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STATEMENT OF

WILLIAM J. ANDERSON, DIRECTOR,

GENERAL GOVERNMENT DIVISION

BEFORE THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ON

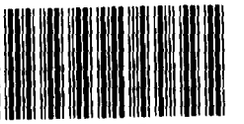
HOUSE BILL 6300,

THE TAX COMPLIANCE ACT OF 1982

Mr. Chairman and Members of the Committee:

We are pleased to be here to assist the committee in its deliberations on H.R. 6300, the Tax Compliance Act of 1982. Our testimony is based primarily on experience we have gained from conducting evaluations of tax administration operations and activities.

During the past 3 years, we have issued numerous reports and given testimony before various congressional subcommittees, including the Ways and Means Oversight Subcommittee, on the income tax noncompliance problem. Currently, we are conducting reviews of various Internal Revenue Service (IRS) programs which deal with the unreported income problem. The appendix to my statement lists various reports we have issued and testimonies



we have given since July 1979. It also lists reviews currently in process which relate to the income tax noncompliance problem.

Mr. Chairman, we endorse the overall objectives of H.R. 6300 because it seeks, through a series of measures, to reduce the shortfall in Federal tax revenues attributable to noncompliance with the tax laws and also seeks to enhance the fairness and credibility of our Nation's tax system. Further, the bill addresses several issues and concerns we have surfaced in our tax administration reviews and contains some solutions we have proposed and/or endorsed in the past.

On March 22, 1982, we testified before the Subcommittee on Oversight of the Internal Revenue Service, Senate Committee on Finance, on Senate Bill 2198. (A companion bill--H.R. 5829--has been introduced in the House). At that time, we emphasized the importance of a healthy tax system to the financial stability and welfare of our country. We supported S.2198's overall objectives of reducing the unreported income problem and enhancing the credibility of our tax system. We also pointed out the need for the Congress to assure that IRS' resources and capabilities keep pace with its increasing workload. (With your permission, Mr. Chairman, I would like to submit a copy of our formal statement on S.2198 for the record).

Like the Senate bill, H.R. 6300 seeks to

--substantially improve and expand information reporting,

--establish a withholding system for pension payments, and

--revise the rules governing interest payments related to certain tax overpayments and underpayments.

However, H.R. 6300 goes further than S.2198 in that it seeks to strengthen IRS' ability to collect taxes on income derived from illegal activities and foreign sources. In addition, it seeks to revise certain administrative and judicial proceedings with respect to partnerships and Subchapter S corporations.

We agree that improvements in these broad areas are needed if IRS is to deal effectively with the decline in voluntary compliance. On the other hand, we also have some concerns over certain aspects of the bill. At this point, therefore, I would like to focus on certain sections of the bill and later comment on IRS' need for resources to implement H.R. 6300 should it be enacted into law.

TITLE I--STRONGER TOOLS FOR DEALING WITH ILLEGAL ACTIVITIES, ABUSIVE TAX SHELTERS, AND CERTAIN TAX PROTESTERS

Title I of H.R. 6300 contains several provisions designed to enable IRS to deal more effectively with illegal activities, abusive tax shelters, and certain tax protesters. It also would enhance IRS' ability to carry out criminal and civil tax investigations by alleviating problems IRS has experienced with the third-party recordkeeper summons provisions of the 1976 Tax Reform Act. However, IRS may experience some difficulties in seeking to administer portions of Title I, as currently drafted.

Part I would improve IRS' ability to detect, assess, and collect taxes on cash and cash-equivalent transactions

Part I of Title I should improve IRS' ability to detect, assess, and collect taxes on cash and cash-equivalent transactions. This would be accomplished by strengthening the laws relating to jeopardy and termination assessments and by strengthening a present currency reporting requirement.

Jeopardy and termination assessments

In December 1979, in testimony before the Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, we pointed out that IRS had all but abandoned use of jeopardy and termination assessments as civil enforcement tools. H.R. 6300 seeks to promote the use of these important compliance tools through revisions to the laws governing them. Current law effectively restricts IRS from immediately assessing and collecting taxes on cash unless the taxpayer can be identified. H.R. 6300 provides IRS, in two defined instances, the tools necessary to immediately assess and collect taxes due the Government. To prevent potential abuses and to avoid potential jurisdictional problems, the committee may want to make some revisions to one of its two proposals in this area.

H.R. 6300 would authorize the Secretary of the Treasury to impose an immediate assessment and collection on the person possessing, recently possessing, or depositing cash if the Secretary believes that the cash was derived from an illegal activity.

The bill defines illegal activity as any violation of Federal, State, or local law punishable by imprisonment. While we believe this proposed addition to the law would enhance the Service's collection efforts, we have two concerns.

First, the bill does not indicate how IRS should determine whether an individual is involved in illegal activities. In the early and mid-1970s, IRS initiated a program directed at narcotics traffickers. Under that program, IRS abused its jeopardy and termination powers in the process.

Many individuals suspected of being involved in illegal narcotics trafficking were assessed taxes via jeopardy or termination action, despite a lack of evidence that taxes were in fact in jeopardy. Moreover, IRS agents often grossly overestimated the amount of taxes due and frequently had initial assessments reduced substantially by subsequent IRS reviews. For example, in a July 1976 report (GGD-76-14), we reported on 40 narcotics-related termination assessments which we had analyzed in detail. The original assessments in these cases totaled more than $1.2 million while the final assessments were reduced to about $342,000.

In 1976, in response to those abuses, the Congress amended the laws related to jeopardy and termination assessments to better protect taxpayers. To avoid the potential for a recurrence of abuses, the committee may wish to specify with greater descriptive clarity the criteria on which IRS may base its belief that an individual is involved in illegal activities before invoking this provision.

Second, we would also recommend that the committee specifically address the relationship between this provision and civil and criminal forfeiture statutes, such as those contained in the Racketeer Influenced and Corrupt Organization Act (18 U.S.C. 1961-1964). This may be necessary because where cash and certain illegal activities are involved, the Justice Department and IRS could have competing interests and this could lead to jurisdictional disputes. Such disputes could be avoided by specifying which statutes take precedence and how the proposed statute is intended to operate when all the cash is subject to forfeiture.

Currency reporting requirement

Besides enhancing the utility of jeopardy and termination assessments, H.R. 6300 also would strengthen the current reporting requirement associated with transporting large amounts of cash out of the country. We support the intent of this provision of the bill because it would revise a reporting requirement which currently is difficult to enforce. There is, however, a need for more specific guidance on how this provision is to be interpreted.

The Bank Secrecy Act of 1970 requires anyone who leaves the United States with more than $5,000 in cash or cash equivalents to file a report with the U.S. Customs Service. One objective of this law is to provide Federal law enforcement investigators with a "paper trail" through which to trace the flow of large amounts of cash used in criminal activities. A single failure to report is punishable by a civil penalty limited to the amount of money transported or by criminal penalties consisting of a fine of not

more than $500,000 and up to 5 years imprisonment. However, Federal officials have experienced difficulty in enforcing this reporting requirement because some courts have ruled that a crime is not committed until the nonreporter actually leaves the country, at which point apprehension of the violator may no longer be possible.

H.R. 6300 is designed to alleviate this problem by amending the law to state that an attempt to transport shall be subject to the same reporting requirements, and subject to the same penalties, as apply to the act of transporting. Enactment of this provision would clearly signal that the act of transporting currency out of the country need not be completed for the filing requirement to be violated. We endorse this signal. However, we believe that further guidance is necessary on what constitutes an attempt to leave the country. For example, has an attempt been made when an individual (1) purchases an airline ticket, (2) enters the boarding area with an airline ticket, or (3) boards a plane which is leaving the country? Definitive guidance in this regard is needed.

Part II would enhance IRS' ability to deal with abusive tax shelters

For several years now, IRS has focused much attention on abusive tax shelters. Of necessity, IRS' approach has centered on the examination process and ensuing litigation. Part II of Title I would provide IRS with new ways of dealing with abusive shelters at the front end of the process, that is, before investors purchase certain shelters and begin filing tax returns which

require examination and often lead to litigation. Used effectively, these new compliance tools could greatly assist IRS in dealing with the problem of abusive tax shelters. On the other hand, administering these provisions may present IRS with some problems.

Among other things, the bill would authorize IRS to assess a new penalty against those promoting or selling abusive tax shelters. In addition, it would authorize IRS to seek an injunction against such persons.

These new compliance tools could enable IRS to prevent the marketing and sale of abusive shelters. This would reduce or eliminate the need for IRS to deal with the large number of tax returns which otherwise would need to be adjusted as a result of taxpayers' participation in such shelters.

Effective use of these tools could significantly slow the rate of growth of IRS' tax shelter case inventory, now reported to be 255,000 returns in the Examination Division. This decrease should enable IRS to reduce the percentage of direct examination time now being spent on tax shelters--about 9 percent--thereby freeing these resources for other compliance-related activities. The decreasing inventory of tax shelter cases should also reduce the burden on the Tax Court, which currently has a backlog of about 11,900 tax shelter cases. Equally important, these provisions could help protect taxpayers from unscrupulous promoters.

While we agree that a legislative initiative in this area is needed, we do have some concerns whether the reach of this

provision is unduly broad. In this regard, it should be recognized that IRS does not presently have a sufficiently clear definition of what constitutes an abusive tax shelter. Given this, we recommend that the legislation itself provide or require the establishment of clear definitions and criteria to assure that IRS' use of these provisions will affect only the truly abusive shelters.

Also, to assure that the Federal Government is taking a coordinated approach, the committee may wish to require close liaison between IRS and the Securities and Exchange Commission when federally registered promotions are involved. Finally, to assure adequate oversight of the implementation of these provisions, the committee may also wish to require that IRS develop summary information on its use of the penalty and the injunction.

Part III would authorize additional penalties to deter certain forms of tax noncompliance

Part III of Title I would authorize IRS to assess a greater fraud penalty than allowed under current law. It also provides for new penalties directed at (1) individuals who aid or advise taxpayers in violating the tax laws and (2) tax protesters. We understand and endorse the committee's goals in these areas. However, some of the new penalties should be written in a more specific manner. Otherwise, they may not achieve the committee's intent or may even have some unintended effects.

Section 121 of H.R. 6300 increases the fraud penalty by adding a percentage of the tax understatement to the present fraud

penalty. This increased fraud penalty could provide an added deterrent against fraud and we therefore support its enactment.

Section 122 provides for a new civil penalty to be applied against persons who aid in, assist in, procure, or advise in the preparation or presentation of a return, affidavit, claim, or other document which they know will lead to an understatement of tax liability under the Internal Revenue laws. We believe that this proposed penalty covers too broad a target population. We think that the penalty would be more appropriate if applied to those holding themselves out as knowledgeable of the tax law and providing aid, advice, or assistance on that basis. This would narrow the target population so that administration of this provision could be better focused, thus insuring a higher probability of success in its application.

The penalty provisions of the bill should also help IRS in its efforts to deter illegal tax protesters. In July 1981, we reported that the protest movement was a growing threat to the Nation's tax system, particularly because of the visibility of protest leaders and activists, and their "sales" approach, which tends to attract followers (GGD-81-83, July 8, 1981). The number of protester returns filed has increased about 283 percent since 1978, from about 7,100 in 1978 to 27,000 in 1981. Many of these returns do not contain sufficient information from which the substantial correctness of the tax shown can be judged (such as constitutional protest scheme returns); others contain information indicating that the amount of tax being paid is

substantially incorrect (such as war protest returns which contain unauthorized subtractions from computed tax liabilities).

The $500 penalty assessment provided for in section 123 of H.R. 6300 should, if judiciously applied, help in deterring at least the average protester from filing such returns. Also, the provisions in section 112 of H.R. 6300 aimed at penalizing and enjoining promoters of abusive tax shelters, might be effective against some protest schemes, such as the family estate trust--one of the most popular schemes at the time of our review. Likewise, the penalty provisions contained in section 122 might also help IRS deter some illegal tax protesters.

In sum, the bill's proposed revisions to the penalty provisions of the Internal Revenue Code could, if modified in certain ways, help IRS deal with some key compliance problems.

Part IV's revised rules governing third-party recordkeeper summonses would facilitate criminal and civil tax investigations

In various reports and testimonies over the past several years, we have pointed out that the summons provisions of the 1976 Tax Reform Act were having an unintended effect. Specifically, we have found that some taxpayers have used the provisions solely as a means for delaying or impeding IRS investigations. Part IV of Title I seeks to partially remedy that problem while preserving essential taxpayer rights. We strongly endorse enactment of this part of H.R. 6300.

In testimony before the House Ways and Means Oversight Subcommittee on April 26, 1982, we specified the reasons why we

believe there is a need for a legislative change to the third-party recordkeeper summons provisions. We will not reiterate that testimony here. However, one recent development has further underscored the need for legislation. On May 4, 1982, IRS provided us with an analysis of third-party summonses it issued during fiscal years 1980 and 1981. Although we have had insufficient time to check the accuracy of IRS' figures, the overall analysis verifies the accuracy of our previous findings. Specifically, IRS found that tax protesters and individuals involved in illegal activities were primary users of the summons safeguard provisions. IRS also found that these individuals frequently used the safeguards solely to delay investigations. That is, they often stayed compliance with summonses but failed to appear in court for hearings. On the other hand, IRS verified that the law has, in some instances, afforded taxpayers protection from improper summonses.

H.R. 6300 seeks to strike a better balance between IRS' information needs and taxpayer rights. The bill retains all the basic safeguards set forth in current law. However, it also seeks to limit taxpayers' ability to use those safeguards solely to delay IRS investigations. This is accomplished by requiring that the taxpayer initiate a court action to stay compliance with a third-party summons. Thus, the committee's approach would have the effect of curbing an abuse while also fully retaining essential taxpayer safeguards.

TITLE II--IMPROVED INFORMATION REPORTING IS WARRANTED

Title II of H.R. 6300 seeks to improve information reporting by having more income covered by such reporting and providing stiff penalties and other measures to assure that payers submit usable reports. It also would exempt IRS from certain requirements of the Paperwork Reduction Act of 1980. These provisions are somewhat similar to those contained in S.2198.

We recognize and have previously supported the need for improved information reporting to help deal with the so-called subterranean economy. IRS' studies show that--next to tax withholding--information reporting represents the single most effective tool for promoting taxpayer compliance in reporting legally earned income. Thus, we support cost-effective information reporting and follow-on computer matching programs. We do, however, have one suggestion for your consideration with respect to information reporting. Also, we are opposed at this time to exempting IRS from the Paperwork Reduction Act of 1980.

We have reported and given congressional testimony several times during the last 3 years on the need for enhanced information reporting. Part I of Title II would improve the use of information reporting as a deterrent to tax cheating by

- --increasing or clarifying the types of income covered;
- --increasing the penalties for payers who fail to file required information returns with IRS or payees;
- --increasing the penalties and, in certain instances, requiring tax withholding when payers or payees fail to provide the identification numbers IRS needs to match information returns with tax returns; and

--requiring IRS to prescribe standards for filing information returns on magnetic tape or in other machine-readable form.

We generally support these provisions. However, H.R. 6300 contains no provision for a minimum penalty if a refund return is not filed in a timely manner. 1/

In our report on tax return nonfilers (GGD-79-69, July 11, 1979), we recommended that the Congress consider the matter of imposing a penalty on nonfilers due refunds, and we proposed various alternatives for imposing such a penalty. Our recommendation for a minimum penalty on nonfilers due refunds was based upon two principal factors. First, it was needed to encourage such persons to comply with the filing date requirements and to assure equitable treatment of taxpayers. Second, we were concerned about the costs IRS incurs in identifying and investigating nonfilers, many of whom are subsequently found to be due refunds. We, therefore, suggest that the committee consider adding to its bill a provision authorizing IRS to impose a penalty on nonfilers due refunds. Such a provision is contained in S.2198.

Now, Mr. Chairman, I would like to discuss the proposal to exempt IRS from the requirements of the Paperwork Reduction Act of 1980.

1/We discuss this matter here because the Joint Committee on Taxation, in its comparative analysis of H.R. 6300 and H.R. 5829 (S.2198), pointed out in its discussion of "Provisions to Improve Reporting Generally" that H.R. 5829 contained a minimum penalty for extended failure to file a tax return.

The Paperwork Reduction Act of 1980 requires that information collection requests must be referred to the Office of Management and Budget (OMB) for approval. Section 215 of Title II of H.R. 6300, like S.2198, would exempt IRS from this requirement. We do not believe that sufficient evidence is presently available to support the need for this exemption.

The Paperwork Reduction Act grew out of a recognition by the Congress and the Executive Branch that the Federal Government runs principally on vast quantities of information which it collects from the public. For example, according to OMB's most recent figures, the Government will impose some 1.3 billion hours of paperwork burden on the public during fiscal year 1982. The act was designed to provide a policy-making framework and an organizational and management structure to improve the management of all the resources employed in collecting, processing, using, disseminating, storing, and disposing of information. In this regard, it addresses a wide range of other information management issues, such as promoting the improved application of computers, telecommunications, and other information technologies.

We strongly supported enactment of the Paperwork Reduction Act, recognizing that it would eliminate IRS' exemption from the reports clearance requirements of the Federal Reports Act of 1942, the predecessor to the Paperwork Reduction Act. Our position was based on the belief that an effective mechanism for eliminating unnecessary paperwork burdens on the public and reducing Federal

information collection and processing costs required that all agencies be included in the clearance process required by the act. Also, IRS imposes nearly half the private sector's burden of reporting to the Federal Government.

At the time and since the act was enacted, several arguments were and continue to be made for exempting IRS from the Paperwork Reduction Act's provisions. These arguments include: (1) OMB's lack of tax expertise, (2) delays in the collection of tax revenues, and (3) the detrimental impact of the paperwork reduction goals on IRS' collection of the information necessary for administering the tax laws.

To us, the most compelling reason for exempting IRS from the Paperwork Reduction Act's requirements would be evidence that the act is impacting adversely on the collection of revenues. Presently, we know of no such evidence. We believe that unless and until such evidence is available, the act's requirements should continue to apply to IRS.

TITLE IV--BETTER COMPLIANCE TOOLS TO DEAL WITH FOREIGN TRANSACTIONS

Title IV of the proposed legislation contains provisions which address certain information gathering and administrative problem areas in the taxing of international transactions. The use of international transactions by individuals and businesses to avoid and evade U.S. taxes has long been a concern to the Congress and to IRS. Although both the Congress and IRS have sought to limit such transactions, noncompliance continues to grow. Especially troubling to IRS is the increase in the use of

offshore tax havens to avoid or evade U.S. taxes. Hopefully, the provisions under title IV will improve IRS' ability to gather information concerning international transactions in general and tax haven transactions in particular.

In January 1981, IRS issued a report based on an extensive review of tax havens. The report, entitled "Tax Havens and Their Use by United States Taxpayers--An Overview," included various administrative, legislative, and tax treaty recommendations designed to prevent serious abuse of the U.S. tax system. Some of these proposed recommendations are contained in Title IV of H.R. 6300.

Section 401 of H.R. 6300 would establish venue for purposes of summons enforcement in the U.S. District Court for the District of Columbia in those situations where a U.S. citizen or resident living abroad is summoned by IRS. Currently, an administrative summons directed to such a person outside the U.S. may prove unenforceable. This is because the law requires that the person reside in or be temporarily located in a U.S. judicial district before a court of that district can enforce the summons. We agree with the intent of section 401. It should enhance IRS' access to books and records in cases where the documents are under the custody or control of an entity or person who resides in a foreign country.

Section 402 contains various provisions concerning burden of proof and the admissibility in court of documentation maintained outside the U.S. Under present law, the burden of proof in tax matters is generally on the taxpayer. Nevertheless, IRS

has experienced problems in dealing with international transactions. In some cases, taxpayers have refused to furnish documents, have used delaying tactics, or have not produced the information until they are in court. In the latter instance, IRS has insufficient time to evaluate the information.

Under section 402, a taxpayer who has refused to provide documentation of foreign transactions requested by IRS during audit would generally be restricted from using the information in court. Exceptions would be made if the taxpayer could prove to the court that the requested documentation was not provided due to reasonable cause.

While we generally agree with the burden of proof and admissibility of evidence provisions contained in section 402, we are concerned with this section because it specifically excludes foreign nondisclosure laws as reasonable cause for a taxpayer not producing documents requested by IRS. This exclusion forces a taxpayer to choose between violating a U.S. law or violating a foreign law. Given this, the committee may wish to further consider the implications of this provision for affected taxpayers.

IRS officials have complained about inadequate reporting of transactions involving controlled foreign corporations. In this regard, section 411 would add another penalty for failure to furnish information required of controlled foreign corporations. The penalty would be $1,000 for each failure to furnish information for an accounting period, with additional $1,000 penalties

for each 30-day period during which the information is not produced. We agree with this provision and believe that it will increase the information available to IRS concerning controlled foreign corporations, particularly those operating in tax haven jurisdictions.

However, we think the provision should go further. As presently drafted, it does not require that similar information be provided to IRS by foreign-controlled U.S. corporations. Foreign-controlled U.S. subsidiaries conduct the same type of transactions with their foreign parents as do controlled foreign subsidiaries with their U.S. parents. Nevertheless, existing provisions require that information returns be filed only by U.S. parent corporations for their foreign subsidiaries.

IRS' international tax examiners consider the data contained on these information returns to be important in identifying potential tax adjustments and in planning their examination work. IRS officials informed us that the need for similar information on foreign-controlled U.S. corporations is becoming increasingly important because of the significant increase in the number and assets of foreign-controlled U.S. corporations. Between 1959 and 1974, the number of foreign-controlled U.S. corporations increased from 1,006 to 6,538 while the assets of such corporations grew from $8.4 billion to more than $75 billion.

In a previous report concerning IRS' determination of income of multinational corporations (GGD-81-81, September 30, 1981), we recommended that information returns be required of U.S. subsidiaries controlled by foreign parent corporations. We still

believe that obtaining information from such entities would prove valuable to IRS. Consequently, we suggest that our recommendation to require information returns from foreign-controlled U.S. corporations be considered for inclusion in section 411 of the bill.

TITLE V--MODIFICATIONS TO RULES FOR CALCULATING INTEREST ARE WARRANTED

Title V of H.R. 6300 makes several revisions relating to interest rate computations and assessments. In general, the revisions make sense from both a policy standpoint and a good business practice standpoint. However, the committee may want to modify the provisions in several respects.

First, H.R. 6300 does not provide for a semiannual determination of the interest rate to be paid on underpayments, on overpayments, and for other purposes. S.2198 and our previous report (GGD-81-20, October 16, 1980) call for a semiannual determination because of the volatile movement in interest rates. For example, in our report, we noted that in fiscal year 1979 an additional $119 million could have been assessed in interest charges on delinquent taxes if such a provision had been in effect. A semiannual adjustment in interest rates would be both fairer and more equitable than the present annual determination. We, therefore, suggest that the committee consider the more frequent semiannual adjustment of the interest rate.

Second, Section 501 of H.R. 6300 provides for daily compounding of interest. Although daily compounding of interest may be feasible, it may not be desirable. Clearly, IRS can program its

computers to make daily compounding computations. On the other hand, it is not so easy for human beings to make the same computations. Quite frequently, for example, IRS revenue officers make delinquent tax computations in the field. This requires a manual interest rate computation. Also, possibly to avoid the recent higher interest rate, more taxpayers who calculate or are assessed taxes after the due date of a return may be paying taxes due before receiving a bill from IRS. In so doing, taxpayers must make a manual interest rate calculation. In addition, many taxpayers may wish to calculate interest assessments for other reasons, such as verifying IRS' computations. If H.R. 6300 is passed in its present form, these individuals would have to make interest computations using a daily compounding formula. Without a special calculator or a knowledge of the mathematics of finance, this would be a very difficult task.

Moreover, the effective interest rate difference between daily and a less frequent compounding period, for example, quarterly or, as recommended by S.2198, semiannually, is not that great. At the current nominal interest rate of 20 percent, for example, daily compounding yields an effective annual interest rate of 22.13 percent. Semiannual compounding would yield a 21 percent rate annually, quarterly compounding would yield 21.55 percent, and monthly compounding would yield 21.94 percent. Thus, the committee may want to consider whether daily compounding is warranted in light of the complexities associated with the process and its marginal yield when compared to a less frequent compounding period.

Third, besides providing for compounding of interest, Section 502(a) of H.R. 6300 would extend the grace period allotted to IRS to process late-filed refund returns. In our report on tax return nonfilers (GGD-79-69, July 11, 1979), we noted that interest was being paid to individuals or corporations filing their returns after the required due date. Under present law, interest accumulates from the due date of the return if the late return is not processed within 45 days after receipt by IRS. S.2198 would make interest payable from the date the return is filed and would retain the 45-day processing period. H.R. 6300 would make interest payable from the due date of the return but would change the grace period for processing late-filed returns to 90 days.

For several reasons, we agree that the return processing grace period for late-filed returns should be extended to 90 days from the date of filing. Late-filing, for example, generally is not caused by IRS. Further, there is a potentially high cost related to current high interest rates. Also, IRS would face processing problems if late-filed returns were received in April in addition to those current returns being filed.

Concerning the latter point, both S.2198 and H.R. 6300 provide that no interest will be paid until a return is filed in a form suitable for IRS processing. S.2198 does not provide a definition of a processible form. Section 502(b) of H.R. 6300 specifies that a return in processible form is one that contains certain identification information and can be mathematically verified. We agree with the concept of these provisions and also believe

that a definition, such as the one provided in H.R. 6300, is essential to assure effective administration.

TITLE VI--EFFORTS TO EASE THE ADMINISTRATIVE BURDEN ON IRS WITH RESPECT TO PARTNERSHIP TAX RETURNS

IRS faces certain administrative problems with respect to partnerships that it does not face when dealing with individuals and corporations. Because partnerships are not taxable entities, IRS must deal separately with each partner in computing taxes due the Government and in settling tax disputes. As a result, legitimate partnerships with complex structures present a formidable administrative burden to IRS. Additionally, the partnership form of business has also become an attractive vehicle for promoters who market tax avoidance schemes with questionable economic value, thereby aggravating IRS' administrative problems.

Title VI of H.R. 6300 would comprehensively amend the partnership tax laws. The proposed amendments would greatly simplify IRS' task in administering the tax laws as they relate to partnerships, individuals and other entities involved in partnerships, and Subchapter S corporations.

Our limited work in the area of partnerships, tax shelters, and the windfall profit tax suggests that there is a need to revise the tax laws relating to partnerships. In a September 1980 report (GGD-80-98), we commented on IRS' processes for planning audit coverage levels and selecting returns in its partnership program. IRS has since implemented many improvements in that program. However, the number of multi-tiered partnerships and

the growth of partnerships in general continue to present a challenge to IRS' resources and capabilities.

For example, at the request of the Joint Committee on Taxation, we analyzed IRS-provided data from partnership returns filed for tax year 1978. Regarding multi-tiered partnerships, we found that 69,091 of the partnerships which filed a return for tax year 1978 indicated that (1) the subject partnership also participated in another partnership and/or (2) one or more of the partners were themselves partnerships. Also, 16,547 partnerships, or over 23 percent of the 70,913 partnerships reporting a loss of more than $25,000, were involved in tiering. Partnerships reporting large losses, according to IRS, are the ones most likely to be tax shelters.

The partnership form of organization is growing in popularity. For example, the number of partnership returns filed has grown from 992,000 in 1972 to 1,362,000 in 1980. The greatest percentage increase has been in the number of partnerships with more than 500 partners each. From 1972 to 1979, that segment increased by more than 232 percent--from 309 in 1972 to 1,027 for tax year 1979 (the last year for which figures are available).

Clearly, something must be done to reduce the administrative burden on IRS while also preserving and protecting taxpayers' rights. Title VI makes a good faith effort in this respect. However, some of those who will be most affected by Title VI have expressed concerns over certain provisions. Those concerns need to be further considered before legislation is enacted.

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In sum, Mr. Chairman, we support the objectives of your bill. We have provided some suggestions and cautions for your consideration. We think they will enhance the effectiveness of H.R. 6300 in achieving greater compliance with the tax laws.

In closing, we would like to alert you to one other area of concern, that being the need for additional IRS resources to effectively implement your proposals. For some time, we have been advocating increases in IRS resources. In this regard, IRS will need, at least on a temporary basis, some additional people and computer resources to implement this bill effectively. Such short-term additional expenditures could yield extensive long-term benefits. We, therefore, suggest that the committee do what it can to ensure that IRS gets the resources it needs to effectively administer this bill should it be enacted into law.

Mr. Chairman, this concludes my prepared statement. We would be pleased to respond to any questions.

GAO Reports and Testimonies Issued Since July 1979 And Ongoing Jobs Related To The Income Tax Compliance Problem

Reports

7/11/79	GGD-79-69: Who's Not Filing Income Tax Returns? IRS Needs Better Ways To Find Them And Collect Their Taxes
8/3/79	GGD-79-43: IRS Can Improve Its Process For Deciding Which Corporate Returns To Audit
8/15/79	GGD-79-59: IRS' Audits of Individual Taxpayers And Its Audit Quality Control System Need To Be Better
11/6/79	GGD-80-9: Improved Planning For Developing And Selecting IRS Criminal Tax Cases Can Strengthen Enforcement of Federal Tax Laws
1/24/80	GGD-80-33: IRS Computer Assisted Audit Program
2/11/80	GGD-80-34: IRS Efforts To Detect And Pursue Corporate Nonfilers
9/5/80	GGD-80-98: IRS Needs To Reconsider Its Examination Strategy For Certain Partners
10/16/80	GGD-81-20: New Formula Needed To Calculate Interest Rate On Unpaid Taxes
10/20/80	FGMSD-84-4: IRS Can Expand And Improve Computer Processing Of Information Returns
4/29/81	GGD-81-25: Streamlining Legal Review Of Criminal Tax Cases Would Strengthen Enforcement Of Federal Tax Laws
5/12/81	GGD-81-66: Observations Concerning The Internal Revenue Service's Management Of Criminal Tax Cases
7/8/81	GGD-81-83: Illegal Tax Protesters Threaten Tax System
7/23/81	GGD-81-80: Bank Secrecy Act Reporting Requirements Have Not Yet Met Expectations, Suggesting Need For Amendment
9/30/81	GGD-81-81: IRS Could Better Protect U.S. Tax Interests In Determining The Income Of Multinational Corporations
11/5/81	GGD-82-4: What IRS Can Do To Collect More Delinquent Taxes

Congressional Testimonies

7/16/79	Before the House Ways and Means Subcommittee on Oversight on IRS' efforts to identify and pursue income tax nonfilers and underreporters
7/17/79	Before the House Ways and Means Subcommittee on Select Revenue Measures on compliance problems of independent contractors
9/6/79	Before the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs on the subterranean economy
10/11/79	Before the House Ways and Means Subcommittee on Oversight on the efforts of IRS' Criminal Division to detect and deter underreporters
11/15/79	Before the Joint Economic Committee on the underground economy
11/29/79	Before the House Banking, Finance, and Urban Affairs Subcommittee on General Oversight and Renegotiation on the use of currency and foreign account reports to detect narcotics traffickers
12/13/79	Before the Senate Governmental Affairs Permanent Subcommittee on Investigations on IRS' Efforts to Combat Narcotic Traffickers
9/18/80	Before the House Ways and Means Subcommittee on Oversight on the subject of compliance by Federal Agencies with the requirements to file 1099 information returns
10/1/80	Before the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs on IRS' document matching program
10/1/80	Before the House Banking Finance, and Urban Affairs Subcommittee on General Oversight and Renegotiation on Implementation of the Bank Secrecy Act's Reporting Requirements
5/11/81	Before the House Ways and Means Subcommittee on Oversight on the adequacy of IRS compliance resources for fiscal year 1982
6/10/81	Before the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs on IRS' efforts against illegal tax protesters

7/23/81 Before the House Banking Finance, and Urban Affairs Subcommittee on General Oversight and Renegotiation on The Bank Secrecy Act

3/17/82 Before the House Government Operations Subcommittee on Commerce, Consumer and Monetary Affairs on the adequacy of IRS' resources

3/22/82 Before the Senate Finance Subcommittee on Oversight of the Internal Revenue Service on The Taxpayer Compliance Improvement Act of 1982

4/26/82 Before the Senate Finance Subcommittee on Oversight of the Internal Revenue Service on The Independent Contractor Tax Classification and Compliance Act of 1982

4/26/82 Before the House Ways and Means Subcommittee on Oversight on IRS policies and procedures to safeguard taxpayer rights and the effects of certain provisions of the 1976 Tax Reform Act

Current Reviews

(1) Review of problems IRS encounters in auditing tax shelter schemes

(2) Review of the quality of IRS' corporate tax return audits

(3) Review of IRS' resource management activities

(4) Review of IRS' use of publicity to promote voluntary compliance with the tax laws

(5) Survey of IRS' rewards for information program

(6) Survey of IRS' unreported income program