U.S. SENATE COMMITTEE ON
Finance
SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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M E M O R A N D U M

To: Reporters and Editors
Re: 2006 Tax Return Filing Season Impact of Delayed Legislative Action on Widely-Applicable Tax Relief Provisions
Date: Wednesday, Sept. 13, 2006

Sen. Chuck Grassley, chairman of the Committee on Finance, asked his staff to explore the 2006 tax filing season impact of delaying legislative action on the extension of widely applicable tax provisions. He made the following statement on his staff's findings. A staff background memo follows.

"Three widely-applicable tax provisions expired on December 31, 2005. The provisions are deductions that have been used by millions of taxpayers, most of them middle-income taxpayers. The most widely applicable is the state and local sales tax deduction. According to IRS data, 8.6 million families and individuals claimed the state and local sales tax deduction in 2004. The second widely-applicable deduction is the college tuition and fees deduction. According to IRS data, 3.7 million families and individuals claimed this deduction in 2004. The third widely-applicable deduction is a deduction for teachers who provide their students with classroom supplies. According to IRS data, 2.66 million teachers claimed this deduction in 2004.

"These provisions are bipartisan and overwhelmingly supported in both the House and Senate. At every stage of the tax legislative process for the last two years, I have pressed for extension of these provisions. These provisions were accounted for in the relevant budget resolution and included in both reconciliation bills. Unfortunately these provisions could not be included in the reconciliation tax relief conference agreement that Congress approved in May. At that time, I received assurances that both the House and Senate leadership would support the agreement on these provisions worked out between Chairman Bill Thomas and me. As part of that agreement, these time-sensitive provisions were to be addressed in the pension conference.

"These provisions were transferred to the so-called Trifecta bill, which also dealt with permanent death tax relief and an increase in the federal minimum wage. I voted for the Trifecta legislation. At the time, I indicated my concern over the potential delay in addressing the expiring tax relief measures if the supporters of the Trifecta were not to prevail. Senator Frist entered a motion to reconsider the cloture vote on the Trifecta package. Six weeks have passed since the Trifecta was last considered, and my concern for the millions of families and individual taxpayers who regularly claim the benefits of this tax relief has grown.

"Some members and staff have suggested that these widely-applicable tax relief measures can be dealt with after the elections. If Congress does return after the elections, the date frequently mentioned is November 13, 2006.

"In testimony before the Finance Committee one week ago, IRS Commissioner Everson indicated taxpayers and the IRS would face unnecessary confusion and compliance errors if legislative action on expiring tax provisions were delayed. Upon learning of this problem, I directed Finance Committee tax staff to consult with the Internal Revenue Service about the effects of legislative delay on the upcoming filing season. The attached staff memorandum reflects those discussions.

"A delay of legislative action beyond the anticipated recess date of September 29, 2006, will cause hardship, tax compliance problems and confusion for the millions of taxpayers who claim these widely-applicable tax benefits. Because of the confusion, taxpayers could miss out on valuable benefits through no fault of theirs. I urge the House and Senate leadership, both Republican and Democrat, to take this problem seriously. Specifically, if action is contemplated on the pending Trifecta or a new version of the Trifecta, that action should take place promptly. If the Trifecta passes the Senate, then the widely-applicable provisions will be addressed and taxpayers will not be harmed. If the Trifecta doesn't pass, I urge the House and Senate leadership, both Republican and Democrat, to process the so-called trailer bill, which contains a bipartisan agreement between the tax-writing committees on the expiring provisions. The trailer bill should be processed expeditiously in this event.

"We owe this vigilance to the millions of affected taxpaying families and individuals. They are, after all, our constituents. The tax code is complicated enough. Millions of American family and individual taxpayers have a right to expect us to act carefully and not to unduly complicate their lives."

MEMORANDUM

From: Finance Committee Tax Staff
Date: September 13, 2006
Re: Extension of expiring tax provisions

Delays in enacting the "extenders" legislation will have a significant adverse impact on tax administration. Because these provisions expired at the end of 2005, the 2006 draft tax forms do not currently include them. If these provisions are extended, the forms must be revised. Because of contractual deadlines with the vendors who print these forms, the Internal Revenue Service (IRS) is running out of time to revise the final forms and still be able to deliver them in time for the next filing season. This memorandum confirms Finance Committee tax staff discussions with the IRS.

The tax deductions for tuition and fees and the above-the-line deduction for certain classroom expenses of elementary and secondary school teachers, as well as the election to deduct State and local general sales taxes, expired on December 31, 2005. Millions of taxpaying families and individuals claim these deductions. For example, for the 2004 tax year, approximately 2.66 million taxpayers claimed the deduction for certain expenses of elementary and secondary school teachers, 3.7 million taxpayers claimed the tuition and fees deduction, and 8.6 million taxpayers claimed the State and local general sales tax deduction.

To claim the tuition and fees deduction and educator expense deductions, taxpayers must file Form 1040 or Form 1040A. Taxpayers are guided by the instructions to these forms. To claim the State and local general sales tax deduction, taxpayers must file Form 1040 and Schedule A. Taxpayers are guided by instructions to Form 1040 and Schedule A.

The IRS contracts with numerous printers to ensure the delivery of the individual tax packages by the end of December so that taxpayers can file their returns in January. A large portion of returns (mostly returns claiming refunds) are received by the IRS in January. In order to ensure that tax form packages are timely mailed by December 27, 2006, the IRS must provide the contents of the tax form packages to the printing companies by November 7, 2006. The IRS needs a 2 to 3 week period to arrange and compose the tax packages. Therefore, as a practical matter, all forms and instructions contained therein should be finalized by October 15, 2006.

The tax law must be changed for these deductions to be extended. If these deductions are not extended prior to October 15, 2006, the IRS will have to rely on the law as it at that time. According to the IRS, this means the IRS will be required to prepare for printing without lines on the tax forms to claim these deductions. If the deductions are extended after the printing process is complete, the IRS will issue supplemental instructions on how to enter the deductions as write-in entries on the tax forms. These supplemental materials can result in an increased number of taxpayer errors, including failure to properly claim a deduction for which a taxpayer is eligible.

Late legislation results in systemic program changes to both manual processing and electronic processing programs. Moreover, additional training will be required. There would also be a dramatic increase in telephone assistance, possible delayed refunds, and increased amended return filings. Software developers would have to update their software programs and e-file testing by the IRS would have to be reprocessed, potentially delaying the filing season. As the tax law change gets closer to the filing season, the chance of error associated with updating these systems to accommodate changes in the law significantly increases.

This year, the IRS resources are already strained due to changes to accommodate the telephone excise tax refund and the availability of split refunds. Split refunds allow taxpayers to have their refund directly deposited into two or three of their accounts at a bank or other financial institution. Prior to the 2006 filing season, refunds could be directly deposited into only one account. Late enactment of this legislation on top of these two new programs would pose additional risk to an already potentially difficult filing season.