

**TESTIMONY OF
MARK W. EVERSON,
COMMISSIONER OF INTERNAL REVENUE,
BEFORE
THE PRESIDENT'S ADVISORY PANEL ON
FEDERAL TAX REFORM
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Good morning, Chairman Mack, Vice Chairman Breaux and members of the President's Advisory Panel on Federal Tax Reform. My remarks this morning will cover three areas: a brief overview of our country's system of tax administration; observations about the way complexity in the code complicates tax administration; and a number of considerations which I believe you may wish to take into account as you develop policy options for Secretary Snow.

Before starting, however, I would like to commend the members of the panel for your willingness to take on this important task. The President has asked that we as a nation step back, assess the existing tax code, and develop a simpler Internal Revenue Code that is both fair and promotes a healthy, sustainable economy. Your framing of the policy options is an important first step.

My job is to oversee the tax administration system and to make sure that the IRS brings in each year the \$2 trillion that funds our Government, and that we do so in a fair and responsible manner without regard to political considerations. As this process unfolds, I don't expect to offer support for, or to oppose, any particular policy options. On the other hand, the IRS does want to help advance your work by providing information on how the existing system works, or doesn't as the case may be, as well as

offering considerations pertaining to particular policy options based on our unique knowledge of the existing Federal system or other national systems.

Our nation's tax administration system is characterized by a number of factors: it is large and complex; its regulatory components extend beyond activities subject to taxation; and it includes not just the collection of taxes due but also important means-tested benefit programs where money is paid out. Furthermore, the functioning and integrity of the system is highly reliant on tax practitioners, and there are direct linkages to other important Governmental activities such as Social Security, Medicare and individual state revenue programs. I mention all these factors as relevant to your work because statutory changes in one area frequently impact another piece of the overall mosaic. At the IRS we administer this system by providing service to taxpayers – helping them understand their obligations and facilitating their participation in the system – and enforcing the laws so that Americans are confident that when they pay their fair share, neighbors and competitors are doing the same.

Concerning the size of our system, last year 183 million people filed individual tax returns. To put that number in perspective, it is fully half again the number of people who voted in the Presidential election. In that sense, paying taxes is a unifying experience fundamental to our democracy and respect for the rule of the law. Taxes are what President Kennedy called “the annual price of citizenship.” The mechanics of our system are themselves complex: each year the IRS receives and processes vast amounts of information. For example, we receive over 220 million tax returns and over

1.3 billion information items, such as W-2s and 1099s, related to tax returns. Many of them shed light on different activities or functions of the same entity. A complete picture, for example, of a corporation's compliance with the tax code can require analysis of employment tax filings, pension plans, partnerships and joint venture interests, international transactions and affiliates, as well as associated charitable foundations and audits of its executive officers.

The regulatory responsibilities of the IRS extend beyond activities subject to taxation. Included are the nation's 1.7 million tax-exempt organizations, a role in the oversight of state and private retirement plans, and tax-exempt bonds, to mention several significant areas. In terms of monies paid out as opposed to collected, the IRS administers the Earned Income Tax Credit, which is the country's largest means-tested benefits program. Last year, the EITC paid out over \$37 billion to 21 million taxpayers. The Health Coverage Tax Credit is another example of a benefits program embedded in the tax code.

Linkage to other Government activities is another dimension of Federal tax administration. Many states model their own tax systems on the Federal system. I would note that, on average, states collect almost \$0.20 for every \$1 the IRS brings in through examination activities. Social insurance and retirement receipts constitute 38% of the monies we expect to take in this year. The IRS is responsible for making sure that the nation's millions of employers properly withhold and remit both their own share of employment taxes as well as that of their employees.

What President Kennedy called our system of “individual self-assessment” relies heavily on tax practitioners to function smoothly and maintain its integrity. Altogether there are approximately 1.2 million tax practitioners, including attorneys, accountants, enrolled agents and other preparers. Beyond paid tax professionals there is an important element of volunteerism. Last year, the IRS worked with 80,000 volunteers at nearly 14,000 sites in cities and towns around the country helping people file their taxes.

As we approach our responsibilities, the IRS strives to do so with a balanced program providing both service to taxpayers and enforcement of the law. Our working equation at the IRS is Service plus Enforcement = Compliance. Not service or enforcement, we need to do both. And I would stress that when we enforce the law, it is imperative we do so with full respect for taxpayer rights.

Complexity in the tax code compromises both our service and enforcement missions. That is because complexity obscures understanding. Those who seek to comply but cannot understand their tax obligations may make inadvertent errors or ultimately throw up their hands and say “why bother.” In the enforcement context, complexity in the code facilitates behaviors at variance with those intended by Congress. A more complex and steadily more international business and financial environment further increases challenges to tax administration. Abusive shelters have been developed and promoted by a commercially reinforcing network of essentially stateless accounting firms, investment banks, and law firms.

Last October, the American Jobs Creation Act became law. There were 193 provisions in the law, 178 of which require IRS actions. 97% of the provisions were effective before, on, or within 6 months of the date of enactment.

The Jobs Act brings important benefits to the economy and does much to strengthen the Government's hand in combating abusive shelters. But it adds a lot of complexity to the code. Let me take one of the provisions of the Jobs Act and give you a real life example of how complexity affects tax administration. The idea of this new provision is simple – an additional tax break to manufacturers by means of a special deduction. While simple in concept, the new provision requires companies to identify which activities are production activities and to make special calculations and allocations of income and expenses solely for the purpose of determining the amount of the new deduction.

To interpret the law, the IRS must issue guidance to help taxpayers understand the key concepts related to this provision of the Jobs Act. The guidance is not easy to craft. By distinguishing “production” from other activities, the provision places considerable tension on defining terms and designing anti-abuse rules. The first round of guidance the IRS issued was over 100 pages long. And I am told it covered only the most critical questions!

Aside from guidance, the IRS must take numerous other actions to implement the new deduction. To name just a few, changes need to be made to forms, schedules, instructions, and publications; training materials for our agents will need to be developed; and programming changes to IRS systems are also required to reflect the revisions to the forms. It will be necessary to devote significant audit resources to administering the new deduction.

Before closing I would like to suggest five factors which I would urge the panel to consider as you weigh policy options for changes to the tax code:

- First, our economy is constantly evolving, with change seemingly ever accelerating. Examples of change include transformation of the workforce to more self-employed individuals; businesses contracting out activities they'd previously done themselves; the relatively greater portion of economic growth generated through smaller, non-manufacturing businesses; and increasing globalization. It is vital to construct a tax system that recognizes this dynamic and is built for the 21st Century, not the 1960s.
- Second, policy options should be carefully assessed for their potential impact on attitudes towards compliance. Fairness and the perception of fairness are essential, as the President has recognized in his charge to you that your proposals be "appropriately progressive."

- Third, administerability is also an important consideration. Bolting on new programs to the tax code without significantly simplifying or eliminating existing elements may in fact make it more difficult to collect the \$2 trillion we need to fund the Government.
- Fourth, make an apples-to-apples comparison. Don't compare a sub-optimized existing system to a perfect, theoretical system. I can assure you from my conversations with counterpart tax administrators that there are administrative and compliance issues in all systems.
- Finally, please recognize that transition issues associated with migration to a new system, or systems, merit close attention. If the transition is not properly planned and managed, the new system will get off to a rocky start. After such a start, it may take decades to recover.

I wish to emphasize that these points are not offered to suggest inaction. That would be perhaps the worst option. I strongly support the President's call for simplification. But, of course, as you would expect anyone in my position to say, given the stakes, before moving forward we need to have a high confidence level that the path chosen will lead to success.

Thank you.