

12-2003

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Steve R. Johnson
Florida State University College of Law

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Recommended Citation

Steve R. Johnson, *The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification*, 51 *U. KAN. L. REV.* 1013 (2003),
Available at: <https://ir.law.fsu.edu/articles/251>

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The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification

*Steve Johnson**

Tax compliance sometimes is thought of as purely a matter of administration. But there are important connections between substance and procedure.¹ Both affect compliance. This article explores how simplification of the substantive tax law can improve compliance. The particular emphasis is on how simplification can liberate human and material resources for the IRS without which otherwise well conceived efforts to improve compliance are likely ultimately to fail.

The landmark Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98)² is central to this. RRA '98 is part of the problem since its excesses imposed serious new resource demands on the IRS. Reducing those demands through moderating those excesses likely will have to be part of the solution.

Put more fully, my thesis is this: The extent of tax compliance in the United States is unsatisfactory. The trend line of compliance has been downward for well over a generation, and the decline has accelerated in recent years. Measures recently undertaken or announced by the IRS are salutary. However, by themselves, these measures are unlikely to reverse the decline. The likelihood is that, absent supporting changes beyond the ability of the IRS to make on its own, these measures will do no more than slow the rate at which American tax compliance declines.

The supporting changes to which I refer are of either of two kinds. First, the budget of the IRS could be increased substantially and consistently over a long period of time. The new directions charted by the IRS could work if they are reliably supported by billions of additional

* E.L. Wiegand Professor, William S. Boyd School of Law, University of Nevada, Las Vegas. B.A., St. Francis College; J.D., New York University. I thank Monica Miller for comments and Shawn Patten for research assistance.

1. By "substantive" tax law, I mean those rules, which prescribe how much tax each taxpayer owes. In "procedural" tax law, I include (i) the rules by which controversies as to the amount of substantive liability are resolved, (ii) the rules which govern collection of the liability once its amount has been determined, and (iii) civil and criminal penalty regimes to encourage prompt and accurate payment of tax.

2. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998) [hereinafter "RRA '98"].

appropriations.³ But additional, sustained budgeting on the order required is highly unlikely, indeed borders on the politically impossible. That being so, the other possible direction emerges as the only real alternative to continued deterioration of tax compliance. That direction is genuine simplification of our tax system.

Simplification would boost compliance in several ways. I will emphasize the resources aspects. Compliance involves honest taxpayers knowing what the law requires of them, and more “aggressive” taxpayers being deterred by or discovered by vigilant enforcement. Simplification that reduces IRS workloads—particularly in areas of only marginal benefit to taxpayers or to the federal fisc—would permit redeployment of resources that would enhance both taxpayer education and assistance on the one hand and enforcement on the other hand. Derivatively, there will be another benefit as well. Our system depends on self-assessment by taxpayers. We are in danger of loss of public confidence in the tax system, with consequent erosion of self-assessment. Many taxpayers believe—not without justification—that other taxpayers are able to manipulate an overly complex system to reduce their tax liabilities. Those who believe that are tempted to adjust their own behavior in ways adverse to compliance. By reducing actual and perceived opportunities for cheating by others and by facilitating enforcement (through resources redeployment) against those who do cheat, simplification can fortify the better instincts of honest taxpayers.

But meaningful simplification is no political cake-walk. In our history, tax simplification has been honored far more by lip service than by effective action. Still, pressures are mounting for genuine simplification of our system, and the alternatives are few. Either we substantially increase our spending on the IRS or we meaningfully simplify tax administration. If we do neither, we will suffer continuing loss of compliance, perhaps ultimately endangering the very viability of the nation’s revenue system.

3. Of course, I do not think more resources alone will solve all the IRS’s problems. Intelligent application of them is necessary too. Certainly, the IRS sometimes has used appropriations poorly. For instance, one of the IRS’s biggest problems is its unsatisfactory information technology. Lots of money has been thrown at this problem over the years, and the IRS has spectacularly mismanaged it, so much so that the IRS’s requests for technology money are now reviewed quite skeptically. See, e.g., George Guttman, *OMB Cuts IRS Modernization Budget Request in Half*, 97 TAX NOTES 1004, 1004 (2002) (relating the Office of Management and Budget’s reduction of the IRS budget to OMB’s belief that the IRS fails to properly plan projects). Resources do not guarantee success, but they surely are necessary to it.

Part I of this article briefly sketches the erosion of tax compliance in the United States. Part II demonstrates that efforts to improve compliance ultimately depend on the availability of adequate resources. Part III explores why resources are now and likely will continue to be inadequate. It notes the double pinch evident recently: RRA '98 imposed great additional demands on the IRS but Congress and administrations have not provided the budgets to allow the IRS to meet these demands while maintaining adequacy in other functions, including enforcement.

Part IV develops the resources links between simplification and compliance. It offers examples of simplifications that could liberate resources for redeployment without unduly compromising important objectives. The particular thrust is changes to RRA '98 rules. Specifically, Part IV proposes changes to mitigate some of the resource stresses created by the 1998 provisions as to offers in compromise, spousal relief, and collection due process hearings and appeals.

Simplification has been urged ardently and eloquently, but usually on grounds other than compliance. My hope is that this article reinforces the movement for tax simplification by fostering realization that the failure to effectively simplify the system means that we will have to either pump billions more into its administration or accept revenue erosion, unfairness, and popular discontent perhaps threatening the viability of the system.⁴

I. THE UNSATISFACTORY STATE OF TAX COMPLIANCE

The IRS frequently releases information on enforcement and compliance. In January 1997, former IRS Commissioner Sheldon Cohen offered these statistics: "The audit rate in 1964–68 was about 4.5 to 5%, compliance was over 90%; today the audit rate is less than 1% and compliance is only about 80%. Think there is a correlation? I do."⁵

In absolute terms, such statistics are of limited reliability. The enforcement figures do not always reflect the same taxes or the same

4. I hope that this assertion is not seen as melodrama. The IRS Oversight Board recently remarked that "a private sector company that fell behind this dramatically [as the IRS has] would find its very survival threatened." 2001 IRS OVERSIGHT BOARD ANN. REP. 3 [hereinafter IRS OVERSIGHT BOARD ANN. REP.]. Of course, the IRS is not a private sector company. The Government's coercive power and need for revenues guarantee that there always will be a tax system and an agency to administer it. But general discontent or evident failure could threaten either the present system or the present agency with radical revision or replacement.

5. Sheldon S. Cohen, *The Erwin N. Griswold Lecture*, 14 AM. J. TAX POL'Y 113, 117 (1997) (citations omitted).

types of examinations or other enforcement activities.⁶ Moreover, they assign undifferentiated weights to different types of examinations that have different intensities and results. In contrasting ways, the audit rate figures both understate and overstate examination activity.

A. *Understatement of Examination Activity*

The audit statistics' understatement of enforcement was noted in an exchange of correspondence between Senator Grassley, then Chair of the Senate Finance Committee, and then IRS Commissioner Rossotti.⁷ Senator Grassley was concerned that "the IRS statistics don't tell the whole story of the actual number of returns that are reviewed by the service."⁸ Specifically, "the audit numbers fail to consider millions of IRS computer-based reviews of taxpayer returns. If these additional millions of contacts were included, the audit rates would be three to four times higher than reported."⁹

The reference is to the IRS's information reporting program (IRP). Under IRP, the IRS receives from third-parties millions of statements as to amounts paid to taxpayers (such as wages, interest, and dividends) and, to a lesser extent, amounts paid by taxpayers (such as home mortgage interest). Currently, the IRS computer-matches those statements with amounts reported on taxpayers' returns.¹⁰ This omission undercuts the comparability of IRS audit statistics across the decades:

6. In contrast to the 4.5% to 5% audit rate given by Commissioner Cohen for 1964 to 1968, a former Treasury Assistant Secretary and leading tax academic says that the IRS audited 6% of returns in 1965. MICHAEL J. GRAETZ, *THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE* 93 (1999).

7. Letter from Senator Charles E. Grassley, Chairman of the Senate Finance Committee, to Charles O. Rossotti, Commissioner, Internal Revenue Service (Mar. 19, 2001) reprinted in *Grassley Questions Accuracy of IRS Audit Rates*, 91 TAX NOTES 159, 195 (2001) [hereinafter *Grassley*]; Letter from Charles O. Rossotti, Commissioner, Internal Revenue Service, to Senator Charles E. Grassley, Chairman of the Senate Finance Committee (Mar. 26, 2001) reprinted in *Rossotti Responds to Grassley*, 91 TAX NOTES 160, 160 (2001) [hereinafter *Rossotti*].

8. *Grassley*, supra note 7, at 159. For others advancing the same argument, see *Auditing IRS Audit Numbers Is Revealing*, HOOSIER TIMES, Apr. 1, 2001, at F3; George Guttman, *Current Audit Statistics Make IRS Look Less Effective Than It Is*, 90 TAX NOTES 1593, 1593 (2001); H. Wayne Cecil, *The Real Audit Rates for Individual Taxpayers*, 75 TAX NOTES, 831, 831 (1997).

9. *Grassley*, supra note 7, at 159. In 1999, there were over 3.6 million IRP contacts with taxpayers and millions more IRP reviews that did not result in contacts with taxpayers. *Id.*

10. For discussion of information reporting and matching, see IRA L. SHAFIROFF, *INTERNAL REVENUE SERVICE PRACTICE & PROCEDURE DESKBOOK* § 3:2.1 (3d ed. 2003) (describing DIF audits).

[T]hese types of audit matching were done primarily by hand in the 1960s and 1970s and thus would have been included as an audit at that time. In the late 1970s, and particularly with the increased third party reporting requirements provided for in 1986, this work was more and more performed by computers yet was not included in the audit rate.¹¹

Commissioner Rossotti agreed that the above point is “well founded” and that “[s]imply focusing on the audit rate does substantially understate the IRS’s capacity to find errors in returns.”¹² Indeed, the Commissioner opined:

With the use of document matching as well as other return verification techniques that will eventually be enabled by new technology, it is my view that there is no need to return to the levels of individual audit coverage that existed even five years ago, which was three times the FY 2000 level.¹³

However, the qualification described above should not lead us to conclude that all is well. Senator Grassley acknowledged that “an IRP contact is [not] equal to a face-to-face audit on a one-for-one basis.”¹⁴ He was right to do so. “[A]verage in-person audit of an individual return results in an assessment of approximately \$9,540, while the average assessment from a document matching case is \$1,506.”¹⁵ As the IRS Oversight Board observed: “While [audit] statistics do not recognize the significant amount of tax return data that is compared to independent sources such as W-2s and 1099s, . . . the statistics represent a very real and troubling trend in enforcement activity.”¹⁶

As currently structured, information reporting and matching has limited or no utility for many types of tax items, including income generated through a business entity, gain or loss on sales of assets, and most itemized deductions. This hampers the effectiveness of that device.¹⁷ Moreover, it raises equity concerns.

11. *Grassley, supra* note 7, at 159. Part of Senator Grassley’s concern was that “the understatement may be used to justify budget and staff increases” for the IRS. *Id.* On the other hand, the IRS once proposed changing the definition of “audit” to include IRP cases, but “this proposal was criticized in some parts of Congress as an attempt to inflate IRS’s statistics.” *Rossotti, supra* note 7, at 161.

12. *Rossotti, supra* note 7, at 160.

13. *Id.*

14. *Grassley, supra* note 7, at 159.

15. *Rossotti, supra* note 7, at 161.

16. IRS OVERSIGHT BOARD ANN. REP., *supra* note 4, at 17.

17. See *Rossotti, supra* note 7, at 161 (discussing the IRS’s FY 1998 estimation that personal income that was beyond verification through document matching was about \$1.2 trillion).

It is relatively easy for the IRS to verify the returns and reported income of taxpayers whose income results from wages, interest and dividends and who take the standard deduction It is harder, and often requires audits, to verify the income of taxpayers with other forms of income and deductions or more complex returns, who are often higher income taxpayers To the extent that the IRS uses more and more document matching and less and less auditing, the effect may be perceived as, and will in fact be unfair because higher income taxpayers will not have their returns verified to the same degree as middle income taxpayers.¹⁸

There may be more mileage that can be squeezed out of information returns and matching, but the row will not be easy to plough. An example is the IRS's recent unsuccessful attempt to electronically match Schedules K-1 from partnerships' Forms 1065 to the returns filed by the partners. In 2000, the IRS announced its intention to do so in a serious manner. Leading commentators questioned the feasibility and efficacy of such an effort.¹⁹ Others, including members of Congress, were frustrated by slow implementation of the program.²⁰ In 2002, the IRS began the matching and, by July, had sent out around 65,000 notices to taxpayers requesting them to explain K-1 versus return discrepancies. However, many of the discrepancies were apparent rather than real and there were complaints about the burden imposed on small business owners. The IRS decided to discontinue sending out such notices as of August 2002.²¹ It is reported that the IRS hopes to resume the K-1 matching program but there is no certainty that it will be resumed or, if it is, that it will be effectively implemented.²²

B. *Overstatement of Enforcement Activity*

Not all examinations are equal. The least demanding, from the taxpayer's standpoint, are exams performed by Service Centers.²³ These

18. *Id.*

19. See Amy Hamilton, *Practitioners Have 'Grave Doubts' About IRS Plans to Match K-1s*, 89 TAX NOTES 1359 (2000) (discussing the Internal Revenue Service Advisory Council's concern about the IRS's plan to electronically match).

20. See, e.g., Amy Hamilton, *Rossotti Says Cheating Top Concern; Houghton Plans Hearing*, 95 TAX NOTES 290, 291 (2002) (discussing IRS's commissioner Rossotti and congressional members' desire to crack down on abuses of the system before commencement of the 2003 national audit program).

21. George Guttman, *Why Did the K-1 Matching Program Go Awry?*, 97 TAX NOTES 736, 736-37 (2002); Sheryl Stratton, *IRS Stops Sending K-1 Mismatch Notices*, 96 TAX NOTES 1038, 1038 (2002).

22. Michael P. Dolan, *IRS Resumes K-1 Matching Program*, TAX ADVISOR, April 2003, at 232.

23. Currently, the IRS likes to call them "campuses" or "compliance centers."

are conducted by mail, typically focus on only one or a few items, and are performed by low paid, less-trained personnel with heavy case loads and, because of high turnover rates, limited audit experience.²⁴ At the other end of the spectrum are face-to-face audits performed by revenue agents. Between the two are office exams conducted by tax auditors.²⁵ Although these categories are of quite different levels of rigor and effectiveness, they are combined without weighting in IRS audit statistics.

As an example, take Fiscal Year (FY) 1997, the year in which Commissioner Cohen offered the statistics cited at the start of this Part I.²⁶ For that year, the IRS reported an overall audit rate of 1.09%, derived from 1,728,122 audits of all kinds of a total of about 158,014,000 tax returns of all kinds filed.²⁷ Of the audits, 394,304 were done by revenue agents; 521,116 were done by tax auditors; and 812,702 were done by Service Center personnel.²⁸ Thus, nearly half of the claimed 1.09% audit coverage was attributable to a type that lacks intensity, depth, and dollar yield. In terms of their impact on compliance, Service Center audits should be weighted at some fraction well under 1, which would drop the reported coverage rate for that year well below one percent.

Since FY 1997, the numbers of audits have declined and reliance on Service Center audits has increased. For instance, for returns filed in calendar year 2000: 168,184,400 returns were filed and 815,057 were examined, for an official coverage rate of 0.48%. Nearly 66% of all returns examined were looked at by compliance centers.²⁹ Weighting compliance center examinations at under 1% would truly yield low coverage.

24. See, e.g., GENERAL ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, COMMITTEE ON THE BUDGET, U.S. SENATE, TAX ADMINISTRATION: DIFFICULTIES IN ACCURATELY ESTIMATING TAX EXAMINATION YIELD 27-29 (GGD-88-119) (1988) (discussing the staffing for these types of examinations).

25. For further description, see Leandra Lederman & Stephen W. Mazza, TAX CONTROVERSIES: PRACTICE & PROCEDURE 93-96 (2d ed. 2002).

26. Cohen, *supra* note 5, at 117.

27. INTERNAL REVENUE SERVICE, 1997 DATA BOOK 10-11, tbl.11 (1997).

28. *Id.*

29. INTERNAL REVENUE SERVICE, 2001 DATA BOOK 17, tbl.10 (2001) available at <http://www.irs.gov/pub/irs-soi/oldatable.pdf> [hereinafter 2001 DATA BOOK].

C. Measurement of Compliance

The taxpayer compliance rates stated by the IRS must also be taken with a generous pinch of salt. They are estimates based on shaky assumptions,³⁰ and they usually reflect excessive optimism.³¹ At least at some times, the IRS estimates have slightly overstated actual compliance because they failed to “take into account tax liabilities of persons who fail to file returns at all.”³² The Staff of the Joint Committee on Taxation has remarked: “One issue . . . is how to measure compliance. There is currently no reliable measure of compliance [A] key issue in measuring the success of the IRS is developing such a measure. In the meantime, the IRS has extrapolated from previous studies of noncompliance.”³³

The foundation of the compliance figures was substantially eroded by the abandonment of the Taxpayer Compliance Measurement Program (TCMP) in 1994, leaving 1988 TCMP data as the most recently gathered.³⁴ TCMP audits were used to establish and confirm statistical benchmarks to guide IRS audits, but the IRS was forced to abandon them because of their cost and their oppressive effect on the luckless taxpayers chosen to undergo them.³⁵ The result was erosion of the accuracy of the IRS’s audit selection guides, which must negatively affect enforcement

30. See, e.g., JOEL SLEMRD & JON BAKUA, *TAXING OURSELVES* 151 (2d ed. 2001) (“The procedure for estimating the tax gap is an imperfect one, and even the IRS would admit that its measures are approximations.”).

31. Professor Graetz recounts a 1984 statement by then IRS Commissioner Roscoe Egger: “[c]learly there’s a trend away from compliance. . . . There’s definitely a continuation of the downtrend that started 20 years ago . . . I think there’s a belief on the part of some taxpayers that they won’t get caught. . . . Even though we’re talking about downtrends, you’re still talking about compliance in the 90 percentile level.” Graetz properly punctures the self-congratulation (or self-deception): “90 percent? The IRS Commissioner was putting on a happy face.” GRAETZ, *supra* note 6, at 90–91.

32. Michael C. Durst (reporter), REPORT OF THE SECOND INVITATIONAL CONFERENCE ON INCOME TAX COMPLIANCE 24 n.16 (1988).

33. STAFF OF JOINT COMMITTEE ON TAXATION, REPORT OF THE JOINT COMMITTEE ON TAXATION RELATING TO THE INTERNAL REVENUE SERVICE AS REQUIRED BY THE IRS REFORM AND RESTRUCTURING ACT OF 1998, 5 (JCX-46-00) (2000), available at <http://www.house.gov/jct/x-46-00.pdf>. [hereinafter STAFF OF THE JOINT COMMITTEE ON TAXATION].

34. For an overview of methods the IRS uses to select returns for examination, see H. Wayne Cecil, *Assuring Individual Taxpayer Compliance: Audit Rates, Selection Methods, and Electronic Auditing*, 68 CPA J. 60 (1998).

35. George Guttman, *Taxpayer Compliance Measurement, British Style*, 87 TAX NOTES 612, 612 (2000); see generally GENERAL ACCOUNTING OFFICE, TAX ADMINISTRATION: STATUS OF IRS’S EFFORTS TO DEVELOP MEASURES OF VOLUNTARY COMPLIANCE (GAO-01-535) (2001) (noting that if compliance errors and problems were handled earlier there would be less burden on the taxpayer).

and compliance.³⁶ Indeed, “[t]he last thorough tax gap study was for 1992, based on the 1988 TCMP.³⁷ The IRS has undertaken several initiatives to fill the information gap created by abandonment of TCMP,³⁸ but they have yet to produce substantial results.

D. Trends

In light of the foregoing, it would be risky to take IRS audit and compliance statistics at face value. They do have some value, though. I subscribe to three propositions suggested by the statistics and shared perhaps widely by those familiar with current tax administration.³⁹ They are (1) IRS enforcement has been declining; (2) taxpayer compliance has been declining; and (3) a correlation exists between enforcement declines and compliance declines. Moreover—and this proposition too is widely accepted—the declines have accelerated in recent years, especially since the mid-1990s.⁴⁰

1. Enforcement Activity

There are three main components of tax enforcement: (i) examination and assessment, whereby liability for underreported tax is established, (ii) collection of such liability, and (iii) in the most egregious cases, criminal prosecution, whose object is not direct realization of additional revenue but deterrence of future underreporting and underpayment. All three have declined in recent years, often sharply.

Examination: Here’s what happened between 1996 and 2000. Correspondence audits of individual returns reporting under \$100,000 in

36. This is a possible additional result. “Without the knowledge provided by the TCMP, IRS audits will become less targeted and, therefore, more taxpayers who are in compliance with the tax laws will come under IRS scrutiny.” Thus, ironically, elimination—effected in order to reduce burdens on taxpayers—“may have actually *increased* IRS intrusiveness in the long run.” Martin A. Sullivan, *Is Taxpayer Cheating Up or Down? Nobody Knows*, 75 TAX NOTES 1177, 1178 (1997).

37. SLEMROD & BAKUA, *supra* note 30, at 151.

38. The most recent is the National Research Program, announced in Fall 2002. See *infra* text accompanying notes 110–12.

39. Earlier important studies addressing these topics included INCOME TAX COMPLIANCE: A REPORT OF THE ABA TAX SEC. INVITATIONAL CONFERENCE ON INCOME TAX COMPLIANCE (Phillip Sawicki ed., 1983), and Jeffrey A. Dubin, Michael A. Graetz & Louis L. Wilde, *The Changing Face of Tax Enforcement 1978–1988*, 43 TAX LAW. 893 (1990).

40. “From fiscal 1996 to fiscal 2001—that is, the period immediately before and the years during the IRS reform effort—the number of face-to-face audits declined 72 percent, correspondence audits declined 56 percent, liens declined 43 percent, levies 86 percent, and seizures by 98 percent.” Amy Hamilton, *IRS’s Budget Tightrope Turns Into Noose*, 97 TAX NOTES 1263, 1263 (2002).

income dropped from 1,260,145 to 395,200, and face-to-face audits of such returns dropped from 470,487 to 122,497.⁴¹ Correspondence audits of individual returns reporting income over \$100,000 fell from 84,008 to 44,393, and face-to-face audits of such returns fell from 125,253 to 54,932.⁴² Audits of income tax returns of corporations with under \$5,000,000 in assets decreased from 47,836 to 16,566.⁴³ Audits of such returns of corporations with over \$5,000,000 in assets decreased from 16,508 to 11,221.⁴⁴

Such declines are all the more striking because the numbers of returns filed have substantially risen. Rising returns and falling audits mean real deterioration in examination coverage. For example, taking a broader time frame,

[f]rom 1988 and 2000, the total number of tax returns filed increased by 18 percent (from 140.33 to 165.77 million). During the same time period the number of tax returns examined decreased by 60 percent (from 1.77 million to 715,915). . . . Taking both statistics into account, the number of tax returns examined went from one out of every 79 in 1988 to one out of every 232 in 2000.⁴⁵

The numbers are striking. IRS officials sometimes attempt to put a good face on the situation. Other times, their exasperation bubbles to the surface.⁴⁶ One is not left with the feeling, either empirically or impressionistically, that the IRS is confident that its enforcement efforts are at a satisfactory level.

Collection: RRA '98 affected all major phases of tax administration, but collection more than any other—both by requiring diversion of personnel and by imposing new limitations on collection. The immediate results were dramatic. Comparing FY 1998 to FY 1999 (when the 1998 Act changes became effective), liens filed by the IRS dropped from 382,755 to 167,867; levies made by the IRS plummeted from 2,503,409 to 504,403; and seizures effected by the IRS fell from

41. IRS OVERSIGHT BOARD ANN. REP., *supra* note 4, at tbl.2.

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.* at 17. As noted in Part I.A, these statistics do not reflect IRP information matching efforts. Nonetheless, "the statistics represent a very real and troubling trend enforcement activity." *Id.*

46. At one point, referring to the IRS's audit presence, the commissioner of the IRS's Small Business/Self-Employed Division exclaimed: "We are almost nonexistent anymore!" Amy Hamilton, *Has the IRS Found a Way To Detect Unreported Income?*, 95 TAX NOTES 1151, 1151 (2002) (quoting Joseph Kehoe).

2307 to 161.⁴⁷ Revenue collected as a result of IRS compliance activities dropped by \$5 billion between FY 1996 and FY 2000.⁴⁸

There has been some rebound since. Nonetheless, all these collection categories registered large declines over a six-year period. Comparing 1996 to 2001, liens filed decreased from 750,225 to 428,376; levies served decreased from 3,108,926 to 447,201; and seizures made decreased from 10,449 to 255.⁴⁹

Criminal enforcement: Criminal tax prosecutions have never been particularly numerous. Nonetheless, they can contribute to compliance if they are well publicized and enter the public consciousness—as happened in Leona Helmsley’s case for instance.⁵⁰

For several decades, though, the criminal enforcement function was off track, losing its original focus on “pure” tax crimes and becoming instead a handmaiden of the “war on drugs” and other non-tax criminal purposes.⁵¹ The Webster Report in 1999 urged correction.⁵² Although some movement has been made in that direction, more remains to be done. The Criminal Investigation Division is still suffering effects from years of budgetary insufficiency, organizational confusion, and mission drift. The number of criminal tax prosecutions declined between the years 1987 and 2000.⁵³

Efforts have been made to improve the criminal investigation presence, but the sailing has been anything but smooth. Between 1995 and 2000, the number of Criminal Investigation special agents dropped from 1300 to 700.⁵⁴ The IRS planned to turn that around by hiring 280

47. STAFF OF THE JOINT COMMITTEE ON TAXATION, *supra* note 33, at 45.

48. See Amy Hamilton, *Money Collected Through IRS Compliance Efforts Down \$5 Billion*, 92 TAX NOTES 17, 17 (2002) (reporting information developed by Treasury Inspector General for Tax Administration).

49. IRS OVERSIGHT BOARD ANN. REP., *supra* note 4, at tbl.2.

50. For discussion of criminal tax enforcement trends, see George Guttman, *The Future Role of IRS Criminal Investigation*, 82 TAX NOTES 591, 591 (1999).

51. The most recent IRS annual report refers to 3284 criminal tax investigations initiated. Of them, 1020 involved legal source tax crimes; 1313 involved illegal source financial crimes; and 951 involved narcotics-related financial crimes. 2001 DATA BOOK, *supra* note 29, at tbl.8.

52. WILLIAM H. WEBSTER, IRS, PUB. NO. 3388, REVIEW OF THE INTERNAL REVENUE SERVICE’S CRIMINAL INVESTIGATION DIVISION 2–8 (1999).

53. As revealed by information from federal courts compiled by Transactional Records Access Clearinghouse (TRAC), which is located at Syracuse University. See *Total Tax Prosecutions According to U.S. Courts, Fiscal Year 1981–2001*, at <http://trac.syr.edu/tracirs/findings/national/aousc.html> (compiling data from the federal courts on the number of criminal tax prosecutions). TRAC statistics are widely cited, but sometimes have been challenged. See, e.g., Amy Hamilton, *IRS Figures Showing Less Prosecution of Tax Cheats*, 99 TAX NOTES 311 (2003).

54. See Heather Bennett, *CI Compliance Rate Not Ideal, but Improving, IRS Official Says*, 95 TAX NOTES 1150, 1150 (2002) (noting a decrease of 583 agents); Christopher Bergin, *CID to*

special agents in FY 2001, 288 in FY 2002, and another 288 in FY 2003.⁵⁵ However, many IRS and Treasury agents were diverted to anti-terrorism efforts after the September 11 attacks and in connection with the Salt Lake City Olympics.⁵⁶ So far, increases in Criminal Investigation Division personnel have occurred but at somewhat less than the planned numbers.⁵⁷ The Division remains “shortchanged on personnel in a serious way.”⁵⁸

2. Compliance

Noncompliance, as measured by estimates of taxes underpaid, also has been increasing. Based on information from the 1988 TCMP project, the IRS estimated that individual and corporate income tax noncompliance cost the federal fisc over \$128 billion in 1992, which was equal to approximately 18% of actual tax liability.⁵⁹ By 1998, the estimate was raised to \$195 billion.⁶⁰ Others have estimated the revenue loss at least \$300 billion.⁶¹

Although such overall estimations are necessarily imprecise, the impression they leave is compatible with taxpayer values as revealed by recent surveys:

• In response to the question “How much, if any, do you think is an acceptable amount to cheat on your income taxes?”, the percentage saying “Not at all” dropped from 87% in 1999 to 76% in 2001.⁶² Thus, nearly a quarter of respondents thought that cheating of some degree is acceptable or might be acceptable. And, of course, a larger percentage might actually think so (and act so) than are inclined to acknowledge it to a survey-taker.

Employment Tax Evaders: “We Will Catch You,” 91 TAX NOTES 1220, 1221 (2001) (noting a loss of 700 CID special agents).

55. Bergin, *supra* note 54, at 1221.

56. Bennett, *supra* note 54, at 1150.

57. The number of special agents grew to 2820 in FY 2001 from 2746 in FY 2000. 2001 DATA BOOK, *supra* note 29, at 33, tbl.31. This is an increase of 74, not the 280 planned.

58. Chuck Gnaedinger, *Senate Banking Panel Looks at IRS Funding*, 97 TAX NOTES 190, 190 (2002) (quoting Senator Paul Sarbanes).

59. SLEMROD & BAKIJA, *supra* note 30, at 151 (citing estimate by the IRS Research Division).

60. Amy Hamilton, *The Tax Gap Game and Inklings of a Focus on Noncompliance*, 79 TAX NOTES 933, 933 (1998) (citing then IRS Commissioner Charles Rossotti).

61. DONALD L. BARTLETT & JAMES B. STEELE, *THE GREAT AMERICAN TAX DODGE* 3 (2000).

62. IRS OVERSIGHT BOARD ANN. REP., *supra* note 4, at tbl. 4.

- In 2001, 42% responded “Yes, more likely” to the question “Do you think it is more likely that people will not report and pay their fair amount of taxes now than in the past?”.⁶³

- In 2001, 9% responded “Yes, more inclined” to the question “Are you more inclined to take a chance of being audited now than you were in the past?”.⁶⁴

One should not attach excessive weight to these survey results, but they should command some attention.⁶⁵ The tax gap numbers are moving up, and the survey numbers of return honesty are moving down. Neither set is copper-bottomed, but their conjunction tends to suggest declining tax compliance in the United States. There is widespread impressionistic evidence to the same effect.⁶⁶

3. Connection Between Enforcement and Compliance

Some taxpayers are so honest that they will file accurate returns (or returns they genuinely believe to be accurate) even when they know there is little or no chance their returns will be examined by the IRS. But a large number of taxpayers have greater moral flexibility. For them, the degree to which their returns are “aggressive” depends very much on their calculus of risk and reward. The size of potential tax savings is factored against the likelihood of audit and the possible magnitude of resultant deficiencies, interest, and penalties.⁶⁷

The existence of this phenomenon is well known although its magnitude is unclear. A public employees group has estimated that 15% to 20% of citizens negligently or willfully refuse to comply with the internal revenue laws.⁶⁸ The true figure is unlikely to be much less and may be more.

63. *Id.* Question 3 (32% said “No, not” and 26% said “Don’t know”).

64. *Id.* Question 5 (76% said “No, not” and 15% said “Don’t know”).

65. The Oversight Board was “reluctant to assign too much importance to a single survey,” but it did note “a possible negative change in attitude on cheating on taxes.” The Board intends to repeat the survey. It concluded: “There is cause for alarm if this trend continues.” *Id.* at 13.

66. The impressions are those of IRS officials and private sector practitioners alike. Then-Commissioner Rossotti said that cracking down on tax abuse will be the “biggest problem his successor will have,” Hamilton, *supra* note 20, at 290, and “[s]ome say tax professionals can no longer convince clients to fear the IRS. . . .” *Id.* (quoting Rep. Amo Houghton).

67. See, e.g., George R. Goodman, *Tax Return Compliance*, 76 TAX NOTES 1201, 1201 (1997) (discussing Rossotti’s interchange with Congress).

68. 144 CONG. REC. S4452, S4458 (daily ed. May 7, 1998) (statement of Senior Executives Association).

Whatever its precise quantification, however, the fact that a sizeable number of taxpayers are driven by the risk/reward calculus strongly argues that enforcement and compliance are correlated, as former Commissioner Cohen maintained.⁶⁹ The declining IRS examination rates are well publicized in the popular media,⁷⁰ and they typically are not accompanied by the caveat as to IRP matching we noted previously.⁷¹ With that decline being noticed by risk/reward calculating taxpayers, declining enforcement will mean declining compliance.⁷²

The most recent IRS Commissioner,⁷³ many other past and present IRS officials,⁷⁴ academics,⁷⁵ and others (including private sector taxpayer representatives)⁷⁶ all have warned of declining compliance. The most recent information on the relationship between enforcement and compliance comes from two studies—the Indirect Effects Study and the Consensus Judgment Study—conducted by the IRS Office of Research. They suggest that a one percentage point increase in the audit rate has the potential to produce over \$50 billion in additional revenue.⁷⁷ The bulk of this would come from indirect effects (the ripple effects of audit and other activities), such as “deterrence, changed public perceptions,

69. See *supra* text accompanying note 5.

70. See, e.g., Jonathan Weisman, *IRS Audits at Record Low Officials Cite Decade-Long Staff Decrease, Old Computers, Law Defending Taxpayers*, USA TODAY, Feb. 16, 2001, at 1A. A 1988 report noted “widespread media attention to low rates of audit coverage, a form of publicity which almost certainly discourages compliance.” Durst, *supra* note 32, at 47 n.45.

71. See *supra* text accompanying notes 7–17.

72. This is especially so since much non-compliance today involves types of income that are highly manipulable, i.e., types of income not covered by information reporting. See *supra* text accompanying note 18.

73. See, e.g., Patti Mohr, *Compliance Problems Top Priority, Rossotti Says*, 91 TAX NOTES 206, 206 (2001) (discussing Rosotti’s testimony before Congress).

74. These officials include former Commissioners Cohen and Alexander. Cohen, *supra* note 5, at 117; Donald C. Alexander, *IRS Reform and Its Impact on the Tax System*, in THE FUTURE OF AMERICAN TAXATION 7 (Joseph J. Thorndike ed., 2002). See also Bennett, *supra* note 54, at 1150 (quoting Mark E. Matthews, recent former chief of the IRS Criminal Investigation Division, as stating “[n]o one at the IRS will argue we’re where we want to be with compliance”).

75. See, e.g., GRAETZ, *supra* note 6, at ch.6 (discussing the proliferation of tax avoidance); SLEMROD & BAKIJA, *supra* note 30, at ch.5 (encouraging simplification of the system and enforcement of its provisions in order to promote taxpayer compliance).

76. Declining compliance feeds on itself. For instance, corporate tax shelters are a major problem. See Owen Ullman, *Treasury to Target Corporate Tax Abuses*, USA TODAY, Feb. 29, 2000, at 1A (quoting then-Treasury Secretary Lawrence Summers as saying that this phenomenon “may be the most serious compliance issue threatening the American tax system today,” and quoting Paul Sax, then chair of the American Bar Association Section of Taxation, as saying “[w]hen individuals learn what corporations in America are doing, they’ll go home and invent their own private shelters”).

77. See Herman Ayayo, Thomas F. Field & Joe Thorndike, *NTA Conferees Mull Future Tax Cuts, IRS Compliance Efforts*, 97 TAX NOTES 1012, 1014 (2002) (reporting remarks of Alan Plumley of the Office of Research, at the annual meeting of the National Tax Association).

education, and changed attitudes.”⁷⁸ According to the studies, “[t]he indirect effects of audits are estimated to be 11 times as large as the direct effects.”⁷⁹ Audits, information matching, criminal convictions, mailing nonfiler notices, and return preparation assistance all were found to have a statistically significant impact on taxpayer compliance.⁸⁰ While caution always is appropriate in considering estimates such as these,⁸¹ the recent studies contribute further evidence of the connection between enforcement and compliance.

II. THE NEED FOR ADDITIONAL RESOURCES

Self-reporting—so called “voluntary assessment”⁸²—is the bedrock of our system of taxation.⁸³ Unlike as in some other revenue systems,⁸⁴ taxpayers here make the first determination of their liabilities via the returns they prepare and file. Moreover, given the low audit rates,⁸⁵ that first determination typically is the only determination.

That being the case, it is central to the health of our revenue system that the returns filed by taxpayers be at least reasonably accurate.⁸⁶ There are two means to promote such accuracy: the velvet glove of education and assistance on the one hand and the iron fist of enforcement on the other. To function well, our system needs both, just as a bird needs two wings to fly. Additional resources are needed for both to operate effectively.

78. *Id.*

79. *Id.*

80. *Id.* Offsetting refunds for outstanding debts and telephone responses to taxpayer service requests were not found to have statistically significant effects. *Id.*

81. See, e.g., Durst, *supra* note 32, at 13–16 (cautioning against excessive reliance on revenue yield projections since “immediate revenue yield constitutes only a partial measure of the success of a tax administration system”).

82. The term is a misnomer, of course. No system that is backed by as extensive an array of civil and criminal sanctions as are found in the Internal Revenue Code is “voluntary.”

83. Treas. Reg. § 601.103(a) (2002); *United States v. Rodgers*, 461 U.S. 677, 683 (1983); *Flora v. United States*, 362 U.S. 145, 176 (1960); *Helvering v. Mitchell*, 303 U.S. 391, 399 (1938).

84. For instance, in Japan and the United Kingdom, most taxpayers do not have to file income tax returns because those countries’ withholding systems are both more precise and more extensive than ours. SLEMROD & BAKUA, *supra* note 30, at 142. *But see id.* at 310 n.28 (the United Kingdom is moving towards requiring more returns). For a proposal that the United States should substantially decrease required returns by adjusting its withholding regimes, see Joseph A. Snoe, *Tax Simplification and Fairness: Four Proposals for Fundamental Tax Reform*, 60 ALB. L. REV. 61, 111–15 (1996).

85. See *supra* notes 41–43 and accompanying text.

86. As an indication of this importance, “98 percent of the revenues collected [by the IRS for FY 2001] were paid without active IRS intervention.” 2001 DATA BOOK, *supra* note 29, at 2.

A. *Education and Assistance*

RRA '98 was partly the cause and partly the effect of a larger process of redirecting the IRS. In the past, I have criticized aspects of RRA '98 and of the process that led to it,⁸⁷ and I criticize other aspects in this article.⁸⁸ But the picture is not entirely gloomy; some aspects of RRA '98 and the process have been wholesome. One of them is attitudinal. Before the process, IRS agents too often held an attitude towards taxpayers resembling "I know you're cheating. I'm going to prove it, or at least resolve all doubts against you."⁸⁹ That attitude was poisonous and, understandably, alienated honest taxpayers. It has been observed that

by far the most important element of the Service's efforts to increase respect for the tax system is . . . [creating] an organizational "culture" of cooperation with the public. To be effective, these efforts should pervade every respect of the Service's activities, especially those in which Service personnel come into contact with the public. Those taxpayers who make honest efforts to comply with the tax laws are equivalent to a business' valued customers, and they should be treated accordingly.⁹⁰

A major thrust of the reform process was dislodging this attitude,⁹¹ and considerable progress has been made. Part of the redirection has

87. See generally Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Tax Burden-of-Proof Rules*, 84 IOWA L. REV. 413 (1999) (criticizing RRA '98 provision codified as I.R.C. § 7491); Steve R. Johnson, *The Proposed Tax Advisor-Client Privilege: An Idea Whose Time Should Never Come*, 78 TAX NOTES 1041, 1041 (1998) (criticizing RRA '98 provision codified as I.R.C. § 7525).

88. See discussion *infra* Part IV.A.

89. "The IRS has been [a] closed organization for many years, with many of its employees having little or no professional experience outside of the [S]ervice. This can lead to misunderstandings, suspicion and a them-against-us attitude toward taxpayers." *Hearing on the IRS Before the Subcomm. on Government Management, Information and Technology of the House Comm. on Government Reform on Oversight*, 1998 WL 186711, 48 106th Cong. (1998) (statement of Michael Marcs of the American Institute of Certified Public Accountants) [hereinafter *1998 Oversight Hearings*].

90. Durst, *supra* note 32, at 48. Indeed, "[t]he view of the honest taxpayer as a valued customer has served as a centerpiece of efforts to improve tax compliance at the state level." *Id.* n.48.

91. Emblematic of the change is the change of the IRS's mission statement. Section 1002 of the Internal Revenue Service Restructuring and Reformation Act of 1998 directed the IRS to review and restate its mission in order to emphasize serving the public and meeting taxpayer needs. RRA '98, *supra* note 2, at § 1002. The IRS announced its revised mission statement in September 1998. It is: "Provide America's taxpayers with top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." IRS OVERSIGHT BOARD ANN. REP., *supra* note 4, at 2. Previously, the mission statement had focused on

been renewed emphasis by the IRS on its taxpayer education and assistance efforts.⁹²

The IRS's taxpayer service and education efforts are multiple. They include: (i) providing general information as to tax preparation and planning, (ii) creating and maintaining liaisons with tax preparers and advisers, (iii) answering specific taxpayer inquiries in aid of their return filing, and (iv) responding to taxpayers in resolving questions as to their accounts for past years.

If performed well, such efforts "may strongly affect the public's commitment to tax compliance."⁹³ This is so for several reasons. First, specific errors can be prevented, both immediately and, as a result of enhanced taxpayer and advisor knowledge, in the future. Second, an atmosphere of cooperation can be created, leading to greater public satisfaction with, and so support for, the tax system.⁹⁴ Third, "a carefully monitored program of taxpayer assistance within the agency provides an effective means to identify patterns of problems and misunderstandings early in the process and to correct them before they become widespread."⁹⁵

When poorly done, however, "the entire enterprise [of taxpayer assistance] can be counterproductive."⁹⁶ Taxpayer frustration at being unable to reach responsive officials and taxpayer anger at being given wrong information can alienate them from the system, decreasing compliance.

Unfortunately, the IRS historically has not performed taxpayer service particularly well. Stories are legion of taxpayers getting only busy signals when calling IRS Taxpayer Assistance or of being given inaccurate information if they do get through. Inadequate budgetary support has been a main reason.⁹⁷ This led to inadequate facilities, high personnel turnover, and less than optimal training.⁹⁸ It also has led to

collecting the proper amount of tax at the least cost, continual improvement of products and services, and achieving public confidence through integrity, efficiency, and fairness. 1998-15 I.R.B. 837.

92. "Since I became commissioner, I have tried to make clear my priorities for the IRS [to put] far more emphasis on trying to see things from the point of view of the taxpayers and emphasizing service and fairness to taxpayers." 1998 *Oversight Hearings*, *supra* note 89, at *4 (statement of Charles Rossotti).

93. Durst, *supra* note 32, at 14.

94. *Id.* at 3.

95. Kent W. Smith & Kary A. Kinsey, *Cooperation and Control: Strategies and Tactics for Tax Examination*, 1 TAX ADMIN. REV. 13, 21 (1985).

96. Durst, *supra* note 32, at 45.

97. *Id.* at 6, 11.

98. *Id.* at 11, 44.

technology gaps as a result of which relevant account information cannot be assessed.⁹⁹ The consequent frustrations are all the greater for taxpayers increasingly accustomed to efficient service when they deal with private sector entities.¹⁰⁰

Improving taxpayer assistance was an important objective beginning in the mid-1990s. Early on, the efforts were fitful and of limited effect.¹⁰¹ The IRS is claiming greater success now. It "estimates that 71.5 percent of taxpayers who call the IRS get through"¹⁰² and that the advice they receive from the IRS assisters is 75.21 percent accurate.¹⁰³ In FY 2001, the IRS says it offered advice to taxpayers nearly 120,000,000 times, taking telephone, teletax, unsolicited correspondence, and walk-in contacts.¹⁰⁴

However, the increased emphasis on taxpayer assistance has been at the expense of enforcement. From FY 2000 to FY 2001, the number of IRS customer service representatives rose substantially, from 13,339 to 15,211. In contrast, the ranks of revenue agents, revenue officers, tax auditors, attorneys, and appeals officers all thinned.¹⁰⁵

Yet, even such predation has not been enough to fully staff taxpayer service efforts. The IRS estimates that, to reach its goals, it will need about 2300 more telephone assisters (which would cost about \$115 million) and about 3000 more staff for walk-in assistance offices (which would cost about \$200 million). Thus, additional resources will be needed for the first of the two pillars of compliance: IRS taxpayer and education. As we are about to see, the same is true of the second pillar: enforcement.

99. *Id.* at 42 ("the detrimental effect of the Service's inability to provide prompt account information almost certainly has been severe").

100. *Id.* at 6.

101. See, e.g., George Guttman, *Lack of Resources Is Showing Up in IRS Performance Measures*, 87 TAX NOTES 1577, 1577 (2002); Barton Massey & Sheryl Stratton, *IRS Struggles with New Customer Service Role*, 83 TAX NOTES 1542, 1542 (1999).

102. George Guttman, *What Would an Adequately Funded IRS Look Like?*, 97 TAX NOTES 36, 37 (2002). The IRS's goal is 87.5%. Private sector companies have rates in the high 90%. *Id.*

103. 2001 DATA BOOK, *supra* note 29, at 25, tbl.23.

104. *Id.*

105. Revenue agents: from 12,828 to 12,371; revenue officers: from 6028 to 5879; tax auditors: from 1698 to 1213; attorneys: from 1484 to 1432; appeals officers: from 1006 to 975. *Id.* at 33, tbl.31.

B. Enforcement

Every worthwhile project of life, be it individual or collective, depends for its success on two ingredients: direction (a sound plan or idea) and energy (in our context, resources). Insofar as IRS enforcement is concerned, I am highly optimistic that the direction component is in place or soon will be—the IRS recently has announced enforcement strategies that hold genuine promise.

However, direction without energy achieves little. The recently announced strategies will fulfill their promise only if they are backed with adequate resources. Moreover, little will be accomplished on balance if resources allocated to the new strategies are withdrawn from other priority areas.

1. New Directions

Other changes have been made as well,¹⁰⁶ but I want to identify four major changes: (i) the National Research Program, (ii) the “high-noncompliance areas” audit focus, (iii) offshore-accounts enforcement, and (iv) the attack on corporate tax shelters.

National Research Program (NRP): In late Fall 2002, the IRS inaugurated a new sampling project to improve its methods of targeting returns for examination.¹⁰⁷ NRP will take the place of the previously abandoned Taxpayer Compliance Measurement Program.¹⁰⁸ Less than 50,000 individual returns will be included.¹⁰⁹ Of these, around 2000 returns involve comprehensive face-to-face audit involving every line item on the return.¹¹⁰ Another 30,000 involve in-person, although more limited, audit.¹¹¹ Another 9000 involve correspondence audit of selected items.¹¹² The remaining 8000 returns involve only information matching

106. For instance, in late 2002, the IRS Large & Midsize Business Division introduced a revised audit process. See Amy Hamilton, *IRS To Roll Out Revamped Audit Process in December*, 97 TAX NOTES 623, 623 (2002) (discussing the altered audit process).

107. News Release, Internal Revenue Service, *IRS Moves to Ensure Fairness of Tax System; Research Program Works to Increase Compliance Program Effectiveness, Reduce Burdens on Taxpayers* (Jan. 16, 2002) (on file with Westlaw, 2002 WL 74410) [hereinafter *IRS Moves to Ensure Fairness*]; News Release, Internal Revenue Service, *What Is NRP?* (Jan. 2002) (on file with Westlaw, 2002 WL 74409).

108. See *supra* text accompanying notes 34–38.

109. *IRS Moves to Ensure Fairness*, *supra* note 107.

110. *Id.*

111. *Id.*

112. *Id.*

without taxpayer contact.¹¹³ Returns are selected across income and demographic lines. The goal of NRP is to provide data profiles in order to refine IRS statistical techniques in order to better target future examinations.¹¹⁴

“High-noncompliance areas” audit focus: The tax and popular press have been replete in recent years with reports of “high end” tax evasion.¹¹⁵ High-end evasion is significant in itself because of the amount of revenue involved. Perhaps even more importantly, the perception that the rich are paying less tax than the law commands can erode compliance throughout the income spectrum.¹¹⁶

In Fall 2002, the IRS announced that it was revising its audit emphases and allocation of audit resources to address this problem.¹¹⁷ The focus will be on (i) offshore credit card users, (ii) high-income taxpayers likely to have underreported income, (iii) abusive schemes, including abusive shelters, trusts, and scams, (iv) high-income nonfilers, and (v) unreported income.¹¹⁸ As part of the effort, the IRS will use a new tool: the Unreported Income Discriminant Index Formula.¹¹⁹

Of course, the IRS has engaged in some enforcement in these areas for years, which has borne some fruit, including recently.¹²⁰ The

113. *Id.*

114. For discussion of NRP, see George Guttman, *IRS National Research Program on Track Despite Training Delays*, 97 TAX NOTES 331, 331 (2002); Amy Hamilton, *IRS Set To Begin Random Audits of Taxpayers*, 97 TAX NOTES 617, 617 (2002); William Stevenson, *Taxpayer Rights and Minimizing Adversarial Nature of NRP Audits*, 96 TAX NOTES 1773, 1773 (2002).

115. See, e.g., Hamilton, *supra* note 20, at 290; David Cay Johnston, *Affluent Avoid Scrutiny on Taxes Even as I.R.S. Warns of Cheating*, N.Y. TIMES, Late Edition, Apr. 7, 2002, sec. 1, at 1.

116. As a prominent tax attorney and now Treasury official put it,

[t]he belief that the tax laws bestow on certain taxpayers opportunities to minimize their taxes has a corrosive effect on the tax system because taxpayers come to see the laws as unfair This is a serious concern because research by social scientists suggests that, when it comes to complying with the law, the belief that the laws are legitimate and ought to be complied with has a stronger motivating effect than the fear of being caught.

Pamela F. Olson, *Predictions*, 20 A.B.A. SEC. OF TAX. NEWSL. 4–5 (Winter 2001); see also Durst, *supra* note 32, at 13.

117. News Release, Internal Revenue Service, *IRS Sets New Audit Priorities* (Sept. 2002) (on file with Westlaw, 2002 WL 31053874).

118. *Id.*

119. For details, see *New Audit Strategy Focuses on ‘High Risk’ Noncompliance Areas*, 97 J. TAX’N 195, 195 (2002).

120. For instance, in November 2002, the IRS and the Department of Justice announced indictments of three individuals in connection with Tower Executive Resources. They set up shell corporations for small business owners that were used to conceal nearly \$9,000,000 in taxable income in secret accounts in the Turks & Caicos Islands and other countries. The indictments follow the June 2002 conviction of another person in connection with the Tower scheme. Press Release, Dept. of Justice, *Indictment of Promoters of Alleged Illegal Offshore Tax Evasion Scheme* (Nov. 5, 2002) available at <http://www.usdoj.gov>.

heightened emphasis under the new initiative is welcome nonetheless. High-end tax evasion is exceedingly corrosive of popular confidence in the tax system,¹²¹ thus of voluntary compliance.

Offshore accounts enforcement: I mentioned this above as part of the new audit focus. Yet enforcement in this area has involved other actions as well. Although the magnitude of the problem is murky,¹²² there is little doubt that substantial numbers of Americans are concealing from the IRS large amounts of taxable income through use of offshore bank, credit card, and other accounts.¹²³ The IRS has issued summonses to obtain information on taxpayers who use offshore credit cards to evade United States taxes. In October 2002, it announced that it had petitioned several federal district courts to obtain approval to serve additional John Doe summonses¹²⁴ on over 70 companies.¹²⁵

In mid-January 2003, the IRS announced a type of amnesty to encourage taxpayers who used this device to come forward. If they did so by April 15, 2003, they would pay tax on the previously unreported income plus pay interest and civil penalties.¹²⁶ However, they will not suffer criminal prosecution or imposition of the civil fraud penalty.¹²⁷

Corporate tax shelters: Individual tax shelters were a major blight on our tax system between the 1960s and the 1980s; corporate tax shelters are now.¹²⁸ The revenue and compliance effects of corporate shelters have been a key item in popular, political, and professional tax

121. See, e.g., Boris I. Bittker, *Federal Income Taxation—Then and Now*, 74 TAX NOTES 903, 907 (1997) (identifying the belief that the rich can escape the income tax with the help of clever lawyers and accountants as a reason for loss of public support for the income tax).

122. Bank secrecy laws in over two dozen tax-haven countries have enabled Americans to hide large incomes while lavishly living through use of the foreign accounts and credit cards. The Government initially estimated that a million American taxpayers have undisclosed credit cards from offshore banks. It now thinks the number is somewhat smaller. Leigh Strobe, *IRS Offers Some Tax Evaders Leniency*, CHATTANOOGA TIMES, Jan. 15, 2003, at C2.

123. For examples of the schemes and their level of organization, see Amy Hamilton, *A Glimpse Inside Offshore Greed*, 98 TAX NOTES 297, 297 (2003).

124. Sheryl Stratton, *Disclosure Initiative Sought for Offshore Credit Card Crackdown*, 97 TAX NOTES 745, 745 (2002). For rules governing enforcement of such summonses, see I.R.C. § 7609(f).

125. Heather Bennett, *IRS Seeks 'Limited' Information from Companies to Identify Cheats*, 97 TAX NOTES 327, 327 (2002).

126. Rev. Proc. 2003-11, 2003-4 I.R.B. 311.

127. *Id.*; see Amy Hamilton, *IRS Offers Amnesty to Taxpayers Hiding Income Offshore*, 98 TAX NOTES 296, 296 (2003) (“Avoidance of criminal prosecution is not one of the promises of partial amnesty, but it is a possibility.”).

128. For comparison of individual and corporate shelters through the lens of at-risk concepts, see James Whitmire & Bruce Lemons, *Putting Tax Shelters at Risk—Discussion and Proposal for Change*, 98 TAX NOTES 585, 585 (2003).

discussions for about half a decade now.¹²⁹ “The Clinton Administration insisted that the greatest threat to the income tax is from corporate tax shelters.”¹³⁰

Attacks on corporate tax shelters have involved legislation, regulations, other administrative pronouncements, and litigation.¹³¹ Then IRS Chief Counsel B. John Williams in a recent speech¹³² “indicated that the Internal Revenue Service had essentially declared war on abusive tax avoidance transactions. . . . [T]his war would progress on three main fronts (enhanced disclosure and registration requirements, more frequent and expeditious published guidance on questionable transactions, and an increased focus on enforcement)”¹³³ A recent clash in this war has received great attention. In July 2002, the Department of Justice filed summons enforcement actions against two national accounting firms (KPMG and BDO Seidman)¹³⁴ in connection with IRS investigations of tax-shelter promotions by the firms.¹³⁵ The firms resisted on privilege

129. One of the earlier pieces was Diana B. Henriques, *10 Years After Tax Overhaul, the Loopholes Expand*, N.Y. TIMES, Dec. 29, 1996, at sec. 4, p. 3. Subsequent articles increasing the visibility of the problem included: Joseph Bankman, *The New Market in Corporate Tax Shelters*, 83 TAX NOTES 1775, 1775 (1999); Martin A. Sullivan, *Shelter Fallout? Corporate Taxes down, Profits up*, 84 TAX NOTES 653, 653 (1999); Janet Novack & Laura Sanders, *The Hustling of X Rated Shelters*, FORBES, Dec. 14, 1998, at 198.

130. Michael J. Graetz, *2001 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Erwin Griswold's Tax Law—and Ours*, 56 TAX LAW. 173, 180 (2002).

131. For a discussion of some of them, see Peter C. Canellos, *A Tax Practitioner's Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 47–72 (2001) (discussing corporate tax shelters generally); Daniel N. Shaviro, *Economic Substance, Corporate Tax Shelters and the Compaq Case*, 88 TAX NOTES 221, 221–44 (2000) (discussing cross-border dividend-stripping and economic substance); Lee Sheppard, *Slow and Steady Progress on Corporate Tax Shelters*, 84 TAX NOTES 191, 191–99 (1999) (discussing the debate over marketing and promoting tax shelters); John J. Tigue, *Public Enemy No. 1—Corporate Tax Shelters*, N. Y. L.J., Sept. 16, 1999, at 3 (discussing corporate tax shelters generally).

132. B. John Williams, Jr., *IRS Chief Counsel Speech on Privilege and Shelters, Address Before the Texas Federal Tax Institute* (June 6, 2002), in TAX NOTES TODAY, June 7, 2002, at 110–29.

133. Robert T. Smith, *After the Alamo: Taxpayer Claims of Privilege and the IRS War on Tax Shelters*, 98 TAX NOTES 233, 234 (2003).

134. A similar enforcement action against another firm, Ernst & Young, was dismissed when the IRS discovered the clients' identities through other means. Sheryl Stratton, *Identity Privilege Pits Shelter Clients Against Accounting Firms*, 98 TAX NOTES 168, 168 (2003).

135. See Lee A. Sheppard, *Government Shuts Down PICO Shelter and Its Progeny*, 97 TAX NOTES 31, 31–36 (2002) (discussing Ernst & Young tax shelter that reduced the individual tax basis and the IRS's discovery of the shelter); Sheryl Stratton, *KPMG Promoter Summons Enforcement Action Goes to Court*, 97 TAX NOTES 26, 27–30 (2002) (discussing the merits of KPMG's assertion of privilege regarding communication with clients).

grounds: the federally authorized tax practitioner privilege¹³⁶ and the attorney-client privilege.¹³⁷

Several judicial opinions have been issued thus far,¹³⁸ but they surely will not end the matter. A lot of litigation (and, quite probably, a lot of lobbying) lies ahead before the privilege issues in this context are finally resolved, and this is but one front of the war against corporate tax shelters.

2. Need for Resources

The promising enforcement initiatives described immediately above can succeed only if they receive adequate resources. This means three things: money to defray expenses, personnel to staff the projects, and training so that the personnel have the skills to do the work well.

Insufficient amounts of these “factors of enforcement” were directly implicated in the low and declining enforcement of recent years. The IRS and others have attributed such decline to, in part, decreases in absolute numbers of staff, shift of staff away from enforcement (into taxpayer service and other functions), and loss of experienced agents.¹³⁹

This last item bears amplification. Merely handing the taxpayer’s return to a warm body who receives a federal paycheck does not guarantee a quality examination, nor does giving a transcript of an account to such a person guarantee effective collection. The agent assigned must possess a level of skill equal to the challenges presented by the particular case.

The requisite skills might come from experience. However, low salaries have been the lot of IRS agents for decades,¹⁴⁰ so the IRS

136. I.R.C. § 7525(a)(1).

137. Sheryl Stratton, *KPMG Privilege Logs Are Under Scrutiny; Court Wants More Detail*, 97 TAX NOTES 165, 165 (2002); Todd Welty, *IRS Aggressively Challenges Privilege*, TAX ADVISER, Oct. 2002, at 670.

138. *United States v. KPMG LLP*, 237 F. Supp. 2d 35, 48 (D.D.C. 2002); *United States v. BDO Seidman, LLP*, 225 F. Supp. 2d 918 (N.D. Ill. 2002), amended by, 2002 WL 932365 (N.D. Ill. 2003).

139. See, e.g., Amy Hamilton, *IRS Enforcement Drops Sharply*, 83 TAX NOTES 188, 189 (1999) (discussing the decline in IRS enforcement levels); George Guttman, *The Interplay of Enforcement and Voluntary Compliance*, 83 TAX NOTES 1683, 1683 (1999) (discussing the decision of IRS management to shift resources).

140. The private sector’s average starting salaries for accounting graduates and for junior lawyers considerably exceed such salaries paid by the government. Durst, *supra* note 32, at 17. “The conclusion cannot be avoided . . . that currently inadequate levels of compensation are crippling tax administration in this country.” *Id.* at 19. Again, “the extremely low level of compensation of IRS personnel in many categories of employment constitutes a severe and increasing danger to the fair and effective administration of the tax law.” *Id.* at 5.

typically will not be able to hire highly experienced auditors. Moreover, in recent years, the IRS has been suffering high attrition among its most experienced examination and collection agents.¹⁴¹ The era of individual tax shelters in the 1960's through 1980's materially altered the nature of the IRS's workload. Individual cases requiring thorough audit skills were dwarfed by mass cases—numerous “investors” in partnerships which, while numerous, mostly divided along well recognized generic lines. The bases on which the IRS disallowed the tax benefits claimed through the shelters were well recognized and generic too, so much so that deficiency notices were composed by typing numerical codes which spit out paragraphs of standardized language.¹⁴² In this period, the IRS gained skills in processing masses of paper but lost skills in individual auditing. There is concern that something similar is happening to the collection function now as a result of the tidal wave of offer-in-compromise processing inundating the IRS.¹⁴³

Thus, adequate staffing for enforcement initiatives will require many agents, *skilled* agents. That requires substantial training efforts. Such efforts entail their own resource demands: the trainees are handling no cases while they are being trained and the trainers—experienced agents—are pulled out of their work to disseminate their skills. Accordingly, the requisite training will entail a major additional commitment of resources.

However, the major investment of money, personnel, and training must be made. Without it, enforcement will continue to languish. To make the point, consider the following examples.

Gift tax enforcement: This problem was explored in a widely noticed article by David Cay Johnston of the New York Times.¹⁴⁴ The article

141. “Because of factors such as inadequate training, uncompetitive salaries and IRS bashing, many well-qualified people do not consider IRS employment, or if hired, leave the Service.” 1998 Oversight Hearings, *supra* note 89, at *69 (statement of Michael Mares of the American Institute of Certified Public Accountants). Moreover, “[i]n recent years there seems to have been an unprecedented turnover in IRS personnel.” James E. Wheeler, *Chevron Case Raises Serious Questions*, 82 TAX NOTES 259, 259–60 (1999) (referring to “the turnstile outflow from IRS employment” to the private sector).

142. See, e.g., *Scar v. Commissioner*, 81 T.C. 855, 859 (1983), *rev'd*, 814 F.2d 1363 (9th Cir. 1987) (discussing an error whereby a transposed number entered by an IRS employee produced a standardized document that asserted a deficiency based on the Nevada Mining Project; the actual deficiency was from a videotape tax shelter).

143. See *infra* text accompanying notes 171–76.

144. David Cay Johnston, *IRS Sees Increase in Evasion of Taxes on Gifts to Heirs*, N.Y. TIMES, Apr. 1, 2000, § 1, at 1. Mr. Johnston's reporting has rendered major contributions to our appreciation of how our tax laws are administered (or not administered). He has received a Pulitzer Prize for it.

established two main points. First, there is a major problem with gift tax compliance: “[A] far greater percentage of Americans who owe gift taxes shortchange the government than do Americans paying income taxes and other levies. What is more, the sums involved in each case are much larger.”¹⁴⁵ Those figures establish that “we have a compliance problem” in the gift tax area.¹⁴⁶

Second, a major cause of the problem—or of the inability to correct it—is lack of resources, particularly staff competent to handle the complex issues presented by large gift returns. The IRS, its auditing and legal staff shrinking in recent years even as the number of complex tax returns grows, lacks the resources to find most taxpayers who underreport their taxable gifts or fail to file required gift tax returns.¹⁴⁷ In 1999, the IRS had only 78 lawyers assigned to gift tax audits, each responsible for auditing more than 3300 gift tax returns.¹⁴⁸ “And even when the agency does find abuses, it lacks the resources to fight more than a small number of the cases in court. IRS lawyers said they were frustrated by their inability to stop what they described as rampant cheating on gift taxes.”¹⁴⁹ An IRS attorney in Manhattan, “said his desk was piled high with gift tax returns that will get little scrutiny.”¹⁵⁰ “There is all this added work and no staff, said the lawyer, who insisted he not be identified.”¹⁵¹ The IRS lawyer added, “I know that there are millions and millions and millions of dollars being passed untaxed right over my desk and there is nothing I can do about it.”¹⁵²

The problem existed in other districts as well. The IRS’s Fresno office received about 11,000 gift tax returns in 1999 and had only three examiners to audit them.¹⁵³ IRS examiners spent about a half hour auditing each complex, large gift tax return.¹⁵⁴

145. *Id.* at 20. According to IRS statistics, “[m]ore than 80 percent of the 1,651 tax returns reporting gifts of \$1 million or more that were audited last year understated the value of the gift.” The average understatement was about \$303,000; the average deficiency about \$167,000; and the revenue loss to the federal fisc about \$275 million. *Id.* at 1.

146. *Id.* at 20 (quoting Tom Hull, IRS national director of specialty taxes). This occurred despite the IRS’s suggestion in 1998 that it might begin to increase its examination of gift tax returns. Barton Massey, *IRS May Increase Examination of Gift Tax Returns, Official Says*, 79 TAX NOTES 936, 936 (1998).

147. Johnston, *supra* note 144, at 20 (citing John Dalrymple, IRS Director of Operations).

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.* (citing former IRS estate tax attorney Joseph D’Amico).

154. *Id.*

Withholding and Employment Tax Enforcement: Except for some tax protestors, most tax avoidance and evasion is covert—for obvious reasons. Thus, it is a clear sign of trouble when the non-compliant noisily go public. In recent years, we have seen that happen in the employment tax area. “Arguing that the federal tax laws do not apply to them, [some] small companies are thumbing their noses at the I.R.S. . . . [T]hey have not only stopped withholding taxes and turning them over to the government, they are also bragging about it on Web sites and radio talk shows”¹⁵⁵ These companies received substantial national publicity. They even organized seminars to promote “the gospel of compliance,” and they repeatedly claimed that they had to be correct under the law since the IRS had not come after them despite the abundant publicity given to them and their position.¹⁵⁶

There was some enforcement action during the time, of course.¹⁵⁷ Nonetheless, the IRS was infuriatingly slow to respond to the open defiance of some small businesses.¹⁵⁸ Years after the initial public acts of defiance, the IRS still was threatening that it “will” catch evaders, rather than announcing that it “had” gotten them.¹⁵⁹

Again, lack of sufficient resources was a large part of the problem. In reply to criticism of its slow response to public, noisy evasion of withholding and employment taxes, the IRS said that it has limited resources, so it must choose which tax compliance battles it will fight.¹⁶⁰

As noted, the current enforcement initiatives involve items like offshore credit cards and accounts, high-income non-filing and underreporting, abusive trusts, and tax shelters.¹⁶¹ In terms of audit difficulty, these areas clearly exceed withholding and employment tax

155. David Cay Johnston, *Defying the I.R.S., Anti-Tax Businesses Refuse to Withhold*, N.Y. TIMES, Nov. 19, 2000, § 1, at 1.

156. *Id.*

157. According to the IRS website, between fiscal year 1998 and fiscal year 2000, 127 persons were criminally convicted for evading employment taxes and 85% of them “were sentenced to an average of 17 months in prison.” Bergin, *supra* note 54, at 1220.

158. The small business sector has been an area of low compliance for generations, especially when much of their trade is in cash. For discussions of this sector, see Durst, *supra* note 32, at 23–34; David Joulfaian & Mark Rider, *Differential Taxation and Tax Evasion by Small Businesses*, 51 NAT’L TAX J. 675 (1998). At one time, the IRS estimated that less than half of the taxes owed by self-employed taxpayers were paid voluntarily. INTERNAL REVENUE SERVICE, GROSS TAX GAP ESTIMATES AND PROJECTIONS FOR 1973–1992, 6 (1988).

159. See Bergin, *supra* note 54, at 1220 (discussing the IRS Criminal Investigation Division’s plans to prosecute more tax evaders).

160. See Johnston, *supra* note 144, § 1, at 1 (discussing the IRS’s lack of resources to stop gift tax evasion).

161. See *supra* notes 115–21 and accompanying text.

evasion. Some of them—particularly shelters—rival gift tax returns in difficulty. Some of them too—like foreign accounts and trusts—while not particularly difficult in concept, will entail great time and efforts to successfully address.

Thus, the experience of gift tax and employment tax enforcement failures suggests that current enforcement thrusts will be blunted unless they are powered by adequate resources.¹⁶² Finding and applying those resources is crucial to improved tax compliance through enforcement.

III. THE RESOURCES BIND

We have seen that tax compliance in the United States is unsatisfactory, and that additional resources are needed to support the mainstays of compliance: service and enforcement. Will additional resources be forthcoming for these purposes?

Unfortunately, the likely answer is in the negative. Congress and recent administrations have subjected the IRS to a resource squeeze. On the one hand, particularly through RRA '98, Congress imposed vast new demands and obligations on the IRS. On the other hand, IRS budgets proposed by the administrations and enacted by Congress conspicuously failed to provide the resources required for these new demands and the old ones on which they were heaped.¹⁶³

A. RRA 1998: New Demands

RRA '98 commanded numerous changes to the organization and direction of the IRS¹⁶⁴ and to its examination, collection, and other

162. Those failures are not the only examples, of course. The Treasury estimates that “[m]ore than \$13 billion in unpaid taxes [go] uncollected [currently] because the IRS lacks the resources to pursue them.” Alan Fram, *President Targets Tax Scofflaws*, LAS VEGAS REV.-J., Feb. 2, 2003, at 10A.

163. The IRS is not free from its share of blame. A key component of both taxpayer service and enforcement is an adequate technological infrastructure. The IRS's mismanagement of its computer systems and of the billions Congress appropriated to improve them has been one of the longer running stories in Washington, D.C.—leaving the spectator, by turns, amused, exasperated, and angry. As to recent IRS technological efforts and needs, see IRS OVERSIGHT BOARD ANNUAL REPORT 3-4 & 22-23 (2002).

164. It is hoped that the reorganization of the IRS commanded by RRA '98 will, in the long run, improve the IRS's responsiveness to its “customers.” Yet, I incline towards the view expressed by former IRS Commissioner Sheldon Cohen that the costs of RRA '98 reorganization will never be recouped. Sheryl Stratton, *Former Commissioners See Challenges Facing the Tax System*, 94 TAX NOTES 693, 694 (2002). At the least, in the short run, there is little doubt that the reorganization contributed to the decrease of the agency's enforcement activities in the late 1990s and early 2000s.

functions.¹⁶⁵ Of the scores of changes, I want here to emphasize three which have had major resources effects: offer-in-compromise liberalization, the collection due process rules, and spousal relief liberalization. Both individually and collectively, these three changes have claimed a large portion of the time and personnel of the IRS and of the courts as well.

1. Offer-in-compromise (OIC) Liberalization

Offers-in-compromise are not new. For generations, the Code has given the IRS authority to compromise tax liabilities.¹⁶⁶ However, the IRS's exercise of this authority was criticized long and loudly. The complaints included that the IRS accepted too few offers, that offer processing was cumbersome and prolix, that there was insufficient review of decisions to reject offers, and that the IRS's willingness to accept offers varied widely throughout the country.¹⁶⁷

RRA '98 responded to such criticisms. Its particular changes,¹⁶⁸ although important, were secondary to the general sense Congress was trying to convey to the IRS: make the offer process easier and more forgiving and accept more offers. Although the IRS has made changes to the offer program,¹⁶⁹ practitioners often complain that the IRS has been too slow to implement the RRA '98 changes or has done so incompletely.¹⁷⁰

See, e.g., Joe Thorndike, *The Price of Reorganization: Fewer Audits and Tax Forgiveness*, 96 TAX NOTES 1308, 1308 (2002).

165. For description of the RRA '98 changes, see *Restructuring and Reforming the IRS and the Code—Congress Takes a Quantum Leap*, 89 J. TAX'N 133, 133 (Martin M. Lore & Gerald A. Kafka eds., 1998); Gerald A. Kafka, *Reformation of the Tax Collection Process—Cumulatively, a Giant Step*, 89 J. TAX'N 207, 207 (1998); Robert Manning & David F. Windish, *The IRS Restructuring and Reform Act: An Explanation*, 80 TAX NOTES 83, 83 (1998).

166. I.R.C. § 7422.

167. See, e.g., Lawrence D. Garr, *Cutting a Deal with the IRS in 1997: Forms over Substance*, 76 TAX NOTES 547, 548 (1997) (discussing current failings in the offer-in-compromise process).

168. See I.R.C. § 7422(c) (requiring the IRS to issue national and local guidelines for use in determining the adequacy of offers); I.R.C. § 7422(d) (requiring establishment of independent administrative review procedures before rejection of an offer is communicated to the taxpayer).

169. Those changes culminated in 2002 with the adoption of new final regulations. Treas. Reg. §§ 301.7122-0, 301.7122-1 (as amended by T.D. 9007, 2002-33 I.R.B. 349); 67 FED. REG. 48025 (July 23, 2002); corrected by 67 FED. REG. 53878 (Aug. 20, 2002).

170. Letter from John K. Harris, CEO of JK Harris & Company, to Nina Olson, National Taxpayer Advocate (May 20, 2002), reprinted in *Practitioner Offers Suggestions for Improving IRS's OIC Program*, 95 TAX NOTES, 1263, 1263 (2002); Robert E. McKenzie, *New Offer-in-Compromise Program Creates Settlement Roadblocks*, 96 TAX NOTES 1105, 1105 (2002); Amy Hamilton, *IRS Still Doesn't Have Offers Program Right, Practitioners Say*, 82 TAX NOTES 774, 774 (1999).

Whatever the merit of these criticisms, two facts are clear. First, the number of offers the IRS has to consider is huge and increasing. For instance, in FY 2000 the IRS received about 109,000 offers and in FY 2001 it received about 125,000.¹⁷¹ The IRS is now receiving over 2300 offers per week.¹⁷²

Second, the effort to swim through this deluge of offers has imposed immense resource strains on the IRS. "The IRS has a huge backlog of offers and has been devoting more and more of its limited collection resources to processing them."¹⁷³ More specifically:

To meet this demand the IRS reassigned staff from other collection programs, such as delinquent account and tax return investigations, to the offers program—more than doubling the number of direct collection field staff hours charged to the program. In fact, according to a General Accounting Office report released last week, IRS collection field staff hours devoted exclusively to working offers increased from 728,000 hours in fiscal 1997 to about 1.6 million hours in fiscal 2001. During that same period the number of direct hours charged to all IRS field collection activities declined by about 30 percent, from about 12.7 million hours in fiscal 1997 to about 8.9 million hours in fiscal 2001.

What this means in plain English is that the share of total IRS direct field collection staff hours devoted exclusively to the offers program grew from about 6 percent in fiscal 1997 to 18 percent in fiscal 2001.¹⁷⁴

Nina Olson, the National Taxpayer Advocate, puts the figure even higher. She calculates that one quarter of the IRS's field collection function is consumed entirely by offer-in-compromise work.¹⁷⁵ She sounded an alarm bell when she exclaimed: "We've [the IRS has] become an offer shop! . . . We need a more sane approach to this."¹⁷⁶

The IRS has taken some steps. For instance, it centralized offer submissions (directing that all offers be sent to either of two compliance

171. INTERNAL REVENUE SERVICE, 2001 IRS DATA BOOK 21, tbl.16 (2001).

172. Amy Hamilton, *IRS Reform, Year 4: "We've Become an Offer Shop"*, 95 TAX NOTES 17, 17 (2002).

173. McKenzie, *supra* note 170, at 1105.

174. Hamilton, *supra* note 172, at 17. Not surprisingly in light of these facts, "IRS officials told the GAO that devoting so many collection resources to the OIC program might be hurting other collection programs." *Id.* at 18.

175. *Id.* at 17.

176. *Id.* at 18 (quoting Nina Olson).

centers) and implemented strict processing rules.¹⁷⁷ In addition, the IRS is seeking to impose user fees on some taxpayers making offers.¹⁷⁸

But such steps are fingers in holes of a dike that is severely cracking. The IRS is "committed to maintaining a viable and credible [offers] program for taxpayers who are serious about compromise."¹⁷⁹ Yet its inventory of unresolved offers has grown rapidly.¹⁸⁰ Recent changes may allow reduction of the backlog, but they are unlikely to liberate resources from the offers program for reallocation to other areas.¹⁸¹

2. Collection Due Process (CDP) rules

RRA '98 created new procedures whereby taxpayers can challenge IRS enforced collection actions. These procedures are triggered at two times: after the IRS files notice of a tax lien¹⁸² and before the IRS effects levy.¹⁸³ At these times, the IRS must notify the taxpayer of her right to administrative review through the IRS Appeals Office (Appeals) and, if Appeals sustains the action, to judicial review through the Tax Court or district court, depending on which has jurisdiction over the type of tax involved.¹⁸⁴

Thus, the principal demands of the CDP regime are on Appeals and the courts. The initial case load predictions were dire indeed. Before

177. McKenzie, *supra* note 170, at 1105. These steps have been criticized as creating "unnavigable roadblocks for submitting offers." *Id.*

178. User Fees for Processing Offers to Compromise, 67 Fed. Reg. 67573 (proposed Nov. 6, 2002) (to be codified at 26 C.F.R. pt. 300); Press Release, Internal Revenue Service, *IRS Proposes User Fee for Certain Offer-in-Compromise Requests* (Nov. 5, 2002) (on file with Westlaw, 2002 WL 31473834).

179. Hamilton, *supra* note 172, at 18 (quoting then-IRS Commissioner Charles Rossotti).

180. "[B]etween fiscal 1997 and 2001 the inventory of unresolved offers almost tripled. The percentage of offers processed by the IRS within six months dropped from 64 percent to 32 percent." *Id.* at 17.

181. Recently, OIC processing has been proceeding more rapidly and the case backlog has declined. However,

much of this progress may be a result of the rigid enforcement of deadlines by the IRS. Hence, some sources say that many new offers are often resubmissions because the IRS will close cases on technicalities due to the pressure to reduce the inventory. Thus, the OIC improvements may be illusory because of churning.

George Guttman, *Oversight Board Concerned About IRS Budget Situation*, 97 TAX NOTES 1404, 1405 (2002).

182. I.R.C. § 6320.

183. I.R.C. § 6330.

184. For detailed discussion of the CDP rules, see Leslie Book, *The New Collection Due Process Taxpayer Rights*, 86 TAX NOTES 1127, 1127 (2000) [hereinafter Book I]; Leslie Book, *Due Process and New Process: New Taxpayer Notice, Hearing and Judicial Review Rights in IRS Collection Actions*, 3 CMTY. TAX LAW REP. 1 (1998) [hereinafter Book II].

RRA '98, the IRS annually issued around nine million collection notices.¹⁸⁵ However, anticipating the effect of CDP, the IRS instituted a pre-notice screening procedure that reduced the number of notices to between three and four million.¹⁸⁶ Based on this, the Tax Court anticipated 105,000 new CDP cases per year.¹⁸⁷

This prediction has not come to pass. Nonetheless, two points. First, collectively, CDP cases consume large amounts of resources, administrative and judicial. Administratively, the Appeals Office had a total of 52,282 cases pending as of October 1, 2001. The great bulk (43,348) were non-docketed cases, 14,829 of which—that is, over 34 percent of non-docketed cases and over 28 percent of all Appeals cases—were collection cases.¹⁸⁸ Not all of the collection cases were CDP cases, but many were.¹⁸⁹ Judicially, CDP cases have become one of the most common types of case handled by the Tax Court. One has but to skim any recent volume of the regular or the memorandum decisions of the Tax Court to appreciate the prevalence of CDP litigation.¹⁹⁰

3. Spousal Relief

Spouses who file joint income tax returns become jointly and severally liable for any taxes, interest, and penalties with respect to the tax year in question.¹⁹¹ To mitigate the possible severity of that regime, the Code has long contained some relief mechanisms.¹⁹² RRA '98 substantially revised and liberalized such relief.¹⁹³ Now, there are three distinct bases of relief: (i) innocent spouse relief available regardless of

185. Sheryl Stratton, *Collection Due Process Notices Are Starting to Go Out*, 22 TAX PRACTICE, 198, 198 (May 17, 1999) (citing then-IRS District Counsel T. Keith Fogg).

186. *Id.* As to levy notices, the IRS first decides whether assets exist. Absent identifiable assets, the IRS will not issue the levy notice.

187. Sheryl Stratton, *Tax Court Prepares for Collection Due Process Actions*, 82 TAX NOTES 1554, 1554 (1999).

188. 2001 DATA BOOK *supra* note 29, at 21, tbl.17. An additional forty collection cases were docketed.

189. For the 2000 through 2002 fiscal years, the IRS received a total of 52,677 CDP cases. National Taxpayer Advocate, FY 2002 ANN. REP. TO CONGRESS 110, tbl. 1.15.1.

190. A computer search on February 6, 2003, disclosed over 160 Tax Court CDP decisions from 2000 to date. CDP was among the ten most frequently adjudicated tax issues in both FY2001 and FY 2002. National Taxpayer Advocate, FY 2002 ANN. REP. TO CONGRESS 253; National Taxpayer Advocate, FY 2001 ANN. REP. TO CONGRESS 259.

191. I.R.C. § 6013(d)(3).

192. Current I.R.C. § 6015, enacted by RRA '98, replaced former I.R.C. § 6013(e).

193. For a description of the revised provisions, see Toni Robinson & Mary Ferrari, *The New Innocent Spouse Provision: 'Reason and Law Walking Hand in Hand'?*, 80 TAX NOTES 835, 835 (1998).

current marital status,¹⁹⁴ (ii) apportioned liability available only to spouses who separated or divorced after filing the return in question,¹⁹⁵ and (iii) catch-all relief available in situations deemed to merit relief but not meeting the requirements of the other two categories.¹⁹⁶

The precise numbers differ, of course, but the same picture emerges for the spousal relief changes as for the OIC and CDP changes: lots of additional work requiring staff diverted from other functions. The response, in numbers of claims filed, far exceeded what Congress, the IRS, and the private sector expected. The flow started when the law became effective and grew quickly thereafter. It had reached about 1000 cases a week in February 1999 and 1200 a week in May 2000.¹⁹⁷ By mid-2000, the IRS had received nearly 79,000 spousal relief claims from 46,000 taxpayers.¹⁹⁸ Viewing the “tremendous” and growing inventory of spousal relief cases, an IRS official described § 6015 as the “section from hell.”¹⁹⁹

To respond, the IRS expended “millions of dollars and thousands of personnel hours” processing spousal relief claims.²⁰⁰ In FY 1999, there were 415 full-time equivalent IRS employees working spousal relief cases, “most . . . plucked directly from the IRS’s examination ranks.”²⁰¹ In FY 2001, the equivalent of 953 full-time employees were allocated exclusively to such work.²⁰² The IRS planned to draw the requisite staff from the ranks of tax auditors.²⁰³ The courts have felt the burden too. Spousal relief cases are among the largest categories in the Tax Court’s current inventory.²⁰⁴

194. I.R.C. § 6015(b).

195. I.R.C. § 6015(c).

196. I.R.C. § 6015(f).

197. Barton Massey, *IRS Receiving Rising Number of Innocent Spouse Relief Cases*, 83 TAX NOTES 1543, 1543 (1999).

198. Sheryl Stratton & Emily Field, *Innocent Spouse Issues Plague Practitioners, IRS, and Courts*, 87 TAX NOTES 1575, 1575 (2000).

199. Massey, *supra* note 197, at 1543 (quoting Thomas W. Wilson, Jr., IRS Assistant Commissioner (Examination)).

200. Ryan J. Donmoyer, *The New Innocent Spouse Relief: More Popular Than Anyone Thought*, 87 TAX NOTES 1023, 1023 (2000).

201. *Id.*

202. *Id.*

203. Massey, *supra* note 197, at 1543.

204. Like CDP, spousal relief also was among the ten (10) most frequently litigated tax issues in both FY 2001 and FY 2002. National Taxpayer Advocate, FY 2002 ANN. REP. TO CONGRESS 256; National Taxpayer Advocate, FY 2002 ANN. REP. TO CONGRESS 258. A computer search on February 6, 2003, disclosed over three score § 6015 Tax Court decisions from 1999 to date. This is the tip of the iceberg, of course, since many more cases are currently docketed awaiting trial or decision and many former cases were resolved before trial and decision.

B. Budgets: Insufficient Support

Like all governmental agencies, the IRS has experienced some better years and some worse years in budgeting. More often than not, the IRS has not received the level of appropriations needed to fully support its obligations. "Historically, the lack of a political constituency has contributed to a level of funding for tax administration which almost certainly is far less than optimal."²⁰⁵ Beyond the absence of positive support, some perceive actual opposition to adequate funding of the IRS, beyond normal inter-functional budgetary competition. Some may view constraining IRS funding as a back-door way to achieve tax cuts.²⁰⁶ I would be reluctant to ascribe this attitude to any particular person or group, but I would not be surprised if it exists in some minds.

One sometimes hears that the IRS has been "fully" funded, but the terminology can be confusing. The key question is whether the IRS is *adequately* funded, *i.e.*, whether it has enough appropriations to come reasonably close to being able to satisfactorily discharge its diverse obligations.²⁰⁷ Adequacy typically has not been reached, and surely has not been reached in recent decades.

For example, the FY 2002 IRS budget was disappointing.²⁰⁸ The FY 2003 did not improve the situation.²⁰⁹ As to it, Larry Levitan, then chair of the IRS Oversight Board, stated:

205. Durst, *supra* note 32, at 12. This note was echoed recently by the former chair of the IRS Oversight Board:

the reason that the IRS does not get adequately funded is that there is no powerful constituency that champions the IRS. No member of Congress ever got a single vote by telling his constituency that he got more resources for the IRS. There is no administration that sees the overwhelming motivation to support the IRS the way it needs to be. There are never enough resources to do everything that is wanted and needed and the IRS loses in the priority battle.

George Guttman, *The IRS's Fiscal 2004 Budget: More or Less?*, 98 TAX NOTES 486, 488 (2003) (quoting Larry Levitan).

206. Former IRS Commissioner Donald Alexander is reported to believe that the current administration harbors this view. Guttman, *supra* note 205, at 487.

207. Here's how the dance is choreographed:

Every year the IRS goes through the same routine. It asks the administration for X dollars of funding for the next fiscal year. X is the amount the IRS thinks it needs to do its job, adjusted for the probability of getting that amount. The administration then usually proposes to give the IRS less than it requested, or Y dollars. Congress, based on appropriations the past few years, gives the IRS almost all the Y dollars. This is known as full, rather than adequate, funding.

George Guttman, *What Would an Adequately Funded IRS Look Like?*, 97 TAX NOTES 36, 37 (2002).

208. See, e.g., George Guttman, *Administration's Budget Request May Crimp IRS Hiring Plans*, 90 TAX NOTES 1286, 1286 (2001) (discussing inadequacy of budget proposal causing problems with IRS's hiring plans); George Guttman, *IRS Budget Growth Smaller Than Desired Sources Say*, 90

Concern about rising noncompliance has resulted in very appropriate demands for the IRS to significantly increase enforcement activities. However, the Oversight Board believes that the administration's request is inadequate and will not enable the IRS to perform significantly more enforcement. If Congress wants adequate enforcement to ensure a fair system for all it will need to appropriate more than the administration requested.²¹⁰

Shortly before the Symposium of which this Article is a part, the administration released its proposed FY 2004 budget. It would give the IRS a budget of \$10.4 billion, an increase of 5.3%. This would include \$133 million for additional audits of companies and high-income individuals, including those who hide income offshore, which is among the IRS's new compliance initiatives.²¹¹

This is not a dreadful IRS budget by historical standards. Neither, though, is it a meaningful improvement. Congress may not approve the full amount requested,²¹² and if it does, that would guarantee nothing for future budgets.

Moreover, were the FY 2004 proposal enacted without reduction, the IRS would be far from adequately funded. Indeed, "after considering several variables, the end result [of the \$10.4 billion proposal] may be that the IRS will not receive a budget increase at all."²¹³ First, more than half of the ostensible 5.3% increase would merely cover mandatory cost

TAX NOTES 1138, 1138 (2001) (discussing the apparent inadequacy of the IRS budget); George Guttman, *The Bush Administration's IRS Budget for Fiscal Year 2002*, 91 TAX NOTES 200, 200 (2001) (discussing the shortcomings and possible problems with FY 2001 budget); Amy Hamilton, *IRS Oversight Board Prepares for Budget Face-Off*, 90 TAX NOTES 1766, 1766 (2001) (containing comments regarding inadequacy of 2002 budget proposal).

209. See, e.g., George Guttman, *IRS Faces Budget Crunch*, 95 TAX NOTES 1546, 1546 (2002) (explaining that the IRS has slowed spending because of a 2002 funding rescission and "disappointment in the Bush Administration's proposed 2003 IRS budget"); Hamilton, *supra* note 20, at 290-91 (stating that "the administration's [2003] IRS budget request is \$92 million lower than what the IRS Oversight Board recommended" and may be based on optimistic assumptions). *Id.*

210. Hamilton, *supra* note 40, at 1264.

211. Fram, *supra* note 162, at 10A. Other uses include an additional \$100 million to gather information to support earned income tax credit enforcement and allowing private collection agencies to collect unpaid taxes on behalf of the IRS (a proposal that failed in the past because of concerns about taxpayers' rights). *Id.*

212. The Administration projects a record deficit of \$304 billion in FY 2004. Fram, *supra* note 162, at 10A. This fact, combined with other spending priorities like military needs and the campaign against terrorism, may make this and future Congresses eager to cut discretionary spending wherever it can. In the past, it often was argued that increased spending on the IRS would yield even larger amounts in additional revenue collected, but that argument has lost force politically. See, e.g., Guttman, *supra* note 3, at 1004 ("[t]he Office of Management and Budget has substantially pared back the IRS budget authorization request for business modernization for fiscal 2004").

213. Guttman, *supra* note 205, at 486.

increases, including pay increases and inflation.²¹⁴ Second, Congress may ultimately require yet greater civilian pay increases and compel the agencies, including the IRS, to defray those increases themselves.²¹⁵ Third, some of the increases to some areas are predicated on the IRS achieving and reallocating certain cost savings. The IRS's record in realizing projected savings is not impressive. The current hypothesized savings may well be overstated.²¹⁶

The IRS hoped for \$10.7 billion, not \$10.4 billion, for the coming year.²¹⁷ Yet even the extra \$300 million would not be adequate. A recent article (based on statements by former IRS Commissioner Rossotti) totaled the IRS's "wish list" for customer service, collection, nonfiler and underreporting cases, abusive trusts and offshore accounts, high-income taxpayers, and large corporations.²¹⁸ The overall amount? "The IRS's wish is to get an extra 35,000 full-time staff. This would cost about \$2.5 billion in labor each year, and even more in support costs."²¹⁹ This would be a staff increase of about 35% and (even without the extra support costs) a budget increase of about 25%.²²⁰

Perhaps these figures correctly depict a fully adequate budget; perhaps they are overstated. But increases of even half of the above amounts are wholly infeasible politically. Recognizing that, the IRS does not even request budgets of such magnitude.

Yet, absent adequate funding, budget reallocations are a game of "robbing Peter to pay Paul." If more goes to taxpayer service, less will go to enforcement.²²¹ If the new enforcement initiatives receive substantial funding, some other important aspect(s) of tax administration will suffer.

One thinks, in this connection, of the principle of physics known as Boyle's Law (or, in France, Mariotte's Law). That principle states that (at constant temperature) the volume of gas varies inversely with its

214. *Id.*

215. *Id.* at 487.

216. *Id.*

217. Adding the IRS "want list" to the administration's \$10.4 billion, the amount would have been \$10.7 billion, which would have been an 8% increase, and would have permitted a staff increase of 1.2%. George Guttman, *What the IRS Wants for Fiscal 2004*, 97 TAX NOTES 1127, 1127 (2002).

218. Guttman, *supra* note 207, at 38.

219. *Id.* at 38.

220. *Id.* With such increases, the IRS thinks it could produce an extra \$30 billion in revenue annually. *Id.*

221. "The pendulum swings back and forth every few years between compliance and customer service, but there is no consensus on how best to proceed." Guttman, *supra* note 207, at 37.

pressure. The principle explains why, when one squeezes a balloon in one place, it tends to expand in another. Similarly, in a constrained budget environment, squeezing one service or compliance area (by reallocating funds to it) requires removing the administrative hand from another part of the balloon, causing that area to bulge out.

In sum, we currently lack adequate tax administration resources, caused in part by additional demands (including those imposed by RRA '98) unmatched by additional budgeting. With inadequate resources, we can choose where to push for compliance. But the resultant neglect of other areas will cause noncompliance in them to expand.

If budgeting cannot be depended upon to be adequate, resources to better grip the whole of the compliance balloon will have to be found elsewhere. That can come only from decreasing demands on the IRS, and such decreases are most likely to be achieved through simplification of the tax system. It is to that possibility that we now turn.

IV. SIMPLIFICATION AND COMPLIANCE

Simplification has been called the "holy grail" of tax reform.²²² It has been justified on many grounds including (i) reduced compliance costs for taxpayers,²²³ (ii) greater popular support for the tax system, (iii) greater transparency of the system, and (iv) greater fairness.²²⁴

Simplification also has been justified on grounds related to compliance.²²⁵ In many areas, the tax law is so complex or so ambiguous that many taxpayers who want to file accurate returns are defeated by

222. Edward J. McCaffery, *The Holy Grail of Tax Simplification*, 1990 WISC. L. REV. 1267 (1990). In tax as in the original legends, though, the grail is understood differently by different people. See, e.g., Boris I. Bittker, *Federal Income Taxation—Then and Now*, 74 TAX NOTES 903, 906 (1997) (identifying definition of a comprehensive tax base as the "holy grail" of tax policy).

223. The IRS has developed a new microsimulation model to measure taxpayer compliance burdens (such as time and money) and to estimate such burdens that could result from proposed tax law changes. This could give compliance burdens greater impact in consideration of tax legislation and assist in simplification efforts. See Ayayo, Field & Thorndike, *supra* note 77, at 1013 (describing the microsimulation model and its usefulness).

224. See, e.g., SLEMROD & BAKIJA, *supra* note 30, at ch.5 (describing the complexity of our tax system and how it can be fixed); Michael A. Andrews, *Tax Simplification*, 47 SMU L. REV. 37, 38–39 (1993) (noting the need for tax simplification); Joseph A. Snoc, *Tax Simplification and Fairness: Four Proposals for Fundamental Tax Reform*, 60 ALB. L. REV. 61, 63–64 (1996) (highlighting the complexities of the tax system).

225. "[T]oday's tax complexity . . . clearly decreases levels of voluntary compliance," in addition to raising compliance costs and reducing the perceived fairness of the tax system. Patti Mohr, *Specialists Discuss Simplification in Light of Bush's Tax Plan*, 91 TAX NOTES 867, 868 (2001) (citing Lindy L. Paul, then chief of staff of Joint Committee on Taxation).

their inability to know with certainty what the law commands of them.²²⁶ Of course, the tax law has become even more complex with each passing year. Return preparers and return preparation computer software are in increasing use,²²⁷ but they are no guarantee that the return will be correct.²²⁸ Computer programs are no better than the information inputted, and return preparers often make errors.²²⁹

When taxpayers do understate their liabilities—either because of honest error or because they were aggressive—complexity decreases the chance that the IRS will detect the understatement. The unpleasant but unavoidable fact is that, even when a return is examined, IRS agents often miss adjustments that should be made. Complexity is one reason. Too often, the law is too complex for IRS agents to apply effectively.²³⁰

The foregoing connections between complexity and compliance are genuine, but another connection is the focus of this article. Simplification of the right kinds can liberate substantial numbers of IRS personnel from tasks of marginal benefit, permitting their redeployment to more valuable activities, be they taxpayer service or enforcement. In this way, the system can at least partly compensate for inadequate appropriations.

Below, we briefly consider the theoretically available routes to simplification. The conclusion will be that piecemeal simplification is more likely to be feasible than major structural changes or realignments

226. Durst, *supra* note 32, at 49. Decrying complexities introduced by the 1986 legislation, one study of compliance stated:

It appears that some of the new provisions, and the regulations that implement them, are so complex as to be beyond the practical abilities of many tax professionals, let alone taxpayers who seek to file their own returns As a result, many taxpayers, including some who are receiving professional advice, probably are simply approximating large portions of their liabilities. Through this process, the image of the tax law as a statement of social obligation is eroded, replaced by an image of the tax laws as a set of vague guidelines which the taxpayer has wide latitude to manipulate.

Id.

227. For depiction of growing use of such aids, see Thomas F. Field, *30 Years of Federal, State, and International Tax Policy*, THE FUTURE OF AMERICAN TAXATION 3, 4–5 (2002).

228. A magazine asked 50 return preparers to compute income tax owed by a hypothetical family on hypothetical facts. The correct answer was around \$23,400. The answers given by the preparers ranged from \$12,555 to almost \$36,000. The answers averaged over \$1500 less than the correct amount. Only 11 of the 50 preparers were particularly close to the correct amount. Greg Anrig, Jr., *The Pros Flunk Our New Tax Test*, MONEY, Mar. 1989, at 110.

229. For instance, by April 17 of the 1999 filing season, the IRS had discovered “simple errors” on nearly a million returns signed by tax practitioners. Karen Hube, *IRS Has a Gripe Too: Sloppy Taxpayers*, WALL ST. J., May 13, 1999, at C1.

230. See, e.g., Durst, *supra* note 32, at 10 (some provisions of the Code “are so complex as to be virtually unadministrable”).

of responsibilities. That being so, this part proposes five specific changes—resource-liberating changes—to the RRA '98 rules.

A. *Theoretically Available Routes to Simplification*

Broadly speaking, there are at least five possible ways to change the Code in order to liberate resources for productive redeployment: (1) impose a moratorium on changes to the Code, (2) relieve the IRS of obligations unrelated to revenue raising, (3) remove large numbers of taxpayers from the tax rolls, (4) abolish whole taxes or major components of taxes, and (5) amend specific substantive or procedural statutes. Most of these are manifest political non-starters or involve issues of complexity and weight far beyond the scope of this article. Thus, we will be left with the fifth avenue as the focus for proposals.

1. Moratorium on Code Changes

Sometimes the best action is inaction. When the tax law frequently changes and the changes are unclear or fail to anticipate major implementation issues, the IRS (and taxpayers) are severely burdened. The need to learn, re-learn, “unlearn,” and just make it up as one goes along, is an invisible yet large cost, claiming time, attention, and energy that could have been profitably applied to other responsibilities.

There is little doubt that the above describes the current unsatisfactory pace and quality of federal tax legislative outputs. Each year brings multiple tax acts, many of them major acts (as in 1997, 1998, and 2001). Unfortunately, the provisions enacted are of declining quality in terms of clarity, specificity, and foresight.²³¹ One aspect of this has been Congress' tendency in recent years to “legislate concepts” rather than firm provisions, leaving it up to the IRS to sort out the details.²³² “[A] process that deals with concepts and not in details, is one that leads to complexity, because legislators don't always focus on the impact of their provisions and what kind of burden they may be imposing.”²³³ Both the volume of tax legislative outputs and the declining quality of

231. “The pace of enactments has far outstripped the care that has gone into them.” Steve R. Johnson, *Further Thoughts on Interpreting Tax Statutes*, 1998 ABA SEC. TAX'N NEWSL. 11, 13 (Winter).

232. Rosina B. Barker & Jasper L. Cummings, Jr., *Interview with Margaret Milner Richardson, Former Commissioner of Internal Revenue*, 1997 ABA SEC. TAX'N NEWSL. 11, 12 (Summer) [hereinafter *Richardson Interview*].

233. *Id.* at 13.

them have put substantial pressures on the IRS. Indeed, its job has been "made worse by each successive Congress."²³⁴

Thus, putting tax legislation on holiday for some years would give the IRS welcome breathing space, allowing it to fulfill its present duties better. But, of course, this will not happen. The economic and political factors that have driven frenetic tax legislation in recent decades show no signs of losing steam.²³⁵ Thus, this relief mechanism will remain purely a theoretical option.

2. Relief from Non-Revenue Obligations

There was a time when people could seriously argue that the Internal Revenue Code should be used only to raise revenue. Those days are long gone.

In the past decade, the President and Congress have used the income tax the way my mother employed chicken soup: as a magic elixir to solve all the nation's economic and social difficulties. If the nation has a problem in access to education, child care affordability, health insurance coverage, or the financing of long-term care, an income tax deduction or credit is [viewed as] the answer.²³⁶

The examples could easily be multiplied. A major one is the earned income credit,²³⁷ which is "truly a welfare system grafted onto" the Code,²³⁸ which means the IRS is "running a negative income tax program for 25 million" Americans.²³⁹

The fundamental problem is that the IRS is being asked to do too much. Having to administer [non-revenue responsibilities] . . . has diverted IRS audit resources The IRS cannot do all these things well Many it cannot do at all. We should not expect it to. A major simplification of the nation's tax law is necessary.²⁴⁰

234. Stratton, *supra* note 164, at 693 (quoting former IRS Commissioner Donald C. Alexander).

235. "The current environment in Washington can best be described . . . as confusing, with lots of tax bills and lots of tax ideas coming from both sides of the aisle." Patti Mohr, *Specialists Discuss Simplification in Light of Bush's Tax Plan*, 91 TAX NOTES 867, 867 (2001) (quoting David Lifson of the American Institute of Certified Public Accountants).

236. Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261, 274 (2002) [hereinafter *100 Million Unnecessary Returns*].

237. I.R.C. § 32.

238. Stratton, *supra* note 164, at 694 (quoting former IRS Commissioner Margaret Milner Richardson).

239. *Id.* (quoting former IRS Commissioner Fred Goldberg, Jr.).

240. *100 Million Unnecessary Returns*, *supra* note 236, at 280-81.

Amen. Freeing the IRS to concentrate on its core revenue mission would liberate vast resources to further that mission. However, simplification through paring the IRS's non-revenue duties is not in the political cards. Using the Code to promote the gamut of social programs is popular with both major political parties and with the public.²⁴¹ Once again, we will have to look elsewhere for the needed relief.²⁴²

3. Shrinking the Tax Rolls

A perhaps more promising possibility would be to free large numbers of low-income taxpayers from income tax liability and therefore from the need to file returns. There would be substantial resources savings for the IRS in taxpayer education and service, return processing, audit, and collection.

Some of this could be accomplished through existing structural mechanisms by raising the standard deduction or personal exemption amounts or by excluding some modest amounts of income from taxability.²⁴³ Of course, there is a fiscal objection to doing so.²⁴⁴ The contribution of low-income taxpayers to the total income tax "take" is modest in percentage terms yet appreciable in absolute dollars.²⁴⁵

There are ways to meet this concern, though. For example, it may be possible to fashion an expanded withholding system that obviates the need to file returns for many yet does not lose great amounts of revenue.²⁴⁶ More ambitiously, Professor Graetz proposes

241. *Id.* at 275.

242. A member of the House Ways and Means Committee put it this way:

It is better if you can do things directly rather than using the tax Code, but when we are talking about trying to help people, empower people . . . sometimes it is a lot easier for us to get those policies done through the tax Code and pay the price of complexity of the tax Code, than to do nothing and to have people who can't find employment in our community.

Jasper L. Cummings, Jr. & Adam J.J. Swirski, *Interview with Congressman Ben Cardin (D. Md.)*, 2002 ABA SEC. TAX'N NEWSL. 17, 19 (Spring).

243. See Jonathan Barry Forman, *Simplifying the Tax System for Low Income Taxpayers*, 1995 ABA SEC. TAX'N NEWSL. 10, 10 (Spring) (suggesting changes that would minimize returns and simplify the process for low-income persons).

244. There also would be political objections. Currently, at least as suggested by the administration's FY 2004 tax proposals, reducing tax for high-income individuals is more attractive to some than reducing tax for low-income individuals. For discussion of those proposals, see William G. Gale, *The President's Tax Proposal: First Impressions*, 98 TAX NOTES 265, 265 (2003).

245. See, e.g., Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 FLA. TAX REV. 1, 8-9 (1998) (finding that the lowest quintile of wage earners account for less than 2% of tax revenues).

246. See Snoe, *supra* note 84, at 111-15 (withholding proposal that would "exempt 50%-80% of taxpayers from filing tax returns.").

enacting a value-added tax (VAT) . . . of 10% to 15% which would finance an income tax exemption of up to \$100,000 and would allow a vastly simpler income tax at a 25% rate to be applied to incomes over \$100,000 without either losing revenue or dramatically shifting the tax burden toward middle and lower income families.²⁴⁷

He calculates that this would eliminate “more than 100 million American families—almost 90% of all filers—from the income tax rolls.”²⁴⁸

There are limitations, to be sure. Merely raising the total income taxability threshold under the current tax structure would still leave tens of millions filing, in order to claim the earned income credit.²⁴⁹ Enacting a VAT would require audit and regulatory activity to police it.

Nonetheless, the approaches noted here do hold promise, both for easing IRS resources challenges and for other substantial policy reasons. Their full analysis is beyond the scope of this article, but I hope they receive serious consideration in due course.

4. Abolishing Taxes or Major Components of Taxes

Large resource savings would accrue if otherwise undesirable taxes or major components of taxes were abolished. Some previous tax regimes were eventually abolished.²⁵⁰ Recent history is uneven. We eliminated the distinction between capital gains and ordinary income in 1986 but resurrected it not long thereafter.²⁵¹ We have scheduled the elimination of the estate tax, but for one year only and the schedule may never be implemented.²⁵²

247. *100 Million Unnecessary Returns*, *supra* note 236, at 282–83.

248. *Id.* at 286. The 1986 legislation did simplify the tax system for many by effectively putting them on the standard deduction. *See Richardson Interview*, *supra* note 232, at 13.

249. *See supra* notes 221–23 and accompanying text.

250. For instance, the excess profits, windfall profits, and interest equalization regimes are no longer with us.

251. Unfortunately. I hope we eliminate it again. *See, e.g., Snoe*, *supra* note 84, at 66–85 (discussing complexity arising from historical distinctions between capital gains and ordinary income); *Interview with Calvin H. Johnson: Arnold, White & Durkee Centennial Professor of Law University of Texas School of Law*, 1993 ABA SEC. TAX’N NEWSL., 27, 30 (Winter) (“[T]he apparent purpose of a capital gains tax-cut is to get rich people to pull their money out of productive investments so as to consume the capital in a life of luxury.”).

252. Moreover, “[e]ven if the 2001 Act’s repeal of the estate tax actually takes effect, there will be pressure for its reinstatement.” Graetz, *supra* note 130, at 176.

Major areas have been identified as candidates for simplification or elimination.²⁵³ Some of the early battles will involve the corporate and individual alternative minimum tax.²⁵⁴ Plainly, many factors—some of them of greater moment than the resource effects that are the subject of this Article—will be part of the debates centering on such major structural changes. I hope, though, that resource effects will be part of the discussions.

5. Amending Specific Statutes

To effect large-scale tax changes, proponents have to muster great political resources and expend substantial amounts of political capital. Even with that, they often need more than a little luck as well.²⁵⁵ So, despite all the sound and fury the country has witnessed in recent decades as to “tearing the current tax system out by its roots” and replacing it, such wholesale action—especially in the name of simplification—is highly unlikely.²⁵⁶

Useful simplifications of the Code are more likely to be achieved through piecemeal improvements than through radical initiatives.²⁵⁷ It is in that vein that the Article now proceeds. Below, we consider piecemeal statutory changes, centered on RRA '98 rules, that hold potential for freeing administrative resources for more profitable use, without eroding beneficial features of the system.

B. Resource Liberation Through RRA 1998 Simplifications

As we have seen, RRA '98 imposed serious resource demands on the IRS.²⁵⁸ The Act went too far. Fortunately, its excesses can be moderated

253. See, e.g., Olson, *supra* note 116, at 5 (mentioning, among other things, repeal of the alternative minimum tax); *Interview with Robert R. Wootton: Tax Legislative Counsel of the Department of Treasury*, 1991 ABA SEC. TAX'N NEWSL., 78, 79 (Summer).

254. See, e.g., Leonard E. Burman et al., *The Individual AMT: Problems and Potential Solutions*, 55 NAT'L TAX J. 555 (2002).

255. For description of how these factors coalesced in the landmark 1986 legislation, see Jasper L. Cummings, Jr. & Adam J.J. Swirski, *Interview with Ronald A. Pearlman*, 2001 ABA SEC. TAX'N NEWSL., 20, 20–21 (Winter).

256. See, e.g., Sheldon S. Cohen, *The Erwin N. Griswold Lecture*, 14 AM. J. TAX POL'Y 113, 122 (1997).

257. See, e.g., Warren Rojas, *Policymakers Debate Tax Reform, Modernization at AEI Event*, 97 TAX NOTES 1375, 1376 (2002) (citing Kenneth J. Kies, former Chief of Staff of Joint Committee on Taxation); Warren Rojas, *Tax Reform Champions Don't Mind Incremental Change*, 95 TAX NOTES 1882, 1882 (2002) (citing John Berthoud, President of the National Taxpayer Union Foundation).

258. See *infra* Part III.A.

without unacceptably reducing anything useful. Specifically, I recommend five changes. The first three have a common thread: eliminating the residual, equitable categories of relief for (1) spousal relief, (2) CDP, and (3) OIC purposes. The other two are particular to one or another of these regimes. They are (4) remove defined categories from OIC eligibility and (5) eliminate CDP hearings when only frivolous issues are asserted.

We consider each of these in turn below. Cumulatively, they should have appreciable effect. They will not usher in a golden age of resource adequacy for tax administration, but they will help in a non-trivial way.

1. through 3. Eliminate Residual, Equitable Relief Categories

Three major taxpayer-relief mechanisms established or enlarged by RRA '98 are spousal relief under I.R.C. § 6015, CDP under I.R.C. §§ 6320 and 6330, and OIC under I.R.C. § 7122. In each case, there are multiple categories of or situations under which relief may be granted. Some categories and situations are more-or-less defined, but, in addition, there is under each regime an avenue of relief that is flexible to the point of open-endedness, that is essentially, perhaps inherently, standard-less. Below, we first describe those categories, then explain why they should be eliminated.

Spousal relief: There are three categories of spousal relief. First, under § 6015(b), relief from joint-and-several income tax liability is available to all spouses who meet five conditions: (1) a joint return was made for the year, (2) the return understates tax because of erroneous items of the other spouse, (3) the spouse claiming relief neither knew nor had reason to know of the understatement, (4) under all the facts and circumstances, it would be inequitable to enforce liability upon the spouse, and (5) the spouse timely elects relief (within two years after the IRS begins collection against the spouse).²⁵⁹ Second, under § 6015(c), relief is available for spouses no longer married or living together if (1) they did not assist the other spouse to defeat collection via asset transfers, (2) they timely elect relief, and (3) they did not have actual knowledge of the understatement.²⁶⁰

259. I.R.C. § 6015(b)(1). The fourth factor largely reduces to whether the spouse claiming relief derived substantial material benefit from the tax underpayment. See Treas. Reg. § 1.6015-2(d) (2002).

260. I.R.C. § 6015(c)(3)-(4).

Although these categories are loose in some respects, they are precision itself compared to the third category. If they fail to meet the requirements of both § 6015(b) and § 6015(c), taxpayers may still qualify for relief under § 6015(f) if “taking into account all the facts and circumstances, it is inequitable to hold the individual liable for [the tax].”²⁶¹

First by revenue procedure²⁶² then by regulations,²⁶³ the IRS and Treasury have sought to give content to this category, mostly by reference to factors familiar under § 6015(b) and 6015(c).²⁶⁴ Thus a number of positive factors will, if present, influence the IRS towards granting § 6015(f) relief,²⁶⁵ and their absence or the presence of a number of negative factors will influence the IRS towards denying the relief.²⁶⁶

However, the factors may not be exclusive; their weighting is not fixed; and the § 6015 decision is made on the basis of all facts and circumstances taken as a whole.²⁶⁷ Moreover, the IRS’s determination need not end the controversy. The courts have asserted, and the IRS has acknowledged, a right to review IRS decisions not to grant § 6015(f) equitable relief.²⁶⁸

CDP: Before the IRS may levy on property, it must inform the taxpayer of her right to a hearing with the Appeals Office.²⁶⁹ Generally similar procedures are required within five days after the IRS files notice of tax lien.²⁷⁰ At the hearing, the Appeals Officer must verify that the IRS has followed prescribed procedures to that point.²⁷¹ At the hearing, the taxpayer may raise “any relevant issue,” including “(i) spousal defenses, (ii) challenges to the appropriateness of collection action, and

261. I.R.C. § 6015(f)(1).

262. Rev. Proc. 2000-15, 2000-1 C.B. 447.

263. Treas. Reg. §§ 1.6015-1.6015-9, 1.6013-4 (as amended by T.D. 9003, 2002-32 I.R.B. 294); 67 Fed. Reg. 47278 (July 18, 2002), corrected by, 67 Fed. Reg. 54735 (Aug. 26, 2002).

264. See generally Gary Fleischman & Sean Valentine, *How to Improve Equitable Relief for Innocent Spouses*, 96 TAX NOTES 874, 874 (2002).

265. Rev. Proc. 2000-15, § 4.03(1), 2000-1 C.B. 448-49. These factors involve marital status, economic hardship, abuse, level of knowledge, legal obligations under divorce decree, and attributability of the items to the other spouse.

266. *Id.* § 4.03(2). The negative factors include attributability of the items to the requesting spouse, significant benefit to the requesting spouse, noncompliance with the law, and legal obligation under divorce decree.

267. *Id.* § 4.03(2)(b); see also Treas. Reg. § 1.6015-4(a) (2002).

268. E.g., *Beck v. Commissioner*, 82 T.C.M. (CCH) 347 (2001), *acq. in result*, 2001-51 I.R.B. 584 (Dec. 17, 2001).

269. I.R.C. § 6330(a)(1).

270. I.R.C. § 6320(a), (c).

271. I.R.C. § 6330(c)(1).

(iii) offers of collection alternatives.²⁷² The taxpayer may also contest his liability for the underlying tax if he did not have opportunity to do so previously.²⁷³ The taxpayer may seek judicial review if the Appeals Officer upholds the collection action.²⁷⁴

In addition, under I.R.C. § 6330(c)(3)(c), appeals must consider “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the [taxpayer] that any collection action be no more intrusive than necessary.”²⁷⁵ That has been interpreted to mean that the Appeals Officer must balance the IRS’s needs against concerns—such as hardship, intrusiveness, and perhaps other factors—that the taxpayer may interpose against collection. Further, the courts may review Appeal’s determination on this matter.²⁷⁶ The IRS and Treasury have issued final regulations as to the CDP rules,²⁷⁷ but they do not notably guide Appeals in effecting such balancing.²⁷⁸

OIC: For decades, there have been two recognized grounds on which offers in compromise could be made: doubt as to whether the taxpayer actually was liable for the tax and doubt as to whether the liability could be collected from the taxpayer’s present and foreseeable assets and income.²⁷⁹ Of these, the second was and remains far the more important, and the IRS had promulgated standards for its determination.²⁸⁰

RRA ’98 required the IRS to develop revised guidelines as to when offers are adequate.²⁸¹ The legislative history stated that Congress wanted factors such as “equity, hardship, and public policy” to be considered in the offer evaluation process.²⁸² This was generally taken as a mandate to create a new, third category of OIC relief, which has come to be known as “hardship” or “effective tax administration” relief. The IRS and the Treasury incorporated this new category into final

272. I.R.C. § 6330(c)(2)(A).

273. I.R.C. § 6330(c)(2)(B).

274. I.R.C. § 6330(d)(1).

275. I.R.C. §§ 6330(c)(3)(C).

276. *E.g.*, *Compucel Service Corp. v. Commissioner*, 2002-1 USTC P 50,284 (D. Md. 2002); *Kitchen Cabinets, Inc. v. United States*, 2001-1 USTC P 50,287 (N.D. Tex. 2001).

277. *Treas. Reg.* § 301.63201-1 (as amended by T.D. 8979, 2002-6 I.R.B. 466); 67 *Fed. Reg.* 2558 (Jan. 18, 2002); *Treas. Reg.* § 301.6330-1 (as amended by T.D. 8980, 2002-6 I.R.B. 477); 67 *Fed. Reg.* 2549 (Jan. 18, 2002).

278. *See* *Treas. Reg.* §§ 301.6320-1(e)(3) (A-E1) (vi) (stating that collection actions should be “no more intrusive than necessary.”), 301.6330-1(e)(3) (A-E1) (vi) (same).

279. *See* LEDERMAN & MAZZA, *supra* note 25, at 628.

280. *See* I.R.M. (CCH) 5.8.5.3 (Nov. 1, 2002).

281. I.R.C. § 7122(c).

282. H.R. 599, 105th Cong. (1998) (enacted).

regulations in 2002,²⁸³ which set out a non-exclusive list of factors for use in determining eligibility for this category of relief.²⁸⁴

Thus, a residual, catch-all, equity basis for relief exists in all three regimes. In spousal relief, it is § 6015 equitable relief. In CDP, it is balancing of hardship. In OIC, it is the hardship or effective tax administration avenue. These bases are undesirable and should be eliminated. I say this for three reasons, of which the third is central to this Article. First, at their best, such bases are unnecessary. The most comprehensive of the factors set out under the three are under § 6015(f). Most of the identified factors repeat concepts from § 6015(b) and (c). To the extent that § 6015(f) provides little more than those two categories, it is unnecessary.

Second, the bases are unpredictable and create risk that taxpayers will be treated inconsistently. As seen, the spousal relief and OIC factors provide for no particular weighting of factors and, ultimately, are open-ended. Balancing under the CDP rules always is an “eye of the beholder” sort of enterprise.

Equitable relief under § 6015(f) has been a “guessing game.”²⁸⁵ The other two residual categories are little better. Multi-factorial, unweighted balancing tests are notorious for their unpredictability.²⁸⁶ We have that evil here. Horizontal equity—the principle that similarly situated taxpayers should be treated similarly—has long been recognized²⁸⁷ as a goal. It is a key value in our tax system.²⁸⁸ The indeterminacy of the spousal relief, OIC, and CDP equity bases puts that value at risk.

Third, as central to this Article, consider the resource effects of the three bases. It is standard procedure for a taxpayer to throw in a § 6015(f) count if making a spousal relief claim on either other ground, to

283. See *supra* note 168. Economic hardship is defined by reference to Regulation § 301.6343-1. See generally Amy Hamilton, *IRS to Refine OIC Equity Factors—Possibly in New Regs*, 97 TAX NOTES 578, 626 (2002) (stating that a team will be appointed to define “hardship” which term originated from T.D. 9007).

284. Treas. Reg. § 301.7122-1(b)(3) (codified at 26 C.F.R. part 301).

285. Fleischman & Valentine, *supra* note 264, at 876; see *August v. Comm’r*, 84 T.C.M. (CCH) 183 (2002) (holding that the IRS abused its discretion in denying § 6015(f) relief and weighing the equities differently, and not every independent reader will agree with the court’s conclusion).

286. See, e.g., *Scriptomatic, Inc. v. United States*, 555 F.2d 364, 367–68 (3d Cir. 1977); *Biedenham Realty Co. v. United States*, 526 F.2d 409, 414–15 (5th Cir. 1976). This is why the nine factors of Reg. § 1.183-2 have left many hobby loss cases essentially toss-ups.

287. E.g., *Thor Power Tool Co. v. Comm’r*, 439 U.S. 522, 544 (1979); *Comm’r v. Sunnen*, 333 U.S. 591, 599 (1948); *Burnet v. Harmel*, 287 U.S. 103, 110 (1932).

288. See, e.g., Rosina B. Barker & Jasper L. Cummings, *Interview with C. Eugene Steuerle*, 1995 ABA SEC. TAX’N NEWSL., 11 (Summer) (discussing how horizontal equity “drives policy more than any other [principle]” and “drives most policy debates”).

throw in an effective tax administration count if making an OIC, and to argue balancing of interests in a CDP hearing. The evaluation of those extra issues adds time, certainly administratively and perhaps also judicially if appeal occurs. It is impossible to quantify that time, but it likely is appreciable. These extra issues occur in tens of thousands of administrative cases each year. It does not take long per case for the total to mount.

Congress made a judgment in including the residual, equitable categories in the three regimes in RRA '98. It knew it wanted to create or expand relief; it thought it had done so through the more directed relief bases it crafted; but it was not sure its nets had caught each case. The residual, equitable categories were created to get those last few possible cases. That is the way the sections have played out. As far as available information indicates, there have been relatively few cases in which relief was denied on other grounds but granted on the residual, equitable grounds.²⁸⁹

Congress made the wrong choice in creating these grounds. It forgot that costs as well as benefits must be considered. As said, the benefits were expected to be and apparently have been, for the rare cases. In securing those rare benefits, there were costs in many more cases: expended administrative resources that could have been applied to much greater effect elsewhere in the tax system. In short, the game was not worth the candle. At a time when the IRS is otherwise squeezed for resources, it is unwise, on balance, to expend its available resources on these residual, equitable categories.

4. Remove Categories from OIC Eligibility

A way to somewhat moderate the torrent of OIC cases would be to declare some types of liabilities categorically ineligible for compromise. A category would be a candidate for such ineligibility if it possessed both of two characteristics: (1) on the merits, this is not a type of liability or taxpayer we should wish to help and (2) identifying when particular cases fall into the category is sufficiently easy that the identification would not consume more time than the exclusion would save.

²⁸⁹ Among the cases discussing I.R.C. § 6015(f) relief, see *Flores v. United States*, 51 Fed. Cl. 49 (2001); *August v. Comm'r*, 84 T.C.M. (CCH) 183 (2002).

I can offer one category now that meets both criteria. Tax liabilities attributable to fraud should not be eligible for relief; offers to compromise such liabilities should be summarily rejected.

Liabilities attributable to fraud meet the first criterion. The Code recognizes that fraud is special, and it treats it more harshly than it treats mere mistake or negligence.²⁹⁰ Similarly, Congress should declare that taxpayers who commit fraud do not deserve OIC relief. First, allowing fraud liabilities to be compromised reduces the “sting” and so the disincentive to commit fraud. Second, the knowledge that taxpayers committing fraud can have parts (perhaps large parts) of their liabilities written off, is likely to erode the confidence of the honest taxpayers in our system. The best analogy is to the Bankruptcy Code. Liabilities attributable to fraud are not dischargeable in the bankruptcy process.²⁹¹ OIC—which often is viewed as an alternative to bankruptcy—should treat such liabilities no more indulgently.

Liabilities attributable to fraud also meet the second criterion. The officer processing the offer can easily determine from the file, or even a detailed transcript, whether a fraud penalty has been assessed against the taxpayer. If so, end of story. Easy. Fast.

Adoption of this change would eliminate the time spent in processing and considering OIC claims as to fraud liabilities. That would be a start. Thought should be given to other candidate categories for ineligibility. One might be liabilities based on frivolous, protestor-type arguments. A barrier might be the ill-advised RRA '98 rule prohibiting the IRS from using “protestor” designations.²⁹² We should abolish that barrier and investigate whether ready indicators of this condition do or can exist in files so that this category can be added to the catalog of OIC ineligibility.

5. Eliminate CDP Hearings on Frivolous Claims

Too often, it has been not honest taxpayers harassed by the system but taxpayers who harass the system who have invoked the rules and protections of RRA '98. These rules sometimes have been another lever pulled by taxpayers bent not on fair resolution but obstruction and delay.

290. See, e.g., I.R.C. § 6501(c)(1) (abolishing statute of limitations on assessment in cases of fraud); I.R.C. § 6651(f) (raising maximum delinquency penalty from 25% to, in cases of fraud, 75% of underpayment); I.R.C. § 6663(a) (imposing 75% penalty on deficiencies with respect to fraudulent returns).

291. 11 U.S.C. § 523(a)(1)(c) (2000). For useful discussion of this rule in the context of tax claims in bankruptcy, see In re Fretz, 244 F.3d 1323 (11th Cir. 2001).

292. RRA 1998, *supra* note 2, at § 307.

In particular, many requests for CDP relief have been filed asserting only frivolous, often rejected, or protestor-type arguments.

An IRS Appeals Office took the view that taxpayers filing requests raising only such arguments need not be granted face-to-face hearings. However, the IRS National Office²⁹³ and the courts²⁹⁴ took a different view, requiring that a hearing be held.²⁹⁵ Once at the hearing, if the Appeals Officer determines that the taxpayer has nothing but frivolous arguments, he may end the hearing,²⁹⁶ but the hearing must be commenced.

The theory appears to be that there may in fact be a real issue in the case even though it is not disclosed by a hearing request raising only frivolous arguments. But again, the reasoning is flawed by the failure to recognize the costs imposed. There *may* be a good issue in there somewhere (but probably not). But there *will* be valuable administrative resources consumed in every case where the hearing is held. The certainty of the resources cost should outweigh the relatively small possibility of a wrong requiring redress.

The *Montijo* case²⁹⁷ illustrates the present regime. The IRS had assessed a frivolous return penalty under § 6702 against the taxpayer. The taxpayer's CDP hearing request asserted only protestor arguments (of the type that resulted in the penalty in the first place). The local Appeals Office granted the protestor only a telephone hearing, on the basis of which that office upheld the penalty. On appeal, the district court required the Appeals Office to hold a face-to-face hearing. Appeals then jumped through that hoop. Unsurprisingly, Appeals affirmed the penalty again after the face-to-face hearing. On a new appeal, the district court easily agreed with Appeals' conclusion holding that there was "no doubt about the validity of the penalty."²⁹⁸

Only someone slavishly attached to ritual over practicality could feel proud of a system that produced a farce like that in *Montijo*. What a

293. See I.R.S. Service Center Advisory 2002-33-001, 2002 WL 1883647 (Aug. 16, 2002); I.R.S. Chief Counsel Advisory 2001-23-060, 2001 WL 634371 (Mar. 23, 2001).

294. *Montijo v. United States*, 2002 WL 507573 (D. Nev. 2002), *modifying* 2002 WL 1466096 (D. Nev. 2002).

295. A seriously divided Tax Court held that face-to-face hearings are not required in all circumstances. *Lunsford v. Comm'r*, 117 T.C. 183, 190-204 (2001).

296. *E.g.*, *Tipp v. Comm'r*, 82 T.C.M. (CCH) 759 (2001); *Inman v. Comm'r*, 81 T.C.M. (CCH) 1583 (2001).

297. See *supra* note 293.

298. *Montijo v. United States*, 2002 WL 1466096, * 3 (D. Nev. 2002). A substantially similar case with similar waste of administrative and judicial resources is *Ahee v. United States*, 2002 WL 1023165 (D. Nev. 2001), *amended by* *Ahee v. United States*, 2002 WL 31061637 (D. Nev. 2002).

waste of both administrative and judicial resources. We should abolish the need for a CDP hearing when the taxpayer's request raises only tired, universally rejected, frivolous arguments.

Indeed, in 2002 Congress had before it legislation (supported by the administration) to do that. The legislation failed but apparently for reasons unrelated to the merits of this proposal.²⁹⁹ The Administration repurposed the measure in its FY 2004 budget proposals,³⁰⁰ and the idea remains a good one. This change would free resources for more profitable use at little or no cost to any genuine protection of honest and compliant taxpayers. As former Commissioner Rossotti testified to Congress last year:

Some individuals are using the [CDP] hearing process to delay collection action by filing requests that rise frivolous issues. . . . IRS Appeals has approximately 20,000 CDP cases in inventory. About four percent, or 800 cases, involve frivolous issue taxpayers. . . . However, the numbers alone do not account for the inordinate amount of time it takes for such cases. Frivolous claims occupy a disproportionate share of time over claims from taxpayers having substantive issues. Frivolous issue taxpayers frequently file voluminous claims. Just reading these to ensure any valid issues presented is extremely time-consuming. A larger percentage of the frivolous issue taxpayers go to court where they raise the same frivolous issues. Also, some of the individuals file Sec. 1203 actions (mandatory employee termination violations) against IRS employees, which are very time-consuming, even when they are not sustained.³⁰¹

V. CONCLUSION

An indispensable ingredient for improved American tax compliance is more resources for the IRS. Congress has imposed heavy and diverse responsibilities on the IRS, but it has failed and will continue to fail to provide the agency the budgetary support that would allow it to perform these responsibilities.

299. H.R. 5728, 107th Cong. § 307(b) (2002). The bill also would have amended the section 6702 penalty as to frivolous submissions. *Id.* at § 307(c). See Amy Hamilton, *Fiscal 2003 Budget: Bush Wants to Modify IRS Reform Act*, 94 TAX NOTES 665, 665 (2002) (discussing Bush's proposal). The proposal would have permitted the IRS to dismiss requests for CDP hearings, installment agreements, offers in compromise, and taxpayer assistance orders if they were based on frivolous arguments or were intended to impede tax administration.

300. See Robert F. Manning & David F. Windish, *A Concise Explanation of the Administration's Tax Proposal*, 98 TAX NOTES 902, 914 (2003) (discussing the "economic growth portion" of Bush's 2004 revenue proposal).

301. *Progress Report on the IRS Restructuring and Reform Act of 1998, Hearings Before the Joint Economic Committee*, 107th Cong. 2d. Sess (2002) (Statement of Charles O. Rossotti).

Thus, at least part of the needed resources will have to come from simplifications of the tax law. Piecemeal simplification is the route most likely to be feasible. This Article has suggested five simplifications to rules created or amended by RRA '98. Certainly, they would not close all of the resources gap, even were all five adopted. However, they would liberate a meaningful amount of resources, whose redeployment to taxpayer assistance, enforcement, or both would assist in improving tax administration and tax compliance in the United States.