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HATCH STATEMENT AT FINANCE COMMITTEE HEARING EXAMINING COMPLEXITY OF U.S. TAX CODE

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining the complexity of the U.S. tax code and issues involving the tax gap:

Albert Einstein once said, *the hardest thing in the world to understand is the income tax*. If there is one thing that we can agree on as Republicans and Democrats, it is that Albert Einstein was a pretty smart guy. But with the Internal Revenue Code, he apparently met his match.

And things are only getting worse. Year after year, the tax code becomes more complex. This has contributed to two separate, but related, problems. First, the complexity of the code undercuts compliance. Complying with the tax code should not be a Choose Your Own Adventure story, where the complexity of the code leaves citizens guessing their tax liability. As Chief Justice John Marshall explained, *the power to tax is the power to destroy*. The power to tax is massive and intrusive. And given our constitutional commitment to personal liberty and the right to property, citizens should be well aware of what their tax liability is.

The second issue, one related to the Code's complexity, is the tax gap. The tax gap is basically the difference between the amount of money that taxpayers legally owe, and the amount that the government actually collects. The tax gap is the great white whale of deficit reduction. If only the government was able to collect what it is owed, our deficits would be reduced significantly. For the 2001 tax year the IRS estimated the tax gap to be \$345 billion. Even after taking into account late payments and IRS collections, that amount was estimated to be \$290 billion. While the government should be able to reduce that amount significantly, it would be a mistake to put too much deficit reduction hope into that the tax gap basket. As an empirical matter, it is impossible to completely eliminate the tax gap. For example, some taxpayers legally owe a significant amount of money, but do not have the assets or income to pay off their tax debt. As the old saying goes, you can't squeeze blood out of a turnip.

Yet, the tax gap debate has philosophical implications as well. The government could close the tax gap entirely by putting IRS agents in every family's living room and in every small

business. But this is a price that a liberty loving people, and their representatives, are rightly unwilling to pay.

When it comes to compliance, I am convinced that the federal government is often its own worst enemy. As the Code becomes more complex, compliance drops, and the tax gap increases. Consider the impact of the health care law alone on the tax code. Courtesy of this law, taxpayers with Flexible Spending Accounts — accounts designed to provide user-friendly choices to patients — now need to go to their doctor to get a prescription for over the counter drugs like Prilosec.

Courtesy of this law, there is a 10 percent tax imposed if you use a tanning bed at a tanning salon, but not if you use one at your gym.

As this committee considers ways to address the tax gap, the whole ordeal over the health care law's 1099 provision provides an instructive example. In the name of reducing the tax gap, Congress and the President imposed considerable burdens on individuals and businesses, redirecting vital resources toward additional government paperwork. The burdens associated with the 1099 provision were so severe that even the provision's proponents were calling for its repeal soon after its enactment.

Outside of health care policy, we have other examples of the political and economic difficulty of addressing the tax gap. To reduce the tax gap, Congress passed a provision requiring 3 percent withholding on government contractors. But as a result of the compliance burdens that it has created, Congress has already delayed the effective date of this provision.

The matters being discussed today are ones that should inform our efforts at fundamental tax reform. As I have said before, I will be guided during that debate by the three criteria that President Reagan set out during the Tax Reform Act of 1986. President Reagan explained that tax reform should promote economic growth, fairness, and simplicity. Tax reform is a priority of this committee, and I believe that President Reagan's three criteria are equally applicable today.

The tax gap implicates President Reagan's second criteria — fairness. When some taxpayers are paying what they owe but their neighbors aren't, that is unfair to the taxpayers meeting their obligations. In effect, it increases their share of the load. Furthermore, lack of compliance undermines confidence in the tax system, in turn leading to less voluntary compliance. In short, when law abiding taxpayers think that the complexity of the code rewards creative accounting, and that some people are getting one over on the government, it will make them less likely to comply voluntarily. Since our tax system collects the vast majority of its taxes through voluntary compliance, maintaining and improving voluntary compliance is critical.

President Reagan's third criteria of tax reform — simplification — is also relevant to today's discussion. Since the Tax Reform Act of 1986 was enacted, Congress has passed over

14,000 amendments to the tax code. Fundamental portions of the tax code, such as the tax rates themselves, are set to expire at the end of 2012 unless Congress again acts to prevent a massive tax increase.

This unfortunately causes uncertainty for small business owners and others, and causes Americans to invest less and hire fewer workers than if Congress were to provide long-term assurances that their tax rates will not increase. The ever-increasing complexity of the tax code, which is only heightened by the temporary nature of many provisions, needs to be improved upon in tax reform. We need a tax system with a more streamlined set of permanent provisions that is easier to comply with and less complex.

Mr. Chairman, thank you again. I look forward to hearing the testimony of the witnesses.

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