# MAKING THE INTERNAL REVENUE SERVICE WORK*

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ABSTRACT

*This is an Article about how to redesign the federal tax system so that the Internal Revenue Service (IRS) can administer it more effectively given that, even in the best of times, Congress is only willing to allow the IRS to have around 85,000 employees and a $12 billion budget. In fact, the recently enacted federal budget legislation provides the IRS with less than $11 billion for Fiscal Year 2015. As the IRS Oversight Board and the National Taxpayer Advocate frequently emphasize, the United States underinvests in the IRS, and that underinvesting means that taxpayer services are suffering and that tax enforcement has been significantly weakened.*

*With budget deficits for "as far as the eye can see" (and the recent IRS troubles with tax-exempt political organizations), the prospects for increased funding for the IRS are remote. In this Article, we consider a variety of approaches that would make it easier for the IRS to raise and collect revenue, and we offer a number of recommendations for legislative and administrative changes. For example, we recommend simplifying the tax system, enhancing third-party reporting, and streamlining the tax-filing and dispute-resolution procedures.*

*In short, this Article discusses how the tax system should be designed so that it can work with a modestly-funded tax administrator. Part I of this Article provides an overview of the federal tax system, and Part II of this Article provides an overview of tax administration. Part III of this Article discusses the key problems with current tax administration. Finally, Part IV of this Article offers a number of recommendations for change, including some that would require legislation and some that could be achieved administratively.*

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TABLE OF CONTENTS

**Introduction** ..... **3**
**I. Federal Taxes** ..... **4**
**A. An Overview** ..... **4**
**B. The Income Tax on Individuals** ..... **6**
**C. Social Insurance Taxes** ..... **8**
1. Social Security and Medicare Taxes ..... 8
2. Unemployment Compensation Taxes ..... 9
**D. The Corporate Income Tax** ..... **9**
**E. Estate and Gift Taxes** ..... **10**
**F. Other Taxes and Revenues** ..... **10**
**G. Other Tax Reporting Entities** ..... **11**
**II. Tax Administration** ..... **11**
**A. Government Players** ..... **11**
1. Congress ..... 11
2. The Executive Branch ..... 12
3. The Courts ..... 17
**B. Tax Administration** ..... **19**
1. Returns ..... 19
2. Voluntary Compliance and the Tax Gap ..... 21
3. Enforcement ..... 24
4. Litigation ..... 27
5. Guidance and Other Activities ..... 28
6. A Summary of the IRS Budget and Staffing Levels ..... 29
7. A Closer Look at the Tax Gap and Compliance ..... 31
**III. Key Problems with Current Tax Administration** ..... **33**
**A. The Internal Revenue Service is Significantly Underfunded** ..... **33**
**B. The Tax Code is Increasingly Complex** ..... **40**
1. Endless Legislation Adds to Complexity ..... 40
2. The IRS has Increasing Responsibilities ..... 41
**C. The Tax Controversy Process is Unnecessarily Complicated** ..... **46**
**IV. Recommendations for Change** ..... **47**
**A. Changes that Would Require Congressional Action** ..... **47**
1. Simplify the Tax System ..... 48
2. Improve the Legislative Process ..... 53
3. Enhance Third-party Information Reporting ..... 56
4. Simplify the Tax Penalty System ..... 57
5. Increase Transparency to Increase Compliance ..... 60
6. Streamline Dispute Procedures ..... 61
7. Give the IRS More Authority to Regulate Tax Practitioners and Preparers ..... 62

8. Consider Expanding Private Debt Collection ..... 62
**B. Administrative Actions that Could be Taken by Treasury and/or IRS ..... 64**
1. Issue Simplifying Regulations ..... 64
2. Move to a Return-free System ..... 65
3. Improve the IRS's Allocation of Resources ..... 66
4. Expand Alternative Dispute Resolution and the Use of IRS Appeals ..... 71
5. Change the IRS Mission ..... 71
**V. Conclusion ..... 73**

## INTRODUCTION

This is an Article about how to redesign the federal tax system so that the Internal Revenue Service (IRS) can administer it more effectively given that, even in the best of times, Congress is only willing to allow the IRS to have around 85,000 employees and a $12 billion budget.[1] In fact, the recently enacted federal budget legislation provides the IRS with less than $11 billion for Fiscal Year 2015.[2] As the IRS Oversight Board and the National Taxpayer Advocate frequently emphasize, the United States underinvests in the IRS, and that underinvesting means that taxpayer services are suffering and that tax enforcement has been significantly weakened.[3]

With budget deficits for "as far as the eye can see"[4] (and the recent IRS troubles with tax-exempt political organizations),[5] the prospects for increased funding for the IRS are remote. In this Article, we consider a variety of approaches that would make it easier for the IRS to raise

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[1] *See infra* Sections II.B.6 & III.A.

[2] Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, div. E, tit. I (Internal Revenue Service), 128 Stat. 2130, at 2336-40 (2014); Associated Press, *IRS Head Says Budget Cuts Could Delay Tax Refunds*, NEW YORK TIMES, Dec. 18, 2014, http://www.nytimes.com/aponline/2014/12/18/us/politics/ap-us-irs-delayed-refunds.html.

[3] *See*, *e.g.*, IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report* 8 (2014), http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf; NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS (2014), at Vol. 1, at viii, http://www.taxpayeradvocate.irs.gov/userfiles/file/2014-Annual-Report/Volume-One.pdf ("the IRS's inflation-adjusted budget has declined by about 17 percent between Fiscal Years (FYs) 2010 and 2015"); NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS (2013), at Vol. 1, at 20, 21 (IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance), http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Volume-1.pdf.

[4] The quote is generally attributed to David A. Stockman, a budget director under President Ronald Reagan. *See*, *e.g.*, Helen Dewar, *Stockman Issues Blunt Warning; Budget Called Vital*, WASHINGTON POST, Apr. 19, 1983, at A1. See also Congressional Budget Office, The Budget and Economic Outlook*: 2015 to 2025* 2 (2015), https://www.cbo.gov/sites/default/files/cbofiles/attachments/49892-Outlook2015.pdf (showing projected budget deficits over the next ten years).

[5] *See*, *e.g.*, Editorial Board, *The Real Internal Revenue Scandal*, NEW YORK TIMES, July 5, 2014, at Sunday Review, http://www.nytimes.com/2014/07/06/opinion/sunday/the-real-internal-revenue-scandal.html.

and collect revenue, and we offer a number of recommendations for legislative and administrative changes. For example, we recommend simplifying the tax system, enhancing third-party reporting, and streamlining the tax-filing and dispute-resolution procedures.

In short, this Article discusses how the tax system should be designed so that it can work with a modestly-funded tax administrator. Part I of this Article provides an overview of the federal tax system tax system, and Part II of this Article provides an overview of tax administration. Part III of this Article discusses the key problems with current tax administration. Finally, Part IV of this Article offers a number of recommendations for change, including some that would require legislation and some that could be achieved administratively.

## I. FEDERAL TAXES

### *A. An Overview*

The federal government raises virtually all of its revenue from the individual income tax, Social Security payroll taxes, the corporate income tax, estate and gift taxes, and excise taxes on selected goods and services.[6] Table 1 shows the various sources of federal revenues since 1940,[7] and Figure 1 shows the relative portion of federal revenues coming from each source.[8] What is most striking is that the federal government has increased its reliance on individual income taxes and payroll taxes and decreased its reliance on corporate income taxes, excise taxes, and other sources of revenue.

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[6] *See*, *e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014 (JCX-25-14, 2014), https://www.jct.gov/publications.html?func=download&id=4568&chk=4568&no_html=1.

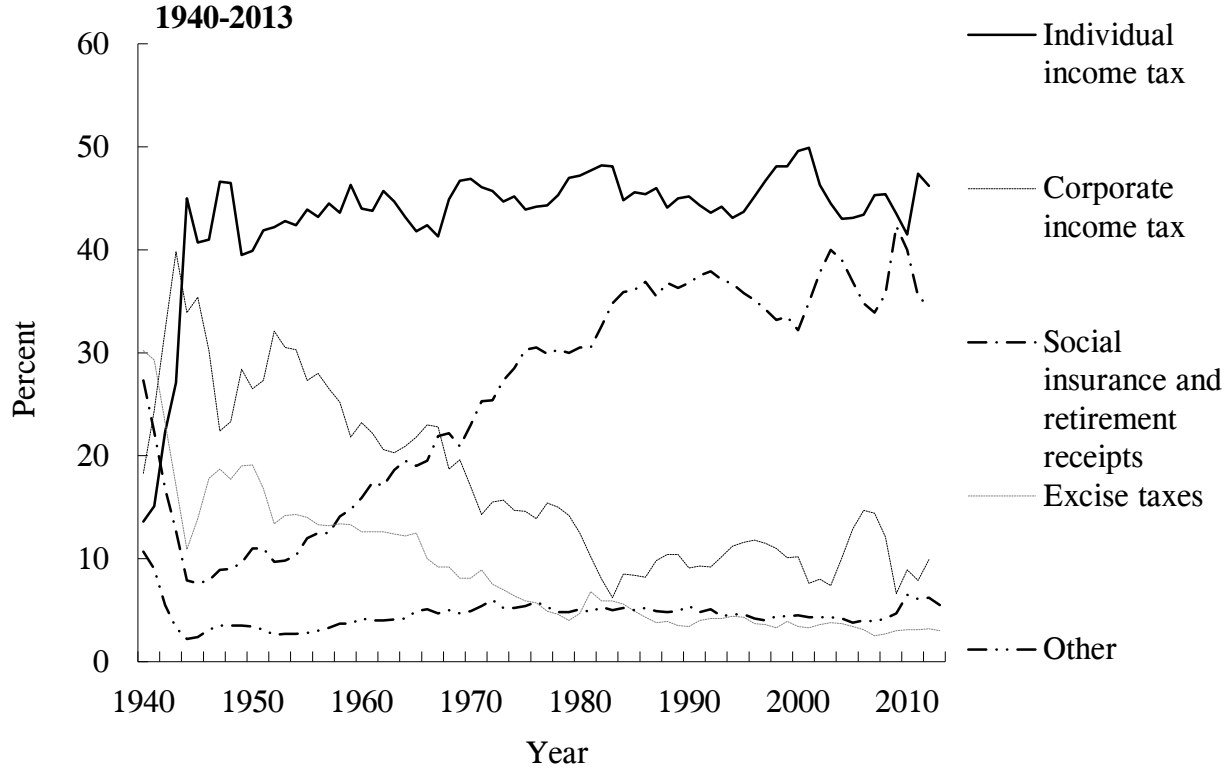
[7] Office of Management and Budget, *Historical Tables*, tbl. 2.1, *available at* http://www.whitehouse.gov/omb/budget/historicals (last visited Jan. 13, 2015). *See also* INTERNAL REVENUE SERVICE, 2013 DATA BOOK (OCTOBER 1, 2012 TO SEPTEMBER 30, 2013) 15-16 tbl. 6 (Publication No. 55-B, Mar. 2014), http://www.irs.gov/file_source/pub/irs-soi/13databk.pdf [hereinafter 2013 IRS DATA BOOK].

[8] Office of Management and Budget, *Historical Tables*, *supra* note 7, at tbl. 2.2.

**Table 1. Federal Revenues by Source, 1940–2015** (millions of dollars)

| *Fiscal year* | *Individual income taxes* | *Corporate income taxes* | *Social insurance and retirement receipts* | *Excise taxes* | *Other* | *Total receipts* |
|---|---|---|---|---|---|---|
| 1940 | 892 | 1,197 | 1,785 | 1,977 | 698 | 6,548 |
| 1960 | 40,715 | 21,494 | 14,683 | 11,676 | 3,923 | 92,492 |
| 1980 | 244,069 | 64,600 | 157,803 | 24,329 | 26,311 | 517,112 |
| 2000 | 1,004,462 | 207,289 | 652,852 | 68,865 | 91,750 | 2,025,218 |
| 2010 | 895,549 | 191,437 | 864,814 | 66,909 | 140,997 | 2,162,706 |
| 2013 | 1,316,404 | 273,506 | 947,820 | 84,007 | 153,365 | 2,775,103 |
| 2015 estimate | 1,533,942 | 449,020 | 1,055,744 | 110,539 | 188,180 | 3,337,425 |

**Figure 1. Percentage Composition of Federal Receipts by Source, 1940-2013**



### *B. The Income Tax on Individuals*

The largest of the federal taxes is the income tax imposed on individuals. As shown in Table 1, the individual income tax raised more than $1.3 trillion in Fiscal Year 2013, and almost 146 million individual income tax returns were filed that year.[9]

The federal income tax is imposed on a taxpayer's *taxable income*.[10] Taxpayers file returns as unmarried individuals, heads of household, married couples filing joint returns, or married couples filing separate returns.[11]

As a starting point, taxpayers first determine the amount of their *gross income*.[12] Gross income includes all income from whatever source derived, including (but not limited to) the wages, salary, tips, gains, dividends, interest, rents, and royalties received by taxpayers during the taxable year.[13] The United States Supreme Court has interpreted the term "gross income" broadly to include all "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."[14]

At the same time, however, there are numerous statutory *exclusions* from gross income.[15] For example, gifts, inheritances, and life insurance proceeds received by a taxpayer are expressly excluded from gross income, as are certain scholarships, fringe benefits, interest earned on State and local bonds, and most Social Security benefits.[16] Also, of note, economic gains are not taxed until the underlying property has been sold and the gain is "realized."[17]

From gross income, taxpayers subtract certain *deductions* to get to taxable income.[18] Most taxpayers simply claim a standard deduction and their personal exemptions.[19] For example, of the almost 145 million individual income tax returns filed for the 2012 tax year, almost 92 million (more than 63%) claimed the standard deduction.[20] Pertinent here, in 2015, the standard deduction amounts are $12,600 for married couples filing joint returns, $9,250 for

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[9] Internal Revenue Service, *SOI Tax Stats – Tax Stats at a Glance*, http://www.irs.gov/uac/SOI-Tax-Stats-Tax-Stats-at-a-Glance (last updated Sept. 23, 2014).

[10] Internal Revenue Code [hereinafter I.R.C.] §§ 1, 63; STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014, *supra* note 6, at 2.

[11] I.R.C. §§ 1, 2, 6012, 6013.

[12] I.R.C. § 61.

[13] *Id.*

[14] Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

[15] *See*, *e.g.*, I.R.C. §§ 101 et seq.

[16] I.R.C. §§ 86, 101, 102, 103, 106, 117, 119 & 132.

[17] I.R.C. § 1001(a). *See*, *e.g.*, David M. Schizer, *Realization as a Subsidy*, 73 New York University Law Review 1549, 1551 (1998).

[18] *See*, *e.g.*, I.R.C. §§ 161 et seq.

[19] I.R.C. § 63(b).

[20] 0.63328 = 91,780,792 ÷ 144,928,472. Internal Revenue Service, *Individual Income Tax Returns 2012* 2 tbl. A (Publication No. 1304, 2014), http://www.irs.gov/file_source/pub/irs-soi/12inalcr.pdf.

heads of household, $6,300 for unmarried individuals, and $6,300 for married individuals filing separate returns;[21] and the personal exemption amount is $4,000.[22]

The remaining individual taxpayers claim certain itemized deductions in lieu of the standard deduction.[23] Also, certain other deductions are allowed without regard to whether the taxpayer chooses to itemize.[24] The tax rate structure is progressive, that is, a taxpayer with a lower taxable income will pay tax at a lower rate.[25] Tax rates are imposed by brackets, which vary depending on the taxpayer's filing status (married, head of household, or single).[26] In 2015, there are seven "ordinary" tax brackets: 10, 15, 25, 28, 33, 35, and 39.6%.[27] Long-term capital gains and dividend income are generally subject to different, lower tax rates.[28] The amount that a taxpayer must actually pay (or, alternatively, will receive as a refund) is equal to the taxpayer's regular tax liability minus her allowable *tax credits*.[29] For example, certain low-income taxpayers are entitled to claim the refundable earned income tax credit, and many taxpayers with children can claim the partially refundable child tax credit and the nonrefundable dependent care credit.[30]

Some individuals must also pay the *alternative minimum tax*, which is payable when it exceeds the individual's regular income tax liability.[31] The tax is imposed at rates of 26 and 28% on "alternative minimum taxable income" in excess of an exemption amount.[32] In 2015, the exemption amounts are $83,400 for married couples filing joint returns, $53,600 for single individuals and heads of household, and $41,700 for married individuals filing separate returns.[33]

Even this brief overview of individual income taxation illustrates the complexity faced by most, if not all, taxpayers. To be sure, some of this complexity is mitigated by the use of tax

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[21] I.R.C. § 63(c); Rev. Proc. 2014-61, 2014-47 I.R.B. 860, at § 3.14 Standard Deduction.

[22] I.R.C. § 151(d); Rev. Proc. 2014-61, *supra* note 21, at § 3.24 Personal Exemption.

[23] I.R.C. § 63(a), (d), (e).

[24] So called "above the line" deductions (I.R.C. § 62) may be taken by taxpayers regardless of whether they choose to itemize or not.

[25] I.R.C. § 1.

[26] *Id.*

[27] *See*, *e.g.*, Rev. Proc. 2014-61, *supra* note 21, at § 3.01 Tax Rate Tables.

[28] I.R.C. § 1(h). There are four capital gains tax rates: 0, 15, 25, and 28%, plus a 20% rate for high-income taxpayers. *Id.* In addition, there is also a 3.8% surcharge on net investment income, which includes capital gains, dividends, and other investment income such as rents. I.R.C. § 1411.

[29] I.R.C. §§ 21 et seq.

[30] I.R.C. §§ 21, 24 & 32.

[31] I.R.C. § 55.

[32] I.R.C. § 55(b).

[33] I.R.C. § 55(d); Rev. Proc. 2014-61, *supra* note 21, at § 3.11 Exemption Amounts for Alternative Minimum Tax.

return software and return preparers.[34] In that regard, 56.3% of the almost 146 million individual tax returns filed for tax year 2012 were completed by a paid preparer.[35] We will return to a discussion of complexity later in the Article.[36]

### *C. Social Insurance Taxes*

#### 1. Social Security and Medicare Taxes

Social Security and Medicare taxes are levied on earnings in employment and self-employment covered by Social Security, with portions of the total tax allocated by law to the Old-Age and Survivors Insurance trust fund (OASI), the Disability Insurance trust fund (DI), and the Medicare Hospital Insurance trust fund.[37] For 2015, employees pay Social Security taxes of 7.65% on the first $118,500 of wages and 1.45% of wages over $118,500.[38] The lion's share of these payroll taxes is used to finance the OASI program (5.30% of wages), and the rest pay for DI (0.9%) and Medicare (1.45%).[39] Employers pay a matching Social Security tax of 7.65% of up to $118,500 of wages for each covered employee.[40] Similarly, self-employed workers pay an equivalent Social Security tax of 15.3% on the first $118,500 of self-employment earnings and 2.9% of self-employment earnings over that amount.[41]

Individuals are liable for an additional Medicare tax of 0.9% if their income exceeds a threshold of $250,000 for married couples filing jointly ($125,000 for married couples filing

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[34] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS (2013), at Vol. 1, at 3, 6 (The Complexity of the Tax Code), http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf.

[35] Internal Revenue Service, *SOI Tax Stats – Tax Stats at a Glance*, *supra* note 9. See also U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-467T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY, Preparers Made Significant Errors (Statement of James R. McTigue, Jr.) 1 (2014), http://www.gao.gov/assets/670/662356.pdf (noting that paid preparers completed approximately 56% of all returns filed for the 2011 tax year)

[36] *See infra* Section III.B.

[37] I.R.C. §§ 3101-3128 & 1401-1403; Social Security Administration, *Social Security & Medicare Tax Rates*, http://www.ssa.gov/oact/progdata/taxRates.html (last visited Oct. 30, 2014); STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014, *supra* note 6, at 15; HOUSE WAYS AND MEANS COMMITTEE, GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS Chapter 1: Social Security Introduction and Overview (2014), http://greenbook.waysandmeans.house.gov/2014-green-book.

[38] *See* Social Security Administration, *Fact Sheet: 2015 Social Security Changes*, http://www.ssa.gov/news/press/factsheets/colafacts2015.pdf (last visited Dec. 12, 2014).

[39] Social Security Administration, *Social Security & Medicare Tax Rates*, http://www.ssa.gov/oact/progdata/taxRates.html (last visited Dec. 12, 2014).

[40] *Id.*

[41] Social Security Administration, *Fact Sheet: 2015 Social Security Changes*, *supra* note 38.

separately, or $200,000 for single individuals, heads of household, and qualifying widow and widowers with a dependent child.[42]

2. Unemployment Compensation Taxes

Unemployment compensation is a joint federal-state program that provides cash benefits to individuals who have recently become unemployed.[43] Benefits are financed through Federal Unemployment Tax Act (FUTA) taxes, a gross tax of 6.2% on the first $7,000 paid annually by covered employers to each employee.[44]

### *D. The Corporate Income Tax*

The federal government also imposes an income tax on corporations.[45] The taxable income of a corporation generally is made up of gross income less allowable deductions.[46] Allowable deductions include ordinary and necessary business expenditures, such as salaries, wages, interest expense, depreciation, certain losses, selling expenses, and other expenses.[47] Most large corporations pay tax at a 35% marginal tax rate.[48] Some corporations are also subject to an alternative minimum tax, which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability.[49] The alternative minimum tax is imposed at a flat rate of 20% on "alternative minimum taxable income" in excess of a $40,000 exemption amount.[50]

Multinational corporations incorporated in the United States face taxation on their worldwide income, mitigated to some extent by the availability of the foreign tax credit and

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[42] I.R.C. § 3102(f)(1); Internal Revenue Service, *Questions and Answers for the Additional Medicare Tax*, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax (last updated Nov. 6, 2014).

[43] I.R.C. § 3301; HOUSE WAYS AND MEANS COMMITTEE, GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS, *supra* note 37, at Chapter 4: Unemployment Insurance; Julie M. Whittaker & Katelin P. Isaacs, *Unemployment Insurance; Unemployment Insurance: Programs and Benefits* (Congressional Research Service Report No. RL33362, Aug. 14, 2014), *available at* https://www.fas.org/sgp/crs/misc/RL33362.pdf.

[44] HOUSE WAYS AND MEANS COMMITTEE, GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS, *supra* note 37, at Chapter 4: Unemployment Insurance.

[45] I.R.C. § 11; STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014, *supra* note 6, at 10; Mark P. Keightley & Molly F. Sherlock, *The Corporate Income Tax System: Overview and Options for Reform* (Congressional Research Service Report No. R42726, Dec. 1, 2014), *available at* https://www.hsdl.org/?view&did=760400.

[46] I.R.C. § 63(a).

[47] I.R.C. §§ 162, 163, 165 & 167.

[48] I.R.C. § 11(b)(1)(D).

[49] I.R.C. § 55.

[50] *Id.*

bilateral treaty provisions when applicable.[51] Multinational corporations have been the subject of many recent news reports for their ability to avoid U.S. taxation by strategies such as inversions, transfer pricing, and earnings stripping;[52] and the U.S. Department of the Treasury (Treasury) has taken some initial steps to curb some of these abusive transactions.[53]

### *E. Estate and Gift Taxes*

The federal government also imposes estate and gift taxes on lifetime transfers and transfers at death.[54] In 2015, each taxpayer can give away up to $5,430,000 of property tax free over her lifetime or at death.[55] Transfers in excess of $5,430,000 are generally subject to an estate tax or a gift tax of up to 40%.[56] Transfers to a spouse and gifts of up to $14,000 to others each year are exempt from tax.[57]

### *F. Other Taxes and Revenues*

The federal government also collects excise taxes on various consumer products and services, including alcoholic beverages, tobacco products, motor fuels, air transportation, and telephone service;[58] and the federal government also collects customs duties.[59]

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[51] *See*, *e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATED TO PROPOSALS TO REFORM THE TAXATION OF INCOME OF MULTINATIONAL ENTERPRISES (JCX-90-14, 2014), https://www.jct.gov/publications.html?func=download&id=4656&chk=4656&no_html=1.

[52] *See*, *e.g.*, Kevin Drawbaugh, *Burger King to save millions in U.S. taxes in 'inversion': study*, REUTERS (Dec. 11, 2014), http://www.reuters.com/article/2014/12/11/us-usa-tax-burgerking-idUSKBN0JP0CI20141211; David Gelles, *Businesses are Winning Cat-and-Mouse Tax Game*, NEW YORK TIMES, Aug. 28, 2014, at B1, http://dealbook.nytimes.com/2014/08/28/businesses-find-ways-to-avoid-corporate-taxes-but-a-fix-seems-unlikely/. For a clear explanation of the corporate inversion strategy, *see* Donald J. Marples & Jane G. Gravelle, *Corporate Expatriation, Inversions, and Mergers: Tax Issues* (Congressional Research Service Report No. R43568, Sept. 25, 2014), *available at* http://www.fas.org/sgp/crs/misc/R43568.pdf.

[53] See Notice 2014-52, 2014-42 I.R.B. 712 (describing regulations that the IRS and the Treasury will issue with respect to inversions and related transactions).

[54] I.R.C. §§ 2001 et seq., 2501 et seq.; STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014, *supra* note 6, at 14.

[55] Rev. Proc. 2014-61, *supra* note 21, at § 3.33 Unified Credit Against Estate Tax.

[56] I.R.C. §§ 2001, 2501-2502.

[57] I.R.C. §§ 2056, 2523; Rev. Proc. 2014-61, *supra* note 21, at § 3.35 Annual Exclusion for Gifts.

[58] *See*, *e.g.*, Office of Management and Budget, *Historical Tables*, *supra* note 7, at tbl. 2.4; STAFF OF THE JOINT COMMITTEE ON TAXATION, OVERVIEW OF THE FEDERAL TAX SYSTEM AS IN EFFECT FOR 2014, *supra* note 6, at 17; STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND INFORMATION ON FEDERAL EXCISE TAXES (JCS-1-11, 2011), https://www.jct.gov/publications.html?func=download&id=3721&chk=3721&no_html=1.

[59] *See*, *e.g.*, Office of Management and Budget, *Historical Tables supra* note 7, at tbl. 2.5.

### *G. Other Tax Reporting Entities*

In addition to the many taxpayers already described, the IRS also receives tax returns and provides guidance to numerous entities that are not subject to tax. In the business area, for example, partnerships file more than 3 million returns each year,[60] and S Corporations file more than 4 million returns a year.[61] Nonprofit organizations (Internal Revenue Code Section 501(c)(3) charities, etc.) also file more than 360,000 returns each year.[62] Pension plans also file around 680,000 returns a year.[63]

## II. TAX ADMINISTRATION

### *A. Government Players*

Our tax laws are enacted by Congress and administered by the IRS with the assistance of many other agencies and entities.

#### 1. Congress

Tax legislation is typically crafted in the House Ways and Means Committee[64] and the Senate Finance Committee,[65] with the assistance of the Joint Committee on Taxation.[66] Legislative branch organizations like the Congressional Budget Office,[67] the U.S. Government

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[60] *See*, *e.g.*, Internal Revenue Service, Statistics of Income, *Partnership Returns, 2011*, http://www.irs.gov/file_source/pub/irs-soi/2011PartnershipsReturnsOneSheet.pdf (last visited Jan. 15, 2015); Internal Revenue Service, Statistics of Income, *SOI Tax Stats - Tax Stats at a Glance*, *supra* note 9.

[61] *See*, *e.g.*, Internal Revenue Service, Statistics of Income, *Table 1--S Corporations: Total Receipts and Deductions, Portfolio Income, Rental Income, and Total Net Income, by Major Industry Tax Year 2011*, http://www.irs.gov/file_source/pub/irs-soi/11co01s.xls (last visited Jan. 15, 2015); Internal Revenue Service, *Statistics of Income, SOI Tax Stats - Tax Stats at a Glance*, *supra* note 9.

[62] *See*, *e.g.*, Internal Revenue Service, Statistics of Income, *SOI Tax Stats - Tax Stats at a Glance*, *supra* note 9.

[63] For example, there were 676,622 private pension plans filing Forms 5500 (Annual Return/Report of Employee Benefit Plan) in 2012. U.S. DEPARTMENT OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, PRIVATE PENSION PLAN BULLETIN 3 tbl. A1 (2014), http://www.dol.gov/ebsa/pdf/2012pensionplanbulletin.pdf.

[64] U.S. House of Representatives Committee on Ways and Means, *Committee Jurisdiction*, http://waysandmeans.house.gov/about/jurisdiction.htm (last visited Jan. 15, 2015).

[65] U.S. Senate Finance Committee, *Jurisdiction*, http://www.finance.senate.gov/about/jurisdiction, (last visited Jan. 15, 2015).

[66] Joint Committee on Taxation, *About Us*, https://www.jct.gov/about-us/overview.html (last visited Jan. 15, 2015).

[67] Congressional Budget Office, *Overview*, http://www.cbo.gov/about/overview (last visited Jan. 15, 2015).

Accountability Office,[68] and the Congressional Research Service also devote significant resources to tax law and policy.[69]

2. The Executive Branch

a. *Internal Revenue Service*

The Internal Revenue Service (IRS) is the bureau in the Treasury that administers and enforces the nation's internal revenue laws.[70] Within the IRS, the Chief Counsel of the Internal Revenue Service provides legal guidance and interpretive advice to the IRS, the Treasury, and taxpayers.[71] The Taxpayer Advocate Service is an independent organization within the IRS that helps taxpayers resolve problems with the IRS and recommends changes that will prevent those problems.[72] The IRS Oversight Board is an independent board that oversees the IRS.[73] In Fiscal Year 2014, the IRS as a whole had 85,692 full-time equivalent employees and a $12.1 billion total program operating level.[74]

i. Collecting Revenue

For the most part, the job of the IRS is to collect almost all of the revenue that funds the government through the income, social insurance, estate & gift, excise, and other taxes already

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[68] U.S. Government Accountability Office, *About GAO*, http://www.gao.gov/about/index.html (last visited Jan. 15, 2015).

[69] Library of Congress Congressional Research Service, *About CRS*, http://www.loc.gov/crsinfo/about/ (last visited Jan. 15, 2015).

[70] Internal Revenue Service, *About IRS*, http://www.irs.gov/uac/About-IRS (last visited Jan. 15, 2015).

[71] I.R.C. § 7803(b) (Chief Counsel for the Internal Revenue Service); Internal Revenue Service, *Office of Chief Counsel At-a-Glance*, http://www.irs.gov/uac/Office-of-Chief-Counsel-At-a-Glance (last updated Apr. 9, 2014). The Office of Chief Counsel had around 1600 attorneys in 2011, but the number of attorneys is lower now. Internal Revenue Service, *A Great Place to Start and a Great Place to Build Your Career* 2 (2011), http://jobs.irs.gov/downloads/CC-Brochure411_2011_Rev.pdf; Marie Sapirie, *Stack Addresses IRS Budget Cuts, FATCA, and BEPS*, 2015 TAX NOTES TODAY 7-7 (Jan. 15, 2015). *See also* 2013 IRS DATA BOOK, *supra* note 7, at 67 tbl. 30 (showing that the IRS had 1523 attorneys at the end of Fiscal Year 2013, down from 1553 attorneys at the end of Fiscal Year 2012). For more on the role of Chief Counsel, *see*, *e.g.*, Roberta Mann, *Chief Counsel's Subtle Impact on Revenue: Regulations, Litigation, and Administrative Guidance*, 65(4) NATIONAL TAX JOURNAL 889 (2012), http://econpapers.repec.org/scripts/redir.pf?u=http%3A%2F%2Fwww.ntanet.org%2FNTJ%2F65%2F4%2Fntj-v65n04p889-98-chief-counsel-subtle-impact.pdf;h=repec:ntj:journl:v:65:y:2012:i:4:p:889-98.

[72] I.R.C. § 7803(c) (Office of the Taxpayer Advocate); Internal Revenue Service, *Taxpayer Advocate Service*, http://www.irs.gov/Advocate (last updated Jan. 14, 2015); Taxpayer Advocate Service, *About the Taxpayer Advocate Service (TAS)*, http://www.taxpayeradvocate.irs.gov/About-TAS (last visited Jan. 15, 2015).

[73] I.R.C. § 7802; IRS Oversight Board, *About Us*, http://www.treasury.gov/IRSOB/about/Pages/default.aspx (last visited Jan. 15, 2015).

[74] U.S. Department of Treasury, *The Budget in Brief, FY 2015* 61 tbl. (2014), http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/Treasury_FY_2015_BIB.pdf.

described in Table 1. Of note, the organizational structure of the IRS has changed over time. At the 1913 inception of the Federal income tax, the Bureau of Internal Revenue was geographically organized by districts across the country.[75] In 1952, the first major reorganization centralized most functions around the National Office.[76] In 1998, the current restructuring abolished the districts, which were superseded by four operating divisions, now known as Wage & Investment, Large Business & International, Small Business/Self-Employed, and Tax-Exempt & Government Entities.[77] During Fiscal Year 2013, the IRS processed more than 240 million tax returns, and in the process, it collected almost $2.9 trillion in revenue.[78]

ii. Administering Tax Expenditures

Congress also uses federal tax laws to shape economic and social welfare policy. Indeed, it has gotten to the point where the IRS has a dual mission: it must both promote tax compliance, and it must administer a wide variety of economic and social welfare programs.[79]

In particular, the individual and corporate income taxes are fraught with so-called tax expenditures.[80] In effect, the IRS not only collects revenue but also administers a variety of

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[75] *See*, *e.g.*, Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 ADMINISTRATIVE LAW REVIEW 717, 741 (2001).

[76] *Id.* at 761-63; INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 1.1.2 (IRS Organizational History), http://www.irs.gov/irm/part1/irm_01-001-002.html#d0e10.

[77] INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL, *supra* note 76, at 1.1.2; H.R. Conference Report 105-599, at 193-94 (1998), 1998 U.S.C.C.A.N. 288; Internal Revenue Service, *At-a-Glance: IRS Divisions and Principal Offices*, http://www.irs.gov/uac/At-a-Glance:-IRS-Divisions-and-Principal-Offices (last updated Sept. 26, 2014).

[78] 2013 IRS DATA BOOK, *supra* note 7, at iii, 1.

[79] *See, e.g.*, Jeremy Coder, *The New IRS: Expanding the Mission?*, 128 TAX NOTES 576 (2010); NATIONAL TAXPAYER ADVOCATE, 2010 ANNUAL REPORT TO CONGRESS (2010), at Vol. 1, at 15 (The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs), http://www.taxpayeradvocate.irs.gov/Annual-Reports-To-Congress/FY-2010-Annual-Report-To-Congress.

[80] The Congressional Budget and Impoundment Act of 1974 defines "tax expenditures" as:

> those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability . . . .

Congressional Budget and Impoundment Act of 1974, Pub. L. No. 93-344, § 3(c), 88 Stat. 297, 299 (1974). *See*, *e.g.*, EXECUTIVE OFFICE OF THE PRESIDENT AND OFFICE OF MANAGEMENT AND BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2015 203 (Chapter 14: Tax Expenditures) (2014), http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/spec.pdf; STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018 (JCX-97-14, 2014), https://www.jct.gov/publications.html?func=startdown&id=4663; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-167SP, TAX EXPENDITURES: BACKGROUND AND EVALUATION CRITERIA AND QUESTIONS (2013), http://www.gao.gov/products/GAO-13-167SP. *See also* Senator Tom Coburn, *Tax Decoder* (Dec. 2014), http://coburn.senate.gov/public//index.cfm?a=Files.Serve&File_id=e1f80788-49ce-4bef-b30d-

economic and social welfare policy programs. For example, the IRS administers some of the nation's largest welfare programs—through the earned income and child tax credits.[81] Similarly, the IRS administers numerous tax breaks for education, including the exclusion for certain scholarships, the deduction for student loan interest, and various education tax credits.[82] Also, the IRS administers a wide variety of tax expenditures for energy.[83] More recently, with the enactment of the Patient Protection and Affordable Care Act (ACA),[84] the IRS also has the additional responsibility of administering health insurance premium tax credits for individuals and a variety of other health care provisions.[85]

Pertinent here, Table 2 shows the Office of Management and Budget's *2015 Federal Budget* estimates of the revenue losses attributable to the 20 largest income tax benefits for Fiscal Year 2015.[86] Since at least 2010, the sum of the estimated revenue loss due to tax expenditures has exceeded $1 trillion a year.[87]

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2c2d074a4f7e (discussing more than 165 tax expenditures costing over $900 billion in Fiscal Year 2015 and more than $5 trillion over the next five years).

[81] I.R.C. §§ 24, 32; Urban-Brookings Tax Policy Center, *Tax Facts: Spending on the EITC, Child Tax Credit, and AFDC/TANF, 1975 - 2011*, http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=266 (last visited Dec. 11, 2014); Jonathan P. Schneller, Adam S. Chilton & Joshua L. Boehm, *The Earned Income Tax Credit, Low-Income Workers, and the Legal Aid Community*, 3 COLUMBIA JOURNAL OF TAX LAW 176 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2175647.

[82] I.R.C. §§ 117, 221, 25A; *see also* STAFF OF THE JOINT COMMITTEE ON TAXATION, BACKGROUND AND PRESENT LAW RELATING TO TAX BENEFITS FOR EDUCATION (JCX-7-14, 2014), https://www.jct.gov/publications.html?func=download&id=4621&chk=4621&no_html=1; U.S. Department of the Treasury, *Report to Congress on Coordinating the American Opportunity Tax Credit and the Federal Pell Grant* (May 5, 2014), http://www.treasury.gov/resource-center/tax-policy/Documents/Report-Coordinating-AOTC-Federal-Pell-Grant-5-5-2014.pdf.

[83] *See generally* STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND ANALYSIS OF ENERGY-RELATED TAX EXPENDITURES (JCX-100-14, 2014), https://www.jct.gov/publications.html?func=download&id=4667&chk=4667&no_html=1.

[84] Pub. L. No. 111-148, 124 Stat. 119 (2010).

[85] *See*, *e.g.*, I.R.C. § 36B (refundable credit for coverage under a qualified health plan); Internal Revenue Service, *Affordable Care Act Tax Provisions*, http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions (last updated Jan. 14, 2015).

[86] EXECUTIVE OFFICE OF THE PRESIDENT AND OFFICE OF MANAGEMENT AND BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2015, *supra* note 80, at 216 tbl. 14-3.

[87] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-11-747T, TAX GAP: COMPLEXITY AND TAXPAYER COMPLIANCE (STATEMENT OF MICHEAL BROSTEK) 5 (2011), http://www.gao.gov/assets/130/126530.pdf. While such totals of tax expenditures are useful for illustrative purposes, those totals need to be "interpreted carefully" since tax expenditures are estimated one at a time, while holding the remaining tax system constant. *Id.* at 5 n.8. Thus, for example, the total of the tax expenditures in any given year does not necessarily reflect the amount of revenue that would be raised by repealing them all.

**Table 2. The 20 Largest Income Tax Expenditures Ranked by Total Fiscal Year 2015-2019 Projected Revenue Effect** (millions of dollars)

| *Provision* | *2015* | *2015-19* |
|---|---|---|
| Exclusion of employer contributions for health insurance and health care | 207,200 | 1,150,700 |
| Deductibility of mortgage interest on owner-occupied homes | 73,910 | 456,330 |
| Exclusion of net imputed rental income | 79,810 | 441,238 |
| Capital gains (except agriculture, timber, iron ore, and coal) | 68,850 | 422,270 |
| Defined contribution employer plans | 61,050 | 414,400 |
| Deferral of income from controlled foreign corporations | 75,540 | 373,210 |
| Capital gains exclusion on home sales | 56,510 | 332,490 |
| Deductibility of nonbusiness State and local taxes other than on owner-occupied homes | 49,290 | 290,800 |
| Deductibility of charitable contributions, other than education and health | 46,630 | 275,810 |
| Accelerated depreciation of machinery and equipment | 15,470 | 257,690 |
| Defined benefit employer plans | 42,340 | 234,960 |
| Exclusion of interest on public purpose State and local bonds | 35,010 | 213,830 |
| Deductibility of State and local property tax on owner-occupied homes | 33,880 | 198,550 |
| Step-up basis of capital gains at death | 32,370 | 179,310 |
| Social Security benefits for retired workers | 29,840 | 159,930 |
| Self-Employed plans | 25,530 | 155,530 |
| Treatment of qualified dividends | 26,650 | 148,950 |
| Exclusion of interest on life insurance savings | 23,040 | 132,370 |
| Child credit | 23,500 | 117,530 |
| Individual Retirement Accounts | 17,480 | 98,020 |

b. *Other U.S. Department of Treasury Offices*

Also, within the U.S. Department of the Treasury, the Assistant Secretary (Tax Policy) is the senior advisor to the Secretary of the Treasury for analyzing, developing, and implementing federal tax policies and programs,[88] and the Treasury Inspector General for Tax Administration (TIGTA) audits and inspects the IRS.[89]

[88] U.S. Department of the Treasury, *About (Tax Policy)* (last updated Apr. 16, 2014), http://www.treasury.gov/about/organizational-structure/offices/Pages/Tax-Policy.aspx.

[89] U.S. Treasury Inspector General for Tax Administration, *About TIGTA*, http://www.treasury.gov/tigta/about.shtml (last updated Dec. 9, 2014).

c. *Department of Justice*

The U.S. Department of Justice, Tax Division, represents the United States in virtually all tax litigation in all federal courts other than the U.S. Tax Court.[90] The Tax Division has around 350 attorneys.[91] The civil sections of the Tax Division handle around 6,600 civil cases in process annually, and alone or in conjunction with Assistant United States Attorneys, the Tax Division handles between 1,300 and 1,800 criminal tax investigations annually.[92] The Tax Division estimates that the Tax Division's trial attorneys return $14 to the Treasury for each dollar invested.[93] Finally, the Department of Justice's Office of the Solicitor General represents the United States in tax cases before the Supreme Court.[94]

d. *White House and Other Agencies*

The President often makes tax policy recommendations to the U.S. Department of Treasury and to Congress,[95] and his Office of Management and Budget[96] and Council of Economic Advisors often offer important assistance in the formulation of the President's tax and related budget recommendations.[97] In recent years, the National Economic Council has

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[90] U.S. Department of Justice, *Tax Division Home*, http://www.justice.gov/tax/ (last visited Jan. 15, 2015); U.S. Department of Justice, Tax Division, *FY 2015 Congressional Budget* 1 (2014), http://www.justice.gov/jmd/2015justification/pdf/tax-justification.pdf. Some IRS Chief Counsel attorneys are designated as Special U.S. Attorneys so they may represent the IRS in bankruptcy proceedings in federal courts. INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 34.11.1.1 (General Information Regarding the SAUSA [Special Assistant U.S. Attorney] Program), http://www.irs.gov/irm/part34/irm_34-011-001.html.

[91] U.S. Department of Justice, *About the Tax Division*, http://www.justice.gov/tax/about_us.htm (last visited Jan. 15, 2015)

[92] U.S. Department of Justice, Tax Division, *FY 2015 Congressional Budget*, *supra* note 90, at 1.

[93] *Id.*

[94] *See, e.g.*, U.S. Department of Justice, *Office of the Solicitor General*, http://www.justice.gov/osg/ (last visited Jan. 15, 2015). In an empirical study of the Supreme Court's certiorari procedures, the researchers found that in a majority of cases, the Court follows the Solicitor General's recommendation on whether to grant certiorari. David C. Thompson & Melanie F. Wachtell, *An Empirical Analysis of Supreme Court Certiorari Petition Procedures: The Call for Response and the Call for the Views of the Solicitor General*, 16 GEORGE. MASON LAW REVIEW 237, 275 (2009). *See also* JASPER L. CUMMINGS JR., THE SUPREME COURT, FEDERAL TAXATION, AND THE CONSTITUTION (2013).

[95] *See, e.g.*, The White House, *Taxes*, http://www.whitehouse.gov/issues/taxes (last visited Jan. 15, 2015).

[96] The White House, *Office of Management and Budget*, http://www.whitehouse.gov/omb (last visited Jan. 15, 2015).

[97] The White House, *Council of Economic Advisors*, http://www.whitehouse.gov/administration/eop/cea/ (last visited Jan. 15, 2015).

served as the principal tax policy player within the Executive Office of the President.[98] Other Executive Branch agencies may also play minor roles in the tax world.[99]

3. The Courts

Disputes between taxpayers and the United States government are ultimately resolved by the federal judicial system.[100] Many tax cases start after a taxpayer receives a notice from the IRS that there is a deficiency owed by the taxpayer.[101] The taxpayer can challenge that "notice of deficiency" by filing a petition with the U.S. Tax Court without having first paid the tax.[102] Other cases start when a taxpayer pays the tax and then sues for a refund either in the U.S. District Court or in the U.S. Court of Federal Claims.[103] The U.S. Department of Justice also initiates many tax collection lawsuits in the U.S. District Courts.[104] Tax issues can also arise in

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[98] National Economic Council, *Overview*, http://www.whitehouse.gov/administration/eop/nec (last visited Jan. 3, 2015).

[99] For example, the U.S. Department of State is actively involved in international tax issues, treaties, and tax information exchange agreements. *See, e.g.*, U.S. Department of Treasury, *Resource Center: Treaties and Other International Documents*, http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/default.aspx (last updated Apr. 11, 2014); STAFF OF THE JOINT COMMITTEE ON TAXATION, TAX TREATIES: STEPS IN THE NEGOTIATION AND RATIFICATION OF TAX TREATIES AND STATUS OF PROPOSED TREATIES (JCS-17-79, 1979), https://www.jct.gov/publications.html?func=download&id=3887&chk=3887&no_html=1.

Many other agencies also care about tax administration and tax policy. *See, e.g.*, U.S. Small Business Administration, *Filing & Paying Taxes*, http://www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/establishing-business/taxes (last visited Jan. 15, 2015); John O'Hare, Mary Schmitt & Judy Xanthopoulos, *Measuring the Benefit of Federal Tax Expenditures Used by Small Business* (Small Business Administration Office of Advocacy report under Contract No. SBAHQ-12-Q-0043 with Quantria Stategies, Nov. 2013), http://www.sba.gov/sites/default/files/rs415tot.pdf; U.S. Department of Housing and Urban Development, *LIHTC Basics*, http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics (last visited Jan. 15, 2015) (explaining how low income housing tax credits work); Amy Burke, Arpit Misra & Steven Sheingold, *Premium Affordability, Competition, and Choice in the Health Insurance Marketplace, 2014* (U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation, Research Brief, June 18, 2014), http://aspe.hhs.gov/health/reports/2014/premiums/2014mktplaceprembrf.pdf (examining the impact of health care premium tax credits on consumer costs).

[100] *See generally* Administrative Office of the U.S. Courts, *Federal Courts in American Government*, http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/FederalCourtsInAmericanGovernment.aspx (last visited Jan. 15, 2015).

[101] I.R.C. § 6212.

[102] I.R.C. § 6213.

[103] I.R.C. § 7422; 28 U.S.C. §§ 1346, 1491.

[104] *See, e.g.*, I.R.C. § 7401-7410 (Subchapter A, Civil Actions by the United States); U.S. Department of Justice, *About the Tax Division*, *supra* note 91.

the U.S. Bankruptcy Courts,[105] and may either be handled by Department of Justice attorneys or IRS Chief Counsel attorneys with a Special Assistant U.S. Attorney SAUSA designation.[106]

The U.S. Tax Court was established by Congress under Article I of the U.S. Constitution.[107] The Court has 19 presidentially appointed judges who serve for a term of 15 years.[108] Jury trials are not available in Tax Court.[109] Appeals generally go to the U.S. Court of Appeals where the taxpayer is located,[110] and then on to the U.S. Supreme Court if it grants certiorari.[111]

The U.S. District Courts are trial courts established by Congress under Article III of the U.S. Constitution.[112] District court judges are presidentially appointed and have lifetime tenure.[113] Jury trials are available.[114] There are 94 U.S. District Courts around the country,[115] and appeals go to 12 regional U.S. Courts of Appeal, [116] and then on to the U.S. Supreme Court if it grants certiorari.[117]

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[105] Administrative Office of the U.S. Courts, *Bankruptcy Courts*, http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/BankruptcyCourts.aspx (last visited Jan. 15, 2015).

[106] *See supra* note 90.

[107] I.R.C. §§ 7441 et. seq.; U.S. Tax Court, *About the Court*, https://www.ustaxcourt.gov/about.htm (last updated May 25, 2011).

[108] U.S. Tax Court, *About the Court*, *supra* note 107.

[109] *Id.*

[110] *See*, *e.g.*, INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 6.2.5.8 (Venue on Appeal), http://www.irs.gov/irm/part36/irm_36-002-005.html#d0e41; Golsen v. Commissioner of Internal Revenue, 54 T.C. 742 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971).

[111] 28 U.S.C. § 1254; INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 36.2.2.1 (Petition for Certiorari Generally), http://www.irs.gov/irm/part36/irm_36-002-002.html.

[112] *See, e.g.*, 28 U.S.C. §§ 1254, 1340; Federal Judicial Center, *How the Federal Courts are Organized*, http://www.fjc.gov/federal/courts.nsf/autoframe!openform&nav=menu1&page=/federal/courts.nsf/page/183 (last visited Jan. 15, 2015).

[113] Federal Judicial Center, *How the Federal Courts are Organized*, *supra* note 112.

[114] 28 U.S.C. § 2402.

[115] Administrative Office of the U.S. Courts, *District Courts*, http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/DistrictCourts.aspx (last visited Jan. 15, 2015).

[116] *See, e.g.*, Administrative Office of the U.S. Courts, *Courts of Appeal*, http://www.uscourts.gov/FederalCourts/UnderstandingtheFederalCourts/CourtofAppeals.aspx (last visited Jan. 15, 2015).

[117] 28 U.S.C. § 1254.

The U.S. Court of Federal Claims is an Article I court that also has jurisdiction over tax refund suits.[118] The court has 16 presidentially appointed judges who serve for a term of 15 years.[119] Jury trials are not available in the U.S. Court of Federal Claims,[120] and appeals from the Court of Federal Claims decisions are heard by the U.S. Court of Appeals for the Federal Circuit (an Article III court),[121] and then on to the U.S. Supreme Court if it grants certiorari.[122]

### *B. Tax Administration*

#### 1. Returns

The United States has a "voluntary" self-assessment tax system. That is, while various statutes require taxpayers to file returns and pay their tax liabilities, taxpayers generally calculate their own tax liability and file the appropriate tax returns.[123] For example, married couples filing jointly generally had to file a joint income tax return for the 2014 tax year if they had more than $20,300 of gross income.[124]

Table 3 shows the number of federal tax returns filed with the IRS for Fiscal Year 2013.[125] Of note, Table 3 does not include the more than two billion W-2s, 1099s, and other third-party information returns that the IRS receives,[126] nor does it include the roughly 680,000 Forms 5500 (Annual Return/Report of Employee Benefit Plan) which are filed by pension plans

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[118] 28 U.S.C. §§ 1491 et seq.; U.S. Court of Federal Claims, *About the Court* (revised Feb. 19, 2014), http://www.uscfc.uscourts.gov/about-court. From August 19 through August 1979, The author Jonathan Barry Forman had the privilege of serving as a judicial clerk of the Honorable Robert J. . See supra note  on this court.

[119] U.S. Court of Federal Claims, *About the Court*, *supra* note 118.

[120] United States Court of Federal Claims, *The People's Court* 4, http://www.uscfc.uscourts.gov/sites/default/files/court_info/Court_History_Brochure.pdf (last visited Jan. 15, 2015).

[121] 28 U.S.C. § 1295; United States Court of Appeals for the Federal Circuit, *Court Jurisdiction*, *available at* http://www.cafc.uscourts.gov/the-court/court-jurisdiction.html (last visited Jan. 15, 2015).

[122] 28 U.S.C. § 1254.

[123] *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATED TO THE REGULATION ON CONDUCT OF PAID TAX RETURN PREPARERS 2 (JCX-34-14, 2014), https://www.jct.gov/publications.html?func=download&id=4580&chk=4580&no_html=1; Internal Revenue Service, *The Truth About Frivolous Tax Arguments* 1-5 (2014), http://www.irs.gov/file_source/pub/irs-utl/friv_tax.pdf.

[124] Internal Revenue Service, *Your Federal Income Tax* 6 tbl. 1-1 (Publication No. 17, 2014), http://www.irs.gov/file_source/pub/irs-pdf/p17.pdf.

[125] 2013 IRS DATA BOOK, *supra* note 7, at 4 tbl. 2.

[126] *See*, *e.g.*, *id.* at 35, 36 tbl. 14 (noting that the IRS received almost 2.1 billion third-party information returns in Fiscal Year 2013).

through the electronic EFAST2 filing system jointly administered by U.S. Department of Labor, the IRS, and the Pension Benefit Guaranty Corporation.[127]

**Table 3. Number of Returns Filed, by Type of Return, Fiscal Year 2013** (numbers are in thousands)

| *Type of Return* | *Number* |
|---|---|
| **United States, total** | **240,076** |
| **Income taxes, total** | **185,035** |
| C or other corporation | 2,248 |
| S corporation, Form 1120–S | 4,566 |
| Partnership, Form 1065 | 3,686 |
| Individual | 145,996 |
| Forms 1040, 1040–A, 1040–EZ | 145,125 |
| Forms 1040–C, 1040–NR, 1040NR–EZ, 1040–PR, 1040–SS | 872 |
| Individual estimated tax, Form 1040–ES | 24,806 |
| Estate and trust, Form 1041 | 3,192 |
| Estate and trust estimated tax, Form 1041–ES | 541 |
| **Employment taxes** | **29,958** |
| **Estate tax** | **32** |
| **Gift tax, Form 709** | **313** |
| **Excise taxes** | **909** |
| **Tax-exempt organizations** | **1,463** |
| **Supplemental documents** | **22,365** |

As already mentioned, in processing those 240 million tax returns in Fiscal Year 2013, the IRS collected almost $2.9 trillion in revenue.[128] The IRS also issued $364 billion in refunds with respect to those 240 million tax returns, and in efforts to combat refund fraud, the IRS suspended or rejected more than 5.7 million suspicious returns and worked with victims of identity fraud to close more than 899,000 cases.[129]

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[127] U.S. Department of Labor, *EFAST2 Filing—Welcome*, http://www.efast.dol.gov/welcome.html (last visited Jan. 15, 2015); U.S. DEPARTMENT OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, PRIVATE PENSION PLAN BULLETIN, *supra* note 63.

[128] *See supra* note 78 and accompanying text.

[129] 2013 IRS DATA BOOK, *supra* note 7, at iii, 1.

2. Voluntary Compliance and the Tax Gap

Most taxpayers voluntarily pay their taxes on time without enforcement actions by the IRS.[130] According to a recent study by the IRS, 83.1% of the true tax liability was voluntarily paid on time without enforcement activities for the 2006 tax year, about the same as for the 2001 tax year.[131] Every percentage point of compliance is vital, as a one percentage point drop in compliance would cost the government around $30 billion per year.[132]

Most of those who do not comply fall into several identifiable categories—primarily individuals with business income and large corporations.[133] The gross tax gap is the difference between a taxpayer's true tax liability and the amounts paid on time.[134] The net tax gap is the difference between true tax liability and amounts paid.[135] The difference between the gross tax gap and the net tax gap reflects IRS enforcement activities, as well as other payments made late without enforcement (such as just before the extended due date or with a voluntary amended or delinquent return).[136] The gross tax gap for 2006, the most recent year for which analysis is

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[130] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 3, 8 (TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers); NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 5 (TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration) ("The U.S. tax system is built on voluntary compliance. The IRS estimates that it collects 85.5 percent of all tax owed. Of that amount, 98 percent is paid timely and voluntarily. Only two percent derives from late and enforced collection actions." [footnotes omitted]).

[131] *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, IR-2012-4 (Jan. 6, 2012), http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study.

[132] Jeremy Scott, *From the Editor: The Precious State of Voluntary Compliance*, 144 TAX NOTES 893 (2014) (reporting on the remarks of IRS Commissioner John Koskinen); William Hoffman, *Koskinen Warns of House IRS Budget's Impact in 2015*, 144 TAX NOTES 919 (2014); National Society of Accountants, *The Latest: IRS Commissioner Koskinen Criticizes Congress at NSA Annual Meeting*, http://www.nsacct.org/publications/the-latest/in-the-news/2014/08/22/irs-commissioner-koskinen-criticizes-congress-at-nsa-annual-meeting (last visited Jan. 15, 2015). Actually, the IRS's 2006 tax gap estimated that a one percentage point drop in compliance cost the government $26.6 billion for the 2006 Tax Year. Internal Revenue Service, *Tax Gap "Map"*, http://www.irs.gov/file_source/pub/newsroom/tax_gap_map_2006.pdf (last visited Jan. 26, 2015) ($26.6 billion per percentage point = $2,210 billion ÷ 83.1%). See also Eric Kroh, *U.S. Seen in Danger of Tumbling Over 'Compliance Cliff'*, 144 TAX NOTES 909 (2014).

[133] *See infra* notes 146-147 and accompanying text.

[134] Internal Revenue Service, *Tax Gap for Tax Year 2006: Overview* 1 (Jan. 6, 2012), http://www.irs.gov/file_source/pub/newsroom/overview_tax_gap_2006.pdf. *See also* James M. Bickley, *Tax Gap, Tax Compliance, and Proposed Legislation in the 112th Congress* 1 (Congressional Research Service Report No. R42739, Sept. 20, 2012), *available at* http://fas.org/sgp/crs/misc/R42739.pdf.

[135] Internal Revenue Service, *Tax Gap for Tax Year 2006: Overview*, *supra* note 134,

[136] *Id.*

complete, was $450 billion.[137] The net tax gap for 2006 was $385 billion, reflecting $65 billion of additional collections.[138] All in all, of the revenue the IRS collects, 98% is paid timely and voluntarily, and only two percent comes from late and enforcement actions.[139]

The tax gap is made up of underreporting, underpaying, and non-filing.[140] Underreporting is by far the largest proportion of the tax gap—$376 billion (83.6%) in 2006.[141] Some $235 billion (62.5%) of the 2006 underreported tax gap was due to the individual income tax.[142] The 2006 tax gap analysis showed that the compliance rate is much higher for income subject to third-party reporting and withholding. For example, wage income is subject to third-party reporting and mandatory withholding,[143] and Figure 2 shows that wages had a tiny net misreporting percentage of just one percent in 2006.[144] Figure 2 also shows that the next best category consists of amounts subject to third-party reporting, but no withholding, such as domestic dividends,[145] with a net misreporting percentage of eight percent.

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[137] *Id.*

[138] *Id.*

[139] NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 5.

[140] *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, *supra* note 131.

[141] *Id.*; Bickley, *Tax Gap, Tax Compliance, and Proposed Legislation in the 112th Congress*, *supra* note 134, at 2.

[142] *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, *supra* note 131, at 2.

[143] I.R.C. §§ 3401 et seq.; Internal Revenue Service, *(Circular E), Employer's Tax Guide* (Publication No. 15, 2014), http://www.irs.gov/file_source/pub/irs-pdf/p15.pdf.

[144] Internal Revenue Service, *Tax Gap for Tax Year 2006: Overview*, *supra* note 134, at 1-2, 3 chart 1.

[145] *See*, *e.g.*, I.R.C. § 6042 (information reporting for dividends); Internal Revenue Service, *2015 Form 1099-DIV, Dividends and Distributions*, http://www.irs.gov/pub/irs-pdf/f1099div.pdf (last visited Jan. 15, 2015).

**Figure 2. Effect of Information Reporting on Taxpayer Compliance (Tax Year 2006 Individual Income Tax Underreporting Gap and Net Misreporting Percentage by "Visibility" Category)**

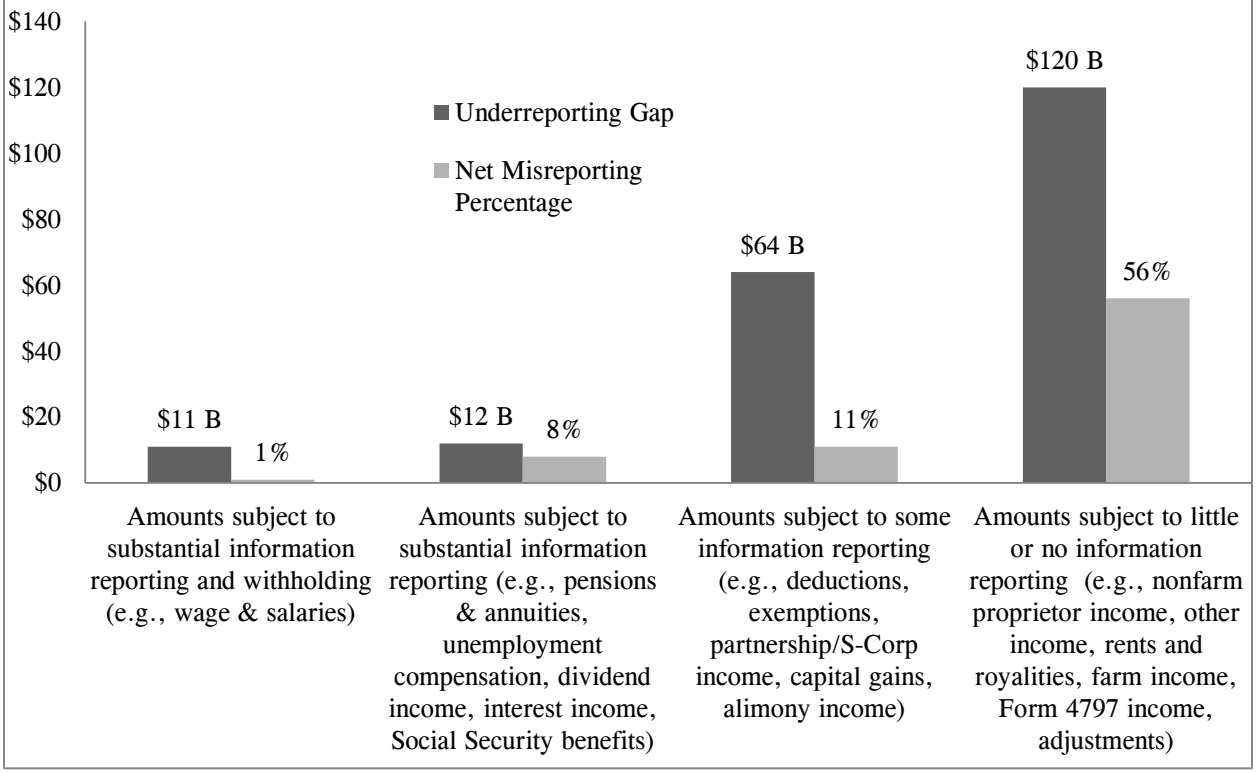


Figure 2 also shows that amounts subject to little of no information reporting by third parties (let alone withholding), such as business income, have a net misreporting percentage of 56%. For individuals, 52% of the underreporting was attributable to such business income.[146] For corporations, 72% of the underreporting was attributable to large corporations, defined as corporations with assets of $10 million or more.[147]

[146] Author calculated percentage from Internal Revenue Service, *Tax Gap "Map"*, *supra* note 132 (52% = $122 billion underreported business income tax liability divided by $235 billion total underreported individual income tax liability).

[147] Author calculated percentage from *id.* (72% = $48 billion underreported corporate income tax liability of large corporations divided by $67 billion total underreported corporate income tax liability).

### 3. Enforcement

The IRS has a number of programs to ensure compliance with the tax filing, reporting, and payment requirements.[148]

#### a. *Math Error*

At the outset, the IRS's Math Error program corrects any obvious math errors as returns are processed.[149] Once a taxpayer has filed a return, the IRS evaluates and processes it. In the routine processing of tax returns, the IRS checks for mathematical and clerical errors before refunds are paid.[150] For example, in 2013, the IRS sent almost 2.0 million notices to taxpayers for such "math errors" on their returns.[151]

#### b. *Document Matching*

The IRS also collects information on taxpayers from employers, financial institutions, and other third parties and compiles that data in its Information Returns Processing (IRP) system.[152] The Automated Underreporter (AUR) program matches that data against the information that taxpayers report on their returns in order to identify returns with potentially underreported income or unwarranted deductions or tax credits.[153] In some cases, a notice is sent to the taxpayer asking for an explanation of the discrepancy, while other cases are referred for an audit.[154] The Automated Substitute for Return (ASFR) program uses that IRP third-party data to identify non-filers and to create substitute returns for them.[155]

#### c. *Examinations*

Correspondence Examinations are formal audits that are handled through correspondence between the taxpayer and the IRS examiner.[156] Field Examinations are face-to-face audits involving meetings between the taxpayer and the IRS examiner.[157]

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[148] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-151, TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES 3-5 (2012), http://www.gao.gov/assets/660/650521.pdf.

[149] *Id.* at 4.

[150] *Id.* The Math Error program also disallows various benefits under certain circumstances.

[151] 2013 IRS DATA BOOK, *supra* note 7, at 35, 38 tbl. 15.

[152] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-151, TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES, *supra* note 148, at 4.

[153] *Id.*

[154] *Id.*

[155] *Id.* at 4-5.

[156] *Id.* at 5.

[157] *Id.*

In Fiscal Year 2013, the IRS examined 1,558,057 returns, about 0.8% of the 189,858,832 returns considered that year.[158] There were 466,093 field examinations and 1,091,964 correspondence examinations,[159] and altogether the IRS recommended additional taxes of more than $62 billion.[160]

Roughly one percent of individual income tax returns were examined in Fiscal Year 2013, including 2.5% of returns with at least $200,000 of income and 10.8% of returns with more than $1,000,000 of income.[161] The IRS also examined 1.4% of corporate income tax returns that year, including, for example, 38% of corporations with between $1 and $5 billion of assets and 91.2% of corporations with $20 billion or more in assets.[162] The IRS also examined 0.42% of Subchapter S Corporations and 0.42% of partnerships.[163] In addition, the IRS examined 25,980 returns of tax-exempt organizations, employee retirement plans, government entities, and tax-exempt bonds.[164]

d. *Appeals within the IRS*

When taxpayers disagree with IRS decisions to assess additional tax or take collection action, taxpayers are generally entitled to an administrative review with the Office of Appeals (Appeals), an independent organization within the IRS.[165] Appeals handles more than 120,000 cases a year.[166] Most of the cases arise as a result of IRS examination or collection activities.[167] In a typical case, the taxpayer gets to Appeals after an audit by filing a protest to the 30-day

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[158] 2013 IRS DATA BOOK, *supra* note 7, at 22 tbl. 9a. *See also* Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, http://www.irs.gov/file_source/PUP/newsroom/FY%202013%20Enforcement%20and%20Service%20Results%20--%20WEB.pdf (last visited Jan. 15, 2015) (reporting slightly different numbers).

[159] 2013 IRS DATA BOOK, *supra* note 7, at 22 tbl. 9a.

[160] *Id.* at 23 tbl. 9a ($62,293,478 = $35,410,048,000 + $26,883,430,000).

[161] *Id. See also* Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 3 (showing slightly different figures).

[162] 2013 IRS DATA BOOK, *supra* note 7, at 23 tbl. 9a. *See also* Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 6 (showing that the IRS examined 15.84% of the returns of large corporations, defined as those with $10 million or more in assets).

[163] Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 5.

[164] 2013 IRS DATA BOOK, *supra* note 7, at 33 tbl. 13.

[165] *See*, *e.g.*, INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL Part 8 (Appeals), http://www.irs.gov/irm/part8/irm_08-001-001.html; Internal Revenue Service, *Appeals . . . Resolving Tax Disputes*, http://www.irs.gov/Individuals/Appeals…-Resolving-Tax-Disputes (last updated Nov. 6, 2014); U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-06-396, TAX ADMINISTRATION: OPPORTUNITIES TO IMPROVE COMPLIANCE DECISIONS AND SERVICE TAXPAYERS THROUGH ENHANCEMENTS TO APPEALS' FEEDBACK PROJECT 1 (2006), http://www.gao.gov/assets/250/249414.pdf.

[166] *See*, *e.g.*, 2013 IRS DATA BOOK, *supra* note 7 at 49 tbl. 21 (showing that Appeals received 123,113 cases in Fiscal Year 2013 and closed 131,176 cases).

[167] *Id.*

letter that she receives from the IRS.[168] Also, filing a petition in the U.S. Tax Court will generally result in the taxpayer's case being referred to Appeals if it has not already considered the dispute,[169] and many IRS collection actions also lead to Appeals.[170]

e. *Collection Activities*

While most taxpayers pay the taxes that are shown on their returns or subsequently assessed after the IRS reviews their returns,[171] the IRS also endeavors to collect taxes that have been reported or assessed but not paid voluntarily. In Fiscal Year 2013, for example, the IRS filed 602,005 federal tax liens and served 1,855,095 notices of levy on third parties.[172]

Noncompliance with the tax laws can also result in civil and criminal penalties.[173] For example, in Fiscal Year 2013, the IRS assessed more than 37 million civil penalties and initiated 5,314 criminal investigations.[174]

f. *Revenue Collected by Enforcement Activities*

Table 4 summarizes how much revenue the IRS has collected in recent years as a result of its various enforcement activities.[175]

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[168] *See*, *e.g.*, Internal Revenue Service, *Letters and Notices Offering an Appeal Opportunity*, http://www.irs.gov/Individuals/Letters-and-Notices-Offering-an-Appeal-Opportunity (last updated, Apr. 15, 2013); Internal Revenue Service, *Examination of Returns, Appeal Rights, and Claims for Refund* 5 (Publication No. 556, 2013), http://www.irs.gov/file_source/pub/irs-pdf/p556.pdf.

[169] Internal Revenue Service, *Examination of Returns, Appeal Rights, and Claims for Refund*, *supra* note 168, at 9; INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 8.4.1 (Appeals Docketed Cases), http://www.irs.gov/irm/part8/irm_08-004-001.html.

[170] *See*, *e.g.*, Internal Revenue Service, *Collection Appeal Rights* (Publication No. 1660, 2012), http://www.irs.gov/file_source/pub/irs-pdf/p1660.pdf; INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 8.22.4 (Collection Due Process Appeals Program), http://www.irs.gov/irm/part8/irm_08-022-004.html.

[171] *See supra* note 131 and accompanying text.

[172] *Id.* at 41 tbl. 16. A federal tax lien gives the IRS a claim to all of a taxpayer's property. *See*, *e.g.*, I.R.C. §§ 6321 et seq.; Internal Revenue Service, *Understanding a Federal Tax Lien*, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Understanding-a-Federal-Tax-Lien (last updated Nov. 6, 2014). A levy is an administrative action by the IRS to seize property to satisfy a tax debt. *See*, *e.g.*, I.R.C. §§ 6331 et seq.; Internal Revenue Service, *Levy*, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Levy (last updated Sept. 9, 2014).

[173] Civil penalties include: I.R.C. §§ 6651 (failure to file tax return or to pay tax), 6662 (imposition of accuracy-related penalty on understatements) & 6663 (imposition of fraud penalty); and criminal penalties include: I.R.C. §§ 7201 (attempt to evade or defeat tax) & 7206 (fraud and false statements).

[174] 2013 IRS DATA BOOK, *supra* note 7, at 42 tbl. 17, 44 tbl. 18.

[175] Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 1 tbl.

**Table 4. Enforcement Revenue Collected, by Fiscal Year** (billions of dollars)

| | *2004* | *2005* | *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* |
|---|---|---|---|---|---|---|---|---|---|---|
| Collection | 25.7 | 26.6 | 28.2 | 31.8 | 31.1 | 26.9 | 29.1 | 31.10 | 30.44 | 31.40 |
| Examination | 12.5 | 13.8 | 13.0 | 15.2 | 15.8 | 12.6 | 16.9 | 12.40 | 10.20 | 9.83 |
| Appeals | 2.2 | 3.9 | 4.3 | 8.3 | 4.8 | 4.8 | 6.7 | 6.50 | 4.20 | 6.83 |
| Document Matching | 2.7 | 3.1 | 3.3 | 3.9 | 4.7 | 4.6 | 4.9 | 5.20 | 5.27 | 5.29 |
| **Total** | **43.1** | **47.3** | **48.7** | **59.2** | **56.4** | **48.9** | **57.6** | **55.20** | **50.20** | **53.35** |

4. Litigation

Taxpayers who disagree with IRS decisions may be able to take their cases to the U.S. Tax Court, a U.S. District Court, or the U.S. Court of Federal Claims.[176] When a taxpayer receives a notice of deficiency from the IRS, the taxpayer usually has 90 days to file a petition in the U.S. Tax Court.[177] When a taxpayer receives an adverse determination after a collection due process hearing at IRS Appeals, the taxpayer has 30 days to file an appeal to the U.S. Tax Court.[178] The Tax Court handles some 30,000 cases a year.[179]As already mentioned, appeals generally go to the U.S. Court of Appeals where the taxpayer is located and then on to the U.S. Supreme Court.[180]

Alternatively, taxpayer claims for the refund of any tax paid can be brought to the appropriate U.S. District Court or in the U.S. Court of Federal Claims.[181] These courts hear refund suits only after the taxpayer has paid the tax and filed a claim for refund with the IRS.[182] The U.S. Department of Justice also initiates numerous civil and criminal cases in the U. S. District Courts.[183] As already mentioned, there are 94 U.S. District Courts around the country, and appeals go to 12 regional U.S. Courts of Appeal, and then on to the U.S. Supreme Court.[184] Also, as already mentioned, the U.S. Court of Federal Claims is a court of

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[176] Internal Revenue Service, *Examination of Returns, Appeal Rights, and Claims for Refund*, *supra* note 168, at 9. *See supra* Section II.A.3.

[177] I.R.C. § 6213 (or 150 days if the notice is addressed to a person outside the United States).

[178] I.R.C. § 6330(d)(1); Danshera Cords, *How Much Process is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings*, 29 VERMONT LAW REVIEW 51 (2004). See also Leslie Book, *The Collection Due Process Rights: A Misstep of Step in the Right Direction*, 41 HOUSTON LAW REVIEW 1145 (2004).

[179] 2013 IRS DATA BOOK, *supra* note 7, at 61 tbl. 27 (showing that the Chief Counsel of the Internal Revenue Service received 29,837 Tax Court cases in Fiscal Year 2013).

[180] *See supra* notes 110-111 and accompanying text.

[181] Internal Revenue Service, *Your Appeal Rights and How To Prepare a Protest If You Don't Agree* 2 (Publication No. 5, 1999), http://www.irs.gov/pub/irs-pdf/p5.pdf. See *supra* note 103 and accompanying text.

[182] Internal Revenue Service, *Your Appeal Rights and How To Prepare a Protest If You Don't Agree*, *supra* note 181, at 2.

[183] U.S. Department of Justice, *About the Tax Division*, *supra* note 91.

[184] *See supra* notes 115-117 and accompanying text.

national jurisdiction located in Washington, D.C., and appeals go the U.S. Court of Appeals for the Federal Circuit, and then on to the Supreme Court.[185]

The IRS Office of Chief Counsel handles Tax Court litigation,[186] while the U.S. Department of Justice Tax Division handles most affirmative and defensive tax litigation in the remaining federal courts,[187] with the Office of the Solicitor General handling all the Supreme Court cases.[188] The Tax Division typically handles around 6,600 civil tax cases, 700 tax appeals, and alone or with the Assistant U.S. Attorneys, the Tax Divisions works between 1,300 and 1,800 criminal tax cases each year.[189]

Pertinent here, the IRS's Low-Income Taxpayer Clinic program provides grants to independently operated low-income taxpayer clinics (LITCs) throughout the United States.[190] Internal Revenue Code Section 7526(b)(1)(B)(i) requires that at least 90% of the taxpayers represented by a LITC to have incomes that do not exceed 250% of the federal poverty level.[191] In 2013, LITCs provided representation in more than 18,000 cases and held more than 25,000 direct consultations with taxpayers.[192] In 2014, the IRS awarded about $10 million in grants to LITCs in 47 States and the District of Columbia.[193]

5. Guidance and Other Activities

The IRS also provides guidance and other assistance for taxpayers. For example, the IRS updates almost all of its forms and publications each year.[194] Also, along with the Office of Chief Counsel and the Treasury Office of Tax Policy, the IRS is actively involved in issuing regulations, revenue rulings, revenue procedures, and other formal guidance.[195] The IRS also issues private letter rulings (PLRs) to taxpayers on qualifying issues.[196] While the IRS collects

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[185] *See supra* notes 118-122 and accompanying text.

[186] *See*, *e.g.*, INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 35.5.1.1 (Responsibilities of the Office of Chief Counsel), http://www.irs.gov/irm/part35/irm_35-005-001.html.

[187] U.S. Department of Justice, *About the Tax Division*, *supra* note 91.

[188] *See supra* note 94 and accompanying text.

[189] *See*, *e.g.*, U.S. Department of Justice, *Tax Division United States Department of Justice FY2015 Congressional Budget* 1 (2014), http://www.justice.gov/jmd/2015justification/pdf/tax-justification.pdf.

[190] *See*, *e.g.*, Taxpayer Advocate Service, *Low Income Taxpayer Clinics Program Report* 4 (Dec. 2014), http://www.irs.gov/pub/irs-pdf/p5066.pdf.

[191] *Id.* at 7.

[192] *Id.* at 10.

[193] *Id.* at 11, 22 Appendix A.

[194] *See*, *e.g.*, Internal Revenue Service, *Forms & Publications*, http://www.irs.gov/Forms-&-Pubs (last updated May 15, 2014).

[195] *See*, *e.g.*, INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL Part 32 (Published Guidance and Other Guidance to Taxpayers), http://www.irs.gov/irm/part32/irm_32-001-001.html.

[196] *See*, *e.g.*, Rev. Proc. 2015-1, 2015-1 I.R.B. 1; INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 32.3.2 (Letter Rulings), http://www.irs.gov/irm/part32/irm_32-003-002.html.

a fee for PLRs, which varies depending on the requesting taxpayer's category, it is unclear whether the PLR fees cover the administrative costs of issuing PLRs.[197]

In addition, the IRS communicates directly with millions of taxpayers and their representatives. In Fiscal Year 2013, for example, there were more than 450 million hits on the irs.gov website, and more than 90 million taxpayers got assistance through its toll-free telephone hotline or at walk-in sites.[198] The IRS Taxpayer Advocate Service also provided post-filing taxpayer assistance to almost 245,000 taxpayers that year.[199]

In addition to dealing with revenue-generating taxpayers, the IRS also provides formal guidance to employee retirement plans, tax-exempt organizations, and the issuers of tax-exempt bonds.[200] The IRS also routinely issues determination letters on employee retirement plans and reviews and approves applications for tax-exempt status by charities and other tax-exempt organizations.[201]

### 6. A Summary of the IRS Budget and Staffing Levels

At bottom, it is the IRS that is America's tax administrator, although it does get some help from other agencies. Accordingly, it makes sense to take a closer look at the IRS's budget and staffing levels. In that regard, Table 5 shows how the IRS allocated its budget in Fiscal Year 2013.[202] Pertinent here, Congress appropriates separate amounts for distinct categories of IRS activity (i.e., Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization), and funds generally cannot be shifted from one appropriation to another.[203]

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[197] Rev. Proc. 2015-1, *supra* note 196. PLR user fees range from $2,200 to $28,300, with discounts for substantially identical requests. *Id.* at 79 (Appendix A—Schedule of User Fees).

[198] 2013 IRS DATA BOOK, *supra* note 7, at 45.

[199] *Id.* at 48 tbl. 20.

[200] *See*, *e.g.*, *id.*, at 53, tbl. 22.

[201] *See*, *e.g.*, *id.* at 54 tbl. 23, 55, tbl. 24, 56 tbl. 25.

[202] *Id.* at 65 tbl. 28.

[203] *See*, *e.g.*, Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, div. E, tit. I (Internal Revenue Service), 128 Stat. 2130, 2336-40 (2014).

**Table 5. Costs Incurred by Budget Activity, Fiscal Year 2013** (thousands of dollars)

| *Budget activity* | *Total* | *Personnel compensation and benefits* | *Other* |
|---|---|---|---|
| **Total obligations against appropriated funds** | **11,597,560** | **8,549,759** | **3,047,801** |
| Taxpayer Services | | | |
| Total | 2,330,161 | 2,173,599 | 156,562 |
| Prefiling Taxpayer Assistance and Education | 603,594 | 551,184 | 52,410 |
| Filing and Account Services | 1,726,567 | 1,622,415 | 104,152 |
| Enforcement | | | |
| Total | 4,960,528 | 4,737,220 | 223,308 |
| Investigations | 595,568 | 561,922 | 33,646 |
| Examinations and Collections | 4,200,534 | 4,015,682 | 184,852 |
| Regulatory | 164,426 | 159,616 | 4,810 |
| **Operations Support** | | | |
| **Total** | **4,048,812** | **1,571,076** | **2,477,736** |
| Infrastructure | 895,702 | 925 | 894,777 |
| Shared Services and Support | 1,134,735 | 701,432 | 433,303 |
| Information Services | 2,018,375 | 868,719 | 1,149,656 |
| **Business Systems Modernization** | **258,059** | **67,864** | **190,195** |

Table 6 shows how the IRS allocated its staff in Fiscal Year 2013.[204]

[204] *Id.* at 67 tbl. 30.

**Table 6. Personnel Summary by Employment Status, Budget Activity, and Selected Personnel Type, Fiscal Year 2013**

| *Employment status, budget activity, and selected personnel type* | *Average positions realized* | *Number of employees at close of fiscal year* |
|---|---|---|
| **Internal Revenue Service, total** | **86,974** | **83,613** |
| **Employment status:** | | |
| Full-time permanent | 84,985 | 81,296 |
| Other | 1,989 | 2,317 |
| **Budget activity:** | | |
| Examinations and Collections | 39,454 | 39,825 |
| Filing and Account Services | 24,881 | 20,780 |
| Information Services | 6,708 | 7,230 |
| Prefiling Taxpayer Assistance & Education | 5,505 | 5,623 |
| Shared Services and Support | 5,061 | 5,111 |
| Investigations | 3,691 | 3,734 |
| Regulatory | 1,223 | 1,232 |
| Business Systems Modernization | 451 | 78 |
| **Selected personnel type:** | | |
| Revenue Agents | 12,270 | 12,212 |
| Seasonal Employees | 11,108 | 6,696 |
| Customer Service Representatives | 9,131 | 9,632 |
| Tax Examiners | 8,724 | 8,894 |
| Revenue Officers | 4,748 | 4,681 |
| Special Agents | 2,509 | 2,539 |
| Tax Technicians | 1,515 | 1,496 |
| Attorneys | 1,497 | 1,523 |
| Appeals Officers | 811 | 800 |

## 7. A Closer Look at the Tax Gap and Compliance

All in all, the IRS is amazingly effective at collecting revenue, despite the relatively low level of audits and other enforcement and collection efforts. For example, in Fiscal Year 2013, the IRS—with a budget of just $11.6 billion—collected more than $2.9 trillion dollars, and that works out to $0.41 for every $100 collected that year.[205] Put differently, that is an average

[205] *Id.* at 63, 66 tbl. 29.

return on investment of about 244 to 1: for every $1 spent on IRS operations, $244 was collected.[206]

To be sure, the tax revenue paid voluntarily costs little to deposit (although determining the correct amounts to refund can require significant efforts). The presence of IRS educational, enforcement, and collection activities seems to inspire voluntary compliance, although the degree to which this is true is unclear.[207] Changes in audit coverage are generally believed to affect voluntary compliance by altering taxpayers' perceived risks of being audited—the higher the risk of being audited, the less likely a taxpayer is to evade taxes.[208] This is consistent with the classic economic theory of tax evasion, which holds that a rational taxpayer will evade taxes if the expected savings from tax evasion exceed the expected penalty for non-compliance.[209]

Accordingly, it would almost certainly make sense to increase the IRS's budget significantly, and it is no wonder that IRS Commissioner John A. Koskinen called the recent Fiscal Year 2015 budget cuts "a tax cut for tax cheats."[210] Unfortunately, however, we do not think that IRS budget increases are very likely, even in the long run.[211] While spending more on enforcement would almost certainly raise far more revenue than it costs, increasing enforcement might also increase the burdens on compliant taxpayers.[212] For example, audits are burdensome for both compliant and noncompliant taxpayers, and even now many audits result in no-change findings.[213] Our politicians are loath to increase enforcement budgets to

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[206] Authors' computation, following Internal Revenue Service, *National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on Tax Reform, IRS Funding and Identity Theft*, IR-2013-3 (Jan. 9, 2013), http://www.irs.gov/uac/Newsroom/National-Taxpayer-Advocate-Delivers-2012-Annual-Report-to-Congress (finding a return on investment of 214 to 1 for Fiscal Year 2012).

[207] Recall that 83.1% of tax liabilities are voluntarily paid on time, and that a one percentage point drop in compliance would cost the government around $30 billion per year. *See supra* notes 131-132 and accompanying text.

[208] Pertinent here, the U.S. Government Accountability Office (GAO) has noted that the voluntary tax compliance of taxpayers' who were not examined could be affected by resource reallocation. U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-151, TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES, *supra* note 148, at 12. However, the indirect effects of enforcement activities are difficult to estimate, and no empirical evidence exists as to whether overall voluntary compliance would increase or decrease as a result of specific resource reallocations. *Id.*

[209] *See, e.g.*, Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 JOURNAL OF PUBLIC ECONOMICS 323 (1972).

[210] Associated Press, *IRS Head Says Budget Cuts Could Delay Tax Refunds*, NEW YORK TIMES, *supra* note 2.

[211] *See infra* Section III.A.

[212] *See, e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO/T-GGD-97-186, TAXPAYER RIGHTS AND BURDENS DURING AUDITS OF THEIR TAX RETURNS (STATEMENT OF JAMES WHITE) (1997), http://www.gao.gov/assets/110/107079.pdf.

[213] *See, e.g.*, U.S. Treasury Inspector General for Tax Administration, *The Recommended Adjustments From S Corporation Audits Are Substantial, but the Number of No-Change Audits Is a Concern* (Reference No. 2012-30-

maximize revenues, as they want to balance their desire for revenue with the political costs of inflicting pain on compliant taxpayers.[214] Some even ascribe nefarious motives to Congress's recent IRS budget cuts. For example, Jared Bernstein, former chief economist to Vice-President Joseph Biden, considers the IRS budget cuts to be "a different way to shrink government, accommodate tax evasion, and even undermine the implementation of health reform."[215]

## III. KEY PROBLEMS WITH CURRENT TAX ADMINISTRATION

### *A. The Internal Revenue Service is Significantly Underfunded*

The Internal Revenue Service is seriously underfunded. At the outset, Table 7 shows how IRS costs and personnel changed from Fiscal Year 2004 through Fiscal Year 2013.[216] Along the same lines, the number of individual income tax returns filed increased by 11% from Fiscal Year 2005 to Fiscal Year 2014 (from 132.8 million returns to 147.8 million), and the number of business entity returns increased by 18% over that period (from 8.8 million returns to 10.4 million).[217]

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062, June 21, 2012), http://www.treasury.gov/tigta/auditreports/2012reports/201230062fr.pdf (expressing concern that 62% of the S corporation returns audited after selection by the Discriminant Index Function system were closed as a no-change).

[214] For example, the National Taxpayer Advocate argues that "the government has a moral and practical imperative to make the tax compliance process as painless as possible." NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 5. On the other hand, the real or perceived "pain" of the IRS's enforcement activities undoubtedly contributes to the overall deterrent effect of that enforcement: people want to avoid that pain, as well as any additional tax and penalties due.

[215] Jared Bernstein, *Why the GOP really wants to defund IRS*, WASHINGTON POST, July 1, 2014, http://www.washingtonpost.com/posteverything/wp/2014/07/01/why-the-gop-really-wants-to-defund-irs/?hpid=z11. See also Associated Press, *IRS Head Says Budget Cuts Could Delay Tax Refunds*, NEW YORK TIMES, *supra* note 2.

[216] 2013 IRS DATA BOOK, *supra* note 7, at 66 tbl. 29. Inflation-adjusted operating costs calculated by author using the Bureau of Labor Statistics, *CPI Inflation Calculator*, *available at* http://www.bls.gov/data/inflation_calculator.htm (last visited Jan. 15, 2015).

[217] NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 9, 10.

**Table 7. Costs, Personnel, and U.S. Population, FY2004-FY2013**

| *Fiscal year* | *Operating Costs (thousands of dollars)* | *Operating Costs (adjusted to 2013, thousands of dollars)* | *Number of Employees (full-time equivalent position realized)* | *U.S. population (thousands)* |
|---|---|---|---|---|
| 2004 | $9,756,344 | $12,031,809 | 97,597 | 294,230 |
| 2005 | $10,397,837 | $12,402,712 | 94,282 | 296,972 |
| 2006 | $10,605,845 | $12,255,491 | 91,717 | 299,835 |
| 2007 | $10,764,736 | $12,094,614 | 92,017 | 302,807 |
| 2008 | $11,307,223 | $12,234,368 | 90,647 | 305,554 |
| 2009 | $11,708,604 | $12,713,892 | 92,577 | 308,189 |
| 2010 | $12,353,344 | $13,197,512 | 94,711 | 310,390 |
| 2011 | $12,358,877 | $12,799,405 | 94,709 | 312,649 |
| 2012 | $12,059,409 | $12,236,051 | 90,280 | 314,908 |
| 2013 | $11,597,560 | $11,597,560 | 86,974 | 317,132 |

Despite the IRS's ever-increasing responsibilities, its IRS's budget has been slashed—by about 17% in real dollars between Fiscal Years 2010 and 2015.[218] For example, although President Obama's requested $12.861 billion for the IRS in Fiscal Year 2014, Congress appropriated just $11.290 billion.[219] Worse still, President Obama's call for $12.476 billion for the IRS in Fiscal Year 2015[220] was met—three months into the fiscal year—with an appropriation of just $10.95 billion, a three-percent cut from Fiscal Year 2014.[221]

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[218] *Id.* at Vol. 1, at viii. *See also* IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report*, *supra* note 3, at 8 (noting that the IRS saw its budget fall in nominal terms in three of the past four fiscal years)

[219] IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report*, *supra* note 3, at, 8 fig. 1.

[220] *Id.*

[221] Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, div. E, tit. I (Internal Revenue Service), 128 Stat. 2130, at 2336-40 (2014); Rachael Bade, *Republicans seek to cripple IRS*, POLITICO, Dec. 11, 2014, http://www.politico.com/story/2014/12/republicans-irs-regulations-113484.html; Catherine Rampell, *As Congress cripples the IRS, tax rates are likely to rise*, WASHINGTON POST, Dec. 15, 2014, http://www.washingtonpost.com/opinions/catherine-rampell-as-congress-cripples-the-irs-tax-rates-are-likely-to-rise/2014/12/15/a7a30754-8476-11e4-b9b7-b8632ae73d25_story.html?wpisrc=nl_opin&wpmm=1; *IRS 2015 Budget Cut Is 'Troubling Development,' Koskinen Says*, 2014 TAX NOTES TODAY 243-12 (Dec. 17, 2014); Matthew R. Madara, *IRS Facing 5 Percent Budget Cut From 2014 Levels, Olson Warns*, 145 TAX NOTES 1093 (Dec. 8, 2014); Stephen K. Cooper, *House Passes Omnibus Spending Bill; Senate Approval Expected*, 145 Tax Notes 1195 (2014). *See also* William Hoffman, *IRS Budget Cuts 'Will Be Visible' in 2015, Koskinen Warns*, 145 TAX NOTES 1208 (2014); Daniel Nasaw & Brian McGill, *Funding Bill: The Losers*, WALL STREET JOURNAL, Dec. 10, 2014, http://blogs.wsj.com/washwire/2014/12/10/funding-bill-the-losers; Marc Heller, *Spending Bill Puts Squeeze, Restrictions on IRS for 2015*, 238 DAILY TAX REPORT (BNA) G-4 (Dec. 11, 2014); U.S. Department of the Treasury, *The Budget in Brief: Internal Revenue Service FY 2015* (2014), http://www.irs.gov/PUP/newsroom/IRS%20FY%202015%20Budget%20in%20Brief.pdf.

Even before the Fiscal Year 2015 budget cut, the IRS was operating at the lowest budget level in ten years (adjusted for inflation); it had already absorbed more than one billion in budget cuts since 2010; and it has reduced the number of employees by 17,000 since then.[222] In that regard, Figure 3 shows how recent IRS budget cuts have led to significant declines in IRS staffing for key enforcement occupations.[223] In response to the latest round of budget cuts, the IRS has implemented a hiring freeze, ceased most overtime pay, and further cut its travel budget.[224]

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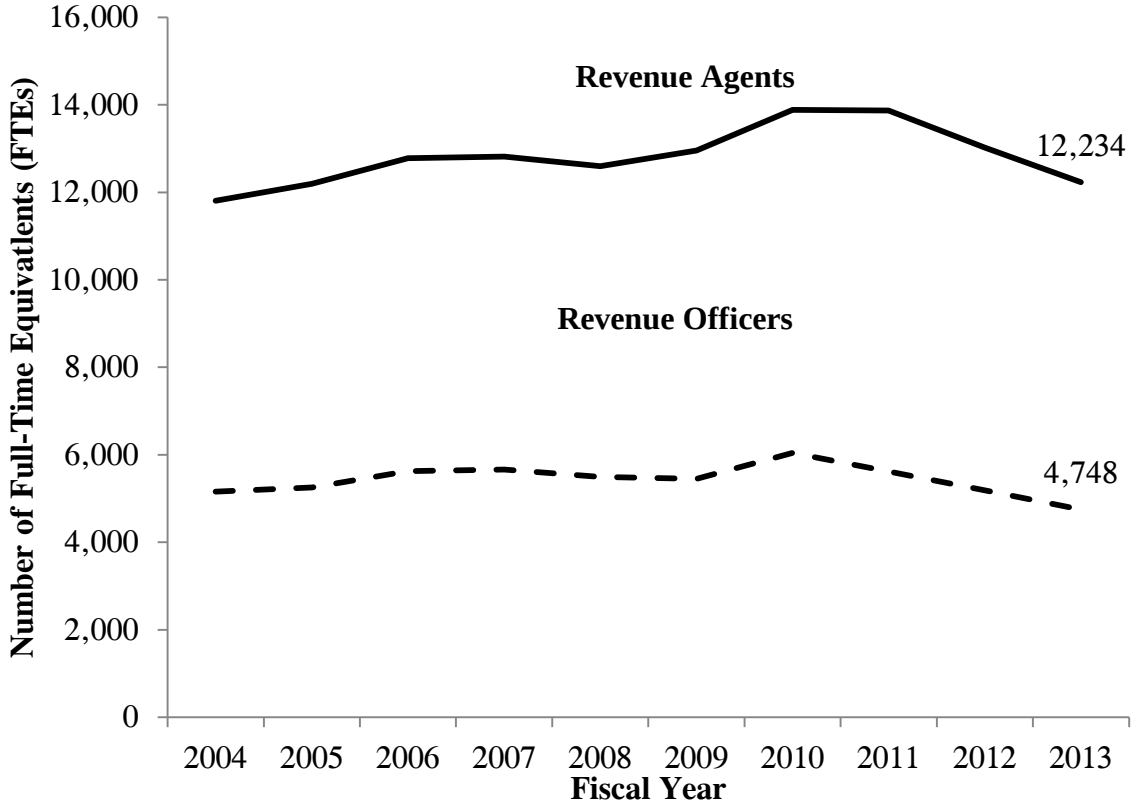
[222] William Hoffman, *Koskinen Denies IRS Service Cuts Are a Protest Over Its Budget*, 2015 TAX NOTES TODAY 11-1 (Jan. 16, 2015); Bade, *Republicans seek to cripple IRS*, *supra* note 221. *See also* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-534R, INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE 2 (2014), http://www.gao.gov/assets/670/662681.pdf; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-605, IRS 2015 BUDGET: LONG-TERM STRATEGY AND RETURN ON INVESTMENT DATA NEEDED TO BETTER MANAGE BUDGET UNCERTAINTY AND SET PRIORITIES 1 (2014), http://www.gao.gov/assets/670/664083.pdf; Bernstein, *Why the GOP really wants to defund IRS*, *supra* note 215; Chuck Marr & Joel Friedman, *Cuts in IRS Budget Have Compromised Taxpayer Service and Weakened Enforcement* (Center on Budget and Policy Priorities, June 25, 2014), http://www.cbpp.org/files/6-25-14tax.pdf (estimating that the IRS has cut its staff by 11% from 2011 to 2014).

[223] Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 1. *See also* IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report*, *supra* note 3, at 14 fig. 6; U.S. Treasury Inspector General for Tax Administration, *Declining Resources Have Contributed to Unfavorable Trends in Several Key Automated Collection System Business Results* (Reference No. 2014-30-080, Sept. 18, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201430080fr.pdf.

[224] William Hoffman & Tom Kasprzak, *Omnibus Prompts IRS Hiring Freeze, Travel Cuts*, 145 TAX NOTES 1323 (2014). *See also* William Hoffman, *Year in Review: Koskinen's Tough Job Likely to Get Tougher in 2015*, 146 TAX NOTES 18 (2015); *Koskinen Outlines How 2015 Budget Cuts Will Affect IRS Employees*, 2015 TAX NOTES TODAY 9-18 (Jan. 13, 2015) (reprinting a message of budget gloom from IRS Commissioner John A. Koskinen to IRS employees).

**Figure 3. Staffing for Key Enforcement Occupations**




While the IRS has been able to use increased electronic filing of tax returns, web-based services, and automation to become more efficient, those improvements have not been enough to offset the recent cuts in the IRS's budget and personnel.[225] Unquestionably, the declines in personnel and resources have led to a decrease in the number of returns examined, and most examinations are now conducted by correspondence.[226] In that regard, Table 8 shows how recent budget cuts have led to a decline in the audit rates of large corporations (those with

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[225] Budget cuts have also contributed to a lower morale among IRS employees. *See, e.g.*, Hoffman, *Year in Review: Koskinen's Tough Job Likely to Get Tougher in 2015*, *supra* note 224; Pete Kasperowicz, *The Next Big Problem at the IRS: Low Worker Morale*, THE BLAZE, July 23, 2014, http://www.theblaze.com/stories/2014/07/23/the-next-big-problem-at-the-irs-low-worker-morale/.

[226] U.S. Treasury Inspector General for Tax Administration, *Trends in Compliance Activities Through Fiscal Year 2013* 13-15 (Reference No. 2014-30-062, Sept. 12, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201430062fr.pdf.

assets of more than $10 million).[227] As already mentioned, 72% of the corporate tax underreporting was due to large corporations.[228]

**Table 8. Examination - Large Corporation Return Closures and Coverage Rates, by Fiscal Year (corporations with assets $10 Million and Higher)**

| | *2004* | *2005* | *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Returns Examined | 9,523 | 10,829 | 10,578 | 9,644 | 9,406 | 9,536 | 10,207 | 10,459 | 10,752 | 9,876 |
| Returns Filed in Prior CY | 56,883 | 54,091 | 56,877 | 57,357 | 61,641 | 65,546 | 61,570 | 59,291 | 60,489 | 62,347 |
| Coverage | 16.7% | 20.0% | 18.6% | 16.8% | 15.3% | 14.5% | 16.6% | 17.6% | 17.78% | 15.84% |

Moreover, according to the IRS Oversight Board, "Uncertainty in the budget process and limited funding has hindered the IRS in addressing its long term strategic goals and initiatives."[229] The IRS Oversight Board emphasized that:

> Congress has increasingly called upon the IRS to implement the tax-related portions of new legislation. Although the IRS has been tasked with more and more responsibilities, it has not received sufficient funding to carry them out.[230]

The IRS Oversight Board's concern about the underfunding of the IRS has been echoed by many other government officials. Indeed, the National Taxpayer Advocate has repeatedly argued that underfunding is one of the most serious problems facing the IRS,[231] and the Internal Revenue Service Advisory Council has also expressed concern.[232]

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[227] Internal Revenue Service, *Fiscal Year 2013 Enforcement and Service Results*, *supra* note 158, at 6. *See also* TRACIRS, *Audit Rates for Largest Corporations with Assets of $250 Million or More* (2014), http://trac.syr.edu/tracirs/highlights/current/auditrateG.html.

[228] *See supra* note 147 and accompanying text.

[229] IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report*, *supra* note 3, at 5. *See also* IRS Oversight Board, *FY2014 IRS Budget Recommendation Special Report* (2013), http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_FY14%20IRS%20Budget_Web061413.pdf; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-605, IRS 2015 BUDGET: LONG-TERM STRATEGY AND RETURN ON INVESTMENT DATA NEEDED TO BETTER MANAGE BUDGET UNCERTAINTY AND SET PRIORITIES *supra* note 222, at 15 (The IRS Has No Long-Term Strategy to Address an Uncertain Budget Environment"); IRS Oversight Board, *FY2013 IRS Budget Recommendation Special Report* (2012), http://www.treasury.gov/IRSOB/reports/Documents/_IRSOB%20FY13%20BUDGET%20REPORT.pdf; IRS Oversight Board, *Annual Report to Congress 2013* (2014), http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_Annual%20Report%202013.pdf.

[230] IRS Oversight Board, *FY2015 IRS Budget Recommendation Special Report*, *supra* note 3, at 11.

[231] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 21; NATIONAL TAXPAYER ADVOCATE, 2011 ANNUAL REPORT TO CONGRESS (2012), at Vol. 1, at 3 (The IRS Is

The Treasury Inspector General for Tax Administration (TIGTA) has also found that key examination and collection statistics showed declines from 2012 to 2013 as the result of budget cuts.[233] Examinations of individual tax returns declined by approximately five percent, and collection activities such as taxpayer liens, levies, and property seizures declined approximately 33%.[234]

TIGTA's analysis of IRS data also showed that reduced funding affected key customer service efforts.[235] Customer service trends showed that the level of service—defined as the relative success rate of taxpayers calling the IRS toll-free assistance lines—declined from 70% in 2009 to just 61% in 2013.[236] The average telephone call wait time has nearly doubled from 8.8 minutes to 16.8 minutes over the period from Fiscal Year 2009 to mid-March 2014.[237]

Things are certainly not going to get any better on the customer service front. In December of 2014, IRS Commissioner John A. Koskinen noted that that "only about 50 percent of the taxpayers who call can reach us on the phone" and "some 24 million Americans may not be able to reach us for help."[238] With the Fiscal Year 2015 cuts now in place, the level of phone service could be as low as 43%, and the IRS may handle up to 1.9 million fewer

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Not Adequately Funded to Serve Taxpayers and Collect Taxes), http://www.taxpayeradvocate.irs.gov//userfiles/file/IRS%20TAS%20ARC%202011%20VOL%201.pdf. *See also* NATIONAL TAXPAYER ADVOCATE, 2011 ANNUAL REPORT TO CONGRESS, *supra*, at Vol. 2, at 1 (From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011), http://www.irs.gov/file_source/pub/tas/irs_tas_arc_2011_vol_2.pdf.

[232] *See*, *e.g.*, Internal Revenue Service Advisory Council, *2014 Public Report* 9 (The IRS Needs Sufficient Funding to Operate Efficiently and Effectively, Provide Timely and Useful Guidance to Taxpayers, and Enforce Current Law, so that Respect for Our Voluntary Tax System is Maintained) (2014), http://www.irs.gov/file_source/PUP/taxpros/2014-IRSAC-Full-Report.pdf; Internal Revenue Service Advisory Council, *2013 Public Report* (The IRS Needs Sufficient Funding to Operate Efficiently, Provide Timely and Useful Guidance to Taxpayers and Enforce Current Law, So that Respect for our Voluntary Tax System is Maintained) 7-12 (2013), http://www.irs.gov/pub/irs-utl/2013%20IRSAC%20Full%20Report.pdf; Internal Revenue Service Advisory Council, *2011 Public Report* (The IRS Must Receive Consistent, Adequate and Appropriate Funding to Achieve the Proper Administrative Balance between Service, Compliance, and Tax Enforcement) 9 (2011), http://www.irs.gov/pub/irs-utl/irsac_2011_report_for_irs.gov_revised_12-12-11.pdf.

[233] U.S. Treasury Inspector General for Tax Administration, *Implementation of Fiscal 2013 Sequestration Budget Reductions* (Reference No. 2014-10-025, June 12, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201410025fr.pdf.

[234] *Id.* at 6.

[235] *Id.* at 9.

[236] *Id.* at 9 fig. 4. *See also* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-133, 2013 TAX FILING SEASON: IRS NEEDS TO DO MORE TO ADDRESS THE GROWING IMBALANCE BETWEEN THE DEMAND FOR SERVICES AND RESOURCES (2013), http://www.gao.gov/assets/660/659777.pdf.

[237] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-534R, INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE, *supra* note 222, at 2.

[238] *IRS 2015 Budget Cut Is 'Troubling Development,' Koskinen Says*, *supra* note 221.

pieces of correspondence than it did in FY 2014.[239] IRS budget cuts are likely to hit low-income and unsophisticated taxpayers especially hard.[240] All in all National Taxpayer Advocate Nina Olson believes that "taxpayer service has reached unacceptably low levels and is getting worse."[241]

Many in the private sector also lament the underfunding of the IRS.[242] For example, in a letter to members of the House and Senate Appropriations Committees, the Chair of the Section of Taxation of the American Bar Association wrote that "the recent trend of funding reductions for the [IRS] is negatively impacting its ability to properly serve taxpayers and enforce the tax laws that Congress enacts."[243] The American Institute of Certified Public Accountants has expressed similar concerns.[244]

Pulitzer Prize-winning journalist David Cay Johnston has noted that "it makes no economic sense to trim the ranks of auditors who generate [revenues of] more than 100 times

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[239] NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at ix.

[240] Low-income taxpayers may also suffer if the budget cuts result in a decline in grants for the Low-Income Taxpayer Clinics that help serve them.

[241] NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 3.

[242] *See, e.g.*, Henry J. Aaron, *You Get What You Pay For: Lessons From the IRS Scandal*, YAHOO! FINANCE, May 31, 2013, http://finance.yahoo.com/blogs/the-exchange/pay-lessons-irs-scandal-234428300.html; David Kay Johnston, *The Tax Policy Budget Shrinks*, 139 TAX NOTES 211 (2013); Bernstein, *Why the GOP really wants to defund IRS*, *supra* note 215; Marr & Friedman, *Cuts in IRS Budget Have Compromised Taxpayer Service and Weakened Enforcement*, *supra* note 222; Catherine Rampell, *Stop starving the beast of the IRS*, WASHINGTON POST, July 1, 2014, http://www.washingtonpost.com/opinions/catherine-rampell-stop-starving-the-beast-of-the-irs/2014/07/01/d3f819d6-008f-11e4-8fd0-3a663dfa68ac_story.html; George Yin, *The Most Critical Issue Facing Tax Administration Today -- And What to Do About It* (June 27, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2459592; George K. Yin, *Saving the IRS*, 143 TAX NOTES 589 (2014); *Transcript Available of Tax Analysts' Panel on the IRS Budget*, 2012 TAX NOTES TODAY 58-56 (Mar. 23, 2012) (transcript of a March 23 panel discussion cosponsored by Tax Analysts and Georgetown University Law Center on budgetary challenges facing the IRS with speakers including Lisa Zarlenga of Treasury's Office of Tax Counsel, National Taxpayer Advocate Nina Olson, and former IRS Commissioner Fred T. Goldberg, Jr.).

[243] Michael Hirschfeld, Chair, Section of Taxation, American Bar Association, *Letter to various members of the U.S. Senate and House Appropriations committees* (Feb. 5, 2014), http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/021014comments.pdf.

[244] Jeffrey A. Porter, Chair, AICPA Tax Executive Committee, *Letter to various members of the U.S. Senate and House Appropriations committees* (Sept. 4, 2013), http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2013-9-04-Appropriations-AICPA-Position-on-IRS-Budget.pdf. *See also Written Statement of the American Institute of Certified Public Accountants for the record of the February 5, 2014 Hearing of the House Committee on Ways and Means Subcommittee on Oversight on the State of the Internal Revenue Service* (Feb. 19, 2014), http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-WRITTEN-STATEMENT-FEB-5-2014-hwmc-OVERSIGHTsubcomte2%2018%2014.pdf.

their annual salaries."[245] Professor Diane Fahey notes that since the first enactment of the income tax, financial elites who recognized that restricting government funding would reduce the federal government's influence and power have acted to undermine the income tax and the government's ability to collect it.[246] Whatever the motivation for the recent budget cuts was, the IRS has a big job to do and less and less money to do it with, and many observers expect a "miserable" 2015 filing season.[247]

### *B. The Tax Code is Increasingly Complex*

#### 1. Endless Legislation Adds to Complexity

Much of the complexity in tax administration comes from Congress constantly tinkering with, and adding to, the Internal Revenue Code. The Internal Revenue Code already includes nearly four million words.[248] In that regard, there were been more than 15,000 tax code changes between 1986 and 2010,[249] and more than 4,680 changes from 2000 to 2012.[250] Late in the year tax legislation is the worst, as it adds significant burdens on the IRS to prepare forms in time for the filing season.[251] In addition, numerous federal tax provisions expire each

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[245] David Cay Johnston, *Honey, they shrunk the IRS*, REUTERS, Jan. 17, 2012, http://blogs.reuters.com/david-cay-johnston/2012/01/17/honey-they-shrunk-the-irs ("The highest-paid IRS auditors make $71 an hour. Based on a 2,080-hour work year, that works out to around $19 million of lost revenue annually for every senior corporate auditor position cut from the payroll.").

[246] Diane L. Fahey, *The Movement to Destroy the Income Tax and the IRS: Who is Doing It and How They are Succeeding*, 15 FLORIDA TAX REVIEW 157, 159 (2014).

[247] Jeanne Sahadi, *"Miserable" tax season could be worst in years*, CNN MONEY, Jan. 5, 2015, http://money.cnn.com/2015/01/05/pf/taxes/tax-filing-irs/; Ashlea Ebeling, *IRS Commissioner Predicts Miserable 2015 Tax Filing Season*, FORBES, Nov. 4, 2014, http://www.forbes.com/sites/ashleaebeling/2014/11/04/irs-commissioner-predicts-miserable-2015-tax-filing-season/; William Hoffman, *Koskinen, Olson Share Fears Over 2015 Filing Season*, 145 TAX NOTES 636 (2014); Hoffman, *Koskinen Warns of House IRS Budget's Impact in 2015*, *supra* note 132. *But see* Christopher Bergin, *Worst Filing Season in 30 Years? Probably Not*, 146 TAX NOTES 551 (2015).

[248] NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, *supra* note 34, at Vol. 1, at 3, 6. *See also* U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-652R, DIFFERENCES IN DEFINITIONS AND RULES IN THE TAX CODE (2014), http://www.gao.gov/assets/670/664890.pdf (noting that definitions for the same or similar terms can differ from one Internal Revenue Code provision to another). To be sure, a shorter tax code would not necessarily be less complex.

[249] The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation* 3 (2010), http://www.whitehouse.gov/sites/default/files/microsites/PERAB_Tax_Reform_Report.pdf.

[250] NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, *supra* note , at Vol. 1, at 6.

[251] *See*, *e.g.*, U.S. Treasury Inspector General for Tax Administration, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Reference No. 2013-40-124, Sept. 30, 2013), http://www.treasury.gov/tigta/auditreports/2013reports/201340124fr.pdf. *See also* Seth H. Giertz & Jacob Feldman, *The Costs of Tax Policy Uncertainty and the Need for Tax Reform*, 138 TAX NOTES 951 (2013).

year,[252] and inflation adjustments integral to many tax provisions require the IRS to change many of its publications every year.[253] Pertinent here, dozens of tax provisions that expired at the end of 2013 were ultimately restored by Congress, retroactively for the 2014 tax year, but not until the end of December of that year.[254]

Our complex tax system imposes a wide range of recordkeeping, planning, computational, and filing requirements of taxpayers.[255] In that regard, the cost of complying with the personal and corporate tax systems alone is at least one percent of gross domestic product, and the economic efficiency costs are estimated to be even larger, on the order of two to five percent of gross domestic product (GDP).[256]

Of course, some taxpayers choose more complicated tax situations, for example, by participating in partnerships with special allocations or engaging in estate tax planning through a variety of trust vehicles. Although we need not feel sorry for taxpayers who choose more complicated tax situations, presumably to minimize their tax liabilities, we do need to acknowledge that those more complicated situations also impose additional burdens on the IRS.

### 2. The IRS has Increasing Responsibilities

Despite the declining funding provided to the IRS,[257] Congress frequently increases the IRS's responsibilities by calling on it to implement the tax-related portions of major new legislation and by increasing the number and complexity of tax provisions. For example, in recent years, the IRS has been called upon to implement the tax-related portions of both the Patient Protection and Affordable Care Act (ACA) and the Foreign Tax Compliance Act (FATCA).[258]

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[252] *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, LIST OF EXPIRING FEDERAL TAX PROVISIONS 2014-2024 (JCX-1-15, 2015), https://www.jct.gov/publications.html?func=download&id=4683&chk=4683&no_html=1. *See also* IRS Commissioner John A. Koskinen, *Letter to the Chairman of the Senate Finance Committee* (Oct. 6, 2014) (urging Congress to act "expeditiously" on whether to extend the tax provisions that expired at the end of 2013 so as not to delay the 2015 tax filing season [for 2014 tax returns]), 2014 TAX NOTES TODAY 195-25 (Oct. 6, 2014).

[253] *See, e.g.*, Internal Revenue Service, *Forms & Publications*, *supra* note 194.

[254] *See, e.g.*, Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, 128 Stat. 4010 (2014) (signed by the President Dec. 19, 2014); STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATED REVENUE EFFECTS OF H.R. 5771, THE "TAX INCREASE PREVENTION ACT OF 2014," SCHEDULED FOR CONSIDERATION BY THE HOUSE OF REPRESENTATIVES ON DECEMBER 3, 2014 (JCX-107-14R, Dec. 3, 2014), https://www.jct.gov/publications.html?func=download&id=4677&chk=4677&no_html=1.

[255] Most notably, taxpayers are generally required to file annual income tax returns. I.R.C. § 6012.

[256] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-11-747T, TAX GAP: COMPLEXITY AND TAXPAYER COMPLIANCE (STATEMENT OF MICHEAL BROSTEK), *supra* note 87, at 5. *See also* William Hoffman, *Compliance Costs Up to $1.5 Trillion, Heritage Panelists Say*, 145 TAX NOTES 896 (2014).

[257] *See supra* Section III.A.

[258] IRS Oversight Board, *Annual Report to Congress 2013*, *supra* note 229, at 7; U.S. Treasury Inspector General for Tax Administration, *Trends in Compliance Activities Through Fiscal Year 2013*, *supra* note 226, at 4-5.

a. *An Increasing Number of Tax Expenditures*

As already mentioned, in addition to having provisions that raise revenue, the Internal Revenue Code includes numerous tax expenditures that are designed to promote a variety of economic and social welfare goals.[259] Over the years, the number of tax expenditures has increased markedly, and new one are added almost every year.[260] For example, to bolster the residential real estate market during the recent economic recession, Congress enacted a complicated new first-time homebuyer credit,[261] which presented significant challenges for both the IRS and taxpayers.[262] In particular, administering provisions like the first-time homebuyer credit forced the IRS to divert resources from its core work of collecting revenue.[263]

b. *A More Detailed Example: Energy-related Tax Expenditures*

The responsibilities for administering economic and social welfare programs can be quite significant. For example, consider the IRS's responsibility for providing guidance and enforcement for various energy-related tax expenditures.[264] Energy-related tax expenditures constitute a significant portion of the federal support for energy—about 44% in 2010.[265]

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[259] *See supra* notes 79-87 and accompanying text.

[260] *See, e.g.*, William McBride, *A Brief History of Tax Expenditures* (Tax Foundation 2013), http://taxfoundation.org/article/brief-history-tax-expenditures; STAFF OF THE JOINT COMMITTEE ON TAXATION, BACKGROUND INFORMATION ON TAX EXPENDITURE ANALYSIS AND HISTORICAL SURVEY OF TAX EXPENDITURE ESTIMATES 16 fig. 1 (JCX-15-11, Feb. 28, 2011), https://www.jct.gov/publications.html?func=download&id=3740&chk=3740&no_html=1; Allison Rogers & Eric Toder, *Trends in Tax Expenditures*, 1985-2016 (2011), http://www.taxpolicycenter.org/UploadedPDF/412404-Tax-Expenditure-Trends.pdf; Congressional Research Service, *Tax Expenditures: Compendium of Background Material on Individual Provisions*, S. Rep. No. 45, 112th Cong., 2d Sess. (2012), http://www.gpo.gov/fdsys/pkg/CPRT-112SPRT77698/pdf/CPRT-112SPRT77698.pdf.

[261] I.R.C. § 36 (added by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110–289, § 3011(a), 122 Stat. 2654, 2888 (2008)).

[262] *See, e.g.*, *Filing Season Update: Current IRS Issues, Hearing Before the Senate Committee on Finance*, 111th Cong. 5-10 (2010) (statement of National Taxpayer Advocate Nina E. Olson), http://www.finance.senate.gov/imo/media/doc/041510notest1.pdf.

[263] *Id.* at 10; U.S. Treasury Inspector General for Tax Administration, *Recovery Act: Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (Reference No. 2010-41-128, Sept. 30, 2010), http://www.treasury.gov/tigta/auditreports/2010reports/201041128fr.pdf. The IRS also had some work to do in connection with the 2009 "Cash for Clunkers" program. *See, e.g.*, *Consumer Assistance to Recycle and Save (CARS) Act of 2009: Taxability of Payments to Dealerships* (National Automotive Dealers Association, Automotive Alert 1, 2009), https://www.nada.org/NR/rdonlyres/877BB9FB-3381-4715-9AC5-CAABF6E31969/0/IRS_MVTA_Alert_CARS_Payments_072009.pdf (discussing the tax treatment of the CARS tax credits).

[264] *See* generally STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND ANALYSIS OF ENERGY-RELATED TAX EXPENDITURES, *supra* note 83.

[265] U.S. Energy Information Administration, *Direct Federal Financial Interventions and Subsidies in Energy in Fiscal Year 2010* xiii (2011), http://www.eia.gov/analysis/requests/subsidy/pdf/subsidy.pdf.

Energy-related tax expenditures range from the venerable intangible drilling costs deduction,[266] enacted in 1916, to the panoply of renewable energy tax credits, including the production tax credit (PTC)[267] and the investment tax credit (ITC).[268] The fossil fuel tax incentives, which primarily consist of expensing and accelerated depreciation type provisions, including generous percentage depletion,[269] do not expire and have been relatively stable over time, although Congress has limited the availability of some of the benefits to independent oil producers.[270]

i. Incentives for Renewable Energy

The renewable energy tax expenditures, on the other hand, have expired multiple times and have undergone some significant changes.[271] The complexity and administrative burdens of the renewable energy tax credits stem from the difficulty of reaping the benefits from the credits when the renewable energy developer itself does not have taxable income. Energy projects frequently operate at a loss in the early years of development, in part because of the nature of new businesses, and, in part because of accelerated depreciation deductions, which provide larger deductions in the early years of a project. Congress does not allow "sale" of tax credits, so energy projects must be structured to "share" the tax credits with investors that have positive tax liability (i.e., with "tax equity investors"). To reap the benefits of tax credits, project developers enter into partnership or sale-leaseback transactions with corporate investors that have income to shelter.

For example, in a so-called partnership flip transaction, one or more tax equity investors are brought in as partners to own a project with the developer. This is the only structure that is available for sharing PTCs, because the PTC rules require the owner of the facility to be the operator of the facility. A partnership flip structure may also be used to allocate ITCs. Alternatively, in a sale-leaseback transaction, the energy project would be sold to the tax investor, and leased back to the project developer, thus transferring the tax benefits to the investor/owner. Sale-leaseback transactions may only be used with ITCs, not with PTCs.

These complex transactions create uncertainty for the taxpayers and enforcement headaches for the IRS. Partnerships are notorious for non-compliance and are difficult to audit

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[266] I.R.C. § 263(c).

[267] I.R.C. § 45.

[268] I.R.C. § 48.

[269] I.R.C. § 613.

[270] *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, DESCRIPTION OF PRESENT LAW AND SELECT PROPOSALS RELATING TO THE OIL AND GAS INDUSTRY (JCX-27-11, 2011), https://www.jct.gov/publications.html?func=startdown&id=3787.

[271] *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND ANALYSIS OF ENERGY-RELATED TAX EXPENDITURES, *supra* note 83; STAFF OF THE JOINT COMMITTEE ON TAXATION, LIST OF EXPIRING FEDERAL TAX PROVISIONS 2014-2024, *supra* note 252.

effectively;[272] and, in any event, the IRS only audits about 0.42% of partnerships.[273] The IRS has provided safe harbor guidance on both partnership flips and sale-leasebacks, which eases taxpayer concerns about certainty to some degree.[274]

In the wake of the financial crisis of 2008 and 2009, Congress created new incentive grants in lieu of energy tax credits.[275] A report by the National Renewable Laboratories found that during the financial crisis, the number of tax equity investors decreased from nearly 20 to just five.[276] Wanting to stimulate renewable energy projects and recognizing that investors had become scarce, Congress added the new incentive grants in lieu of ITCs in the American Recovery and Reinvestment Act of 2009 (ARRA).[277] While the incentive grant was not technically a tax benefit, the amount of the grant was determined by the amount the taxpayer would have received as an ITC, and the IRS was responsible for the administering the grant program. As of May 10, 2013, the Treasury, through the IRS, had awarded 9,016 grants totaling $18.5 billion.[278] Among the enforcement concerns raised by the administration of this grant program were 1) whether taxpayers had claimed both ITCs or PTCs and a Section 1603 grant for the same property and 2) whether leasing transactions were used to overstate fair market value and inflate the grant amount.[279]

As noted above, renewable energy tax incentives have expired repeatedly.[280] As a consequence, determining whether an energy project is eligible for a benefit can be challenging for both taxpayers and the IRS. For example, when Congress extended the PTC for wind energy projects in early 2013, it changed the long-standing eligibility criteria from "placed-in-

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[272] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-53, PARTNERSHIPS AND S CORPORATIONS: IRS NEEDS TO IMPROVE INFORMATION TO ADDRESS TAX COMPLIANCE (2014), http://www.gao.gov/assets/670/663185.pdf.

[273] *See supra* note 163 and accompanying text.

[274] *See, e.g.*, Rev. Proc. 2007-65, 2007-2 C.B. 967 (partnership flips); Rev. Proc. 2001-28, 2001-1 C.B. 38 (sale-leasebacks).

[275] *See*, *e.g.*, U.S. Department of the Treasury, *Recovery Act: 1603 Program: Payments for Specified Energy Property in Lieu of Tax Credits*, http://www.treasury.gov/initiatives/recovery/Pages/1603.aspx (last updated Nov. 13, 2014).

[276] Michael Mendelsohn & John Harper, § *1603 Treasury Grant Expiration: Industry Insight on Financing and Market Implications* 2 (National Renewable Energy Laboratory Technical Report NREL/TP-6A20-53720, June 2012), http://www.nrel.gov/docs/fy12osti/53720.pdf.

[277] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1603, 123 Stat. 115, 344-66 (2009). The grant program was extended until the end of 2011, under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 707, 124 Stat. 3296, 3312 (2010).

[278] U.S. Treasury Inspector General for Tax Administration, *Review of Section 1603 Grants In Lieu of Energy Investment Tax Credit* 1 (Reference No. 2014-IE-R006, Dec. 17, 2013), http://www.treasury.gov/tigta/iereports/2014reports/2014IER006fr.pdf.

[279] *Id.* at 1-2.

[280] *See supra* note 271 and accompanying text.

service" to "begin construction."[281] This change, although it had some precedent based on the eligibility criteria for the Section 1603 grant, required more guidance from the IRS and will likely lead to more compliance burdens on both taxpayers and the IRS.[282]

Needless to say, it is particularly challenging for the IRS to be involved in awarding benefits to taxpayers based on technical criteria about which the IRS has little technical expertise. For example, Congress limited the amount of credits available for the qualifying advanced energy project credit to a total of $2.3 billion.[283] Although the IRS was expected to act in consultation with the U.S. Department of Energy to award certifications for the credit, the IRS nonetheless ran into problems.[284] A Treasury Inspector General for Tax Administration study found that the IRS issued guidance using simplified criteria that were inconsistent with the statutory language and used program policy factors, without clear statutory authority to do so, which may have affected the ranking of projects.[285] The tax credits for advanced coal and gasification projects have led to many of the same kinds of administrative challenges.[286]

ii. Energy Tax Incentives for Consumers

Energy tax incentives for consumers have also increased the administrative burden on the IRS.[287] For example, the Treasury Inspector General for Tax Administration (TIGTA) identified several key elements of eligibility for the residential energy tax credit that the IRS was unable to verify under its current procedures: 1) whether the taxpayer purchased a qualified energy saving product and/or made energy efficient improvements, 2) the cost of the energy saving improvements, 3) whether the energy saving improvements were made to the

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[281] American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 407(a)(3)(C), 126 Stat. 2313, 2340-41 (2013).

[282] For example, the change has already required three notices from the IRS: Notice 2013-29, 2013-1 C.B. 1085 *clarified by* Notice 2013-60, 2013-2 C.B. 431, *clarified by* Notice 2014-46, 2014-35 I.R.B. 520.

[283] I.R.C. § 48C(d)(1)(B).

[284] U.S. Treasury Inspector General for Tax Administration, *Assessment of the Internal Revenue Service's Interpretation of Section 1302 of the Recovery Act: Qualifying Advanced Energy Project Credit* (Reference No. 2013-40-029, Mar. 21, 2013), http://www.treasury.gov/tigta/auditreports/2013reports/201340029fr.pdf.

[285] *Id.*

[286] I.R.C. §§ 48A & 48B; Internal Revenue Service, *Audit Technique Guide for Sections 48A and 48B – Advanced Coal and Gasification Project*, http://www.irs.gov/Businesses/Audit-Technique-Guide-for-Sections-48A-and-48B--Advanced-Coal-and-Gasification-Project-Credits (last updated Jan. 30, 2014).

[287] *See, e.g.*, Internal Revenue Service, Energy Incentives for Individuals in the American Recovery and Reinvestment Act, http://www.irs.gov/uac/Energy-Incentives-for-Individuals-in-the-American-Recovery-and-Reinvestment-Act (last updated Apr. 28, 2014) (showing lots of recent guidance).

taxpayer's principal residence, and 4) the time period during which the costs were incurred.[288] In some cases, the IRS even had the data to identify erroneous claims, but failed to do so.[289]

### *C. The Tax Controversy Process is Unnecessarily Complicated*

As we have seen, the tax controversy process is quite complicated.[290] The many different types of administrative appeal mechanisms could be much better coordinated, and one really has to wonder why tax disputes can be heard by so many different courts. Moreover, the current system is highly technical, and many taxpayers can have multiple bites of the apple (e.g., in proceedings to contest the liability and in subsequent proceedings to contest collection activities). Both the IRS and taxpayers would benefit from a more streamlined system of tax administration. In general, every taxpayer should generally get just one opportunity for an independent administrative review of IRS determinations and one opportunity for judicial review.

Over the years, Congress has made some significant improvements in the controversy system. For example, before the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA),[291] IRS controversies involving partnerships that invested in tax shelters typically involved audits of individual partners rather than of the partnership itself, and that led to multiple controversies that burdened the IRS, clogged the courts, and resulted in inconsistent results for similarly-situated taxpayers.[292] The so-called TEFRA audit procedures streamlined the process.[293] Now, instead of auditing each and every partner, TEFRA established unified audit procedures for most partnerships with more than 10 partners: basically, the IRS audits the partnership and then applies the results of that single audit to the partnership items on the tax returns of the individual partners.[294] Thus, the TEFRA changes significantly simplified tax administration.[295] All in all, changes that streamline or reduce the number of individual controversies can help both taxpayers and the IRS.

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[288] U.S. Treasury Inspector General for Tax Administration, *Processes Were Not Established to Verify Eligibility for Residential Energy Credits* 4 (Reference No. 2011-41-038, Apr. 19, 2011), http://www.recovery.gov/arra/Accountability/inspectors/Documents/201141038fr.pdf.

[289] *Id.*

[290] *See supra* Section II.B.

[291] Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982).

[292] *See*, *e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, (H.R. 4961, 97TH CONG., PUB. L. NO. 97-248) 267-68 (JCS-38-92, 1982), https://www.jct.gov/publications.html?func=startdown&id=2381.

[293] I.R.C. §§ 6221-6234.

[294] INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 4.31.2 (TEFRA Examinations - Field Office Procedures), http://www.irs.gov/irm/part4/irm_04-031-002r.html.

[295] To be sure, further improvements in the TEFRA audit procedures are probably needed. *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-732, LARGE PARTNERSHIPS: WITH GROWING NUMBER OF PARTNERSHIPS, IRS NEEDS TO IMPROVE AUDIT EFFICIENCY (2014), http://www.gao.gov/assets/670/665886.pdf;

Congress has also enacted provisions that reduce controversy. For example, after years of litigation over whether or not punitive damages received in personal injury law suits were excluded from income, Congress amended Internal Revenue Code Section 104(a) to establish that, subject to a limited exception, punitive damages are not excludable from income.[296] Clarifying changes such as this can reduce the need for costly and burdensome disputes.

So, too, repealing tax expenditures or, at least, adding limits will reduce the number of disputes between taxpayers and the IRS. For example, there can be no doubt that adding the 10% floor on deductible medical expenses and the 2% floor on the deduction for miscellaneous itemized deductions have reduced the number of amount of controversy between taxpayers and the IRS.[297]

## IV. RECOMMENDATIONS FOR CHANGE

The most obvious way to improve the IRS would be to increase its funding, and that is what virtually all observers recommend.[298] For that matter, a majority of taxpayers support more funding for IRS services and enforcement.[299] Of course, we started this Article with an understanding that the prospects for increased funding for the IRS are remote,[300] so we will immediately move to recommendations as to what Congress, the Treasury, and the IRS can do with the current level of resources. We will divide our remaining recommendations into those that would require legislation from Congress and those that could generally be done administratively by Treasury and/or the IRS.

### *A. Changes that Would Require Congressional Action*

Short of increasing the IRS budget, this Section discusses a range of tax reforms that Congress could take that to assist the IRS in its primary task of collecting revenue. Of course,

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Partnership Auditing Fairness Act, S. 3018, 113rd Cong. (1997) (introduced by former Senator Carl Levin [D-Mich.]); Amy S. Elliott, *Wilkins Proposes Solution to Large Partnership Audit Dilemma*, 145 TAX NOTES 748 (2014); *but see* Steve R. Johnson, *Reforming Federal Tax Litigation: An Agenda*, 41 FLORIDA STATE UNIVERSITY LAW REVIEW 205, 258-64 (2013) (urging abolition of the bulk of the TEFRA regime).

[296] The change was made by the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605(a)-(c), 110 St. 1755, 1838-39 (1996). *See*, *e.g.*, O'Gilvie v. United States, 519 U.S. 79 (1996); Ronald H. Jensen, *When Are Damages Tax Free?: The Elusive Meaning of "Physical Injury,"* 10 PITTSBURGH TAX REVIEW 1932 (1997)

[297] I.R.C. §§ 67(a), 213(a).

[298] *See* sources cited in Section III.A *supra*; CHARLES O. ROSSOTTI, MANY UNHAPPY RETURNS: ONE MAN'S QUEST TO TURN AROUND THE MOST UNPOPULAR ORGANIZATION IN AMERICA 278, 284-85 (2005) (suggesting that Congress should fund the IRS to do its job by funding technology to increase productivity and funding the IRS to rebuild staff); Note, Susan Striz, *The Key to Closing the Tax Gap: Understanding*, 112 WEST VIRGINIA LAW REVIEW 1053, 1088-89 (2009-2010).

[299] IRS Oversight Board, *2014 Taxpayer Attitude Survey* 3, 10 figs. 11 & 12 (2014), http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf.

[300] Nevertheless, even we were surprised that Congress cut the IRS's Fiscal Year 2015 budget by still another three percent. *See supra* note 221 and accompanying text.

as unlikely as Congress is to increase funding, the likelihood of any major Congressional action on tax reform is also remote.[301] For that matter, there is no guarantee that Congressional actions would actually improve the tax system. In that regard, for example, rather than enhancing third-party information reporting to reduce opportunities for taxpayers to evade taxes, recent Congressional action has tended to curtail third-party reporting.[302]

1. Simplify the Tax System

The complexity of the tax system increases the burdens on both taxpayers and the IRS. Complexity erodes voluntary compliance with the tax laws, creates a perception of unfairness for the system, and impedes the effective administration of the tax laws.[303] Consequently, simplification of the tax system should result in significant economic and equitable gains. Indeed, with limited resources, it seems unlikely that the IRS can effectively administer a tax system as complicated the one we currently have.

There is a long history of calls for simplification of the tax system.[304] For example, in 1984, the U.S. Department of Treasury began the most successful exploration of tax

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[301] For example, in a survey conducted in March of 2014 by the accounting firm Ernst & Young, business tax professionals had no expectation that tax reform would pass in 2014, and that there was only a 20% chance that the Ways & Means Committee would even mark-up a tax reform bill. Ernst & Young, *Business tax reform and trends: survey views: Views on the prospects for federal tax reform* (2014), http://www.ey.com/US/en/Services/Tax/Tax-Policy/Business-tax-reform-and-trends-survey-views. As it turned out, there was no tax reform in 2014, and few believe that any major reforms will occur until at least 2017, after the next Presidential election. *See*, *e.g.*, Bernie Becker, *Tax reform: Could it happen?*, THE HILL, Jan. 4, 2015, http://thehill.com/policy/finance/228078-tax-reform-could-it-happen.

[302] *See infra* Section IV.A.3; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-11-747T, TAX GAP: COMPLEXITY AND TAXPAYER COMPLIANCE (STATEMENT OF MICHEAL BROSTEK), *supra* note 87, at 14-15. In particular, the GAO recommends improving information reporting of higher-education expenses. *Id.* at 15.

[303] *See supra* Section III.B.

[304] A partial list of simplification proposals includes: STAFF OF THE JOINT COMMITTEE ON TAXATION, STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986 (JCS-3-01, 2001), https://www.jct.gov/publications.html?func=startdown&id=2088 (volume 1 of a three volume study); The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (2005), http://govinfo.library.unt.edu/taxreformpanel/final-report; The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation*, *supra* note 249; The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth* (2010), http://momentoftruthproject.org/report.

Of note, both the U.S. House Ways and Means Committee have recently laid the groundwork for tax reform. *See*, *e.g.*, U.S. House Committee on Ways and Means Chairman Dave Camp, *Tax Reform Act of 2014, Discussion Draft, Section-by-Section Summary* (2014), *available at* http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=370987%20; Republican Staff of the U.S. Senate Committee on Finance, *Comprehensive Tax Reform for 2015 and Beyond* (Dec. 2014), http://www.finance.senate.gov/newsroom/ranking/download/?id=9dcf2310-68d2-4d80-9e92-3b1d35442b29; U.S.

simplification to date with its white paper entitled *Tax Reform for Fairness, Simplicity, and Economic Growth* (Treasury I), which report eventually led to the enactment of the Tax Reform Act of 1986.[305] Treasury I defined simplification in two parts: (1) simplification of factors that plague taxpayers as they prepare their returns, such as forms, instructions and record-keeping; and (2) simplification of loophole provisions that encourage tax planning and avoidance and distort decision-making.[306] The latter form of simplification might not qualify as simplification if simplification is defined as reducing the number of words or pages in the tax laws. Commentators have noted that even if simplification of the Code would be possible, it may not be desirable.[307] For example, while the Tax Reform Act of 1986 has been held up as a model of simplification because it reduced the number of rate brackets and eliminated many tax preferences, it also added to the complexity of the Code by including anti-abuse provisions such as the passive activity loss rules.[308] Moreover, certainty in the tax laws comes with complexity.[309] At the same time, however, it is important to have clear and simple tax rules for most taxpayers.[310] In any event, while it may not be possible to simplify the federal tax system for all taxpayers, it should be possible to simplify the federal tax system for individuals and especially for low-income individuals.[311]

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Senate Committee on Finance, *Tax Reform Option Papers* (2013), http://www.finance.senate.gov/issue/?id=6c61b1e9-7203-4af0-b356-357388612063.

[305] Pub. L. No. 99–514, 100 Stat. 2085 (1986); U.S. TREASURY DEPARTMENT, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEPARTMENT REPORT TO THE PRESIDENT (1984), three volumes, *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/tax-reform-index.aspx. *See also* PRESIDENT OF THE UNITED STATES, THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, SIMPLICITY, AND GROWTH (1985), *available at* http://www.treasury.gov/resource-center/tax-policy/Pages/tax-reform-pres85index.aspx (a/k/a Treasury II).

[306] Charles E. McLure, Jr., *Rationale Underlying the Treasury Proposals*, in ECONOMIC CONSEQUENCES OF TAX SIMPLIFICATION 29 (Federal Reserve Bank of Boston Conference Series No. 29, 1985), https://www.bostonfed.org/economic/conf/conf29/conf29.pdf.

[307] See Samuel A. Donaldson, *The Easy Case Against Tax Simplification*, 22 VIRGINIA TAX REVIEW 645 (2003); Deborah L. Paul, *The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?*, 76 UNIVERSITY OF NORTH CAROLINA LAW REVIEW 151 (1997).

[308] I.R.C. § 469; Donaldson, *The Easy Case Against Tax Simplification*, *supra* note 307, at 670.

[309] *See* Giertz & Feldman, *The Costs of Tax Policy Uncertainty and the Need for Tax Reform*, *supra* note 251, at 951 ("A growing body of research suggests that policy uncertainty imposes substantial economic costs in and of itself."); Donaldson, *The Easy Case Against Tax Simplification*, *supra* note 307, at 662.

[310] *See*, *e.g.*, Kenneth W. Gideon, *Assessing the Income Tax: Transparency, Simplicity, Fairness*, 81 TAX NOTES 999 (1998).

[311] *See*, *e.g.*, Jonathan Barry Forman, *Simplification for Low Income Taxpayers: Some Options*, 57 OHIO STATE LAW JOURNAL 145 (1996).

a. *Fundamentally Revamp the Tax System*

Tax academics often contemplate the optimal tax system. For some this would be a pure income tax; for others a pure consumption tax.[312] In the real world, however, most governments impose multiple taxes and, therefore, must have multiple enforcement schemes. To be sure, it would be less costly to administer a single tax. With a single tax, however, it may be easier for taxpayers who engage in tax avoidance behaviors to avoid paying their "fair share," while having multiple taxes may make it more likely to collect some revenue from all citizens with the ability to pay tax. For example, because unrealized gains are not caught by the income tax, entrepreneurs (like Bill Gates) can successfully avoid income taxation on much of their economic income. But if the government imposed a consumption tax and a wealth tax, as well as an income tax, such entrepreneurs would, at least, be subject to some tax. Accordingly, Professor David Gamage argues that rather than moving towards a comprehensive income tax (or a comprehensive consumption tax), most real-world governments should endeavor to levy labor-income taxes, value-added taxes, capital-income taxes, *and* wealth taxes.[313]

That said, we wonder whether it really makes sense for the IRS to raise revenues from as many different taxes as it does. Some might call for repeal of taxes that raise insignificant amounts of revenue. In that regard, for example, excise taxes yield less than three percent of total tax revenues.[314] On the other hand, excise taxes sometimes serve some important purposes. First, unlike the federal income tax, federal excise taxes are "recession-proof." Even taxpayers who may be in a net operating loss position for federal income tax purposes will be liable for any applicable federal excise taxes. Thus, excise taxes can provide the government with a more dependable source of revenue in a down economy. Second, excise taxes can be designed to control externalities and to impose tax burdens on those who benefit from government spending.[315] Finally, excise taxes also can be used to discourage consumption of potentially harmful substances (such as tobacco and alcohol) that individuals might over-consume in the absence of taxation.

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[312] *See especially* DAVID BRADFORD AND THE U.S. TREASURY TAX POLICY STAFF, BLUEPRINTS FOR TAX REFORM (Arlington, VA: Tax Analysts. 2nd ed. 1984). For the original Treasury Department version, *see* U.S. Department of the Treasury, *Resource Center: Tax Reform* (last updated Feb. 24, 2012), http://www.treasury.gov/resource-center/tax-policy/Pages/blueprints-index.aspx.

[313] David Gamage, *Analyzing the Optimal Choice of Tax Instruments: The Case for Levying (all of) Labor-Income Taxes, Value-Added Taxes, Capital-Income Taxes, and Wealth Taxes*, 68 TAX LAW REVIEW ___(Oct. 9, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2465522.

[314] Tax Policy Center, *Annual Federal Excise Tax Revenue by Type of Tax 1996 – 2012* (May 8, 2014), http://taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=74&Topic2id=80. See also STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND INFORMATION ON FEDERAL EXCISE TAXES, *supra* note 58.

[315] *See, e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND ANALYSIS OF ENERGY-RELATED TAX EXPENDITURES, *supra* note 83, at 25-26.

Estate and gift taxes are another example of low-yielding taxes, and these are subject to considerable (and economically inefficient) avoidance planning.[316] At the same time, however, appreciated assets that avoid estate taxation may escape taxation altogether because of the income tax system's step-up in basis for inherited assets.[317] In that regard, it might make sense to repeal the estate and gift tax and instead treat gifts and inheritances as income under the individual income tax.[318] It might also make sense to integrate the individual income tax (largely a tax on labor) with the Social Security payroll tax (another tax on labor),[319] and it might make sense to integrate the corporate income tax with the individual income tax.[320]

Professor Michael Graetz proposed a two-tier tax system that would replace much of the current income tax system with a value-added tax.[321] His proposal called for a $100,000 per family exemption under the individual income tax together with a value-added tax of 14 or 15%, and he believes that his proposal would eliminate the need for as many as 100 million individual income tax returns. Under his proposed reform, only those relatively few families with incomes over $100,000 would have to file individual income tax returns. However, even a simple value-added tax—one that exempted relatively few goods and services—would have its own significant administrative and compliance burdens.[322] However, one signal benefit of a

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[316] *See*, *e.g.*, Kevin Brady, Republican Staff of the Joint Committee on Economics, *Cost and Consequences of the Federal Estate Tax: An Update* (2012), http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=bc9424c1-8897-4dbd-b14c-a17c9c5380a3.

[317] I.R.C. § 1014.

[318] *See, e.g.*, Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARVARD LAW REVIEW 1177 (1978); Michael J. Graetz, *Taxation of Unrealized Gains at Death—An Evaluation of Current Proposals*, 59 VIRGINIA LAW REVIEW 830 (1973).

[319] *See*, *e.g.*, Jonathan Barry Forman, *Let's Combine the Income and Payroll Taxes into a Rational System*, 59(1) The TAX EXECUTIVE 55 (Jan.-Feb. 2007); Forman, *Simplification for Low Income Taxpayers: Some Options*, *supra* note 311, at 192-94.

[320] *See*, *e.g.*, U.S. Department of the Treasury, *Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once* (1992), http://www.treasury.gov/resource-center/tax-policy/Documents/integration.pdf; R. Glenn Hubbard, *Corporate Tax Integration: A View from the Treasury Department*, 7(1) JOURNAL OF ECONOMIC PERSPECTIVES, 115-32 (Winter 1993), http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.7.1.115; Keightley & Sherlock, *The Corporate Income Tax System: Overview and Options for Reform*, *supra* note 45, at 25. *See also* Michael J. Graetz & Alvin C. Warren, *Unlocking Business Tax Reform*, 145 TAX NOTES 707 (2014); N. Gregory Mankiw, *One Way to Fix the Corporate Tax: Repeal It*, NEW YORK TIMES, Aug. 23, 2014, http://www.nytimes.com/2014/08/24/upshot/one-way-to-fix-the-corporate-tax-repeal-it.html?rref=upshot&abt=0002&abg=1&_r=0.

[321] MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES (2007).

[322] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-08-566, VALUE-ADDED TAXES: LESSONS LEARNED FROM OTHER COUNTRIES ON COMPLIANCE RISKS, ADMINISTRATIVE COSTS, COMPLIANCE BURDEN, AND TRANSITION (2008), http://www.gao.gov/assets/280/274387.pdf.

comprehensive shift in tax base might be to limit the use of the tax system for non-revenue purposes. As noted earlier, the growth in using the tax system to encourage behavior via tax expenditures has been metastatic, resulting in ever-increasing workloads for the IRS.[323]

In the end, however, we think that comprehensive tax reform is unlikely until after the next Presidential election.[324] As former IRS Commissioner Charles O. Rossotti (1997-2002) noted in his 2005 memoir:

> Perhaps someone, someday, will come up with an ideal, simple system that enough people can agree on for raising $2 trillion per year so that the existing tax code can be done away with. But for now, and probably for many years to come, taxpayers and the IRS are required to comply with the tax code as it exists—and as it changes every year.[325]

b. *Modified Revamp: Simplify Certain Provisions*

Because some complexity is unavoidable, we may have to settle for systematic reform of individual tax expenditures or groups of tax expenditures.[326] For example, it could make sense to repeal or limit the deductions for home mortgage interest, State and local taxes, and for charitable contributions.[327] More comprehensive reforms would include simplifying and consolidating the various family tax credits, the tax incentives for education, and the tax incentives for savings and retirement.[328] Simplification of capital gains taxation and business

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[323] *See supra* Section III.B.2.

[324] Becker, *Tax reform: Could it happen?*, *supra* note 301. The prospects for business tax reform are a little bit brighter as both Congress and the White House seem interested in reducing the corporate tax rate. *See*, *e.g.*, Luca Gattoni-Celli & Lindsey McPherson, *Hatch Reform Report Reframes Business Tax Paradigm*, 145 TAX NOTES 1193 (2014)

[325] ROSSOTTI, MANY UNHAPPY RETURNS: ONE MAN'S QUEST TO TURN AROUND THE MOST UNPOPULAR ORGANIZATION IN AMERICA, *supra* note 298, at 274.

[326] Jeffrey Partlow, *The Necessity of Complexity in the Tax System*, 13(1) WYOMING LAW REVIEW 303 (2013). See also ROSSOTTI, MANY UNHAPPY RETURNS: ONE MAN'S QUEST TO TURN AROUND THE MOST UNPOPULAR ORGANIZATION IN AMERICA, *supra* note 298, at 274-75 (recommending that Congress at least simplify the parts of the Internal Revenue Code that affect most taxpayers).

[327] I.R.C. § 163, 164, 170. *See*, *e.g.*, Amanda Eng, Harvey Galper, Georgia Ivsin & Eric Toder, *Options to Reform the Deduction for Home Mortgage Interest* (Urban-Brookings Tax Policy Center, Mar. 18, 2013), http://www.taxpolicycenter.org/publications/url.cfm?ID=412768; Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter Orzag, *Efficiency and Tax Incentives: the Case for Refundable Tax Credits*, 59 STANFORD LAW REVIEW 23 (2006). For example, adding a 10% floor to the deduction for medical expenses and a 2% floor on the deduction for miscellaneous itemized deductions has reduced the record-keeping burdens on taxpayers and the verification burdens on the IRS. I.R.C. §§ 67(a), 213(a).

[328] *See*, *e.g.*, The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation*, *supra* note 249, at 4, 10, 23. In particular, it would make sense to restructure the earned income tax credit. *See*, *e.g.*, JONATHAN BARRY FORMAN, MAKING AMERICA WORK 129-31 (2006); Isabel Sawhill & Quentin Karpilow, *Raising the Minimum Wage and Redesigning the EITC* (Brookings, Jan. 30, 2014), http://www.brookings.edu/~/media/research/files/papers/2014/01/30-raising-minimum-wage-redesigning-eitc-sawhill/30-raising-minimum-wage-redesigning-eitc-sawhill.pdf.

taxation would also make sense,[329] and many analysts have called for repeal of the alternative minimum tax.[330]

### 2. Improve the Legislative Process

We are at the point where it is difficult to enact even rational improvements to the tax system.[331] Something needs to change.

#### a. *A Permanent Loophole-closing Commission*

In the old days, before gridlock, technical corrections bills floated through Congress, but today Congress is gridlocked.[332] When faced with politically difficult decisions, Congress has sometimes resorted to limiting itself to simple up-or-down votes. For example, relying on the recommendation of the Base Realignment and Closure Commission, Congress managed to overcome political partisanship and significantly reduce the number of military bases.[333] Perhaps, a similarly-styled tax reform commission would enable Congress to actually achieve tax reform or, at least, to repeal a few loopholes.[334]

We can imagine tax legislation being hammered out by a super-group, voted up or down by Congress, and signed by the President. To be sure, our enthusiasm for this approach is tempered by the recent failure of Congress's Joint Select Committee on Deficit Reduction, also known as the Supercommittee.[335] Created by the Budget Control Act of 2011, the

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[329] *See*, *e.g.*, The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation*, *supra* note 249, at 36 (simplify taxation of capital gains), 46 (simplification for small businesses), 65 (corporate tax reform), 81 (addressing international corporate tax issues).

[330] *See*, *e.g.*, *id.* at 49; NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, *supra* note 248, at Vol. 1, at 24 (The Alternative Minimum Tax Corrodes Both the Tax System and the Democratic Process).

[331] *See*, *e.g.*, Eric Solomon, *The Process for Making Tax Policy in the United States: A System Full of Friction*, 67(3) TAX LAWYER 547 (Spring 2014); Brian Faler, *After IRS scandal, GOP rejects tax crackdown*, POLITICO.COM, updated July 28, 2014, http://www.politico.com/story/2014/07/irs-republicans-109423.html.

[332] *See*, *e.g.*, Sarah A. Binder, *Polarized We Govern?* (Brookings Center for Effective Public Management, May 2014), http://www.brookings.edu/~/media/research/files/papers/2014/05/27-polarized-we-govern-binder/brookingscepm_polarized_figreplacedtextrevtablerev.pdf, (finding that levels of legislative gridlock have steadily risen over the past half-century).

[333] *See*, *e.g.*, U.S. Department of Defense, *BRAC: Base Realignment and Closure 2005*, http://www.defense.gov/brac/faqs001.html (last visited Jan. 19, 2015).

[334] *See also* James R. Hines Jr. & Kyle D. Logue, *Delegating Tax* (Oct. 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2402047.

[335] *See*, *e.g.*, Joint Select Committee on Deficit Reduction, *Statement from Co-Chairs of the Joint Selection Committee on Deficit Reduction* (Press Release, Nov. 21 2011), http://cybercemetery.unt.edu/archive/deficit/20120113174127/http:/www.deficitreduction.gov/public/index.cfm/pressreleases?ID=fa0e02f6-2cc2-4aa6-b32a-3c7f6155806d; Lori Montgomery & Paul Kane, *Supercommittee announces failure in effort to tame debt*, WASHINGTON POST, Nov. 21, 2011,

Supercommittee was supposed to come up with a deficit reduction plan to avoid the imposition of automatic budget sequestration.[336] If the Supercommittee had come up with a recommendation, it would have been subject to an up-or-down vote in Congress without amendment. Unfortunately, the Supercommittee deadlocked and failed to come up with a plan.[337] We worry that a tax super-group might face a similar fate.

Pertinent here, however, in 2010, the United Kingdom's Treasury Department established an independent Office of Tax Simplification that provides the government with nonbinding, independent advice on simplifying its tax system.[338] Perhaps, the U.S. government should create a similar permanent and independent "Office of Tax Simplification" to provide the government with nonbinding but independent advice on simplifying the tax system. Alternatively, Congress could empower the Joint Committee on Taxation to make formal, legislative tax reform proposals.[339]

b. *Make Congress Write the Details*

Congress regularly relies on Treasury and the IRS to fill in the details of tax legislation.[340] Treasury and the IRS continue to churn out regulations in an effort to make the statutes that Congress passes work.[341] One might consider this a co-dependent relationship in which Treasury and the IRS have become enablers of sloppy legislation. Congress knows it can pass off responsibility for vague and badly-drafted tax laws to Treasury and the IRS, and to the extent that the IRS spends its efforts and limited resources on issuing guidance to "fix" those tax laws, it just encourages Congress to be irresponsible.

Another reason for encouraging more clearly written statutes is that regulatory pronouncements may be more likely to lead to litigation. For example, the Patient Protection

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http://www.washingtonpost.com/business/economy/debt-committee-failure-will-become-official-with-written-joint-statement/2011/11/21/gIQAfRmCiN_story.html.

[336] Budget Control Act of 2011, Pub. L. 112-25, § 401,125 Stat. 240, 259 (2011).

[337] *See supra* note 335 and accompanying text.

[338] *See*, *e.g.*, *Office of Tax Simplification home page*, https://www.gov.uk/government/organisations/office-of-tax-simplification (last visited Dec. 16, 2014); Her Majesty's Treasury, *Office Of Tax Simplification Framework Document* (2010), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193545/ots_framework_document_jul10.pdf.

[339] *See*, *e.g.*, Joint Committee on Taxation, *Statutory Basis for the Joint Committee on Taxation*, https://www.jct.gov/about-us/statutory-basis.html (last visited Dec. 17, 2014).

[340] I.R.C. § 7805 provides a general authorization for the Treasury and IRS to write regulations, and many provisions of the Internal Revenue Code specifically authorize the Treasury and IRS to write regulations. *See*, *e.g.*, I.R.C. §§ 132(o) (certain fringe benefits), 385(c)(3) (treatment of certain interests in corporations as stock or indebtedness).

[341] *See*, *e.g.*, Internal Revenue Service, *Priority Guidance Plan*, http://www.irs.gov/uac/Priority-Guidance-Plan (last updated Nov. 7, 2014); Kristin E. Hickman, *Administering the Tax System We Have*, DUKE LAW JOURNAL 1718, 1748-49 (2014), http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=3428&context=dlj.

and Affordable Care Act (ACA) makes tax credits available to individuals who purchase health insurance through health insurance exchanges "established by the State."[342] The IRS issued a regulation interpreting that statute broadly enough to include the purchase of health insurance in federal exchanges in those States that failed to establish their own "State" exchanges.[343] A flood of litigation ensued,[344] and the U.S. Supreme Court is now considering the validity of that regulation.[345]

Of course, if Congress did write all the details into its tax legislation, we would be unlikely to see a reduction in the number of pages or words in the Internal Revenue Code or in the accompanying Treasury Regulations that follow. For example, in the 1970s, Treasury embarked on writing detailed fringe benefit regulations under Section 61(a)(1) of the Internal Revenue Code.[346] Congress stepped in and put a budgetary "freeze" on the issuance of those regulations.[347] Finally, in 1984 Congress enacted major fringe benefit legislation that, among other things added the multi-page Section 32 to the Internal Revenue Code,[348] which enactment, was, of course, followed by even more pages of regulations.[349] Moreover, both the statute and the regulations have been amended numerous times since 1984.[350]

The revenue estimating process may also encourage regulatory rather than Congressional action. Regulations that cost revenue are not accounted for by the Joint Committee on Taxation, which "scoring" is required for all tax bills proposed by Congress.[351]

In the end, Treasury and the IRS really have little choice about writing regulations. The public and practitioners often need guidance, and they lobby both Treasury and Congress to get

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[342] I.R.C. § 36B(c)(2)(A)(i).

[343] Treas. Reg. § 1.36B-2(a)(1).

[344] *See*, *e.g.*, Jonathan H. Adler, *D.C. Circuit grants en banc rehearing in Halbig v. Burwell*, WASHINGTON POST, Sept. 4, 2014, http://www.washingtonpost.com/news/volokh-conspiracy/wp/2014/09/04/d-c-circuit-grants-en-banc-rehearing-in-halbig-v-burwell/.

[345] *See, e.g.*, King v. Burwell, 759 F.3d 358 (4th Cir. July 22, 2014), *cert. granted*, 83 U.S.L.W. 3286 (U.S. Nov. 7, 2014) (No. 14-114).

[346] *See*, *e.g.*, STAFF OF THE JOINT COMMITTEE ON TAXATION, TAXATION OF FRINGE BENEFITS 5 (JCS-38-78, 1978), https://www.jct.gov/publications.html?func=download&id=4017&chk=4017&no_html=1.

[347] *Id.*

[348] I.R.C. § 32 (added by the Deficit Reduction Act of 1984, § 531(a)(1), Pub. L. No. 98–369, 98 Stat. 494, 877-81 (1984).

[349] *See, e.g.*, Treas. Reg. §§ 1.132-1 et seq.

[350] *See*, *e.g.*, Tax Reform Act of 1986, Pub. L. No. 99–514, §§ 1114(b)(5), 1151(e)(2)(A), (g)(5), 1853(a), 1899A(5), 100 Stat. 2451, 2506, 2507, 2870, 2958 (1986).

[351] Mann, *Chief Counsel's Subtle Impact on Revenue: Regulations, Litigation, and Administrative Guidance, supra* note 71.

it. Not surprisingly, when Treasury is tardy in issuing regulations, sometimes Congress steps in, often making an even bigger mess.[352]

3. Enhance Third-party Information Reporting

As already explained, the tax gap analysis shows that third-party reporting significantly enhances compliance.[353] For example, Figure 2 showed that because of third-party withholding and reporting on wage income, individuals report approximately 99% of their wages. Moreover, third-party reporting facilitates cost-effective enforcement via automated checking of the amounts reported on the return with the amounts reported by the third party (the Automated Underreporter [AUR] program). The U.S. Government Accountability Office (GAO) estimated that the AUR program raised $22 for every dollar spent.[354] The GAO examined the 2007 and 2008 tax years and found that correspondence and field examinations accounted for more than 80% of the total administrative costs of the four audit programs it reviewed over that two-year period.[355] These non-automated audits are much more expensive—the GAO estimated that the correspondence examinations of individual taxpayers raised just $7 per dollar spent, field examinations of individual taxpayers raised only $1.80 per dollar spent.[356]

Despite clear evidence that third-party reporting significantly and efficiently enhances compliance, Congress appears to be moving in the opposite direction. In 2011, for example, Congress repealed the expanded reporting requirement that had been added by the Patient Protection and Affordable Care Act (ACA) in 2010 as well as the expanded reporting requirement for landlords added by the Small Business Job Act. Before the ACA, Section 6041 of the Internal Revenue Code required businesses making payments to a single recipient of at least $600 in a single year to file a Form 1099-MISC, Miscellaneous Income, with the IRS and with the recipient.[357] IRS regulations exempted, among other things, payments made to corporations and payments made for merchandise.[358] Beginning in 2012, the ACA required all businesses to report payments to, and purchases from, any taxable entity totaling $600 or more in a calendar year, regardless of the payee's corporate status or whether the payments were

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[352] *See, e.g.*, Exxon Mobil Corp. et al. v. Commissioner, 689 F.3d 191, *aff'g* 136 T.C. 99 (2011) (In 1986, Congress instructed Treasury to study and promulgate regulations on interest netting rules for overpayments and underpayments. In 1998, Congress became impatient with Treasury and enacted I.R.C. § 6621(d), which required a technical correction and led to the litigation cited above, in which the taxpayer prevailed.)

[353] *See supra* Section II.B.2.

[354] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-151, TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES, *supra* note 148, at 6.

[355] *Id.* at 4, 8.

[356] *Id.* at 8.

[357] I.R.C. § 6041.

[358] Treas. Reg. § 1.6041-1 (1960).

made for merchandise or other property.[359] The Joint Committee on Taxation estimated that the provision would have raised $17.1 billion over the following decade.[360]

Similarly, the Small Business Jobs Act of 2010 amended Section 6041 to subject recipients of rental income from real estate to the same information reporting requirements as taxpayers engaged in a trade or business.[361] In particular, rental income recipients making payments of $600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income were required to provide an information return (typically, a Form 1099-MISC, Miscellaneous Income) to the IRS and to the service provider. The Joint Committee on Taxation estimated that the provision would have raised $2.5 billion over the following decade.[362]

These two Form-1099 information-reporting expansions had many detractors who argued that the provisions would hurt small businesses, restrict economic growth, and increase unemployment; and the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 soon repealed those expansions.[363] One Congressional supporter praised the repeal: "Now our job creators can go about their business without fear of being hammered by mountains of additional, unnecessary tax paperwork."[364] The fate of these expanded-reporting provisions casts doubt as to whether Congress would be willing to make the IRS more efficient by requiring more third-party reporting.

### 4. Simplify the Tax Penalty System

The tax penalty system is another world altogether. The purpose of tax penalties is to encourage compliance, but the tax penalty system has become so complex that it is both difficult for the IRS to determine the appropriate penalty as well as nearly impossible for

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[359] Pub. L. No. 111-148, § 9006, 124 Stat. 119, 855 (2010).

[360] STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATED REVENUE EFFECTS OF THE AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 4872, THE "RECONCILIATION ACT OF 2010," AS AMENDED, IN COMBINATION WITH THE REVENUE EFFECTS OF H.R. 3590, THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT ('PPACA')," AS PASSED BY THE SENATE, AND SCHEDULED FOR CONSIDERATION BY THE HOUSE COMMITTEE ON RULES ON MARCH 20, 2010 1 (JCX-17-10, 2010), https://www.jct.gov/publications.html?func=startdown&id=3672.

[361] Pub. L. No. 111-240, § 2101, 124 Stat. 2504, 2561 (2010).

[362] STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN SENATE AMENDMENT #4594 TO H.R. 5297, THE "SMALL BUSINESS JOBS ACT OF 2010," SCHEDULED FOR CONSIDERATION BY THE UNITED STATES SENATE ON SEPTEMBER 16, 2010 2 (JCX-48-10, 2010), https://www.jct.gov/publications.html?func=startdown&id=3708.

[363] Pub. L. No. 112-9, 125 Stat. 36 (2011).

[364] Statement of Republican Senator Mike Johanns of Nebraska, cited in Felicia Sonmez, *Obama Signs Repeal of Health Care Laws 1099 Tax Reporting Rule*, WASHINGTON POST, Apr. 14, 2011, http://www.washingtonpost.com/blogs/2chambers/post/obama-signs-1099-repeal-into-law-marking-first-repeal-of-national-health-care-law-provision/2011/04/14/AFRhYjeD_blog.html.

taxpayers to connect their behavior with a particular penalty.[365] Moreover, tax penalties are among the most litigated issues identified in the annual reports of the National Taxpayer Advocate.[366] Numerous commentators have called for simplification of the tax penalty regime.[367]

Imposing penalties for failure to accurately report tax liability is supposed to improve compliance.[368] It is not only the penalty itself, but the perception of the penalty that encourages compliance. In particular, if taxpayers believe that tax penalties are imposed arbitrarily or unjustly, penalties could have the opposite effect and lead to lack of respect for the tax system and reduced compliance. While the penalty system is statutory, the IRS has some discretion in whether to impose or abate a penalty.[369]

In 1998, as part of the IRS Reform and Restructuring Act (RRA), Congress required Treasury to study the tax penalty system.[370] Treasury recommended restructuring the failure to file and failure to pay penalties,[371] establishing a threshold below which the failure to pay estimated tax penalty would not be imposed,[372] and increasing the penalty for filing a frivolous

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[365] *See*, *e.g.*, American Institute of Certified Public Accountants, *Report on Civil Tax Penalties: The Need for Reform* (Apr. 11, 2013), http://www.aicpa.org/Advocacy/Tax/TaxLegislationPolicy/DownloadableDocuments/AICPA-legislative-proposals-penalties-2013.pdf.

[366] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 423 (MOST LITIGATED ISSUES: Introduction) (noting that tax penalties are among the most litigated issues); NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, 222 (MOST LITIGATED ISSUES: Introduction) (noting that tax penalties are among the most litigated issues).

[367] *See*, *e.g.*, Charles P. Rettig, *Practice: Enhancing Voluntary Compliance Through the Administration of Civil Tax Penalties*, 13(2) JOURNAL OF TAX PRACTICE & PROCEDURE 17 (Apr.-May 2011) (calling for a comprehensive review of the civil tax penalty structure); Kyle D. Logue, *Optimal Tax Compliance and Penalties When the Law Is Uncertain*, 27 VIRGINIA TAX REVIEW 241 (2007); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUMBIA LAW REVIEW 569 (2006).

[368] *See*, *e.g.*, Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARVARD JOURNAL ON LEGISLATION 111, 123 (2009).

[369] INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 20.1.1 (Introduction and Penalty Relief), http://www.irs.gov/irm/part20/irm_20-001-001r.html.

[370] Pub. L. No. 105-206, § 3801, 112 Stat. 685, 782 (1998).

[371] U.S. Department of the Treasury, Office of Tax Policy, *Report to Congress on Penalty and Interest Provisions of the Internal Revenue Code* 3-4 (1999), http://www.treasury.gov/resource-center/tax-policy/Documents/intpenal.pdf (recommending that the I.R.C. § 6651 failure to file and failure to pay penalties be restructured to eliminate the frontloading of the failure to file penalty and to impose a higher failure to pay penalty).

[372] U.S. Department of the Treasury, Office of Tax Policy, *Report to Congress on Penalty and Interest Provisions of the Internal Revenue Code*, *supra* note 371, at 4-5 (recommending simplifying changes to the I.R.C. § 6654 failure to pay estimated tax penalty).

tax return from $500 to $1,500.[373] RRA also required the Joint Committee on Taxation to conduct a study of the tax penalty system.[374] The Joint Committee recommended repealing the penalty for failure to pay tax, modifying the accuracy related penalty standards, and changing the preparer penalty.[375] Some of these legislative recommendations were eventually enacted. For example, in 2006, Congress increased the penalty for filing a frivolous tax return from $500 to $5,000.[376] However, Congress has not yet enacted any systematic reform of tax penalties.[377]

In the late 2000s, the National Taxpayer Advocate and the American Institute of Certified Public Accountants (AICPA) both issued calls for penalty reform.[378] The AICPA expressed concern that "the overall framework of civil penalties . . . is not sufficiently geared towards encouraging voluntary compliance.[379] National Taxpayer Advocate Nina Olson has noted that inappropriately designed penalties could reduce compliance if "they provide a disincentive for noncompliant taxpayers to step forward, are so disproportionate or arbitrarily imposed that taxpayers feel they are unjust, or result in protracted disputes that leave the IRS with few resources to impose them."[380] Also, a recent National Taxpayer Advocate study found that taxpayers who were subject to default penalty assessments were significantly less compliant five years after the assessment than taxpayers who were not penalized.[381] This evidence

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[373] U.S. Department of the Treasury, Office of Tax Policy, *Report to Congress on Penalty and Interest Provisions of the Internal Revenue Code*, *supra* note 371, at 7 (recommending simplifying changes to the I.R.C. § 6702 penalty for filing a frivolous return).

[374] IRS Reform and Restructuring Act (RRA), Pub. L. No. 105-206, § 3801, 112 Stat. 685, 782 (1998); JOINT COMMITTEE ON TAXATION, STUDY OF PRESENT- LAW PENALTY AND INTEREST PROVISIONS AS REQUIRED BY SECTION 3801 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 (INCLUDING PROVISIONS RELATING TO CORPORATE TAX SHELTERS) (JCS-3-99, 1999), Vol. 1, https://www.jct.gov/publications.html?func=download&id=2896&chk=2896&no_html=1, Vol. 2, https://www.jct.gov/publications.html?func=download&id=2893&chk=2893&no_html=1.

[375] *See*, *e.g.*, JOINT COMMITTEE ON TAXATION, STUDY OF PRESENT- LAW PENALTY AND INTEREST PROVISIONS AS REQUIRED BY SECTION 3801 OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998 (INCLUDING PROVISIONS RELATING TO CORPORATE TAX SHELTERS), *supra* note 374, at Vol. 1, at 3-6.

[376] Tax Relief and Health Care Act of 2004 Pub. L. No. 109-432, § 407(a), 120 Stat. 2922, 2960-62 (2004).

[377] NATIONAL TAXPAYER ADVOCATE, 2008 ANNUAL REPORT TO CONGRESS (2008), at Vol. 2, at 11 (A Framework for Reforming the Penalty Regime), http://www.irs.gov/file_source/pub/tas/08_tas_arc_vol2.pdf.

[378] *Id.*; American Institute of Certified Public Accountants, *Report on Civil Penalties: The Need for Reform* (Aug. 28, 2009), http://www.aicpa.org/press/pressreleases/2009/downloadabledocuments/aicpa-report-civil-tax-penalty-reform.pdf.

[379] American Institute of Certified Public Accountants, *Report on Civil Penalties: The Need for Reform*, *supra* note 378, at 2. *See also* American Institute of Certified Public Accountants, *Report on Civil Tax Penalties: The Need for Reform*, *supra* note 365.

[380] NATIONAL TAXPAYER ADVOCATE, 2008 ANNUAL REPORT TO CONGRESS, *supra* note 377, at 4-5.

[381] NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 2 , at 1, 11 (Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?). See also NATIONAL

suggests that penalty reform could improve compliance, while also lessening the IRS's workload.

5. Increase Transparency to Increase Compliance

Making the tax system more open could also help the IRS administer the tax system. In that regard, for example, Professor George Yin recently recommended that the IRS could regain the public's trust by increasing the transparency of the agency's tax administrative decisions.[382] Specifically, he recommends that the IRS should increase disclosure of its decisions in the tax-exempt organization area. Basically, Professor Yin believes that there should be meaningful transparency of the IRS's decision as to whether or not to grant tax-exempt status *and* the underlying tax return information provided by the applicants. Some have also advocated for public disclosure of the tax returns of corporations.[383] Others have also suggested that the judicial standing rules should be changed to allow litigants to challenge the tax benefits received by other taxpayers.[384] As Section 6103 of the Internal Revenue Code currently limits the disclosure of taxpayer information in most situations, legislation would be needed for such increases in transparency.

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TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 94 (PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote
Voluntary Compliance, as Recommended by Congress and Others)

[382] Yin, *The Most Critical Issue Facing Tax Administration Today -- And What to Do About It*, *supra* note 242; George K. Yin, *Reforming (and Saving) the IRS by Respecting the Public's Right to Know*, 100 VIRGINIA LAW REVIEW 1115 (2014).

[383] *See*, *e.g.*, Joshua D. Blank, *Reconsidering Corporate Tax Privacy*, 11 NEW YORK UNIVERSITY JOURNAL OF LAW AND & BUSINESS ___ (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524617; Reuven S. Avi-Yonah & Ariel Siman, *The One Percent Solution: Corporate Tax Returns Should Be Public (And How to Get There)*, 2014 WORLDWIDE TAX DAILY 32-11 (Feb. 18, 2014). *See also Dwenger Presents Improving Tax Collection by Public Shaming Today at UC-Berkeley*, http://taxprof.typepad.com/taxprof_blog/2014/11/dwenger-presents-improving-tax-collection-.html; Jon Forman, *Shaming tax cheats*, JOURNAL RECORD [of Oklahoma City], June 8, 2009, at 6A.

[384] *See*, *e.g.*, Eileen J. O'Connor, remarks at a panel of the American Bar Association, Section of Taxation, Committee on Tax Policy and Simplification, January 24, 2014, in Phoenix, Arizona. In general, taxpayers do not have standing to sue the federal government over the tax benefits of other taxpayers. Frothingham v. Mellon, 262 U.S. 447 (1923). Taxpayers do, however, have standing to sue the government to prevent an unconstitutional use of taxpayer funds. Flast v. Cohen, 392 U.S. 83 (1968) (finding that a taxpayer had standing to sue the federal government to prevent it from spending funds on religious schools in violation of the First Amendment's ban on the establishment of religion). But Flast v. Cohen does not give taxpayers standing to challenge the constitutionality of tax credits or other tax expenditures. Arizona Christian School Tuition Organization v. Winn, 555 U.S. 488 (2011).

6. Streamline Dispute Procedures

It is clear that the IRS and U.S. Department of Justice spend a great deal of their resources on dispute resolution and litigation.[385] Accordingly, it would make sense to streamline the applicable procedures. Taxpayers should always get an opportunity to dispute their tax liabilities. In that regard, it would make sense to expand the jurisdiction of the U.S. Tax Court so that it could hear virtually all tax disputes.[386] Indeed, some argue that it should be the only court for federal tax disputes.[387] In any event, it would make sense to take refund jurisdiction away for the U.S. Court of Federal Claims.[388]

Congress should also rethink its commitment to collection due process (CDP) hearings and appeals.[389] CDP is one of the most litigated issues identified in the annual reports of the National Taxpayer Advocate,[390] and according to Professor Steve Johnson these "CDP cases claim substantial resources from the IRS and the Tax Court."[391] Like Professor Johnson, we believe that judicial review of IRS collection activities should be more limited.[392]

Finally, some have also recommended creating a national appellate tax court to hear virtually all appeals from tax cases.[393] This proposal would lead to faster resolution of tax issues and greater national uniformity.

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[385] For example, s*ee supra* Table 5 to see how the IRS allocated its budget in a recent year.

[386] *See, e.g.*, Comment, Adrianne Hodgkins, *Getting a Second Chance: The Need for Tax Court Jurisdiction Over IRS Denials of Relief Under Section 66*, 65(3) LOUISIANA LAW REVIEW 1167 (2005).

[387] *See*, *e.g.*, Larry Kramer, *Jurisdiction Over Civil Tax Cases*, 1990 BRIGHAM YOUNG UNIVERSITY LAW REVIEW (1990).

[388] Johnson, *Reforming Federal Tax Litigation: An Agenda*, *supra* note 295, at 256-57. We come to this conclusion despite the fact that author Jonathan Barry Forman once clerked for a judge on the U.S. Court of Federal Claims, and he fondly recalls that the tax cases that he worked then were among the most interesting cases on the court's docket. *See supra* note 118.

[389] *See supra* note 178 and accompanying text.

[390] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 477 (Most Litigated Issue No. 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330).

[391] Johnson, *Reforming Federal Tax Litigation: An Agenda*, *supra* note 295, at 265-66. See also Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 INDIANA LAW JOURNAL 57 (2009); *but see* Leslie Book, *A Response to Professor Camp: the Importance of Oversight*, 84 INDIANA LAW JOURNAL SUPPLEMENT 63 (2019).

[392] Johnson, *Reforming Federal Tax Litigation: An Agenda*, *supra* note 295, at 266.

[393] *See*, *e.g.*, Erwin N. Griswald, *The Need for a Court of Tax Appeals*, 57 HARVARD LAW REVIEW 1153 (1944); Jasper L. Cummings, Jr., *Creation of National Appellate Tax Court Will Improve Tax Law* in TOWARD TAX REFORM: RECOMMENDATIONS FOR PRESIDENT OBAMA'S TASK FORCE 30, 30-32 (Tax Analysts ed., 2009), http://www.taxanalysts.com/www/freefiles.nsf/Files/CUMMINGS-9.pdf/$file/CUMMINGS-9.pdf; Striz, *The Key to Closing the Tax Gap: Understanding*, *supra* note 298, at 1087-88; JUDICIAL CONFERENCE OF THE UNITED STATES, REPORT OF THE COURTS STUDY COMMITTEE 69 (Apr. 2, 1990); Martin D. Ginsberg, *The Federal Courts Study Commission Committee on Claims Court Tax Jurisdiction*, 40(3) CATHOLIC UNIVERSITY LAW REVIEW 631 (1991); *but see* James P. Holden, *The Federal Courts Study Committee Has Not Made the Cases for Its Proposed*

7. Give the IRS More Authority to Regulate Tax Practitioners and Preparers

Tax preparers and tax practitioners are often the gateway between the IRS and taxpayers. For example, 56.3% of the almost 146 million individual tax returns filed for tax year 2012 were completed by a paid preparer.[394] Unfortunately, the IRS's authority to regulate practitioners and preparers is limited,[395] and recent cases have questioned even that limited authority.[396] In order to ensure the competency of tax preparers and practitioners, Congress should give the IRS explicit authority to regulate them.[397]

8. Consider Expanding Private Debt Collection

While increasing third-party reporting would likely increase IRS efficiency, another one of Congress's ideas would likely increase costs for the IRS. The American Jobs Creation Act of 2004 authorized the IRS to enter into contracts for private debt collection of tax debts.[398] Some commentators think that the private sector can do almost anything better than the government.[399] The IRS began using private debt collectors in 2006 but discontinued the

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*Overhaul of the Tax Litigation Process*, 40(3) CATHOLIC UNIVERSITY LAW REVIEW 639 (1991) Johnson, *Reforming Federal Tax Litigation: An Agenda*, *supra* note 295, at 252-54.

[394] Internal Revenue Service, *SOI Tax Stats – Tax Stats at a Glance*, *supra* note 9.

[395] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-467T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY PREPARERS MADE SIGNIFICANT ERRORS (STATEMENT OF JAMES R. MCTIGUE, JR.), *supra* note 35, at i, 3-6.

[396] *See*, *e.g.*, Loving v. Internal Revenue Service, 742 F.3d 1013 (D.C. Cir. 2014) (finding that the IRS lacked statutory authority to require all federal tax return preparers to submit to registration, competency testing, and continuing education requirements); Internal Revenue Service, IRS *Statement on Court Ruling Related to Return Preparers*, http://www.irs.gov/uac/Newsroom/IRS-Statement-on-Court-Ruling-Related-to-Return-Preparers (last updated Mar. 5, 2014); Steve R. Johnson, *How Far Does Circular 230 Exceed Treasury's Statutory Authority?*, 146 TAX NOTES 221 (2015); Jamie Patrick Hopkins, *Loving v. IRS: The IRS's Achilles' Heel for Regulated Tax Advice?*, 34 VIRGINIA TAX REVIEW 191 (2014); STAFF OF THE JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATED TO THE REGULATION OF CONDUCT OF PAID TAX RETURN PREPARERS (JCX-34-14, 2014), https://www.jct.gov/publications.html?func=download&id=4580&chk=4580&no_html=1; Kip Dellinger, *Ridgely Allows Contingent Fees? Not So Fast, CPAs!*, 145 TAX NOTES 575 (2014).

[397] *See*, *e.g.*, Internal Revenue Service Advisory Council, *2014 Public Report*, *supra* note 232, at 20 (Statutory Authority of the IRS to Regulation Tax Return Preparers); NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 61 (REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers); William R. Davis & Jaime Arora, *Legislation Needed to Strengthen Circular 230, Hawkins Says*, 145 TAX NOTES 492 (2014); W. Edward Afield, *A Market for Tax Compliance*,62 CLEVELAND STATE LAW REVIEW 315 (2014); Johnson, *How Far Does Circular 230 Exceed Treasury's Statutory Authority?*, *supra* note 396, at 237-38; Michelle Drumbl, *When Helpers Hurt: Protecting Taxpayers From Preparers*, 145 TAX NOTES 1365 (2014).

[398] Pub. L. No. 108-357, § 881(e), 118 Stat. 1418, 1625 (2004).

[399] *See*, *e.g.*, John Stossel, *Private Enterprise Does It Better*, TOWNHALL.COM, Aug. 8, 2004, http://townhall.com/columnists/johnstossel/2010/08/04/private_enterprise_does_it_better; but *see*, Erik Eckholm,

program in 2009,[400] and, according to the *2013 Annual Report* of the National Taxpayer Advocate Nina Olson, the IRS was significantly more effective than the private debt collectors in collecting tax liabilities in all but the first six months after case receipt, collecting about twice as much as a percent of the dollars available for collection.[401] The National Taxpayer Advocate report further concluded that

> these results likely understate the difference in IRS and [private debt collector] effectiveness, since our analysis placed the IRS at a significant disadvantage: All of the cases were older when the IRS got them, and some were more than two years older; and the [private debt collectors] worked the cases first and collected the easy dollars, while the IRS only got cases the [private debt collectors] had already worked.[402]

Despite this evidence, private tax collection is again being proposed on Capitol Hill.[403] In a recent letter describing the prior program, National Taxpayer Advocate Nina Olson said that it "undermined effective tax administration, jeopardized taxpayer rights protections, and did not accomplish its intended objective of raising revenue."[404] Although the Joint Committee on Taxation predicted that the program authorized by the American Jobs Creation Act of 2004 would raise more than $1 billion in revenue,[405] the program actually lost money.[406]

According to National Taxpayer Advocate Olson, recent private-debt-collection proposals are even worse than the prior program.[407] The private debt collection proposal contained in a bill reported out of the Senate Finance Committee in April of 2014 would have required (prior legislation "allowed") the IRS to operate a new private debt collection program and would have required that all (prior legislation allowed IRS discretion to select) "inactive tax

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*Democrats Step Up Criticism of Halliburton Billing in Iraq*, NEW YORK TIMES, June 25, 2005, http://www.nytimes.com/2005/06/28/politics/28haliburton.html?pagewanted=all.

[400] NATIONAL TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 2, at 97, 99 (The IRS Private Debt Collection Program—A Comparison of Private Sector and IRS Collections While Working Private Collection Agency Inventory).

[401] *Id.* at Vol. 2, at 107.

[402] *Id.*

[403] *See*, *e.g.*, *Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014*, at 121-24 (Senate Report No. 113-154, Apr. 28, 2014) (explaining Sections 304 and 305 of the version of S. 2260, the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014, 113th Cong. that was reported out of the Senate Finance Committee on April 28, 2014).

[404] IRS Taxpayer Advocate Nina E. Olson, *Letter to various members of the U.S. Senate Finance and House Ways and Means committees* 2 (May 13, 2014), http://www.taxpayeradvocate.irs.gov/userfiles/file/NTA_PDC_letter.pdf.

[405] STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 4520, THE "AMERICAN JOBS CREATION ACT OF 2004" 9 (JCX-69-04, 2004), http://www.jct.gov/x-69-04.pdf.

[406] IRS Taxpayer Advocate Nina E. Olson, *Letter to various members of the U.S. Senate Finance and House Ways and Means committees*, *supra* note 404, at 2.

[407] *Id.*

receivables" be assigned to private debt collectors, subject to limited exceptions.[408] Critically, that proposal and Olson's response highlight an important consideration for attempts to streamline IRS operations: the government must consider long-term compliance. Olson notes that aggressive collection actions might force some marginal taxpayers into public assistance programs, which could cost the government more than the amount of the tax collected.[409] The private debt collectors would not care about long-term compliance or taxpayer hardship, as their compensation would be based on a percentage of tax collected.[410] The Joint Committee on Taxation estimated that the Senate Finance Committee private debt collection proposal would raise $2.4 billion over ten years which is not very much compared to the size of the tax gap or to the amount of revenue brought in by the IRS collection function in 2013 ($31.4 billion).[411] All in all, it seems likely that the government would get more bang-for-the buck by giving more money to the IRS rather than giving it to private debt collectors.

### *B. Administrative Actions that Could be Taken by Treasury and/or IRS*

#### 1. Issue Simplifying Regulations

The IRS and Treasury have the primary responsibility for drafting regulations that interpret the Internal Revenue Code.[412] Regulations do not always complicate tax law. Simplifying regulations can be both popular and non-controversial.

The so-called "check-the-box" regulations are a case in point. Before 1996, the IRS decided how to tax business entities by applying the so-called *Kintner* regulations.[413] The regulations identified four corporate characteristics: (1) continuity of life, (2) centralized management, (3) limited liability, and (4) freely transferable interests.[414] If an entity had three corporate characteristics, it was taxed as a corporation.[415] If it had two or fewer corporate

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[408] The prior legislation was contained in I.R.C. § 6306 (2004). The new proposal is contained in Sections 304 and 305 of the version of S. 2260, the Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act of 2014, 113th Cong. (2014) that was reported out of the U.S. Senate Committee on Finance on April 28, 2014. *See supra* note 403.

[409] IRS Taxpayer Advocate Nina E. Olson, *Letter to various members of the U.S. Senate Finance and House Ways and Means committees*, *supra* note 404, at 7.

[410] *Id.* at 8.

[411] *Id.* at 14; STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATED BUDGET EFFECTS OF AN AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 3474, THE "EXPIRING PROVISIONS IMPROVEMENT, REFORM, AND EFFICIENCY ('EXPIRE') ACT OF 2014," SCHEDULED FOR CONSIDERATION BY THE SENATE 4 (JCX-51-14, May 15, 2014), https://www.jct.gov/publications.html?func=startdown&id=4601.

[412] *See*, *e.g.*, I.R.C. § 7805.

[413] Kinter v. U.S., 107 F. Supp. 976, 979 (D. Mont. 1952), *aff'd.*, 216 F.2d 418 (9th Cir. 1954); Treas. Reg. § 301.7701-2(a)(1) (1960); *see* Heather M. Field, *Checking in on "Check-the-Box*," 42 LOYOLA (LOS ANGELES) LAW REVIEW 451, 460 (2009).

[414] Treas. Reg. § 301.7701-2(a)(1) (1960).

[415] Treas. Reg. §§ 301.7701-2(a)(2), (3) (1960).

characteristics, the IRS would disregard it for tax purposes if it had a single owner or tax it as a partnership if it had more than one owner.[416] The *Kintner* regulations intentionally made it more difficult to obtain corporate tax treatment. In 1996, Treasury promulgated the so-called "check-the-box" regulations.[417] Whereas under prior *Kintner* regulations, the IRS determined the tax classification of a business entity by examining its corporate characteristics, the check-the-box regulations allowed non-corporate entities to elect their tax classification. The regulations solved problems for both the IRS and taxpayers. The IRS no longer needed to use resources to litigate or issue guidance on entity classification issues.[418] Of course, the check-the-box regulations may be a special case. The rise of the limited liability company under State law together with the 1986 Tax Reform Act's lowering of individual income tax rates had fundamentally changed the business entity landscape.

For that matter, despite their length, the fringe benefit regulations discussed above did provide much simplifying guidance for taxpayers.[419] The Treasury regulations dealing with alimony and property settlement also provided significant simplifying guidance, and, notably, they were written in a clear question-and-answer style that was designed to be understandable by both divorce attorneys and tax attorneys.[420]

While simplifying regulations are helpful if the opportunity arises, in many circumstances simplifying regulations would merely lead to revenue loss. For example, the IRS spends a lot of time and resources litigating the employee/independent contractor distinction,[421] but a check-the-box regime for that classification would likely eviscerate the entire employment tax system.

### 2. Move to a Return-free System

One way to simplify the tax system, at least for low-income taxpayers, would be to move to either a return-free or final withholding tax system.[422] Under a return-free system, the IRS

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[416] *Id.*

[417] Treas. Reg. § 301.7701-3, T.D. 8697 (1996).

[418] Field, *Checking in on "Check-the-Box*," *supra* note 413, at 464.

[419] *See supra* note 349 and accompanying text.

[420] Treas. Reg. §§ 1.71-1 et seq., 1.215-1 et seq., 1.104-1 et seq.

[421] *See*, *e.g.*, Internal Revenue Service, *Independent Contractor (Self-Employed) or Employee?*, http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Self-Employed-or-Employee (last updated Oct. 2, 2014); INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 4.2.5 (Technical Guidelines for Employment Tax Issues), http://www.irs.gov/irm/part4/irm_04-023-005r.html; NATIONAL TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS, *supra* note 248, at Vol. 1, at 197 (IRS WORKER CLASSIFICATION PROGRAM: Current Procedures Cause Delays and Hardship for Businesses and Workers by Failing to Provide Determinations Timely and Not Affording Independent Review of Adverse Decisions).

[422] *See*, *e.g.*, Forman, *Simplification for Low Income Taxpayers: Some Options*, *supra* note 311, at 197-200; Roberta Mann, *Beyond Enforcement: Top 10 Strategies for Encouraging Tax Compliance*, 111 TAX NOTES 919, 927-28 (2006); U.S. Department of the Treasury, *Report to Congress on Return-Free Tax Systems: Tax*

would prepare tax returns for individual taxpayers based on information reports received from employers and other taxpayer income sources. Under a final withholding system, the amounts withheld from employers and other income sources would be the tax, thus eliminating the need for many taxpayers to file tax returns. For example, under its Pay-As-You-Earn-System (PAYE), the United Kingdom uses information reporting and withholding to ensure that most wage earners do not need to file a tax return.[423] Along similar lines, the IRS recently considered moving towards a so-called "real-time tax system" that could receive all third-party information returns and make them available online for use by taxpayers and preparers.[424] Although Congressional action to expand third-party reporting would enhance such return-free tax systems, the IRS should be able to eliminate return preparation for many taxpayers under current law.[425] Pertinent here, recognizing how burdensome return preparation can be, the National Taxpayer Advocate recently recommended that the IRS should help prepare returns, at least for vulnerable populations (including low income, disabled, and elderly taxpayers).[426]

3. Improve the IRS's Allocation of Resources

The IRS could also do a better job with the resources that it has. The U.S. Government Accountability Office (GAO) believes that "[a] long-term strategy that includes a fundamental reexamination of IRS's operations, program, and organizational structure could help it operate

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*Simplification Is a Prerequisite* (2003), http://www.treasury.gov/resource-center/tax-policy/Documents/noreturn.pdf; Austan Goolsbee, *The Simple Return: Reducing America's Tax Burden Through Return-Free Filing* (Brookings Institution, Hamilton Project Discussion Paper No. 2006-04, 2006), http://www.brookings.edu/~/media/research/files/papers/2006/7/useconomics-goolsbee/200607goolsbee.

[423] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-11-540T, TAX ADMINISTRATION: PRELIMINARY INFORMATION ON SELECTED FOREIGN PRACTICES THAT MAY PROVIDE USEFUL INSIGHTS (STATEMENT OF MICHEAL BROSTEK) 9 (2011), http://www.gao.gov/assets/130/125975.pdf.

[424] Internal Revenue Service, *Real Time Tax Initiative*, http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative (last updated Jan. 13, 2015).

[425] To be sure, there are real challenges with trying to prepare returns based largely on third-party reporting of wages, interest, dividends, etc. First, those third-party information returns are not always perfected and filed with the IRS in time to prepare returns by April 15th of each year. Second, even if the IRS receives those third-party information returns, it will not know about any taxpayer information that is not covered by those third-party information returns. Telling taxpayers "this is all the income we know about" might undermine their incentive to report other amounts that are not subject to third-party reporting. In any event, the IRS will still need more information from taxpayers to determine their eligibility for various tax benefits (including filing status). Finally, from a policy perspective, many believe that it is important for citizens to prepare and file tax returns so that they know the price they pay for citizenship. *See*, *e.g.*, Lawrence Zelenak, Learning to love Form 1040 : two cheers for the return-based mass income tax (2013).

[426] NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 315 (RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery).

more effectively and efficiently in an environment of budget uncertainty."[427] For example, many believe that the IRS should restore at least some of the geographic organizational structure that it had before its 1998 functional reorganization.[428]

a. *Shift Resources from Guidance to Enforcement*

Although the IRS needs to strike the proper balance between taxpayer service and enforcement activities, it probably should shift more of its limited resources towards enforcement.[429] Pertinent here, a recent report by the Treasury Inspector General for Tax Administration (TIGTA) found that IRS employees could take more action to collect outstanding taxpayer liabilities before closing cases as currently not collectible (e.g., filing more notices of federal tax lien).[430] Also, to reduce the amount of identity theft and refund fraud, the IRS could take a little longer evaluating returns and complete more compliance checks before it issues refunds.[431]

We note that, in the past, encouraging enhanced enforcement has sometimes backfired. For example, the 1998 IRS Reform and Restructuring Act implemented collection due process procedures because Congress got the impression that IRS agents and revenue officers had become overzealous in pursuing taxpayers, in part because performance reviews were based on

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[427] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-605, IRS 2015 BUDGET: LONG-TERM STRATEGY AND RETURN ON INVESTMENT DATA NEEDED TO BETTER MANAGE BUDGET UNCERTAINTY AND SET PRIORITIES, *supra* note 222, at 18.

[428] *See*, *e.g.*, Frank Wolpe, *Restoring Trust in the Internal Revenue Service*, 33(2) ABA SECTION OF TAXATION NEWS QUARTERLY 1 (Opinion Point, Winter 2014), http://www.americanbar.org/content/dam/aba/publishing/newsquarterly/14win/opinionpoint-restoring-trust.pdf; Frank Wolpe, *A Renewed Call for True Structural Reform to Restore Trust in the Internal Revenue Service by Rebuilding Field Operations with Democratic and Republican Participation* (Nov. 25, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2530786. *See also* NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 31 (IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance), 46 (APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State), 311 (ACCESS TO APPEALS: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico).

[429] *See supra* Table 5 to see how the IRS allocated its budget in a recent year. To be sure, as Congress appropriates separate amounts for distinct categories of IRS activity, the IRS's ability to shift resources around without Congressional approval is somewhat limited. *See supra* note 203 and accompanying text.

[430] U.S. Treasury Inspector General for Tax Administration, *Delinquent Taxes May Not Be Collected Because Required Research Was Not Always Completed Prior to Closing Some Cases As Currently Not Collectible* (Reference No. 2014-30-052, Aug. 25, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201430052fr.pdf;

[431] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *supra* note 256, at 20-21.

revenue collected.[432] The pendulum of tax enforcement has swung several times during the time the authors have been watching, and we hesitate to advocate pushing that swing too far towards enforcement.[433]

In any event, with limited resources, the IRS will have to better prioritize the kinds of guidance that it issues.[434] In the long run, it seems inevitable that the IRS will spend less time on private letters rulings and determination letters for individual taxpayers and will instead favor regulations, revenue rulings, and other forms of guidance that can reach many taxpayers simultaneously, rather than one-by-one.[435]

b. *Shift Audit Resources*

While enhanced third-party reporting seems unlikely to happen[436] and private debt collection appears counterproductive,[437] the IRS could shift its audit resources to enhance its efficiency.[438] Refundable credits pose a particular problem for the IRS, both in terms of time and adverse press.[439] In 2011, for example, 24.6 million returns claimed the refundable earned

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[432] *See supra* notes 178 & 389-392 and accompanying text.

[433] *See*, *e.g.*, Kathryn Keneally & Charles P. Rettig, *IRS Enforcement: The Pendulum has Swung Too Far*, 9 JOURNAL OF TAX PRACTICE AND PROCEDURE 13 (2007-2008); ROSSOTTI, MANY UNHAPPY RETURNS: ONE MAN'S QUEST TO TURN AROUND THE MOST UNPOPULAR ORGANIZATION IN AMERICA, *supra* note 298, at 103-07.

[434] *See supra* Section II.B.5 for a discussion of the kinds of guidance that the IRS issues.

[435] *See*, *e.g.*, Matthew R. Madara, *IRS Not Expecting to Eliminate Plan Determination Letter Program*, 145 TAX NOTES 778 (2014) ("The IRS has no intention of eliminating its determination letter program for retirement plans, but the agency would like to expand its use of preapproved plans to cover more types of arrangements, an IRS official said November 13."); Alison Bennett, *Annual Guidance Plan May Be Affected*, 03 BLOOMBERG BNA DAILY TAX REPORT G3 (Jan. 7, 2015).
By Shrinking Budget, Top IRS Official Says

[436] *See supra* Section IV.A.3.

[437] *See supra* Section IV.A.8.

[438] *See*, *e.g.*, NATIONAL TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS, *supra* note 3, at Vol. 1, at 112 (WORKLOAD SELECTION: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy).

[439] *See*, *e.g.*, U.S. Treasury Inspector General for Tax Administration, *The Internal Revenue Service Is Working Toward Compliance With Executive Order 13520 Reporting Requirements* (Reference No. 2015-40-009, Dec. 29, 2014), http://www.treasury.gov/tigta/auditreports/2015reports/201540009fr.pdf (estimating that in Fiscal Year 2013, earned income tax credit claims totaled approximately $60 billion and that 24% of the earned income tax credit payments were paid in error);U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-737T, IMPROPER PAYMENTS: GOVERNMENT-WIDE ESTIMATES AND REDUCTION STRATEGIES 4 (July 9, 2014), http://www.gao.gov/assets/670/664692.pdf (showing EITC to be in the top five programs with improper payment estimates); U.S. Treasury Inspector General for Tax Administration, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* (Reference No. 2014-40-093, Sept. 29, 2014), http://www.treasury.gov/tigta/auditreports/2014reports/201440093fr.pdf.

income tax credit (EITC), 20.5 million returns claimed the refundable child credit, and 7.6 million returns claimed the refundable portion of the American Opportunity Tax Credit.[440]

Recently, the U.S. Government Accountability Office (GAO) analyzed a hypothetical reallocation of IRS examination resources over two years (2007 and 2008) and found that a shift of about $124 million in enforcement resources could have increased direct revenue by $1 billion over the $5.5 billion per year IRS actually collected.[441] The GAO analysis shifted the $124 million from examinations of lower-income returns with the earned income tax credit (EITC) and from lower-income business returns without the EITC to examinations of higher-income returns and lower-income nonbusiness returns without the EITC.[442] The GAO concluded that the IRS should collect and analyze more return and audit data to assist them in "more finely adjusting its resource allocation decisions."[443]

The GAO suggested that the IRS should study the feasibility of estimating the marginal revenue and marginal costs within each program and within each taxpayer group and determine how "the broad characteristics of the returns that would likely be selected (or not selected) in a modest program expansion (or contraction) would differ from the average return actually audited now."[444] That "information would help the IRS assess the extent to which revenue productivity would likely decline, if at all, if more exam resources are devoted to a particular group of taxpayers."[445] In short, the IRS should select returns for enforcement that are the most cost-effective to pursue.

In addition, the GAO suggested that the IRS should examine whether there is a link between the time that specific examiners spend on each case and the revenue collection amounts for each case.[446] That analysis would allow the IRS to estimate ratios of direct revenue to cost that better incorporate differences in the hourly costs across examiners with different skill levels.[447] The GAO noted that there are challenges in estimating the influence of enforcement activity on voluntary compliance, but the GAO encouraged the IRS to leverage its existing efforts to study voluntary compliance to improve information on the influence of enforcement activity on voluntary compliance.[448]

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[440] Justin Bryan, *Individual Income Tax Returns, 2011*, 33(2) STATISTICS OF INCOME BULLETIN 5, 13, 14 (Fall 2013). *See also* Internal Revenue Service, *Individual Income Tax Returns 2012*, *supra* note 19.

[441] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-151, TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES, *supra* note 148, at 10.

[442] *Id.* at 10.

[443] *Id.* at 15.

[444] *Id.*

[445] *Id.*

[446] *Id.*

[447] *Id.*

[448] *Id.*

Basically, the IRS should use return-on-investment information to help manage its enforcement resources.[449] Of course, collecting and studying data requires resources. When budgets are slim, what should the IRS cut? Should it cut research or revenue-collecting staff? It is a conundrum similar to the age-old question of what came first, the chicken or the egg.

Enhanced examination of partnership tax returns could also improve collections. Partnerships are frequently used by both small businesses and large corporations to facilitate tax sheltering, yet the audit rate of partnership returns is only around 0.42%.[450] The GAO has found that the IRS does not effectively audit large partnerships because of tax law complexity and the administrative constraints due to tight budgets.[451] The GAO also found that IRS examinations and automated document matching have not been effective in finding partnership and S corporation misreported income and that matching K-1s to partnership and S corporation tax returns could enhance detection of non-compliance.[452]

c. *Expand the Compliance Assurance Process (CAP)*

The IRS initiated the Compliance Assurance Process (CAP) program for large business taxpayers in 2005 and expanded it and made it permanent in 2011.[453] Under CAP, participating taxpayers work collaboratively with the IRS to identify and resolve potential tax disputes before the taxpayer files its federal income tax return. Both taxpayers and the IRS are able to achieve tax certainty sooner and with less administrative burden than in the traditional post-

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[449] *See*, *e.g.*, U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-605, IRS 2015 BUDGET: LONG-TERM STRATEGY AND RETURN ON INVESTMENT DATA NEEDED TO BETTER MANAGE BUDGET UNCERTAINTY AND SET PRIORITIES, *supra* note 222, at 18-24; U.S. Treasury Inspector General for Tax Administration, *The Use of Return on Investment Information in Managing Tax Enforcement Resources Could be Improved* (Reference No. 2013-10-104, Sept. 23, 2013), http://www.treasury.gov/tigta/auditreports/2013reports/201310104fr.pdf. Technically speaking, the IRS should estimate the marginal return-on-investment of its various enforcement possibilities and allocate its resources to the strategies that will maximize revenue (i.e, get the best bang-for-the-buck).

[450] *See supra* note 163. See also the discussion of partnership audit procedures in Section III.C *supra*.

[451] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-746T, LARGE PARTNERSHIPS: GROWING POPULATION AND COMPLEXITY HINDER EFFECTIVE IRS AUDITS (STATEMENT OF JAMES R. WHITE) 17 (2014), http://gao.gov/assets/670/664917.pdf.

[452] U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-14-453, PARTNERSHIPS AND S CORPORATIONS: IRS NEEDS TO IMPROVE INFORMATION TO ADDRESS TAX NONCOMPLIANCE 15, 19 (2014), http://www.gao.gov/assets/670/663185.pdf.

[453] Internal Revenue Service, *IRS Expands and Makes Permanent Its Compliance Assurance Process (CAP) for Large Corporate Taxpayers*, IR-2011-32, http://www.irs.gov/newsroom/article/0,,id=237975,00.html. *See also* INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL 4.51.8 (Compliance Assurance Process (CAP) Examinations), http://www.irs.gov/irm/part4/irm_04-051-008.html; Loren M. Opper, *Compliance Assurance Process*, 63(6) THE TAX EXECUTIVE 413 (Nov.-Dec. 2011), http://www.tei.org/news/articles/Documents/Compliance%20Assurance%20Process.pdf.

filing examination program.[454] CAP has proven to be effective and efficient, and the IRS should explore further expansions of the program.

4. Expand Alternative Dispute Resolution and the Use of IRS Appeals

Alternative dispute resolution (ADR) is often considered a cost effective way to avoid litigation.[455] The Appeals Office at the IRS, founded in 1927, could be regarded as one of the earliest dispute-resolution organizations in the United States.[456] While negotiation was the original ADR function of Appeals, it now offers mediation, arbitration, and rapid settlement procedures.[457] Taxpayers may use ADR before or after entering the formal Appeals process.[458] Appeals ADR programs appear to be underutilized, although statistics about particular programs are not available.[459] Transparency and information about the use or non-use of ADR at Appeals would be useful in evaluating possible ways to improve the program.

5. Change the IRS Mission

In 1998, the IRS adopted a new mission statement: its mission is to:

> Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities by applying the tax law with integrity and fairness to all.[460]

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[454] U.S. Treasury Inspector General for Tax Administration, *The Compliance Assurance Process Has Received Favorable Feedback, but Additional Analysis of Its Costs and Benefits Is Needed* (Reference No. 2013-30-021, Feb. 22, 2013), http://www.treasury.gov/tigta/auditreports/2013reports/201330021fr.pdf; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO-13-662, CORPORATE TAX COMPLIANCE: IRS SHOULD DETERMINE WHETHER ITS STREAMLINED CORPORATE AUDIT PROCESS IS MEETING ITS GOALS (2013), http://www.gao.gov/assets/660/657092.pdf; *but see* Leigh Osofsky, *Getting Realistic About Responsive Tax Administration*, 66 TAX LAW REVIEW 121 (2012) (cautioning that CAP has weaknesses).

[455] *See*, *e.g.*, National Arbitration Forum, *Business-to-Business Mediation/Arbitration vs. Litigation* (2005), http://www.adrforum.com/users/naf/resources/GeneralCommercialWP.pdf.

[456] David Parsly, *The Internal Revenue Service and Alternative Dispute Resolution: Moving from Infancy to Legitimacy*, 8 CARDOZO JOURNAL OF CONFLICT RESOLUTION 677, 678 (2007); U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GGD-97-71, IRS INITIATIVES TO RESOLVE DISPUTES OVER TAX LIABILITIES 2 (1997), http://www.gao.gov/assets/230/224004.pdf. *See also supra* notes 165-170 and accompanying text.

[457] Ken Jones, *Appeals Arbitration: Not a Compelling Litigation Alternative*, 143 TAX NOTES 1059 (2014). *See also* Rev. Proc. 2003-41, 2003-1 CB. 1047 (announcing the availability of "fast-track" mediation for small business/self-employed taxpayers); Rev. Proc. 2003-40, 2003-1 C.B. 1044 (announcing the availability of "fast-track" settlement for large and mid-size business taxpayers); Internal Revenue Service, *Alternative Dispute Resolution*, http://www.irs.gov/Individuals/Alternative-Dispute-Resolution (last updated Feb. 18, 2014).

[458] Stephen Folan, *Even ADR Must Pay Its Dues: An Analysis of the Evolution of the Internal Revenue Service's ADR Programs and Where They Still Need to Grow*, 13 PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL 281, 284-87 (2013).

[459] Jones, *Appeals Arbitration: Not a Compelling Litigation Alternative*, *supra* note 457, at 1062.

[460] Internal Revenue Service, *The Agency, its Mission and Statutory Authority*, http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority (last updated Nov. 4, 2014).

In recent years, however, many have noted that the IRS has clearly suffered from mission creep, much of it mandated by Congress.[461] In addition to collecting taxes, the IRS now administers dozens of government programs that distribute government benefits, regulate non-profits, pensions and health care, and subsidize activities such as renewable energy electricity generation.[462] Professor Kristin Hickman found that about a third of the IRS's recent regulatory efforts were concerned with programs and projects that are not associated with traditional revenue-raising; i.e., projects concerned with non-revenue-raising tax expenditures, the Patient Protection and Affordable Care Act (ACA), exempt organizations, employee benefits, and campaign finances.[463] Professor Hickman found that "whether the focus is on documents, projects, or page counts, it is apparent that Treasury and the IRS commit substantial resources to adopting regulations that interpret, elaborate, and implement tax provisions aimed primarily at regulatory and social welfare programs, purposes, and functions rather than raising revenue."[464]

Similarly, National Taxpayer Advocate Nina Olson has noted that "the trend toward requiring the IRS to administer social benefits in addition to its core tax administration duties increasingly diverts current IRS resources and diminishes taxpayer service."[465] Olson has argued for a new mission statement that recognizes the IRS's "dual role as part tax collector, part benefits administrator."[466] Olson said that the mission statement is important for two reasons: "first, it serves as the organizing principle around which the IRS's strategic plan is built, and second, a revised mission statement would make clear that the IRS will require sufficient funding to perform both roles well."[467]

On the other hand, former IRS Commissioner Mortimer Caplin (1961-1964) would move the mission statement in the opposite direction, noting that "the IRS's core purpose is to collect the proper amount of tax revenue in a fair, efficient, and impartial manner."[468] Caplin laments that the current mission "does not even mention the collection of taxes."[469]

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[461] Coder, *The New IRS: Expanding the Mission?*, *supra* note 79, at 579.

[462] *See supra* Section III.B.2.

[463] Hickman, *Administering the Tax System We Have*, *supra* note 341, at 1748-49.

[464] *Id.* at 1752-53.

[465] NATIONAL TAXPAYER ADVOCATE, FISCAL YEAR 2011 OBJECTIVES REPORT TO CONGRESS v (2010), www.irs.gov/pub/tas/nta2011objectivesfinal..pdf.

[466] Coder, *The New IRS: Expanding the Mission?*, *supra* note 79, at 577. If the IRS were to change its mission statement to reflect its dual role, would it also make sense to rename it the "Internal Revenue and Benefits Service?"

[467] *Id.*; NATIONAL TAXPAYER ADVOCATE, 2010 ANNUAL REPORT TO CONGRESS, *supra* note 79, at Vol. 1, at 17.

[468] Coder, *The New IRS: Expanding the Mission?*, *supra* note 79, at 579; Internal Revenue Service, *Previous IRS Commissioners (1955-2013)*, http://www.irs.gov/uac/Previous-IRS-Commissioners-(1955-2013) (last updated Oct. 31, 2014).

[469] Coder, *The New IRS: Expanding the Mission?*, *supra* note 79, at 576.

Changing the IRS mission statement, whether to go back to a focus on revenue collection or to reflect the IRS's actual dual role, is primarily a matter of symbolic value. If the IRS were to go back to its original mission, it could use that to object to the additional burdens placed upon it. If it were to adopt a dual mission, as National Taxpayer Advocate Olson suggests, it could use that mission to request additional funding. Unfortunately, having slashed the IRS budget in recent years, Congress is unlikely to be swayed by either argument.[470]

## V. CONCLUSION

In this Article, we have explored many ways to help the IRS live within its shrinking budget. We continue to believe that taxpayers and the federal fisc would be best served by increasing the IRS budget in line with its vastly increased responsibilities. Our research has revealed that advice is one valuable commodity that the IRS has received in abundance. Taking all or a portion of the advice offered in this Article could help the IRS cope with its budget woes. However, if Congress continues to treat the IRS as a scapegoat for Congress's own failures and as the servant for its unfunded mandates, respect for the agency and compliance are both likely to continue to decline.

[470] *See supra* Section III.A.