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Restructuring the Internal Revenue Service: A Comparison of Two Major Bills in the 105th Congress

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Summary

In the 105th Congress, the Senate and the House passed broadly similar versions of H.R. 2676, a bill that would restructure the Internal Revenue Service. The House passed its proposal on November 5, 1997; the Senate approved its version of the bill May 7, 1998. On June 24, a Conference Committee reported its version of the bill; the Conference version added a reduction in the holding period for favorable capital gains treatment from 18 months to 1 year. The House approved the Conference bill on June 25.

The legislation stems from the 1997 report of the National Commission to Restructure the IRS.¹ It creates an Oversight Board with private sector members as well as government officials; it directs the IRS to undertake organizational changes; it provides new protections and rights for taxpayers in their dealings with the IRS. This CRS report describes the main elements of the House and Senate bills and the conference agreement, but a detailed comparison is beyond its limited scope. It will be updated when the Senate takes action on the conference report.

Restructuring of IRS Management

On November 5, 1997, the House of Representatives passed H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997, by a vote of 426 to 4. The bill would establish for the first time an IRS Oversight Board composed of 11 members, of whom 8 would be private sector executives. These would be selected by the President for their experience in the management of large service organizations, customer service, federal tax law, information technology and organization development. The other 3 members of the board would be the Secretary of the Treasury, the Commissioner of the

¹ U.S. Congress. *Report of the National Commission to Restructure the Internal Revenue Service. A Vision for a New IRS.* Washington, DC. June 25, 1997.

IRS, and a representative of the Treasury's employee union. The board's responsibilities would include:

Strategic Plans: establishment of (a) mission and objectives, and standards of performance relative to either, and (b) annual and long-range strategic plans;

Operational Plans: review (a) plans for modernization of the tax system, (b) plans for outsourcing or managed competition, and (c) plans for training and education;

Management: (a) recommend to the President candidates for appointment as the Commissioner of Internal Revenue (b) review the Commissioner's selection, evaluation, and compensation of senior managers, and (c) review and approve the Commissioner's plans for reorganization of the Internal Revenue Service;

Budget: To (a) review and approve the budget request of the IRS, which will be prepared by the Commissioner, (b) ensure that the budget request supports the annual and long-range strategic plans.

Senate passed its version of the bill on May 7; its bill contains the same standards for the Oversight Board and the same responsibilities, but it proposes that the Board be composed of 6 executives from private life, plus the Treasury Secretary, the IRS Commissioner, and a union representative. Under both bills, it would be unlawful for any member of the executive branch to try to halt or initiate an audit of any taxpayer. Any such request would have to be reported to the Chief Inspector of the Service.

A unique feature of the Senate bill is that it includes a provision to restructure the IRS according to a plan devised by Charles O. Rossotti, who was confirmed on November 4, 1997, as Commissioner of the IRS. The plan would reorganize the agency around the needs of four large groups of taxpayers: (a) those with primarily wage and investment income, (b) small business owners and other self-employed people, (c) big businesses, and (d) tax-exempt organizations, including pension plans.

Taxpayer Protection and Rights²

A group of provisions in both the House and Senate legislation addresses taxpayer protection and rights. Under the House-passed legislation, the IRS would be required to inform taxpayers about their rights before interviews concerning an audit, and explain IRS criteria for deciding who would be audited. If the case reaches court, the burden of proof of a disputed tax liability would, if certain conditions are met, fall upon the IRS, not the taxpayer. The bill expands the authority of the courts to award administrative costs as well

² For more detailed discussion of the taxpayer rights provisions of the House-passed bill, see: U.S. Library of Congress. Congressional Research Service. *Taxpayer Protections in the Proposed IRS Restructuring Act: Attorneys' Fees and Damages for IRS Abuses* by Marie B. Morris. CRS Report No. 98-20 A; and, *Taxpayer Protections in the Proposed IRS Restructuring Act: Burden of Proof* by Marie B. Morris, CRS Report No. 97-1029 A. *IRS Reform: Innocent Spouse Rule* by Thomas Ripy, CRS Report No. 97-1020 A.

as attorneys' fees to a taxpayer if it is shown that the Service's view has no basis. Civil damages could be assessed in cases of IRS negligence.

The IRS could no longer use information about a taxpayer's lifestyle as a basis for initiating an audit. In addition, the 3-year period in which a taxpayer must file for a refund could be extended in the case of a taxpayer who was disabled during the filing period. Notices of "deficiency" would have to be accompanied by an explanation of the appeals process and notification of the deadline for filing a tax court petition. All of the provisions described above also appear in the Senate legislation.

The House bill would make "innocent spouse" status easier to obtain. That is, it would be easier for a spouse not to be held liable on the basis of having no knowledge of a false report by his/her partner; it would do so by eliminating the threshold amounts that underpayments must exceed to qualify for innocent spouse treatment. The Senate bill, on the other hand, provides innocent spouse relief by allowing an innocent spouse -- in the case of a deficiency -- to elect to limit his or her liability for the unpaid taxes to the liability they would owe if filing separately.

The Senate bill, but not the House proposal, also contains a provision suspending interest and penalties after 1 year if the IRS fails to notify the taxpayer of the deficiency within 1 year of a timely filed return.

Both the House and Senate versions of H.R. 2676 contain provisions intended to improve IRS performance in assisting taxpayers. For example, both bills would provide up to \$3 million annually for matching grants for low income taxpayer clinics, restricting individual grants to a maximum of \$100,000 annually for 3 years, providing that a clinic can provide matching funds. The Senate bill contains in similar form the most significant protections for taxpayers that are found in the House bill, plus a few additional protective provisions, such as:

- an expansion of the alternative dispute resolution mechanism to require the IRS to establish a pilot program of binding arbitration, subject to election by both parties;
- codifying fair debt collection practices;
- making more easily available a mechanism for appeal against collection activities; and
- requiring the IRS to give 30 days' notice before applying liens, or seizures, with 90 days' notice for life insurance.

The Joint Committee on Taxation

Under the House-passed version of H.R. 2676, two annual hearings would be held by the Joint Committee on Taxation (JCT) and representatives of the six congressional committees that now oversee the IRS. These include the Senate Committee on Appropriations, the Senate Committee on Governmental Affairs, and the Senate Committee on Finance, as well as the House Committee on Appropriations, the House Committee on Ways and Means, and the House Committee on Government Reform and Oversight. In these hearings, the JCT would report on strategic and business plans for the IRS, on progress of the IRS in meeting objectives, on whether IRS' budget supports those

objectives, on progress in improving taxpayer service and compliance, on progress in technology modernization, and the annual filing season.

The House version of H.R. 2676 would also require that any bill reported by the House Committee on Ways and Means or the Senate Committee on Finance that would change the 1986 tax code be accompanied by a report from the Joint Committee on Taxation that would assess whether the newly proposed legislation would add complexity to the tax code or exacerbate the difficulties of administering the code.

The Senate bill would not require the JCT to organize hearings, but would require the Joint Committee to provide analysis of all newly proposed tax legislation. The analysis would be required to include an estimate of the number of taxpayers affected, and, if applicable, the income level of affected individual taxpayers. It would discuss, as well, the extent to which existing tax forms would have to be revised, to what extent taxpayers might need to keep additional records, whether additional regulatory guidance would need to be developed, whether the proposed law might lead to disputes between taxpayers and the IRS, and other questions.

Duties of the Taxpayer Advocate

One portion of the House bill that could affect the way daily business is conducted by IRS staff is the list of additional responsibilities assigned to the IRS' Taxpayer Advocate. He/she would be required to report to the House Committee on Ways and Means and the Senate Committee on Finance by June 30 of every year on the objectives of the Taxpayer Advocate's office, and by December 31 of each year on the activities of the office. The topics to be discussed in the latter report include descriptions of the most troublesome problems taxpayers have encountered, what steps have been taken to resolve the problems, which problems remain unsolved, recommendations for administrative or legislative action that would prevent future problems, and others.

The Senate bill takes a slightly different approach to creating a taxpayer-sensitive environment at the IRS. The Senate bill would create a new office of Treasury Inspector General for Tax Administration (and eliminate the IRS Office of Chief Inspector) to do the kind of investigation that the House bill would have the Taxpayer Advocate carry out. The Senate bill would make the new Inspector General a presidential appointee who must be confirmed by the Senate. It would require that IRS internal security and portions of internal audit be transferred to the office of the Treasury Inspector General, and that at least 900 of the 1200 full-time positions in the office of the Treasury Inspector General be assigned to IRS matters.

Changes in Personnel Practices³

The House-passed version of H.R. 2676 contains changes in personnel practices for the IRS which, while observing commitments to the Treasury employees' union, would

³ For additional information, see *Personnel Management Flexibility for the Internal Revenue Service: 105th Congress Legislation* by Barbara L. Schwemle. CRS Report No. 98-4 December 18, 1997.

attempt to make employees more closely accountable, more easily rewardable, and more conscious of the goals of the service.

Both the House and Senate bills carry provisions intended to allow the Commissioner to pay top officials more than under current arrangements, but the Senate bill offers more top executives improved pay than does the House bill. It would allow the Commissioner to appoint up to 40 executives who are already expert in tax administration without the approval of the Office of Personnel Management or the Office of Management and Budget. These executives could be paid amounts up to the salary of the Vice President. Up to 25 senior executives would be eligible for performance-related bonuses, subject to the condition that an individual's total compensation not exceed the salary of the Vice President. In addition, the Commissioner would have more flexibility in appointing persons who are not IRS career employees to senior positions. This provision, plus the option of appointing up to 40 highly paid executives (compared with 8 in the House bill) are the main differences between the personnel practices sections of the respective bills.

The Senate bill would, in addition, permit pay increases for career IRS employees who are recognized as superior performers without a concomitant increase in management responsibilities. Any change in the current pay system, however, would have to be agreed to by the union and introduced on a trial basis of up to 5 years under the title "demonstration project."

Electronic Filing

Both the House and the Senate bills set as a main goal that 80 percent of tax filings be made electronically by 2007, and they require the IRS to develop incentives to promote electronic filing.

Cost of the House and Senate Bills

According to estimates by the Joint Committee on Taxation (JCT), the House version of H.R. 2676 would be approximately "revenue neutral" over 5 years.⁴ That is, its revenue losing measures are approximately offset by items that would increase revenues; the bill would increase federal tax revenues by a net amount of \$96 million over 5 years. Over 10 years, however, the House bill would result in an estimated net revenue loss of \$2.7 billion. The revenue-losing items in the House bill are the proposals related to taxpayer rights; taken alone, the revenue losing measures would reduce revenue by an estimated \$2.6 billion over 5 years and by \$6.2 billion over 10 years. The bill's sole revenue-raising item is a clarification of the tax deduction for accrued vacation pay, totaling \$2.7 billion over 5 years and \$3.4 billion over 10 years.

The Senate bill is likewise estimated to be approximately revenue neutral over 5 years, with a net revenue increase of \$11 million; like the House bill, there is also an estimated net revenue loss over 10 years, but in this case much smaller: only \$271 million. Underlying the net figures, the Senate's revenue-losing items are larger than those of the House. Taken

⁴ Revenue estimates are from: U.S. Congress. Joint Committee on Taxation. *Comparison of the Estimated Budget Effects of HR 2676, the Internal Revenue Service Restructuring and Reform Act of 1986, As Passed by the House and the Senate*. JCX-44-98. May 28, 1998.

alone, they total \$6.3 billion over 5 years and \$18.8 billion over 10 years. The Senate's revenue-raising offsets are larger than those of the House, totaling \$6.3 billion over 5 years and \$18.5 billion over 10 years.

Summary Comparison of the House and Senate Bills

Although in many respects, the House-passed and Senate-proposed bills are similar, there are some differences. For example, each makes provision for an oversight board for the IRS, but the House bill's board would have 11 members, while the Senate bill's board would have 9. While the two bills have slightly different provisions on new rights for taxpayers, they both would give those taxpayers whom the Service deems deficient in their payments more power against the Service than they now have. While the House-passed bill leans heavily on expanded responsibilities for the Joint Committee on Taxation and the Taxpayer Advocate, the Senate bill assigns watchdog duties to a new office, that of the Treasury Inspector General for Tax Administration. Both bills include personnel changes that aim at establishing more specific standards for promotion and retention based on work contributing to meeting the goals of the service for all employees, but the Senate bill focuses more on rewarding top executives to be appointed from outside IRS. The Senate bill includes an immediate restructuring of the Service according to the plan devised by the new IRS Commissioner, Charles O. Rossotti. The House bill envisions the restructuring being planned by Commissioner Rossotti and the new Oversight Board after the legislation is passed. The House-passed measure envisions the Oversight Board remaining in place indefinitely, while the Senate bill would sunset the Board in 2008.

The Conference Agreement

On June 24, a Conference Committee reported a version of the IRS bill (H.Rpt. 105-599). In the areas of IRS management and organization, the Senate's 9-member version of the oversight board was adopted. In addition, the agreement adopted the Senate's provisions directing reorganization of the IRS into units servicing particular groups of taxpayers with similar needs.

Another prominent divergence between the House and Senate bills was innocent spouse provisions (see above, p. 3). Here, a compromise was struck, with the Senate's apportionment of deficiency concept available in the case of divorced or separated couples and the House plan being followed in all other cases. In the case of suspension of interest and penalties where no notice is sent, a somewhat less generous version of the Senate's proposed suspension was adopted.

The conference agreement contains a major provision not contained in either the House or Senate bill: a reduction in the 18-month period capital assets were required to be held to qualify for the reduced capital gains rates implemented by the Taxpayer Relief Act of 1997. The conference agreement reduces the holding period to 1 year. The agreement also adds a revenue-raising offset in the form of more liberal eligibility rules for converting traditional Individual Retirement Accounts (IRAs) into the Roth IRAs enacted in 1997.

The conference agreement's net revenue effect is an estimated revenue gain of \$496 million over 5 years and \$1.1 billion over 10 years.