IRS management. Since that time, debate has continued on the issue of where IRS Inspection would be optimally placed organizationally to provide assurance that taxpayers are treated properly. This is not a new issue. During the debate preceding the passage of the 1988 amendments to the Inspectors General Act that established the Treasury OIG and left IRS Inspection intact, as well as on several other occasions since, concerns have been raised about the desirability of having a separate IRS Inspection Service.

Historically, we have supported a strong statutory Treasury OIG, believing that such an office could provide independent oversight of the Department, including IRS. That is, reviews of IRS addressed to the Secretary of the Treasury, rather than the IRS Commissioner, should improve executive branch oversight of tax administration in general and provide greater assurance that taxpayers are treated properly, fairly, and courteously. We have also noted that under the statute, Treasury OIG is authorized to enhance the protection of taxpayer rights by conducting periodic independent reviews of IRS dealings with taxpayers and IRS procedures affecting taxpayers.

We have also recognized that, to meet his managerial responsibilities, the IRS Commissioner needs an internal capability to review the effectiveness of IRS programs. IRS Inspection has provided Commissioners with investigative and audit capabilities to evaluate IRS programs since 1952. IRS Inspection currently has roughly 1,200 authorized staff in its budget who are split about equally between its two divisions, Internal Security and Internal Audit.

The Treasury OIG, on the other hand, has fewer than 300 authorized staff to provide oversight of IRS Inspection activities as well as to carry out similar investiga-

tions and audits for Treasury and its 10 other very diverse bureaus. IRS officials have been concerned that if IRS Inspection is transferred to the Treasury OIG, the transferred resources will be used to investigate or audit other Treasury bureaus to the detriment of critical IRS oversight.

The Inspectors General Act provides guidance on the authorities, qualifications, safeguards, resources, and reporting requirements needed to ensure independent investigative and audit capabilities. No matter where IRS Inspection is placed organizationally, certain mechanisms need to be in place to ensure that it is held accountable and can achieve its mission without undue pressures or influence. For example, a key component of accountability and protection against undue pressures or influence is reporting of investigative and audit activities and findings to both those responsible for agency management and oversight.

TAXPAYER ADVOCATE'S ABILITY TO BRING ABOUT CHANGE REMAINS AN OPEN QUESTION

Another IRS organization responsible for protecting the rights of taxpayers is the Taxpayer Advocate. The position was originally codified in the Taxpayer Bill of Rights 1 as the Taxpayer Ombudsman, although IRS has had the underlying Problem Resolution Program (PRP) in place since 1979.

In the Taxpayer Bill of Rights 2, the Taxpayer Advocate and the Office of the Taxpayer Advocate replaced the Taxpayer Ombudsman position and the headquarters PRP staff. The authorities and responsibilities of this new office were expanded, for example, to address taxpayer cases involving IRS enforcement actions and refunds. The most significant change may have been to emphasize that the Advocate and those assigned to the Advocate's Office are expected to view issues from the taxpayers' perspective and find ways to alleviate individual taxpayer concerns as well as systemic problems.

The Advocate reported that it resolved 237,103 cases in fiscal year 1997. Its reported activities included establishing cases to resolve taxpayer concerns, providing relief to taxpayers with hardships, resolving cases in a proper and timely manner, and analyzing and addressing factors contributing to systemic problems. The report also discussed activities and initiatives and proposed solutions for systemic problems.

Even with the enhanced legislative authorities and numerous activities and initiatives, questions about the effectiveness of the Taxpayer Advocate persist. The questions relate to the Advocate's (1) organizational independence within IRS; (2) resource commitments to achieve its mission; and (3) ability to identify and correct systemic problems adversely affecting taxpayers. We have recently initiated a study of the Advocate's Office to address these questions about the Advocate's effectiveness.

The first question centers on the Advocate's organizational placement at headquarters and field offices. The Taxpayer Advocate reports to the IRS Commissioner. Taxpayer Advocates in the field report to the IRS Regional Commissioner, District Director, or Service Center Director in their particular geographic area. Thus, these field advocate officials report to the IRS executives who are responsible for the operations that may have frustrated taxpayers and created the Advocate's caseloads.

The second question involves the manner in which the Advocate's Office is staffed and funded. For fiscal year 1998, the Advocate's Office was authorized 442 positions to handle problem resolution duties. These authorized Advocate Office staff must rely on assistance from more than 1,000 other field employees, on a full-time or part-time basis, to carry-out these duties. These 1,000 employees are funded by their functional office, such as Collection or Customer Service. While working PRP cases, these employees receive program direction and guidance from the Advocate's Office. They are administratively responsible to their Regional Commissioners, District Directors, or Service Center Directors—again, the same managers responsible for the operations that may have frustrated taxpayers.

The third question was debated during oversight hearings last year regarding the Advocate's ability to identify and correct IRS systems or processes that have frustrated taxpayers. The question historically has been the amount of attention afforded the analysis of problem resolution cases to identify systemic issues in light of the Advocate's workload and available staff. The more recent question, however, has been the ability of the Advocate's Office to bring about needed administrative or legislative changes to address systemic problems.

Questions about organizational placement, dedicated staffing, and ability to change IRS processes and systems all must be answered in assessing whether the Advocate's environment is free of undue pressures that may detract from its ability to focus on its overall mission. Our recently initiated study is designed to provide such an assessment of the Advocate's effectiveness.

SUMMARY

In summary, Mr. Chairman, we are unable to determine whether existing IRS controls are adequate to ensure that allegations of employee misconduct and taxpayer abuse are identified, investigated, and prevented from recurring, because existing systems do not capture this information. Both Treasury OIG and IRS Inspection have responsibility for investigating allegations of misconduct. We supported the 1988 amendments to the Inspectors General Act that established an independent Treasury OIG, and recognized the IRS Commissioner's need for an internal capability to evaluate IRS programs. The Inspectors General Act provides guidance on the authorities, qualifications, safeguards, resources, and reporting requirements needed to ensure independent investigative and audit capabilities.

Questions also remain unanswered about the effectiveness of the Taxpayer Advocate in representing taxpayers. Regardless of where IRS Inspection and the Advocate sit organizationally, to protect taxpayers they must be able to discharge their responsibilities free of undue pressures or influence and be held accountable for achieving their respective missions.

Thank you, Mr. Chairman. This concludes my prepared statement. I will be happy to respond to any questions you or other Members of the Committee may have.

Attachment.

INFORMATION SYSTEMS RELATED TO TAXPAYER ABUSE ALLEGATIONS

Two of the IRS systems—Inspection's Internal Security Management Information System (ISMIS) and Human Resources' Automated Labor and Employee Relations Tracking System (ALERTS)—are designed to capture information on cases involving employee misconduct, which may also involve taxpayer abuse. ISMIS is designed to determine the status and outcome of Internal Security investigations of alleged employee misconduct; ALERTS is designed to track disciplinary actions taken against employees. While ISMIS and ALERTS both track aspects of alleged employee misconduct, these systems do not share common data elements or otherwise capture information in a consistent manner.

IRS also has three systems that include information on concerns raised by taxpayers. These systems include two maintained by the Office of Legislative Affairs—the Congressional Correspondence Tracking System and the IRS Commissioner's Mail Tracking System—as well as the Taxpayer Advocate's system known as the Problem Resolution Office Management Information System (PROMIS). The two Legislative Affairs systems are designed to track taxpayer inquiries, including those made through congressional offices, to ensure that responses are provided by appropriate IRS officials. PROMIS is to track similar inquiries to ensure that taxpayers' problems are resolved and to determine whether the problems are recurring in nature.

Treasury OIG has an information system known as the Treasury OIG Office of Investigations Management Information System. It is designed to track the status and outcomes of Treasury OIG investigations as well as the status and outcomes of actions taken by IRS in response to Treasury OIG investigations and referrals.

Justice has two information systems that include data that may be related to taxpayer abuse allegations and investigations. The Executive Office for the U.S. Attorneys maintains a Centralized Caseload System that is designed to consolidate the status and results of civil and criminal prosecutions conducted by U.S. Attorneys throughout the country. Cases involving criminal misconduct by IRS employees are to be referred to and may be prosecuted by the U.S. Attorney in the particular jurisdiction in which the alleged misconduct occurred.

The Tax Division of Justice also maintains a Case Management System that is designed for case tracking, time reporting, and statistical analysis of litigation cases the Division conducts. Lawsuits against either IRS or IRS employees are litigated by the Tax Division, with representation provided to IRS employees if the Tax Division determines that the actions taken by the employees were within the scope of employment.

PREPARED STATEMENT OF RAY WOOLNER

The Professional Managers Association (PMA) is a national membership association representing the interests of more than 200,000 professional managers and management officials in the federal government. PMA's core belief is that federal managers and management officials have thoughtful and essential input on management issues that should be brought to the attention of the Administration, Con-

gress and the public. We appreciate the opportunity you have provided to present our members' concerns and suggestions on HR 2676, The Internal Revenue Service Restructuring and Reform Act of 1997 to the Committee.

The managers and management officials of the Internal Revenue Service (IRS) are dedicated to the fair and efficient administration of the tax law. These dedicated men and women have spent their working careers in the public service and pursue the goal of fair and efficient tax administration on a daily basis. PMA members believe that improving government operations is at the core of their role as federal managers. In that context, we offer the following concerning the reform of the Internal Revenue Service.

The ultimate standard to which any reform legislation must be held is the best interests of the American people. Whether the bill currently before your Committee will best serve the American taxpayer is still an open question. PMA supports IRS Commissioner Charles O. Rossotti's restructuring plan as outlined before your Committee on January 28, 1998 and we look forward to participating in the process that will ultimately lead to those reforms. We are concerned, however, that the bill now before your committee has serious structural and procedural flaws that will significantly diminish the effort to improve IRS operations and will hinder Commissioner Rossotti's ability to implement his plan.

Specifically, PMA has serious concerns about the viability of the Oversight Board concept set out in the bill. Although we do not oppose an Oversight Board, we urge that the powers vested in the Board be closely reviewed and that any and all opportunities for real or apparent conflicts or potential conflicts of interest be immediately uncovered and resolved at the outset. This Board and its role in the operations of IRS have the potential to negatively affect tax administration. The mere appearance of a conflict of interest weakens the public confidence in the fairness of the tax system. Without that confidence, the foundation of voluntary compliance is compromised. All steps must be taken in the legislation to limit the opportunity for the Board to directly affect ongoing tax administration operations. The focus of the Board should be long-term planning and resource identification or allocation and not the daily operation of the tax administration system. In that regard, PMA does not believe that the Oversight Board should be granted the authority under § 6103 of the Internal Revenue Code to allow access to taxpayer account information. Such access would further exacerbate conflict of interest concerns and erode taxpayer confidence in the fairness and impartiality of the system.

Our second concern with the bill is the placement of the head of the employee union on the Board. We believe that placement is both unnecessary and ill advised. Taking this action, the purpose of which is unclear, compromises the balance intended by the Labor-Management Relations Title of the Civil Service Reform Act and creates serious conflicts of interest for the Union and its leadership. The balance of power has been carefully established in statute to allow labor and management, in the spirit of cooperation and collaboration, to work through their differences and ultimately, with the help of third parties, to do what is best for the efficient operation of the government. Powers granted by the seat on the Board, along with powers assigned in other parts of the legislation, would give the representative of one segment of the employees of the agency an inordinate amount of influence over agency operations.

The Union is in a clear conflict of interest on the Board by virtue of its role as the exclusive representative of bargaining unit employees. Decisions and direction assigned by the Board must ultimately be bargained with the Union. At the same time, the Union, as part of the Board, will oversee the activities, evaluations and selection of managers and leaders of the agency, including the Commissioner. These two roles clearly present conflicts and barriers to the operation of labor-management relations under the statute and to the goal of this legislation—IRS reform.

We strongly endorse the previous testimony of former IRS Commissioners Donald Alexander and Sheldon Cohen that the Union not be given a seat on the Oversight Board. However, if the role of the Board is such that employee views are necessary for it to function, we recommend that a representative of IRS managers have a seat on the Oversight Board to ensure the benefit of the widest range of IRS management and employee views.

Section 9301b. of the bill gives the Union far too much control over the personnel flexibilities through which the Commissioner is charged with reforming the agency. The present language restricts the Commissioner's actions with respect to bargaining unit employees by giving the Union the right to refuse to agree to any change in working conditions suggested by the agency leadership both nationally and locally. In addition, the bill does not require the Union to engage in any third-party intervention to resolve differences. The balance of powers set out in 5 U.S.C. Chap-

ter 71, Labor-Management Relations, is completely set aside in favor of a Union veto of management actions. This section of the legislation should be stricken.

PMA would like to offer these additional specific suggestions on the legislation for your consideration:

- Readjust the labor-management relationship to adopt a standard of the best interests of government operations. For some time now the emphasis on collaboration and cooperation has resulted in energies being directed toward "partnership" and not into the more important and relevant question of government operations. A standard should be adopted to govern labor management relations in IRS requiring the parties to pursue solutions that promote customer service, mission accomplishment, quality, productivity and efficiency. This standard will put the interest of good government before all others in resolving disputes between the parties. With wider authority to reform the IRS, the employee union and the Commissioner should be held to this higher standard of performance that promotes the interests of the American people and the efficient and effective operation of their government.
- Create an alternative system of pay and benefits for managers, supervisors and management officials. The present system treats leaders in the same manner it does rank and file employees with respect to reductions-in-force, pay and other personnel matters. While the legislation recognizes a need for greater rewards and motivators for top levels, it does not make the same provision for leadership at the lower levels. Managers are not given incentives to think and act in innovative ways about their organizational goals and mission, structure, processes or systems. A system that rewards managers and supervisors and motivates them to reinvent and reform their operations is needed.
- Reform the system for dealing with poor performers to promote speed of decision-making and appeals. Requirements beyond 30-60 days for any step in the process (improvement period, notice, appeals, etc.) should be reduced to 30 days or less and the appeal process limited to three months. Poor performance, for whatever reason, should not be tolerated for more than six months.
- Grant the IRS the authority to offer voluntary separation incentives in the form of buyouts to employees throughout the period of transition as suggested by Commissioner Rossotti.
- Allow pay banding to permit managers to properly compensate those employees whose work is deserving and withhold pay increases from those whose work is lacking. Managers have little or no control over increases given to individual employees. Real authority to grant increases or withhold them will significantly change the employer/employee relationship and empower managers to create better performers at the workplace by connecting compensation with performance.
- Lastly, the wide grant of authority given to the Commissioner of IRS under this legislation to create demonstration projects and develop other personnel flexibilities should be accompanied by a requirement to consult with representatives of managers and management officials over how those changes affect them. Reformation of the culture of the organization will require that all employees be aligned with the change. Most critically, the managers who are leading the change must participate in the development of that change. Given the sweeping new view of the organization laid out before you by Commissioner Rossotti on January 28, 1998, we believe that managers should be brought on board first, through consultation with their representatives, before changes affecting them are implemented. Bargaining unit employees are afforded the opportunity to participate in decisions affecting them through their exclusive representative; the managers and management officials of IRS are not included in such deliberations. Participation in decisions over matters affecting the working conditions, personnel practices and policies for managers and management officials should be mandated by this legislation.

COMMUNICATIONS

STATEMENT OF PAULA A. ADAMS, TELLURIDE, CO

November 10, 1997

EDITORIAL SECTION,
Committee on Finance,
U.S. Senate,
Washington DC.

Dear Sirs:

HOW THE IRS DELIBERATELY MADE MY CHILDREN, AND MYSELF HAVE TO GO INTO HIDING, HAD OUR ANIMALS SHOT, WE SHOT AT, THROWN IN JAIL, LOST HOME, SECURITY, CREDIT, SEPARATED MY CHILDREN FROM ME, AND LOST EVERYTHING IN LIFE. WE NEED HELP!

IRS, audited my employer and in the process, my former employer had so many connections within all government agencies. He got off.

The Special Agents involved said if this were true about my employer having so many contacts, that if I would help they would clean house from local law enforcement all the way to the top. This began in the state of Arizona.

My children and I were guaranteed safety and new identy and relocation.

Corruption from local law enforcement, state level U.S. District Attorney Janet Napolteano, Grant Woods, Arizona U.S. Attorney General, Arizona State Tax Revenue agent, Arizona State Judges, all the up to Janet Reno, and U.S. District Attorney Douglas Metcalf, prosecuting Attorney for the IRS.

Mr. Metcalf deliberately put our lives in danger and was paid off and admitted it when I was on the phone with him during the investigation.

I am taking a very big risk trying to get help as I am homeless, can't get a job, I have gone from excellent health to poor, as my children are in poor health mental and physical do to running for our lives. We are separated from each other as my children are afraid it would be more dangerous for me to be near them.

I do have supporting evidence of the above mentioned facts! If you question my integrity please contact the agent now for DEA in Phoenix, Arizona.

I need help in finding out how to get protection for myself and my children do to my testifying against my former employer. It was in regards to an IRS audit, Drugs, INS. The US District Attorney, Doug Metcalf, was the prosecuting attorney, only he was on the side of the man he was suppose to prosecute and wanted me to be quite and not cause him any problems. Mr. Metcalf received compensation from the man he prosecuted, as well as making the fines light, along with the judge.

FACTS: The IRS Special Agent Jim McCormick, Internal Security IRS, Tom Hickson were the two people I first spoke with in regards to information. They were told from the start as was the main office in Texas, if I were guaranteed safety for my family and I, I would help. It was promised that we would have protection. "not to worry." I informed them there were several people within different departments of the government that were corrupt and the employer knew them. They were informed of the relationship with Janet Reno, U.S. Attorney General, Grant Woods, Arizona U.S. Attorney, the newly to be elected Janet Napolitano Attorney General.

I worked closely with Mr. McCormick and as we progressed, he brought in a man, Gary Mengel, Arizona IRS special investigations.

Mr. Mengel was "shacking up" with my employers ex-wife's best friend. My employer is still very close to his ex-wives. My employer had a call from his ex-wife letting him know everything that was going on through Mr. Mengel's girl friend. Most of what had been said was confidential.

Mr. Metcalf made the statement, "the people who live on the western part of the United States are "hicks." He doesn't think there is any need for my protection as it could cause him a lot of embarrassment and his job if I speak up.

After Mr. Metcalf prosecuted this case he quit his position with the government and moved on elsewhere. Mr. McCormick supervisors said that Mr. Metcalf would or was suppose to give recommendation to our safety and without it they didn't know what else to do. They would like to help.

I have lost my home, my family, everything. I am homeless, can't get financial help, can't hold a job due to my mental state. My children are running for their lives as I am. All we had asked for were to be safe and have new identities so we could start over. It was told and guaranteed to me we would have this if I would testify.

Here are some of the facts: I was employed by Donald Hopkins, of Sedona, AZ. as a secretary/bookkeeper. I watched over the years how Mr. Hopkins treated his employees, including me. When Mr. Hopkins wanted to let someone go, he would accuse them of stealing, or anything he could think of to discredit them. Most of the employees didn't steal.

Mr. Hopkins was indicted. He is known for his harassment, connections to and with government officials, and the power he has.

This man is not stupid. He is very intelligent in the business world and always tries to manipulate everyone. His philosophy is if he can black mail people they will do what he wants when he wants. He must be in total control at all times. He has always stated, "that if I steal everyone does." He would brag about how he got his money and stole everything and black mailed people to get what ever he wanted since he was young. He had bragged about having people killed for little money exploited women, and non-American, (blacks, Jews, Mexicans etc.).

When I first spoke with Mr. McCormick and Tom Hickson, they were informed that this was a serious case do to people getting killed, families being torn apart etc. This was stressed over and over again. I was assured that all precautions would be taken in this matter, along with all the other problems that may arise as we go along before Mr. Hopkins was indicted.

I was assured that my children and I would be protected at all times and would go into witness protection.

Mr. Hopkins has attorney friends who are "special friends" with U.S. Attorney General Janet Reno, and very close friends with Arizona Attorney General Grant Woods and Janet Napolitano. Mr. Hopkins attorney friends informed us that Ms. Reno and Mr. Woods, would make sure Janet Napolitano would be elected, as she was one of us and would be a real asset to our group. No one could touch us since we are so powerful."

Mr. Hopkins was setting me up to show I was stealing from him. He wanted me to quit but I needed the job to support my children and myself. I was looking for another job.

Mr. Hickson and Mr. McCormick were informed of this. I asked them to check into my background as I was very proud of my work especially my ethics. I have always believed in our Government, and tried to do what is right by all. I believed in Mr. McCormick, he was always very professional and I believed in our government.

My name was sealed by court order, and was not to be released for any reasons until my family and I were safe. That was our agreement. First and foremost was my children's safety.

When it was about time for Mr. Hopkins to go before the Judge, Mr. Metcalf, U.S. Attorney General, was the prosecuting attorney for the IRS. Mr. McCormick and I both stressed that it was very important my name stay out of anything because of the death threats. Mr. Metcalf didn't believe anything I said. He said he had meet "Don" and he was a very pleasant and nice man. Mr. Metcalf said I don't know why you are causing such a nice man like Don so much trouble. You are a typical woman, that is only good for spreading your legs, raising kids." Don was right about you. How can you cause this poor man such pain and suffering."

Mr. Hopkins has a personality like Dr. Jekyll and Mr. Hyde. He goes from one extreme to the other, mainly mad. Mr. Hopkins has a persona about him, especially when his lively hood is being challenged.

Mr. Hopkins has no respect for women, children, and colored people. He was always making very sexist comments and displays.

Please understand I have been backed into a corner, my children are my life. They are everything to me and now I can't see or be with them, as they are afraid. I have nothing more to lose.

PLEASE PLEASE PLEASE PLEASE can someone help us.

We had to leave the state of Arizona to stay alive. I was thrown into jail. I found out that Mr. Hopkins paid some people to kill me while I was in jail, except I man-

aged to stay alive and get out. My children have been put in jail for no reason, except to get to me. This was a known fact. We all have been shot at numerous times, this was documented but yet no help. My dog was shot while standing by me. Our vehicles have been run into in the parking lot, one vehicle caught fire due to someone messing with the gas lines. This goes on and on. Mr. McCormick is aware of all of this and can verify these incidents.

Please help us. Any help would be of great appreciation.

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION

The American Bankers Association (ABA) is pleased to have an opportunity to submit this statement for the record on Recommendations of the National Commission on Restructuring the Internal Revenue Service, S. 1096, and H.R. 2676.

The American Bankers Association brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks makes ABA the largest banking trade association in the country.

At the outset, we would like to commend Chairman William Roth (R-DE) for holding this hearing to further examine the June 25, 1997 report of the National Commission on Restructuring the IRS. We would also like to commend Senator Bob Kerrey (D-NE) for his work as co-chairman of the Commission and for the introduction, along with Senator Charles Grassley (R-IA) of the "Internal Revenue Service Restructuring and Reform Act of 1997," S. 1096. This important legislation would provide a number of incentives to encourage the electronic filing of tax and information returns. It would also authorize appropriate amendments to the Internal Revenue Code to "facilitate paperless electronic filing."

We further commend Chairman Roth for his interest in strengthening the burden of proof provision of the instant legislation.

THE IRS SHOULD BE AUTHORIZED TO PAY SERVICE FEES TO PRIVATE SECTOR CREDIT AND DEBIT CARD SYSTEMS

The ABA has worked closely with the Commission to develop proposals to improve compliance through the effective use of advanced technology. The ABA supports efforts to move towards expanded electronic filing of tax and information returns. Electronic filing would significantly improve efficiencies and promote the goals of the financial services industry to expand new products and services while also promoting IRS efficiency and other objectives.

However, we are most concerned that the Taxpayer Relief Act of 1997 (P.L. 105-34) [*hereinafter* TRA] contains a provision, which if left uncorrected, will impede rather than encourage electronic filing. Specifically, the TRA prohibits the payment of any fees by the IRS for use of a credit card tax payment service. By contrast, the instant legislation, section 205(b) of S. 1096, would provide for a separate budget appropriation for payment of credit card fees. H.R. 2676 does not contain a proposal relating to paperless payment. For the reasons that follow, ABA urges you to correct the current law and pass legislation that would allow the IRS to pay appropriate merchant fees in connection with credit card payment of taxes.

Currently, governmental entities at all levels, state and local as well as federal, are allowing taxpayers to make payment by credit card. The TRA provision prohibiting the IRS from paying ordinary merchant fees departs from current practice and discourages acquiring credit card banks from offering card services to consumers wishing to expedite the filing and payment of federal taxes through the use of credit cards. It is axiomatic that anyone buying a service should pay a fair value for said service. The proposal in S. 1096 to permit IRS payment of credit card merchant fees would not provide any special treatment for merchant banks. Indeed, it would simply restore the level business playing field that the Taxpayer Relief Act inadvertently upset.

SHIFT OF THE BURDEN OF PROOF SHOULD INCLUDE GIFT, ESTATE AND GENERATION SKIPPING TRANSFER TAXES

The burden of proof provision would provide that the IRS shall have the burden of proof in certain court proceedings involving income tax liability. The legislation is silent with respect to gift, estate and generation skipping transfer taxes. Thus, in the case of a dispute encompassing both income and transfer taxes, based upon the same pertinent facts, the burden may be shifted to the IRS for income tax litigation purposes but not for transfer tax litigation.

We see no reason in principle for such distinction and believe it would create another tax trap for the unwary. Moreover, in its current form, this provision would add unnecessary complexity and confusion to tax controversy matters. Accordingly, we urge you to include gift, estate, and generation skipping transfer taxes in the provision providing for shift in the burden of proof.

CONCLUSION

The ABA urges you to pass legislation that will allow the IRS to pay the appropriate merchant fees in connection with tax payments made by credit card. Without modification, as provided in S. 1096, the current law will continue to impede and discourage the electronic filing of tax and information returns. We further urge you to include gift, estate, and generation skipping transfer taxes in any burden of proof provision adopted by this Committee.

We appreciate having this opportunity to present our views. We look forward to working with you in the further development of Internal Revenue Service restructuring.

STATEMENT OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

INNOCENT SPOUSE TAX RULES

Introduction

The American Institute of CPAs (AICPA) is the national professional organization of CPAs, with more than 320,000 members. Many of our members are tax practitioners who, collectively, do tax planning and prepare income tax returns for millions of Americans.

Background

Currently, when a married couple files a joint federal income tax return, each spouse is individually responsible for paying the entire amount of tax associated with that return. Because of this joint and several liability standard, one spouse can be held liable for tax deficiencies assessed after a joint return was filed that were solely attributable to actions of the other spouse. The current "innocent spouse" relief provisions are not effective, are too restrictive to help very many aggrieved taxpayers, and are in need of reform. The AICPA urges that the current innocent spouse rules be modified and expanded.

In addition, due to the high divorce rate in this country, the current inequitable divorce taxation rules affect a large percentage of taxpayers, many of whom do not have or cannot afford sophisticated tax advice available to them. For obvious reasons, these taxpayers are not communicating well with each other, nor functioning well as one unit. Tax filing is further complicated for separated taxpayers, who still qualify for filing joint tax returns. Many times separated taxpayers file joint tax returns because the total tax liability on the joint return is less than the total tax liability on two married filing separately tax returns, without considering the joint and several liability standard. In addition, the innocent spouse rules are ineffective for many aggrieved spouses. The government's involvement in divorce and separation matters should be as unintrusive as possible.

Section 321 of H.R. 2676

We note that Section 321 of H.R. 2676 generally makes innocent spouse relief easier to obtain. It eliminates the understatement thresholds, requires only that the understatement be attributable to an erroneous (not just a grossly erroneous) item of the other spouse, and allows relief on an apportioned basis. The provision also grants the Tax Court both jurisdiction to review any denial of relief (or failure to rule) by the IRS and authority to order refunds if it determines the spouse qualifies for relief and an overpayment exists as a result of the spouse so qualifying. The provision requires the development of a form and instructions for use by taxpayers in applying for innocent spouse relief. The provision is to be effective for understatements with respect to taxable years beginning after the date of enactment.

The AICPA supports this provision in H.R. 2676, but urges that the relief being granted be made retroactive to apply to returns for the last three taxable years provided the specific issue has not already been addressed by a final court determination rendered with respect to the taxpayer.

Examinations and Collections

Both spouses should be notified and involved in examinations of joint tax returns. This is one area that needs further study as there may be notification issues for

both divorcing taxpayers and the IRS. Congress should consider the appropriate steps that should be taken in contacting both spouses early in the examination process of a joint return. We support 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. Since the IRS probably will not know about a separation or divorce, the spouses may need to notify the IRS of their separated status or divorce and how they can be contacted, similar to notifying the IRS of an address change by filing a Form 8822, Change of Address. Perhaps Form 8822 could be modified for such purposes. Additionally, legislation may be required to ensure that disclosure laws are changed to provide adequate information to the divorced spouse in community property states.

Currently, as described in the AICPA testimony before the House Committee of Ways and Means Subcommittee on Oversight at the March 24, 1995 hearing on taxpayer bill of rights legislation, often a divorced spouse is not aware that a liability has been created in an examination process where the other spouse was the party examined, as in a situation where one individual 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, collection efforts often only occur against the spouse living in the area of the IRS office assigned the collection case, even though the distant spouse may be the source of the liability. The root of the problem is in the examination procedures that do not (but should) require both spouses to be involved in an audit.

We are pleased to see (in Announcement 96-5, item 7, 1/5/96) the IRS administrative adoption of a rule allowing the IRS to notify one spouse of collection activity against the other spouse with regard to a joint return liability, and amending the Internal Revenue Manual to provide uniform procedures for such notifications. The disclosure of collection activities to divorced spouses is an improvement to the current situation.

In addition, due to the joint and several liability that exists today, many divorced individuals avoid contacting the IRS in hopes that the money will be collected from the other spouse, or in fear that they will have to pay the entire balance once they come forward. This new administrative change will help—allocating the liability (as discussed below) would be better.

Innocent Spouse Rules

The present innocent spouse rules are statutorily too narrow—many aggrieved spouses do not qualify under the current innocent spouse rules, but should be granted relief. Very few aggrieved spouses qualify as an innocent spouse due to knowledge requirements that imply that virtually all middle-income or higher income taxpayers "knew or should have known" all financial matters. This knowledge standard typically ignores the "division of duties" concept still prevalent in and maintained by countless family units.

The innocent spouse rules need a complete overhaul. At a minimum, if the current joint and several liability system is retained, the innocent spouse rules need to be modified. Furthermore, an allocated liability standard (as discussed below)—where known tax liabilities are fixed at the time of filing and unknown liabilities are fixed at divorce—would reduce (or eliminate) the need for innocent spouse provisions.

Alternatively, if the allocated liability standard is rejected, further consideration should be given to eliminating joint tax returns and developing a rational, individual separate tax return filing system for all taxpayers.

Allocated Liability Standard

We suggest an allocated liability standard as a replacement to the joint and several liability standard. A system that allows the known (reported) tax liability to be allocated between the spouses at the time of filing with each spouse's percentage of liability to be clearly stated on the face of the return (above the signature line or part of the tax liability line on the Form 1040), and any unknown tax liability (e.g., liabilities other than those already reported on returns) to be allocated between the spouses at the time of divorce (similar to every other liability of a married couple in the divorce process) would improve the fairness and equity of the system, as well as improve the speed and equity of the collection process. Defaults could be built into the system to allocate the liability differently if there has been undue manipulation of the rules, step transactions or fraud (including disposition or allocation of marital assets). Further analysis is needed on abusive situations and possible procedures, as well as possible transition rules for treating tax liabilities that arise from a year prior to the effective date of an allocated liability standard.

Retention of the joint tax return—allocation of the liability. Under this approach to the allocation of a known tax liability, the spouses would determine their respective allocation percentages of the total liability reflected on the joint return. The determination would be at the taxpayers' discretion. If the taxpayers did not want to be burdened with determining a specific allocation based on a detailed income/deduction analysis, they could agree on any general allocation percentage, or not determine an allocation at all. If no allocation is chosen, the default allocation would be 50/50. It would be in the spouses' best interest to agree to the liability allocation at the time of filing and clearly state their allocation percentages on the face of the return. Furthermore, withholding, estimated, and other tax payments could be allocated in a similar way. The IRS would have the authority to reallocate in situations where there is undue manipulation of the rules, step transactions, or fraud. This approach is referred to as the "allocated liability standard" throughout the rest of our comments.

Unknown liabilities could be allocated primarily by the divorce decree and separate maintenance agreement. If the divorce decree or separate maintenance agreement is silent on this matter, the percentage allocation of the unknown liability would be the same as the percentage allocation of the known liability on the return filed for the tax year in question. Absent any indication in the divorce decree/separate maintenance agreement or on the tax return, the allocation would be 50/50. It would be in the spouses' best interest to agree to the unknown liability allocation in the divorce decree/separate maintenance agreement. Any situation involving undue manipulation of the rules, step transactions, or fraud would invalidate these allocations and the IRS would have the authority to reallocate.

In summary, the allocated liability standard suggested above would set the allocation of the known liability at the time of filing and the unknown liability at the time of divorce, with adequate backup procedures and safeguards for abusive situations. These methods would most likely eliminate, or substantially reduce, the problems associated with the unfair results and ineffectiveness of the current innocent spouse rules, and would ultimately provide simpler and more equitable rules concerning the tax aspects of divorce and separation.

Separate tax returns. An alternative to the allocated liability on a joint return would be to allow individual tax liability to be calculated on a separate return for each spouse. This approach could eliminate or mitigate the marriage penalty (and filing status concerns) assuming that the rate/bracket structure is modified so that there is one filing status and, therefore, only one set of tax brackets/rates that apply to all taxpayers. In addition, this approach would allow the IRS to deal with only one individual at a time and would eliminate the frequent confusion involving social security numbers of taxpayers who marry and divorce. While a separate return approach would result in a more precise allocation of the liability, we recognize that in adopting such a system there would be inherent administrative complications and burdens for both the IRS (increased number of returns to be processed and examined) and practitioners/taxpayers (additional inquiries and schedules). Therefore, further study regarding separate returns is needed.

As part of any study considering changing the system of liability allocation, we suggest that, in evaluating whether joint and several liability should be retained, Congress should consider whether joint and several liability may, in some cases, actually be a hindrance to collection since some spouses may be inclined to delay the collection process in the hope that the other spouse will ultimately pay the tax.

SPECIFIC COMMENTS (based on the questions in IRS Notice 96-19)

Administrative Burden

An allocated liability standard would be an equitable improvement over the current joint and several liability standard, without increasing the administrative burden of either the IRS or taxpayers. We suggest an allocated liability standard where the tax liability would be allocated between the spouses based on their agreement rather than a mathematically calculated proportionate liability standard. We believe an allocated liability standard would be better than a proportionate liability standard because there would be no analyses required to determine the breakdown (unless the taxpayers chose to do such analyses).

We anticipate, that for the vast majority of married taxpayers, the allocated liability standard would not increase their compliance burden because they likely will either not respond to the optional allocation question on the tax return or simply respond with a 50/50 allocation since they probably view themselves as an equal partnership of a single economic unit. For the remainder of married taxpayers, the determination of the allocation would be based on an arms length negotiation or analysis undertaken by the taxpayers, not by the IRS. The "complexity" and "administrative burden," if any, would be voluntary. Therefore, the responses to questions

1-6 below focus on an allocated liability standard rather than a proportionate liability standard. We also note that our alternate proposal of separate return filings would resolve the issues of either proportionate or joint and several liability.

Spouses Not Cooperating

As stated in the allocated liability standard section above, if the liability is known and the spouses are not cooperating with each other, the allocation of liability would be determined on the tax return. If no allocation is on the return, a default allocation of 50/50 would be used. The IRS could reallocate in abusive situations.

If the liability is unknown and the spouses are not cooperating with each other, the allocation would be based on what is stipulated in the divorce decree or separate maintenance agreement. If the divorce decree/separate maintenance agreement is silent on this matter, the default would be the known liability allocation stated on the return for the year in question. If the allocation is not stated on the return for that year, then a 50/50 allocation would be used. The IRS could reallocate in abusive situations.

No Undue Advantage of the Tax System

An allocated liability standard would not allow taxpayers to take undue advantage of the tax system because spouses typically negotiate their divorce decree/separate maintenance agreement (and would negotiate their tax return liability allocation) at arms length. However, the IRS would retain the right to reallocate the liability if there is undue manipulation of the rules, step transactions, or fraud. Further analysis is needed on possible reallocation procedures. We note that there may be an increase in collections due to fairer, simpler rules.

Under an allocated liability standard, the Service would not need to trace assets and allocate deductions and credits between spouses to determine the correct liability; rather the allocation would be determined on the return for known liabilities or in the decree/separate maintenance agreement for unknown liabilities. Since the IRS would know from the allocation which spouse to collect the specific funds from, the need to trace assets would be removed, which should lead to a more efficient collection process. Assets would only need to be traced in the (hopefully few) cases involving abuse of the system.

No Burdensome Filing Requirements

An allocated liability standard would not create burdensome filing requirements because additional schedules and columns for reporting the items attributable to each spouse would not be necessary. The taxpayer would not be required to file any additional schedules showing how the allocation percentages were derived. However, at the option of the taxpayer, detailed schedules could be computed and retained for reference.

Regarding the allocation of unknown liabilities, perhaps a filing should be required to report the percentage allocation from the divorce, similar to Form 8379, Injured Spouse Claim and Allocation. These forms would qualify for electronic filing. Our comments above regarding notification of divorce status and addresses of both spouses for examination purposes may also be relevant here and may need further study.

Changes Concerning Communications, Examinations, Assessments, Collections, Payments and Refunds of tax, Penalties and Interest

If an allocated liability standard is adopted, minor changes would be needed concerning communications with taxpayers, examinations, assessments, collections, payments and refunds of tax, penalties and interest, in order to ensure that the proper spouse was contacted for the proper allocated amount. The IRS would communicate with the appropriate spouse(s) pertaining to the appropriate allocated amount(s) due. This extra burden would result in the proper person being contacted about the proper amount.

We note that the IRS changed the communication rules recently to ensure both spouses are notified of all collection activities. The IRS can already contact both spouses, so the change would be that the communication would now include an allocated amount for each spouse. Regardless of the liability standard, both spouses should be notified of all matters concerning communications, examinations, assessments, collections, payments and refunds, interest, and penalties.

Absent, or prior to, the adoption of an allocated liability standard, the IRS should pursue enhanced administrative procedures in the area of aggrieved spouses. The IRS should be directed to develop internal procedures relating to collection that would call for "patience and restraint" when IRS agents attempt to collect from the "appropriate party" so as to avoid, whenever possible, unfairly burdening the "wrong" spouse. The IRS should be told to make every effort to first collect from

the spouse responsible for the liability, as opposed to first attempting to collect from the spouse easiest to contact and with the most liquid and accessible assets. This may require patience on the part of the IRS, but may resolve many of the aggrieved spouse situations and would result in the proper person paying the liability.

Effect on State, Local, and Other Tax Systems

Adoption of such an allocated liability standard would not significantly affect state, local, and other tax systems. Presently, 44 states (including the District of Columbia) impose individual income taxes, and eight states presently calculate taxes on a separate basis. Many states do not rely on the federal tax calculations, and many states impose their own tax system different from the federal system.

Specifically, if separate federal returns are filed, the federal income and deduction amounts could be easily combined for combined state return filings, and duplicated for the separate state return filings. On the other hand, if joint federal returns are filed, the income and deduction amounts could be duplicated for joint state return filings, and for the separate state return filings, the taxpayer could (with the states' approval) either use the allocated amounts from the federal return or the amounts derived under the current system.

With respect to state tax collection matters, it would be up to each state to consider an allocated liability standard or continue with their present system.

Divorce Decree, Separation Agreement, or Other Property Settlement

Basing the respective spouses' tax obligations and liabilities on the terms of a divorce decree, separation agreement, or other property settlement would only apply to unknown liabilities. In such a case, the allocation would be fair and simple. All other liabilities of a divorce are allocated according to the divorce decree, and the strength of the state laws would add to the collection of federal tax.

This would not require the IRS to be a party to divorce proceeding. Rather, the interests of the government could be represented in such cases by the arms length negotiations that occur under state law and the default provisions. In addition, the IRS would retain the right to reallocate the liability if there is undue manipulation of the rules, step transactions, or fraud. We note that there already is precedent concerning the Service relying on divorce decrees in the areas of alimony and exemptions.

As stated above, if the divorce decree or separation agreement does not provide for allocation of the unknown tax liability, the tax allocation (for known liabilities) on the tax return in question would be used, and if no allocation was determined, a 50/50 allocation default would be used, which would be equitable in most divorce cases.

Those spouses less able to influence the terms of a divorce decree or separation agreement would not be adversely affected by this system because any situations involving manipulations or under-reporting of tax liability by one spouse would be categorized as an abusive situation whereby the IRS would be allowed to reallocate liability based on the facts and circumstances. Also, where inadequate legal representation of both parties results in the divorce decree/separation agreement being silent on this matter, the defaults (i.e., back to the return and then to 50/50 allocation), should protect the spouses and would be better than under the current rules.

Reform the innocent spouse provisions

As we stated above in our comments on innocent spouse rules, there are many situations in which the present innocent spouse provisions do not function in an appropriate manner. Since the rules are based on adjusted gross income levels and two different standards (i.e., the income and knowledge standards), they are not fair and many truly aggrieved spouses are not allowed relief. The current presumption that taxpayers "should have known" effectively eliminates the vast majority of taxpayers from successfully qualifying as an innocent spouse and receiving the appropriate relief. The access to innocent spouse relief should be expanded and simplified. In addition, the facts and circumstances should be considered when determining innocent spousal relief.

Specifically, we think I.R.C. section 6013(e)(4) is overly complex and sets differing standards for innocent spouses based on the level of adjusted gross income, thus punishing innocent spouses with adjusted gross income (AGI) of more than $20,000. This section holds spouses with AGI in excess of $20,000 to a higher standard than those with AGI of $20,000 or less. For example, the tax for a taxpayer with AGI of $20,100 in the preadjustment year would have to be understated by more than $5,025 (i.e., more than 25 percent of AGI) before the taxpayer could qualify for innocent spouse relief, while a taxpayer with AGI of $20,000 would only need an understatement of $2,001 (i.e., more than 10 percent of AGI) to qualify for innocent spouse relief.

We note that section 6013(e)(4) can be easily simplified by eliminating subparagraphs B and D, and revising subparagraph A as stated on page 6 in our March 1995 legislative proposal. Section 6013(e)(4)(A) should be changed to remove the different percentage calculations based on different levels of adjusted gross income and apply the 10 percent of AGI threshold to all aggrieved spouses regardless of their level of AGI. This change would eliminate the need for section 6013(e)(4)(B).

Further, the preadjustment income of the person seeking innocent spouse relief should not include anyone else's income, such as a new spouse. This is another discriminatory provision. A person applying for innocent spouse status should not be treated differently whether remarried or single. Section 6013(e)(4)(D), which includes the income of another spouse in computing the income of the "claiming spouse" for purposes of determining the AGI threshold, should be eliminated.

Any situations involving manipulations or under-reporting of tax liability by one spouse should allow relief to the other aggrieved spouse, and should allow the IRS to step in and reallocate liability based on the facts and circumstances. We note that an allocated liability or separate return standard would significantly reduce the need for these rules.

Expanded innocent spouse relief might be abused in only a few limited situations, and in those cases, the IRS should have the right to not apply the innocent spouse relief rules. Those cases might involve undue manipulation of the rules, step transactions, or fraud. The relief granted to those truly in need, but excluded by the present innocent spouse rules, should outweigh the limited abusive situations.

There are several changes to the Service's administrative practices that should be made with respect to the innocent spouse provisions.

An administrative change that could be implemented now to help many divorcing and separated spouses (not just innocent spouses) is to amend Form 1040-ES, Estimated Tax for Individuals. The form should provide for two amount fields so that the taxpayers can allocate the payment to each spouse's account when they are filing joint income tax returns. This would be very useful for those years during which a divorce or separation occurs. The AICPA discussed this suggested change with the IRS Tax Forms Development Committee on June 3, 1996, and included this suggestion in the AICPA 1996 Recommendations for the Revision of Tax Forms and Publications, submitted to the IRS on June 25, 1996.

In addition, as discussed above, regardless of liability standard, the IRS should pursue enhanced administrative procedures in this area of aggrieved spouses.

Lastly, we have developed regulatory domestic relations tax proposals, including a proposal to modify Treas. Reg. §1.6013-5(b) regarding the criteria applying to innocent spouse relief provisions.

STATEMENT OF TIMOTHY ANDERSON, TEMPE, AZ

Greetings. Thank you for this opportunity to contribute my offerings to this forum, and thank you for holding these hearings in the interest which they address, that of enhancing "taxpayer due process."

It has long been recognized and accepted that "the power to tax is the power to destroy." Tragically for America, The IRS has used that power aggressively, liberally, tyrannically, and literally in the actual and virtual destruction of many American's, all without the protective blessings of Due Process. Thus, it is most encouraging to see this Committee finally representing the interests of the people, by Congressional concern with Due Process for the Citizen in the Citizen's dealings with the Internal Revenue Service.

The "Notice of Levy" is by far the IRS most abusive tool afforded to them by Congress under the authority of Section 6331 of the Internal Revenue Code. Of particular interest to myself, and I am sure millions of other tax payers (not taxpayers) is the issue of the IRS using the collection practice of issuing "Notice of Levys" upon the banks, employers, and other holders of assets, belonging to individuals from whom the IRS seeks to collect an alleged debt.

As aired in the "Oversight Hearings on IRS Operations" of September 1997, this levy process, absent due process and the order of any court of competent jurisdiction, is used against millions of individual taxpayers, and tax payers, each year. The IRS' levy process and procedure is the basis for the total financial ruination of many thousands of Citizens. Because the IRS' levying process is executed outside of the authority and oversight of any Judicial Branch's court order, the victim is rendered voiceless and defenseless. The use of such unrestrained power by any government agency, to destroy an individual's and his family's lives is unjust, immoral, and outside of the intent and reason for the establishment of the American Republic.

The financial holders, upon whom the "Notice of Levys" are issued, are intimidated by citation of law pointing out statues, on the reverse side of the Notice, portending penalties against such holders for non compliance with the demands of the Notices. While the holder is induced to commit the crime of conversion on behalf of the IRS, few if any individuals, whose property is turned over to the IRS by the holder, are able to fight back because the levy process is designed to, and does, take away all financial means of doing so. Attorneys and CPAs will not even talk to one who is so set upon by the IRS, and thus, one who cannot pay attorney's fees for representation.

The IRS' levy process, if not an act of overt extortion, certainly skirts the edges thereof. However, one may not lay the full blame upon the IRS.

Given such unrestrained power, most entities eventually will exercise that power to it's fullest limits. That is the reason I am pleased to see that this Committee has finally opened this Nation's eyes to the need for (in the words of Senator Roth) "reform [that] must go beyond a few minor improvements at strengthening taxpayer protections, to literally address the balance of power between the taxpayer and the agency." In our form of government-by-the-people, the scales measuring that "balance of power" must always weigh most heavily on the sides of the people, lest the government be defined as the people's master, and not the reverse.

Therefore, it is fitting that these hearings address that balance, which is manifest in the peoples access to Judicially administered Due Process.

It is further fitting, and overdue, that Congress reign in the awesome powers it has given to the IRS OVER the people whom Congress is sworn to protect and to serve, and whom the IRS has and does consistently abuse by it's well documented, and in millions of cases, unremedied exercises of such extensive power.

It is not my intent herein to merely point out what we already know. Rather, the purpose of this statement is to offer my recommendations from the view point of one of the IRS' abused tax payers, myself. The IRS' unlawful and abusive destruction of my family's and my own lives, by it's powers to bypass Judicial DUE PROCESS in exercising it's Section 6331 levy powers, has caused me the necessity of doing something too few individuals ever have the time and opportunities do: In defense of my self, I have had to research, study, and understand, the laws surrounding my rights, and the Internal Revenue Code (IRC) through which Congress has granted the IRS the abusive powers to destroy people at will without the benefit of an order of the court.

Since my 30 year career has been destroyed and my job has been since outsourced, I have had the time to make use of the Law Library to study. As a result of that study, I now have several recommendations for this Committee's consideration towards the goal of (again in the words of Senator Roth) "root[ing] out abuses . . . ."

Before the presentation of those recommendations, it is imperative that I first point out some complicitory behavior on the parts of all 3 Branches of Government, where such behavior supports a course which is contrary to the stated intent of "IRS Reform." I am speaking of the liberal use of the word "taxpayer" in reference to Americans, and use of the intentionally negative and provocative label of "tax protestor," as it is applied to Citizens prior to any proper adjudication via the guarantees of lawful DUE PROCESS.

Taxpayer

It is at best a deception to refer to Americans as "taxpayers." This term is created in the IRC, and as both Congress and the IRS know, "taxpayer," as so used, is a term which identifies no specifically designated person in the Internal Revenue Code. One becomes this "taxpayer" not by virtue of his/her American Citizenship, but rather by the act of voluntarily complying. To refer to the American public at large as "taxpayers" is in itself abusive. Judges, the President, Treasury Secretaries, IRS Commissioners, and even several Senators who participated in the September 1997 IRS Oversight Hearings, frequently use and used the phrase "voluntary compliance" in referring to the income tax system. It is also so designated in the Code of Federal Regulation. By publicly and liberally referring to the American public as "taxpayers," the fact of the "voluntariness" of the income tax system is deceptively given the aura of mandated participation for all of the public who is being addressed. This is dishonest and must be stopped. I shall again address the issue of the term "taxpayer" in my recommendations.

Tax protestor

Of all of the abusive terminology in the IRS vocabulary, usage of this one is the most subversive, and probably the single most powerful, label used by Congress and

the IRS to repress the rights of individuals who challenge the IRS' rightful and lawful entitlement to such individuals earnings and personal properties.

"Tax Protestor" (also Protester) is yet another linguistic creation of the IRS. When used by the IRS to designate an individual, there are certain procedures which are undertaken in the handling of the tax related affairs of such individuals by the IRS, which include but are not limited to, audits, criminal investigation, and levies.

Yet, there exist no statutory and regulatory provisions for the legal, nor lawful, definition of "tax protestor." Also, there are not any such laws and rules, which designate and define the application of procedures for the handling of the tax related affairs of "tax protestors" by the IRS. In plain English the designation of individuals as "tax protestors," and the subsequent "variant" treatment of such individuals by the IRS, as a result of that designation, is unauthorized by law. Where injuries and or damages occur, as a result of such designation and treatment, a crime has been committed against that individual.

What is even more a disservice to the American public than the abusive purpose and use of the "tax protestor" label by the IRS, whom we have come to expect to stand outside of both law and morality, is the use of the term by Congress and other government officials.

On September 3rd, 1997, Senator Roth said, " There will be no condoning of tax protesters, or any others who would misinterpret our objectives to legitimize anti-government attitudes or behavior. These hearings are about good government, about correcting problems within government . . . ."

It must be remembered that the IRS in it's demands, whether directly or through the law, for payment of an alleged tax obligation (debt), is still a creditor. The person upon which the IRS' claim and demand is made has the right to deny such obligation and to counter-demand that the IRS demonstrate it's rightful and lawful, as well as legal, entitlement to the payment of tax debts that the IRS creditor demands. No American should be pre-judged and excluded from the forum, as Senator Roth did, based upon the individual's insistence that such entitlement to such demanded obligations be proven as lawfully applicable to that individual personally.

Due to being designated a "tax protestor," and absent his day in court, the tax payer is summarily branded and then targeted and financially neutered, without justification or adjudication, simply because he disagrees with the IRS. One CANNOT lawfully or justly be designated a tax protester, with all it's attendant consequences, until after and unless he has had the opportunity to present his case in a true judicial court. I don't mean the Tax Court, which is yet another legislative gift of Congress to the IRS' power arsenal, and is not a judicial body of the Judicial Branch, governed by the Federal Rules of Civil Procedure which insures and directs the course of due process in civil matters.

Once this label is applied, even those in Congress adopt a vindictive attitude towards the unfortunate individual, based solely upon the designation of the IRS's arbitrary and contrived agenda. No American who merely insists that his Constitutional rights be respected, should be stigmatized and ostracized by the application of such a label and all of the negative consequences and scorn that go with it, without FIRST securing that individual his RIGHTFUL day in court.

The lack of due process in this regard amounts to punitive measures and damning opinions being taken against the individual without the benefit of any lawful hearing. Such is the intent of labeling, and it's use by Congress is dishonest and appauling.

All government officials are sworn to support the Constitution, of which the guarantee of "due process" is a vital part. For any elected representative to engage in the use of such labeling tactics to exclude the concerns of any segment of the American public, based upon the unsubstantiated label of "tax protestor," goes against their duty to the public that they are elected to represent and serve.

It is my sincere hope and request that Congress and all other government officials cease the practice of assisting the IRS in it's abusive behavior by giving aid and comfort through the use of these two deceptive and misleading terms, which are outside of the proper sanction of a lawful application thereof.

Recommendations

There are many federal court cases, which can be cited, in which conflicting opinions from circuit to circuit, court to court, and Judge to Judge can be demonstrated. Such conflicts exist, due in large part, to too many re-definitions of commonly used terms employed within the IRC. Between Congress, the IRS, Courts, and the public, there exist a gulf of misunderstanding of the true meanings of the tax laws, resulting in the needs for interpretation of both the meaning of the statutes, and of the intent of Congress. These needs for interpretation in turn spawn an unjust applica-

tion of law, with such unjust application then being based upon the luck of the draw as to which court is doing the interpretation.

This is not how our systems of law and justice are designed to be administered, nor can true justice even be administered through the law, where that law is written unclearly. And where such conflicts do occur, by logical reasoning, in one case or another, due process itself is not being administered properly and/or justly.

The following are my comments and recommendations towards the purposes of serving the right of Due Process by adjusting "the balance of power between the taxpayer," the individual American tax payer, and the IRS:

1. Make the IRC's language and terminology understandable and accessible to all individuals of the non-law-trained, general, American public who are of average and reasonable intelligence.

Do so by removing and/or replacing, through-out the IRC, the deceptive and unclear language, where by words of common usage, as such are used by the general public, are redefined in the IRC to have meanings that are totally different than those meanings which are commonly understood to be by the non-law-trained public.

2. Clarify WHO the "taxpayer" is in the Internal Revenue Code.

Eliminate the term "taxpayer" and replace it with specific, unambiguous, designations, spelled out plainly and clearly in terms such as "United States citizens, American citizens, corporations . . . ," ETC. Such designation should detail "Who" the tax payer is, and not what duties or obligations the tax payer has, which evasively does not specify "Who."

Define specifically what sub-chapters of the IRC pertain to what specific persons, as such person will be defined in place of the current term "taxpayer," for instance; 26 USC Section 6331 Levy and Distraint.

3. Eliminate the real and potential abuse of individuals, by the application of labels, which are legally undesignated and unsubstantiated, such as "tax protestor," by requiring the IRS to sue the disputing tax payer, in a civil Judicial Branch court action, just as any other creditor must do when their claims are disputed. This will properly dispose of ALL illegitimate tax protests, and establish non conflicting case precedents, which will in turn, smooth the operations of the courts, and reduce costs to the IRS, and the disputer, by permitting the court to quickly (and more importantly) justly, dispose of any frivolous cases. This will also preclude any need for a legislative "Tax Court" and it's associated overheads and lack of civil procedural rules and protections.

4. Remove the "criminal" language from the IRC. It's neither criminal to owe a debt, nor is it criminal to challenge an alleged debt's validity. If there are legitimate criminal offenses possible in the areas of income taxes, those offenses are more properly defined and lodged, with all other such statutes, in Title 18 of the United States Code.

The IRS is not an official United States Government's law enforcement agency, and therefore, the IRS' administration of law enforcement activities as applied to Americans is both, unlawful and unjust. The proper venue and jurisdiction for such lawful law enforcement activity is the United States Department of Justice, NOT the IRS.

Remove the "law enforcement" language from the IRC, as well as the functions and powers which such language authorizes. With criminal code related to the internal revenue properly lodged in Title 18, consistently, the law enforcement functions regarding the internal revenue, must also be vested in the Department of Justice, who administers Title 18.

5. Finally, preface the IRC with the inclusion of language overtly revealing the true Constitutionally voluntary nature of participation in the federal income tax system. Those who wish to contribute may and will. Those who do not wish to volunteer and contribute, which is their right, must not be compelled either by coercion, extortion, nor deceit and non-disclosure, to participate against their will and/or wishes.

End of recommendations

Please accept this statement in the spirit in which it is offered, that of the betterment of the conditions of all Americans, and towards the just applications of the systems of public taxation.

STATEMENT OF THE ASSOCIATION OF AMERICAN RAILROADS

Mr. Chairman and Members of the Committee.

The Association of American Railroads (AAR)[1] appreciates the opportunity to present these comments for the record of the Committee's hearing on restructuring of the Internal Revenue Service (IRS).

In recent months, much of the discussion about IRS reform has focused on the individual taxpayer and the abuses they have suffered. However, as a trade association representing Coordinated Exam Program (CEP) taxpayers, we would like to comment with respect to the administration of the tax collection system and how it does not work. In large part, we believe many of our issues with the IRS are directly traceable to its size, bureaucratic nature, and misguided management practices. Four examples follow:

1. Whenever a high-ranking IRS official speaks to a group of tax professionals, the message focuses on how fair and impartial the IRS tries to be as taxpayers navigate through the process of complying with the tax laws and procedures. These same officials also proclaim the Service's willingness to be flexible and innovative in resolving conflicts and express a desire to apply the APA process to other disputes with large case taxpayers. However, our experience tells us that this message is not getting through to the audit or field level agents. Simply put, too many agents assigned to our members' cases make it difficult if not impossible, to comply with the tax laws and procedures. The fairness and impartiality message must be communicated to the agents and reinforced with policies, procedures, and reward mechanisms that are internally consistent and reinforce the desired behavior. In fact, the principles found in the IRS' own Mission Statement (a copy of which is attached), if understood and followed regularly and systematically at all levels in the IRS, would go a long way towards substantially improving the IRS' administration of the Internal Revenue Code.

2. The IRS has created an Industry Specialization Program (ISP), which focuses on specific tax issues within various industries such as banking, insurance, health care, and transportation. ISP team members from the Examination Division, Appeals Division and District Counsel work together on the development, coordination and resolution of tax issues within these industries. If properly administered, the ISP program can facilitate the resolution of troublesome industry-wide tax issues on a consistent and equitable basis without costly and time-consuming litigation.

One ISP industry settlement initiative has been successfully pursued in the railroad industry through hard work and mutual cooperation between the ISP team and industry representatives. Unfortunately, the other two attempts to use the ISP process in the railroad industry were not successful. In both of these situations, the IRS did not clearly define the authority of ISP teams to negotiate and implement industry-wide settlement agreements. Such authority must be clearly defined for the program to achieve its objectives.

For example, on one major ISP issue—Track Repair—our members have been unable to determine who the ultimate decision maker is, i.e., whether it is the support Case Manager, the key district Case Manager, the Exam ISP, the Appeals ISP, the Accounting Methods ISP, one of any number of IRS counsel who are involved, the Appeals Office, the National Office, etc. This illustrates that establishment of clear lines of authority and responsibility are necessary for the ISP program to work.

3. A third example involves the IRS' tax treatment of expenditures associated with the railroad industry's compliance with federal environmental, safety, and health regulations. The cost of compliance is increased by the IRS' insistence that many of the expenditures incurred to implement these regulations be capitalized rather than allowed as ordinary and necessary business expenses. The IRS' policy is in direct conflict with the social and public policy objectives which these environmental, safety, and health regulations are intended to achieve, in that it discourages attainment of these objectives.

For example, the IRS continues to require that taxpayers capitalize the costs of asbestos removal and certain soil remediation costs. In the former case, the costs are recovered over the life of the structure while in the latter the taxpayer cannot recover the costs until the land is disposed of or sold. Whereas Congress and the IRS have historically passed laws and issued regulations to prevent taxpayers from claiming deductions for expenditures that violate public policy,

[1] AAR is a trade association whose members account for 75% of total rail line-haul mileage, generate 93% of total rail freight revenues, and employ 91% of the freight railway workforce.

the IRS should be directed to administer the law and issue regulations that encourage—or at a minimum do not penalize—taxpayers' investment in activities (such as safety and environmental remediation programs) that clearly promote the public's interests.

4. The recent IRS restructuring hearings made it clear that job performance at the IRS and, as a result, compensation, is in part measured by statistics, e.g., how much additional liability is identified by the agent at the examination level.

That specific performance standard often leads to tax adjustments that have little or no basis for being included in a Revenue Agent's Report (RAR). Invariably, the taxpayer will devote significant time at the exam level to reverse the adjustment, generally with little or no success, as there is no incentive for the agent to reverse a proposed adjustment. Thereafter, taxpayers most likely will take those issues to Appeals, or directly to court. In either case, taxpayers will spend considerable additional time and effort to refute the adjustments. The IRS Appeals Office likewise must devote time and effort to understand all the adjustments that are protested. Studies show that of all the additional CEP case liability dollars taken to Appeals, only one in five is sustained by the IRS. Although there are a number of reasons for this result, one of the more significant ones is that there is often no basis for the adjustment in the first place.

Although this is only one of many problems with the management system in effect today, this one could be resolved by ensuring that the measurement device used by the IRS is consistent with the IRS' Mission Statement, as referenced above. AAR suggests that an agent's job performance should be measured by the agent's adherence to the Mission Statement and the rate of the agent's adjustments that are ultimately sustained through Appeals and the courts, not by what the agent includes in the RAR.

Again, AAR appreciates the opportunity to present the perspective of the railroad industry on this important issue. We would be pleased to work with the Committee as it examines the changes that are needed in the IRS.

STATEMENT OF THE FEDERAL MANAGERS ASSOCIATION

[SUBMITTED BY KEN MCDANIELS]

Thank you for allowing the Federal Managers Association (FMA) to provide its views on the efforts to restructure and reform the Internal Revenue Service. FMA represents the interests of the over 200,000 managers and supervisors within the Federal Government. This includes approximately 8,500 front-line and mid-level managers working for the IRS.

The Internal Revenue Service has a unique and important role in our government. As an agency that employs 102,000 people and interacts with tens of thousands of Americans on a daily basis, it plays a critical role in governmental operations. FMA praises the effort of Chairman Roth and members of the Finance Committee and their staffs in tackling the difficult goal of improving operations at the IRS, while trying to ensure a fair and appropriate balance in obtaining public and employee input in the process.

FMA believes that front-line managers play a key role in bringing about change in an agency. By adding the Federal Managers Association to the National Partnership Council (E.O. 12983, 12/21/95), President Clinton recognized the benefit of the valuable experience and input provided by front-line managers. It is front-line managers who implement policy at the level that most directly impacts the public. In many situations, IRS front-line managers have a vastly different prospective than top level IRS executives who are involved in policy making. Although front-line managers may have the best insight into how to make reforms work, they have rarely been allowed to provide real input into agency reforms.

The following are our comments on selected provisions of H.R. 2676:

CREATION OF AN IRS OVERSIGHT BOARD

We have serious concerns about the provision of H.R. 2676 which provides the union with a seat on the Oversight Board, while management associations, such as FMA, do not have one. In order to achieve balance and the success envisioned in H.R. 2676, management representatives need to have their voices heard. We recognize the obstacles to expanding the Board. Therefore, we believe that a suitable alternative to create balanced employee input would be to create an ex-officio committee consisting of representatives of the union and management associations, such as FMA, that would meet with the Oversight Board on a regular basis.

PERSONNEL FLEXIBILITIES

The Federal Managers Association believes that the new IRS Commissioner needs to have adequate personnel flexibilities in order to make reforms work. However, there must be an eye toward ensuring IRS adherence to Merit System Principles. An area of the bill that concerns us is the issue of the veto authority given to the union. We fear that managers could end up being treated unfairly in a system where the union would be able to veto any personnel changes as they apply to bargaining unit employees, while managers would have no such veto power on changes that impact them. Also, this veto authority would allow the union an opportunity to prevent any changes it does not support, while allowing the Commissioner no recourse to pursue these changes.

TAXPAYER ADVOCATE

Since the Senate Finance Committee hearings last fall, the IRS has made great strides in the area of improving taxpayer service. This has included the "Problem Solving Days," which, by all accounts, have been extremely successful. We believe that the IRS should be commended for these efforts and be allowed to continue its work in this area. This should include allowing the Taxpayer Advocate Office to remain within the agency. Attempts to remove the Taxpayer Advocate Office from the agency would serve to undermine the voluntary compliance system that has historically served our country well.

BURDEN OF PROOF

FMA is concerned about Section 301 of H.R. 2676 which would shift the burden of proof to the IRS in any court proceeding with respect to a factual issue. We acknowledge that, on its face, this appears to be a sound and popular provision. However, we believe this change would likely lead to a series of unintended negative consequences that would defeat the reasons for the shift of the burden in the first place. Its passage would undoubtedly cost the government a great deal of revenue as taxpayers will be more likely to claim non-deductible expenses, as they will see the shifting of the burden of proof to the IRS, perhaps mistakenly, as protection against a disallowance of the deduction.

Furthermore, examiners may believe that they must use the available enforcement tools, such as summons or third party interviews, to verify actual matters more often than they do now. It would indeed be ironic if a provision intended to protect taxpayers may actually result in IRS actions which may be more intrusive. FMA, therefore, urges reconsideration of this provision.

CONCLUSION

During the past year, many have expressed the view that IRS managers need to be held accountable for their actions. Additionally, on numerous occasions, as in the case with the Field Office Performance Index, it has been stated that IRS front-line managers in the field misinterpreted the guidance provided by the National Office. These same front-line managers who were not involved in the formulation of many policies and procedures which were criticized during past Senate Finance Committee hearings, have not been adequately included in the effort to reform the agency.

We strongly believe that management associations, such as the Federal Managers Association, provide decision makers in the Legislative and/or Executive Branches their only opportunity to receive unfiltered and essential input from front-line managers, the people closest to the service to the public. A large majority of IRS managers do not feel that they can provide honest feedback in the current climate. Your work to help ensure the inclusion of their input in the ongoing process of reforming and improving the agency would help to alleviate these concerns.

Once again, we thank you for allowing us this opportunity to provide our opinions on the important work before the Senate Finance Committee.

STATEMENT OF HAROLD J. KRENT

PROFESSOR AND ASSOCIATE DEAN,
CHICAGO-KENT COLLEGE OF LAW,
Illinois Institute of Technology.

FEBRUARY 3, 1998.

HON. WILLIAM V. ROTH, JR.,
Chairman, Senate Finance Committee,
U.S. Senate,
Washington, DC.

You have requested my views as to the constitutionality of the Internal Revenue Oversight Board as constituted under the House bill, H.R. 2676. The bill creates an Oversight Board composed of eleven members, and delegates to the Board tax policymaking authority. The constitutional question centers upon the appointment and removal provisions governing the member of the Board who is to be "a representative of an organization that represents a substantial number of Internal Revenue Service employees." § 7802(b)(1)(D).

As an initial matter, the appointment and removal provisions are only problematic if the members of the Board are considered "officers of the United States." Under *Buckley v. Valeo,* 424 U.S. 1, 125-26 (1975), officers include "any appointee exercising significant authority pursuant to the laws of the United States." Although there may be an argument that the Board is to serve principally in an advisory capacity, it appears that the Board exercises sufficient authority under Section 7802(d) that the members must be considered officers of the United States. See also *Freytag v. Commissioner,* 501 U.S. 868, 880-82 (1991) (concluding that special trial judges are officers). The bill would vest in the Board, among other responsibilities, the power to "approve strategic plans of the Internal Revenue Service" and to "approve the budget request of the Internal Revenue Service." The House Report notes that "[w]ith respect to those matters over which the board has approval authority, the Board's decisions are determinative." Assuming that adverse consequences would flow from the Board's refusal to accept the IRS's strategic plans or budget requests, then members of the Board would plainly exercise the type of authority that can only be exercised by officers of the United States.

Officers of the United States must be appointed by the President with the consent of the Senate.[1] Two reasons underlie the decision to vest appointment authority exclusively in the President. First, because the President's superintendence over execution of laws is tied so closely to appointments, restrictions on his appointment power would undermine the President's ability to fulfill that responsibility. Presidents can influence implementation of federal policy through their choice of officials. Cf. *Public Citizen v. United States Dep't of Justice,* 491 U.S. 440 (1989) (stating that, to apply FACA to ABA committee consideration of judicial candidates could well interfere with the President's appointment authority). As the Court stated in *Buckley,*

> The vesting of the executive power in the President was essentially a grant of the power to execute the laws. But the President alone and unaided could not execute the laws. He must execute them by the assistance of subordinates. . . . As he is charged specifically to take care that they be faithfully executed, the reasonable implication, even in the absence of express words, was that as part of his executive power he should select those who were to act for him under his direction in the execution of the laws.

424 U.S. at 135-36.

Second, if Congress imposes too many restraints on the President's appointment power, then Congress in essence assumes the appointment power for itself. Congress cannot take part so directly in the execution of the laws it fashions. As Justice Kennedy has written, "[n]o role whatsoever is given either to the Senate or to Congress as a whole in the process of choosing the person who will be nominated for appointment." *Public Citizen,* 491 U.S. at 483. Otherwise, Congress would be able to both make and execute the laws, circumventing the checks and balances system enshrined in the Constitution.

There are two substantial constitutional problems raised by the structure of the Oversight Board. First, under Section 7802(b)(1)(D), one member of the Board must be "a representative of an organization that represents a substantial number of Internal Revenue Service employees." Second, that same member under Section 7802(b)(4)(C) "shall be removed upon termination of employment, membership, or other affiliation with the organization" described above. No clear precedent exists to control either issue. After studying the provisions, my best guess is that courts

would strain to find the first provision constitutional if a case or controversy were properly presented to the courts—which is unlikely— and conclude that the removal provision is constitutionally infirm.

1. **Section 7802(b)(1)(D).** Congress oftentimes specifies qualifications for officeholders as part of its responsibility to determine how laws should be implemented. For instance, Congress has directed that International Trade Commissioners must have "qualifications requisite for developing expert knowledge of international trade problems." 19 U.S.C. § 1330(a). Similarly, the Solicitor General must be "learned in the law." 28 U.S.C. § 505. Congress has also directed that some offices be filled by a mixture of Republicans and Democrats. No more than three of the six commissioners on the International Trade Commission can be from the same political party. 19 U.S.C. § 1330(a). Analogous restraints govern appointment of members of the National Mediation Board and the Federal Election Commission (among others). 45 U.S. C. § 154; 2 U.S.C. § 437c(a)(1). In addition to qualifications, Congress has also directed that certain individuals serve on agencies by virtue of service in another federal office. Indeed, in this case, the Secretary of the Treasury and the Commissioner of Internal Revenue serve on the Oversight Board. Seven of the twelve members of the Federal Open Market Committee serve because of their position on the Board of Governors of the Federal Reserve Board. See 12 U.S.C. § 341.

Congress presumably can impose reasonable restraints on the President's choice of whom to appoint to various offices. Those qualifications seem ancillary to Congress's unquestioned authority to create and disband agencies. In delegating authority, Congress can select which office should carry out the delegated tasks, and what the qualifications of officeholders should be. Presidents have generally acquiesced in such restrictions, but while abiding by congressional directions, they have claimed the discretion to depart from such restrictions if the situation warranted. For relatively recent examples, see, e.g., Statement on Signing the Cranston-Gonzales National Affordable Housing Act, 26 Weekly Comp. Pres. Doc. 1930, 1931 (Nov. 28, 1990); Statement on Signing the National and Community Service Act of 1990, 26 Weekly Comp. Pres. Doc. 1833, 1834 (Nov. 16, 1990); Statement on Signing the Intelligence Authorization Act, Fiscal Year 1990, 25 Weekly Comp. Pres. Doc. 1851, 1852 (Nov. 30, 1991).

No case has arisen testing the limits of Congress's power to restrict the President's appointment power by imposing too stringent qualifications. The lack of a test case is not surprising. If the President decides to abide by the restrictions, no justiciable case seems possible. The President may have selected the same official irrespective of the qualifications, or may just be bowing to the practical need for obtaining senatorial consent for the appointment. Conversely, the President has little incentive to flout congressional will when the Senate can block any appointment it deems unwise. The congressional limitation, therefore, will not cause injury in fact, even if unconstitutionally restricting the President's appointment authority. (A disappointed appointee can never show that the Senate would have ratified the appointment but for the restriction). If the President ignores the restrictions, a case conceivably could arise if the Senate then ratified the President's choice. Anyone who later claims injury in fact due to that officer's action might assert that the officer was appointed counter to legitimate congressional directions. To my knowledge, this situation has never arisen.

Analogies are sparse, but perhaps the closest lies with Congress's decision to vest appointment authority of inferior executive officials outside of the executive branch. In *Morrison v. Olson,* 487 U.S. 654 (1988), the Court considered the extent to which Congress can vest in the courts of law the power to appoint inferior officers in the executive branch. The Court held that such interbranch appointments were permissible as long as not "incongruous." Id. at 677. See also *Ex parte Siebold,* 100 U.S. 371, 397-98 (1880). Such an approach, if adopted in this context, would permit congressional restrictions upon the appointment power as long as the qualifications—whether political affiliation or educational pedigree—were not incongruous in light of the duties exercised by the officer.

At some point, Congress's restriction of options would violate the Appointments Clause, irrespective of the relevance of the qualifications imposed. For instance, if Congress directed the President to appoint the head of "an organization that represents a substantial number of Internal Revenue Service employees" then only one person would fit that description. The fit between the qualifications imposed and the duties to be imposed is loose—one can represent employees without serving as head of the union. More importantly, if Congress so limited the President's choice to only one individual, it would be exercising a power clearly denied it under the Constitution. *Cf. Olympic Fed. Sav. & Loan Ass'n v. Director, Office of Thrift Supervision,* 732 F. Supp. 1183, 1193 (D.D.C.), *dismissed as moot,* 903 F.2d 837 (D.C. Cir. 1990) (When Congress "abolished one agency and removed its three officers, yet des-

ignated one of the three as the head of the newly-created successor agency, Congress exercised the kind of decisionmaking about who will serve in Executive Department posts that the Constitution says it cannot"). Congress must leave at least some room for choice to the President, and the qualifications must be germane to the delegated authority.[2]

Those defending the appointment limitation can argue that Congress has a stronger reason for the appointment qualification here than in *Olympic Federal*. The goal of the appointment provisions in the bill is to ensure that different interest groups are represented on the Oversight Board. Not only are those involved in various walks of private life to be represented—such as those expert in customer service or taxpayer needs, § 7802(b)(2)(A)—but so is the Commissioner of Internal Revenue and a member of an employee organization. Congress cannot accomplish its goal of representing different interests on multi-member Boards without imposing significant restrictions on the President's appointment authority. Consider that Congress has directed interest groups to be represented on other multi-member executive commissions, principally those that serve advisory functions. See, e.g., Modernization Transition Committee under Weather Service Modernization Act, 15 U.S.C. § 313; National Homeowner Trust, 42 U.S.C. § 12851; Agency for Health Care Policy & Research, 42 U.S.C. § 299; National Institute of Building Sciences, 12 U.S.C. § 1701j-2.

In short, the House bill restricts presidential appointment power to a far greater degree than prior statutes. The President's choice for this particular member of the Board is circumscribed by the qualification that he or she be a representative of an employee group. Nonetheless, Congress's power to ensure that different interest groups be represented on a multi-member Board would likely sway a court to uphold the restrictions. In any event, the appointments provision is unlikely to be raised in a properly drawn case or controversy.

2. **Section 7802(b)(4)(C).** Under the proposed statute, the President retains the authority to remove all members of the Oversight Board at will. In our jurisprudence, "the power of removal [is] incident to the power of appointment." *Ex parte Hennen*, 38 U.S. (13 Pet.) 230, 259 (1839). The removal power represents the only formal means by which Presidents can control their subordinates' ongoing exercise of power and ensure unified execution of the law. The power to remove an official is emblematic of a continuing relationship between the President and subordinate officials, and in the public eye links that official's conduct to the Presidency itself. In isolation, the removal authority recognized in § 7802(b)(4) guarantees that the President can exercise supervision over the members' exercise of significant federal authority. Or, as the Supreme Court summarized in *Morrison*, as long as the President retains "sufficient control . . . to ensure that the President is able to perform his constitutionally assigned duties," 487 U.S. at 696, no constitutional problem arises.

But the difficulty here is that Congress has authorized the IRS employee group to exercise the removal power as well. Under this provision, once a representative of the Internal Revenue Service employees is terminated from "membership, or other affiliation with the organization" he or she is removed from the Oversight Board. Thus, while the President enjoys the plenary authority to remove the representative, § 7802(b)(4)(A), that authority is shared in part with the employee organization itself. Should the organization rescind the representative's membership or other affiliation with the organization, then he or she is removed from office. The employee organization may have rules protecting representatives from expulsion or disaffiliation, but those rules can be modified. The exercise of removal authority by private parties is, with the possible exception of the FOMC discussed below, unprecedented.

Nonetheless, defenders of the provision might make several arguments to preserve the removal provision. First, the power to remove in this case is exercised not by Congress as in *Myers* and *Bowsher* but by private parties, namely the employee organization. A defender of the removal provision might therefore argue that less of a separation of powers problem arises, for private parties have long enjoyed some power to shape policies affecting their lives. For instance, in cases such as *Currin v. Wallace*, 306 U.S. 1 (1939), and *United States v. Rock Royal Cooperative, Inc.*, 307 U.S. 533 (1939), the Supreme Court sustained marketing orders proposed by the Department of Agriculture that would only go into effect if the affected private parties approved the orders through a referendum. The Court in Currin reasoned that "Congress has merely placed a restriction upon its own regulation by withholding its operation as to a given market unless [the growers approve it]." 306 U.S. at 15. The Court has also sustained a delegation to the American Railway Association to establish a mandatory drawbar height. *Saint Louis, Iron Mountain & Southern Ry. v. Taylor*, 210 U.S. 281 (1908).

When Congress assigns private parties such roles, however, it undermines executive branch control over delegated authority. The exercise of removal authority threatens presidential supervision more directly than direct delegations to private parties as in *Rock Royal* and *Saint Louis, Iron Mountain & Southern Ry.* Each exercise of delegated authority by the Oversight Board will in part by overseen by the employee group. And, the authority of the IRS Oversight Board extends well beyond the interests of the employee group. Indeed, the Supreme Court in *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936), invalidated delegation to coal producers and miners to set maximum hours and minimum wages for the industry. The terms set were in turn to be enforced by steep financial sanctions. In striking down the Act as an excessive delegation, the Court reasoned in part that unaccountable private parties could not exercise such a fundamental say in execution of the laws: "This is legislative delegation in its most obnoxious form, for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business." Id. at 311. The question presented here, therefore, is whether the private group's exercise of the removal authority affords it too much say in implementation of the laws governing the entire nation.

The private organization's power of removal carries with it the power to control. As the Court stated in *Humphrey's Executor v. United States*, 295 U.S. 602, 629 (1935), "it is quite evident that one who holds his office only during the pleasure of another, cannot be depended upon to maintain an attitude of independence against the latter's will." The court further explained in *Bowsher v. Synar*, 478 U.S. 714, 727 n.5 (1986), that it is the officer's "presumed desire to avoid removal by pleasing Congress, which creates the here-and-now subservience to another branch that raises separation-of-powers problems." If Congress enjoyed any role in the removal process, then it could exercise too much "control over the execution of the laws." Id. at 726. Thus, the Court invalidated the congressional power to initiate removal in *Bowsher*. See also *Myers v. United States*, 272 U.S. 52, 161 (1925) (stating that, to permit Congress to "draw to itself, or to either branch of it, the power to remove or the right to participate in the exercise of that power . . . would be . . . to infringe the constitutional principle of the separation of governmental powers"). Had the Brookings Institute, instead of Congress, wielded the removal power over the Comptroller General, the constitutional infirmity would not disappear.

As an analogy, if Congress determined that the Solicitor General must be a member of the American Bar Association, and that the Solicitor General may be removed from office if the ABA canceled the Solicitor General's membership, the constitutional difficulty I think would be clear.[3] A private group would have excessive influence over the Solicitor General's actions. The Solicitor General would recognize that any step taken at odds with official ABA positions could jeopardize his tenure in office. The fact that the President also could exercise removal authority would not be a sufficient safeguard, for any successor in office would owe allegiance to the private employee group or face dismissal. The Solicitor General would have to please two masters, and the continuing loyalty to the private group undermines the presidential control that the Supreme Court found essential in *Morrison*. Exercise of the removal authority by anyone other than the President, therefore, cannot easily be squared with our system of separated powers.

Second, one can argue that the statutory removal provision should not be treated as a removal provision per se, but rather as a recognition that certain individuals serve on the Board only by virtue of their office, and thus can no longer serve on the Board after their position ceases. For instance, the Secretary of the Treasury also serves on the Oversight Board, and would no longer serve after resignation or discharge by the President.

The closest analogy presented may be the membership of the Federal Open Market Committee. Five out of twelve of the members of the FOMC are not appointed by the President. Rather, they serve on the committee by virtue of their status as presidents or vice-presidents of the twelve regional Federal Reserve Banks, which are privately owned, 12 U.S.C. § 448(f), although the Board of Governors of the Federal Reserve can remove them from office for cause. Presumably, if a president of a regional Federal Reserve Bank is removed from office during a term by the private boards of directors of the regional banks, his or her role on the FOMC automatically ends.

The FOMC analogy, however, is of only limited persuasive force. It is likely far easier for the employee organization to remove a representative from a position of authority than it is for the regional Federal Reserve Banks to remove a President or vice-President. Moreover, no definitive precedent upholds the constitutionality of the FOMC. Most cases have refused to reach the merits of challenges to the constitutionality of the composition of the group. *See, e.g., Committee for Monetary Re-*

form v. Board of Governors of the Federal Reserve System, 766 F/2d 538 (D.C. Cir. 1985); *Riegle v. FOMC,* 656 F.2d 873 (D.C. Cir. 1981); *Bryan v. FOMC,* 235 F. Supp. 877 (D. Mont. 1964). One district court dismissed a constitutional challenge to the FOMC, *Melcher v. FOMC,* 644 F. Supp. 510 (D.D.C. 1986), but that decision was reversed on justiciability grounds by the D.C. Circuit. 836 F.2d 561 (D.C. Cir. 1987). Even then, the court relied on historical arguments that private members of the Board should not be considered officers of the United States, an argument which would be unavailing in this context. Finally, the employee representative of the IRS employee group serves not merely by virtue of his or her position, but because the President deemed the individual best suited for the office.

Irrespective of the FOMC precedent, permitting an organization to remove an officer of the United States seems problematic even when Congress's very purpose is to ensure that the views of the private organization be represented in the agency. If a private group deems that the Solicitor General is no longer "learned in the law," 28 U.S.C. § 505, authorizing removal would allow too great a role in the officer's enforcement of the law. Similarly, if Republican and Democratic party leaders could remove members of the International Trade Commission whose views no longer reflected the views of party faithful, then the party leadership would have too great a role in how the International Trade Commission exercised its functions. Exercise of the removal authority by a private organization threatens principles of executive accountability underlying Article II.

Third, unlike in *Bowsher,* the officer on the IRS Oversight Board exercises power only as one out of eleven members. The private group unquestionably would have greater control if it could remove all eleven members of the Board. Nonetheless, the vote of one member of the group may prove dispositive in any particular close vote. I doubt that courts would excuse any separation of powers violation on the ground that the officer was not important enough. Indeed, in *FEC v. NRA Political Victory Fund,* 6 F.3d 821 (D.C. Cir. 1993), *cert. dismissed,* 115 S. Ct. 537 (1994), the D.C. Circuit invalidated the composition of the FEC because Congress had placed two of its agents as non voting members on a committee comprised of six voting members.

In short, vesting a private group with removal authority over an officer of the United States undermines the President's ability to coordinate execution of the laws. The officer would have divided allegiance, and consequently less reason to adhere to the President's policy priorities. The President's retained removal authority would be insufficient, by itself, to ensure adequate control. The Court therefore will likely strike down the removal provision providing that the employee representative's role on the Board will be automatically terminated if the employee organization severs its relationship to the officer.

Please let me know if I can provide you with any additional information.

Sincerely,

HAROLD J. KRENT.

ENDNOTES

[1]: The Appointments Clause provides in pertinent part that the President "shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law." U.S. Const. Art II, 2, cl.2.

[2]: Interestingly, some state courts have invalidated legislative delegations to private regulatory entities. See, e.g., *Toussaint v. State Board of Medical Examiners,* 329 S.E.2d 433 (S.C. 1985); *Rogers v. Medical Ass'n of Georgia,* 259 S.E.2d 85 (1979).

[3]: The departure from separation of powers principles would be even greater had Congress directed that the Solicitor General's duties were to be performed by the President of the ABA. Congress in essence usurps the President's appointment authority by vesting such significant duties in private parties.

STATEMENT OF THE ILLINOIS STATE BAR ASSOCIATION

LEGISLATIVE RECOMMENDATION ADOPT
AT THE BOARD OF GOVERNORS MEETING JULY 18, 1997

TO AMEND THE INTERNAL REVENUE CODE OF 1986 TO PROHIBIT THE USE OF NATIONAL AND LOCAL EXPENSE STANDARDS IN DETERMINING A TAXPAYER'S ABILITY TO PAY FOR PURPOSES OF INSTALLMENT AGREEMENTS AND OFFERS IN COMPROMISE

SUGGESTED STATUTORY LANGUAGE

Section 1. Section 6159(b) of the Internal Revenue Code of 1986 is amended by adding the following:

(b) EXTENT TO WHICH AGREEMENTS TO REMAIN IN EFFECT.

(1) IN GENERAL—Except as otherwise provided in this subsection, any agreement entered into by the Secretary under subsection (a) **shall be based upon the taxpayers' ability to pay and** shall remain in effect for the term of the agreement.

(6) ABILITY TO PAY. In determining ability to pay, the Secretary shall take into account the taxpayer's necessary living expenses based solely upon the taxpayer's facts and circumstances and without regard to national or local standards.

Section 2. Section 7122 of the Internal Revenue Code of 1986 is amended by adding the following as new subsection (c):

(c) **ABILITY TO PAY. In evaluating the sufficiency of an offer of compromise, the Secretary shall take into account the taxpayer's ability to pay as determined in accordance with section 6159(b).**

Section 3. The amendments made by sections 1 and 2 shall be effective upon enactment.

COMMENTS

Section 6159 of the Internal Revenue Code of 1986, (26 USC §6159)(the "Code") authorizes the Secretary of the Treasury to enter into written agreements with any taxpayer for the satisfaction of a tax liability imposed under Title 26 of the United States Code in installment payments if the Secretary determines that such agreement will facilitate the ultimate collection of tax.

Section 7122 of the Code authorizes the Secretary to compromise any civil or criminal case arising under the internal revenue laws. Prior to 1992, the Internal Revenue Service had a low rate of acceptance for Offers in Compromise. In many Districts around the country Offers in Compromise were discouraged by Internal Revenue Service employees. There was great disparity among the Districts as to the standards for Offers in Compromise. On February 26, 1992, the Internal Revenue Service announced new procedures for Offers in Compromise. Those procedures greatly liberalized the Offer in Compromise process and greatly increased the chances that a troubled taxpayer might be able to make a partial payment in settlement of his tax liability. The Service adopted the following policy statement:

"The Service will accept an Offer when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. An Offer in Compromise is a legitimate alternative to declaring a case as currently not collectible, or to a protracted installment agreement. The goal is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government.

"In cases where an Offer in Compromise appears to be a viable solution to a tax delinquency, the Service employee assigned to the case will discuss the compromise alternative with the taxpayer and, when necessary, assist in preparing the required forms. The taxpayer will be responsible for initiating the first specific proposal for compromise.

"The success of the Offer in Compromise program will be assured only if taxpayers make adequate compromise proposals consistent with their ability to pay and the Service makes prompt and reasonable decisions. Taxpayers are expected to provide reasonable documentation to verify their ability to pay. The ultimate goal is a compromise which is in the best interest of the taxpayer and the Service. Acceptance of an adequate Offer will also result in creating, for the

taxpayer, an expectation of and a fresh start toward compliance with all future filing and payment requirements." (Policy Statement P-5-100.)

In accordance with this new policy statement the Internal Revenue Service adopted manual provisions and created an entirely new environment. Since the adoption of the new procedures in 1992, Revenue Officers have solicited Offers in Compromise cases where in the past no compromise would have been available. Internal Revenue Service employees exhibited a great deal of flexibility during the negotiation process after the adoption of the 1992 policy revisions. The environment from February 1992 to September 1995 greatly contrasts with past policies of the Service where Offers in Compromise were not encouraged and in fact some Districts seem to do their best to thwart Offers.

By administrative pronouncement effective August 29, 1995, the Internal Revenue Service began using national and local standards to decide a taxpayer's "ability to pay" for purposes of Installment Agreements and Offers in Compromise. These standards, which are derived from Bureau of Labor Statistics, establish predetermined levels of necessary living expenses based on family size, monthly income, and county of residence. Those necessary living expenses are then compared with monthly income to determine the taxpayer's ability to pay a delinquent tax. Taxpayers wanting to pay their tax delinquencies in installments or who seek to compromise their tax liability because of doubt as to liability or doubt as to collectibility have experienced adverse consequences as result of the use of these standards.

First, a taxpayer's ability to pay a tax liability is no longer based upon **the taxpayer's particular facts and circumstances,** but rather, on standards established by the Internal Revenue Service. These standards establish predetermined levels of allowable expenses based solely upon factors such as family size, monthly income and county of residence. Often these standards have resulted in the determination of the taxpayer's ability to pay **which bears no rational relationship to the taxpayer's particular facts and circumstances.**

Second, the standards have effectively taken away the Internal Revenue Service employee any discretion in determining whether the Installment Agreement or Offer in Compromise **will facilitate collection of the liability.** Under current practices, an Internal Revenue Service employee's recommendation will be based upon the determination of a taxpayer's ability to pay after allowance for necessary expenses, including expenses determined by reference to national and local standards. While the employee has authority to make exceptions with respect to Installment Agreements (provided the employee can justify the proposed departure), he has no corresponding authority with respect to Offers in Compromise.

In our opinion this policy has not facilitated the collection of tax; but rather, has become an impediment to the approval of Installment Agreements and Offers in Compromise. As a result, many tax practitioners believe that more and more taxpayers are seeking relief under the bankruptcy statutes rather than paying tax liabilities according to their ability to pay. This is a trend which is the direct result of tax policy and is one which should be reversed.

We recommend that these national and local standards be abandoned in favor of a methodology for determining a taxpayer's ability to pay which reflects the taxpayer's particular facts and circumstances.

* * * * *

No member of the Board of Governors or Council of the Section on Federal Taxation of the Illinois State Bar Association is known to have a material interest in the Recommendation by virtue of a specific employment or engagement to obtain the result of the Recommendation. We recommend that the amendment be given only prospective application.

STATEMENT OF ROBERT D. LONG

THE NEED TO PROTECT THE IRS FROM POWERFUL TAXPAYERS

Many people have now made known their needs and desires in the ongoing effort to bring reform to the IRS. I fully agree with all these efforts, but I also wish to insert a cautionary note. In building a "kinder, gentler" IRS we must also guard the interests of taxpayers in making sure that the IRS will be able to operate effectively in ensuring compliance with the tax code. It is in the interests of everyone that all pay their fair share of the tax burden. This is not merely a need to maintain the status quo; it is a need to guard the IRS against the abuses of powerful taxpayers who have tremendous resources to bring to bear in bending the IRS to their will.

This is a situation which we have seen manifest in recently published accounts of dealings between the IRS and Scientology.

It may seem odd that in view of the testimony already given about the abuses of the IRS against taxpayers that I would be urging you to also protect the IRS from the abuses of organizations who would use their resources against the IRS. However, I believe that any successful reform of the IRS must take into account both of these issues. To do one without the other will surely prevent the IRS from successfully (and equitably) carrying out its mission.

We have been conditioned to think only in terms of how the government becomes overbearing in its dealings with the citizenry of this country. But it is also true that the citizenry can become overbearing in its dealings with a government agency. This has been true in abuses of the Welfare and Social Security agencies where individuals have used their resources in attempts to defraud these agencies. Although it may be a foreign concept for us to think in terms of an organization using its resources against the IRS, the evidence is that this situation has already occurred.

The case I have in mind which illustrates better than I ever could the abuses which are possible, is the case of the long history of dealings between the "Church" of Scientology and the IRS. It is not a case in which one could describe either side on the conflict as having entirely clean hands. But it is a good example of the weaknesses in the current IRS structure and where change is needed.

In relating this information I must say that not all details of this situation have been made public. I am relying heavily on my own experiences as a member of Scientology in the 1970's (an organization which I have disavowed any connection to since 1978—even though they still send me junk mail and count me as a member for promotional purposes). I also rely upon the published IRS closing agreement with Scientology (which has not been validated by the IRS, but which I have every reason to believe is genuine). I am also basing my statements on published evidence gathered by the U.S. government and made available through FOIA, the statements of other former members of Scientology, and news reports.

For decades the IRS denied tax-exempt status to Scientology organizations, and denied tax deductions for payments to Scientology by individual Scientologists for courses and personal services (a position supported by a U.S. Supreme Court ruling). The IRS in 1993 suddenly and mysteriously announced that it was reversing course and granting tax exempt status to Scientology and its related organizations, and allowed individuals to deduct payments made to Scientology for personal services.

The circumstances and details of this sudden change in policy have been cloaked in mystery ever since. Tax Analysts has fought an ongoing battle with the IRS to force legal disclosure of the mysterious closing agreement made with Scientology, an agreement which the IRS has steadfastly refused to disclose even with redaction's. No one outside of Scientology leadership and the IRS knew what the exact terms of the agreement were until someone leaked it to the media a couple of months ago.

The agreement, disclosed by the Wall Street Journal, contains far more than "taxpayer return" information as alleged by the IRS. It includes evidence that strongly suggests that the agreement was the end result of an orchestrated campaign of harassment of the IRS by Scientology. Its terms indicate a "caving in" to the demands of Scientology and contain unprecedented concessions to the organization. As part of the terms of the agreement, the IRS even agreed to circulate a "Church Fact Sheet" about Scientology to foreign governments, which was prepared by Scientology and contains material false statements. In view of the subsequent secrecy accorded the agreement and supporting documentation by BOTH Scientology and the IRS, the question of whether there was impropriety involved in obtaining the agreement must be asked.

Scientology has a public policy of using the law to harass and punish rather than to win on issues. At the heart of the negotiated deal between the IRS and Scientology is an agreement to effectively end over 2000 lawsuits against the IRS. The bulk of these lawsuits were based on the non-tax deductibility of payments to Scientology by individuals, an issue already brought once to the Supreme Court and ruled in favor of the IRS. Some of the other lawsuits were similarly meritless and other lawsuits were brought against individual IRS agents. All in all, they accomplished Scientology's stated policy of using lawsuits to harass rather than to win.

Scientology has also publicly commented on the fact that it extensively employs private investigators in dealing with its enemies. Accounts from many people have indicated that these PI's are not just gathering information, but furthering Scientology's goals of using harassment as a tool for dealing with enemies. There are also allegations of criminal acts committed by at least one of their PI's in carrying out Scientology's wishes. Scientology has sued individual IRS agents in its quest for tax exempt status and undoubtedly employed its PI's in attempts to find any

dirt they can on IRS employees. It has been alleged that Scientology had specific knowledge of wrongdoing of some IRS employees. Was this information used as further leverage against the IRS to accomplish its ends?

Several media accounts have characterized the terms of the agreement as being tantamount to the IRS asking for a token payment in exchange for a cessation of hostilities. Clearly, Scientology brought massive resources to bear in a campaign of harassment of the IRS in order to get its way. Several newspaper articles have questioned whether this sends a signal that it does pay to harass the IRS in order to get what you want. Clearly we need to do something about this.

I believe the steps needed to prevent further abuses of the IRS by organizations, which could potentially bring large amounts of resources to bear on the agency, include the following:

(1) The most important first step is that you continue your efforts to ensure that the IRS deals equitably with all taxpayers

(2) Take steps to ensure proper oversight of the IRS and its agents. This will reduce the possibility that inappropriate behavior may be used as leverage against the agency or its agents

(3) Sunshine disinfects—publicly disclose all but actual taxpayer return information in the Scientology and all other cases like this where non-public agreements have been made. A non-profit organization is in a sense a public trust. In exchange for recognition that the organization is intended to benefit others rather than itself, it is being exempted from a normal obligation that we all have. The public has a right to know upon what basis an organization is operating as non-profit and what arrangements it has made with the IRS to ensure compliance with its obligations (specifically, to operate as a legitimate non-profit entity in lieu of paying taxes). In the case of a church, school, or religious organization they should have a limited expectation of privacy except as to the details of their internal financial dealings. This is the cost of doing business as a public trust.

(4) In the Scientology case, upper management of the IRS bypassed normal approval channels for the Closing Agreement. This introduces a significant possibility of abuse of power. It also gives this specific case a prominent appearance of impropriety, even if none exists in actual fact. Situations like this need proper oversight, possibly requiring approval or review by the Joint Committee on Taxation. I believe that the Joint Committee on Taxation should be asked to immediately review this and all similar cases of irregular Closing Agreements with non-profit entities.

(5) Scientology is a "poster child" for why we need tort reform in this country. As long as an organization like Scientology is allowed to run rampant in abusing the legal system with the time, resources, and cost of litigation to defend oneself against meritless lawsuits being the punishment meted out to the luckless victims of this abuse, one can expect such abuses to continue

(6) Expenditure of significant resources on political lobbying is grounds for denial of non-profit status. Expenditure of significant resources on investigations and litigation initiated by an organization should likewise be grounds for denial of non-profit status.

I thank you for your consideration in this matter. I hope my insights are of some help to you in your current efforts to restructure the IRS. I commend you for doing a very necessary and important job.

STATEMENT OF THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

[SUBMITTED BY ROBERT L. GOLDSTEIN, CPA]

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Director—Tax Policy

James A. Woehlke

INTRODUCTION

The New York State Society of Certified Public Accountants (hereinafter the "Society" or "NYSSCPA"), with over 31,000 members is the largest and oldest state professional CPA professional organization. Our members practice locally, nationally, and internationally as the primary tax advisers to millions of individual and business taxpayers. It is our belief that the Congress, the Internal Revenue Service (hereinafter the "Service" or "IRS"), and we have a common constituency: the American taxpayer. It is from this vantage point that we provide this committee with our comments on H.R. 2676, the Internal Revenue Service Restructuring and Reform Bill of 1997.

The NYSSCPA wrote and testified before the National Commission on Restructuring the Internal Service (the National Commission) and the Senate Finance Committee during the past year. On both occasions, we stressed the profound need for a change in the culture at the IRS from an organization that views itself as a law enforcement agency to a customer-service agency with a law enforcement component. Equally important, the IRS must be viewed as a customer-service agency by the American taxpayer. Since the September 1998 Senate Finance Committee oversight hearings, others, including Commissioner Rossotti, have echoed this call. Though we have often criticized the Service for what we believe to be compelling reasons, we believe that the IRS plays a vital role in our voluntary system of tax compliance, the chief beneficiary of which is our "civil society." We further believe that the vast majority of IRS employees are dedicated workers who do the best job they can with the tools available to them.

Over a long period of time, however, the public's faith in the Service's ability to carry out its mission has eroded. The oversight hearings held by this committee in

September 1997 and the results of the Service's Internal Audit Review of the Use of Statistics and Protection of Taxpayer Rights in the Arkansas-Oklahoma District Collection Function were clearly a wake-up call to the IRS. Since that time, the Service has:

—Instituted monthly problem-solving days
—Dramatically expanded telephone service
—Initiated a review to improve its lien and levy procedures
—Reinforced its prohibition on the use of enforcement statistics in evaluating front-line managers
—Undertaken to improve and expand the Problems Resolution Program
—Resolved the cases involving the four taxpayers who appeared before this Committee in the oversight hearings and has begun to establish new procedures to monitor such complaints. While the steps taken by the Service outlined above are a good beginning, it is clear that new, profound structural and cultural changes are required. We support, in the main, the report of the National Commission, *A Vision for A New Internal Revenue Service, and Internal Revenue Service Restructuring and Reform Bill of 1997* (H.R.2676) passed by the House of Representatives late in 1997. We have been asked for our comments on this proposed legislation to aid in your deliberations. Accordingly, we respectfully submit our comments in the areas of governance, taxpayer bill of rights, and congressional accountability for the Internal Revenue Service.

TITLE I—EXECUTIVE BRANCH GOVERNANCE AND SENIOR MANAGEMENT

The Society believes that fundamental change is required in the governance of the IRS to:

—Change the culture of the Service to one of customer service
—Prepare viable long-term strategic plans
—Design and implement a successful taxpayer system modernization program
—Fulfill its proper role in assisting the Congress in simplification of the tax law
—Hire, train, and retain the highest qualified personnel
—Improve the financial management of the Service
—Utilize private sector expertise

Accordingly, the Society supports the proposal in H.R. 2676 to create an independent Internal Revenue Service Oversight Board ("Board"). In this connection, however, we make the following comments:

1. Some have expressed concern that the Board, with its independent access and reporting responsibility to the Congress, will undermine the effectiveness of the Treasury Department to set tax policy and sow discord in the relationship between the Service, the Treasury, and the Congress. On the contrary, we believe that, with its independence, the Board will have the opposite effect. We believe that this cooperative effort will make the IRS more responsive to public concerns, because through the Board the Congress, the representatives of the people, will be better and more timely informed. We further believe that a private-sector view will enhance, not diminish the information, talent, and expertise available to the Service.

2. We agree with the staggered, five-year terms, which together with the proposed fixed five year term for the Commissioner (Sec.7803(a)(1)(A)) will provide and enhance continuity in the overall management of the Service.

3. Section. 7802(c) enumerates the general responsibilities and specific exclusions of the Board. The section in part states:

(C) General Responsibilities—

(1) In General—The Oversight Board shall oversee the Internal Revenue Service in its administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party.

(2) Exceptions. The Oversight Board shall have no responsibilities or authority with respect to—

(A) the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes and tax conventions,

(B) law enforcement activities of the Internal Revenue Service, including compliance activities such as criminal investigations, examinations, and collection activities, or

(C) specific procurement activities of the Internal Revenue Service.

The exceptions in subsection (2) will seriously impinge on the Board's ability to fulfill the "General Responsibilities" enumerated in subsection (1). How can the Board "oversee" the management, conduct, direction, and supervision of the execution and application of the internal revenue laws and related statutes if they are constricted by the exceptions in (2)?

We are in full agreement with the concept of taxpayer confidentiality and do not believe that the Board should have access to specific taxpayer information. However, to effectively oversee and assist in changing the culture of the Service, the Board must have some responsibility for overseeing the "law enforcement activities of the Internal Revenue Service including compliance activities such as criminal investigations, examinations, and collection activities." In addition, it seems logical to us that the Service would welcome the input of the Oversight Board in procurement activities, certainly to the extent that it affects the Board's mission.

Our objections to this section would be alleviated by the insertion of the word "specific" in two places as follows:

> (2) Exceptions-The Oversight Board shall have no specific responsibility or authority with respect to—* * * (B) law enforcement activities of the Internal Revenue Service, including compliance activities such as specific criminal investigations, examinations, and collection activities. [Emphasis added.]

Without such a change, the Board will be reduced to consulting on strategic plans and reviewing operational functions (see testimony of Commissioner Rossotti, January 28,1998, regarding General Governance). We do not believe that this was the intention of the National Commission. Nor do we believe such a limited scope will result in a Board that would be adequate to the task of changing and subsequently monitoring changes to the culture of the Service.

4. Much has been written about the potential for conflict of interest of part-time Board members who would earn the bulk of their livelihood in the private sector. The Board is to focus on overall governance of the IRS and (even with the suggested changes to the legislation above) would not deal with the day to day decisions or specific law enforcement matters. We do not foresee this as a problem since as ?special governmental employees," Board members would be subject to existing conflict-of-interest rules. There are, therefore, adequate safeguards in the law.

TAXPAYER ADVOCATE

We have previously written and spoken enthusiastically in support of the Problems Resolution Program. The beneficial impact of the Taxpayer Advocate and the Problems Resolution Process has been made abundantly clear in testimony before the National Commission and the Finance Committee. We heartily support the measures in H.R. 2676 and acts by the Service to strengthen and expand this program.

However, we strenuously disagree with that portion of H.R. 2676, which would prohibit the Taxpayer Advocate from accepting any employment with the Service for at least five years after ceasing to be the Taxpayer Advocate. This prohibition will discourage talented career IRS employees, who are not near retirement, from seeking this position. Further, it is exactly the culture, training, and ability to pragmatically solve problems embodied in the Problems Resolution program, which is so necessary to the rest of the Service. Why would the Congress wish to deny this asset, an experienced former Taxpayer Advocate, to the Service?

TITLE III—TAXPAYER PROTECTION AND RIGHTS

We substantially support the expansion of taxpayer rights, also known as Taxpayer Bill of Rights 3. ("TBOR 3") We do have comments regarding specific portions of the TBOR 3.

1. To remove a serious trap for the unwary, we strongly encourage the passage of Section 341-Privilege of Confidentiality Extended to Taxpayer's Dealing With Non-Attorney Authorized to Practice Before Internal Revenue Service. Taxpayers choose from among several types of professionals when seeking tax advice. Most prominent among tax advisers are attorneys, CPAs, and enrolled agents. Currently, taxpayers need to be wary in making this choice, because only confidential communications between a taxpayer and an attorney are protected from discovery by the government. This protection resulted from the ages-old legal doctrine called attorney-client privilege. Because of this situation, taxpayers occasionally fall into a trap. To correct a previous tax-filing error, a taxpayer might seek out a tax adviser and confide in a CPA or enrolled agent the circumstances of his or her error. In so doing, the taxpayer relates informa-

tion that is later discoverable by the government. Had the taxpayer first sought the advice of an attorney, the communication would not have been discoverable. Section 341 would remove this unfortunate trap for the unwary.

2. We also support section 312-Civil Damages For Negligence In Collection Actions. However, we suggest that a procedure be developed to settle such matters if the IRS acquiesces in and is desirous of avoiding the costs and risks of litigation. We recommend that the provision be expanded to cover wrongfully filed tax liens.

3. Regarding section 321-Spouses Relieved in Whole or In part of Liability in Certain Cases-we suggest that this provision be made retroactive to cover tax returns filed for the three years prior to the date of enactment.

4. We suggest that section 346-Offers-In-Compromise-be amended to reflect that revenue officers are encouraged, not just allowed to use their discretion to permit variations from local and national standards when the circumstances are appropriate. We believe that the national and local standards should be updated annually for changes in the cost of living. Offers that are deficient in a clerical matter or have nonmaterial omissions should not be rejected outright. Rather, the revenue officer should contact the taxpayer or his or her representative in an attempt to secure such information before rejecting the request

5. Concerning section 376-Limitation of Penalty on Individual's Failure To Pay For Months During Period of Installment Agreement-we believe that there should be no penalties while the installment agreement is in effect and the taxpayer is fulfilling his or her obligations. To assess penalties in these situations is counterproductive to the process of bringing the taxpayer's obligations current. These taxpayers often desperately want to comply with tax obligations, but their financial limitations preclude them from complying as quickly as they would wish.

6. Regarding section 381-Review of Penalty Administration and Development of Recommendations-we recommend that the review address all penalty issues and include abatement practices.

7. You should not include Section 301—Burden of Proof—in the TBOR 3. Unlike a criminal matter, it is the taxpayer who asserts the positions taken on his or her tax return. It is, therefore, incumbent on the taxpayer to provide the support for the positions he or she asserts. This provision would shift the burden of proof under certain conditions in court proceedings. Relatively few taxpayer audits result in litigation; so relatively few taxpayers would be impacted by this proposed change. Yet, we anticipate the change will result in significant changes in tax auditor behavior that will adversely impact all audited taxpayers. Among the behavioral changes we anticipate are

A. Agents will feel compelled to make broad document requests during examination to assure that they have taken all precautions to have sufficient documents in the event of a burden shift

B. To protect the government from the eventuality of a burden shift, Revenue Officers will begin asking for excessive documentation to put the taxpayer in the position of being unable to satisfy the conditions for a burden shift.

C. The question of whether the taxpayer has fully cooperated and provided sufficient documentation will now become another area for an already overburdened court system to consider.

We suggest the following additional provisions should be added to the TBOR 3:

1. Interim extensions (July 15, for partnerships and trusts and August 15, for individuals) should be eliminated and the initial extensions should be for six months. There is already only one six-month extension for corporations. This change would have no cash flow effect to the government, as any tax due for trusts or individuals is paid with the initial extension. Second extensions create no pressure for early filing, as the practitioner can sign them and they are routinely granted. These second extensions must be signed and mailed by the practitioner, received by the IRS, posted to the system, stamped approved and mailed back to the taxpayer or the representative. The entire process is a complete waste of time and cost for both the IRS and the practitioner. The elimination of these extensions would also be consistent with the Paperwork Reduction Act.

2. Powers of Attorney are a perennial source of irritation in relations between the Service and the practitioner community. We recognize the absolute right of every taxpayer to privacy and confidentiality, as well as the great care the Service must take with these issues. Nevertheless, Congress should give consideration to a "check-the-box" power of attorney or "tax information authorization," whereby the taxpayer can check a box on the tax return at the time of filing

giving the IRS permission to discuss the contents of the tax return with the preparer who has signed the tax return. In the event that the taxpayer changes accountants and such communications are required, a standard power of attorney can be filed superseding the one on the tax return.

TITLE IV—CONGRESSIONAL ACCOUNTABILITY FOR THE INTERNAL REVENUE SERVICE

1. H.R. 2676 calls for two hearings a year to be attended by representatives of all the congressional committees and subcommittees charged with IRS oversight. While this is a step forward, there is nothing in this legislation which either coordinates the activities of these committees and subcommittees with a view to avoiding duplication or overlapping investigations and hearings. Further, there does not appear to be a mechanism for the coordination of the reporting responsibilities of the Oversight Board or the Taxpayer Advocate to the various committees of the Congress.

2. The complexity of the tax law is a major problem for the Congress to address. While the complexity of the tax law is not at the root of controversies between the IRS and the practitioner community and taxpayers, it does exacerbate the Service's challenges in administering the tax system and the taxpayers' difficulties in comprehending and meeting their tax obligations. There is also a very large backlog of Treasury Regulation projects. The IRS needs to issue regulations and other guidance so that taxpayers and representatives know the Service's position on issues to make compliance both more likely and consistent.

We believe that this complexity leads to inadvertent noncompliance and the creation of an adversarial atmosphere between the taxpayer and the Service. Over the past decade, the CPA and legal professions have submitted numerous meaningful simplification proposals to the Congress. The AICPA developed a "complexity index" for use by policy makers in designing tax laws.

Proposed tax law changes should not be enacted without the Congress first securing from the IRS a draft of tax form changes that would be required. This discipline would help avoid complexity. The professional staffs of the Congress should consult with practitioner organizations on a regular basis, in connection with writing of new tax legislation so that the compliance effect of dealing with legislative proposals would be clearer to members of the staff. Further, the practitioners may be able to suggest ways for the Congress and their staffs to accomplish their objectives in a simpler manner without sacrificing fairness or sacrificing the objective of the legislation.

We thank the Committee for allowing the NYSSCPA to present the views and suggestions of its members. We are prepared to assist you in any way that you deem relevant to reform the IRS into a true taxpayer service agency.

STATEMENT OF AMY M. POWERS, LITTLETON, CO

At the encouragement of my family and the recent publicity of the IRS hearings, I would like to bring your attention to my experiences with the IRS and a joint tax return I signed 11 years ago. I have summarized my current negotiations with the IRS and have also listed the other individuals and attorneys I have contacted. Following that, is the history in detail of my contact with the government over the past 11 years.

My current situation is this. I have submitted an Offer and Compromise which has taken nearly a year and a half to be approved. The first offer of $8,000 (the original taxes assessed on the 1986 joint return) was rejected, but my recent counter offer has been accepted and my deadline to pay the sum of $25,000 is March 15, 1998. The $25,000 represents more than half of the amount due ($42,000 with interest and penalties). I am in the process of obtaining funds to meet this deadline, and I—as much as I do not want to pay one dime—I realize I may have to continue in this direction and meet the deadline, while at the same time seek action against the IRS or support from other members of the government and the public sector.

I have written to or contacted the following individuals:

- Senator Allard, CO
- Senator Campbell, CO
- Ms. Gayla Russell, CPA (pro-bono work for innocent spouses), FL
- David Keating, Attorney with National Taxpayers Organization, Alexandria, VA
- Peter Moison, current Attorney, Denver, CO

With the March 15th deadline quickly approaching, I am torn between reneging my Offer and Compromise which would ultimately give rise to a more aggressive stance from the IRS and/or pursuing a greater support structure from my local Senators, the Senate Finance Committee, and other activist groups supporting the thou-

sands of other women who face the same risks. I am sure with the recent publicity, the government's sense of urgency to collect this money is just as great as mine not to pay and succumb to their threats. However, I do have a family and other bills and do not want to jeopardize my current financial standing.

Meanwhile, my ex-husband also submitted an Offer and Compromise which was subsequently rejected and he in turn declared bankruptcy.

Detailed History:

Below I have documented the key events throughout these 11 years.

Eric R. Hammond (ERH): I met ERH in 1984 while attending Principia College in Illinois. Eric attended one quarter that year. While attending Principia, he was also working on a computer game as a contractor for Electronic Arts (EA), one of the most successful video entertainment companies today located in Northern California. Eric was asked to return to California to complete the final details of his project. The game he created was "One-on-One with Larry Bird and Dr. J." At the time, it was the highest grossing game for EA and Eric, consequently, was making royalties and was extremely successful. After One-on-One, Eric worked on a football game for EA, as well as some others. He maintained a contractor status. All of this success came before we were married. In other words, the finances in question resulted in his earnings prior to our marriage.

Key Dates:

July 26, 1986—Amy McCain married Eric Rayburn Hammond (ERM) in California.

April 1987—Filed taxes for 1986, owing approx. $8,000. Signed joint tax return. I believe ERH did the taxes himself. In past years, his mother had done his taxes. I also believe these were quarterly taxes. In 1986, I was working for a department store part-time and taxes were appropriately being deducted. ERH was not working at this time.

September, 1987—Separated from ERH and moved to Atlanta. ERH did not want to be married anymore and I had a good friend in Atlanta. We had an amicable separation. Our divorce was finalized in February.

April, 1988—I filed my 1987 tax return in Georgia. I filed "Married—Filing Separate."

January, 1989—Sought legal council on divorce process. ERH and I discussed the process and he agreed to take full responsibility for any debt we had incurred while married (IRS and any credit cards). The papers were drawn up and included, was a paragraph stating he would be responsible for said debt.

February, 1989—Both parties signed divorce papers.

April, 1989—I filed by 1988 tax return in Georgia. I filed "Single."

1990—ERH joined the U.S. Navy—joined the U.S. Navy Seals. He was in for approximately 6 months when he quit. It is my understanding, from a conversation we had and one his mother had with my mother, that the U.S. Navy made a deal with ERH to "overlook" his past debts with IRS and tax liens because on his entrance exam he scored a perfect score.

April, 1990—I filed by 1989 tax return in Georgia. I filed "Single."

April, 1991—I filed by 1990 tax return in Georgia. I filed "Single."

April, 1992—I filed by 1991 tax return in Georgia. I filed "Single."

During this period from September, 1987 to November, 1992, I received NO communication from the IRS regarding any debt or any back taxes owed.

November 3, 1992—Received a certified letter from the IRS demanding payment of approximately $35,000 for a 1986 tax return.

November 4, 1992—Contacted law offices of Chamberlain, Hrdlicka, White in Atlanta. Obtained legal council from Scot Kirkpatrick and Joe Odom. They were given power of Attorney and communicated my stance to the IRS. They did not pursue—in fact, they asked for assistance from me to located ERH.

November, 1992—Requested copy of 1986 tax return and detail concerning it from the IRS. Request was denied.

November 24, 1992—Submitted another letter to IRS agent J. Gonzales and Judy Martin requesting same information.

December 16, 1992—Finally received 1986 income tax transcript.

November 28, 1992—Married Justin C. Powers in Denver, Colorado.

January, 1993—Conversation with ERH and Joe Odom. ERH was contracting again for Electronic Arts. Was working with Mr. Gonzales, IRS agent, to make payment arrangements.

February 5, 1993—Letter to Mr. James Austin, Atlanta IRS agent, explaining current situation.

January, 1994—Requested another transcript of 1986 income tax.
July 1, 1994—Justin and I moved to Denver. We were expecting our first child.

During this period of approx. 2 years (January '94 to March '96, I received NO communication from the IRS.

March 25, 1996—Received another letter from the IRS demanding payment of approx. $40,000 for 1986 tax debt.
June, 1996—Obtained legal council from Peter Moison and Marty Green, attorneys. The IRS took a very aggressive stance right away. On advice of my attorneys it was time to "accept" the responsibility and pay the piper. Also during this time, I inadvertently received a copy of an "Investigation History" from Willy Wilcox, IRS agent. It revealed that the IRS was also going after ERM's current wife, Cindy Siegmund Hammond.
July 31, 1996—Received notice from the IRS to Levy wages and salary. Notice also went to employer.
August 6, 1996—Submitted Offer in Compromise to IRS to pay original debt of $8,000.
August 13, 1996—Received letter from IRS to release Levy on wages.
August 28, 1996—Offer returned from IRS with letter stating, ". . . originals must be submitted, no facsimiles or copies . . ."
Resubmitted Offer
November 14, 1996—Offer returned again. Apparently submitted on an "obsolete" form.
February 5, 1997—Resubmitted Offer again.
I may be pointing out the obvious here, but with the "pettiness" of an original carbon conform vs. a photo copy (which this attorney has used in the past) just highlights more of the waste, fraud and quasi-extortion within the IRS.
April 30, 1997—Received letter from IRS—notifying me of an overload in offer investigations and an offer investigator will be contacting me by May 24th.
May 14, 1997—Received letter—Offer has been assigned to Robert Evers, IRS. I am requested to pull together personal financial information.
May 19, 1997—Notice of Federal Tax Lien assessed against me.
June 19, 1997—Submit personal financial data and letter to Robert Evers.
October 10, 1997—Received letter from IRS—still reviewing Offer.
November 17, 1997—Receive letter from Robert Evers. Offer was rejected and they (IRS) were prepared to go the next step. They assessed my earnings and those of my husband's too, and determined I could afford to "pay in excess of $27,000."
January 30, 1998—Resubmitted Offer in Compromise to IRS to pay $25,000.
March 15, 1998—Deadline for $25,000 payment to IRS.

So there is the history and based on these dates, I would like to add a few comments.

Once I moved to Atlanta in 1987, ERH and I still kept in touch. He would move around from place to place—sometimes staying with friends. I believe the IRS was attempting to collect from him and I also believe that was the reason for his travels. I also understand that the 1986 tax debt is not his only outstanding debt to the government.

What I find ironic is that I maintained 3 residences in the city of Atlanta for almost seven years and filed tax returns dutifully each year, and yet was never notified of this debt. It was as if the seven year statute was ready to expire and uppopped my name in the computer as someone to start collecting from. One would assume that a joint-return would entitle me to copies of correspondence over the past 11 years. I have discovered the hard way that the IRS does not have to same assumption. I was told through my attorney that one IRS agent said . . . "if this was such a concern of hers, she should have contacted us."

Furthermore, within the last week, my attorney submitted a request to the IRS to obtain copies of Eric's Offer and Compromise and any correspondence the IRS had with him. We discovered another communication barrier within the IRS. My Power of Attorney is not "good enough" for the IRS and therefore they responded to the request stating that I, personally, must submit the request. This is just another example of the waste, fraud and corruption within the system. Meanwhile, interest and penalties continue to increase.

I respect the laws of the government and for the most part believe in the basic principles of the IRS, however, I must now side with the thousands of other women in the same situation. It is not right for the IRS to hold any spouse liable for past debt, especially if it is unknown to the other spouse. I recall from recent hearings that a judge ruled against one women because she had a bachelor's degree and should have "known better" about her ex-husbands fraudulent investments. What does one have to do with the other?! My ex-husband wrote computer games and

made close to $80,000 for a few years. He did not have a college degree. And because I have a degree, the IRS sees my earning potential greater than his.

Moreover, I believe there has been a significant effort put forth to track me down, as opposed to my former husband, Eric Hammond. And in one instance in Atlanta, an IRS agent left his business card in the front door of my house with a message reading " . . . call be before midnight. You can reach me at home . . . ." Unfortunately, we never used the front door and we discovered the card several weeks after it had been left there. Additionally, the IRS has on several occasions contacted me to help them locate Eric.

Understanding that I did sign a joint return, my total income for the year in question was substantially less than that made by my former husband and the withholding from that income more than covered my share of the tax liability. My former husband has demonstrated the ability to earn a considerable income at a very young age and I strongly believe this was not a "once in a lifetime opportunity." I know what he is capable of earning and believe he should be forced to do so, as I am.

In closing, I would like to add that I am remarried and have been for 5 years and have a 3-year-old daughter. After 11 years, I do not feel that my husband should, in anyway, be held responsible for this so-called debt. This situation has strapped us financially and we have been forced to access our retirement accounts, as well as a bank loan to pay this off. Meanwhile, my ex-husband has declared bankruptcy. And as far as I can tell, the IRS has given up on him. Wouldn't jail be the next logical step?

I thank you for speaking with me and encouraging this letter and as I mentioned, I am willing to participate in any future hearings that may be planned and could be in Washington, D.C. with a day's notice.

STATEMENT OF THE SECURITIES INDUSTRY ASSOCIATION

The Securities Industry Association ("SIA") appreciates the opportunity to submit written testimony on the proposals to restructure the Internal Revenue Service. We commend Chairman Roth and all the members of the Committee for holding these extensive hearings on the proposals to restructure the Internal Revenue Service.

The SIA brings together the shared interests of nearly 800 securities firms throughout North America to accomplish common goals. SIA members—including broker-dealers, investment banks, specialists, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. Many of these firms are small businesses that affiliate with entrepreneurs who provide financial planning and/or accounting services as well as stock brokerage services. In the United States, SIA members collectively account for approximately 90 percent, or $100 billion, of securities firms' revenues. They manage the accounts of more than 50 million investors directly and tens of millions of investments indirectly through corporate, thrift, and pension plans.

The securities industry provides taxpayers with information that enables them to file timely and accurate returns—an important role in the tax filing process. We also provide the IRS with similar information that enhances the agency's ability to administer the federal tax laws. The securities industry is proud of our extensive compliance efforts, and of the cooperative spirit in which we have worked with the IRS to assure that taxpayer income is fully reported. IRS statistics bear out the fact that compliance levels for securities industry filings are very high.

We strongly believe that changing the current information return deadline would benefit both taxpayers and the IRS, and substantially improve the tax filing process. We urge the Committee to thoroughly review the process and timetable for delivering information returns.

Role of Securities Firms In Tax Filing Process

The securities industry is a major filer of information returns, providing returns each year to 50-million investors. Our firms pride themselves on their track records for accuracy and timeliness. Nevertheless, a number of factors contribute to the need for payers to file amended and corrected returns after the original due date. Amended and corrected returns are a processing and compliance nightmare, which cost taxpayers, financial firms, and the IRS a tremendous amount of money, time, and effort.

The most significant contributing factor is the short time frame for processing and providing information to taxpayers. Even under optimal circumstances, it is difficult to meet the current deadlines. While payers have until January 31 to mail information returns to payees, most large firms must cease processing on or about January 15. This is necessary to ensure sufficient time to print, insert, and mail millions of

consolidated information reporting forms by the required mail date. Since this information is not available before year end, there is not much time to review the integrity of the information being sent. If processing problems arise, and they frequently do, securities firms have only a few days to correct such problems before they are required to provide amended and corrected returns.

Secondly, the financial information required to be reported is not only generated internally, it is also collected from outside sources. The most significant outside information relates to the characterization of distributions from Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs). Income classifications (e.g., capital gain versus ordinary dividend) are normally not available from the companies themselves until the second week in January, leaving virtually no processing time. Moreover, these initial classifications/allocations are frequently wrong, causing mutual funds and securities firms alike to file amended returns with their shareholders and investors.

Classification information is not only limited to REITs and RICs, but extends to corporations as well. Corporations may also change the taxability of their distributions due to insufficient earnings and profits or other corporate actions (e.g., taxable mergers, exchanges, spin-offs, and other reorganizations). Again, the securities industry is at the mercy of these companies to provide this tax reporting information during the first two weeks of January. If such firms fail to meet this deadline, corrected and amended returns must be sent to payees and the IRS.

Finally, the information that is provided from outside sources is provided on paper, and not in a uniform format. Once received, securities firms must take the information, format it, create computer-readable files to analyze, and prepare Forms 1099. While the securities industry has worked with other industry groups and vendors to provide a standardized flow of information, the result has been less than perfect. Consequently, this limitation adds further stress to a process that is already overburdened.

Need To Change Information Return Deadline

Beginning with the Revenue Act of 1962, payers have been required to provide information returns to the IRS and payees. Since then, information reporting requirements have exploded in scope and complexity. Most recently, for example, the Tax Reform Act of 1997 required that capital gain distributions from RICs and REITs be classified for 1997 as either long-term, mid-term, and unrecaptured Section 1250 capital gains. Obtaining this information from all RICs and REITs, and developing a means of effectively conveying it to investors, will be a tremendous challenge since current 1099 Forms do not accommodate this type of information.

While reporting requirements have increased, so too have the number of taxpayers receiving the information. Tens of millions of middle-class Americans have invested in the market over the past fifteen years as the Dow Jones average has soared from 800 to more than 8,000. According to a NBC/Wall Street Journal poll published last year, 51 percent of adults say they own stock shares or mutual funds. The growth in mutual fund shareholders confirms this trend. The total number of mutual fund shareholder accounts increased from 24.6 million in 1983 to 151.0 million in 1996. In light of the ever-increasing complexity of reporting, increasing numbers of investors, and inadequate time frames for providing information, there is little doubt that if the deadline for providing returns is not extended, the trend towards amended and corrected returns will continue.

Recommendation

Accordingly, SIA recommends that Congress facilitate the flow of timely and accurate information returns to taxpayers and the IRS by changing the mailing date of Forms 1099 to February 15 from January 31, and the filing due date to the IRS from February 28 to April 15. This recommendation is consistent with the proposal contained in the National Commission on Restructuring the Internal Revenue Service. These changes in the mailing and filing dates would dramatically reduce the number of amended and corrected returns provided to taxpayers and the IRS since payers will have more time to ensure the integrity of the information provided. This reduction in corrected returns will enable taxpayers to file their tax returns correctly the first time, instead of having to file amended returns in order to "get it right." Similarly, such a reduction will minimize the number of IRS inquiries due to mismatched income amounts, as well as reduce the processing that multiple tax filings require of the IRS. In short, such a change will save taxpayers, financial firms, and the IRS significant resources while making the process more efficient.

STATEMENT OF JAMES I. SHEPARD, FRESNO, CA

The issue which I wish to address is the provision of H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997, that would change the burden of proof in trials in Tax Court.

When a taxpayer files an income tax return he or she affirmatively states in writing that the amount of tax shown is the correct amount due. Currently, if questioned on audit, should the taxpayer chose to file a petition in Tax Court the taxpayer bears the burden of proof on the only issue before the court, what is the correct amount of tax due. My concern for the proposed change arises from my experience as both a tax practitioner and a tax lawyer. For more than 20 years, as a lawyer in Denver, Colorado, and Allison, Iowa, and as a tax consultant with an accounting firm in Fresno, California, I prepared state and federal income tax returns as part of my practice. During this time I attended countless audits on behalf of my clients, processed administrative appeals and tried cases in Tax Court. Based on my experience and my knowledge of the taxpayers' attitude, I am strongly opposed to the change in the burden of proof and urge the Senate to reject that part of the bill.

My concerns are as follows:

1. The Change Will Cause a Revenue Loss. If the proposed change is made, tax practitioners across the country will find that their clients will be more aggressive in their attitude, particularly in claiming deductions. As the taxpayers learn that the IRS has the difficult task of proving the unknown, taxpayers will begin to deduct questionable or improper expenses knowing that the IRS may never audit the return, but more importantly, may never be able to prove that a claimed deduction is illegal. The revenue loss arising from a change in public attitude of this nature may not be immediate, but it is inevitable.

2. The Revenue Loss Will Flow Through to the States. Because most state income taxes are computed by reference to the adjusted gross income shown on the federal income tax return, the shift in the burden of proof will cause a loss of income tax revenue to the states.

3. Small Taxpayers Bear the Burden of Revenue Loss. Perhaps more importantly, is that it is natural to expect the wealthier taxpayers to become more aggressive in their tax reporting duties than the smaller taxpayers-the smaller taxpayer is far more likely to decide to pay a tax found due on audit then to litigate a case in Tax Court simply to take advantage of the taxpayer favorable burden of proof. Thus the smaller taxpayers will pay a tax asserted due after an audit, where a deduction is dependent on the taxpayer's intent, for instance, while the wealthy taxpayer will refuse to pay such a tax, being able to pay the cost of going to Tax Court.

4. The Audit Process Will Become Less Efficient. In order to adjust for the loss of revenue, the return examination process will likely become more stringent. As Office Auditors and Revenue Agents become more aware of the change in the burden of proof and the need for detailed information at trial they will require taxpayers to produce more documents and information and to provide detailed narrative reports of transactions. This more stringent examination process will eventually increase the cost of audits and reduce the number completed-the system will become less efficient and more costly, all at the expense of the taxpayers.

5. The Change is Counter-Productive. A likely consequence of the proposed change is that the taxpayer will face more burdensome audits. Office Auditors and Revenue Agents inevitably will adjust their methods to account for the change in the burden of proof, a greater emphasis will be placed on gathering evidence to sustain that burden, should the matter go to trial. The taxpayer will be required to spend more time and effort to provide information designed to satisfy the burden of proof, because it will be more expedient to develop a case at the audit level than many months later when a case is pending in court. Thus, the average taxpayer undergoing an audit will encounter more rigid requirements for the substantiation of deductions and other items reported on their returns.

6. The Voluntary Self-Assessment System of Taxation Will Become Less Effective. The fundamental fatal flaw in this proposal, which appears to be designed more to punish the IRS than to accomplish a meaningful improvement in our tax system, is that we have a voluntary, self-assessment system of taxation. Like it or not, until we change to an involuntary tax system, a national sales tax, for instance, our government is at the mercy of the taxpayer to report the tax which the taxpayer determines to be due.

The principal compliance enforcement mechanism, the taxpayer audit, simply cannot examine every return filed to ensure taxpayer compliance. Thus the system is dependent on taxpayers' properly reporting the true nature of their transactions-the taxpayer not only has all of the books and records but solely possesses most of the knowledge of the nature of the underlying transactions. While the IRS Reform bill makes certain provisions for requiring the taxpayer to produce books and records, books and records which the taxpayer creates and which may be of questionable veracity, where the proper tax is dependent on a taxpayer's intent it may likely be impossible for the IRS to demonstrate the absence of a claimed intent. Whether an expense is business or personal in nature, or whether property was used in the taxpayer's business, for instance, are questions often dependent on the taxpayer's intent which cannot be disproved by use of books and records. The present system accounts for these factors by requiring the taxpayer to sustain the burden of proof where the court is able to judge the taxpayer's veracity when testifying about such transactions-if the court finds the taxpayer's testimony believable it will find for the taxpayer. Requiring the IRS to call a taxpayer to testify to prove a negative is an entirely different matter.

The Internal Revenue Code is replete with instances in which the taxation of a particular transaction is dependent on "all facts and circumstances." Many of the "all facts and circumstances" situations are heavily dependent on the taxpayer's intent. To require the IRS to prove the absence of a specific state of mind creates a loophole for the wealthy taxpayer through which countless dollars of revenue will disappear.

7. Tax Professionals Oppose the Change. Every accountant, tax lawyer or knowledgeable individual with whom I have discussed the issue agrees, the burden of proof should not be changed. Further, a Tax Advisory Committee, a group of experienced, knowledgeable tax professionals and educators appointed to assist the National Bankruptcy Review Commission, adopted a proposal to specify that the debtor-taxpayer would bear the burden of proof in the determination of tax makers in bankruptcy court, consistent with the current rule in Tax Court. The Commission unanimously adopted the proposal. This proposal is based on the knowledge that forcing the taxing authority to prove what only the debtor-taxpayer knows creates an opportunity for coercive style litigation tactics, prevarication and, in many cases, outright fraud.

8. The Lawyers are the Big Winners. Section 301 of H.R. 2676 provides that the burden of proof shifts to the IRS when, "the taxpayer has fully cooperated with the Secretary with respect to such issue, including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the Secretary, . . ." (Emphasis supplied). The italicized portions of the proposed statutory language are open invitations to litigation-none of these terms are subject to ready definition and all potentially require judicial determination in every case.

STATEMENT OF JONATHAN R. SIEGEL

FEBRUARY 5, 1998.

Senator WILLIAM V. ROTH, JR.,
Hart Senate Office Building,
U.S. Senate,
Washington, DC.

Dear Senator Roth: You solicited my opinion regarding the constitutionality of some provisions of H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997. I am very happy to provide this reply.

EXECUTIVE SUMMARY

I conclude, first, that members of the IRS Oversight Board contemplated by the bill would be "officers" (or at least "inferior officers") of the United States subject to the Appointments Clause of the Constitution.

I next conclude that the provision requiring the President to appoint a "union representative" as a member of the Board would probably not be held unconstitutional by a court. Courts could take the view that provisions restricting the President's appointment power are constitutional because they are best viewed as nonbinding expressions of the Senate's intentions regarding confirmation of nominees. Moreover, a challenge to the provisions is unlikely to arise in any justiciable form. In addition,

even if the restrictions in the appointment provision would be binding, they could be "reasonable and relevant qualifications," which the Supreme Court has suggested are permissible.

Finally, I recommend deleting the provision requiring the removal of the "union representative" from the Board upon the termination of that member's association with the union. This provision would give a private group the power to remove a federal official from office. Such an arrangement would, so far as I am aware, be unprecedented. It would combine two constitutional concerns: delegation of power to private parties and interference with the President's control over executive officials. While there are reasonable arguments that this provision is constitutionally permissible, it would pose a significant risk of undermining actions taken by the Oversight Board.

THE STATUTORY PROVISIONS IN QUESTION

You asked about two provisions of the bill relating to the appointment of members of the Internal Revenue Service Oversight Board that the bill contemplates. The first states that one member of the Board must be "a representative of an organization that represents a substantial number of Internal Revenue Service employees and who is appointed by the President, by and with the advice and consent of the Senate." The other states that this member would be removed from office "upon termination of employment, membership, or other affiliation" with said organization. See H.R. 2676, § 101, which would be codified at 26 U.S.C. § 7802(b)(1)(D), (b)(4)(C).[1]

In my opinion, these provisions of the bill raise three constitutional questions. First, would members of the proposed IRS Oversight Board be "officers" or "inferior officers" of the United States to whom the Appointments Clause of the Constitution would apply? Second (assuming the answer to the first question is yes), would the appointment provision improperly interfere with the President's appointment power? Third (again assuming the answer to the first question is yes), would the removal provision impermissibly grant authority to a private entity to remove a federal official?

1. The Powers of the Oversight Board Would Make Its Members "Officers" (or at Least "Inferior Officers") Subject to The Constitution's Appointments Clause

The first question is whether members of the IRS Oversight Board would be "officers" (or "inferior officers") of the United States to whom the Constitution's Appointments Clause would apply. An appointee who exercises "significant authority pursuant to the laws of the United States" is an "officer" subject to the Appointments Clause. *Buckley v. Valeo,* 424 U.S. 1, 126 (1976). By contrast, if an agency's powers are "of an investigative and informative nature, falling in the same general category as those powers which Congress might delegate to one of its own committees," so that the agency's functions are "merely in aid of the legislative function of Congress," then the agency's members may be appointed in any manner that Congress may provide. Id. at 137-39.

The current text of H.R. 2676 leaves some ambiguity as to the nature of the Oversight Board. The Board's "specific responsibilities" are listed in § 7802(d). Some of these responsibilities could, plainly, be exercised by persons not appointed in accordance with the Appointments Clause. For example, under the bill, the Board would have the responsibility to "recommend to the President candidates for appointment as Commissioner of Internal Revenue and recommend to the President the removal of the Commissioner." § 7802(d)(3)(A). Since any citizen could make such recommendations, and since there is no requirement in the bill that the recommendations be followed, these functions would not by themselves make the Board members constitutional officers. Similarly, the Board's role in the preparation of an IRS budget request, which would be transmitted to Congress together with the President's budget request for the IRS, § 7802(d)(4), could reasonably be characterized as action taken "in aid of the legislative function of Congress," since the budget request would not, by itself, have any operative effect. The Board's power to "review" the operational functions of the IRS, § 7802(d)(2), would seem to be in the same category.[2]

The status of some of the Board's other responsibilities is less clear. The bill provides that the Board would "review and approve" strategic IRS plans. § 7802(d)(1) (emphasis added). The words "and approve" suggest that the Board would have power to affect actual IRS operations. However, the bill does not clearly establish what would follow from the Board's refusal to approve a strategic plan. Similarly, it is not clear whether the Board's general responsibility to "oversee" the IRS, § 7802(c)(1), entails power to affect actual IRS operations, or whether this responsibility is akin to the oversight of executive agencies routinely carried out by congressional committees.

However, there is one specific responsibility of the Board and one other power that it would have that lead me to conclude that the Board's members would be subject to the Appointments Clause. The first is the Board's responsibility to "review and approve the Commissioner's plans for any major reorganization of the Internal Revenue Service." § 7802(d)(3)(C). The natural interpretation of this provision would be that the Commissioner could carry out a major reorganization of the IRS only with the approval of the Board. Turning to the House Report for additional guidance confirms this conclusion. The Report provides that "[w]ith respect to those matters over which the Board has approval authority, the Board's decisions are determinative." H.R. Rep. No. 364, 105th Cong., 1st Sess. [hereafter House Report] 36 (1997) (emphasis added).

Construing the text of H.R. 2676 together with the House Report, it therefore appears that the Board's decisions would affect actual IRS operations. The Commissioner, for example, would be unable to effect a major consolidation of IRS regions or districts without Board approval.[3] The power to block the IRS Commissioner on a major decision of this kind is certainly an important executive power that Congress could not delegate to one of its own committees, because it would "alter[] the legal rights, duties, and relations of persons . . . outside the legislative branch." *Immigration & Naturalization Service v. Chadha,* 462 U.S. 919, 952 (1983).

In addition, under H.R. 2676 the Board's approval would be required for the appointment of the Taxpayer Advocate. See § 102, which would be codified at 26 U.S.C. § 7803(c)(1). The Taxpayer Advocate has significant executive power under 26 U.S.C. § 7811 and is therefore a constitutional "officer" or "inferior officer." Since Congress could not assign to itself or one of its committees the appointment of executive officers, see *Buckley v. Valeo,* supra, the role of the Board in the appointment of the Taxpayer Advocate further demonstrates that its members would be subject to the Appointments Clause.

Some clarification of the Board's authority to affect actual IRS operations might be desirable. However, for the reasons given above, I conclude that the members of the Oversight Board would be "officers" (or at the least, "inferior officers") of the United States subject to the Appointments Clause of the Constitution[4] and to other separation of powers principles governing executive officers.

2. It is Unlikely that a Court Would Hold the Appointment Provision to Be Unconstitutional

H.R. 2676 provides that the President, by and with the advice and consent of the Senate, must appoint as one member of the IRS Oversight Board "a representative of an organization that represents a substantial number of Internal Revenue Service employees." § 7802(b)(1)(D). The question is whether this restriction impermissibly interferes with the President's appointment power. Although the question is difficult to answer with confidence, because the constitutional issues raised by statutory restrictions on the President's appointments power have never really been decided by the Supreme Court or even by courts of appeals, I conclude, for three different reasons, that courts would be unlikely to hold this appointments provision unconstitutional.

a. The Appointment Provision, Viewed as a Nonbinding Expression of the Senate's Intentions Regarding Confirmation of Nominees, Would be Constitutional

The Constitution provides that the President shall appoint all officers of the United States whose appointments are not otherwise provided for. U.S. Const., art. II, § 2. Justice Kennedy has concluded that the Constitution gives "[n]o role whatsoever . . . either to the Senate or to Congress as a whole in the process of choosing the person who will be nominated for appointment" and that the judiciary should not "tolerate any intrusion by the Legislative Branch" into powers that the Constitution textually commits to the President. *Public Citizen v. United States Department of Justice,* 491 U.S. 440, 483-485 (1989) (Kennedy, J., concurring).[5]

On the other hand, the Constitution grants the Senate an important role in the appointments process. The President's power is to appoint officers "by and with the Advice and Consent of the Senate." U.S. Const., art. II, § 2. The Constitution places no restrictions on the Senate's Advice and Consent authority. The Senate may reject or approve the President's nominees "for whatever reason it deems proper." *Federal Election Comm'n v. NRA Political Victory Fund,* 6 F.3d 821, 825 (D.C. Cir. 1993), cert. dismissed, 513 U.S. 88 (1994).

Putting these two points together, one may conclude that statutory restrictions on the President's ability to appoint executive officers who are subject to Senate confirmation are constitutional because they are best viewed as nonbinding expressions of the intentions of the Senate regarding its exercise of its Advice and Consent

power. That is, an apparent statutory restriction on the President's appointment power should not be viewed as imposing an actual legal barrier to the appointment of any candidate of the President's choosing. Rather, it should be viewed as an advance statement of the Senate's intention to reject any nominee who does not meet stated criteria.

This view is suggested by the D.C. Circuit's opinion in *NRA Political Victory Fund, supra.* In that case, the court observed that congressional limitations on the President's appointment power may raise serious constitutional questions and that Presidents have often viewed such limitations as not being legally binding. See 6 F.3d at 824. However, the court also noted that such legislation may impose "political restraints" because of the Senate's power to reject a presidential nominee for any reason. Id. at 825. The court observed that a Senate resolution or even an informal communication to the President regarding the Senate's intentions would have the same effect as a statutory restriction. Id. On this view, the President's appointments power is in fact restricted, not by an apparent statutory limitation, but by the President's "perception of the present Senate's view as it may be assumed to be reflected in the statute." Id.

Since the Senate may reject a presidential nominee for any reason, it would follow that any set of qualifications may be inserted into an agency's organic statute, on the understanding that these restrictions do not actually prevent the President from submitting any nominee to the Senate, but only indicate to the President that the Senate will reject nonconforming nominees. Taking the view suggested by the D.C. Circuit in *NRA Political Victory Fund,* the restriction contained in § 7802(b)(1)(D) of H.R. 2676 would be constitutional.

b. The Constitutionality of the Appointment Provision Would Be Unlikely to Come Before a Court in a Justiciable Case

In addition to being concerned about the constitutionality of § 7802(b)(1)(D), the Senate may wish to know whether this section, if enacted into law, would actually lead to a judicial judgment that the IRS Oversight Board is unconstitutionally constituted. There is another reason why this likelihood of such a judgment is very low. So long as the President complies with statutory restrictions regarding the qualification of appointees, legal challenges based on those restrictions are nonjusticiable. In *NRA Political Victory Fund, supra,* the D.C. Circuit held that it could not assume that apparent statutory restrictions on the President's appointment power, with which the President had complied, had in fact limited his power to appoint whomever he wanted, since there was no way of knowing whether he would have appointed different people in the absence of the restrictions. Accordingly, the court refused to hear a challenge to the restrictions. 6 F.3d at 824-25.

A similar result would follow in the case of a challenge to § 7802(b)(1)(D) of the present bill. So long as the President chose to respect the qualification requirements contained in the provision, no one would be in a position to prove that the President would have chosen differently absent the statutory qualifications, and a court therefore could not pass on a challenge to them. A justiciable controversy could arise, as the D.C. Circuit remarked, only if the President chose to disregard the statutory qualifications and the Senate confirmed a presidential nominee who did not meet the qualifications. See 6 F.3d at 825. I am aware of no case in which such disregard of the qualifications by both the President and the Senate has ever occurred.[6] I conclude, therefore, that it is extremely unlikely that the provisions of § 7802(b)(1)(D) would ever lead to a judgment of unconstitutionality.

c. Even if Binding, the Qualifications Contained in the Appointment Provision Would Probably Not Be Held Unconstitutional

Finally, I will consider the constitutionality of 7802(b)(1)(D) from one other viewpoint. Assuming that the provision would be an enforceable restriction on the President's power of appointment, and imagining that a justiciable case testing its constitutionality somehow arose, would a court hold the provision unconstitutional?

Justice Kennedy, as noted above, appears to have concluded that Congress may not restrict the President's appointment power. However, the Supreme Court as a whole has never taken that view. Indeed, the Court has never passed upon the question at all. Such hints as may be gleaned from occasional comments in Court opinions suggest that the Court would take a more flexible approach to the issue of statutory qualifications for presidential appointees.

For example, even in *Myers v. United States,* 272 U.S. 52 (1926), in which the Court took its most Executive-favoring view of the President's power concerning executive officers,[7] the Court stated that Congress may "prescrib[e] . . . reasonable and relevant qualifications and rules of eligibility of appointees." Id. at 129. The only limitation on Congress's power that the Court mentioned was that the quali-

fications could not "so limit selection and so trench upon executive choice as to be in effect legislative designation." Id. at 128; see also *Mow Sun Wong v. Hampton*, 435 F. Supp. 37, 42 n.6 (C.D. Cal. 1977), aff'd 626 F.2d 739 (9th Cir. 1980), cert. denied, 450 U.S. 959 (1981).[8]

Such an approach would be consistent with the Supreme Court's general approach to many separation of powers questions. Currently, the Court analyzes many separation issues using a flexible balancing test. With regard to limitations on presidential powers concerning executive officers, the Court has permitted such limitations so long they do not aggrandize the powers of Congress and so long as they are not "of such a nature that they impede the President's ability to perform his constitutional duty." *Morrison v. Olson*, 487 U.S. 654, 691 (1988); see also *Nixon v. Administrator of General Services*, 433 U.S. 425, 443 (1977); *Bowsher v. Synar*, 478 U.S. 714 (1986) (rule against congressional self-aggrandizement).

The statutory qualifications contained in §7802(b)(1)(D) of H.R. 2676 would not violate the constitutional rule against congressional self-aggrandizement by giving Congress or any of its officers a role in the nomination of any member of the IRS Oversight Board. Given the generous interpretation of the word "representative" suggested by the House Report that accompanies the bill,[9] the qualifications would not so limit the President's selection so as to be, in effect, legislative designation of a Board member. The statutory qualifications would be no more restrictive than some found in other agency organic statutes, past and current.[10]

Moreover, the qualifications would appear to be "reasonable and relevant." While there is no official, judicially articulated explanation of this phrase, I would hazard the statement that a qualification is "reasonable and relevant" if it bears a rational relation to a legitimate congressional goal. Here, it seems apparent that the goal of section 7802(b)(1)(D) is to promote good labor relations between the IRS and its employees by ensuring that the IRS Oversight Board will have a member who will give appropriate voice to employee needs, concerns, and interests. This would seem to be a perfectly legitimate goal for Congress. The qualification that the Board member be a "representative of an organization that represents a substantial number of Internal Revenue Service employees" bears a rational relation to this goal.

Finally, given the limited powers to be exercised by the IRS Oversight Board under the bill (see point 1, above), I would say that the statutory qualifications on this Board member would not likely be held to impede the President's ability to perform his constitutional duty. This conclusion is buttressed by the fact that, under the bill, Board members would be removable from office at the will of the President. § 7802(b)(4)(A). I therefore conclude that the qualifications provided in § 7802(b)(1)(D) would not likely be held to be unconstitutional.

3. The Removal Provision Should be Deleted from the Bill

H.R. 2676 provides that the member of the IRS Oversight Board appointed pursuant to § 7802(b)(1)(D) "shall be removed upon termination of employment, membership, or other affiliation with the organization described in" that subsection. § 7802(b)(4)(C). The effect of this provision is to give the private labor union to which the member belongs the power to remove a federal official from office. I conclude that, while there are reasonable arguments as to the validity of such a power, the delegation to a private organization of the power to remove federal officials from office would pose a substantial risk to the validity of actions of the Oversight Board and that this removal provision should therefore be deleted from the bill.

a. The Delegation, to a Private Group, of the Power to Remove a Federal Official Poses Substantial Constitutional Difficulties

Supreme Court concern about the delegation of federal power to private parties played a role in one of the very small set of cases in which federal statutes have been struck down on nondelegation grounds. In *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936), the Court invalidated a statute authorizing coal producers and miners, by a supermajority vote, to fix minimum wages and maximum hours. The Court stated that "[t]his is legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business." Id. at 311. A similar concern could be raised here. In determining whether to take action that could remove the "union" member from the Oversight Board, the union might not inquire disinterestedly whether the member was serving the public interest, but rather seek to advance its own interests.

Moreover, the particular power that would be delegated to a private group here is the power to take action that removes a federal official from office. The nondelegation problem would therefore combine with concerns about interference with the President's control over executive officials. This combination would make

§ 7802(b)(4)(C) a particular concern for those judges, such as Justice Scalia, who believe in a unitary executive branch in which the President must retain "exclusive control" over the exercise of executive power. See *Morrison v. Olson,* 487 U.S. at 705 (Scalia, J., dissenting).

Finally, § 7802(b)(4)(C) is of concern because it is, so far as I am aware, without parallel in federal law. I know of no other federal statute, past or present, that gives a private party the power to remove a federal official from office.[11] Certainly I know of no case in which such a power has received judicial approval.

There are, it should be noted, reasonable arguments that the removal provision would be constitutional. Despite *Carter Coal,* federal statutes, past and present, have successfully placed some federal power directly in private hands, particularly where the power is exercised in conjunction with federal employees so as to promote its being exercised in a public-regarding way. For example, federal statutes provide that certain orders issued by the Secretary of Agriculture may become effective only upon receiving approval from private producers and handlers of agricultural products. See, e.g., 7 U.S.C. § 608c(8); *Block v. Community Nutrition Institute,* 467 U.S. 340, 342 (1984). The Supreme Court approved a similar scheme in *Currin v. Wallace,* 306 U.S. 1, 15-16 (1939).[12]

Here, one might argue that the union would not directly exercise federal executive power, but only retain some power over one member of a multi-member federal body exercising such power. The union would not retain authority to remove that member at will; it could act only by expelling that member from the union, an action that would be constrained by other federal laws such as the Labor-Management Reporting and Disclosure Act. See 29 U.S.C. § 411(a)(5) (member of a labor organization may be disciplined only after full and fair hearing upon written specific charges). Furthermore, under H.R. 2676 the President would also have the power, at will, to remove any member of the IRS Oversight Board. The President's power would help satisfy the rule of *Morrison v. Olson,* that interferences with the President's power over executive officials must not impede the President's ability to perform his constitutional duty.

However, the foregoing points notwithstanding, the removal provision of the bill would raise serious constitutional concerns. It would delegate federal power to private parties in a way that, so far as I am aware, would be unprecedented and that has never received judicial approval, and it would combine the already delicate issue of delegating federal power to private parties with the equally delicate issue of interference with the President's ability to control federal officers. The result is substantial uncertainty that poses a significant risk to the constitutionality of the bill.

b. The Removal Provision Could Lead to a Judgment Invalidating Actions of the IRS Oversight Board

Moreover, the removal provision should be of particular concern, because, unlike the appointment provision, it could lead to a court challenge that could vitiate Board actions. The Supreme Court's cases show that if there is a problem with the provisions governing the removal of a federal executive official, a person harmed by an action of that official may raise a challenge to the validity of the action, even if the improper removal power is never exercised. In *Bowsher v. Synar,* 478 U.S. 714 (1986), plaintiff challenged powers exercised by the Comptroller General on the ground that the Comptroller General, who was removable by act of Congress, could not constitutionally exercise executive power. The Court permitted the case to go forward even though Congress had never removed or threatened to remove the Comptroller General for reasons of policy, because Congress's power to remove the Comptroller General created a "here-and-now subservience" that made a challenge to the Comptroller's exercise of power ripe. Id. at 728 n.5.

It would follow that any person harmed by an action of the IRS Oversight Board could challenge that action on the ground that one of the Board's members was subject to a constitutionally invalid removal power. There would be no need to show that the member was in any danger of actual removal. The result is that this removal provision could cast a cloud of doubt over all actions of the proposed IRS Oversight Board.[13] Of course, given the limited powers to be exercised by the Board (see point 1, above), there may not be many cases where someone can demonstrate injury from a Board action, which would be a prerequisite for suit. In any such case, however, the removal provision would be a ground for challenge.

Whether or not the removal provision for the union member would ultimately be held to be invalid by the courts, I suspect that Congress would be loath to imperil the entire enterprise of creating an IRS Oversight Board for the sake of this provision. I would therefore recommend that this provision be deleted.

c. Deleting the Removal Provision Would Probably Not Substantially Detract from Congressional Goals

Deleting the removal provision, I note, would probably not substantially undermine the congressional objectives with regard to the union member of the Board. The restrictions in the appointment provision would still ensure that the President would choose a person who would likely be a good representative on the Board of the interests of IRS employees. The Senate, through the appropriate use of its Advice and Consent power, could further ensure that this goal is met. While the deletion of the removal provision would mean that this Board member could, in theory, continue to serve on the Board even after ceasing to be affiliated with the union he or she represented at the time of appointment, in practice, it would probably happen in most cases that the member would continue to be affiliated with the union throughout his or her term as a Board member. And finally, if the union member did cease to be affiliated with the union and yet continued to serve on the Board, the President could always choose to remove the union member from the Board, since the bill provides that all members of the Board would serve at the pleasure of the President. It therefore seems that the deletion of this provision would create only a small likelihood that the union member of the Board would fail to represent IRS employee interests appropriately.

In short, I think that deleting this provision would remove a substantial risk that the actions of the new IRS Oversight Board would be held constitutionally invalid without markedly undermining the congressional purposes of including the union member on the Board. On balance, it seems to me that deleting this provision would be the wisest course.

CONCLUSION

I conclude that while the appointment provision of § 7802(b)(1)(D) is unlikely to be held unconstitutional, the removal provision contained in § 7802(b)(4)(C) raises serious constitutional concerns and would best be deleted. I hope this letter is of assistance to you, your committee, and to the Senate.[14]

Respectfully yours,

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ENDNOTES

[1]: For convenience, I will hereafter refer to provisions within section 101 of the House bill by giving the section numbers that they would have within Title 26 after codification if the bill were enacted into law.

[2]: H.R. 2676 would also require the Commissioner of Internal Revenue to "consult" with the Oversight Board concerning the matters specified in § 7802(d)(2) and (3). See § 102 (which would be codified at § 7803(a)(3)). Again, however, it is not clear what is entailed by this duty of consultation; the text of the bill does not appear to require the Commissioner to act in accordance with the desire of the Oversight Board on matters as to which consultation is required.

[3]: See House Report at 36 (citing such a consolidation as an example of a "major reorganization").

[4]: It is unnecessary to determine more specifically whether the Board members would be "officers" or whether they would be "inferior officers." The Appointments Clause of the Constitution applies to both.

[5]: Justice Kennedy's opinion was joined by Chief Justice Rehnquist and Justice O'Connor. In the Federalist Papers, Alexander Hamilton also stressed the importance of placing the appointment power solely in the President's hands. He stated that the power should be "[t]he sole and undivided responsibility of one man," who would exercise "his judgment alone;" pointing out a candidate would be "his sole duty." The Federalist No. 76 at 455-57 (C. Rossiter ed. 1961).

[6]: Although the D.C. Circuit did not mention it, a justiciable controversy could presumably also arise if the President used his recess appointment power to install an appointee in disregard of the statutory qualifications. Again, however, I am unaware of any case in which such presidential action has occurred.

[7]: In Myers, the Court held that Congress could not by statute restrict the President's power to remove a postmaster first class from office.

[8]: Even when he was Assistant Attorney General for the Office of Legal Counsel, Professor Walter Dellinger agreed that the case law suggests that Congress has the power to impose reasonable qualifications for presidential appointees. See Walter Dellinger & H. Jefferson Powell, *The Constitutionality of the Bank Bill:*

the Attorney General's First Constitutional Law Opinions, 44 Duke L.J. 110, 132 (1994).

[9]: The House Report states that "[i]n appointing the union representative, the President is not constrained to choose an individual recommended by a union covering IRS employees, but may choose whoever the President determines to be an appropriate representative of the union." House Report at 36 n.11.

[10]: For example, the current statute concerning the board of directors of Amtrak provides that the President must choose, among others, one director "from a list of 3 qualified individuals submitted by the Railway Labor Executives Association" and one director "selected as a representative of business with an interest in rail transportation." 49 U.S.C. § 24302. Congress once required the President to choose three members of the Railroad Labor Board from six nominees made by railroad employees and three members from six nominees made by carriers. Act of Feb. 28, 1920, c. 91, § 304, 41 Stat. 456, 470. Justice Brandeis's opinion in *Myers v. United States* contains an extensive catalogue of statutory restrictions on the President's appointment power. See 272 U.S. at 265-274 (Brandeis, J., dissenting).

[11]: Some statutes are ambiguous. For example, 12 U.S.C. § 263 provides that certain members of the Federal Open Market Committee "shall be" presidents or first vice presidents of certain Federal Reserve banks, which are private organizations. The natural implication of the words "shall be" would seem to be that such members of the FOMC would lose their membership upon ceasing to be a president or first vice president of a Federal Reserve bank. However, the statute does not expressly say so, and, moreover, it is not clear whether FOMC members are federal "officers" subject to the Appointments Clause at all. See *Melcher v. Federal Open Market Committee,* 644 F. Supp. 510 (D.D.C. 1986) (holding that they are not), aff'd on other grounds, 836 F.2d 561 (D.C. Cir. 1987), cert. denied, 486 U.S. 1042 (1988)

[12]: An extensive catalogue of federal statutory delegations of power to private parties may be found in Harold J. Krent, *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government,* 85 Nw. U. L. Rev. 62 (1990). Professor Krent, while expressing the view that delegations of federal power to private parties are difficult to reconcile with modern separation-of-powers doctrine, explores the possibility that the separation of powers can be preserved if the delegates' authority is sufficiently constrained by executive branch supervision or external pressures. Id. at 95-105; see also Harold H. Bruff, *Public Programs, Private Deciders: The Constitutionality of Arbitration in Federal Programs,* 67 Tex. L. Rev. 441, 463 (1989) ("powers granted to private deciders must be structured so that both internal incentives and outside supervision conform their decisions to the public interest").

[13]: This doubt would apply regardless of whether the union member of the Board cast a deciding vote on any particular Board action. In *Federal Election Comm'n v. NRA Political Victory Fund,* 6 F.3d 821 (D.C. Cir. 1993), cert. dismissed, 513 U.S. 88 (1994), the court overturned an action of the Federal Election Commission on the ground that the Commission contained two improper members even though those members had no vote at all.

[14]: I noticed one other, very minor, point while reading § 7802 that I thought I would call to your attention, although it is not related to the question you asked. The bill provides that "[n]o return, return information, or taxpayer return information (as defined in section 6103(b)) may be disclosed to any member of the Oversight Board described in subsection (b)(1)(A) or (D)." § 7802(c)(3). Interpreted literally, this provision would make it unlawful for the IRS to provide a Board member with a copy of his or her own return, a result Congress could hardly intend. Perhaps this problem could be fixed by inserting, before the period at the end of the sentence, the phrase ", except for any return, return information, or taxpayer return information that the member would be entitled to receive if he or she were not a member of the Oversight Board."

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