

## House Committee on Ways and Means

Statement of The Honorable Fred T. Goldberg, Jr., Commissioner,  
Internal Revenue Service, 1989–1992

Testimony Before the Subcommittee on Oversight  
of the House Committee on Ways and Means

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Chairman Houghton, Ranking Member Pomeroy, distinguished Members of the Subcommittee, thank you for the opportunity to participate in today's hearing on tax simplification. I am appearing at your request as a former IRS Commissioner. I am speaking on my own behalf and not on behalf of any client or other organization.

Before beginning my remarks, I would like to note, as we say farewell to President Reagan, that the Tax Reform Act of 1986 demonstrates how much can be accomplished in reforming the tax laws under the right circumstances and with the right kind of visionary and bi-partisan leadership. For reasons I note below, the opportunity for fundamental reform will come around again later this decade; the question is whether those in charge will rise to the challenge.

I would also like to compliment you, Mr. Chairman, for your efforts to simplify our tax laws and for the noteworthy simplification proposals you introduced earlier this year. Likewise, your colleagues Congressman Rob Portman and Congressman Benjamin Cardin should be acknowledged for their long-standing commitment to simplification and their ongoing and successful efforts to simplify the rules governing tax-favored retirement savings. Ways & Means Committee Chairman Thomas and other members of the Ways & Means Committee, including Congressmen Neal, Johnson and Ramstad have also put forward meaningful simplification proposals.

Unfortunately, despite these efforts, tax simplification remains everyone's favorite orphan. All of us involved in the tax system – Congress, the executive branch, practitioners and taxpayers –

proclaim our affection for this child of our dreams, but few are willing to adopt her as our own. The benefits of meaningful simplification include a more transparent and “fair” system; improved compliance and far less “tax shelter” activity; reduced burden, frustration and compliance costs for taxpayers; and more effective and less costly tax administration. To date, little has been done to reap these benefits and the prospects for substantial progress appear dim.

What I find so discouraging is the gulf between what can be done and what’s being done. It’s not as though we are lacking for ways to simplify the system. Proposals introduced by you and your Congressional colleagues; the Bush Administration’s pending budget proposals; the Joint Committee’s comprehensive and compelling tax complexity report of three years ago; the joint recommendations of the AICPA, the Tax Executives Institute, and the Tax Section of the ABA – there is no end to the good ideas; what’s lacking is their enactment into law.

I will limit my remarks to three topics: short-term priorities, administrative action, and long-term opportunities.

Priorities. Given budget constraints and limited legislative resources, it is important to focus on those areas with the greatest potential impact. My recommendations:

(a) Enact a uniform definition of “child” along the lines of your proposal, Mr. Chairman, and simplify the Earned Income Tax Credit. These proposals have been around for a long time; they would be of great benefit to millions of Americans who are ill-equipped to deal with the absurd complexity of the current rules. Numerous different definitions of “qualifying child” appear throughout the tax code, causing needless taxpayer confusion when attempting to claim benefits. Further, the Earned Income Tax Credit provisions contain complex and lengthy requirements that exclude many deserving individuals and necessitate significant record-keeping. Individuals in complicated family situations face additional complicated rules. To ease taxpayer confusion and reduce Earned Income Tax Credit and other tax filing errors, the Bush Administration has proposed simplification in both of these areas; its five related simplification measures would provide important

relief to low-income families. There is hope for enactment this year, and the time has come to get it done.

(b) Simplify the appalling array of education-related incentives. Taxpayers are faced with many options to alleviate the costs of higher education. However, the mere number and perplexing intricacies of these benefits make it extremely difficult for taxpayers to choose and interpret the ideal option. The complexity is understandable but unnecessary, and the confusion it causes is intolerable. As evidenced by the Administration's recent proposals to consolidate benefits, simplify rules for expenses, increase the number of qualifying taxpayers, and standardize definitions throughout the code, the case for simplification in this area is compelling.

(c) Simplify the rules governing tax-favored retirement savings. Congressmen Portman and Cardin have provided bi-partisan leadership in this area, with many successes to their credit. But more can and should be done. For example, while recent legislation has improved portability, there is still far too much friction in the system as workers' jobs and circumstances change. Likewise, the current IRA regime should be replaced by some form of the Administration's RSA proposal and a revised and permanent refundable Savers' Credit. These proposals would demonstrate that good policy and tax simplification go hand-in-hand. The so-called Roth IRA model (no current tax deduction and no tax on distribution) is vastly simpler than the traditional IRA (current tax deduction and tax on distribution). Taking savings out from under the tax system is far easier, and provides far greater certainty, than excluding wages and running the savings through the tax system. The combination of RSAs and a refundable Savers' Credit has the compelling virtue of universality and is of greatest benefit to low and middle income taxpayers.

(d) Simplify and reform the rules governing international taxation. This is where the tax system is the most outdated, complex, and generally unworkable. Simple rules may be incompatible with a global environment in which many taxpayers are governed by different and conflicting tax regimes, but actions can and should be taken to minimize the extraordinary complexity of our current system. Economic activity has changed most rapidly in the international arena, and yet the underlying rules were created

over four decades ago. While patched repeatedly, these rules are in need of serious overhaul. For example, the rules governing the foreign tax credit, passive foreign investment companies, and Subpart F income are complicated to interpret and apply. They should be substantially updated and simplified. I commend your efforts on a bi-partisan basis in this area, Mr. Chairman.

Each of these areas merits prompt attention. Many affect tens of millions of Americans and represent our country's core values – family, work, education and savings. It is possible to make meaningful improvements quickly and with relatively modest revenue loss. As recently noted by tax professionals and behavioral economists, too much complexity and too many options create legislatively sanctioned planning opportunities for the few who are well advised, while bewildering most taxpayers. We are left with the worst of all worlds: a system that is perceived as unfairly favoring the well off, while leaving many individuals unable and unlikely to take the benefits the tax code affords. The simplification measures I described have vast potential to reduce opacity, ease compliance burdens and enforcement costs, and curb the corrosive effect of the current complex system.

Administrative Action. A great deal of simplification can be accomplished through administrative action by Treasury and the IRS. The current Administration deserves very high marks for its focus on simplification and its accomplishments over the past several years. In 2002, the Administration adopted multiple tax form simplification measures. It eased the filing burden on millions of small businesses by raising the gross receipts and assets threshold for filing Schedules L, M-1, and M-2 on certain corporate returns. Also in 2002, the Treasury and the IRS increased the limit for filing separate schedules for interest and dividend income. This has permitted millions to avoid having to file an additional schedule and allows many to file Form 1040EZ when this would have otherwise been disallowed. The INDOPCO regulations, guidance regarding the cash method of accounting, procedures to streamline Section 9100 relief and remedy inadvertent S Corp failures provide a few additional illustrations.

Once again, however, much more can and should be done. Additional regulatory initiatives in the areas of tax accounting and international tax would be particularly welcome, although there are

targeted opportunities throughout the Code and existing regulations.

It is important to note the Bush Administration's simplification initiatives are not limited to guidance, form changes, and the like. They also include changes in the way the IRS does business. Without question, the Administration's "split refund" proposal is the most significant initiative in this area. There is a substantial need to increase household savings in America, and tax refunds are an important potential source. The "split refund" proposal could maximize this benefit of tax refunds for many families.

Specifically, the Administration's 2005 Budget provides for the IRS to permit taxpayers to have their refunds wired to more than one account. The average IRS refund check is more than \$2,000; for many families, this is the biggest single cash payment they receive during the year. The Administration's proposal has been universally acclaimed and – if implemented – would dramatically simplify savings and financial management by millions of taxpayers. Given the importance of this proposal, you should monitor closely the progress the IRS is making in carrying out the Administration's policy.

Long-Term Need/Long-Term Opportunity. The Federal income tax has served the nation well for close to a century. The system, however, is showing its age. The piling of complex provision on top of complex provision – coupled with changes brought about by technology, sophisticated capital markets and global competition – have left much of the system unworkable and (in my view) beyond repair. True simplification requires rethinking the tax base and restructuring much of the system.

While simplification is a worthwhile objective, it does not provide sufficient grounds for fundamental tax reform. (Perhaps it should, but it won't). However, the tax system's "perfect storm" is on the horizon. It will arrive this decade and nothing can be done to prevent or defer its arrival. All of the following are certain to happen:

Unless modified, the AMT will devour the tax system. Without changes to the tax laws, by 2014, the number of taxpayers subject to the AMT will increase by a factor of fourteen relative to the

number of taxpayers subject to the AMT in 2003 – from 3.3 million in 2003 to over 46 million in 2014 according to Treasury Department estimates. By 2013, the cost of repealing the AMT will exceed the cost of repealing the regular individual income tax. It is worth remembering that the AMT was enacted on account of concerns about high income individuals avoiding all income tax. Now its reach extends to the middle class, which is clearly not what Congress intended.

The temporary tax cuts enacted since 2001 will begin to expire. Some temporary (and limited) AMT relief expired last year and more expires this year. Across-the-board rate cuts, the increased child credit, marriage penalty relief, and various savings incentives expire in 2010. Phase-out of the estate tax expires in 2010. The reduced tax rate on capital gains and dividends, enacted in 2003, will expire at the end of 2008. The ten year cost (2005–2014) of making permanent the rate cuts, reduced rates on dividends and capital gains, and estate tax repeal would be more than \$850 billion.

In 2008, the first of the populous Baby Boomer Generation turns 62, the earliest age at which Social Security benefits can be claimed. Without substantial change in the system, Social Security outlays will exceed payroll revenues during the next decade, demonstrating that the so-called Trust Fund is indeed a fiction and placing additional demands on general revenues. By 2014, Social Security and Medicare outlays will account for 42% of all federal spending and 8.4% of GDP.

The pressing need to deal with these issues creates a unique opportunity for a fundamental reconsideration of our tax system. The question is whether Congress and the Administration will take advantage of that opportunity or continue futile efforts to patch the current system, a system that is beyond repair.

The simplification that could be accomplished in this broader framework extends far beyond the few proposals I have discussed today. For example, many initiatives have been proposed to reduce complexity (as well as distortions caused by the current system) in the context of enterprise income taxation. The Treasury's 1992 exploration of a comprehensive business income tax ("CBIT") is one such measure. Under CBIT, with the exception of small businesses in terms of gross receipts, all business entities would be subject to

a uniform, comprehensive entity level tax rate regardless of their corporate or noncorporate form. Generally, CBIT would not impose further taxes at the owner level and would equate the treatment of debt and equity. Redefining the tax base in this manner, imposing a single rate of tax, and exempting small businesses would dramatically simplify the system and improve economic efficiency by reducing tax-based distortions.

Another alternative at the enterprise level would be to mandate modified conformity between financial accounting and federal income tax rules. While some tax provisions permit or require conformity to financial accounting standards, many do not. This undermines financial accounting transparency, complicates IRS enforcement efforts, and increases the number of times a taxpayer must evaluate adjustments and compute income. Unifying various tax and financial accounting standards could alleviate many of the burdens imposed on both taxpayers and the IRS, promote transparency, and help deter tax shelter activities, without disturbing the distinct objectives of each regime.

In the context of taxes on individuals, similar opportunities exist. One alternative would be to try – again – what was attempted in 1986: reduce rates and eliminate tax preference items. Unfortunately, the experience of the past 18 years suggests that reforms along those lines are short-lived and that more fundamental change is required. Proposals to replace some or all of the income tax and the payroll tax with some form of consumption tax (e.g., a value added tax, national sales tax, or flat tax) have been around for a long time. They merit serious, bi-partisan consideration during the years to come.

Whether in the context of individual, business entity, or international taxation, simplification efforts must be taken seriously. The system is far more precarious than many acknowledge, and the benefits of decreased complexity far outweigh the costs of change. Important changes can be accomplished in the short-run through targeted legislation and administrative initiatives. By the end of this decade, the coming storm creates the potential for fundamental change. I would like to commend this Subcommittee for your attention to this issue.

I would be happy to answer any questions.