EXECUTIVE COMMITTEE MEETING

FRIDAY, MARCH 18, 1988

U.S. Senate

Committee on Finance

Washington, D.C.

The meeting was convened, pursuant to notice, at 9:47 a.m. in room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (Chairman) presiding.

Present: Senators Bentsen, Moynihan, Baucus, Boren, Bradley, Mitchell, Pryor, Riegle, Rockefeller, Daschle, Packwood, Danforth, Chafee, Heinz, Wallop, Durenberger, and Armstrong.

Also present: Donald Chapoton, Deputy Assistant Secretary for Tax Policy, Treasury Department; William Nelson, Esquire, Chief Counsel, Internal Revenue Service.

Also present: Bill Wilkins, Staff Director/Chief Counsel; Jim Gould, Chief Tax Counsel; Ronald A. Pearlman, Chief of Staff, Joint Committee on Taxation; Ed Milhalski, Minority Staff Director; Norman Ritcher, Tax Counsel; Janet Pollan, Tax Counsel; John Calvin, Minority Chief Counsel; and Lindy Paull, Minority Tax Counsel.

(The prepared statement of Senator Wallop appears in the appendix.)

The Chairman. This meeting will come to order. Please cease conversation and take your seats.

Our meeting this morning is to consider two very timely subjects. One of them is the taxpayers' bill of rights and the other is the collection of the Federal excise tax on diesel fuel.

I want to particularly congratulate Senator Pryor for the job he has done on the taxpayers' bill of rights. The Internal Revenue Service has a thankless job of collecting taxes, but they cannot be carrying out those duties in a way that there is often intimidation, and in some cases we have seen that. If you get into that kind of a deal then you lead a real distrust of the tax system.

During the hearings conducted by the Finance Committee over the past year we found that in some of those IRS offices you really have a bully mentality, and we have heard some real horror stories and testimony before the Committee.

This bill is not an attempt to bash the IRS, but it is an effort to protect texpayers from heavy-handed abuse and some bureaucratic incompetence. The bill has come a long way since its introduction last year. We all know that the bill, as originally introduced, had some serious problems, and those have geen recognized by Senator Pryor. The IRS Commissioner, Larry Gibbs, did a good job of educating all of us, and I must say he is really dedicated at trying to

correct some of the more gross abuse that have been taking place in the IRS. But one of the points he made was that the burden should be shifted in cases of proof in tax cases, that as it was proposed to the IRS that the burden be shifted to the IRS, that that would really not have worked. And so that has been corrected.

Over the last several weeks, Senator Pryor and his staff have been working intensively with the IRS, with the Finance and with the Joint Tax Committees, to come up with a package of further improvement. Now he is going to offer that package as an amendment today.

It appears to me that that amendment will make this taxpayers' bill of rights a responsible, sound piece of legislation that will make a major contribution. He has substantially modified the regs flex provision that the IRS told us would cripple their regulation-writing ability. He has dropped the criminal provisions that might have had a chilling effect on many legitimate IRS investigations. Yet, he kept some teeth in this bill. And the IRS is not going to like the bill. It is going to shake up the IRS a little, and the IRS will probably have to reexamine some of its procedures.

Overall, I think it is good legislation and I am happy to be supporting it.

Now the way I would like to proceed this morning is, first,

to have Senator Pryor offer his package of amendments so that we can have those amendments formally on the table. And after he does that, then I would like to call on the distinguished ranking Republican member, Senator Packwood, for comments that he may have. And then I would propose to open the floor to comments and amendments from the other members. Then after we reach a decision on the taxpayers' bill of rights, then we will take up the diesel tax issue.

Senator Pryor.

Senator Pryor. Mr. Chairman, I would like to thank you for your comments. I would like to say if I might, Mr. Chairman, at this point that putting this complex piece of legislation together over the past year, or probably 14 months now, would have been a total impossibility without the total cooperation of the staff of the Senate Finance Committee and the staff of the Joint Tax Committee. We have gone, we think, the long mile in seeking recommendations and advice, not only from the present IRS Commissioner--and we are, and have been, in an adversarial position with our good friend, Mr. Gibbs, over many of these sections for this past year--but still we have reached some language now in all of these sections that we think is responsible and reasonable.

We have sought the advice, for example, of the New York State Society of CPAs, the American Bar Association Tax Section, the American Institute of Certified Public

Accountants, the U.S. Department of Justice, the National Taxpayers' Union, the National Association of Enrolled Agents, those that practice before the IRS. We have made some sweeping change in jurisdiction of the United States Tax Court. We do have their recommendations here.

And, Mr. Chairman, once again I must say I doubt that this is a perfect bill, but it is as near as reasonable as we could draft at this particular time.

This is the second draft of the legislation that we will be considering this morning, Mr. Chairman, introduced, I believe, in the fall when it was placed in the Reconciliation bill. And this morning, with the permission of the Chairman and my colleagues, I would at this time offer a series of correcting amendments, some more than technical; some somewhat substantial. But I would at this time, Mr. Chairman, offer these amendments to be considered as we go through the legislation, section by section. I so offer those amendments as a package at this point.

The Chairman. Thank you very much.

Senator Pryor. Thank you, Mr. Chairman.

The Chairman. I would like to recognize Ron Pearlman, who is the former Assistant Secretary of the Treasury and is now the new Director of Staff of the new Joint Tax Committee. And he is a man who has had an extraordinary good career. He made a major contribution in the Treasury Department, and

I know he has come back here at a very substantial financial sacrifice. But I am just delighted to see him heading up that very important Committee which contributes a great deal to our decision making process, a very important position and it is encouraging to see that kind of man coming back into public service. Thank you.

Mr. Pearlman. Thank you, Mr. Chairman.

The Chairman. I would now like to turn to my colleague, Senator Packwood, for any comments he might have.

Senator Packwood. Mr. Chairman, I have no other opening comments other than this. I want to congratulate Senator Pryor for the work that he has done on this. And although I do not see him here, Commissioner Gibbs, who I think is an extraordinary Commissioner in terms of keeping us involved, the public involved, and we are lucky to have the two of you working together and I think we are going to get a bill that is going to satisfy everybody.

The Chairman. Senator Packwood, I certainly share those things about Larry Gibbs. I think he is doing an extraordinary job and has really communicated with this Committee very well.

Yes, Senator Bradley.

Senator Bradley. Mr. Chairman, I have had long discussions with Senator Pryor on the taxpayers' bill of rights, and I think that many of my objections he has met. We

might want to talk a little bit later about the attorneys' fees section of the bill which still concerns me. But my greater concern is how we are going to pay for this, Mr. Chairman, because I see on the agenda it is the IRS refund offset program. And as you know, that has been reserved in the minds of many to pay for welfare reform. And I am reluctant to say we are going to spend this money now for all of these other areas, and then when we come to welfare reform, we don't have the money to spend on that very important public policy area.

It seems to me that if you have to choose between diesel fuel and the underclass that you ought to choose the underclass.

The Chairman. Senator, I don't think we have to do that. And I have been concerned about the very thing you are talking about, and we will address it and I think we will address it satisfactorily. But the point being, when we get to it, using it on the offset, I only want to use it on that offset the first year and I sure do not want to extend it beyond that because I want to protect that source of revenue for the welfare bill. But we will get into the details of that with you.

Senator Bradley. So the welfare bill in your 1990 and beyond would have this source?

The Chairman. Yes.

Are there further opening comments on this by any of the members?

Senator Wallop. Mr. Chairman, I would simply like to have a statement inserted in the record as an opening statement.

The Chairman. Without objection it will be done.

Senator Wallop. I would like to say that I really am glad that you have chosen this time. April 15th is not very far away. And the taxpayers' bill of rights, plus addressing the diesel fuel problem, is important to us when one views the structure of our tax system as being, as you so ably stated, based in large measure on voluntary compliance. Voluntary compliance means trust in the system of collection.

When you have a tax such as the diesel fuel tax, whose purpose is to achieve a level of compliance that the IRS does not believe is taking place, but the means that they select is to make those who are honest pay for those who are dishonest and I do not think that is correct and I think these two things are very much in keeping one with the other.

The Chairman. Thank you very much, Senator Wallop.

If there are no further statements, will staff proceed on these amendments that have been presented?

Mr. Gould. Yes, sir.

Would you like an explanation or walk through of the bill?

The Chairman. That is correct, and with attention given to the amendments that are represented.

I understand that each of us has in front of him a description of the bill and the Pryor amendments that are being offered. But will you walk the Committee through the bill?

Mr. Gould. Norm, why don't you walk through it?

Mr. Ritcher. The first provision is one that would require the IRS to prepare a statement describing the rights and obligations to the taxpayer and the procedures for appeal refund claims and collection and distribute that statement to all taxpayers at their initial contact with the taxpayer regarding any termination or collection of a tax.

The second provision is a set of provisions involving --

The Chairman. Which document are you working off of? Do we have something before us that you are addressing or not?

Mr. Ritcher. I am summarizing the document entitled "Explanation of Proposals by the Joint Tax Committee."

The Chairman. All right. Is that this one here (indicating)?

Mr. Ritcher. And the particular provision that I just described is on page 3 at the top.

The Chairman. All right.

Senator Chafee. Mr. Chairman?

The Chairman. Yes. Senator Chafee.

Senator Chafee. As they go through this, obviously each of the provisions will sound fine. And I must say, unless you are a very experienced tax practitioner, we will not see anything necessarily good--I presume good--but not much of evil in here. And I would be curious as to what the approach of the Administration, of the IRS people, represented by Treasury--I suppose by Mr. Chapoton--is to the provisions.

The Chairman. Senator Chafee, let's do this in trying to move this morning. We have Treasury here and we have the IRS here. Let us go through the explanation, and go through it if you can in a fairly cursory manner, and then let's go back to those things that are in controversy. We will let Secretary Chapoton testify and Mr. Nelson too. They can point out those things they disagree with.

Senator Chafee. All right. Thank you.

The Chairman. All right.

Mr. Ritcher. I just described the disclosure of rights and obligations statement provisions. The next provision is a set of provisions involving procedures for taxpayer interviews. That provision requires that regulations be issued to identify what constitutes a reasonable time and place for the scheduling of an interview. It allows the taxpayer to make an audio recording of an interview. It requires the IRS employee at the beginning of any audit or

collection interview to explain that process to the taxpayer, and allow the taxpayer to suspend the interview at any time he wishes to consult with an attorney or other representative he might have. And it also prohibits the IRS from acquiring the taxpayer to accompany his representative except upon an administrative summons.

If the representative is hindering or delaying the process, the IRS can notify the taxpayer that that is so and then speak to him directly.

Senator Pryor. At that point, Mr. Chairman, if I may, it is my understanding that in this area Mr. Pearlman has a problem with regard to our amended language relative to the power of attorney litany. I pledge to you, Mr. Pearlman, that in drafting, I think we can work out that. That is a very, very slight technical problem. Thank you.

Mr. Pearlman. That is not a problem, Senator.

Senator Pryor. Norm, I hate to interrupt you.

Mr. Ritcher. The third provision, described on page 4 of the Joint Tax Committee's explanation, would require the IRS to abate any penalties imposed on any deficiency attributable to erroneous written advice furnished to the taxpayer by the IRS unless the taxpayer provided inadequate or inaccurate information. That provision was compromised to eliminate interest from the scope of the provision.

The fourth provision is one that would to do a taxpayer

assistance audit, and would authorize the taxpayer ombudsman to issue a taxpayer assistance order where the taxpayer faces unusual, unnecessary or significant loss.

The first provision, on page 5 of the document, would establish an Inspector General for the Treasury and a separate Inspector General for the IRS. The Inspector General for the IRS would have to be selected from the IRS career ranks. This provision is substantially the same as the provision that passed the Senate in February as part of the Governmental Affairs bill, S. 908.

The next provision prohibits the IRS form using records of tax enforcement results to impose production quotas or evaluate their personnel.

The next provision would require the IRS to solicit comments on contemplated tax regulations from the Small Business Administration and to give the Small Business Administration four weeks to respond before the IRS issues those regulations. This is the compromise provision from the one that would have required the IRS to comply with the Regulatory Flexibility Act with respect to their regulations.

Senator Bradley. Mr. Chairman, do you want us to raise questions as we go through or do you want to wait?

The Chairman. Oh, that would be fine. If members like to raise questions, please do so.

Senator Bradley. When does this apply, at what stage in

the regulatory process?

Mr. Ritcher. The compromise as drafted would now give the SBA a 30-days pre-publication opportunity to comment before the regulations are issued.

Senator Pryor. As to the effect on small business.

Mr. Ritcher. As to the effect on small business.

Senator Bradley. The way it was structured before, it was how, before it was changed?

Mr. Ritcher. The way it was structured before, the Regulatory Flexibility Act would have applied, which meants that the IRS would have had to publish an analysis of the impact on small business, along with their proposed rule making.

Mr. Gould. And what concerned the IRS particularly, we understand--and is what they told us--was that that analysis of the effect on small business would be reviewable by the Administration's Budget Office by the OMB. And the IRS feared that that would have the results of slowing down the regulatory process considerably or crippling it.

The Chairman. Mr. Nelson, if you have any comments, we would like to have them.

Mr. Nelson. Yes, sir. We welcome comments regarding regulations as they impact small business and any other taxpayers. Our real concern is that the process, which is, frankly, very burdensome on Treasury and the IRS right now--

not being impacted adversely--the requirement of a four-week pre-publication notice to anyone would significantly impact our ability to provide necessary guidance.

We have three kinds of guidance we are talking about: Proposed regulations which have no substantive effect when issues; therefore, there is no real reason to get pre-publication comments there.

The second kind is final regulations. Those have been proposed, and, frankly, we do not think we would be significantly impacted by giving notice of final regulations.

The principle one that concerns us is temporary regulations. We only publish temporary regulations, which are effective when published, when there is a need for guidance that taxpayers can rely on immediately and that we can rely on.

In the past couple of years, we have had to make fairly extensive use of temporary regulations. And the fact that we would have to slow down for four weeks, and then take into account comments, would, in fact, cause us some trouble. I checked today. We have published, for example, the passive loss package less than a month ago, clearly late from many taxpayers' standpoint, clearly late from our standpoint. But had we had to wait for four weeks and then take into account comments on the 242-page package, we think that the cost to

taxpayers would have outweighed the benefit.

So what we would like to try to work with the Committee to come up is a mechanism to assure that the process will not be slowed down, but that the legitimate interest of small business and any other taxpayers are taken into account affirmatively.

Senator Bradley. But what if it is supplied only to final regulations, not to the temporary problems?

Mr. Nelson. I don't think we would have any problem with that at all.

Mr. Gould. Mr. Chairman, from Senator Pryor's point of view, one problem with that is that the IRS, when they issued temporary regulations, those regulations have the full force for the temporary period of final regulations. In other words, from the point of view of the small business community, those regulations are full regulations and there is not necessarily any end to the temporary period. Some temporary regulations have been out for periods of years.

So while it is true that final regulations I think are the biggest problem from the point of view of the small business community, and those have the most serious impact, temporary regulations have a very serious impact as well on the small business community. And I think there would be some problem from their point of view in --

Senator Pryor. Mr. Chairman, if I might expand on what

Mr. Gould has just stated. The temporary regulation issue has been before this Committee on many, many occasions. We have attempted to address it in our amendment. I think the temporary regulation issue is, frankly,--I don't want to say has been abused, but it has certainly been overused by the IRS for a long period of time.

Let me just, if I might, show my colleagues a book. These are the temporary regulations (indicating). They go back to January of 1963 when Harry F. Byrd, Sr. was the Chairman of the Senate Committee on Finance.

Senator Packwood. The moderate Senator Byrd?

Senator Pryor. Yes. It was not Harry, Jr. that we knew. It was Harry, Sr. And they go back to 1963. These are all temporary regulations.

The Chairman. You mean they are still classified as temporary?

Senator Pryor. Still published in the temporary proposed regulations.

The Chairman. I thought Harry Byrd, Sr. and Jr. were quite permanent, but these are even more.

(Laughter)

Senator Pryor. Well, I do think it just demonstrates how we have sort of overabused this big section of temporary regulations. We are trying to narrow that gap. We are trying to force the IRS to very efficiently issue those regulations

in a timely manner.

Mr. Nelson. Senator Pryor?

Senator Pryor. Yes.

Mr. Nelson. We are trying hard to get those regulations out. I hear what you are saying. I spent 15 years in private practice. I saw "temporary" stretched out a long time. But I can assure you that if you went back and checked through what we have done in the past 18 months/two years, you would find that in most cases the need to get the regulation out, at least in my judgment, outweighed the need to slow the process down. That has been particularly true in the past several months.

I think we published 15 or 16 regulations since the 1st of January.

You may criticize us for not being responsive enough, but the need is there and the impact is significant. It is not just four weeks. If the regulation is complicated, which is where we need to comments, it is a four-week delay to get the comments, and then we have got to take the comments into account if we are going to be responsible and responsive to the intent of the legislation. We are talking about four to six to eight weeks to 10 weeks.

Secretary Chapoton. Mr. Chairman, I would like to echo what Mr. Nelson said. The regulation projects are a joint effort between IRS and Treasury. IRS does the initial

drafting after consultation with Treasury. After the initial drafting takes place, the regulations are sent over to Treasury. There is further joint studies done of the regulation projects, tough issues. Will and I get together and we work on them. This has been a major concern and a major problem under the 1986 Act. It is to get guidance out at the earliest possible date. And we have worked hard; our staffs have worked hard.

We issue temporary regulations only when we think guidance needs to be in some form that the taxpayers or the IRS can rely upon.

Now we clearly recognize the concern that Senator Pryor is raising and we do worry about it. We certainly try not to abuse the notion of temporary regulation because they do have the force and effect of law. But at the same time, there are many cases where temporary regulations are needed, from the Government's standpoint or from the taxpayers' standpoint.

Further delay in that regard would be very worrisome to us. Comments can come in--they would come in in these difficult areas--and further delay would simply be a great concern to us.

Senator Bradley. Mr. Chairman?

The Chairman. Yes.

Senator Bradley. How many of these regulations go back to 1961?

Mr. Nelson. Senator, I cannot answer that question right now. I hope not many.

Secretary Chapoton. I would say that that is embarrassing, to say that there are temporary regulations that are still out there in temporary form. And perhaps we should be under some constraint that there should be some such limit that temporary regulations should not be in temporary form.

The concept with temporary regulations is not to put them out there and leave them out there, that we do not do anyting. The concept is to put them out there so that people can rely on them and then finalize them. They are in proposed form. We invite comments; we have hearings. And I think something should be done as soon as possible. It is totally inconsistent with that system that they would be staying out there in that form that lon.

Senator Bradley. So what you would say is that this applied to temporary regulations, that you could have taxpayers out there who need to have information from the IRS. Without the information, they will not be able to advise their client or they will not be able to make their tax returns properly.

Secretary Chapoton. Proposed regulations, just to give you an example, do not constitute substantial authority under the Substantial Understatement penalty that we

discussed this past Monday. So that means that when a taxpayer is taking a position, if all he has got to rely upon is preposed regulations, he cannot use that regulation to support his position and, thereby, be sure that he would avoid the Substantial Understatement penalty. He needs some form of authority and the proposed regulations would not give that.

Senator Bradley. But temporary regulations would give that.

Secretary Chapoton. Temporary regulations would give that.

Senator Bradley. My concern is that if people are out there and they want to get information, and they cannot get to the information, and that ultimately has a political reaction. I mean, they come to us. They complain to us. That is the purpose of the taxpayers' bill of rights, to try to redress some of those grievances.

But now if they go, and they are delayed, they cannot get an answer to their question, the answer the IRS gives them, well, that's the taxpayers' bill of rights. It is the law that Congress passed that prevents us from giving you the information to fill out your return properly. That is a concern that I have about it applying to temporary regulations.

The Chairman. Senator, I can understand that. But what

worries me is when I hear--and I am sure that is the extreme case, the 1961--but four weeks as compared to 27 years does not seem to be too big a price to pay--and I am using the extreme, of course--to try to get input on these things.

Senator Pryor. Mr. Chairman, I may have a way out of this thicket and may be able to suggest a method of answering Senator Bradley's concerns. We do not intend nor desire in this legislation to slow down the process. We want to make it more efficient and more timely.

I might suggest, Mr. Chairman, that we might look at some language--a very minor change--in addressing what we might call emergency regulations, and giving the Small Business Administration the delegating authority to SBA to waive their rights to look at some of these regulations if it is ascertained that they do not in any way have an impact on small business.

And our study indicates that 95 percent of the IRS regulations that they issue have no effect on small business.

So what we may be doing is just forcing SBA to concentrate only on those that have a true impact on small business and classify those as emergency regulations and speed up the process. I offer that as a suggestion.

Mr. Nelson. Senator, if I may respond. There are several projects that I can think of just off the top of my head that would clearly impact small business. The Passive

Loss regulations being one of very significant impact on all business, and one that, frankly, we spent an enormous amount of time trying to mitigate the impact on small business before we published them.

That is a project of massive impact that would be significantly delayed and delayed past the filing season. And that troubles us significantly.

Regulations on fiscal years, both under the 1986 Act and the 1987 Act. The community is desparate for guidance that they can rely on on whether or not they have to in fact change their fiscal year to a calendar, and if so, what the cost is.

Now we have been burning the midnight oil literally for a while trying to work those problems out. That affects small business. If we have to delay that, we are not only delaying reliable guidance for taxpayers, it is also money.

We would like to work with you, and we have been working with you. I mean, we could not have asked for a better hearing. But to assure the small business community and this Committee that if this bill is passed, that the interests of small business are taken into account, but in a manner that is does not cost small business more than it benefits small business, and in business in general; taxpayers in general.

I don't really have a suggested alternative at this

point other than to say that post-publication notice and comment requirements would assure that the small business advocate comments on regulations and do it quickly.

As to the point about long, outstanding temporary regulations, I frankly did not know we had any out that has been out since 1963. And I and Mr. Chapoton would be happy to work with you to come up with some mechanism to clean those off the books and to be sure that that process is not abused.

Senator Chafee. Mr. Chairman?

The Chairman. Senator Chafee.

Senator Chafee. Mr. Chairman, I am troubled by the proposal here because it seems to me what taxpayers want is certitude and as fast as possible so they can go about their business. And that applies to small business or any business. And it seems to me we want to think of that here. And it seems to me that it is not accurate for us, as I understand the discussion here, it would not be accurate for us to characterize that there is a four-week delay under this, there is a four-week delay to receive the comments, and then they must go through evaluating the comments. And I presume it could delay the process a good deal beyond the four weeks.

And so I have a tilt toward permitting them to keep the temporary regulations under the present law, but with a

deadline set on how long the temporary regulations will be in duration. It really is scandalous if temporary regulations have been out for 27 years. There must be an acceptable time period you could agree at that after X months, or whatever it is, a temporary regulation must be replaced by a permanent regulation. But I do see the problem that the Treasury is wrestling with here of trying to let people know as soon as possible on these very matters that have come up that we have all dealt with in those 1986 revisions.

Senator Dashcle. Mr. Chairman?

The Chairman. Senator Daschle.

Senator Daschle. Mr. Chairman, my point was going to be similar to Senator Chafee's. If we are going to clarify or define this further, I think we certainly have to address the term "temporary." There is nothing temporary about 27 years. A mandated sunset, some reevaluation after a certain period of time certainly seems more in making temporary regulations mandatorily permanent at some point seems to me to be something we should address, whether it is now or later. But temporary regulations for 27 years not only surprises the IRS but certainly surprised me.

The Chairman. Senator Pryor, do you have any further comments?

Senator Pryor. I think Mr. Gould has possibly a thought

that we might consider, Mr. Chairman.

The Chairman. All right.

Mr. Gould. We have just been discussing this with the staff, Mr. Chairman, and along the lines of exactly what Senator Chafee and Senator Daschle were proposing, you might consider a proposal that would retain Senator Pryor's provision for final regulations, but for temporary regulations, require that at the same time temporary regulations are published, to require the IRS also to issue proposed regulations which would at that time start an SBA comment period with the proposed regulations. And then at the same time you impose a deadline on, or an expiration date, on the temporary regulations of, for example, one year, so that the SBA would comment on the proposed regulations, then the temporary regulations would expire.

Mr. Nelson. We could put on two shifts. We could handle the one year. I think we can work toward that direction. Almost all temporary regulations are published "proposed". And they have the APA comment period and we do try to take them final. And I would think that although we did not come prepared to discuss this today, I think a reasonable sunset on temporary regulations is certainly not bad tax policy.

Secretary Chapoton. Mr. Chairman, I might also comment.

The Chairman. Secretary Chapoton.

Secretary Chapoton. I agree that it is embarrassing to

have temporary regulations out for 27 years. That probably indicates they are simply not controversial, because where regulations are controversial in temporary and proposed form, we hear about them and there is considerable pressure to act in a reasonable period of time. And I feel that we do the best we can in that regard. But I agree with Will that some way to put a time limit on that, and make sure they are in proposed and temporary form initially so that we got comments right away from whomever.

The Chairman. That sounds like a pretty good compromise being worked out to address the concern of small business and still give you some extra time there.

Mr. Nelson. What we might suggest, if we can, is that the time -- assuming that we are moving at deliberate speed to go to final regulations, we need to think about exactly how long it is appropriate, whether it is one year, or 18 months, or, you know, six months, or whatever. We have not really thought about this, Mr. Chairman, so it is a little bit hard to say how much time we really think is appropriate and how much time you think is appropriate.

The Chairman. All right, Mr. Nelson. That is fine. And I think we have developed the subject and shown the problem and some possible compromises that can achieve what Senator Pryor is talking about to address the terms of the IRS.

Senator Pryor. Thank you, Mr. Chairman.

Mr. Gould. Good. We probably should nail time that time period, at least for purposes of the bill today.

Senator Bradley. What is the IRS's advice? You have got to meet the deadline.

Mr. Nelson. Yes. May we caucus here for a second?

The Chairman. No. We will move ahead here. And we may handle this with a floor amendment and do it that way, but let's move ahead now. Mr. Ritcher.

Mr. Ritcher. Starting again on page 7, the provisions entitled "Explanation of IRS's Assessments." These are a pair of provisions that would require the IRS to give more complete explanation of the bases for taxes due, and deficiency notices and the assessment of penalties.

Senator Pryor. Mr. Chairman, let me just, if I might.

The Chairman. Yes.

Senator Pryor. We held a hearing in the Oversight Committee on this Monday past where we had IRS, Treasury, and other groups before our Subcommittee. We now have 152 penalties that the IRS can impose upon the taxpayer. The taxpayer has no penalties that he or she can impose upon the IRS.

Now part of this is our fault, the Congress' fault. We have got to take the blame for some of it. Part of it is the IRS, and the courts, and whatever. But this area simply means that the IRS from here on out is going to have to

establish a basis for assessing penalties, explain that penalty to the taxpayer. We had the two-cent tax deficients the other day with a $400.00 penalty, and so forth. We can find many of those examples. We think this section is very much --

The Chairman. You had a what?

Senator Pryor. We had a two-penny deficiency of a taxpayer. They had paid 22,000 and some on taxes and they had underpaid by two cents. The IRS assessed a penalty of $400.29 upon the taxpayer.

The other case was a little--if I might use this--a little grandmother from Montana, Senator Baucus' home state, a widowed grandmother, who wrote the IRS a little note on her income tax return that evidently the IRS did not like. They fined the little lady $500.00 penalty. Now we think this is arbitrary, we think it is capricious, and we think the taxpayer at least should be told why these penalties are being assessed.

The other thing we are finding out, Mr. Chairman, you would not believe the number of taxpayers when they are assessed an abusive penalty, pay the penalty. They pay it. They don't want to fight the IRS. They don't want to see red flags in the computer for the next eight years. And they pay it. They give up and say, what can I do about it? We think this is abusive, and this is a first look at the

reevaluation of our penalty system in the taxpayers' bill of rights.

Senator Armstrong. Mr. Chairman, would the Senator yield for questions?

Senator Pryor. I would be happy to. Excuse me. I did not mean to take all that time.

Senator Armstrong. A related complaint that comes to my attention is that so often when the notices go out, almost always they are unsigned. There is not any name of a person.

Senator Pryor. An excellent point.

Senator Armstrong. Does your proposal address that issue?

Senator Pryor. Senator Armstrong, it does not. And I wish I had thought of that. Why didn't you tell me about that a few months ago? I would have had that in here.

Senator Armstrong. Would you just add that in at the appropriate time?

Senator Pryor. Can we look at this? You mean, in other words, to have when the taxpayer receives a notification --

Senator Armstrong. The name of the person --

Senator Pryor. -- the agent or the individual who has assessed the penalty?

Senator Armstrong. Exactly.

Senator Pryor. What would IRS think about that?

(Laughter)

Mr. Nelson. My name is on all answers in pleadings in court.

Senator Pryor. But you have an unlisted telephone number though.

Mr. Nelson. Not true, not true.

The vast majority of notices are computer-generated. They are generated by computers, they are mailed by computers, and the notice tells the taxpayer how to contact the Service. But there is not a specific individual who specifically writes one of these things. So it would take some organizational effort to try to identify specific individuals by name that they could respond to.

Senator Armstrong. Mr. Chairman, that is exactly the heart of the problem. The reason why, as Senator Pryor points out, that people pay these penalties, and in fact conform in many, many ways to IRS practices, which are not by any reasonable definition fair, is because it is just too hard to fight the system. And I am not even talking about an unsophisticated taxpayer. I am talking about lots of taxpayers.

As a taxpayer myself, I have been advised on more occasions than once by my legal counsel that it is cheaper to pay it than it is to fight it even if we are right. It seems only reasonable to me that there ought to be on a

document of this character the name of the person who made the decision. I am even tempted to say his telephone number ought to be on there. But at least it ought to be more than just the information number of some public affairs officer. There ought to be some person to whom a taxpayer or his legal counsel or CPA can go to discuss the matter. The way it is now, you have got to first crack all that through, and even for 500 or a thousand dollars, you cannot start to hire a lawyer to do that if it has any complexity at all.

Senator Riegle. Would the Senator yield at that point?

Senator Armstrong. Yes, sir.

Senator Riegle. It seems to me there would be another value in that as well, and that is if we find out that there is a pattern of bad judgment or abusive conduct, you have a way of finding out where it is coming from. And those kind of people ought not to be in the Federal service. So it is not just a question of calling back, it is a question of finding out who the people are with those attitudes because, frankly, I do not want them working for the Government.

Senator Pryor. Senator Armstrong, I received a letter--if I might, Mr. Chairman--a few weeks back. I think I have got about 11,000. I have lost 10. I don't even have the staff to answer all of them. But this letter said, "Dear Senator Pryor: Please put me in contact with a human being in the Internal Revenue Service." And I think that is what

you are talking about. They feel that the human contact has been lost.

Mr. Chairman, I don't address this issue of identification in my legislation.

The Chairman. Why don't we do this. Why don't we see if we can work this one out and maybe have it as a Committee amendment unless we run into something that is just insurmountable that we do not understand.

Senator Armstrong. I would appreciate that, Mr. Chairman, if you just get that in.

The Chairman. All right.

Mr. Nelson. Mr. Chairman, may I comment?

The Chairman. Yes, Mr. Nelson.

Mr. Nelson. We agree, Senator Armstrong, and are working as hard as we can to try to humanize that part of the Service. The fact is that the vast majority of notices are machine-generated. They are generated in bulk. It is a cost benefit issue for this Congress.

We would be pleased to get together with you and discuss with you the things we are doing to try to find humans for people to talk to when they need to.

The Chairman. Mr. Nelson, I am going to move this along. And what I have stated is that we will discuss this with you, and if we find it is an insurmountable problem --

Mr. Nelson. All right, sir. I am sorry, sir. We will

try to work this out for a floor amendment, a possible floor amendment.

The Chairman. Sure. That is what I stated.

Mr. Nelson. All right.

The Chairman. Yes.

Mr. Nelson. All right.

Mr. Ritcher. At the bottom of page 7 is described a provision concerning installment payments of tax liability. This provision would authorize the IRS, give statutory authorization to the IRS to enter into installment agreements with taxpayers, and would identify the specific instances under which the IRS could modify or annul such an agreement. Instances such as the failure to keep current on his current liabilities, or a finding that the collection of the tax is somehow in jeopardy.

The provision following that one on page 8 is a set of provisions dealing with the levy process. The first one of those provisions would extend the period of time between the notice of intent to levy and the actual levy to 30 days from 10 days before the IRS may go ahead and levy on the taxpayer's property.

The Chairman. Well, let me make it clear, Mr. Secretary, and Mr. Nelson, that at any point we state a section that deeply concerns you, that you differ with us, tell us why and interrupt at that point.

Secretary Chapoton. Yes, sir. Thank you, sir.

Mr. Nelson. Yes, sir.

The Chairman. All right.

Mr. Ritcher. In addition, the provision would require the release of a levy on wages and salaries under certain specified circumstances, such as the payment of the liability. It would also index the current law on amounts that exempt certain possessions of the taxpayer from levy. It would index those amounts to the end of 1990.

In addition, it would increase the amount of exempted weekly income by about 50 percent. It would also exempt the taxpayer's principal residence and essential business property from a levy unless the Assistant District Director or his superior personally approves that seizure.

In addition, it would prohibit levies where they are uneconomical. That is, where the estimate of the expenses of the levy in sale would exceed the fair market value of the property.

It would also prohibit the IRS from demanding the surrender of a bank account until a 21-day period has passed after the notice of levy. In that period of time, the taxpayer would have an opportunity to persuade the IRS that it was a mistake, if it was.

Senator Chafee. Mr. Chairman?

The Chairman. Yes, Senator Chafee.

Senator Chafee. Mr. Chairman, did you say something about indexing here? Where is that? You said something about indexing to 1990.

Mr. Ritcher. That is right. There is a current law certain --

Senator Chafee. Is that on the document?

Mr. Ritcher. It is not on the document. That actually is the compromise provision. In the document, the provision is to increase the levy amounts to $10,000.

Senator Chafee. Well, Mr. Chairman, I don't like indexing. I just think it is bad business. I think we should review these things on occasion and I am just opposed to indexing.

Senator Pryor. Mr. Chairman, I think I can explain this provision and hopefully to Senator Chafee's satisfaction.

The Chairman. Senator Pryor.

Senator Pryor. First, there is a very major change in the levy process. Now, we have what is called--and, please, IRS, correct me if I am wrong--we have what is called the 10-day letter. Once the taxpayer received the 10-day letter and does not respond, or does not settle that deficiency, IRS can levy, seize, collect, whatever.

I am changing that in our proposal to 30 days. There will be now a 30-day letter instead of a 10-day. And I know your concern, and I am getting to it, but they are close

related.

We think during this extra 20 days, Senator Chafee, there will be an implied interest in negotiating a settlement between the taxpayer and the IRS. We are going to grant another 20 days.

I know that you are concerned about the index. My original taxpayers' bill of rights exempted changing from the present law exempt from levy, where it is $1,000 at this point, I put it up to $10,000. I said IRS cannot get anything below $10,000. Well, that was not working, and we had some troubles with all of the people who made recommendation that we go back to the present law, $1,000, however, index that $1,000 each three years based on inflation.

Am I correct? And then each three years that would sunset? Am I correct, Mr. Gould?

Mr. Gould. The proposal is to index the amounts yearly, but the indexing procedure would stop after 1990.

Senator Pryor. And then we would have to reinstitute the indexing procedure.

Mr. Gould. Right. That is correct.

Senator Chafee. So it only runs to 1990.

Mr. Gould. Right.

Senator Pryor. Right.

Mr. Gould. In our staff discussions on that provision,

Senator Chafee, the sunset was included explicitly for the purpose of preventing that indexing from potentially getting out of hand. It was a substitute for immediate variable large increases in those exemption amounts that were in Senator Pryor's original bill.

Senator Pryor. I might also state that this area, 4743, was considered by Treasury, as I understand, the larges area of "revenue loss." I never did think that those revenue loss estimates were correct, but, anyway, you did. So we are trying to work out those concerns here. Thank you.

Senator Chafee. Well, I don't like indexing, but I suppose I will be a little bit pregnant. And thank you, Mr. Chairman.

The Chairman. All right. Thank you.

Mr. Ritcher. The next provision at the bottom of page 9 would provide for administrative and Tax Court review of jeopardy assessments and levies. The provision in the middle of page 10 would require the IRS to establish an administrative procedure for the appeal of a filing of a notice of lien, and also, under the compromise, would require the IRS to file with the release of a lien a statement in the public record explaining why the lien was released.

Then there is a series, beginning at the bottom of page 10, of provisions that would expand the Tax Court jurisdiction to save the taxpayer from having to, if he has

a case in the Tax Court, from having to go to another forum to handle some related aspect of that case. Those provisions go up to page 12.

There is also a provision at the bottom of page 12 that would expand the Tax Court's jurisdiction to cover refunds, claims for refunds. Currently, the Tax Court's jurisdiction extends only to deficiencies.

Then on page 13 is a provision that would expand the current law provision that allows the recovery by the taxpayer of costs and fees that they incur when the IRS takes a position that is not substantially justified. The specific expansions would be to allow the recovery of costs incurred at the administrative level, dating from the time of the first communication that the taxpayer receives from the IRS that allows the taxpayer to go to the IRS appeals office.

It would also shift the burden of proof as to the reasonableness of the position to the IRS.

Senator Armstrong. Mr. Chairman, could we have a little discussion on that point?

The Chairman. Yes, of course.

Senator Armstrong. This is the heart of the proposal. The rest of the things that are in this bill are worthy, but this is the guts of it.

I am not sure--and I would be grateful for legal

counsel on this issue--whether we have gone far enough in shifting the burden of proof. In, in order to avoid paying the attorney costs of the taxpayer, all the Government has to show is that they had some basis, some--what is the magic word here--substantial justification for their position. As a practical matter, we have not done anything.

Of course, there will always be some justification. They may be tortured, they may lose, they might lose 100 cases in a row, but still, if they have a plausible reason--and I am just now trying to speak of the taxpayer, and there are enough lawyers in the room that they can clean this up a little--but I am not sure we have sold the problem. Have we, Senator Pryor?

Senator Pryor. Senator Armstrong, if I may respond, I have probably spent more time in this one issue of the burden of proof than all of the other parts of this legislation, put together.

At first, I shifted the burden of proof totally to the IRS, from the taxpayer to the IRS. Frankly, I am going to admit--and I am going to argue a little bit here for the IRS--if a taxpayer fails to produce the evidence and the records and the receipts that only the taxpayer has, it is going to be impossible to collect any taxes in this country. The IRS has a very strong point at this stage of the proceeding, that is, it is the burden of proof on the

taxpayer to produce those records to justify a deduction exemption for items on their tax return.

So then we started looking at what stage of the proceeding would the burden of proof begin to shift. And, frankly, we looked at every stage of the proceeding, and the most workable and the most fairest area was to shift the burden of proof in this area to the IRS from the taxpayer, making the IRS prove that there was substantial justification for hauling the taxpayer into court and assessing him with deficiencies, et cetera.

And the final reason I might say for that change, Mr. Chairman, we are finding more and more cases where the taxpayer has just not had an opportunity to recover attorney's fees. And we think it is time for the burden to shift. We think this is the place for the burden to shift in the process in that relationship to the taxpayer and the tax collector, and this is where we did it.

Senator Armstrong. I don't think you got the burden shifted. Let me just go back over what you said.

You described a situation in which, in the first instance, you were concerned that the IRS would not be able to collect the taxes if some taxpayer did not come forward with their proof of a deduction, the restaurant receipts or whatever it might be, the invoices for services rendered and so on.

It is pretty hard for me to imagine some taxpayer letting a matter get to court--to the Tax Court, and hiring attorneys and stuff--in order to prove a case when all they really had to do is just cough up the documentation. Now there might be such a case, but what possible motive would a taxpayer have to do that?

So I would judge that the circumstances you described in the first instance would be quite a rare occurrence.

The Chairman. That is a rather major issue and I would like to hear from the Administration.

Senator Armstrong. Mr. Chairman, could I complete the point I am making?

The Chairman. Oh. I thought you were through. Go right ahead.

Senator Armstrong. I am not quite done.

The Chairman. All right.

Senator Armstrong. I think the first point that Senator Pryor made really is not a very likely occurrence. The larger question is where you have a dispute over legal issues. And it is a very common thing where in different circuits you will have different rulings. And so the IRS would be perfectly justified in a circuit where there had not been a decision to say they had a substantial justification for taking a position, even though there might be two or three other circuits where an issue had been decided on the other

side. So that the taxpayer also would have substantial justification.

It seems to me that if the IRS dragged some taxpayer through a knothole and then ultimately cannot prove its case, that the taxpayer is entitled to get his attorney's fees back. It is not a question of proving that the IRS maleficence, it is a question of justice to the taxpayer. And it seems to me that once the IRS loses the case, that proves not that they acted improper, not that there was maleficience, not that they ought to be criticized, only that the poor taxpayer ought to get his attorney's fees back.

And so I think we need to do some more work on this, Mr. Chairman.

The Chairman. I would like to hear from the Administration on this.

Mr.Nelson. Yes, sir.

First, Senator, it is in fact quite common for taxpayers to ignore notices and not bring forward their documentary evidence until they have received a statutory notice of deficiency. It is unfortunate that that is true, and I have often wondered about the psychology of it, but it is very, very common for this to happen.

Senator Armstrong. Well, sir, we are not talking about that. We are talking about only after it has gone to Federal court.

Mr. Nelson. No, sir.

Senator Armstrong. You are talking in a deficiency proceeding.

Mr. Nelson. No, sir.

This particular bill as it is drafted causes the fees to commence to accrue at such time as the taxpayer is eligible to discuss his case with the appeals office of the Internal Revenue Service.

Senator Armstrong. Well, now wait just a minute here. Let's look at the document called "Explanation of Proposals," page 13. It refers to a taxpayer who prevails in a tax case in any Federal court. In the case you have described, why in the world would the IRS take a taxpayer to court?

Mr. Nelson. That is the present law description, Senator.

Senator Armstrong. I am looking at the bottom of the page where it says, "Description of Proposal. The Taxpayer who prevails in a Federal tax proceeding." You are saying that covers more than a court case?

Mr. Nelson. I think it goes back earlier, Senator Armstrong.

Secretary Chapoton. Yes.

Senator Armstrong. Then let's carve that out. If that is the abuse you are concerned about, we can accommodate that easy. That I still think would be a rare case and involves,

relatively speaking, small dollars. Where the real abuse arises is where you have to look right down the gun barrel of whether or not to hire attorneys to take it through Tax Court or the Federal District Court. And it seems to me that if the taxpayer prevails, he or she ought to get back his attorney's fees.

Mr. Nelson. It is essentially present law that if the taxpayer substantially prevails and we did not have substantial justification, we pay fees.

I think what you are saying, Senator, is that if the taxpayer substantially prevails, he gets paid without regard to substantial justification.

Senator Armstrong. That is exactly what I am saying. And let me just, for the benefit of anybody who did not follow that the first time around, make the point again.

It is perfectly possible for the Service to have substantial justification and for the taxpayer to also have substantial justification, each have a good legal theory, but my point is that if the taxpayer wins and proves his point, he should not have to bear the burden of paying attorney's fees which are often very heavy. In other words, there ought to be some incentive for the Service to be restrained in its enforcement, particularly when you have got a case as I have just described of conflicting opinions in different jurisdictions.

My principle is--and let me just sum it up and let others comment--my principle is if the thing goes to court, and the taxpayer wins, then the taxpayer ought to be reimbursed for attorney's fees.

Senator Danforth. Mr. Chairman?

Senator Moynihan. Senator Danforth.

Senator Danforth. I think that is an interesting point. I wonder if that concept were to apply, should it have more general application? And then let's suppose that anyone were sued by any government, if the defendant prevails in the lawsuit, should he recover attorney's fees? Say somebody were prosecuted for a crime, and the person were acquitted, or even if there was a mistrial, should that person receive attorney's fees? And should it also apply generally to similar cases?

If Mr. Smith sues Mr. Jones, and Mr. Jones prevails, should Mr. Jones recover attorney's fees?

Maybe the answer to that question is yes. I mean, I think all of us have been concerned about the explosion of the litigation in this country. Maybe the answer to that question should be yes.

If it should be yes, generally, then I am not sure about the wisdom of carving out one particular instance where it applies in the case of the Internal Revenue Service.

Senator Armstrong. Well, let me tell you why that is

exactly what we ought to do, at least in my opinion. Even if you don't believe this principle deserves general application--and I am inclined to believe that it does deserve that kind of application--the IRS is by its very nature so ominous, such a threat to most taxpayers, and in fact has such a long history of litigating matters which are really almost impossible for the average taxpayer to defend, that if we are going to start applying this principle anywhere this would be the place to start.

Let me also make the point that the response we have had, that the present law permits taxpayers to recover attorney's fees where the IRS has shown not to have a substantial justification--and that that is similar to what is in the bill now--would cause somebody to ask, well how often do attorney's fees ever get awarded back to the taxpayer? My impression is that that is a pretty rare occurrence.

Mr. Nelson. Yes, sir.

Senator Armstrong. How rare is it? Twenty percent of the time?

Mr. Nelson. No, no, no.

Senator Armstrong. Ten percent?

Mr. Nelson. Less than that.

Senator Armstrong. Five percent?

Mr. Nelson. Less than one percent.

Senator Armstrong. Less than one percent?

Senator Pryor. I think it is less than 100 percent.

Senator Armstrong. In a hundred cases last year?

Mr. Nelson. Pardon.

Senator Armstrong. Less than 100 times last year?

Mr. Nelson. Yes. I would guess it is less than 100.

Senator Armstrong. Senator Pryor, that is why I don't think we have solved the problem.

Senator Danforth. Well, let me ask you a question if I might. I guess the question is, what is the language now, that it has to be good faith?

Mr Nelson. Substantial justification. A taxpayer has to substantially prevail, and we have to have not had the substantial justification for the provision, which is consistent with the Equal Access to Justice Act, which is the statute that applies to the Federal Government in general.

This, gentlemen, is a question of how much. This is money. It is purely and simply how much of the cost of tax administration the Federal Government is willing to bear. It is a policy question.

Senator Danforth. Mr. Nelson, what effect would that have on the practices of the IRS with respect to the most cases that are litigated, they are pretty close questions of law, arent' they, or a fact?

Mr. Nelson. Our success rate in litigation is quite high.

Senator Danforth. Aren't many of these cases pretty close cases? The kind of case that goes to court is, generally speaking, on matters on which people of good faith could disagree.

Mr. Nelson. We think that -- well, it's hard to say. They are close. We tend to win a lot more than we lose.

Let me say that of the cases that come out of examination in dispute, whether they go straight to litigation or go through appeals, the Appeals Division disposes of well over 90 percent of them without litigation. So we do resolve the vast majority of the examination cases without having to litigate.

Of the ones that are litigated, or go to court, a substantial portion of those do settle. So that the actual trials are in the hundreds in a year. But we will dispose of 50,000 cases this year.

Senator Danforth. Are there cases in which --

Mr. Nelson. That's docketed cases. Excuse me.

Senator Danforth. Are there cases in which taxpayers take frivolous positions in order to, in effect, delay the day of coughing up their taxes?

Mr. Nelson. Yes, sir.

Senator Danforth. Is that frequent?

Mr. Nelson. It is not infrequent.

Senator Armstrong. But they have to pay interest, Jack,

if they finally have the tax levied against them. They don't only pay the tax, but they pay interest and they may pay substantial penalties.

Senator Danforth. But should they pay attorney's fees?

Senator Armstrong. Maybe so.

Mr. Nelson. At present, there is a frivolous litigation penalty.

Senator Danforth. There is a what?

Mr. Nelson. At present, there is a frivolous litigation penalty of up to $5,000. That is imposed very seldom. The Court tends to just --

Senator Armstrong. There are a number of other kinds of penalties which amount to the same thing, however.

Senator Danforth. What is the cost to the Government of litigating a frivolous case?

Mr. Nelson. Gee, I would have to --

Senator Danforth. The per day cost is pretty significant.

Mr. Nelson. Well, it is pretty significant. The average cost of a lawyer --

Senator Danforth. Higher than $5,000.

Mr. Nelson. Oh, yes. No question about it.

Senator Pryor. Mr. Chairman?

The Chairman. Senator Pryor.

Senator Pryor. I am wondering if our staff might just

very briefly explain in a nutshell what we have done here in this. Would that be permissible, Mr. Chairman?

The Chairman. Yes, of course.

Senator Pryor. Thank you.

Mr. Gould. I would be happy to, Senator Pryor.

The Chairman. Senator Danforth, I did not mean to cut you off. All right. Go ahead.

Mr. Gould. First, let me clarify that Senator Pryor's proposal in his bill does not address the proposal at all, I mean, the issue at all that Senator Armstrong was dealing with, which is can a taxpayer recover attorney's fees in any case that he wins in the courts. It does not deal with that. It does not change the so-called substantial authority standard.

In other words, if the IRS in any phase in the proceeding has plausible grounds--good grounds by that term--for their position, then in no circumstances will the taxpayer be allowed to recover attorney's fees. In other words, Senator Pryor's concern expressed in his provision was the case where the IRS comes in without good grounds, either in the audit stage or in the court. And what his provision does is essentially two things. One, it broadens the scope of the forum, or the circumstances in which attorney's fees can be recovered back into the administrative stages of the IRS. Essentially, the provision provides that

when the IRS notifies the taxpayer that there is a deficiency, and the taxpayer then has the right to go to the Appeals Office in the IRS. But if at that stage--that is, at the time that notification was issued--the IRS did not have the good grounds for their position, that the meter on the attorney's fees can start running.

In addition, Senator Pryor's proposal shifts the burden of proof to the Government to show that the good grounds--the substantial authority--was -- or substantial justification standard was met. However, the IRS had expressed concern that that shift of the burden of proof would be too tough a standard for the IRS and would lead to bad results. Where the IRS issued a computer notice, for example, and the taxpayer was not at least required to come in and show that he had produced the documents and the basic supporting evidence in favor of his position.

So Senator Pryor's proposal does provide that the taxpayer has to show that he has come in and made a good-faith effort to argue his case and to produce the documents. However, in general, the burden of proof to show the substantial justification has shifted to the Government, which means essentially the Government would have to make a showing on the law, and would have to -- presumably that standard could have a practical effect on a judge's mind. In tied cases or in close cases, a judge might award

attorney's fees in cases where they currently would not.

Senator Pryor. Thank you, Mr. Nelson.

Senator Armstrong. Mr. Chairman, I don't know how you want to resolve it.

The Chairman. Well if you want an amendment, Senator, why don't you propose an amendment.

Senator Armstrong. I think I want to seek Senator Pryor's advice on this, because I believe his intent and purpose are identical to my own.

The thing to keep in mind is that in many of these instances there is substantial justification on both sides. What happens as a practical matter is that taxpayers will not even litigate these cases if they do not have some opportunity, some belief that if they win they can get their attorney's fees back. And as a consequence, abusive ought to believe in illegal regulations may go unchallenged.

That might seem a farfetched thought, but in this room a couple of years ago we heard two days of testimony from a man who spent $6 million defending himself against some actions of the IRS; was ultimately vindicated, and, in fact, even though he was vindicated, others had pled guilty to similar kinds of charges, and a couple of them actually went to jail.

So we are not talking about farfetched situations. We are talking about real life situations involving taxpayers.

And when it comes down to the grandmother in Montana, she is going to pay the amount. I don't know if you were in the room earlier, Senator Baucus, when that was described. She is not going to hire an attorney to argue over a $500 assessment or a $50 assessment. And even on very large issues, in a lot of cases it should be easier to give in than it is to fight it.

The Chairman. I understand the concern of Senator Armstrong. I think Senator Pryor has addressed it in a reasonable way. But if you differ, if you want to offeran amendment, of course, you are free to do so.

Senator Mitchell.

Senator Mitchell. Mr. Chairman, can I inquire of Mr. Chapoton and Mr. Nelson? Is it the aspect of Senator Pryor's proposal that moves the authority to impose fees back earlier in the process which troubles you or is it the shifting of the burden of proof to the IRS in the subsequent hearing to determine whether or not fees can be recovered?

Mr. Nelson. Both.

Senator Mitchell. Both of them.

Mr. Nelson. Both.

Senator Mitchell. I see.

Let me ask you a further question on the shifting of burden of proof. The law now, as it has been described here, permits recovery if the IRS's position is without substantial

justification. The burden is on the taxpayer to establish that. Is that correct?

Mr. Nelson. Yes, sir.

Senator Mitchell. So there has been some at least precedent established in defining what is substantial justification.

Mr. Nelson. Oh, yes.

Senator Mitchell. That is an existing standard with which courts are either familiar or with which they can become familiar.

Mr. Nelson. Yes, sir.

Senator Mitchell. Why do you object to the burden being shifted? In an ordinary case,the Government will be more familiar with the standard, will have the greater resources, is the initiator of the action, and, therefore, is in the best position to establish the substantial justification of its position. Would not that be the case?

Mr. Nelson. The principal problem is administrative burden. In the vast majority of cases, as evidenced by the fact that we have not lost many C cases, we do have substantial justification.

Senator Mitchell. Right.

Mr. Nelson. A substantial part of the burden of proof is not just weighing the evidence in the law and tilting the balance one way or the other in a 50/50 perfectly balanced

split. A substantial portion of that is the burden of going forward, of producing the evidence, of saying this is what I gave the Government and this is what I did, and this is what they said, et cetera, et cetera, et cetera.

Given the number of cases that we have--indeed, we issues 741,000 30-day letters last year. That is the appeals notice--it would be fairly burdensome on us to have to keep up with the records and be in a position to initiate that burden of going forward.

Now in fairness, Senator Pryor has gone a fairly long way by placing the obligation on the txpayer to show that he did present his evidence and his law to the exam stage.

So to some extent, he managed to take the wind a little bit out of our sails today by doing that.

I would point out that while the Equal Access to Justice Act has the burden of proof on the Government, in general, in litigation cases, these are going back into the administrative process of the Internal Revenue Service substantially, and thereby very significantly increasing the purview, the number of potential cases in which issues can arise. We have to carry the burden. It will cost us money. I do not think it is a fee issue. I do not think we are going to pay a lot of fees, but I think we will spend a lot of money and burn a lot of staff time responding to form pleadings.

Senator Mitchell. Well, Mr. Chairman, if I could just interject and say, I think that is really the heart of the problem. I served as United States Attorney and personally tried many cases involving the IRS, and I must say, when you get actually to court, you generally are very well prepared. And there is a rather rigorous screening process, particularly in criminal cases, so that by the time a case gets to the United States Attorney for trial, I never saw a case in which there was not substantial justification. They are very careful; they do not like to lose cases. And so they select only those that have a reasonably high probability of winning in order to bring them.

The problem is that they do not want to have to defend or pay costs for these computer-generated things prior to trial, that is, those in the administrative process where the probably varies much higher.

I think if you limited this to courts--and I personally do not see anything wrong with shifting the burden to the Government--the ordinary case, it is the Government that really is far better able to meet the burden of proof. It has the resources. It initiated the action. It has familiarity with the law, all of which are not generally available to the taxpayer.

I think the real problem is going back in the process prior to litigation that will create a lot of administrative

burden and cost to them.

Mr. Nelson. It is a combination of factors, Senator.

Senator Mitchell. Yes.

Mr.Nelson. It is the going back to the appeals stage and the shifting of the burden of proof that, in tandem, create a significant problem.

Senator Mitchell. Yes, I understand that. But what I am saying is I do not agree with you on shifting the burden of proof. I think that is totally justified under the circumstances in which these cases exist and occur.

Senator Armstrong. Mr. Chairman, could I address a question to Senator Mitchell?

The Chairman. Senator Armstrong.

Senator Armstrong. I believe he was not here during part of the earlier discussion. But as usual, he came right to the heart of the point. I think I heard him say that he rarely, or never, saw a case where there was not substantial justification.

Senator Mitchell. That is correct.

Senator Armstrong. The point that I made before your arrival was that in many of these cases there is substantial justification on both sides. What I think I understand from what you said is that almost never would a taxpayer be able to recover his attorney's fees in a trial under this provision.

Senator Mitchell. I do not want to generalize from my own

experience, and I am certain that there are cases brought in which there is not substantial justification. I believe that it is likely to be in a distinct minority of cases, and I think there should be a mechanism for dealing with the occasional error in judgment. And that is why I favor this process. And I also believe it is more equitable under the circumstances to shift the burden.

But I think the reality is--and I believe that anyone familiar with the system will bear this out--that while these occasions--the case you cited and others--do occur--human beings do make errors--I believe any fair analysis would indicate that in an overwhelming majority of cases there is substantial justification, meaning it is not frivolous. There is some reason to believe they have grounds for bringing the action. And I think they would be upheld in most cases. I think the taxpayer ought to have that outlet, the occasional error of judgment.

Senator Armstrong. The point that we are trying to air--and I think the Chairman would like to move on, but with his indulgence I will just explain it for the benefit of the late arrivals--I think we all agree and understand that. In fact, we have been told that almost never, under the standard of substantial justification, which is already in the law, is a taxpayer able to recover attorney's fees.

I am saying that the very heart of this bill is to say

that if a taxpayer goes to court to defend his rights and wins, that the taxpayer ought to be entitled to recover attorney's fees. And yet, under the standard of substantial justification, that is very, very unlikely to happen.

And so my suggestion is that in some way or another we need to massage this or amend it or work on it. And I do not think, Mr. Chairman, I want to shoot from the hip and offer an amendment this morning, but I would like to confer with anyone who is of a like mind, particularly the chief sponsor of the bill, and see if we cannot fix that up, because this is not going to let taxpayers get their attorney's fees, in my opinion.

Senator Mitchell. Well, if I could just conclude in a comment. I think Senator Danforth correctly pointed out that that raises a much broader question. That principle of recovery by the victorious party exists in other societies which have a legal system similar to ours. It does not exist in our society. Courts do have authority to grant attorney's fees where they deem the action to have been frivously brought. Indeed, they have the authority, too rarely exercised, to require attorneys to pay the cost directly because they did not uphold their obligation to not bring frivolous actions. That is one of the, unfortunately, least used authorities.

I think you would want to think about that carefully,

because I don't know that you would want to just say it applies to the Treasury Department. Should it apply to the Justice Department, the Environmental Protection Agency? Should it apply throughout our court system?

Senator Armstrong. I have in fact been thinking about this for quite some time, and I am reluctant to go as far as my heart tells me we ought to go. But this is the ideal place to apply this principle just because of the very nature of the kind of suits that arise.

The Chairman. Well as I understand, Senator Armstrong, you are going to be conferring with some of your colleagues about a possible amendment that you would be offering at a later date.

Senator Bradley?

Senator Bradley. Mr. Chairman, I would like to inquire in the present version of the taxpayer bill of rights. At what point can the taxpayer get reimbursement for legal expenses? Is it in response to a deficiency notice? No.

Mr. Nelson. Senator, it is longer than that.

Senator Bradley. No, no. In the present taxpayer bill of rights, how early will the taxpayer be able to get reimbursement?

Mr. Gould. Recoverable cost would begin to accrue from the first communication received by the taxpayer. That would propose a deficiency and allow them to go to appeals in the

IRS.

Mr. Nelson. That would include a protect of fees incurred to protect a 30-day letter of proposed deficiency.

Senator Bradley. Mr. Chairman, I am concerned with this aspect of the bill because it sounds to me like it is a kind of lawyers' employment section.

Let's say, for example, that I have two bank accounts, and I get interest from one and interest from another. And I combine the two and declare the total interest, put it to the IRS, put it on my form. The two banks then report separately to the IRS, and the IRS sees a number that is different than the one that is on my form, and they then send a notice to me, saying that there is a deficiency here, that you did not declare the interest that the two banks said you obtained.

What I do now is I send them a letter saying, well, look at line, whatever, 60, you will see the total interest and it is over. What happens under this bill, and what would happen in case after case is you simply call a lawyer and say, handle this for me, will you? This is ridiculous. Handle it for me; you will get your fees paid.

And since the taxpayer will be reimbursed for legal fees, there will virtually be fiew, if any, instances where the taxpayer will interact with the IRS. It will be law firm X, and it will be little boutique law firms set up to take

advantage of this provision, and the end will be you will further depersonalize the process, if that is even possible, and I think it will breed a kind of detachment from the process and ultimately will lead to much greater cost, because it will all be lawyers billing the Government at $500 an hour.

The Chairman. Well, H.R. Block charges what?

(Laughter)

Mr. Nelson. Oh, I am sorry. I don't know that.

The Chairman. There you have the two points of view. And I am prepared to listen to amendments if you want them, otherwise, I want to move this process along.

Mr. Gould. Mr. Chairman, could I make one clarification?

The Chairman. Yes.

Mr. Gould. In the circumstances that Senator Bradley described where the IRS makes an initial communication to the taxpayer describing what Senator Bradley described, under Senator Pryor's amendment, the taxpayer would have an obligation before the attorney's fee meter started running to write that letter essentially that Senator Bradley described. And if the taxpayer did not do that, but waited, rather, for the official commuication from the IRS, it would entitle the taxpayer then to go to the Appeals Office. The attorney's fee meter would not start running. The taxpayer has to show that he has gone in and made that interaction with

the IRS and tried to come forward with the appropriate evidence.

Senator Pryor. That is in the amendment that I offered earlier today.

Mr. Gould. Your argument is precisely what the IRS came and told us a couple of days ago would happen if we did not include that provision, if Senator Pryor did not include that provision.

The Chairman. All right.

Senator Pryor. Mr. Chairman, if I might say one thing. I think right here now I will not take but 30 seconds. We have a classic case I think of our good friend, Senator Armstrong, who was the tenth cosponsor--an original cosponsor--of this legislation very early last year, wanting to go a little further, and our good friend, Senator Bradley, not not wanting to go quite as far. Once again, if we are shifting the burden, that should at least be a start in hopefully satisfying Senator Armstrong--and also marrying 4151 with 4753, those two sections--we are seeing an increase in the likelihood, Senator Armstrong, of the taxpayer in the area of civil damages against the IRS occurring. So we are strengthening the taxpayer's position significantly there. And, thirdly, and most important, in all of these--and this is a policy call, I think--in all of these sections, what we are really trying to do is to make

the Internal Revenue Service more careful--more careful--in hauling the taxpayer in, and charging the taxpayer something that they cannot substantially justify. And with Senator Bradley's concerns, I have talked over these concerns with Senator Bradley, and I am saying that we have tried to draft this legislation to reach a balance and we think that we are just about to achieve it. And I hope that you will be understanding of that, and maybe we will not amend this too much at this stage to strength it or weaken it.

The Chairman. I think we have all had these examples. We have all personally had them. I had all the notices sent to me by the IRS for, I think, it was three years of past tax payments and returns, and saying that it did not have the substantiating evidence, and where was that evidence. And when we got all through with our correspondence back and forth, they had received every bit of it. And someone had unstapled it from the returns, and sent it to a different section and they finally found it. But I had a little heartburn for a while there until they finally resolved it.

Senator Chafee. Mr. Chairman?

The Chairman. Senator Chafee.

Senator Chafee. On this particular issue I am not quite sure where we stand. First of all, I would like to ask Mr. Nelson. Working from the present documents that we have before us, the legislation Senator Pryor has submitted, is

the IRS satisfied?

Mr. Nelson. No, sir, in two significant respects. First, in general, this is a substantial breech from Equal Access to Justice. But let's leave that aside and accept that as the way it is in this bill right now. There are two areas that we want to certain about.

One is at least a point of clarification from Senator Pryor, and that is when the taxpayer is required to come in and respond to Senator Bradley's comment, which is try to deal with the examination stage and provide evidence and law. Is it clear that the taxpayer needs to show us that he did that; that to that extent, he has got that limited burden of going forward. If it is, it will help a lot in terms of our administrative process even if you leave the burden of proof shifted, which we opposed. But we would like to be very clear that we do not have to show that he did not make reasonable efforts to present his facts in law. And if we could clarify that, I don't know whether I would have a serious heartburn or not.

Senator Pryor. I think the amendment, Mr. Nelson, speaks for itself, and that is that it provides that the taxpayer is required to take reasonable steps to present all relevant evidence and legal arguments prior to coming to the Office of Appeals. And I think this would answer your concern.

Mr. Nelson. If that means that the taxpayer, if he looks

for fees, has to show that he did that, that he did, and we do not have to show that he did not--proving the negative is very difficult--then I would say that sizing up where we are, we generally do not like to shift the burden of proof. But that is a significant clarification and we appreciate it.

The second thing is something that we have not discussed and that is that even if we assume that you take the fee point back to appeals, which is also a major breech with general Equal Access to Justice concepts, what we are doing by looking solely at the 30-day letter, particularly with the CP 2000 computer notices, is we are ignoring the fact that it is the appeals officer who refines the position of the Government and helps determine what the Commissioner's position is.

So if a CP 2000 notice, for example, goes out, and there is a mismatch or a problem, the first real chance you get to talk to anybody quite often is at appeals. It is very quick; it is not very expensive. You do not have to pay any money to go; you can go pro se. But the appeals officer's job in the system is to dispose of the cases and to refine the position of the Government.

Now what we are doing by saying the position is the raw position taken in the notice that lets the taxpayer go to appeals, is we are depriving the Commissioner of the ability to decide what his position really is, which no other agency

has to deal with. That first notice is an interim determination, and we do not have appeals officer grade personnel back in service centers to review all of those notices. So what we are doing is--and the Committee just needs to know that it is doing it--is that it is not just compensating people for litigation and quasi litigation cost, it is in fact compensating people, in part, for that portion of the Commissioner's system that develops the position that the Government is going to advance.

We would much prefer, even within the context of this bill, and even if we are going to say that expenses accrue from the day to the the 30-day letter, to at least let the appeals officer take a crack at disposing of the case and to treat the position of the Government as the position taken by the appeals officer, who works for the Commissioner.

He is not an administrative law judge. So that even if you want expenses to accrue from one point in time, what we are doing is saying--and that is also just a financial decision on your part--we would very much like to see this position of the Government be the position taken by the appeals officer. And if that is unreasonable, and this Committee would like to have us pay those fees for talking to that appeals officer, who did not respond affirmatively and in an appropriate manner, then we think that is not totally inappropriate. But it is an issue. There are really

three issues: burden of proof; time at which expenses accrue; and whose position is the position of the Government? And the position of the Government is generally, in these cases, determined by appeals. Appeals is our principal quality control function in the Service. And that is where we differ.

The Chairman. All right. Let me say, Senator Chafee, you were out of the room for a while, but we have had extensive debate over this and I think we have got an excellent one as we have explored this. And I am prepared to take amendments if someone wants them, but otherwise, let's hold those amendments to the floor.

Senator Armstrong. Mr. Chairman?

The Chairman. Yes, Senator Armstrong.

Senator Armstrong. Since I have discussed this at some length, I am reluctant to open it further, but in the light of what we have just been told a moment ago, could I ask what the term "tax proceeding" means?

The Chairman. Yes, of course.

Mr. Nelson. In which statute, Senator?

Senator Armstrong. Well, around here we do not deal with statutes much. I am on page 13 of the handout.

Mr. Nelson. In the amendment?

Senator Armstrong. In other words, what we are talking about is a taxpayer who prevails in a proceeding. Now I was

listening carefully to what you were describing, and I was just trying to figure out how anybody would ever get anything back.

Mr. Nelson. The proceeding under this is the proceeding before the appeals officer, as well as the proceeding in litigation.

Senator Armstrong. I understand how someone could prevail in a judicial proceeding. I do understand that. You can either win or you lose. But I do not quite understand how that would arise at the administrative appeal.

Mr. Nelson. That happens when we concede the case. If the appeals officer, whose job is to --

Senator Armstrong. But under the theory you have advanced, the Government has not even taken a position until the appeals process has been completed, until the appeals officer comes in.

Mr. Nelson. That is correct.

Senator Armstrong. Have you got that, Senator Pryor? First, we say we are not going to give them attorney's fees if they win in court; now we say, on the other hand, we are not going to give it to them if they win at the administrative appeals level. This is such a narrow area where anybody would ever get anything back.

Senator Pryor. It is my understanding under the procedure that the notice, the notice itself, is the position

of the Director of the United States Internal Revenue.

Mr. Nelson. As it is written --

Senator Pryor. Isn't this correct?

Mr. Nelson. I think that Senator Chafee asked me where we disagreed. And one of the points of disagreement is, in fact, that the manner in which the Commissioner developes his position is a continuing prospect from point to point. And the appeals process is where the quality review goes in in a lot of these smaller case situations. And if he has got it drafted --

Senator Pryor. And, Mr. Nelson, pardon me. I think Senator Armstrong is hitting on a very interesting part of this whole debate. It is at this stage where the taxpayer has to assume the largest burden of financial responsibility to pay the accounts and the attorneys. It is at this stage. Also, the Treasury has estimated, Mr. Chairman, that the cost to the Government for this section being implemented is very, very negligible.

Secretary Chapoton. Senator Pryor, I do think we need to be a little cautious about that cost figure because it includes only costs that are recovered. It does not include this cost that Senator Bradley is referring to.

Senator Bradley. That is before the lawyer boom.

Secretary Chapoton. The bills for keeping the records and for changing procedures.

Senator Bradley. If you get a letter saying, "Can you substantiate your income totals," where you do not see all the documents, you can do that. But you call a lawyer, you say, Joe, send them the documents. Joe sends them the documents and a bill for whatever Joe chooses to charge. And under this provision, the taxpayer pays your lawyer.

I think that is going a little too far.

Senator Armstrong. Is that in fact what this section says?

Mr. Gould. No, it does not.

Senator Bradley. It does not say it?

Mr. Gould. Remember again, Senator Bradley, the taxpayer, under Senator Pryor's amendment, is required to go forward and produce those documents. Now if the IRS then looks at the documents and says, you're right, you don't owe us tax, there are no attorney's fees.

Senator Bradley. But if they owe them one cent, if the taxpayer owes the Government one cent, then the $500 or $1000 attorney the Government has got to pay.

Mr. Gould. The attorney's fees would be awarded with respect to a position that is not substantially justified, and it is presumably going to relate to the overall effect of the notice that was given the taxpayer, not the one cent of it.

Senator Armstrong. But how is he awarded it? Who makes

the decision in that scenario of the award?

Senator Bradley. It would seem to me he would send the bill.

Mr. Nelson. The appeals officer himself can award them, and if the taxpayer is not satisfied, the taxpayer, under the Senator's bill, can appeal to the Tax Court in the small case procedure. So we do increase Tax Court litigation.

Senator Pryor. Well, we grant concurrent jurisdiction with the Federal courts now to the Tax Court. And the Tax Court is a much less extensive litigation process than the Federal District Courts it is my understanding. Am I correct in that, Mr. Nelson? I think I am.

Mr. Nelson. It is concurrent.

Mr. Gould. Mr. Chairman, one point that I might want to make to put this in perspective.

The Chairman. All right.

Mr. Gould. It is just to describe what kind of revenue we are talking about, what kind of fee levels we are talking about. We received information from the IRS that, since attorney awards have been authorized, which was in 1982--six years--the total awards have been around $700,000. The estimate by the Joint Tax Committee staff now is that the award would be around $5 million per year under Senator Pryor's provision.

Secretary Chapoton. But, Jim, I would caution that is

not the thing that is concerning us, the $5 million. It is the extra burden on the IRS to keep the additional records, and to change its procedures at this stage.

But, mainly, if I understand it, we ought to keep the additional records necessary to show what positions were developed at this stage in the proceeding. Is that right?

Mr. Nelson. And to just defend these things. I can assure you that if I were in practice it would be a form pleading that would go on every protest letter I write that would say, and by the way, pay me fees.

We really are not that concerned about the number or amount of fees that we pay. We do have a fair amount of confidence that the system does wash out most of the problems, at least those where lawyers and accountants are going to be appearing. But we are very concerned about two things. One is lawyerizing the system, which is what Senator Bradley's issue is. With this, you get to hire a lawyer to do something a taxpayer can do by himself at no cost.

And the second one is simply the administrative cost of responding to a vast number of appeals when there is no real evidence that we have seen that people are incurring large unreimburseable costs in any respectable percentage of cases.

Senator Armstrong. Mr. Chairman, I do not want to be argumentative, but for the IRS to come here and make a statement like that emphasizes the nature of the problem. If

they are unaware of this, if this has never come to anybody's attention that people in this country are incurring enormous expenses, along with a lot of anxiety. I mean, from where you guys sit, the IRS just looks like a bunch of civil servants. From out in the country it looks like the Gestapo. I mean, people are terrorized by this stuff.

Unsigned penalty notices. Provisions which may seem perfectly simple to all the lawyers seem unbearably complex to the average taxpayer. They get hauled in, and I will bet every Senator around this table can cite a lot of examples of their own personal knowledge of taxpayers who come in and told them the most horrible stories. And if you guys are not aware of this, then what you really need to do is what the Sultan of Bagdad was urged to do: go out and disguise yourself and act like you are not with the IRS and just hang around with some taxpayers for a while.

(Laughter)

Secretary Chapoton. Senator, I can assure you I have received my share of notices as well. And we are not unmindful of that. I mean, it is not my job, it is the IRS's job. But this is more of a cost item than it is a fairness item.

Senator Armstrong. See, he was not aware of this, but he thought about it after we break up.

The Chairman. Gentlemen, are we at a point where we can

move on on this?

Senator Wallop. Mr. Chairman, just one statement. If I might add one other thing that Senator Armstrong, one of the consequences of the public reaction that Senator Armstrong refers to is really pretty simple. That is, that people pay rather than confront, even things they do not owe. And I think the issue of fairness here--I am trying to reach that--is to give them the confidence that if they really are certain they are right that they are not going to be strung up and they are not going to put through a financial wringer that is greater than the fine that they are contesting for the penalty.

The Chairman. All right, gentlemen. I must say, Mr. Nelson, there are enumerable cases--and I have heard of a lot of them--where people, where you have a relatively small claim by the IRS where the recipient feels it is outrageious and not right, but he does not want to start paying expensive attorney's fees, and he says it is just cheaper to pay it. And we get a lot of those.

Now would you go ahead with the bill?

Mr. Ritcher. At the middle of page 14 is a provision that relates to the Government's failure to release liens. Under current law, the Government is required to release liens upon certain events, such as the satisfaction of the underlying tax liability. This provisions would impose damages on the

IRS, would allow a taxpayer to recover either actual damages or $100 per day for every day that the lien is improperly maintained after it should have been released.

At the bottom of page 14 is another provision for recovery of damages against the IRS, and that has to do with cases where the IRS -- an IRS employee has carelessly, recklessly or intentionally disregarded any law or regulation in a manner that has caused a taxpayer to incur damages. Under this provision, damages would be denied if the taxpayer was contributorily negligent, and any suit under this provision would be subject to the penalty for instituting frivolous or groundless claims. That was referred to earlier.

Senator Armstrong. Mr. Chairman.

The Chairman. Senator Armstrong.

Senator Armstrong. Are we referring now to 4753?

Mr. Ritcher. That is correct.

Senator Armstrong. I would like to address a question about 4753 and 4754. I heartily approve of the theory of this, but I am wondering if it is broad enough. The write up refers to disregard of provisions of the Code or regulations.

My question is, suppose an IRS agent violates other statutes in the conduct of an investigation, or an audit, or something, would this be covered?

Senator Pryor. I think I could answer that if I might.

And we are going to touch that in the next section and that is the criminal penalty section. And I might say that I am deleting the criminal penalty section because I think it would be redundant to have such a section. I would like--and I will request of the Chairman and the staff--to have Committee language referring to the 1974 Privacy Act, Senator Armstrong, which I think covers your concern, plus the Bibbons cases, or that route to redress of the taxpayer against the Federal employee or against the Government. And I think that we would answer your concerns in that way.

Senator Armstrong. I do not think maybe quite. If I see this correctly, a taxpayer may recover, may even recover damages, if he is damaged, because some IRS employee ignores the revenue code. I am saying suppose the IRS employee violates the law in some other way--and again, this is not a speculative matter. It is based on a lot of testimony before this Committee, where IRS agents and Justice Department agents acting in concert with the IRS, in fact, have been found by courts in Colorado, Maryland, and a number of other places, who violated the law. I mean, just in the words of one Federal judge who testified here, having thrashed the grand jury process and a lot of other things--my question is: is this broad enough to permit them to recover damages in that case?

Senator Pryor. If we use the Bibbons language --

Senator Armstrong. I am sorry, I do not know what Bibbons is.

Senator Pryor. That is the manner and the mechanism in which the taxpayer may proceed into Federal Court against a Federal employee or an agency of the Government. And, please, if I am wrong, correct me.

Mr. Ritcher. That is correct.

Senator Pryor. And then the Privacy Act of 1974 also has a remedial propositon in that Act which allows the taxpayer to recover in cases of gross negligence or abusive knowledge when the agent was abusing the taxpayer.

Senator Armstrong. Well, let me give you a specific case that occurred I think in Maryland, in the Omni case.

Senator Pryor. Yes.

Senator Armstrong. Where a Justice Department lawyer working with the IRS admitted having manufactured evidence. In that case, could the taxpayer go back and collect damages?

Senator Pryor. I think using the two procedures just mentioned, I think that the taxpayer would have that right.

Senator Armstrong. How about the case where the IRS agent broke into the mails, would that also be --

Senator Pryor. Without, let's say, a warrant or without the proper cloak of authority?

Senator Armstrong. Yes, without a warrant.

Senator Pryor. If the taxpayer could prove that the individual had no authority to do so, I think that the taxpayer might well prevail either under the Privacy Act or under the Bibbons case procedure.

Senator Armstrong. Well, I don't understand the Privacy Act reference.

Senator Pryor. Of 1974.

Senator Armstrong. My point is simply this, that if the IRS brings a case and forces a taxpayer to defend it, when the case is based, in whole or in part, on illegal activity, why shouldn't the taxpayer have a right to get his attorney's fees and damages back? I just want to be sure this is broad enough to do that.

Senator Pryor. I think the taxpayer would have that right under Section 4753 under the Civil Damages Section.

Senator Armstrong. Thank you.

Senator Pryor. And I might say that we are establishing for the IRS the same characteristics I think--I may be in the wrong section--and that would be the same standard of care, and that is reckless -- where is that, Jeff?

Mr. Ritcher. Carelessly, recklessly and intentionally disregarding the rules.

Senator Pryor. Right. That is the terminology. We are putting the same burden on the IRS that they are putting on the taxpayer in that section. So we are equalizing the

burden there.

Senator Armstrong. But what this refers to is the Code, meaning the Revenue Code. I am asking whether that is broad enough to include careless disregard or violation of other statutes than the Revenue Code.

Mr. Ritcher. I would point out, Senator, that current law has a provision in it that would impose criminal sanctions on IRS employees that violate a number of --

Senator Armstrong. This, however, is not directed to employees. It is directed to the Government. That is the hitch. In each of the cases I have described--each of which, by the way, is a real case that has been adjudicated by a real Federal court. These are not speculative--in those cases, very likely the taxpayers involved did have a valid suit against the employees involved, but not against the Government. And what we are addressing here is the question of the Government. My concern is whether or not this reference to the Revenue Code is broad enough to cover these cases and I just want to be sure it is.

Excuse me. I interrupted your answer.

Mr. Ritcher. Oh, no, that is fine.

You are correct. The statute as it is written now refers only to Internal Revenue laws.

Senator Armstrong. Mr. Chairman, with the approval of the sponsor, I would like to -- did you hear the response from

staff? Staff believes this only covers the IRS Code, or the taxation laws generall, I guess. I think that should be broadened, David, to include any violation or reckless disregard of any law, because if we do not, we leave unanswered the questions I have raised which, in fact, are based on actual cases that have been tried in the Federal courts.

I don't know why anybody ought to be able to violate the law and not give rise to this kind of a cause of action.

Senator Pryor. I would accept such an amendment, Senator Armstrong, for a change.

Senator Armstrong. I so move.

Senator Pryor. Thank you.

The Chairman. Is there objection to that?

(No response)

The Chairman. Further discussion?

(No response)

The Chairman. Then it will be changed to reflect that. All right.

Mr. Ritcher. That brings us to page 15, the provision on criminal penalties for improper IRS investigations. As Senator Pryor just mentioned, this provision has now been deleted under the compromise.

Senator Moynihan. Mr. Chairman, could I ask, this has been deleted?

Senator Pryor. The criminal provision, whereby a taxpayer might go in and, let's say, try to imprison the IRS employee, or try to charge him of several thousand dollars personally, personal liability, we have deleted, Senator Moynihan, because we think this is adequately covered in the Privacy Act of 1974, and in the procedures under the so-called Bibbons cases in criminal law where the taxpayer can seek redress against the Government, and against the employees.

We feel it would be a redundancy in the Code to put that in there. And I am going to ask for Committee language, making reference here, but deleting the criminal sanctions against the individual IRS employee.

Senator Moynihan. Could I ask my friend? I was under the impression, and perhaps I am wrong, that this provision has to do with the practice must in disgust how established, I don't know, of the President saying, get that guy's tax returns.

Lyndon Johnson was said to do it all the time. Richard Nixon was said to do it some of the time. What is going on today, I don't know. Isn't this what we are talking about?

Senator Pryor. Not exactly. What we were talking about was when an IRS agent or an IRS employee maybe had it in for a taxpayer, maybe the taxpayer was not reverant enough to the auditor during the process, so the agent just says, well, we will recklessly disregard the statute and the procedures, and

we will just haul this fellow, or this lady, into court. And they hash them around there for a few years. We think that we have adequate coverage.

Senator Moynihan. Well, can I ask, because, you know, we have had a generation of one constitutional abuse after another coming out of the White House. I mean, we had a brush with constitutional death on Iran Contras; it is not over. And in the beginning, at least in the Johnson Administration, it was the understanding in Washington that the Internal Revenue Service was being used to get people that the President did not like, or somebody in the White House did not like.

Mr. Nelson, what is the record? Do you have the institutional memory in those matters?

Mr. Nelson. I don't have the institutional memory, but what you are talking about is currently against the law already. Both the Privacy Act and Section 6103 of the Internal Revenue Code preclude those kinds of disclosures. And if the President personally wants information he has got to personally ask for it, is my recollection of the statute. He has not done it since I have been there. And the record is sent to the Joint Committee.

The use of that, sir, it is already criminalized. It is not only against the law; you go to jail for doing it, any redisclosure of information for any purpose not relavent to

tax administration.

Senator Moynihan. That is disclosure of information. What about politically motivated and directed investigations? I mean, we have heard so much about them in Washington, and I think the record is fact that it has happened.

Mr. Nelson. I can assure you that since I have been in the Service, and the Commissioner has been here--and we came the same day--we have never had a contact of anything like that from the White House. They are scared to death to even speak to us on the street. That just doesn't happen.

I am not sure that there is a statute that would at the current time criminalize someone for directing an audit from outside the agency. I don't believe one currently exists.

Senator Moynihan. Well, shouldn't one?

Mr. Nelson. I would personally not object to one.

One relatively important point--and I say this candidly, but with no intention of slamming anyone--we have gotten a number of reqeusts since I have been here from Congress, from different members, to investigate either individuals or groups or types of situations. I can think of a number. Congress, obviously, does not have line authority to order it, but we have certainly been wood-sheded as it were by a number of different members requesting that we conduct an examination of a person of an issue.

Sbnator Bradley. Wait a minute. Maybe I tuned in late

in this process.

(Laughter)

Senator Bradley. You have gotten requests that an individual taxpayer be investigated?

Mr. Nelson. We have had a number of situations where members have sent us information concerning taxpayers, requested that we take it into account, and then follow it up vigorously to be sure that we have taken it into account with respect to individual taxpayers and individual groups.

Senator Moynihan. Well surely you don't think that is a very desirable arrangement, do you?

Mr. Nelson. Personally, I don't think it is very desirable at all. I am simply pointing out that since I have been here the pressure has not been from the Administration. So I guess if we are going to craft the statute, we need, we need to be careful about how we are going to craft it.

Senator Moynihan. Fine. We can do both.

Mr. Nelson. And the lines get a little fuzzy. I can think of a situation where an oversight member has requested information on specific activities and suggested that we are not being aggressive enough in pursuing certain things, with names attached.

Senator Pryor. Now are you making reference there to the possibility of certain groups being tax exempt, for Jim and Tandy Bakker, and those?

Mr. Nelson. That is a generic possibility. I cannot talk about taxpayers, Senator.

Senator Pryor. Right.

Mr. Nelson. You can; I cannot.

Senator Pryor. Well, I think the House had a hearing on this issue of tax exempt organizations. Now is that what you have reference to?

Mr. Nelson. We have had a number of situations where different members did not think we were being aggressive enough or we were being too aggressive in enforcing the laws against specific types of taxpayers. It happens quite often in recent memory when we are dealing with exempt organizations, among other things, where political idealogies tend to differ. But there have been other situations.

We try to be responsive to Congress, but we do not feel that when Congress asks us to look at something that we are directed to conduct an examination and indeed don't. We take information and make our own decisions.

I am simply pointing out that in my experience, not the Service, we have never had any contact of that nature of the Administration. It has almost always come from other branches of Government.

Senator Moynihan. Almost always?

Mr. Nelson. Always.

Senator Moynihan. Well there is a difference between

almost always and always.

Mr. Nelson. Well, strike the almost from the record, Senator Moynihan. I am not personally familiar with a situation where we have been requested or directed to investigate any taxpayer by anyone outside the agency.

Senator Moynihan. Could I ask you, sir, in the files of the IRS, if that is the case, do you know of such events in the past?

Mr. Nelson. No, sir.

Senator Moynihan. Does nobody know?

Mr. Nelson. I cannot answer for anybody else. I have no personal knowledge or institutional hand me down knowledge. I have heard rumors about pre-Watergate and Watergate days, but so have you, and I expect your rumors are more correct.

Senator Moynihan. And are these just left at the level of rumors? Wouldn't the Service want to know?

Mr. Nelson. Pardon.

Senator Moynihan. Is it sufficient to your purpose that these should be rumors about which are not --

Mr. Nelson. If they happened 20 years ago, I think that my resources are better spent trying to deal with the issues that are current today. And I am simply telling you that in my term, which is now 19 or 20 months, we have had no interference whatsoever from the Administration.

Senator Moynihan. Mr. Nelson, we are not talking, nobody

is accusing you of anything. We are trying to find out is there a pattern of executive power?

Mr. Nelson. No, sir, there is absolutely no pattern.

Senator Moynihan. You have heard rumors, but you don't know more than that.

Senator Bradley. And what is the policy of the IRS when such suggestions in whatever form arrive from outside the IRS?

Mr. Nelson. In whatever form, whether it is from taxpayers individually, from members, or from the Administration.

Senator Bradley. No, no. From people in an administration or from another branch of government.

Mr. Nelson. If it is from the Administration, we have not had to deal with the issue. I can assure you the agency would scream loudly about that.

Senator Bradley. All right.

Mr. Nelson. We may be bureaucrats, but we are not venal. And we take our responsibility very seriously.

Senator Moynihan. You say you would scream if someone from the White House called you, you would make a public statement?

Mr. Nelson. The President has the capacity to request taxpayer information. He has the capacity to contact the agency, but that requires records being kept.

Senator Moynihan. Yes.

Mr. Nelson. I cannot tell you precisely how I would react if it happened, but I can assure you it would not be exploited.

Senator Moynihan. Well you said you would scream.

Mr. Nelson. Yes.

Senator Moynihan. A minute ago you said you would scream.

Mr. Nelson. You asked me what would I do after I screamed. I am not sure.

SEnator Moynihan. But you would scream.

Mr.Nelson. Yes. Absolutely.

Now having said that, when members call, we are not in a line position. They have the capacity to budge in a little bit, but not to direct examinations and we try to listen.

Senator Bradley. This is the point at which I tuned in. A member of Congress writes a letter pleading a case for a particular individual and the IRS pays attention?

Mr. Nelson. The IRS pleads the case for the individual. We get thousands of those. We get literally thousands of Congressional contacts on behalf of individuals. We get a fair number against individual taxpayers.

Senator Armstrong. Mr. Chairman?

The Chairman. Yes, Senator Armstrong.

Senator Armstrong. Mr. Chairman, based on the discussion, I am not personally sympathetic to deleting Section 4754 for the reasons that Senator Moynihan has

spelled out. Indeed, if anything, I think we ought to change it where it says that it will be unlawful for anybody to conduct an investigation that is not connected with the Administration or enforcement of the tax laws to say that it would still simply be unlawful to use these laws to conduct an investigation for any other purpose than the enforcement of these laws. It doesn't matter whether it is the White House or who it is. It was just some rambunctious IRS agent. The only reason for which surveillance or investigations or audits or anything else should be conducted is to enforce the tax laws, not for political reasons, not for personal reasons, not to make work or anything else.

Senator Moynihan. Could I say by thanking my friend, Mr. Armstrong, I mean, we just heard Mr. Nelson say, well, we know there are rumors that have happened in Watergate before. I would scream. Well I don't know why I would have to scream. I wonder if our very distinguished Mr. Chairman here couldn't consider what Mr. Armstrong just suggested, to retaining this, within the context that we are talking about the abuse of executive power and that maybe the abuse of the legislative office as well.

Senator Pryor. I answer my friend from New York by saying that, very respectfully, I had the same concerns the Senator from New York and the Senator from Colorado had in drafting this original part of the taxpayers' bill of rights

when there was an abuse or an overreach of the Federal Government. I say this in all respects that I truly believe that the Privacy Act of 1974, coupled with legislation of 1976--and I don't know exactly what that legislation is; 6103, I have been informed--solves the concerns and accommodate the concerns of both of you.

I don't mind. I will say something I probably should not say. I was one of three members of the Senate voting not to impeach Judge Clayborn because of overreach. And I am sensitive to overreach. And I think that the Congress--and I say this with all respect, Mr. Chairman, to all the Committees--I think the Congress has been sorely negligent over the years, sorely negligent, in looking at overreach and abuse of Federal powers. And I am talking about the FBI and all down the line. And I saw a lot of overreach in that particular case. And I am just trying to say that I am as sensitive to this concern as you are.

Senator Moynihan. Well, listen, you are speaking to a Senator on whose behalf the FBI offered $50,000 if I could be corrupted and Senator Javits only $25,000 because he didn't have much time left.

(Laughter)

Senator Moynihan. Well, it wasn't very funny. It wasn't funny at all. Mr. Webster said, "What to hell is this all about?"

Could I just ask then, because you are on top of this or master of it, could we have some report language that says that Mr. Nelson told us he has heard rumors of Presidents directing that somebody's income taxes be checked out and so forth and so on, and with a rather institutional casualness. Well, you know, they are rumors; they poisoned a few people, dropped some down wells, things like that, you know, old boys will be boys. That was a long time ago, 12 years.

Senator Danforth. Mr. Chairman, I don't really think that is a fair characterization of what Mr. Nelson said. Mr. Nelson has been asked repeatedly whether he has received any inquiries or any demands from the White House, and he has answered repeatedly that on his watch the answer to that is clearly no.

Senator Moynihan. No, sir. That is all in the record.

Senator Danforth, I did not ask that.

Senator Danforth. He was asked then about matters that were not within his personal knowledge of what went on in prior Administrations and so on, and he answered that. But I really don't think that it is a fair characterization of anything that Mr. Nelson has said to indicate that he is in any sense cavalier about anything that has happened to him.

Senator Moynihan. Senator Danforth, at no time did I ask about this Administration. I was referring to President

Johnson and President Nixon. And that is a matter of fact.

Senator Danforth. Well, would you like Mr. Nelson's opinion on President Johnson and President Nixon?

Senator Moynihan. Well, I honestly thought there would be some institutional memory or did that happen or did it or didn't it and should or shouldn't it?

Mr. Nelson. There is much greater institutional memory of the scandals in the late 40s and early 50s where we actually were found to have done something wrong, and a couple of tax officials spent some time in the slammer. The events following those periods have been investigated at great length long before I thought about coming to Washington by committees of Congress, and prosecutors, and otherwise, and the agency came out clean in those cases.

So the institutional memory goes back to the famous King Commission report from which we remind ourselves of every day. The agency has been corrupted once.

Senator Moynihan. But that was internal money corruption.

Mr. Nelson. Yes.

Senator Moynihan. That is not what I am talking about. Could I just ask would it be possible to have some report language taking cognizance of this?

Senator Pryor. I think the Senator from New York --

The Chairman. Well, Senator, that's fine, but I just

do not want to get back into something that happened, with all due respect, 20 or 30 years ago and trying to resurect it. We have had all kinds of commissions, we have had all kinds of hearings, we have had all kinds of investigation that have addressed those particular issues.

Senator Moynihan. But have we had statute?

The Chairman. Yes, we have extensive statutes on this.

Mr. Nelson. EA, JA and 6103 were the results of concerns about abuse of the Service. I don't mean EA, JA, I mean, the Privacy Act. And the Privacy Act, in general, with respect to --

Senator Moynihan. Which was the post-Watergate Act.

Mr. Nelson. Yes.

Senator Pryor. I think we can accommodate the concerns in Committee of the language, Mr. Chairman.

The Chairman. All right. Fine.

Would you proceed, Mr. Ritcher?

Mr. Ritcher. One provision remains. That is at the bottom of page 15. This provision would establish a statutory Assistant Commissioner for Taxpayer Services.

The Chairman. All right. Is that it?

Mr. Ritcher. That's it.

Mr. Nelson. We do have one comment about that one, Senator, if we may. With respect to, for example, the establishment of an Assistant Commissioner of that type, we

currently have that job combined with returns processing. That is the type of situation where we need some lead time on effective date to reorganize the agency.

IG would be another situation where there is sufficient organizational impact, that from an effective date standpoint we need a little slack to get ready.

With respect to other provisions, we need to be sure that to the extent there are required procedures to be changed, notices to be changed, things like that, we have got at least three months or so.

So, Senator Pryor, the first of the year for organizational changes, if that is acceptable, and three months, 90 days, for other things.

Senator Pryor. I think we can work out that transitional change. In addition, I think our colleagues would like to know that we want to put this particular position in statute.

When Larry Gibbs goes back to Dallas, or New York, or wherever Mr. Gibbs is going to go--I mean, I hope he doesn't go any time soon; he is a splendid Commissioner--we want this position in statute, knowing that that job is going to be there and mandated under the law. And I think we can accommodate the transition problem.

Mr. Nelson. All right. We appreciate that.

Senator Chafee. Mr. Chairman?

The Chairman. Yes, Senator Chafee.

Senator Chafee. I have a question. I am not quite sure why we have all these things. We have got an ombudsman who presumably, as I understand what an ombudsman is, it is to represent the people and to take care of their interests as he wonders around through the agency. Then isn't there an inspector general provided for in this legislation?

The Chairman. No. He fills a completely different role as I understand it. But go ahead.

Senator Chafee. All right.

And then tell me the difference between an ombudsman and an Assistant Commissioner for Taxpayer Services.

Senator Pryor. The Assistant Commissioner for Taxpayer Services, Senator Chafee, would run the forms operation. We now, by the way in IRS, have someone called the Director of Forms. This would all come under the Assistant Commissioner for Taxpayer Services. They would run the phone calling network and system 1-800 program, the walk in program at the local IRS offices out in the districts and out in our States, and it would be that individual that would coordinate all of those taxpayer services where the ombudsman would be that individual who would be stationary and not have the same jurisdiction at all as the Assistant Commissioner.

Senator Chafee. Well, one more job for somebody.

Mr. Nelson. Those positions already exist, Senator.

We do have to split out taxpayer service. But there is an ombudsman now. This is codifying a fair number of existing positions.

Our only objection to these provisions is, as what the Commissioner has said on a fair numbers of times, it gets a little close to micromanagement to tell us that we have to have a position. We have it today. We agree with its needs for today. Twenty years from now, who knows? Do we need to have that in the statute? But, in general, this is not terribly disruptive for us.

We have these positions, and if Congress, in its wisdom, wants to institutionalize them and legalize them, then that will be.

Senator Pryor. Well, Mr. Nelson, of course, we know too that under this new provision, and to Senator Chafee, we are going to require annually a report on the taxpayer services out in the field.

Mr. Nelson. That is true.

Senator Pryor. And that would be another responsibility of this position created by statute.

The Chairman. Thank you.

Gentlemen, what I would like to do in proceeding here is probably go until about 1:00 o'clock and try to finish if we can. And that means for the conferees on the Trade Bill that we would move that to 2:00 o'clock. And as I look at the

calendar for the rest of the month it is terribly crowded for us on the Committee. So if we can finish, I would like to.

I would like to proceed on the diesel tax portion of it, and then we will know how much revenue we have to raise, and then deal with those areas where we will attempt to raise the revenue to keep this thing revenue neutral.

So I would ask you now if we can have a motion to vote on the Pryor taxpayers' bill of rights, as amended. And that section will be contingent still on our being able to accomplish the rest of this and raise the revenue for it.

Senator Moynihan. I so move, Mr. Chairman.

Senator Pryor. Thank you, Senator.

The Chairman. Yes.

Senator Chafee. There has been indicated some concern over the shifting of the burden of proof and when do the cost when somebody can start charging for their lawyer's fees, at what point? Now is there going to be any further discussion? Senator Pryor has indicated that some of these matters might be worked out on different points that have been raised here. What happens next?

Let's say we report this bill out today. Then what happens?

The Chairman. Well, we can propose some Committee amendments, and that is often done, and we will have the

discussion of those members that are concerned and interested. And if we can arrive at a concensus on that, we will propose those as Committee amendments to the bill on the floor.

Senator Chafee. Well, I must say that I thought the points Mr. Nelson raised when the lawyer's costs start running made some sense. Well, maybe we will have another crack at it as a Committee amendment before this measure is considered on the floor.

The Chairman. We have had the motion made. All in favor of the motion as stated make it known by saying aye.

(Chorus of ayes)

The Chairman. Opposed by a similar sign.

(No response)

The Chairman. The motion is carried.

All right. If you will proceed. Who is handling the diesel tax presentation?

Mr. Gould. Mr. Chairman, I believe you have some materials.

The Chairman. All right. The ones I am getting now are the revenue raisers. I want to deal with the diesel tax itself and then we will see what we have to on revenue raisers.

Senator Danforth. Mr. Chairman, is the bill open for amendment?

The Chairman. Let me make a comment on this to get it

started, if I may, Senator Danforth.

We are now going to deal with the collection of the Federal excise tax on diesel fuel. And I know we all have heard from our constituents concerning this one. Senator Boren, he chaired a Subcommittee hearing on the matter two days. He heard from a great many witnesses, both within the Senate and outside the Senate. And I also want to recognize the contribution that was made by Senator Dasche, who introduced S. 2075, which called for tax-free sales of diesel fuel to farmers.

The bill also called for title reporting and requirements to help the IRS, because the IRS was having a problem policing the tax-free sales. And that is the concept we are going to look at here today.

You have in front of you on page 16 of the markup document a proposal for dealing with diesel tax matters. As you probably know, the proposal reflected in the document essentially is to permit farmers and fishermen to purchase diesel fuel tax-free from wholesalers. And a reporting procedure would be set up to allow the IRS to trace these tax-free purchases.

Under the proposal in the document, other off-road users would not be able to purchase tax-free, but would be made whole by receiving interest on their refunds of the tax. That is to take care of the float question. Ever since the

markup documents were distributed Wednesday afternoon the IRS and Joint Tax staff have been meeting nonstop. They have been trying to figure out how to police that diesel tax more closely without requiring the pay and refund procedures that require some exempt users to make loans to the Government.

The Joint Tax staff now tells us that we can permit all off-road users to purchase diesel fuel tax-free from wholesalers without significantly greater revenue cost than if we permitted farmers and fishermen to do so.

Now, obviously, this assumes the implementation of reporting requirements. It assumes that the IRS will take reasonable steps to audit these tax-free sales.

Now given that new information from the Joint Tax staff, I would like to propose that we permit all off-road users to purchase diesel fuel tax-free. Obviously, we are going to have to raise some offsetting revenues to take care of that. We are also going to have to raise some for the taxpayers' bill of rights, as Senator Bradley was concerned about. I am prepared to have staff suggest a couple of revenue raisers to make this possible.

You know what brought this about on the diesel tax. I can recall I had the Federal Highway Administrator in to talk to me, Ray Barnhart, saying that he felt there was some $500 million worth of revenue being lost by tax evasion, and

that we ought to move forward on that. The Administration proposed that. And we made that step. But since that time we have found a great deal of opposition to it because of a feeling by a number of people that, in effect, they are giving the Government a free ride on their money, that they are taking advantage of the float, and that it is a burdensome accounting procedure for a number of people who are tax exempt anyway. So I would like to address this situation.

I would like, first, to call on the staff to give us a picture of the revenue situation. How much revenue loss we are talking about?

Senator Packwood. Mr. Chairman, could I ask you one question?

Senator Heinz. Mr. Chairman, there is a vote in progress.

The Chairman. I see. The Senate is voting on a motion to table the Glenn amendment to H.R. 1414, the Price-Anderson bill.

Senator Packwood. Could I ask you a question before we go to vote?

The Chairman. Yes.

Senator Packwood. Did you say to exempt all off-road purchasers?

The Chairman. That is right.

Senator Packwood. So this would include barges, would include loggers using diesel fuel in the woods. I just want to make sure.

Mr. Gould. On purchases from wholesale distributors. That is correct, Senator Packwood.

Senator Packwood. All right.

Mr. Gould. There is not a proposal here for anybody who purchases from wholesale distributors, any exempt user, that is, who purchases from wholesale distributors.

Senator Packwood. Thank you.

The Chairman. Well I would like for the staff to do that. But I think we had better go vote. And then I would like for the staff to tell us some of the revenue raisers, where we ought to be trying to get that.

Senator Heinz. Mr. Chairman, one question.

The Chairman. All right.

Senator Heinz. Senator Packwood asked about if all off-road users were going to be taken care of, and the question I have is, does that include off-road users like barge operators?

The Chairman. Well, Senator, we will get into all of that in detail.

Senator Heinz. All right.

The Chairman. But the problem I have got is that all of this is important to each of you, and I am not sure that we

ought to do this by just part of us leaving. I think we ought to recess and come back. Make this vote and come back as quickly as we can. All right?

(Whereupon, at 12:10 p.m., the meeting was recessed.)

AFTER RECESS

(12:34 p.m.)

Mr. Wilkins. We are suspending the markup today. We will resume at 10:00 o'clock on Monday.

(Whereupon, at 12:35 p.m., the meeting was concluded.)

C E R T I F I C A T E

This is to certify that the foregoing proceedings of an Executive Committee Meeting of the United States Senate Committee on Finance, held on March 18, 1988, were transcribed as herein appears and that this is the original transcript thereof.

WILLIAM J. MOFFITT
Official Court Reporter

My Commission expires April 14, 1989.

STATEMENT OF SENATOR MALCOLM WALLOP Malcolm Wallop

MARKUP OF TAXPAYER BILL OF RIGHTS AND DIESEL FUEL EXCISE TAX

FRIDAY, MARCH 18, 1988

MR. CHAIRMAN, APRIL 15 IS ON THE HORIZON AND WITH THE PROBLEMS CREATED BY THE CHANGE IN COLLECTION POINT OF DIESEL EXCISE TAXES SOON TO BE A REALITY, YOU HAVE SELECTED A MOST APPROPRIATE TIME TO MARKUP THE TAXPAYER BILL OF RIGHTS AND FIND A SOLUTION TO THE EXCISE TAX PROBLEM. I COMMEND YOU FOR YOUR INITIATIVE ON THESE ISSUES.

I ALSO COMMEND SENATOR PRYOR FOR HIS WORK AND LEADERSHIP IN DEVELOPING THE TAXPAYER BILL OF RIGHTS. EVER CHANGING TAX LAWS, AND THEIR EVER INCREASING COMPLEXITY, TELLS ME THAT THIS LEGISLATION IS REALLY TIMELY.

MR. CHAIRMAN, THE SUCCESS OF OUR TAX SYSTEM IS BASED ON THE CONCEPT OF VOLUNTARY COMPLIANCE. THERE IS THEREFORE A DELICATE BALANCE BETWEEN THE RIGHTS OF TAXPAYERS AND THE OBLIGATION OF THE GOVERNMENT TO COLLECT THE PROPER AMOUNT OF TAX OWED.

I AM CONVINCED THAT FOR TOO LONG THE SCALES HAVE BEEN TIPPED IN FAVOR OF THE IRS. THE TAXPAYER BILL OF RIGHTS WILL RESTORE AT LEAST SOME OF THIS BALANCE TO THESE SCALES. IT IS NOW TIME TO ENACT THIS LEGISLATION INTO LAW.

THERE IS ANOTHER ISSUE OF IMPORTANCE TO WYOMING. IT FITS WITH THE CONCEPT OF THE BILL OF RIGHTS. WE MUST ALLEVIATE THE IMPACT THE COLLECTION POINT CHANGE FOR DIESEL FUEL EXCISE TAXES WILL HAVE ON OFF-ROAD AND TAX EXEMPT USERS. THIS CHANGE PLACES NEEDLESS AND UNCALLED FOR BURDENS ON THESE USERS.

THE CHANGE IN COLLECTION POINT WAS SOLD ON THE BASIS REDUCING FRAUD AND IMPROVING COMPLIANCE. BUT THE COST OF THIS CHANGE WILL FALL SQUARELY AND HEAVILY ON THE BACKS OF HONEST AND LEGITIMATE WYOMING DIESEL FUEL USERS. PEOPLE WHO DO NOT CHEAT NEVERTHELESS WILL HAVE HIGHER UP-FRONT FUEL COSTS, ADDITIONAL RECORD KEEPING REQUIREMENTS, AND LOSS OF CASH FLOW TO TAKE CARE OF THOSE THAT DO CHEAT. IT IS PARTICULARLY OFFENSIVE THAT TAX EXEMPT USERS WILL NOW BE FORCED TO GRANT THEIR GOVERNMENT AN INTEREST FREE LOAN ALL UNDER THE GUISE OF IMPROVED COMPLIANCE.

WYOMING, LIKE MANY OTHER STATES, HAS A LARGE NUMBER OF HIGH VOLUME TAX EXEMPT USERS OF DIESEL FUEL. THESE USERS RANGE FROM FARMERS AND RANCHERS TO DRILLING AND WELL SERVICING CONTRACTORS, TO MINING AND LOGGING OPERATORS TO GENERAL CONTRACTORS. THESE FIRMS CANNOT AFFORD A 27% INCREASE IN FUEL COSTS OR WAIT UP TO ONE YEAR TO RECEIVE A REFUND OF A TAX THEY NEVER OWED. THESE OPERATIONS DESERVE RELIEF FROM THE NEW LAW SCHEDULED TO TAKE EFFECT ON APRIL 1, 1988. IT IS MY HOPE THAT TODAY THIS COMMITTEE CAN DEVELOP A SOLUTION TO THIS PRESSING PROBLEM.

EXPLANATION OF PROPOSALS

SCHEDULED FOR FINANCE COMMITTEE

MARKUP on MARCH 18, 1988

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

March 16, 1988

JCX-5-88

CONTENTS

A. Debt Collection: Extension of Program for IRS Collection of Nontax Debts Owed to Federal Agencies

Present Law

Federal agencies are authorized to inform the IRS that a person (who has received proper notification from the agency) owes a past due, legally enforceable debt to the agency. The IRS then must reduce the amount of any tax refund due the person by the amount of the debt and pay that amount to the agency. The refund offset applies to individuals and corporations. This program is scheduled to expire after June 30, 1988.[1]

Description of Proposal

The Federal debt collection program could be extended for one year.

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[1] In the Omnibus Budget Reconciliation Act of 1987, the debt collection program was extended for six months from December 31, 1987, to June 30, 1988, expanded to apply to refunds due corporations, and expanded to cover all Federal agencies.

B. Taxpayer Bill of Rights

Overview

The following is a description of the provisions of the Taxpayer Bill of Rights as approved by the Senate Finance Committee in October 1987 as part of its reconciliation submissions to the Senate Budget Committee.[2] These provisions were ultimately not included in the budget reconciliation bill considered by the Senate and enacted into law. Section citations refer to the sections of the budget reconciliation bill (S. 1920) as initially reported by the Senate Budget Committee.

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[2] The only exception to this is that the description of the provision relating to the IRS Inspector General is a summary of the IRS Inspector General provision of S. 908, The Inspector General Act Amendments of 1988. Senator Pryor intends that the IRS Inspector General provision of S. 908 be substituted for the Inspector General provision in the Taxpayer Bill of Rights.

Sec. 4732. Disclosure of rights and obligations of taxpayers

Present Law

The Internal Revenue Service (IRS) provides information to taxpayers in various notices and publications. There is no statutory requirement that the IRS provide a comprehensive written explanation of the rights and obligations of the taxpayer and the IRS during the tax dispute resolution process.

Description of Proposal

The IRS would be required, when it first contacts a taxpayer concerning the determination or collection of any tax, to provide a "brief but comprehensive" written explanation of rights and obligations of the taxpayer and the IRS during the audit, appeals, refund, and collection processes.

Sec. 4733. Procedures involving taxpayer interviews

Present Law

Reasonable time and place.--The Code provides that the IRS shall select a reasonable time and place for an examination of a taxpayer. No regulations have been promulgated elaborating on this provision.

Recordings.--No statutory provision governs audio recordings of IRS interviews, although the IRS generally permits a taxpayer to make an audio recording of an interview if prior notice to the IRS is given.

IRS explanation.--The IRS has a general practice of providing written explanatory materials to taxpayers in advance of the initial audit interview.

Taxpayer representatives.--If a power of attorney has been executed properly in favor of a person eligible to practice before the IRS, the IRS permits the person to represent the taxpayer during all stages of the administrative process.

Description of Proposal

Reasonable time and place.--The IRS would be required to publish regulations within one year of enactment enumerating standards for determining whether the selection of a time and place for interviewing a taxpayer is reasonable.

Recordings.--The Code would be amended to allow a taxpayer to make an audio recording of an in-person interview at the taxpayer's own expense. IRS employees also would be authorized to record taxpayer interviews, provided the taxpayer receives prior notice of such recording and is supplied a transcript upon request and payment of the costs of transcription.

IRS explanation.--Prior to initial taxpayer interviews, IRS employees would be required to explain to taxpayers the audit process and taxpayers' rights under that process.

Taxpayer representatives.--The Code would be amended to provide that a taxpayer may be represented during a taxpayer interview by any attorney, public accountant, enrolled agent, or enrolled actuary who is not disbarred from practice before the IRS and has a properly executed power of attorney from the taxpayer. If a taxpayer indicates during an interview with the IRS that he wishes to consult with that representative, the interview would have to be discontinued. Absent an administrative summons, a taxpayer could not be required to accompany his representative to an interview.

The procedures involving taxpayer interviews would apply to interviews conducted on or after 30 days after enactment.

Sec. 4734. Abatement of penalties and interest

Present Law

The IRS may abate administratively some penalties in a variety of circumstances. The IRS may also abate interest attributable to IRS error or delay.

Description of Proposal

The IRS would be provided with authority to abate any part of the penalties and interest imposed with respect to a deficiency that is attributable to erroneous written advice furnished by the IRS to a taxpayer, where such advice was specifically requested by the taxpayer and reasonably relied upon, unless the taxpayer failed to provide accurate information when requesting the advice.

Sec. 4735. Taxpayer assistance orders

Present Law

The Taxpayer Ombudsman administers the IRS Problem Resolution Program, which is designed to resolve a wide range of tax administration problems that are not remedied through normal operating procedures or administrative channels. The Ombudsman cannot resolve disputes involving substantive

issues of the tax law.

Description of Proposal

The Taxpayer Ombudsman would be provided statutory authority to issue a taxpayer assistance order, if, in the determination of the Ombudsman, the taxpayer is suffering or about to suffer irreparable loss and the IRS has failed to carry out its duties under the law. The taxpayer assistance order could require remedial actions, such as release from levy of property of the taxpayer, and would be binding on the IRS unless reversed by a district director or his superiors.

Sec. 4736. IRS Inspector General

Present Law

The Treasury Department has a nonstatutory Inspector General with internal audit and investigative responsibilities for the Department, except for its four law enforcement agencies: IRS, Secret Service, Customs Service, and the Bureau of Alcohol, Tobacco, and Firearms. These functions are performed at the IRS by the Inspection Division, which reports directly to the IRS Commissioner.

Description of Proposal

A statutory Inspector General would be established within the IRS. It would be separate from a statutory Inspector General to be established within the Treasury Department, which would have general oversight responsibility over all other agencies within the Treasury Department. The IRS Inspector General would be appointed by the President from a small pool of senior career personnel at the IRS with demonstrated ability in investigative techniques or internal audit functions. The Inspector General office for the IRS would incorporate the existing IRS Inspection Division. The IRS Inspector General would not have the power to change taxpayer liability determinations, and would be under the direction and control of the IRS Commissioner with respect to matters requiring access to certain sensitive information, such as ongoing criminal investigations and deliberations on policy matters. If the Commissioner exercises the authority to prohibit an audit or investigation in order to prevent disclosure of sensitive information, the Commissioner would be required to notify appropriate committees of Congress. (This description is a summary of the IRS Inspector General provision of S. 908, The Inspector General Act Amendments of 1988, which was passed by the Senate on February 2, 1988. Senator Pryor intends that this provision of S. 908 be considered, rather than the Inspector General provision of the Taxpayer Bill of Rights.)

Sec. 4737. Basis for evaluation of IRS employees

Present Law

The IRS Manual prohibits the use of production quotas or goals based upon sums collected to evaluate IRS enforcement officers, appeals officers, and reviewers.

Description of Proposal

The IRS would be statutorily prohibited from using records of tax enforcement results to evaluate enforcement officers, appeals officers, and reviewers or to impose or suggest production quotas or goals. Each district director must certify each month that this prohibition is being observed.

Sec. 4738. Application of the Regulatory Flexibility Act to the IRS

Present Law

The Regulatory Flexibility Act requires Federal agencies, including the IRS, to publish an analysis of the impact of proposed and final rules on small businesses or other small entities. These analyses are reviewed by the Small Business Administration. In addition, these analyses (as well as the regulations themselves) are reviewed by the Office of Management and Budget pursuant to an Executive Order. The requirement to publish an analysis of the impact of rules on small businesses does not, however, apply to interpretative regulations, which exempts most IRS regulations.

Description of Proposal

The Secretary of the Treasury must certify that each IRS regulation is substantially the only alternative under the tax law for the regulation to be considered interpretative under the Regulatory Flexibility Act. Thus, the Secretary must certify that no significant interpretation of the statute is possible except for the interpretation in the regulation. If the Secretary is unable to certify this, the regulation must include an analysis of its impact on small businesses and is subject to review by the Office of Management and Budget and the Small Business Administration.

Sec. 4739. Preliminary letter of deficiency

Present Law

A statutory notice of deficiency must be sent to a taxpayer by certified or registered mail before the IRS can

collect tax. The Code does not require that a preliminary notice of potential deficiency be sent, although IRS general practice is to provide four of these notices to taxpayers.

Description of Proposal

The IRS would be required to send to a taxpayer by certified or registered mail a preliminary letter of deficiency if it determined that there is a potential deficiency. The preliminary letter would be required to be sent at least 30 days prior to sending a statutory notice of deficiency, except when the statute of limitations would expire within 90 days or when the taxpayer waives a right to such letter.

Secs. 4740-4741. Explanation of IRS assessments

Present Law

The Code does not specify the content of the statutory notice of deficiency. The IRS generally explains the basis of a tax deficiency in the notice, but generally does not explain the calculation of interest owed. Moreover, there is no requirement in IRS regulations that the IRS explain the basis for assessing penalties.

Description of Proposal

The IRS would be required to describe in any notice of deficiency or tax due the basis for an asserted deficiency and to identify the portion of the amount due that constitutes interest, additions to tax, and penalties. The proposal would apply to mailings made after 180 days after enactment. In addition, the IRS would be directed to issue regulations within 90 days after enactment requiring IRS employees to explain and support assessments of penalties.

Sec. 4742. Installment payment of tax liability

Present Law

The IRS is not required to enter into installment payment agreements with taxpayers, but generally does so if a taxpayer who is unable to pay the delinquency in full is able to make payments on the delinquent taxes and pay current taxes as they become due. A change in the taxpayer's financial condition may result in modification of the installment payment agreement.

Description of Proposal

The IRS would be granted statutory authority to enter into a written installment payment agreement if it determines that such agreement will facilitate collection of tax. The

agreement would be binding on the IRS and the taxpayer unless the taxpayer (1) provided inaccurate information, (2) undergoes a significant change in financial condition, (3) fails to pay an installment when due, or (4) fails to pay any other tax liability when due.

Sec. 4743. Levy and distraint

Present Law

Notice.--At least 10 days before collecting a tax by levy (i.e., seizure of the taxpayer's property) the IRS must provide the taxpayer written notice of its intent to levy. If the IRS finds that collection of tax is in jeopardy, it may collect the tax by levy without providing this notice or waiting 10 days.

Property subject to levy.--Property subject to levy includes any property (or rights to property being held by others) belonging to the taxpayer, except property specifically excluded from levy by law, which includes (1) fuel, provisions, furniture, and personal household effects, not exceeding $1,500 in aggregate value; and (2) books and tools necessary for the trade, business, or profession of the taxpayer, not exceeding $1,000 in aggregate value.

Levy on wages.--The IRS may instruct the taxpayer's employer to pay to the IRS amounts payable to the taxpayer as wages, except (1) so much of the wages of the taxpayer as is necessary to comply with a prior judgment of a court of competent jurisdiction for support of any minor children of the taxpayer, and (2) a minimum amount of wages or other income (in general, $75 per week plus $25 per week for each dependent).

Release of levy.--The IRS has authority to release a levy if it determines that this will facilitate the collection of tax.

Description of Proposal

Notice.--The required period between the IRS providing written notice to a taxpayer and the collection of tax by levy would be extended to 30 days. As under present law, the notice and waiting period requirements would not apply if the IRS finds that collection of the tax is in jeopardy. The notice preceding levy would be required to contain a description of Code provisions and administrative procedures applicable to specific aspects of collection, and a description of all alternatives available to the taxpayer which could prevent levy on the taxpayer's property. The proposal would apply to levies made on or after enactment.

Property subject to levy.--The types of property exempt from levy would be expanded to include: (1) fuel, provisions, furniture, and personal household effects, not exceeding $10,000 in aggregate value; (2) books, tools, machinery, or equipment of taxpayers (other than C corporations) if necessary trade or business property, not exceeding $10,000 in aggregate value; (3) a taxpayer's principal residence, a motor vehicle used as a primary means of transportation to work, and necessary tangible personal property used in the taxpayer's trade or business, unless an IRS district director or assistant director personally approves levy in writing, or if collection of the tax is found to be in jeopardy; and (4) property with respect to which the estimated expenses of levy and sale exceed the fair market value of the property or the tax liability. In addition, banks and other financial institutions would be required to hold accounts garnished by the IRS for 21 days after receiving the IRS notice of levy, in order to provide taxpayers an opportunity to notify the IRS of errors with respect to garnished accounts.

Levy on wages.--The amount of wages exempt from levy for each week would be equal to the taxpayer's standard deduction and personal exemptions allowable for the taxable year in which the levy occurs, divided by 52. In addition, a levy on wages would continue only until (1) the liability is satisfied or becomes unenforceable by reason of lapse of time, (2) an installment payment agreement is executed, or (3) the IRS determines that the liability is unenforceable due to the taxpayer's financial condition.

Release of levy.--The IRS would be required to release a levy on property if (1) the liability is satisfied, (2) release will facilitate the collection of the liability, (3) an installment payment agreement has been executed, (4) the expenses of levy and sale exceed the liability, or (5) the value of the property exceeds the liability and partial release would not hinder collection.

Sec. 4744. Review of jeopardy levy and assessment procedures

Present Law

Assessment of a tax (i.e., recording of the tax liability in the office of the District Director) is the final act by the IRS that establishes the liability of a taxpayer for a tax. After assessment, the IRS will attempt to collect the tax. The Code authorizes the IRS to make a jeopardy assessment (i.e., to immediately assess and demand payment of a tax and any penalties and interest) where collection would be endangered if regular procedures are followed. Furthermore, if the IRS determines that collection of tax would be jeopardized by waiting the regular 10-day

period after notice and demand for payment have been provided to the taxpayer, the IRS can collect the tax by jeopardy levy (i.e., immediately seize certain of the taxpayer's property). The Code provides special rules relating to administrative review and judicial review (by Federal district courts) of jeopardy assessments. These rules do not apply to jeopardy levies.

Description of Proposal

The existing rules relating to the review of jeopardy assessments would be extended to the review of jeopardy levies. The Tax Court would be provided exclusive jurisdiction with respect to challenges to a jeopardy assessment or jeopardy levy if the taxpayer is already before the Tax Court with respect to any deficiency covered by the jeopardy assessment notice. In all other cases, the appropriate district court would have exclusive jurisdiction over such an action.

Sec. 4745. Administrative appeal of liens

Present Law

A taxpayer can obtain a review within the IRS of an initial determination of tax deficiency before the matter proceeds to collection, but the Code does not provide specific procedures for the administrative appeal of IRS decisions concerning the collection of a tax liability.

Description of Proposal

The IRS would be required to promulgate regulations within 180 days after enactment that provide an administrative procedure enabling any taxpayer to appeal the imposition of a lien.

Sec. 4746. Jurisdiction to restrain certain premature assessments

Present Law

Jurisdiction to restrain IRS assessment and collection of tax rests solely with the Federal district courts. Consequently, even though as a general rule no assessment or collection of tax may be made until the decision of the Tax Court has become final, a taxpayer with a case before the Tax Court who is faced with a premature IRS assessment is forced to challenge that assessment in Federal district court.

Description of Proposal

The Tax Court would be provided exclusive jurisdiction to restrain the assessment and collection of any tax by the

IRS that is the subject to a timely filed petition that was pending before the Tax Court prior to the assessment and collection being challenged. If a premature assessment is made prior to the taxpayer's filing of a petition with the Tax Court, the appropriate Federal district court would continue to have jurisdiction over any challenge to the assessment.

Sec. 4747. Jurisdiction to enforce overpayment determinations

Present Law

The Tax Court has jurisdiction to determine that a taxpayer is due a refund of a tax for which the IRS has asserted a deficiency. However, if the IRS fails to refund an overpayment determined by the Tax Court, the taxpayer must seek relief in another court.

Description of Proposal

The Tax Court would be granted jurisdiction to order the refund of an overpayment plus interest if, within 120 days after a Tax Court decision has become final, the IRS fails to refund to a taxpayer an overpayment determined by the Tax Court. If the IRS fails to establish that its delay was substantially justified, then the taxpayer would be entitled to interest on the overpayment at 120 percent of the statutory interest rate and to reasonable litigation costs.

Sec. 4748. Jurisdiction to review certain sales of seized property

Present Law

If a taxpayer fails to pay a tax on notice and demand after the IRS makes a jeopardy assessment, a lien arises in favor of the United States upon property belonging to the taxpayer and the IRS can immediately seize the taxpayer's property. Pending issuance of a notice of deficiency, and, if the taxpayer challenges the assessment in either the Tax Court or Federal district court, pending the decision of such court, the IRS cannot sell property seized pursuant to a jeopardy assessment, unless (1) the taxpayer consents to the sale, (2) the IRS determines that the expenses of conservation and maintenance will greatly reduce the net proceeds, or (3) the property is liable to perish or become greatly reduced in value by keeping, or cannot be kept without great expense. If the taxpayer wishes to contest an IRS determination to sell seized property, the only recourse is to bring suit in Federal district court.

Description of Proposal

The Tax Court would be granted jurisdiction during the pendency of proceedings before it to review the IRS' determination to sell seized property under one of the present-law exceptions to the stay of sale.

Sec. 4749. Jurisdiction to redetermine interest on deficiencies

Present Law

Following a decision by the Tax Court, the IRS assesses the entire amount redetermined as the deficiency by the Tax Court and adds to the deficiency interest computed at the statutory rate. If the taxpayer disagrees with the IRS' interest computation, however, the Tax Court does not have jurisdiction to resolve that dispute.

Description of Proposal

If a dispute arises over the IRS' computation of the interest due on a deficiency, then within one year from the date the Tax Court decision became final the taxpayer could move to reopen the Tax Court proceeding for a determination of interest due. The taxpayer would be required first to pay the entire deficiency redetermined by the Tax Court and the interest determined by the IRS. The proposal would apply to assessments of deficiencies made after the date of enactment.

Sec. 4750. Refund jurisdiction for the Tax Court

Present Law

When a taxpayer receives notice from the IRS that it has determined a deficiency of tax, the taxpayer may, before paying the determined liability, petition the Tax Court for a redetermination of the deficiency within 90 days after the notice of deficiency was mailed. Alternatively, the taxpayer may pay the deficiency and file a claim for refund of the disputed amount with the IRS. If the IRS rejects the refund claim, or does not act within six months, then the taxpayer may bring an action for refund in Federal district court or the United States Claims Court, but not the Tax Court.

A taxpayer may also file with the IRS a claim for refund of an overpayment not attributable to a deficiency, and if the refund is rejected by the IRS, then the taxpayer may bring an action in Federal district court or the United States Claims Court seeking a refund of the asserted overpayment. The Tax Court has no jurisdiction to determine whether a taxpayer has made an overpayment except in the context of a deficiency proceeding.

Description of Proposal

The Tax Court would be granted jurisdiction over tax refund actions against the IRS, including both refund actions arising out of a taxpayer's payment of a deficiency asserted by the IRS and refund actions arising out of overpayments not attributable to a deficiency. The general prerequisites governing the commencement of tax refund actions would apply to refund actions filed in the Tax Court. A taxpayer would continue to have the option of filing a claim for refund in the appropriate Federal district court or the United States Claims Court.

Sec. 4751. Awarding of costs and certain fees in administrative and civil actions

Present Law

Reasonable costs.--A taxpayer who prevails in a tax case in any Federal court may be awarded reasonable litigation costs, including attorneys fees (generally limited to $75 per hour), expenses of expert witnesses, and court costs. Costs incurred during the IRS administrative process generally are not recoverable.

Burden of proof.--To be awarded reasonable litigation costs, the taxpayer must establish that the position of the United States in the case was not substantially justified and that the taxpayer substantially prevailed with respect to the amount in controversy or the most significant issue(s) in the case.

Position of United States.--In determining whether the position of the United States was substantially justified, the position of the United States begins with the position taken by the IRS district counsel. This generally does not include positions taken in the audit or appeals processes.

Administrative settlement of claims for litigation costs.--The Code does not provide explicit authority to the IRS to settle administratively claims for litigation costs.

Description of Proposal

Recoverable costs.--A taxpayer who prevails in a Federal tax proceeding could (if the burden of proof with respect to costs is satisfied) recover all reasonable costs incurred during administrative or judicial proceedings following the date of the preliminary letter of deficiency. This proposal would apply to proceedings commenced after enactment.

Burden of proof.--The burden of proof with respect to awards of costs would be shifted to the Government, so that if a taxpayer prevails in the proceeding, the Government would be required to establish that its position was substantially justified in order to prevent the taxpayer from recovering costs.

Position of United States.--In determining whether the position of the United States was substantially justified, the position of the United States begins with the position taken in the preliminary letter of deficiency.

Administrative settlement of claims for litigation costs.--The IRS would be provided with authority to settle claims for recovery of costs incurred in administrative and judicial proceedings.

Sec. 4752. Civil cause of action for damages due to Government's failure to release lien

Present Law

The Code does not grant taxpayers a right to bring an action for damages resulting from the government's wrongful failure to remove a lien on the taxpayer's property.

Description of Proposal

Taxpayers would have the right to sue the Government in district court if any Federal employee knowingly or negligently fails to release a lien on the taxpayer's property as required under the Code. Taxpayers could recover (1) reasonable litigation costs plus (2) the greater of actual damages or $100 per day for each day the failure continues after the taxpayer provides written notice to the IRS of the failure to release the lien.

Sec. 4753. Civil cause of action for damages due to unreasonable action by the IRS

Present Law

Taxpayers do not have a specific right to sue the Government for damages sustained due to unreasonable actions taken by an IRS employee.

Description of Proposal

Taxpayers would have the right to sue the Government in Federal district court for damages if an employee of the IRS carelessly, recklessly, or intentionally disregards any provision in the Code or regulations and the issue is ultimately resolved in favor of the taxpayer. The taxpayer

could recover litigation costs plus actual damages, unless the taxpayer was contributorily negligent. If the district court determines that the taxpayer's lawsuit was frivolous, the court may impose a penalty on the taxpayer of up to $10,000.

Sec. 4754. Criminal penalty for improper IRS investigations

Present Law

The Code does not explicitly prohibit investigations of a taxpayer or related compilations of records that are not relevant to the administration or enforcement of the internal revenue laws.

Description of Proposal

It would be unlawful for any Federal employee acting in connection with the revenue laws to knowingly authorize, require, or conduct any investigation of, or surveillance over, any taxpayer that is not connected with the administration or enforcement of the internal revenue laws. Maintenance of records containing information from such an investigation also would be prohibited. Violation of this prohibition would result in dismissal of the employee and, upon conviction, a fine up to $10,000, imprisonment for up to 5 years, or both. The court also could award damages against the employee in favor of the injured taxpayer.

Sec. 4755. Assistant Commissioner for Taxpayer Services

Present Law

There is currently within the IRS an Assistant Commissioner (Taxpayer Services and Returns Processing). This position is not provided by statute.

Description of Proposal

The proposal would establish statutorily an Assistant Commissioner for Taxpayer Services, who (jointly with the Taxpayer Ombudsman) must annually report to the Congress concerning the quality of taxpayer services provided by the IRS.

C. Collection and Exemption Procedures for Diesel Fuel Excise Tax

Present Law

Effective after March 31, 1988, the 15.1-cents-per-gallon excise tax on diesel fuel is imposed on the sale of the taxable fuel by a producer, defined to include wholesale distributors as well as actual producers of the fuel.

Exemptions from tax are provided for off-highway business uses, including inter alia, use on a farm for farming purposes, use as supplies for vessels and trains, and use in construction activities. Further exemptions are provided for use by State and local governments and by nonprofit educational organizations.

In general, exemptions from the tax are realized by means of refunds following tax-paid sales. These refunds may be accomplished either by credits against the exempt user's income tax (often realized by reductions in quarterly estimated tax payments), or in the case of users of significant amounts of fuel ($1,000 or more per quarter of fuel tax refund), by direct claims filed quarterly with the Internal Revenue Service.

A special rule authorizes the Treasury Department to adopt regulations permitting sales without payment of tax (on a case-by-case basis) when diesel fuel is sold directly by a wholesale distributor to (1) a person who will use the fuel as fuel for trains or as a chemical feedstock and (2) State and local governments for their exclusive use.

Before April 1, 1988, the diesel fuel tax is imposed at the retail level, with most exemptions being realized through tax-free sales.

Description of Proposal

(1)(a) The special rules currently applicable to State and local governments and railroads could be expanded to permit tax-free sales on the same basis to exempt users who are not required to make quarterly estimated income tax payments and who are not subject to income tax withholding.

(b) To curb the potential for increased tax evasion arising from expanding the number of persons qualifying for exempt sales, reporting procedures similar to the Form 1099 rules that apply under present law to interest income could be adopted.

(c) Special refund procedures could be included

allowing the additional persons allowed by the bill to buy diesel fuel without payment of tax to file for a one-time interest-bearing refund equal to the tax (other than tax for which a credit or refund previously could have been claimed) paid before those users qualified for direct tax-free sales.

(2) The rules governing eligibility for quarterly refunds to off-highway business users required to buy tax-paid could be liberalized to provide (a) that interest would be paid on such refunds from the date Treasury received the tax payments and (b) that the $1,000 tax requirement would be reduced to $750 and made cumulative for the first three calendar quarters of any year (rather than being determined with respect to each such quarter).

(3) The Treasury Department regulatory authority to permit tax-free sales to exempt users could be made mandatory. Treasury could be required to issue these regulations within 90 days after enactment of the bill.

Senate Finance Committee
Mark-Up
March 18, 1988

Senator Pryor's Proposed Amendments to the Taxpayer's Bill of Rights (as included in S.1920)

Sec. 4732. Disclosure of rights and obligations of taxpayers

1. Provide the IRS with authority to issue regulations to prevent multiple statements from being sent to the same taxpayer.

Sec. 4733. Procedures involving taxpayer interviews

1. With respect to the taxpayer's right to make audio recordings of IRS interviews, provide that the taxpayer must provide advance notice to the IRS of intent to record.

2. With respect to the taxpayer's right to receive a transcript of a recording made by the IRS under this provision, provide that it is sufficient for the IRS to supply the taxpayer with a copy of the recording itself.

3. With respect to requiring the IRS to explain the process to the taxpayer at the beginning of an interview, require a description of only the audit process at the initial audit interview, and of only the collection process at the initial collection interview; provide also that a written statement handed to the taxpayer at the interview or within a short time before the interview is sufficient.

4. Provide that the IRS must notify the taxpayer at an interview that the case has been referred to the Criminal Investigations Division, if the case has been.

5. If the taxpayer wishes to consult with his representative, provide that the interview is "suspended," not "terminated"; provide also that, in order to suspend the interview, the taxpayer must clearly state his desire to consult with his representative.

6. With respect to the IRS's right to notify the taxpayer that the representative is hindering or delaying the process, provide that this right is triggered if the IRS employee "believes" that the representative is obstructive.

7. With respect to the issue of who is a representative for purposes of this section, provide that anyone disbarred

"or suspended" does not qualify; delete "public accountant" and substitute "certified public accountant".

Sec. 4734. Advice of the IRS

1. Provide that abatement is mandatory under the provision.

2. Eliminate interest from the scope of this provision.

3. Substitute the word "proposed" for the word "imposed".

4. Provide that the provision is effective for advice requested after the date of enactment.

Sec. 4735. Taxpayer assistance orders

1. Provide that the Ombudsman may delegate authority under this provision to appropriate personnel in the field.

2. Provide that the statute of limitations is tolled during the pendency of a taxpayer's application for relief under this provision.

3. Substitute "significant" for "irreparable".

4. Provide that the provision does not prevent the Ombudsman from taking action in the absence of a taxpayer application for relief.

5. Delete the requirement that the Ombudsman must make a finding that an IRS employee has failed to carry out his duties under the law.

Sec. 4736. Office of Inspector General

No amendments to the Inspector General provision in S.908 as passed by the Senate.

Sec. 4737. Basis for evaluation of IRS employees

1. Incorporate more of IRS Policy Statement P-1-20.

2. Provide that certifications under this provision must be made quarterly.

Sec. 4738. Application of Regulatory Flexibility Act to the IRS

1. Substitute for the provision a rule requiring the IRS to solicit comments from the Small Business Administration before issuing regulations; under the substitute, the SBA would have four weeks from the time of the solicitation to comment on the impact of the regulations on small business.

Sec. 4739. Preliminary letter of deficiency

Delete this provision.

Sec. 4740. Content of tax due and deficiency notices

1. Provide that an inadequate description under this provision does not invalidate the notice.

Sec. 4741. Fuller explanation of basis for assessing penalties

No amendments.

Sec. 4742. Installment payment of tax liability

1. Provide that the IRS may alter, modify or annul an installment agreement where it determines that collection of the tax is in jeopardy, or where the taxpayer fails to supply updated financial information upon request.

2. Provide that the provision is effective for agreements entered into after the date of enactment.

Sec. 4743. Levy and distraint

1. With respect to the effect of a levy on salary and wages, provide that the IRS may consider the economic hardship that may be suffered by the taxpayer, and delete the condition relating to unenforceability of the liability.

2. With respect to the levy exemption for fuel, furniture, provisions, and personal effects, delete the increase and instead index the current law amount through the end of 1990.

3. With respect to the levy exemption for books and

tools of a trade or business, delete the increase and instead index the current law amount through the end of 1990.

4. With respect to the levy exemption for wages and salary, provide that credit for personal exemptions not be available where the taxpayer is already claimed as a dependent on another taxpayer's return (to avoid duplication of an exemption with respect to the same dependent).

5. With respect to levies subject to review by an assistant district director or a superior, delete primary commuting vehicle from the scope of the provision; clarify that for the provision to apply to business property, the property must be essential business property.

6. With respect to the prohibition on uneconomical levies, provide that the prohibition applies only where the expenses would exceed the fair market value of the property to be seized.

Sec. 4744. Review of jeopardy levy and assessment procedures

1. Provide that the Tax Court has concurrent, and not exclusive, jurisdiction under this provision.

Sec. 4745. Administrative appeal of liens

1. Redraft the provision so that the IRS is required to provide the taxpayer with an administrative procedure to obtain review of the filing of a notice of lien in the public record and the opportunity to petition for the release of such lien; an appeal made under this provision would not prevent the IRS from filing a notice of lien.

2. Provide that the IRS must file, along with any release of lien, a statement describing the reason for the release.

Sec. 4746. Jurisdiction to restrain certain premature assessments

1. Provide that the Tax Court has concurrent, and not exclusive, jurisdiction under this provision.

Sec. 4747. Jurisdiction to enforce overpayment determinations

No amendments.

Sec. 4748. Jurisdiction to review certain sales of seized property

No amendments.

Sec. 4749. Jurisdiction to redetermine interest on deficiencies

No amendments.

Sec. 4750. Refund jurisdiction for the Tax Court

1. Provide that the Tax Court also has jurisdiction over the interest paid on a deficiency, counterclaims for unpaid interest, and equitable recoupment.

2. Provide that the provision would be effective six months after date of enactment (instead of July 1, 1988).

Sec. 4751. Awarding of costs and certain fees in administrative and civil actions

1. Provide that recoverable costs begin to accrue as of the first written communication received from the IRS that allows the taxpayer the opportunity to seek administrative review of the proposed deficiencies in the Office of Appeals.

2. Provide that taxpayers are required to have taken reasonable steps to present all relevant evidence and legal arguments to examination or service center personnel prior to coming to the Office of Appeals.

Sec. 4752. Civil cause of action for damages sustained due to failure to release lien

1. Provide that recoverable actual damages are limited to direct economic (and not consequential) damages. Provide further that the taxpayer has a duty to mitigate damages.

2. Provide that the per diem damages recoverable under this provision are limited to $1,000.

3. Provide that amounts recoverable under this provision are to be treated as refunds for purposes of the Tax Court's jurisdiction. Provide further that the taxpayer must have exhausted administrative remedies before filing a claim or seeking review in court.

4. Provide that the per diem damages do not start to accrue until after 10 days after the IRS receives notice from the taxpayer that a lien has been improperly maintained.

5. Provide that reasonable litigation costs recoverable under this provision are only those costs incurred but for the improper maintenance of a lien; ensure there can be no double recovery under this provision and sec. 4751.

6. Provide that the IRS has regulatory authority to provide rules to require the taxpayer's notice under this provision be mailed to a particular location.

7. Provide that the provision applies to notices issued (and damages arising) after the effective date.

Sec. 4753. Civil cause of action for damages sustained due to unreasonable actions by the IRS

1. Provide that the provision applies only where the IRS's unreasonable action is in connection with a collection action.

2. Provide that recoverable damages are limited to direct economic (and not consequential) damages proximately related to the collection action. Provide further that the taxpayer has a duty to mitigate damages.

3. Provide that amounts recoverable under this provision are to be treated as refunds for purposes of the Tax Court's jurisdiction. Provide further that the IRS has authority to settle administratively claims under this provision and that the taxpayer must have exhausted administrative remedies before filing a claim or seeking review in court.

4. Provide that a claim under this provision is barred unless filed within two years of the discovery of the unreasonable action.

5. Provide that reasonable litigation costs recoverable under this provision are only those costs incurred but for the unreasonable collection IRS action; ensure there can be no double recovery under this provision and sec. 4751.

6. Provide that the provision is effective for actions after the effective date.

Sec. 4754. Authorizing, requiring, or conducting certain investigations

Delete this provision.

Sec. 4755. Assistant Commissioner for Taxpayer Service

No amendments.

New Sec. 4756. Jurisdiction to modify certain estate tax decisions

1. Provide that if, subsequent to the entry of a Tax Court decision, a decedent's estate claims a deduction as an administration expense for any interest with respect to estate tax paid under the section 6166 installment payment provisions, the Tax Court may modify its decision (which otherwise would be final) solely in order to reflect the estate's entitlement to a deduction of interest on such Federal or state taxes as an administration expense under section 2053.

Modification of Wine Flavors Credit

Present Law

A credit is allowed against the distilled spirits tax for the alcohol content of a taxable distilled spirits beverage that is derived from wine and/or flavor components. The credit is equal to the difference between the distilled spirits tax rate and the lower, wine tax rate. Typical wine flavorings in products such as brandy constitute no more than 2.5 percent of the alcohol content of the beverage.

According to BATF, within the past two years, use of the credit has expanded beyond wine flavoring situations. Some producers are transferring neutral spirits distilled from grain to wineries. At the winery, the spirits are mixed with some grape derived alcohol. The "wine" mixture is then diluted repeatedly with water to the point that it is not a drinkable solution. The alcohol product is removed from the winery to a distillery where it is used in making inexpensive distilled spirits beverages. The wine credit is claimed with respect to the percentage of alcohol content in the beverage that is attributable to the wine. BATF estimates that, in the average case, the credit is being used to reduce the effective tax rate on these distilled spirits products from $12.50 per proof gallon to around $8.00-$8.50 per proof gallon.

Description of Proposal

The maximum wine credit with respect to any distilled spirits beverage could be limited to no more than 2.5 percent of the alcohol content of the beverage and to alcohol content attributable to direct wine-derived flavors.

Effective date.--The provision would be effective on the date of the bill's enactment.

Gas Guzzler Excise Tax (sec. 4064 of the Code)

Present Law

The Energy Tax Act of 1978 imposed an excise tax on automobiles that did not meet statutory standards for fuel economy. The amount of tax varies according to the fuel efficiency of a model of automobile. No gas guzzler tax is imposed if the fuel economy of the automobile model is at least 22.5 miles per gallon (as determined by the Environmental Protection Agency). For automobiles that do not meet that standard, the tax begins at $500 and increases to $3,850 for the automobile models that are the least fuel-efficient.

Explanation of Option

The tax rates on automobiles that do not meet the statutory standard for fuel economy could be doubled. The special rules for small manufacturers (which have never been utilized) could be repealed.

Effective date.--The proposal would apply to automobiles sold after the date of enactment.

Internal Revenue Service

memorandum

date: February 17, 1987

to: All Group Managers
Field Branch II

from: Chief, Field Branch II

HANDWRITTEN NOTE TO THE RIGHT IS FROM MANAGER (NAME HAS BEEN DELETED), READS: "ALL REVENUE OFFICERS I NEED YOUR HELP TO AVOID GETTING INTO TROUBLE." →

All R/O
I need
your
help to
avoid
getting
into
trouble

subject: Monthly Report - January 1987

I am sure each of you has analyzed and evaluated the January monthly report for your group. Personally, for a five week period, it is a sorry report. Not one manager has come forward to explain the poor performance statistical indicators. Example: one (1) CID Referral, four groups had zero (0); seven (7) seizures for the Branch, one group with zero (0) and two groups with one (1) each; and the number of low closures.

It appears the fewer cases that the revenue officers have assigned to them, the less work they do. WPSS has not helped at all in the performance or quality areas. I still see Forms 5942 from SPS with the same old findings. I realize that in January we experienced two snow storms, but the first one did not take place until January 22nd. Furthermore, field time was disasterous, some revenue officers did not even turn in travel vouchers for January because they did not have any travel.

Where are you as managers? What are you doing, and is it effective? As managers, you must become actively involved by doing your follow-ups, performing timely reviews (formal and informal), reviewing Forms 795 (daily reports), making field and office visits, reviewing field time, etc. The revenue officers that are performing above a satisfactory level will be rewarded, and the ones that are not will be documented with corrective action taken.

Your mid-year evaluations will be prepared in approximately one and one-half months. You will be evaluated on your accomplishments or lack of accomplishments. Need I say more?

Wilbur E. McKean

NOTE: THE STATEMENTS BELOW WERE PART OF THE WRITTEN TESTIMONY PRESENTED BY I.R.S. COMMISSIONER LAWRENCE GIBBS DURING THE APRIL 21 HEARING OF THE OVERSIGHT SUBCOMMITTEE

IEW INCLUDE NOTING WHETHER THE AGE, FAIR OR POOR; PROVIDING ...ING THE NECESSARY TRAINING TO MAKE CERTAIN IMPROVEMENT CAN BE MADE, AND FINALLY, FOLLOWING UP AT A LATER TIME TO BE CERTAIN THE DESIRED IMPROVEMENT IS ACCOMPLISHED.

I WOULD LIKE TO NOTE HERE THAT ENFORCEMENT PERSONNEL ARE NOT EVALUATED ON A QUOTA SYSTEM. IN FACT, WE HAVE A POLICY STATEMENT, P-1-20, WHICH STATES THAT TAX ENFORCEMENT RESULTS TABULATIONS SHALL NOT BE USED TO EVALUATE SUCH PERSONNEL OR TO IMPOSE ANY PRODUCTION QUOTAS OR GOALS. I HAVE ATTACHED A COPY OF THAT POLICY STATEMENT TO MY TESTIMONY.

THE SERVICE IS ORGANIZED IN SUCH A WAY THAT EACH LEVEL HAS THE RESPONSIBILITY FOR PROVIDING FORMAL AND INFORMAL FEEDBACK TO THE NEXT LOWER LEVEL REGARDING QUALITY. FOR EXAMPLE, THE SEVEN REGIONS MONITOR THE PRODUCTS PRODUCED BY THE DISTRICTS AND SERVICE CENTERS IN A PROGRAM CALLED REGIONAL OFFICE REVIEW PROGRAM, AND DISTRICT AND SERVICE CENTER MANAGERS ARE HELD ACCOUNTABLE FOR THE WORK OF THEIR RESPECTIVE STAFFS.

FUNCTIONAL AREAS WITHIN THE NATIONAL OFFICE ALSO CONDUCT QUALITY REVIEWS OF THE FIELD OPERATIONS IN THEIR PROGRAM AREAS HOLDING THE REGIONS ACCOUNTABLE FOR DISTRICT/SERVICE CENTER ACTIVITIES.

Punish or Perish at IRS

Will the Taxman's Quotas Catch You on April 15?

WASH POST 3/13/85

By David Burnham

ABOUT A YEAR ago, a middle-level official in the Internal Revenue Service named Wilbur E. McKean sent a pointed one-page memorandum to the six group managers under his immediate command.

McKean, the man in charge of the Baltimore District's Field Branch II, was not happy with his managers. "I am sure each of you has analyzed and evaluated the January report for your group," he wrote. "Personally, for a five-week period, it is a sorry report. Not one manager has come forward to explain the poor performance statistical indicators."

McKean was talking numbers, numbers of seizures that had been performed, numbers of investigations closed, numbers of criminal tax matters that had been uncovered. And he wanted production. During the January reporting period, he said, the 91 revenue officers and staff assigned to Field Branch II had made only seven seizures and referred only one case to the criminal investigating division.

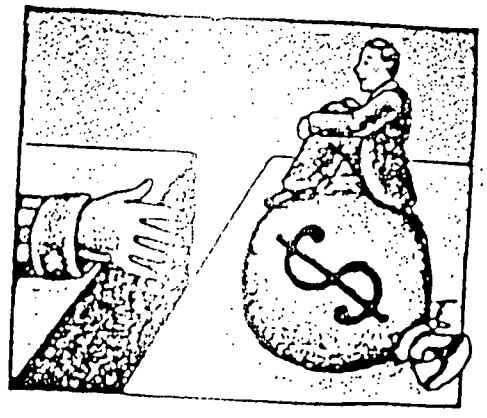
"It appears the fewer cases that the revenue officers have assigned to them, the less work they do," McKean told the six supervisors. "Where are you as managers? What are you doing and is it effective? The revenue officers that are performing above a satisfactory level will be rewarded, and the ones that are not will be documented with corrective action taken. You will be evaluated on your accomplishments or lack of accomplishments. Need I say more?"

There was no need for McKean to say more. Once again the public had been provided a glimpse of the elaborate quota systems that dominate the lives of many of the 102,000 men and women who work for the federal government's most powerful civil agency.

Because production quotas are such a common part of modern industrial life, they have become largely invisible. After all, most of us work at jobs where our bosses have set either explicit or implicit numerical goals. During my own career, for example, I worked for United Press International, Newsweek and The New York Times. At each of these institutions, there was a clear understanding among reporters about the number of stories the editors expected them to write: two or three stories a day at UPI, two or three stories a week at the Times. (There were individual variations. It was understood, for example, that while Seymour Hersh might write only one dynamite story a month, reporters assigned to the Times' handout-filled financial section should turn in one story a day.)

The more or less polite production expectations felt by most reporters, telephone operators or auto assembly-line workers affect primarily the workers themselves. IRS quota systems, however, are directly felt by the public. These quotas trigger the enforcement actions of a gigantic agency as it attempts to get more than 100 million taxpayers to live up to the mandate of a

See IRS, C2, Col. 1



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Punish or Perish at IRS

IRS, From C1

confusing and ambiguous tax law. (The IRS insists that it doesn't have a formal system of quotas.)

Here an analogy is helpful. Many police departments establish quota systems requiring their officers to hand out so many tickets a week or to make so many arrests each month. Almost always, the police quota systems are aimed at law-enforcement problems—such as narcotics, prostitution or traffic violations—where there are no immediate victims. The quota systems utilized by most state and local police departments create many unintended and harmful effects. For the public, of course, the most obvious problem is the arbitrary enforcement sometimes engendered by the quotas.

Sydney C. Cooper, a distinguished former commander in the New York City Police Department, remembers when he was the precinct captain in one section of Brooklyn. "There was pressure from headquarters to cut down on traffic accidents, so we passed on the word from Centre Street that each cop in the precinct was going to have to write so many moving-violation tickets a month. What happened, of course, was that once a month those jokers would remember the chart and go out and knock off the first 10 cars that didn't come to a complete and total halt at an obscure stop sign in the precinct."

Cooper pointed out that quotas have another seriously negative impact: they tend to lead the police in the wrong direction, to focus, for example, on minor traffic violations that have little if anything to do with the factors, such as late-hour drunk driving, involved in most traffic fatalities or serious accidents.

In some instances, law-enforcement quotas encourage corruption. During the 1960s, a New York City Police Commissioner laid down the rule that every narcotics detective had to make a certain number of felony arrests a month if he wanted to keep his highly valued position. As established by the Knapp Commission investigation a few years later, the rigid quota may have helped to push virtually every narcotics detective in New York City into establishing corrupt relations with drug addicts who could provide them useful leads.

Cooper added, however, that despite these gigantic problems quotas are an essential management tool. "Given the lack of direct supervision inherent in police work, how else can you make sure that everyone is pulling their load?" he asked.

Many of the difficult management problems that confront the police executives also face IRS field managers. Both the traffic cop and the IRS revenue officer have been ordered to enforce unpopular laws in situations where there are no immediate and obvious victims calling for help. Because cops and revenue officers are not automatons, they naturally lean toward postponing the often difficult moment when they stop a speeding motorist or seize the assets of a delinquent taxpayer. To counter this natural reluctance, managers fall back on quota systems that produce the acts of mindlessly arbitrary law enforcement that so enrage the public.

As in the case of the New York Police Department, quotas often lead the IRS in the wrong direction. The IRS goal is not to make ten jillion seizures a month; the aim is to encourage citizens to pay their taxes.

Wilbur McKean's February memo about how he intended to use production statistics to evaluate the supervisors who worked for him was made public this summer by Sen. David Pryor (D-Ark.), whose Finance subcommittee was attempting to devise a taxpayers' bill of rights. John Pepping, a revenue officer from Los Angeles, told the subcommittee about a sign, recently taped on a supervisor's door, that read: "Seizure Fever—Catch It." Pepping also testified that agents with the week's best performance records were awarded extra leave time.

Despite this and other clear evidence obtained by the subcommittee, the agency denied all. IRS Commissioner Lawrence Gibbs testified, "I would like to note here that enforcement personnel are not evaluated on a quota system. In fact, we have a policy statement, P-1-20, which states that tax-enforcement results tabulations shall not be used to evaluate such personnel or to impose any production quotas or goals."

Evidence that the IRS is a quota-driven agency goes back a long, long way. So do the official denials. In 1924 a Senate committee investigating the IRS questioned C. R. Nash, the assistant to the commissioner, about rumors that agents' promotions depended on "finding error in favor of the government," Nash responded in the same world-weary tone that would be adopted by unborn generations of pained IRS officials. "I believe that a few years ago, there was some system—or I would not say there was a system, but the efficiency of the revenue agent was rated to some extent on

A revenue officer from Los Angeles told the subcommittee about a sign taped on a supervisor's door that read: "Seizure Fever—Catch It."

the amount of additional tax he reported," he said. "That policy has been discarded."

But neither the underlying reality of tax enforcement nor the questions would go away. In February 1973, a Senate Appropriations subcommittee again heard flat denials of a quota system from then IRS Commissioner Johnnie M. Walters. But the overwhelming requirements of administering a large agency engaged in the enforcement of an unpopular law and the evidence collected by the Senate committees in 1924, 1972 and 1987 makes the regular denials foolish.

Pryor and his staff are rightly concerned that IRS quotas sometimes lead to the arbitrary and improper harassment of taxpayers. But interviews with IRS officials, former officials and investigators also show that the quotas, far from promoting fair and efficient tax collection, can have the opposite effect: they can cause the agency to ignore the most serious kinds of tax cheats.

Richard Jaffe lives in Miami and currently works as a special investigator for the county prosecutor investigating the Miami Police Department. For many years he was one of the IRS' most intelligent and aggressive agents. During a recent interview, Jaffe told how the quota system encouraged his colleagues working in the agency's examination division not to refer serious tax-fraud cases to the criminal division: "The more cases closed, the faster [people in the examination division] are promoted. The book says, however, that if they come across a case that looks like fraud, they're supposed to refer it to the criminal division. The problem here is that when an auditor sends a case to criminal, it isn't closed. Furthermore, if it turns out the auditor has spotted a genuinely serious matter, it may eat up a lot of time and prevent him from closing a lot of other cases."

In fact, Jaffe said, the quota system operating within the examination division tended to sabotage the work of the criminal division. "I know auditors who in their entire career have never referred a single case to the criminal side," he said. "What makes it worse is that these are guys who often become senior IRS supervisors."

A tax lawyer who is a partner in one of Wall Street's largest law firms also was very aware of the IRS quota systems. "If I want to settle one of my cases, I always make my approach towards the end of the month," he explained. "It is clear that from about the 20th to the 30th of each month agents are more interested in closing cases than at other times and I have always assumed it was because they were worried about making their monthly statistical requirements."

Several recent consultant studies undertaken at the request of the IRS itself have come to the same conclusion. A 1986 study done by Research Management Associates, Inc., suggested that heightened pressure for more aggressive collection efforts—including employer reports of evaluations based on measures of additional revenue collections—contributed to an observed rise in assaults and threats made by taxpayers against IRS employees.A year earlier, another IRS consultant Dr. Bronston T. Mayes, a professor at California State University, Fullerton, concluded that IRS production pressures, often interpreted by employees as a lack of concern for their physical safety, together with the heavy workload, the ambiguous nature of the tax law and the potential threat to taxpayers combined to make the agents' job one of the most difficult in the United States.

Because so many aspects of IRS are computerized, it is easy for agency managers to set numerical quotas and evaluate employee performance on the basis of quantity rather than quality. Two congressional research groups, the General Accounting Office and the Office of Technology Assessment have raised questions about the use of computerized employee monitoring systems by IRS and other public and private employers. The OTA report, issued last September estimated that 20 to 35 percent of federal workers currently are subject to computer monitoring and raised serious questions about how the practice effected "privacy, fairness and quality of work life."

The steadily increasing computerization of the IRS and the growing reach of the tax law means one thing: despite all the official denials, the decisions of more and more agency employees and managers are going to be dictated by quotas.

What to do? Probably the first thing is to admit their existence. That's not as easy as it sounds. As former New York City Police commissioner Patrick Murphy, who for many years ran the Police Foundation, observes, "Quotas are a very tough political problem for law enforcement. If you talk about them in an open way, the public feels they are being picked on unfairly. If you deny what the officers know exists, it feeds their cynicism, leads to even poorer performance and kind of corrupts the whole system." Murphy feels that quota systems are a poor substitute for effective leadership, but he also acknowledged there were occasions when such pressures were necessary. "Quotas are a real management dilemma," he said. "It's very tough, but in the end I think they probably need to be looked at more directly." As long as the IRS goes on insisting that quotas do not exist, the needed examination of the problems they create is not likely to occur.