

# SIMPLIFICATION OF THE TAX SYSTEM

---

---

## HEARING

SUBCOMMITTEE ON OVERSIGHT  
OF THE  
COMMITTEE ON WAYS AND MEANS  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED EIGHTH CONGRESS  
SECOND SESSION

—————  
JUNE 15, 2004  
—————

**Serial No. 108-68**

—————

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

99-686

WASHINGTON : 2005

---

For sale by the Superintendent of Documents, U.S. Government Printing Office  
Internet: [bookstore.gpo.gov](http://bookstore.gpo.gov) Phone: toll free (866) 512-1800; DC area (202) 512-1800  
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

## COMMITTEE ON WAYS AND MEANS

BILL THOMAS, California, *Chairman*

PHILIP M. CRANE, Illinois	CHARLES B. RANGEL, New York
E. CLAY SHAW, JR., Florida	FORTNEY PETE STARK, California
NANCY L. JOHNSON, Connecticut	ROBERT T. MATSUI, California
AMO HOUGHTON, New York	SANDER M. LEVIN, Michigan
WALLY HERGER, California	BENJAMIN L. CARDIN, Maryland
JIM MCCRERY, Louisiana	JIM MCDERMOTT, Washington
DAVE CAMP, Michigan	GERALD D. KLECZKA, Wisconsin
JIM RAMSTAD, Minnesota	JOHN LEWIS, Georgia
JIM NUSSLE, Iowa	RICHARD E. NEAL, Massachusetts
SAM JOHNSON, Texas	MICHAEL R. MCNULTY, New York
JENNIFER DUNN, Washington	WILLIAM J. JEFFERSON, Louisiana
MAC COLLINS, Georgia	JOHN S. TANNER, Tennessee
ROB PORTMAN, Ohio	XAVIER BECERRA, California
PHIL ENGLISH, Pennsylvania	LLOYD DOGGETT, Texas
J.D. HAYWORTH, Arizona	EARL POMEROY, North Dakota
JERRY WELLER, Illinois	MAX SANDLIN, Texas
KENNY C. HULSHOF, Missouri	STEPHANIE TUBBS JONES, Ohio
SCOTT MCINNIS, Colorado	
RON LEWIS, Kentucky	
MARK FOLEY, Florida	
KEVIN BRADY, Texas	
PAUL RYAN, Wisconsin	
ERIC CANTOR, Virginia	

ALLISON H. GILES, *Chief of Staff*  
JANICE MAYS, *Minority Chief Counsel*

---

## SUBCOMMITTEE ON OVERSIGHT

AMO HOUGHTON, New York, *Chairman*

ROB PORTMAN, Ohio	EARL POMEROY, North Dakota
JERRY WELLER, Illinois	GERALD D. KLECZKA, Wisconsin
SCOTT MCINNIS, Colorado	MICHAEL R. MCNULTY, New York
MARK FOLEY, Florida	JOHN S. TANNER, Tennessee
SAM JOHNSON, Texas	MAX SANDLIN, Texas
PAUL RYAN, Wisconsin	
ERIC CANTOR, Virginia	

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

## CONTENTS

	Page
Advisory of June 8, 2004, announcing the hearing .....	2
WITNESSES	
Internal Revenue Service, Hon. Don C. Alexander, Commissioner, 1973–1977 .	31
Internal Revenue Service, Hon. Mortimer M. Caplin, Commissioner, 1961– 1964 .....	25
Internal Revenue Service, Hon. Sheldon S. Cohen, Commissioner, 1965–1969 .	29
Internal Revenue Service, Hon. Fred T. Goldberg, Jr., Commissioner, 1989– 1992 .....	34
—————	
Fordham University School of Law, Tax Litigation Clinic, Elizabeth Maresca .	12
H&R Block, Premium Tax Services, Jeannette Parshall .....	15
New York City Fire Department, Robert Sweeney .....	8
Rivermine Software, Nina Doherty .....	9
SUBMISSIONS FOR THE RECORD	
Coalition for Tax Fairness, Timothy John Carlson, Arlington, VA, statement ..	48
Father’s Rights Association of New York, Efrain Rodriguez, Jr., Mahopac, NY, statement .....	50
Klaassen, David R., Marquette, KS, statement .....	51
Reform AMT, Alan Veeck, Pittsburgh, PA, statement .....	52



## **SIMPLIFICATION OF THE TAX SYSTEM**

---

**TUESDAY, JUNE 15, 2004**

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON OVERSIGHT,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 2:02 p.m., in room 1100, Longworth House Office Building, Hon. Amo Houghton (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

## SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE  
June 08, 2004

CONTACT: (202) 225-7601

### Houghton Announces Hearing on Tax Simplification

Congressman Amo Houghton (R-NY), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the simplification of the tax system. **The hearing will take place on Tuesday, June 15, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include individual taxpayers and a panel of former commissioners of the Internal Revenue Service (IRS).

#### BACKGROUND:

On April 2, 2004, Chairman Houghton introduced nine legislative proposals to simplify the U.S. Tax Code. The Houghton package of simplification bills highlights areas of the Internal Revenue Code that can be simplified to make it easier for people to complete their tax returns. Committee Member Rob Portman (R-OH) introduced a comprehensive tax simplification bill in the 107th Congress, the "Tax Simplification Act of 2002" (H.R. 5166).

The Houghton simplification package includes bills that would repeal the Alternative Minimum Tax (AMT), reducing the number of AMT taxpayers by 114 million, and saving approximately 463 million hours of tax return preparation time; establish a uniform definition of a child that is based on residence, relationship, and age; and change the term "Head of Household" filing status to "Single Parent or Guardian" filing status, a term that is less likely to cause a mistake in choosing a filing status. Other proposals that would simplify the tax laws include: the "Taxation of Minor Children Simplification Act" (H.R. 4135), the "Education Tax Credit Simplification Act" (H.R. 4136), the "Small Business Tax Modernization Act" (H.R. 4137), the "Personal Holding Company Tax Repeal Act" (H.R. 4138), and the "State Business Law Tax Conformity Act" (H.R. 4139). With the exception of AMT repeal, all of the foregoing proposals are low-cost or revenue-neutral. Chairman Houghton also introduced a House resolution to require all future tax bills to contain a simplification title.

In announcing the hearing, Chairman Houghton stated, "The load that we place on taxpayers to understand the tax system is, in a word, heavy. Hard working Americans like Bob Sweeney, a New York City firefighter, and Robert Klaassen, a Kansas attorney with 13 children, are being forced to contend with a tangled, shadow tax system: the Alternative Minimum Tax."

"Millions of others are unable to navigate the complex series of rules which determine eligibility for common tax benefits such as the dependency exemption. I hope this hearing and the bills I introduced to simplify the tax code will persuade the Congress to take action to simplify the code."

#### FOCUS OF THE HEARING:

The hearing will focus on simplification of the current tax system.

### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

**Please Note:** Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "108th Congress" from the menu entitled, "Hearing Archives" (<http://waysandmeans.house.gov/Hearings.asp?congress=16>). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the on-line instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You **MUST REPLY** to the email and **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Tuesday, June 29, 2004. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

### **FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov>.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

---

Chairman HOUGHTON. Good afternoon, ladies and gentlemen. We are delighted to have you here. Thank you very much to the witnesses for being here. I am going to make an opening statement, then Mr. Pomeroy will, and then Mr. Portman will. So, let me just begin.

In some ways our tax system represents what one might call the pinnacle of our civilization. Spanning 7 million words of statute law and interpretive regulation, it is arguably the most intricate law of all time. Future archeologists looking back might view the Rosetta Stone of the tax law and will marvel at its ability to reconcile com-

peting objectives, such as the need to treat similarly situated taxpayers in similar fashions. Yet, unlike complex and natural systems made by God, our tax system does not always work in harmony. In written testimony that we are making available today, Professor Joel Slemrod estimates that this year individuals will spend \$85 billion to comply with the complex rules that govern our tax system. Businesses will spend an additional \$40 billion. This natural overhead expense is an extraordinary 14-and-a-half percent of income tax receipts.

Many experts have offered recommendations to simplify the Tax Code, and they have reached at least one consensus: Congress somehow must repeal the Alternative Minimum Tax (AMT). If we do not repeal this tax, it will, within in a short period of time, swallow the ordinary tax system. This clearly will be a disaster. It will double the work necessary to calculate income tax for tens of millions of Americans. It will also make planning difficult or impossible, and it will shift part of the tax burden of this country onto the shoulders of individuals like Bob Sweeney, a New York City firefighter; Robert Klaasen, a father of 13; and Nina Doherty, a casualty of the high-tech economy you will be seeing. We will be hearing from Mr. Sweeney and Ms. Doherty today on our first panel. Unfortunately, Mr. Klaasen could not be here, but he has provided some written testimony.

Chairman HOUGHTON. Now, Mr. Sweeney fell into the AMT because he pays relatively high State taxes because he has work-related expenses that the AMT treats as suspect. Mr. Klaasen pays AMT because of his large family and high medical expenses. Ms. Doherty faces AMT because she was restricted from selling the stock of a small company that later went bankrupt, as sometimes small companies do.

Another area of agreement among experts is that the definition of a qualifying child should be made uniform. The inconsistent rules, millions of Americans face a difficult challenge to determine whether their care of a child makes them eligible for tax benefits or not. As Professor Elizabeth Maresca will testify, they often get it wrong, and these mistakes can have severe consequences. Congress can and should make the definition of a child uniform. That should not be too difficult.

In addition to our individual witnesses, we are honored to have testify four former Commissioners of the Internal Revenue Service (IRS), very distinguished citizens of this country. Collectively their experience spans the Administrations of five Presidents, and they have more detailed knowledge of the tax system, I must assume, and its functioning than any other group that I know of. I look forward to their testimony in how to simplify the Tax Code.

In April of this year, we introduced a comprehensive package of 10 pieces of legislation that would substantially simplify the Tax Code for virtually every individual and small business. Subcommittee Member Rob Portman, seated to my right, also has introduced legislation that would repeal the AMT and make the definition of a child more uniform. Ranking Member Pomeroy, who is here on my left, shares my interest as well, and I hope to work with them closely.



Our tax system isn't perfect, but that always is a given. We should not let the academic pursuit of a perfect system that may never exist blind us to the work that we can do now, right now, to improve life for ordinary taxpayers. So, our witnesses today remind us of the importance of that objective.

Chairman HOUGHTON. I am now pleased to yield to the Ranking Democrat Mr. Pomeroy.

Mr. POMEROY. I want to thank the Chairman and congratulate him on convening this hearing and assembling this outstanding list of witnesses. I suppose that Congress in Presidential election years is not known for the pursuit of good governance necessarily, and I don't mean to heap that burden on one party or the other; I just think that it gets to be extraordinarily political around here, and we lose our way a little bit in terms of what good governance really ought to hold us to.

Well, tax simplification is pure good governance, and it hasn't had a more worthy champion over the years than Chairman, Amo Houghton. So, it would sure be wonderful in your remaining months in Congress if we could pass the "Houghton Memorial Tax Simplification Straighten It Up Act." Count me in. There is a lot that we can do both big and small, and the fact that we can't perhaps in one fell swoop fix everything should not detract us from at least identifying glaring issues and beginning our work on them. I am very pleased to work with my colleague Representative Rob Portman in that regard as well.

One of the issues that will come under discussion today, perhaps one of the most expensive, difficult issues that we will be encountering, is the AMT issue. My friend and colleague from Springfield, Massachusetts, Richard Neal, has been the leader in early identification of this as an emerging problem; he saw it before many of us did in terms of something that we are going to have to deal with, and he has led the effort to date. So, his participation in the course of our discussion today is going to be very valuable. With that, Mr. Chairman, I would just conclude by saying you once again have led the way in terms of something that the Committee on Ways and Means has got to get real serious about. If we don't provide the leadership, nobody is going to provide the leadership in terms of building a Tax Code that basically is a sustaining revenue basis for this country. Thank you for holding this hearing. I yield back.

Chairman HOUGHTON. Well, thank you. I would just like to add something here. This is sort of a personal feeling, that ever since I was on this Committee with Jake Pickle, I think this has been the most bipartisan Subcommittee I have known. We have always worked that way, and we have always worked our differences out. I think it is productive not only for us in Congress, but also, I think, for the witnesses. So, what I would like to do is to turn to Mr. Portman for an opening statement.

Mr. PORTMAN. Thank you, Mr. Chairman. I hate to start on a discordant note after that comment, but I must say as an anthropology major, I find your comparison of the Tax Code to the Rosetta Stone as an insult to the stone.

Thank you for having this hearing. Mr. Pomeroy, thank you for your comments; Mr. Neal for your contributions over the years on

the AMT. This is an incredible issue. I think, in all seriousness, the Chairman is right, our Tax Code in many respects does represent who we are. It is our attempt to balance all these competing interests, and I think we have failed in that. I think we have created such a complex Tax Code that it has a negative impact on our economy and a frustrating impact on our service and on our taxpayers.

You have been in the trenches on this over the years, Mr. Chairman. I appreciate the work you have done on it. I think you should take some comfort in the fact that we are making some progress. Last night in this very Committee room we passed out of this Committee legislation to simplify the International Tax Code in some significant ways, not as far as many of us would like to go, but there are some significant simplifications that you had been promoting for years that are included, including the foreign tax credit market baskets, and the interest allocation rules that will help make it a little bit easier to work through some of our tax complexities. As you have mentioned, I have also introduced legislation in this area. Many of the provisions that I have introduced have been included in your legislations, your bills, as well, Mr. Chairman. I think one reason both of us have pushed for simplification is because of its impact on the system.

We are going to hear from taxpayers today. I look forward to it. The taxpayer frustration I hope everybody understands and is obvious, but sometimes less obvious is its impact on the IRS itself. Maybe that doesn't motivate people to push for simplification, but it does me, because our tax system itself is under such incredible stress because of complexity. The IRS has a lot of problems, but a huge one is complexity. We are going to hear from four former Commissioners today, at least I see four here with us, and I look forward to talking to them about that. They have all been through it for years. As Co-Chairman of the National Commission on Restructuring the IRS, we were not supposed to look at simplification, but we did, simply because as we began to peel back the layers of the onion and get into the myriad of problems that the IRS was then experiencing, one clearly was its inability to administer the enormous complexity that we in the Congress have put upon it through our Tax Code.

So, there are lots of reasons to push for tax reform and tax simplification. One is there is a decreased level of voluntary compliance with more complexity. I firmly believe that from my own experience with my constituents. One of them called me once and said, Congressman, I would like to pay my taxes, but I just can't figure it out. I won't give you his name, nor did he give me his name, but this happens in all of our offices, I am sure. People just get so frustrated, they literally cannot figure it out. I'd like to touch on increased compliance costs. You talked earlier, Mr. Chairman, about the University of Michigan studies which are very disturbing in terms of the amount of time, effort, and money put into our tax compliance system.

Reduced perception of fairness in the Federal tax system. Being so complex, there is a concern about fairness, and I believe that this contributes to this lack of voluntary compliance. Finally, as I said before, the increased difficulties with the administration of tax laws themselves is problematic. Of course, there is the frustration

of taxpayers. So, I thank you very much, Mr. Chairman, for holding this hearing, and look forward to the testimony from our witnesses and look forward to taking that testimony and trying to put forward some legislation. As the Chairman said earlier, this is the art of the possible here in Congress, but at least it moves us toward simplification. I do think the bill last night is a small step in the right direction, at least on the international corporate provisions. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you very much, Mr. Portman. Mr. Neal, would you like to make a statement?

Mr. NEAL. Thank you, Mr. Chairman. Just a note. I think that you are absolutely right when you say that this has been the most bipartisan Subcommittee, and indeed you have been one of the most bipartisan Members of Congress. The sad commentary on all of this is that year after year there are fewer people like you. We have been talking here about AMT for a long time. We have talked about simplifying the Tax Code. I think that simplification ought to be the middle ground in this institution. It is something that can be done. On the AMT, I will just let the witnesses know that I have been at this for a long period of time. I have never been involved in an issue of my public career of 31 years where more people patted me on the back, thanked me, said, great job, and did less about it. It is because of the financial realities and what ideology now does in this institution, the intransigence that develops. I think that this is a problem that gets worse year after year after year, and trying to bring it up has been most difficult. I will tell you, as it relates to stock options, an awful lot of fine people as well as those with a certain number of children are really being hurt by AMT, and this institution can do something about it if it only had the will. Thank you.

Chairman HOUGHTON. Thank you very much. Mr. Johnson, would you like to make an opening statement of any kind? All right. Thank you very much.

Let us go to our first panel. We have Robert Sweeney of the New York City Fire Department of Douglaston—that is in the Queens. Nina Doherty, Sales Engineer at Rivermine Software; and Elizabeth Maresca, Associate Clinical Professor at Fordham University School of Law, and Supervising Attorney, Tax Litigation Clinic; and Jeannette Parshall, director of Premium Tax Services at H&R Block's office in Wheaton, Maryland. So, we will start with you, Mr. Sweeney.

Mr. POMEROY. Mr. Chairman, if I might, just at the outset, Mr. Sweeney and Ms. Maresca are from New York City. Our Ranking Member Charlie Rangel had hoped to be here to greet you and introduce you as you testify. He is otherwise detained in light of his schedule. He has asked me to give you a special welcome to this Committee. We are very pleased you could take the time to testify. Thank you, Mr. Chairman.

Chairman HOUGHTON. I thought you were going to say they were from North Dakota originally.

Mr. POMEROY. You are welcome any time.

Chairman HOUGHTON. Well, anyway. Go ahead, Mr. Sweeney. Thank you, Mr. Pomeroy.

**STATEMENT OF ROBERT SWEENEY, NEW YORK CITY  
FIRE DEPARTMENT, DOUGLSTON, NEW YORK**

Mr. SWEENEY. Good afternoon, Chairman Houghton, Ranking Member Pomeroy, and Members of the Committee. My name is Robert Sweeney. I am a New York fireman. I work for the New York City Fire Department, and as Assistant Chief I have supervisory responsibility for all the firehouses in the borough of Queens. We would like you to know that the New York City firefighters appreciate the support of Congress. However, I am here today to discuss what may be unintended consequences of the AMT. My tax accountant Dr. William Stevenson asked me to accept your invitation to come before you and explain how the AMT has affected my family in the negative way.

It is my understanding that the AMT negatively affects large numbers of middle-class taxpayers like me who earn less than \$150,000 per year, and will in future years affect many more millions earning even less. While I cannot explain to you how the AMT works, I can tell you how it affects my wife, my three children, and me. As I understand it, Congress has permitted us firemen to deduct various unreimbursed job-related expenses. A firefighter's job-related expenses include things like union dues, firehouse taxes, dry cleaning of uniforms, educational expenses, and many other out-of-pocket expenditures. Last year my unreimbursed expenses were about \$5,500. My family also had some modest investment fees which Congress has made deductible. Not only did we lose all of our miscellaneous firefighters' expense deductions and investment expense deductions, but we also lost some of our State income tax and real estate tax deductions as well.

My tax accountant tells me for the second year in a row that the AMT has taken these lawful deductions from us. We have received no tax benefits for the job-related expense deductions that were made a matter of law by Congress many years ago. The AMT cost my family about \$10,000 over the last 2 years. The extra tax we have paid has reduced what we could spend for our children's education and well-being. I also learned from my tax accountant that, when the AMT is calculated, we do not get the full benefit of deductions or credits for our children.

It seems to me that this tax is affecting people who cannot afford it. It seems to me that ordinary people should not be subject to a tax that they have never heard of, that is too complicated to calculate, that is impossible to plan for, and that drains their ability to care for their family. It is an honor to appear before you today, and I hope in some small way I helped you progress and fix the negative consequences of the AMT on middle-class families like mine. Thank you.

[The prepared statement of Mr. Sweeney follows:]

**Statement of Robert Sweeney, New York City Fire Department,  
Douglaston, New York**

Good afternoon Chairman Houghton, Ranking Member Pomeroy and members of the Committee. My name is Robert Sweeney. I am a New York Fireman. I work for the New York City Fire Department and as Assistant Chief I have supervisory responsibility for all the fire houses in the borough of Queens. We would like you to know that New York City Firefighters appreciate the support of Congress; how-

ever, I am here today to discuss what may be unintended consequences of the Alternative Minimum Tax.

My tax accountant, Dr. William Stevenson, who is an enrolled agent, asked me to accept your invitation to come before you and explain how the Alternative Minimum Tax has affected my family in a negative way. It is my understanding that the AMT negatively affects large numbers of middle class taxpayers like me who earn less than \$150,000 per year and will in future years affect many more millions earning even less.

While I can't explain to you how the Alternative Minimum Tax works, I can tell you how it affects my wife, my three children and me. As I understand it, Congress has permitted us firemen to deduct various unreimbursed job related expenses. A firefighter's job-related expenses include things like union dues, professional literature, dry cleaning of uniforms, educational expenses and many other out of pocket expenditures. Last year my unreimbursed expenses were about \$5,500. My family also had some modest investment fees which Congress has made deductible. Not only did we lose all of our miscellaneous fire fighter's expense deductions and investment expense deductions, but we also lost some of our state income and real estate tax deductions as well.

My tax accountant tells me, for the second year in a row, that the Alternative Minimum Tax has taken these lawful deductions from us. We have received no tax benefits for the job related expense deductions that were made a matter of law by Congress many years ago. The Alternative Minimum Tax cost my family about \$10,000 over the last two years. The extra tax we have paid has reduced what we could spend for our children's education and well being.

I also learned from my tax accountant, that when the Alternative Minimum Tax is calculated, we do not get the full benefit of the deductions or credits for our children. It seems to me that this tax is affecting people who cannot afford it. It seems to me that ordinary people should not be subject to a tax they have never heard of, that is too complicated to calculate, that is impossible to plan for and that drains their ability to care for their family.

It is an honor to have appeared before you today and I hope in some small way I have helped you progress and fix the negative consequences of the Alternative Minimum Tax on middle class families like mine.

---

Chairman HOUGHTON. Thank you very much, Mr. Sweeney. Ms. Doherty, please.

**STATEMENT OF NINA DOHERTY, SALES ENGINEER,  
RIVERMINE SOFTWARE, FAIRFAX, VIRGINIA**

Ms. DOHERTY. Mr. Chairman, Members of the Committee, my name is Nina Doherty, and I would first like to thank you for the opportunity to speak with you today. I am married, a working mother of three, living in a modest northern Virginia suburb with my husband of 17 years. Today I work full time for a small software company, and I am sharing my story with you in the hope that it will shed light on how AMT treatment of incentive stock options can have a devastating impact on average, hardworking people like me. In 1994, I became the first employee of a small startup telecommunications company. Part of my compensation included incentive stock options. Seven years later I found out to my huge shock that there could be an egregious impact from exercising stock options due to unintended consequences of the AMT.

Back in March of 2002, before I learned of the AMT, I exercised some stock options, and it appeared that all my hard work and sacrifice and working for this startup would pay off. My company was going public, as many did at the time, and it was everyone's perception that the stock value would remain stable or maybe even grow. Unfortunately, shortly thereafter the stock market tumbled, and my paper stock value was reduced to nothing. Despite the

dwindling stock value, I never thought to sell my stocks even after my restrictions lapsed in September 2000. I continued to hold on to my stock because I was told by my financial adviser, before I ever exercised any options, that due to the way the law was written with regard to capital gains tax penalties, it was more beneficial for me to hold on to it for at least a year. In April of 2000, while on a Girl Scout trip with one of my daughters, I got a call from my accountant about the taxes he had just prepared. He told me that because of the AMT, I owed a lot of money, but he didn't want to tell me how much until I got back to town. Alarmed, I asked him to tell me right there and then, and that is how I found out that I owed tax equal to 100 percent of our annual family income. I was dumfounded, and, quite frankly, so was my accountant. Now my family is facing potential financial ruin as a result of this massive penalty.

Unfortunately, the highly complex nature of the AMT befuddled both my highly trained financial adviser and my accountant, a situation affecting family after family across the country. It wasn't just the complicated Tax Code that led me to hold on to the stock. The spirit and the intent behind the "incentive" in the incentive stock option is that employees like me are encouraged by law to hold on to our stock for a longer period of time to help our companies grow by investing in the future. Certainly it was never the intent to hurt the very people that contributed to a company's success. Despite this, countless families are facing financial ruin due to the AMT International Organization for Standardization (ISO) issue, and mine is not a unique story. The big problem with paying the AMT is that the tax prepayment is simply a prepayment of tax—or, the tax payment is simply a prepayment of tax. When this all was in the sixties, the volatility of the stock market was not anticipated by Congress, and there was no evidence at the time that prepaying this would create hardship. Unfortunately, many families like mine cannot afford to prepay this tax.

There was no actual gain for victims like me, this tax will generate a useless tax credit, meaning that our prepayment of this tax is nothing more than an interest-free loan to the government. By today's law we can only recover the tax prepayment and credits at about 3,000 per year, which for our family means 30 plus years. For many people the credit will exceed their life expectancy. Recently the IRS levied our bank account, seizing \$30,000 my husband had in savings from a loan against his 401(k). The money was needed to do repairs on our 10-year-old house and replace our failing minivan. Next we received official notice that there was a Federal lien filed by the IRS on any and all property that we owned. With this and the past 3 years of worry about this problem, there has been a terrible strain on my family and my marriage. Every day this issue is like a dark cloud over our heads, and we wonder if we should just declare bankruptcy.

My family and I respectfully urge those of you on the Committee to take immediate action on correcting this injustice through a repeal of the AMT ISO provision, or through targeted and principled measures that will help those of us currently facing this problem, and also prevent similar results from occurring in the future. For families like mine, time has run out. The IRS is enforcing the strict

letter of the law, threatening to take our homes and retirement funds to collect money despite the fact that we never had any actual gain. Please don't allow this injustice to continue. Taxpayers deserve fair treatment in connection with simpler rules, and we appreciate your current consideration of a solution that is fair and just. Again, thank you for your time.

[The prepared statement of Ms. Doherty follows:]

**Statement of Nina Doherty, Sales Engineer, Rivermine Software,  
Fairfax, Virginia**

Mr. Chairman and Members of the Committee: My name is Nina Doherty and I would like to first thank you for the opportunity to speak with you today.

I am a married working mother of three living in a modest Northern Virginia suburb with my husband of 17 years. Today, I work full time for a small software company. I am sharing my story with you in the hope that it will shed light on how the Alternative Minimum Tax treatment of Incentive Stock Options can have a devastating impact on average hard working people like me.

In 1994, I became the first employee of a small start up Telecommunications Company. Part of my compensation included Incentive Stock Options. Seven years later, I found out to my huge shock that there could be an egregious impact from exercising Stock Options due to unintended consequences of the Alternative Minimum Tax.

Back in March 2000, before I learned about the Alternative Minimum Tax, I exercised some stock options and it appeared that all my hard work and sacrifice in working for a start-up would pay off. My company was going public as many did at that time, and it was everyone's expectation that the stock value would remain stable and perhaps even grow. Unfortunately, shortly thereafter, the stock market tumbled and my "paper" stock value was reduced to nothing. Despite the dwindling stock value, I never thought to sell them even after my restrictions lapsed in September 2000. I continued to hold onto my stock because I was told by my financial advisor before I ever exercised any options that due to the way the law was written with regard to capital gains tax penalties, it was more beneficial for me to hold it for more than one year.

In April of 2001, while on a Girl Scout trip with one of my daughters, I got a call from my accountant about the taxes he had just prepared. He told me that because of the Alternative Minimum Tax, I owed a lot of money, but he didn't want to tell me how much until I got back into town. Alarmed, I asked him to tell me right there and then—and that is how I found out that I owed tax equal to 100% of our annual family income! I was dumbfounded, and quite frankly, so was my accountant. Now my family is facing potential financial ruin as a result of this massive penalty.

Unfortunately, the highly complex nature of the Alternative Minimum Tax code befuddled both my highly trained financial advisor and my accountant, a situation affecting family after family across this country.

And it wasn't just complicated code that led me to hold onto the stock. The spirit and intent behind the *incentive* in an Incentive Stock Option is that employees like me are encouraged by law to hold onto our stocks for a longer period of time, to help our companies grow by investing in the future. Certainly, the intent was NEVER to hurt the very people that contributed to a company's success. Despite this, countless families are facing financial ruin due to the ISO AMT issue—mine is not a unique story.

The big problem with paying the AMT is that the tax payment is simply a prepayment of tax. When this law was written in the sixties, the volatility of the stock market was not anticipated by Congress and there was no evidence at that time that prepaying this tax would create hardship. Unfortunately, many families like mine cannot afford to prepay this tax. Because there was no actual gain for victims like me, this tax will generate a useless tax "credit", meaning that our prepayment of this tax is nothing more than an interest-free loan to the government. By today's law, we can only recover the tax prepayment in credits at \$3,000 per year, which for our family means 30+ years—for many people the credit will well exceed their life expectancy.

Recently, the IRS levied our bank accounts, seizing \$30,000 that my husband had in savings from a loan against his 401(k). This money was needed to do repairs on our ten year old home and replace our failing minivan. Next we received official notice that there was a Federal lien filed by the IRS on any and all property that we

own. With this and the past three years of worry about this problem, there has been terrible strain on my family and my marriage. Every day this issue is like a dark cloud over our heads and we wonder if we should just declare bankruptcy.

My family and I respectfully urge those of you on the Committee to take immediate action on correcting this injustice, through a repeal of the AMT/ISO provision, or through targeted and principled measures that will help those of us currently facing this problem, and also prevent similar results from occurring in the future. For many families like mine, time has run out: the IRS is enforcing the strict letter of the law—threatening to take our homes and retirement funds to collect the money despite the fact that we never had any actual gain.

Please don't allow this injustice to continue. Taxpayers deserve fair treatment in connection with simpler rules, and we appreciate your current consideration of a solution that is fair and just.

Again, thank you for your time.

---

Chairman HOUGHTON. Thank you very much. Those are two extraordinary stories. Ms. Maresca.

**STATEMENT OF ELIZABETH MARESCA, ASSOCIATE CLINICAL PROFESSOR, FORDHAM UNIVERSITY SCHOOL OF LAW, AND SUPERVISING ATTORNEY, TAX LITIGATION CLINIC, NEW YORK, NEW YORK**

Ms. MARESCA. Good afternoon, Mr. Chairman and Members of the Subcommittee. My name is Elizabeth Maresca, and I am an associate professor at Fordham Law School and the supervising attorney of its Low-Income Taxpayer Clinic. It is my pleasure to talk to you today about the tax simplification legislation regarding a uniform definition of “qualifying child.” This change will benefit both taxpayers and the IRS, and it will make our tax system much more fair and efficient. Fordham Law School’s Low-Income Taxpayer Clinic has been in operation for about 4 years, and over that time we have represented hundreds of low-income taxpayers. One of the most frequently recurring problems in our representation of these taxpayers stems from the multiple definition of “qualifying child.” Simplicity in this area will go a long way in reducing the burdens on many taxpayers who are working hard to support their families and naturally claim their children on their tax returns, as Congress has long intended that they should. The current law uses some financial measurements which impose unrealistic record-keeping obligations on taxpayers, and these requirements are specifically daunting for low-income workers who often do not have bank accounts and are likely to pay for their food and clothing and shelter with cash and money orders. Under current law they are required to record all their outlays for these items and be able to document the support of their children in their household.

Removal of the financial analysis which is currently under the law is especially important because it removes the recordkeeping requirement, but also because of the unique complications under which low-income people live. They usually have a financial safety net, and they may rely on such things like New York City has a free breakfast and school lunch program for their children. They may shop at a food pantry in their neighborhood. They may receive groceries or clothing from a local charitable organization. Many have free health insurance for their children from New York State. At other times, of course, the family receives subsidized housing ei-



ther from the State or the Federal Government, food stamps, or Temporary Assistance for Needy Families (TANF). When you combine all those sources of income into the household, it is very difficult, if not impossible, to determine how it affects their eligibility for claiming their children at issue.

However, under the proposed definition for qualifying child, all of my clients will be able to know if they qualify. They need to know the age, the relationship, and the residency of the children under their care. It is easy to determine, and it is also easy to document. A further problem that occurs in my work is that the IRS' staff also has difficulty interpreting the current legislation. When the IRS pulls a return for audit for a low-income taxpayer who has claimed the earned income credit, they freeze the refund for that return and all subsequent tax refunds. Often the audit of the tax year takes 2 to 3 years to complete, which means that the taxpayer is waiting up to 3 years for 3 tax refunds which he desperately needs to support his family.

If you use the uniform definition of qualifying child, it will make it much easier for the IRS to interpret and make the audit process to go much more quickly, the refunds will be released sooner to the taxpayers, and a significant burden will be reduced. One final area that perplexes my clients is their reliance on the paid tax preparer. In my experience, many of these tax preparers cause more problems than they solve because they, too, have difficulty interpreting the legislation as it applies to the client. Simplifying the law will enable the taxpayers and their tax preparers to correctly report on the original return. A correct original return reduces audit burdens on the IRS. Simplifying the law will reduce the audit burdens and get the refunds to the taxpayers faster. Increase compliance, reduce administrative burdens, and decrease of the length of the IRS audit is very important results of the proposed legislation. I would like to thank you for the opportunity to speak to you today, and specifically for presenting my views based on my clients' experiences.

[The prepared statement of Ms. Maresca follows:]

**Statement of Elizabeth Maresca, Associate Clinical Professor, Fordham University School of Law, and Supervising Attorney, Tax Litigation Clinic, New York, New York**

Mr. Chairman and members of the Committee, my name is Elizabeth Maresca. I am Associate Professor of Law at Fordham University School of Law and the Supervising Attorney of its Low-Income Taxpayer Clinic. It is my privilege to testify before you and urge you to adopt this much needed tax simplification proposal which will replace the current multiple definitions of a qualifying child with a single, sensible Uniform Definition of a Qualifying Child. This change will benefit both low income taxpayers and the IRS, as it makes our tax system more fair and efficient.

Fordham Law School and its Clinical Program are located at Columbus Circle in the heart of Manhattan. The Low Income Taxpayer Clinic has been in operation for four years and we have served hundreds of low income taxpayers. Most of our clients are the working poor who have been denied their earned income tax credits by the IRS. The typical client seeks our representation after he or she has made repeated attempts to correspond with the IRS regarding the disallowance of their EITC, dependency exemptions and head-of-household filing status. All too often, the IRS is unable to respond to these requests in a timely manner or responds with a form letter requesting more documentation which the taxpayer does not have and has no ability to obtain.

One of the most frequently recurring problems in our representation of low income taxpayers stems from the multiple definitions of qualifying child in the tax code. Simplicity in this area will go a long way in reducing the burdens on the many

low income taxpayers who are working hard to support their families and naturally claim their qualifying children on their tax returns, as Congress has long intended they should.

In my work, we represent taxpayers who are in controversies with the IRS over the correctness of their tax returns. The proposed legislation will reduce the number and the complexity of IRS audits and reducing a significant burden on the millions of taxpayers who claim the tax benefits connected to their children.

#### A. THE COMPLEXITY OF THE CURRENT LAW MAKES IT DIFFICULT FOR TAXPAYERS INTERPRET THE LAW AS IT PERTAINS TO THEIR CHILDREN

Current law uses financial measurements which impose unrealistic record keeping obligations upon taxpayers, requiring extensive record keeping on everyday household budget matters. These requirements are specifically daunting for low-income workers, who often do not have bank accounts and are likely to pay for food, clothing and even shelter with cash or money order. Under the current law, they are required to record each modest outlay for food, clothing, heat, electricity, phone service, rent and other expenses. Many Americans rely on cancelled checks or electronic banking records; however, for many of my clients it can be quite a challenge to document that they have paid their rent, although they may have lived in the same apartment for some years without any problem. In addition to living without access to banking services and relying upon check cashing stores, it is very common for low-income workers in NYC to live in shared apartments for which they are not on the lease or have an oral arrangement with a landlord. Often they have moved once or twice since the tax year at issue and have no way to contact the landlord for proof that they paid their rent during the tax year under audit.

Removal of the financial analysis currently required under the law is an especially important change for the low-income taxpayer. This is true because not only because it removes a burdensome record keeping requirement, but also because of the unique complications that often characterize their financial situations. Many low-income workers are compelled to rely upon some type of financial safety net to supplement their low wages. They may rely upon something as simple as New York City's free breakfast and lunch program for school children. Many shop at food pantries or receive groceries or clothing from religious or community based organizations. The family may participate in programs such as New York State's free health insurance for children. Of course at times the family receives easily identified government assistance such as subsidized housing, food stamps or TANF. Many cases present the more difficult situation in which another member of the household, who is not part of the nuclear family we represent, may receive Social Security Insurance or Disability Insurance benefits. In these situations, it is difficult if not impossible to determine how these funds are used and thus how they affect the client's eligibility for the claiming the children at issue.

All too often, my clients cannot determine what their household expenses were during the tax year at issue, what other assistance they received and how it all plays into the total amount of support for the child or household. Most are not aware that these other sources of financial support affect their rights to claim their children under the tax laws.

The proposed definition of qualifying child, and the requirements for documentation, is very welcome and user friendly to the low-income worker. All of my clients know the age, relationship and residency of the children under their care. The proposed legislation allows the low-income taxpayer to easily determine, and obtain the documents to prove, that their children and other children under their care are their "qualifying child" under the tax laws.

The proposed legislation simplifies the record keeping requirements under the tax code. The taxpayer needs only a few pages to establish the three-part test under the proposed legislation—a birth certificate, or other legal document to prove relationship and age; and a letter from a school, landlord, health care provider or clergy to establish residency. In New York, these are the simplest documents to obtain and often the taxpayer can gather them within a few days at little or no cost. Further, they are more than sufficient to permit the IRS to enforce the law and ensure that taxpayers meet their legal obligations.

#### B. THE COMPLEXITIES OF THE CURRENT LEGISLATION CAUSE SIGNIFICANT DELAYS IN RETURN PROCESSING CAUSING DELAYS IN ISSUING THE TAX REFUNDS DUE TO THE LOW-INCOME WORKERS AND THEIR FAMILIES

It has been my experience that the IRS, their auditors, Appeals Officers, paralegals and attorneys also have difficulty applying the current legislation to the low-income family. The IRS' inability to easily apply the law has an extremely negative affect on the low-income worker as it delays the completion of the IRS audit. While

one tax year is under audit, the IRS freezes all subsequent tax refunds. The taxpayer often has to wait 2 to 3 years for their much needed tax refunds for the year under audit and the subsequent tax years. These delays cause a significant financial hardship on low-income workers and their families.

The audit process will be sped up by the proposed legislation because the documents needed to establish the taxpayer's eligibility under the laws will also be reduced. Currently, there is a myriad of documents requested and required to establish the taxpayer's eligibility to claim their children. As stated earlier, these documents often do not exist or cannot be obtained. If they do exist it will often take the taxpayer significant effort and time to gather them. The documents which will be required under the proposed legislation are easily obtained and are much less voluminous. Consequently, the burden to the taxpayer will be significantly reduced.

Unifying the definition of qualifying child will reduce record keeping requirements and simplify the return preparation process. More importantly, the proposed legislation reduces the burden on the taxpayer and the IRS after the return is filed. The proposed legislation will decrease the time it takes the IRS to complete the audits, which will in turn allow the Service to release the taxpayer's much needed refunds in a timelier manner.

#### C. COMPLEXITIES OF THE CURRENT LEGISLATION CAUSE MANY LOW-INCOME WORKERS TO PAY FOR PROFESSIONAL SERVICES TO PREPARE THEIR TAX RETURNS

The current complexities in this area impose another unneeded burden on my clients by compelling many of them to hire a tax-return preparer, despite the fact that all their reportable income is often contained on a single Form 1099 or Form W-2. Although their return is only 3 pages and 10 to 12 lines on a Form 1040, too many of my clients that have paid over a week's salary to a tax preparer for a return that should take only about 30 minutes to prepare. Further, in my experience, these tax preparers are all too often "fly-by-night" operators who cause many more problems than they solve and introduce errors that plague both the taxpayer and increase the audit burden on the IRS. Simplifying the law will enable both the taxpayer and these professionals to correctly report on the original return. Correct reporting reduces the incidents of audits and math-error notices, reduces the burden on the taxpayer and allows the refundable credits to be paid to family much more quickly.

#### D. CONCLUSION

The proposed legislation for a uniform definition of qualifying child enjoys wide support. For the millions of families claiming the benefits of the earned income credit, dependency exemption, child tax credit and head-of-household filing status, the proposed legislation will increase compliance, reduce administrative burdens, decrease the length of the IRS's audit of these issues and enable the IRS to release tax refunds in a more-timely manner to a community who desperately rely on these funds for their families survival.

I wish to thank the Subcommittee for the opportunity to present my views on the simplification of the tax code and specifically on the proposed legislation for a uniform definition of qualifying child.

Chairman HOUGHTON. Thank you very much, Ms. Maresca. Ms. Parshall.

#### **STATEMENT OF JEANNETTE PARSHALL, DIRECTOR, PREMIUM TAX SERVICES, H&R BLOCK, WHEATON, MARYLAND**

Ms. PARSHALL. Mr. Chairman, Representative Pomeroy, Members of the Subcommittee, thank you for the invitation to appear today. Mr. Chairman, I want to commend you, Mr. Portman, and your colleagues for making tax simplification a priority. I know that among your proposals are some suggested by H&R Block. I hope that all of H&R Block's 2004 simplification suggestions can be included in your record.

I have been an income tax professional, working as one, for 28 years. My practice today centers in Wheaton, Maryland, where I

prepare over 100 tax returns each year, and directing H&R Block's premium tax office that prepares 2,000 returns. Most of my own clients are suburban professionals with complex returns. Much has changed since I started. For the first 14 years, I prepared returns by hand using a manual calculator. Today I wouldn't dream of completing a tax return without continual training and computer technology that does comparative calculations to ensure that clients pay the lowest legal tax.

Consider some of the complexity taxpayers face today. We have over 600 forms, schedules, and instructions; 5 different definitions for child; multiple rates and dates for capital gains; a plethora of pension plans, each with different rules and consequences; ever-changing criteria for the earned income tax credit; and, of course, there are multiple education deductions and credits. We have a nonrefundable child credit and a fully or partially refundable child credit. The worksheets to sort out the order are mind-boggling. We have sunrises and sunsets; phase-ins and phase-outs.

Tax software and professional preparation enable taxpayers to manage some of this complexity. Today 85 percent of tax returns are prepared with a computer, compared to 16 percent in 1990; and 56 percent of taxpayers used a tax professional, compared to 48 percent in 1990. Of course, complexity is not the only reason to seek professional tax help. Convenience, speed, anxiety reductions, life changes such as marriages, births and moves, and, increasingly, annual financial advice all play a part. Complexity is a major factor.

Of course, not every taxpayer faces serious complexity. Two-thirds of taxpayers do not itemize their deductions; 40 percent of taxpayers are able to use short forms. Millions of self-preparers use software like Tax Cut to make life simpler, and wage-earners generally have a lighter burden than self-employed taxpayers. There are understandable reasons for some complexity as tax laws are tailored for fairness, to fit available funds, or to favor certain activities like education, homeownership, or retirement savings. Some complexity can also bring tax relief. Most of my clients pay less Federal income tax as a result of recent complex legislation. If complexity has benefits, it also exacts a price. Some taxpayers overpay as a result of complexity and confusion. When Congress enacts so many changes so frequently, it is hard for taxpayers, tax professionals, or the IRS to fully absorb or appreciate them. In the 18 years since the Tax Reform Act 1986 (P.L. 99-514), Congress has made 7,662 changes to the Internal Revenue Code (IRC), averaging more than 425 a year. Most taxpayers can't keep up.

Mr. Chairman, we live in a more complex world than the one in which I started preparing tax returns in 1977. The Tax Code reflects that. The issue of simplification is not new. Henry Bloch, who started our tax preparation firm almost 50 years ago, testified repeatedly in favor of simplifying the Tax Code through the seventies and early eighties. So, the simplification effort is ongoing. We can still do more, and we should. On behalf of H&R Block, I appreciate the opportunity to support your efforts.

[The prepared statement of Ms. Parshall follows:]

**Statement of Jeannette Parshall, Director, Premium Tax Services,  
H&R Block, Wheaton, Maryland**

Mr. Chairman, Representative Pomeroy, Members of the Subcommittee:  
Thank you for the invitation to appear today.

Mr. Chairman, I want to commend you, Mr. Portman, and your colleagues for making tax simplification a priority. I know that among your proposals are some suggested by H&R Block. I hope that all of H&R Block's 2004 simplification suggestions can be included in your record.

I have been a professional tax return preparer for 28 years. My practice today centers in Wheaton, Maryland, where I prepare over 100 tax returns each year and direct an H&R Block office that prepares 2,000 returns. Most of my own clients are suburban professionals with complex returns.

Much has changed since 1977, when I started.

For the first 14 years, I prepared returns by hand, using a manual calculator. Today I wouldn't dream of completing a return without the help of continual training and computer technology that does comparative calculations to ensure that clients pay the lowest legal tax.

Consider some of the complexity taxpayers face today:

- Over 600 forms, schedules, and instructions.
- Five different definitions for a child.
- Multiple rates and dates for capital gains.
- A plethora of pension plans, each with different rules and consequences.
- Ever changing criteria for the Earned Income Tax Credit. Multiple education deductions and credits.
- A nonrefundable child credit and a fully or partially refundable additional child credit. Plus worksheets to sort out the order when a taxpayer has refundable and nonrefundable credits.
- Sunrises and sunsets; phase-ins and phase-outs.
- And, worst of all, the AMT, which is impossible for even the most-well-educated taxpayer to understand.

Tax software and professional preparation enable taxpayers to manage some of this complexity. Today, 85 percent of returns are prepared with a computer compared to 16 percent in 1990; and 56 percent of taxpayers use a tax professional compared to 48 percent in 1990.

Complexity is not the only reason to seek professional tax help. Convenience, speed, anxiety reduction, life changes (marriages, births, moves), and, increasingly, annual financial advice all play a part. But complexity is a major factor.

Of course, not every taxpayer faces serious complexity: two-thirds of taxpayers do not itemize their deductions; 40 percent of taxpayers are able to use short forms; millions of self-preparers use software like *TaxCut*<sup>®</sup> to make life simpler; and wage earners generally have a lighter burden than self-employed taxpayers.

There may be understandable reasons for some complexity as tax laws are tailored for fairness, to fit available funds, or to favor certain activities like education, homeownership, or retirement savings. And some complexity can also bring tax relief. Most of my clients pay less Federal income tax as a result of recent, complex legislation.

But if complexity has benefits, it also exacts a price.

Some taxpayers overpay as a result of complexity and confusion.<sup>1</sup> And when Congress enacts so many changes so frequently, it is hard for taxpayers, tax professionals, or the IRS to fully absorb or appreciate them. In the 18 years since the 1986 tax reform act, Congress has made 7,662 changes to the Internal Revenue Code, averaging more than 425 a year. Most taxpayers can't keep up.

Mr. Chairman, we live in a more complex world than the one in which I started preparing returns in 1977. The tax code reflects that. But the issue of simplification is not new. Henry Bloch, who started our tax preparation firm almost 50 years ago, testified repeatedly in favor of simplifying the tax code through the 1970s and early 1980s. So the simplification effort is ongoing. We can still do more, and we should.

<sup>1</sup> A March 2002 General Accounting Office report showed missed deductions and credits alone may have caused over 2 million Americans to overpay their Federal taxes by an average of over \$400 each. A January 2002 GAO report found that small businesses overpaid their taxes by \$18 billion over the prior two years because of tax return errors. An October 2002 Treasury report found 600,000 low-income taxpayers didn't claim the refundable portion of the child credit, costing them an average of \$390 each. A March 2004 Treasury report found tens of thousands of farmers overpaid taxes by an average of over \$500 because they did not take advantage of income averaging. See also, Eric Toder, et al., "Estimating the Compliance Cost of the U.S. Individual Income Tax," 61 *National Tax Journal* 673 (September 2003).

On behalf of H&R Block, I appreciate the opportunity to support your efforts.

---

Chairman HOUGHTON. Thank you, Ms. Parshall. That was wonderful testimony. It was wonderful testimony for everyone here. I am going to turn to Mr. Pomeroy now to start the questioning.

Mr. POMEROY. It was wonderfully succinct testimony, Mr. Chairman, and I think brought us a very good idea about the havoc this complexity is wreaking in ordinary people's lives that try to do the right thing, but find a Tax Code that is absolutely bewildering, unjust, and otherwise increasingly regressive as it takes away some of the deductions we put in place for working families. Mr. Sweeney, when did you fall onto the AMT alternative as a tax obligation?

Mr. SWEENEY. I believe about 2-and-a-half years ago. I have been promoted up through the ranks, and my salary has gradually increased, I felt the implications of the AMT.

Mr. POMEROY. Is this a problem with some of your officers?

Mr. SWEENEY. Yes. My colleagues at my rank, they suffer the same consequences also. That is correct.

Mr. POMEROY. You all would be paying the same high local taxes, and some of the things that would result—

Mr. SWEENEY. Right. A lot of our common deductions are not allowed or not accepted under the AMT, so it affects all of us pretty much along the same lines.

Mr. POMEROY. Well, you are on the vanguard. There will be 35 million of us joining you soon if we don't make some changes. So, you are bringing us, I think, the early glimpse of what Congress will expect from constituents, broad swaths of middle-class family constituents, saying, what is this about?

Mr. SWEENEY. I don't know the exact numbers, but I would tend to believe that every year the numbers would increase up the lines until basically the whole middle class would be involved under the AMT umbrella.

Mr. POMEROY. Ms. Doherty, your situation is very disturbing. There have been legislative proposals surfaced to address that issue specifically. Are you aware of anything percolating along now that might be responsive?

Ms. DOHERTY. Well, one of the things I have found is that the IRS has not been able or has not been very responsive in terms of the O and C (offer and compromise) process or effective tax administration. What I am finding is that my friends that have gotten all the way through process that are in a similar situation, they get a nice note saying, thank you for your application, but we want all the money. So, basically the IRS is not using these tools. I have heard that there is—

Mr. POMEROY. What is the O and C that you are referring to?

Ms. DOHERTY. Offer and compromise. They make their offer, and unfortunately it is being rejected, and the IRS is still trying to collect the entire amount even though there was actually no gain. I understand that there is a bill in the Senate that would help the IRS, give them a little bit more latitude and be able to utilize the tool of the O and C in effective tax administration, so,

especially in particular as it applies to the AMT ISO issue. I would be very grateful to see support of that bill.

Mr. POMEROY. In the meantime, I hope you will be able to continue to work with the IRS to resolve it. You are still a two-income family?

Ms. DOHERTY. Right. We are a two-income family, but it is very—it is discouraging when we are trying to kind of catch up, and the IRS is just clamping down, and we feel kind of like we have no option but to pay the money that we don't have.

Mr. POMEROY. Well, you can't get blood from a turnip. Is that an old saying?

Ms. DOHERTY. That is right. My husband hails from Ireland, so he would definitely agree with you on that statement.

Mr. POMEROY. Well, thank you for being so candid with the personal dimensions of what this stock option has done to you.

Ms. DOHERTY. Well, I think it is important.

Mr. POMEROY. We need to know. All too often we can deal with broad policy, and the kind of family based horror story you have brought to our attention is important.

Ms. DOHERTY. This is not a unique story. There are thousands of families like mine, some in much worse situations. So, I feel that I represent those people.

Mr. POMEROY. Thank you. In light of my time elapsing, Ms. Parshall, thank you very much for your testimony. One can just tell listening to you, you have prepared a lot of returns, dotted I's, crossed the T's, and taken excellent care of your clients' tax needs. One of the things that I have had a chance to visit with your firm about over the years is the growing dimension of the vending-related services, like the loan in advance of refund and these kinds of things. Are you finding as a preparer that you are under a lot of pressure to sell extra stuff?

Ms. PARSHALL. Not from the company. I don't personally have that issue. I deal mostly with high-income professionals. The company is not pushing the refund anticipation loan. That is something like fifth on the list of options that we are told to present. What I find is clients come in, they want it. I say, I think it is a lousy idea, because I do, and I am very honest with them about it. If you can manage without the money, don't do this. The sad fact of life is there are people who do need the money tomorrow. I find that hard to understand, you may find that hard to understand, but it exists.

Mr. POMEROY. No. I find it pretty easy to understand. I like the market having choices, but I am very anxious about abuse of sales, and in the trust relationship between a preparer and the clients, I am anxious about what might be abuse there.

Ms. PARSHALL. We have full disclosure of all aspects of the refund anticipation loan, and, as I say, we do not push it. Again, we have to provide the service that the client wants. I can't make his decisions for him.

Mr. POMEROY. Thank you very much. I yield back, Mr. Chairman.

Chairman HOUGHTON. Thank you very much. Now, Mr. Johnson. Oh, Mr. Portman.

Mr. PORTMAN. Oh, no. Go ahead.

Chairman HOUGHTON. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. I appreciate that.

Ms. Doherty, because AMT taxes are actually prepaid taxes, shouldn't you eventually get that money back when you use your AMT credits?

Ms. DOHERTY. Well, if I live long enough, yes, I will get it back. The AMT ISO provision operates as a prepayment of tax based on presumed tax, based on the regular Tax Code. The problem is this prepayment, in order for it to equal what would be due under the regular Tax Code, and for that to work, my stock would have had to have risen and risen and gotten greater to equal what I would have to prepay. Now, in the real world that we live in, unfortunately stocks are stable or they drop, or in my case my company went bankrupt and the stock actually became worthless. So, certainly there is no way that the effective tax rate that I am paying would be equal to what gets paid under AMT rules. So, now we have a gap between the AMT payment versus regular Tax Code, and that becomes the AMT credit. Unfortunately, that AMT credit cannot be realized right away, so mine will take 30 plus years. I suppose there are some people that might get it back quickly, but I know a number of people whose credit will not be returned in their lifetime. I am not exaggerating. It won't even be back in their children's lifetime in theory. So, I really appreciate you asking that question, because it is really important that we find a way to get this prepayment of tax back to the hardworking individuals that are having to pay it.

Mr. JOHNSON. There are companies in the same boat that, we are just giving the government a loan, only it is permanent for the most part.

Ms. DOHERTY. Exactly.

Mr. JOHNSON. She spoke of, Mr. Chairman, a bill over in the Senate, happens to be John Kerry's, but I have got a companion bill here that would allow individuals who are stuck in AMT to recoup about 50 percent of their credits each year depending on what they pay in taxes, 50 percent of their tax bill. I think I would like to see that move forward. Ms. Parshall, you talked about the complexity of taxes. Frankly, we just—what did we add, 150 pages last night? I don't think there is any—any tax consultant that knows the Tax Code totally. That is why you have got specialties out there. Would you like to speak to that? How in the world can we live when we keep complicating our lives?

Ms. PARSHALL. Well, there are a bunch of things. Overall total simplification is down the road, but there are smaller bites that can be accomplished. Ms. Maresco talked about the single definition for child.

Mr. JOHNSON. In my opinion, you try to take small bites out of this Tax Code, and you just complicate it further. So, I think probably the Chairman agrees with me, you almost have to take the whole thing out and throw it out and start over. That is a hard thing to do, because you have got so many forces pushing against you from all angles. You guys out there in the consultant world can make it happen if you will just get after it.

Ms. PARSHALL. Well—

Mr. JOHNSON. That is why you are here today.



Ms. PARSHALL. Yes, sir.

Mr. JOHNSON. Would you like to make another comment?

Ms. PARSHALL. Well, there are a few things that can be done without small bites as it were, the unified definition of a child, a couple of things on the educationline. For example, on education credits and deductions, we have one income level at which one phases out, a different income level at which the other phases out. Couldn't that be even just a little uniform there? Capital gains, I don't know how many rates we have now. We used to have a deduction. A deduction was a lot simpler. Now we have all these rates. So, there are some little things that can be done in the interest of simplification without throwing out the baby with the bath water.

Mr. JOHNSON. We would like to do that. I wish you would talk to the U.S. Senate about it.

Ms. PARSHALL. They haven't invited me, sir.

Mr. JOHNSON. Thank you, Mr. Chairman. I appreciate the time.

Chairman HOUGHTON. Mr. Johnson, I think you bring up a good point. Obviously the Tax Code is outdated, it is cumbersome. This is why we are having this hearing. We just can't wait for nirvana; we have got to do something in the meantime. That is the whole purpose of this hearing. Would you like to say something, Mr. Portman?

Mr. PORTMAN. Thank you, Mr. Chairman. Thanks to the witnesses for helping us today to think through some of these issues. Mr. Sweeney and Ms. Doherty, your comments are consistent with what we are hearing back home from our constituents about the way in which the AMT has now affected more and more of our families. In my own district, people making \$50,000 a year with four kids are beginning to have to calculate their taxes in both ways. Your story, Ms. Doherty, is so compelling.

I do have legislation to repeal the AMT altogether, personal and corporate. I have felt that, since I got elected, it is impossible to do this, because that is probably about, conservatively speaking, \$600 billion in revenue loss over the next 10 years. It is more and more of a revenue raiser for our government, because people like you are now paying it. So, the question is, how do you go at it in a way that is reasonable to get it done rather than just rail against it and say we should repeal it, which I believe, on a philosophical basis, we have got to figure out how to get at it.

So, again, your testimony is helpful in figuring out ways—I like the idea of indexing it. We should have done that initially. I like the idea of dealing with some of the individual issues like the options issues. I just think it is unfair, because I think if some of these provisions in the Code which are tax preferences, deductions, credits, and so on, aren't appropriate, we should get rid of them. We shouldn't say we are going to pick some and have winners and losers, and then end up making people calculate their taxes both ways. It is the accountants employment of the last 10 years and going forward. Even accountants I have talked to would much rather be doing something else than figuring out our taxes under these two different regimes. For the IRS, think about that, it is a nightmare for it. You essentially have two taxes. The enforcement is ob-

viously a huge problem. I appreciate your compliance with our Tax Code, Ms. Doherty, but I imagine this has been tough for you going through with offers of compromise and so on.

On the AMT, Ms. Maresca, I know you didn't get into that as much as you did some of the other issues, but have you looked at this from an academic point of view in terms of what are some smaller steps we could take? As you know, in our tax relief bills in 2001, 2002, and 2003, we essentially did hold a harmless provision where people wouldn't be getting into the AMT because of the tax relief we put in place. I think it was \$8 billion worth of relief over 10 years in 2003 just to do that, which is nothing, but just to keep it from getting worse. Have you looked into this in your academic work?

Ms. MARESCA. I haven't spent a lot of time working with the AMT. I do know a lot of my colleagues pay the AMT. I can say that my understanding is that there—some things need to be adjusted for inflation, and that is part of the issue. Again, I don't know the revenue consequences, so I can't really speak to it.

Mr. PORTMAN. On uniform definition of a qualified child, I have got legislation out there introduced last Congress. There are five different definitions for dependency, exemption, as you know now, for the child credit, for dependent care, head of household, and so on. You would provide for one definition; is that correct?

Ms. MARESCA. That would—

Mr. PORTMAN. Have you looked at the legislation?

Ms. MARESCA. Yes. One definition is that that removes the financial measurements because that often is the most impossible to prove. When you are in audit, and your earned income credit is frozen, the earned income credit, the purpose of it is to raise families with children out of poverty. It is not raising them out of poverty if they can't get it. If I have a client that comes in with a 2001 tax year with \$4,000 that is frozen, I just have them do their 2003 returns—2001 is frozen, 2002 is frozen, 2003 is frozen. So, a gentleman may make \$10,000 a year, he has got \$12,000 of frozen refunds. The IRS just can't work through them any faster, and I think it is mostly because the clerks at the service center are confused, by the way, and they don't know what to do with the paperwork that comes in, so they either do nothing or just issue a notice, or a notice of deficiency.

Mr. PORTMAN. Of your clients, what percentage would you say are affected by the definition of child?

Ms. MARESCA. At least 40 percent. Maybe up to 50 percent.

Mr. PORTMAN. Forty or 50 percent?

Ms. MARESCA. Yes.

Mr. PORTMAN. That is the earned income tax credit (EITC), but it is also on—

Ms. MARESCA. Well, generally they qualify under the EITC. The new definition of qualifying child removed the financial requirements. So, they qualify, they have qualifying children. What they don't have is a dependent exemption or head of household filing status or perhaps a child tax credit. The way it works when you are poor is you don't really need those things because if you make \$10,000 or \$12,000 a year, the tax effect is maybe \$200. So, often we amend the returns just to remove those items, forego that

possible \$200 just to get the refundable earned income tax credit back to them.

Mr. PORTMAN. Well, Ms. Parshall, this question is for you, too. I will follow up in writing because my time has expired, unless we have a second round.

Mr. PORTMAN. Again, I want to thank each of the panelists for being here and helping us to work through some of these at least bites at simplification so that we can come up with a fair Tax Code. Thank you, Mr. Chairman.

Chairman HOUGHTON. Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman. I am sorry I am late. This is one of the few jobs that you have three different places to be all at 3:00 p.m. or 2:30 p.m., and nobody thinks anything of it. It is just sort of routine. Anyway, I am sorry, Mr. Chairman. Thank you.

I would like to ask Ms. Parshall, what—in your experience, what is the single most important priority that you see that Congress could do with respect to your clients to simplify things? I know that is a very broad question, but what I am talking about is I read an article that a tax columnist wrote I guess it was last week, and it said that the 1986 tax bill was sort of a benchmark, and it really did do some things that simplified the Tax Code. There was some unintended consequences in the real estate business and elsewhere, but that it did to some degree simplify the Tax Code, and that every day since then the Tax Code has become increasingly more complicated. Would you agree with that, number one? Number two, what would be your suggestion if you were sitting where Chairman Houghton is?

Ms. PARSHALL. Well, let us take the easy one first. The simplification would be to throw out the AMT. I had more clients with AMT this past tax year than I had had in my first 27 years of preparing tax returns. I have yet to see the AMT credit work for anyone. So, it is a form I am filling out that they are getting charged for, which I then throw out because I don't want to charge them for a form that isn't doing them any good. So, that would be the simplest thing. That to me is the major complex—in my particular practice I am not doing many earned income credit returns. I am dealing with higher-income professionals with complex returns, and they are the people who are being hit hardest. People in States like New York, which has high local taxes, they are getting hit hard. The higher your local tax, the more chance there is of you going into AMT territory. The Federal tax rate has gone down, local tax rates have gone up, and they meet at AMT.

Addressing 1986, I would have to disagree about 1986 being a simplification. In 1987, when I did tax returns for the 1986 tax year, I was still working by hand with a thick lead pencil and a pink pearl eraser, and my desk had more crumbs from the eraser that year than any year before or since. That was the year when they took away tax shelters, we had phase-ins of 65, 40, I have lost track. Everything got phased in. Yes, it has gotten worse since then, but I don't think 1986 as being a particularly simple year for tax.

Mr. TANNER. I was quoting a tax columnist that I was reading.

Ms. PARSHALL. He was not out in the trenches, quite possibly.

Mr. TANNER. Okay. Thank you, Mr. Chairman.

Chairman HOUGHTON. Well, clearly we have some issues to deal with. General George Catlett Marshall used to say two things: one, don't get into the minutiae; and second, don't fight the problem. We seem to be fighting the problem. I hope that we can help you come up with a solution. Thank you very much for your testimony. Now we will have the second panel.

Mr. POMEROY. Mr. Chairman, as the second panel comes forward, I would ask your permission to enter a statement from Rich Neal in the record. I didn't realize he had to go, or I would have yielded some of my time to him to make this point. Here is a very good statement about the AMT and the need to do something, and I will put it in the record, if you don't mind.

Chairman HOUGHTON. Absolutely. Thank you very much. We will do it.

[The information follows:]

Thank you Mr. Chairman and Mr. Pomeroy for the opportunity to join you today. As you know, tax simplification is something we find easy to talk about, yet hard to achieve. For the last three Congresses, I have authored a bill on tax simplification, which would include a paid-for repeal of the Alternative Minimum Tax (AMT).

The AMT is shifting from a "class tax" to a "mass tax." Congress, Joint Tax, CBO, and even the Bush Treasury Department have acknowledged that by the end of this decade, the number of taxpayers on the AMT will explode and eventually ensnare over 30 million American taxpayers.

If we do nothing, more than three-quarters of taxpayers with incomes *between \$75,000 and \$100,000* will be caught by the AMT. More than one-third of those with incomes *between \$50,000 and \$75,000* will be caught by the AMT.

Contrast this with the fact that by the end of this decade, the AMT will *only* affect one-quarter of households with incomes greater than \$1,000,000. Does this sound like tax fairness and equity—imposing extra taxes on **three-quarters** of those making \$75,000 a year, but only **one-quarter** of the millionaires?

I understand the reasons for the original imposition of the AMT, but it has outgrown its usefulness.

The AMT is unfair for middle class families, not allowing parents to claim exemptions for their children and imposing significant marriage penalties. Again, if we do nothing, the AMT will hit **97% of all families** with two children earning between *\$75,000 and \$100,000* by the end of the decade.

We cannot continue the piece-meal, short-term AMT relief we had done the last few years. In fact, just last night, the Committee passed \$4 billion in permanent AMT relief for businesses, but only a short-term extension through next year to protect individuals and their personal non-refundable tax credits, like the dependent care or elderly and disabled tax credits.

I am also pleased that you will be hearing today from individuals impacted by the AMT on incentive stock options. I cannot understand why Congress has allowed such punitive taxes on these stock options, which provide long-term, employee ownership in companies, particularly in the fast-growing technology sector. The AMT has put many of these employees in a tax trap, owing 10 to 100 times their annual income in taxes to the IRS on phantom income, which they will never see. I first offered legislation in 2001 to try to fix this problem, and since then, I have been joined in this effort by our colleague Sam Johnson. Unfortunately, we have not yet been successful.

Perhaps, Mr. Chairman and Mr. Pomeroy, hearings such as this will help highlight the problem, educating our Members, and building support for fixing the problem. Thank you again for the opportunity to join you today.

---

Chairman HOUGHTON. Now, the second panel is the Honorable Mortimer Caplin, Commissioner of the Internal Revenue Service between 1961 and 1964; the Honorable Sheldon Cohen, Commissioner of the Internal Revenue Service 1965 to 1969; the Honorable Donald C. Alexander, Commissioner of the Internal Revenue Serv-

ice between 1973 and 1977; and the Honorable Fred Goldberg, Commissioner of Internal Revenue Service 1989 to 1992. So, we are honored to have you gentlemen here. Mr. Caplin, would you begin your testimony. Thank you.

**STATEMENT OF MORTIMER M. CAPLIN, COMMISSIONER,  
INTERNAL REVENUE SERVICE, 1961-1964**

Mr. CAPLIN. Mr. Chairman, it is a privilege to be with you today. I want to commend the Chairman for calling this hearing on a subject vital to all Americans, tax simplification. The Nation relies on a self-assessment system to raise trillions of dollars each year in support of the country. This type of system is dependent upon the willingness of the American taxpayer to honestly report his income and deductions and compute his own taxes or her own taxes, and our level of success is something admired throughout the world. The willingness to comply depends upon the taxpayer's trust in the system and their belief it is being administered fairly across the board, that their neighbor down the street is paying his or her fair share. American taxpayers don't like to be suckers. When they hear of an annual \$311 billion tax gap, this hardly provides any reassurance and hardly encourages compliance. We see today broad evidence of a lack of confidence in the tax law, a disrespect for the administration of the law, a tendency to play the audit lottery—without revenue agents out there to audit returns—and a readiness to engage in extreme tax avoidance and fraudulent tax evasion plans.

The current Commissioner is trying to counter this. He has put greater emphasis on enforcement and looking into evasion schemes of all sorts. Congress is confronted, obviously, with a monumental task to try to enact comprehensive tax reform. I am a believer in undertaking a comprehensive effort, although I respect the attempts to make some corrections here and there. Some suggest scrapping the system in its entirety, replacing it with a complete substitute, perhaps some form of consumption tax sales or value-added tax. Then there are those who ardently support the very simple flat tax. No deductions, only a single rate of tax on income from wages, but not from capital, not on interest or dividends or rents or capital gains.

Now, I don't see such a monumental change in the foreseeable future, particularly with the uncertain revenue raising capacity of a brandnew system like that. The financial and economic risks at stake in a large and complex society such as ours, and the sweeping transitional problems that would face individuals and business taxpayers, as well as the tax administrators who for years and years would be auditing old returns under one system and having to switch to another. Meaningful simplification would be extraordinarily difficult and, we know, would be challenged by competing interests, individuals, businesses of all sorts. It would require forceful Presidential leadership and that would be seriously needed. You need a carefully chosen commission to make a study of this. You need adequate staffing and a readiness for hearings. I think it is worth the effort, because regardless of the outcome, and this has happened before, there would be a body of knowledge and background that would help us in later studies. This happened back in

1954, the studies that were done and which played a big part in the 1954 Tax Code. Wilbur Mills, he held a series of hearings beginning in 1959, and they were very fruitful in terms of the later laws. I think that output is worth the effort to accumulate that knowledge and learning.

I am reminded of 40 years ago when Senator Russell Long, who later became Chairman of the Senate Finance Committee, took up the challenge and offered very bold legislation, a simplified tax method. It was close to a gross income tax, a broadening of adjusted gross income tax—and there were no personal deductions—a lower tax rate, capital gains treated the same as ordinary income. Although it never passed, it did show that a simple one-page tax return could be prepared. In honor of Senator Long, I like to call it the “Long Short Form.” It could be done. Well, close to 20 years ago, a very successful effort was undertaken that was preceded by many hearings and many studies and finally wound up as the Tax Reform Act 1986. It was simple and complex at the same time. It was not an easy piece of paper to work with but it did create a fairer and more equitable law, thanks to President Reagan who was behind it and Chairman Dan Rostenkowski of the Ways and Means Committee and Chairman Bob Packwood of the Senate Finance Committee. They got together somehow. It was bipartisan. It was remarkable.

We have seen, unfortunately, over the years that the 1986 act has been whittled away and we are nearly back where we started from. I do think it stands as a monument to the art of the possible. It could be done. I say, in the same tradition, we ought to undertake a project along comparable lines. I have laid out in my paper seven steps that I regard as guidelines—and I see I am running over my time—but it is based upon a broad-based tax return with lower rates across the board, elimination of the AMT by broadening the tax base, severely broadening the tax base to make the revenue available. It would treat all forms of income alike. Equal tax treatment where people have equivalent incomes. It will go a long way to restore confidence in the honesty and integrity of our tax system and I think it would serve our Nation well.

[The prepared statement of Mr. Caplin follows:]

**Statement of The Honorable Mortimer M. Caplin, Commissioner,  
Internal Revenue Service, 1961–1964**

My name is Mortimer Caplin, of the Washington law firm of Caplin & Drysdale. I served as U.S. Commissioner of Internal Revenue from 1961 through 1964, during the Kennedy and Johnson Administrations, and have specialized in tax law for over 50 years—as a professor at the University of Virginia School of Law and as a lawyer, representing a wide variety of business and individual taxpayers.

It is a privilege to appear before the Oversight Subcommittee and I commend the Chairman for focusing on the issue of “tax simplification.” It is an effort owed to all taxpayers of this country who, year after year, are overwhelmed by complex tax laws, complex returns, and complex administration as they struggle to meet their annual tax obligations. At the very least, they are entitled to the hope and expectation that some relief is at hand.

Our nation’s ability to raise trillions of dollars annually to support the functioning of our government rests primarily on a voluntary self-assessment tax system—one dependent upon the willingness of taxpayers to honestly report their incomes and deductions and accurately compute their taxes. Their willingness to comply depends in no small part on their trust in the system and their belief that the law is being administered fairly and across-the-board, with their neighbors down the street paying their fair share of taxes, too. Will Rogers once opined that people want “just

taxes” more than they want lower taxes, wisely adding: “They want to know that every man is paying his proportionate share according to his wealth.” American taxpayers do not like to feel they are suckers.

However, word of an annual \$311 billion tax gap—from underreporting, underpayment and non-filing—hardly provides reassurance and hardly encourages compliance. To counter this, IRS Commissioner Mark W. Everson, while still striving for improved taxpayer service, is now placing heightened emphasis on the enforcement aspect of tax administration, particularly focusing on tax shelters, tax fraud and other tax abuses. He often quotes President John F. Kennedy’s 1961 tax message to Congress, “Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.” And this is the very condition that we face today—lack of confidence in our tax laws, disrespect for the administration of these laws, tendencies to play the “audit lottery,” and a ready willingness to engage in extreme tax avoidance and evasion schemes of all sorts.

While our tax laws and the IRS will never be loved, the respect of our citizenry must be earned and public confidence in the system restored. At the very least, the public is entitled to reassurance of the law’s fairness, honesty and openness; and, to this end, the issues of complexity and the difficulties of compliance come to the forefront.

#### *Complexity and Alternatives*

How often it is that we hear the anguished cries of taxpayers and tax professionals, “If only the tax law and tax administration could be simplified!” This same theme is heard in the 1997 *Report of the National Commission on Restructuring the Internal Revenue Service* as well as in RRA 98 section 4022, “Tax Law Complexity Analysis.” The *Report*, for example, states:

“The Commission found a clear connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration.”

“. . . The Commission found that significant noncompliance—both inadvertent and intentional—results from various obstacles within the current system, including the cost of compliance and the complexity of the tax law. Reducing taxpayer burden by simplifying the tax laws and administration must start with the Congress and the President.”

These challenges have not been met even partway. Complexity reports required by the statute have done little to ease the problem. Frequent changes and added complexity continue.

Needless to say, complex laws lead to complex administration and a highly dissatisfied public—hardly the atmosphere for steadfast compliance. Taxpayers repeatedly throw up their hands in utter defeat, voice disdain for both the tax system as well as the entire government, and frequently follow up by deciding in their own favor every conceivably uncertain question that may arise. Until greater efforts are made to address basic roots of the problem—extraordinary complexity and murky transparency—the nation’s fisc suffers and the IRS is left “holding the bag,” with unfair criticisms and a highly unpopular reputation.

Congress is confronted with a gigantic task in seeking fundamental simplification. Some suggest that the income tax be scrapped in its entirety and replaced with a complete substitute—perhaps some form of consumption tax, a federal sales tax or value added tax. And then there are those who ardently back the very simple “Flat Tax”—widely heralded to require only a postcard return, with no itemized deductions, and only a single rate of tax to be imposed on income from wages but not from capital (whether interest, dividends, rents or capital gains).

Such an entirely new system of taxation, however, is not likely in the foreseeable future—particularly with its uncertain revenue-raising capacity, the risks at stake in a large and complex economy like ours, and the sweeping transitional problems that would confront individual and business taxpayers as well as tax administrators. Some form of consumption tax might well be suitable now to complement our income tax system, but not to substitute for it.

Realistically, to significantly ease complexity, Congress must think in terms of modification of the income tax law and then contemplate its complete revision.

#### *Overhaul the Income Tax*

“Simplification” and “fairness” must be kept at the heart of any new proposal. Congress, in my view, could provide unprecedented relief to taxpayers and, at the same time, could help revitalize public faith in the running of our government by focusing on a broad-base, low graduated rate income tax system.

Today, our tax laws are riddled with a vast array of targeted tax preferences and incentives that complicate compliance, erode our tax base and necessitate increased tax rates to meet the nation's revenue demands—special deductions and credits, exemptions and exclusions, deferrals, special rates and other preferred treatment for particular industries, groups or individuals. Aside from issues of fairness, such provisions create unbelievable complexity often leading to distortion of normal decision-making and encouragement of tax-motivated, non-economic behavior. Tax avoidance and abuse are inevitable byproducts.

We also see the tax laws excessively used, again and again, to promote a wide variety of social and economic objectives. The result: tax base erosion, shifting of the tax burden, added complexities, and further fueling of taxpayer frustration. Much too often, Congress finds this “backdoor financing” route significantly more convenient, albeit more revenue costly, than the better-monitored process of direct appropriations.

A meaningful simplification effort would be an extraordinarily difficult undertaking, one of lengthy duration and certain to be sharply challenged by competing forces of all dimensions—business, political, economic and otherwise. Forceful Presidential leadership, as in the Reagan years, clearly would be needed; and appointment of a carefully chosen commission undoubtedly would be required, with adequate staffing and preparation to undertake extensive hearings. Regardless of the final outcome, the related studies and analyses would produce long-range benefits to future enactments of the country's tax laws.

Some 40 years ago, Senator Russell Long, who became Chairman of the Senate Finance Committee, took it upon himself to lead a charge to provide true simplification for individual taxpayers. He offered bold legislation that called for an across-the-board “Simplified Tax Method.” It was close to a tax on gross income (“simplified taxable income”)—no personal deductions; lower rates; capital gains to be taxed in the same manner as other income. And its special charm was that the program was optional. A taxpayer had the choice of using the regular income tax (“the old way,” with all its complexities), or the new simplified method. All you had to do was to make a 5-year renewable election, with the right to terminate in the event of bankruptcy, disability, or adverse changes in the Code or regulations. While the legislation was never adopted, it did illustrate how individual income tax compliance could be made truly simple with hardly any recordkeeping. An instant tax return was a real possibility. And, in honor of the Senator, I've always liked to refer to it as “The Long Short-Form”!

Close to 20 years ago, one of the most successful efforts for basic income tax reform was achieved in the *Tax Reform Act of 1986*, under the leadership of President Ronald Reagan, with the full backing of Chairman Dan Rostenkowski of the House Ways & Means Committee and Chairman Bob Packwood of the Senate Finance Committee. Subsequent legislation has whittled away many of the 1986 Act's achievements on fairness and simplification. But the legislation still stands as a monument to “the art of the possible”—broadening the tax base by eliminating many tax breaks and loopholes, lowering the rate structure, taxing capital gains in the same way as ordinary income, and embracing the principle that “those with similar amounts of income should pay essentially the same amount of taxes.”

In the same tradition of the 1986 Act, Congress could begin the process now to simplify tax reporting, ease administration, and restore taxpayer confidence in the entire tax system. To this end, I suggest setting in motion the enactment of tax changes along the following lines:

1. Focus on tax return simplification by eliminating as many complexities as possible within the parameters of reasonable revenue costs.
2. Curtail the use of the tax law as the first responder for solving our social and economic problems.
3. Eliminate the bulk of special preferences, creating a sizably broadened tax base.
4. Restore a straightforward graduated rate structure, free of disguised rate increases inherent to floors, bubbles, phase outs, clawbacks, and the like.
5. Tax capital gains in the same manner as ordinary income.
6. Lower all graduated rates across the board.
7. Repeal the alternative minimum tax (“AMT”) for individuals as well as corporations, offsetting the enlargement of the tax base.

We as a people would be better served by a broad-base, low rate income tax system, with only the most limited of tax favors. Such a straightforward regime, aimed at treating all forms of income alike and providing equal tax treatment for persons with equivalent dollar incomes, would clearly be simpler, fairer and more efficient for the people at large.



Such a transparent system, free of bells and whistles, would go a long way to restore faith in the integrity of a sound tax system that is so vital to the security and well-being of our nation.

Chairman HOUGHTON. Thank you Mr. Caplin. Mr. Cohen.

**STATEMENT OF SHELDON S. COHEN, COMMISSIONER,  
INTERNAL REVENUE SERVICE, 1965-1969**

Mr. COHEN. Mr. Chairman and Members of the Committee, tax simplification is something we talk about regularly and do very little about. It is always our second or third priority. Shakespeare puts it better than I do. He said, frankly, the fault dear Brutus, is not in our stars but in ourselves. That is, we won't do it and we all recognize it. There is a constituency of one for simplifications. The Commissioner of IRS and his staff are very interested in this and it would make their lives easier and their work easier and they would enjoy it. The rest of us will always opt for some deduction or some credit when faced with that versus simplification.

Many of you are going to talk about a change to some new tax system. Mr. Caplin just mentioned that. Of course, they don't take into account the complications and disruptions that would cause, and the uncertainty. One little thing: at the end of the day, if you enact that system and it is perfect, what gives you the right to think that your confreres, years from today, won't corrupt that system just as they have done this one. If we don't have the discipline to fix this one, we don't have the discipline to enact the new one that will be better. Now, you need to face up to the issue of dealing with the expenditure of funds through the tax system. That has become a corrupting influence and a complication. Rather than expend money for a variety of public goods, we don't collect money from people who do those public goods. We think that saves money. That doesn't, really. We have the wrong agency administering the thing, whether it is housing or public welfare or whatever it happens to be. The wrong agency is administering it and the cost is there. We just don't get a good administration, so we pretend we get it at a bargain. Anything you can draft as a spending program, I can draft as a tax program. You are asked to do that regularly and you do do it regularly. The budget rules of the last years have pushed you in that direction. They have been enacted for good reasons, but as tax evaders do you kind of use the same techniques to get around the rules.

There are two ways to move to simplification. That is, the grand move that has been described to you. The second alternative technique is the shorter, the targeted move. I am not a grand person. I would take on the smaller targets and I would pick the targets of opportunity. Wilbur Mills had a wonderful idea; and that is, pick out five or six good areas, have small groups plan the attack, and then deal with those five or six areas. I have outlined in my paper the five or six areas that I would pick. You could pick four, five others, but don't make the target too big. If you make the target too big, you take on all the dragons, all of the lobbyists, all of the problems of the world. Now the problem, of course, is with the present lack of money to even it out, you have to have basically revenue-

neutral kind of reform, and that makes it much more difficult because you are going to have some losers and some winners. The losers will moan and groan. The winners won't win so much, but they are going to be on your side. They will be with you, but not ardently with you, and that makes it very difficult. I think I will just stop there. I don't want you to have to listen to the same ideas. I will be glad to answer any questions.

[The prepared statement of Mr. Cohen follows:]

**Statement of The Honorable Sheldon S. Cohen, Commissioner,  
Internal Revenue Service, 1965-1969**

Mr. Chairman and Members of the Subcommittee, I am pleased to appear before you today at your request to testify on the issues relating to Tax Simplification. My testimony today represents my own views and not those of my firm or any of its clients.

Because of the press of the short time since you requested my testimony, I will use an outline instead of fully written testimony. Should you wish me to amplify any of my ideas presented here, I would be pleased to do so for your record.

Tax Simplification is something all of us talk about but few of us do much about. I have been practicing in the tax area for 52 years and it comes up regularly but only on rare occasions does anything affirmative happen.

Shakespeare, as usual, put it more aptly than I can. He said "the fault, dear Brutus, is not in our stars, but in ourselves." (Julius Caesar, I, ii, 134). We all say how much we want and need simplification. Only the Commissioner of the Internal Revenue and his staff mean it and try to do something about it. The rest of us try to rationalize why we should pay less and others more. And you on the Committee try to please your constituents who are asking for some deduction or credit or rate cut or similar benefit—but rarely talk about simplifying the law except in most general terms. Some of those who do talk about simplification will urge you to change to an entirely new tax system—but they never take into account the complications and disruption it would cause to move to any new system. And if we do not have the discipline to make this system simple and direct—what right to we have to believe that any proposed new system will not be corrupted too? (In Pogo's words—"We have met the enemy and it is us.")

Many of us have been concerned for a number of years because of the multiple roles we expect our tax system to play. For example, a portion of the federal financing of urban renewal and development is accomplished by enacting a complex series of tax credits and deductions that must be administered by the IRS. These policies should be financed through expenditure programs administered by experts in the field. I realize that because of budget restraints enacted over the years, it is easier not to collect a tax than it is to get an expenditure bill through the Congress. They are the net equivalent of each other. What can be drafted as a spending program can be also drafted as a tax program. Nevertheless, using the tax system as a surrogate for expenditure programs is an inefficient means to accomplish the desired policy and weakens a national asset—our formerly smooth-running, well-administered tax system. Although from Congress' perspective, it may have the advantage of showing lower expenditure levels than really exist.

The Congress will periodically go into a binge of preaching simplification—but when faced with a real issue you will opt for, what you conceive as, equity. You can not have simplification and equity. That is hard to say—but it is true. A simple law is not equitable as it has arbitrary lines. Cross the line and the result changes. An equitable law needs fluid lines so it has to be more complex. We face this issue regularly and most of us choose equity. We must, in order to move toward simplification, choose to be arbitrary on occasion, much as that connotes bad things in other situations. An illustration in the current news is to allow the charitable deduction for some standard deduction users. Thus negating a measure (the standard deduction) enacted for simplification reasons.

There are two essential ways to move toward simplification. The major tax act with major changes (i.e., like the 1986 Act)—or smaller, more targeted area changes. I have been practicing in and out of the government for over 50 years. I saw the Code recodified twice: once in 1954 when I was one of its draftsmen and again in 1986 each time with some success—but most of it eroded in the years that followed.

I am a devotee of the smaller fix not the giant move. Wilber Mills, back in the 1970s, began studies to do this type of reform. I would suggest that the Committee pick a few areas which affect the largest number of taxpayers and those least able

to cope with complex Code. Those areas would be the first to attempt to simplify. The areas I would start with are the EITC, AMT, dependency definitions, educational benefits and savings incentives. These effect great numbers of people and would have the most bang for your buck. For example, in the areas of educational benefit and savings incentives, you often have multiple provisions to provide benefits that present confusing choices to the taxpaying public and impose additional tasks on the IRS.

Dr. Lawrence Woodworth and I designed the first deadwood bill in the late 1960s. Our idea was to eliminate the provisions of the Code which by their terms were superseded and outdated. There was no opposition to the bill—but no enthusiastic support either. It took until 1976 to pass that bill. There were no sponsors and no real opposition, as a simplification bill had no monetary benefit directly and merely reduced paperwork and reading for people. No one up here seemed interested.

Suggest a new deduction or credit and you will have many co-sponsors. Suggest a technical change or simplification and you have 435 skeptics.

A revenue neutral change will cause some losers and some winners among the taxpayers. So the losers will lobby you against the idea and the winners will get so little they will be quiet. Thus simplification has little support—but would make administration easier and therefore make everyone's life a little easier.

I hope this Committee will suggest an effort to the full Committee. I don't believe new major studies are necessary. Many practicing lawyers and accountants would be willing to work with you—I am sure many professors would likewise pitch in. What is lacking is the determination, grit and leadership to pull it off. Now is a good time to start. I would be pleased to assist.

---

Chairman HOUGHTON. Those are very interesting and we will get back to them. I see your five areas. Don Alexander.

**STATEMENT OF DONALD C. ALEXANDER, COMMISSIONER,  
INTERNAL REVENUE SERVICE, 1973-1977**

Mr. ALEXANDER. Thank you, Mr. Chairman and Members of the Subcommittee and thank you, Commissioner Goldberg. Let the record show that Commissioner Goldberg and I share one red light while our two predecessors share one each. I want to commend you, Mr. Chairman, on your nine bills that you have very recently introduced to try to take some of the steps that Commissioner Caplin and Commissioner Cohen mentioned, going at simplification in nine—I would like to say the word “easy,” but I can't—nine steps. It would be a major step forward if all those bills were enacted and I think it is quite unlikely that they will be.

I wish I could be more optimistic. I wish I could be more optimistic about the success of the reintroduction of your last year's bill, Congressman Portman, which would have had a sweeping effect on the complexity of our current law. I am dedicated to Congressman Pomeroy's efforts and Congressman Johnson's to try to simplify our retirement system, which is badly in need of it. Well, let's talk about the 1986 act. We all have. I might as well chip in. I think it was a great expedition, started off by President Reagan in his 1984 State of the Union address, where he pointed out that he wanted to simplify the entire Tax Code so all taxpayers, big and small, would be treated more fairly, and he thought that would have a very good effect on compliance. I think he was right on all counts. In 1986, we did manage to do a lot of good and we didn't do it in little bitty steps, but we did one great big step, and we did one thing that was really bad and that was the alternative minimum tax. That was a terrible idea. It was necessary in 1986 because it was thought to be the only way to raise the necessary

money so the rest of the act could go through, and also because we were still worried about those 165 taxpayers with incomes of more than \$200,000 that had been mentioned in 1969 by the then-Secretary of the Treasury as not paying any income tax. Why not give them an AMT?

Now, I think the small step versus big step concept that you have heard about from this panel might deserve a little more from me, and I think it is going to get much better and bigger from Commissioner Goldberg. I don't think you are going to be able to do reform in small steps. I wish you could. I hope you could do something about having a uniform definition of who is entitled to claim a child. Of course, we are not redefining a child but redefining the relationships that the taxpayer has to the claimed child. There is no need and no sense in having the different definitions that you have heard a little bit earlier from the people that have to cope with this system. That is something you ought to be able to do. Whether you could do it separately, I don't know. I think the big bang theory has much going for it. Maybe we can do what we did in 1986 again, and this time do it right. How we can do that without raising rates, I am not sure. We can narrow the base if we are willing to do another thing that Commissioner Cohen mentioned.

In the past decade the present Congress have used income tax the way Mike Graetz's mother employed chicken soup, as a magic elixir to solve all of the Nation's social difficulties. One problem is that each Congress wants to have its own stamp on the solution for the child. So, each Congress wants to have a nice child credit. Each successive Congress doesn't want to rely on the lifetime learning credit, so it has to enact something like the Hope credit. In addition to that, I just want to second what Commissioner Cohen said. Let's stop, at least, using the Internal Revenue Code to try to solve all of our social and economic problems. Let us give those to the agencies of jurisdiction.

[The prepared statement of Mr. Alexander follows:]

**Statement of The Honorable Don C. Alexander, Commissioner,  
Internal Revenue Service, 1973-1977**

My name is Donald C. Alexander, and I am appearing today in my personal capacity as a former tax collector and a long-time tax practitioner.

First, I want to commend this Subcommittee for having this hearing and for seeking to reduce the burden that complexity imposes upon American taxpayers. As Chairman Houghton stated when he introduced nine simplification proposals on April 2, 2004, "if our system becomes too complex for the ordinary citizen, then non-compliance will no doubt accelerate." Chairman Houghton further pointed out that ongoing simplification of the tax system should be a top priority of Congress. Cong. Portman showed his dedication to the goal of simplification when he introduced the sweeping recommendations contained in his Tax Simplification Act of 2002, H.R. 5166.

In his third State of the Union Address on January 25, 1984, President Reagan said:

Let us go forward with an historic reform for fairness, simplicity, and incentives for growth. I am asking Secretary Don Regan for a plan for action to simplify the entire tax code, so all taxpayers, big and small, are treated more fairly. And I believe such a plan could result in that underground economy being brought into the sunlight of honest tax compliance. And it could make the tax base broader, so personal tax rates could come down, not go up. I've asked that specific recommendations, consistent with those objectives, be presented to me by December 1984.

The 1986 Act was indeed a triumph in many ways. The tax base was indeed broadened, the rates were greatly reduced, and many of the ornaments in the Internal Revenue Code were dropped or greatly curtailed. Unfortunately, however, the alternative minimum tax on individuals was not removed but instead was expanded to become the monster that it is now. More and more individuals fall within it for its unindexed exemption becomes more inadequate each year. Both Chairman Houghton's current proposals and Congressman Portman's 2002 proposal would curtail or repeal the alternative minimum tax. Unfortunately, such action, while necessary, is very expensive. Congress and the Administration must fix this problem and at last reverse the trend toward the individual alternative tax becoming the primary tax for individuals.

Much of the relief in the 1986 Act has been eroded, and an example of such erosion is the misnamed Taxpayer Relief Act of 1997. In that Act we saw fit to provide a full deduction for unreimbursed travel costs of certain Federal employees, to give an above-the-line deduction for expenses of certain governmental officials compensated on a fee basis, to provide Roth IRAs and above-the-line deduction for interest on education loans, to retroactively reinstate an exclusion for employer-provided educational assistance and to provide education IRAs, among other things.<sup>1</sup> Why not give the Department of Education some more money, to strengthen and expand Pell Grants, and broaden their scope? But doing the sensible thing requires outlays and does not reduce taxes, and there is the problem.

Simplification is a goal to which many have aspired recently. Unfortunately, however, the tax laws have become more complicated and the consequent burden on taxpayers and the IRS has increased year by year. While some of the Code's complexity stems from duplication and overlap,<sup>2</sup> much is due to cramming the Code with ornaments that don't belong in a rational tax system. As Michael Graetz told us in 2001:

In the past decade the President and Congress have used the income tax the way my mother employed chicken soup: as a magic elixir to solve all the nation's economic and social difficulties. If the nation has a problem in access to education, child care affordability, health insurance coverage, or financing of long-term care, to name just a few, an income tax deduction or credit is the answer.

*2001 Erwin N. Griswold Lecture before the American College of Tax Counsel: Erwin Griswold's Tax Law—And Ours*, The Tax Lawyer, Vol. 56, No. 1, at 178 (Fall 2002).

We seem to be addicted to using the tax system as a means of promoting all sorts of good things<sup>3</sup> by spending through the Internal Revenue Code. Thus we avoid the political difficulty of voting for additional expenditures and give the benefit of an ostensible reduction in taxes. It's a two-fer.

The earned income credit is based on a very fine concept: an income supplement to encourage the poor to work rather than to remain on welfare. I thought this great idea should be administered by the then Department of Health, Education and Welfare. Milton Friedman, who favored a negative income tax, thought otherwise and he persuaded the then Administration to adopt the EITC. I predicted that it would be very difficult for the IRS to administer and that the Internal Revenue Service was not the right agency to engage in social work. Obviously, I lost, and it doesn't help to say that the predicted problems have occurred.

Although the Internal Revenue Code had been used long before the 1970s to favor certain activities<sup>4</sup> we have now developed this into an art form. In addition to the enormous welfare program that the IRS must administer, it also administers major segments of our housing incentives, our education incentives, our health incentives, our child care needs and all sorts of narrowly-focused economic incentives.

That is why alternative tax systems like a national sales tax<sup>5</sup> or so-called "flat tax" to replace much or all of the individual income tax seems attractive at first sight and could be made to be reasonably progressive if we care anymore about the ability to pay. One can be reasonably certain, however, that the apparent simplicity would likely evaporate soon when various claimants to favored treatment pressed their case with Congress and the Administration.

<sup>1</sup>Of course we should encourage education, and we have the Department of Education to do just this.

<sup>2</sup>Such as multiple definitions of a child.

<sup>3</sup>As well as discouraging a few bad things.

<sup>4</sup>And even particular individuals.

<sup>5</sup>A credit-invoice value added tax would be far superior to a national sales tax, but those with long memories have not forgotten Chairman Ullman.

Expenditures through the Internal Revenue Code are similar to regular spending programs for they are intended to achieve policy objectives that have little or nothing to do with a system designed to produce the needed amount of revenue by applying a tax rate to an income tax base. The major difference between a tax expenditure and regular government spending is that under the tax expenditure approach, instead of the government sending out a check to the recipient, the recipient pays less in tax.<sup>6</sup> For example, we now have a national concern about the dire effects of obesity. We could address this problem by creating a direct spending program to subsidize weight loss. Or, we could provide a tax expenditure designed to produce the same result but place the administrative problems on the IRS.<sup>7</sup> In theory, it may not matter whether a government uses direct spending or a tax expenditure to achieve a policy goal. As the Institute on Taxation and Economic Policy has pointed out, however, tax expenditures are evaluated far differently from other government spending:

- Unlike most government spending programs, tax expenditures are usually open-ended: they have no built-in budget limits, and generally there is no annual appropriations review or oversight process. Anyone who meets the statutory criteria for eligibility can get the subsidy.
- Direct spending usually requires a government agency to weigh the worthiness of an application from any potential beneficiary. In contrast, most tax expenditures require no action other than the filing of a tax return.
- Tax agencies typically have little expertise, or interest, in assuring that tax-expenditure programs are working as they should. By contrast, government agencies tend to look closely at the effectiveness of their direct spending initiatives.
- Basic facts about who benefits from tax expenditures—and what they do with their subsidies—are often hidden behind the cloak of tax return secrecy, while the beneficiaries of conventional spending programs are usually to identify.

*Tax Expenditures: Spending by Another Name*, Institute on Taxation and Economic Policy Brief #4, April 2004.

As a result of these flaws, tax expenditures frequently prove to be expensive subsidy programs for which there is little or no oversight. Furthermore, they complicate the tax laws by straining the tax system's administrative resources; they generally involve unlimited or uncertain costs; they evade periodic budgetary review; and they are administered by an agency unfamiliar with the substantive problems addressed by the subsidies and unable to coordinate particular tax expenditures with subsidy programs administered by agencies having jurisdiction.

It may be politically correct and socially popular to spend through the Internal Revenue Code, but doing so violates the basic tenets of classic tax policy: fairness, efficiency, and simplicity. Furthermore, the tax system should be designed to impose and to collect taxes, not to administer social programs. Therefore, if we can muster the political will, we should replace tax expenditures with nontax outlays.

---

Chairman HOUGHTON. Mr. Goldberg.

**STATEMENT OF FRED T. GOLDBERG, COMMISSIONER,  
INTERNAL REVENUE SERVICE, 1989-1992**

Mr. GOLDBERG. Thank you, Mr. Chairman. I would like to echo my colleagues' sentiment in congratulating each of you and congratulating you collectively on your bipartisan efforts to simplify the Tax Code. I think that you—each of you on the panel, more than most, is seriously committed to this all important agenda. I am submitting a more detailed written statement for the record and will limit my comments to three areas. As a child of the sixties I believe we can have it all, so I am going to talk about having it all. I think in the short term, there are clear legislative priorities

<sup>6</sup>If the tax expenditure is refundable, the lucky beneficiary receives a check in addition to, or in lieu of, a tax deduction.

<sup>7</sup>Would the IRS simply accept the taxpayer's word? Or would it weigh a representative sample of taxpayers at the beginning of the taxable year and at the end of the year? What about growing children? What about pregnant women? How large a weight increase is permitted? How could you achieve the goal but also discourage anorexia?

that are worth pursuing. The first is to enact a uniform definition of child and to simplify the earned income tax credit. The second is to simplify the appalling, unworkable array of education-related incentives. The third is to continue, under the leadership of Congressman Portman and Congressman Cardin, efforts to simplify the rules governing tax-favored savings and simplify and reform rules governing international taxation.

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 laws. Without change, we remain in the worst of all worlds. A complex system that distorts behavior is perceived as unfairly favoring the wealthy and leaving many working families unable to take advantage of the benefits that the Tax Code purports to offer. Second, a great deal of simplification can be accomplished in the short run through administrative actions. The current Administration deserves high marks for its recent efforts; however, much more can and should be done. Additionally, initiatives in the areas of form design, filing requirements, tax accounting and international tax would be particularly welcome.

Simplification also requires changes in the way the IRS does business. Without question, the Bush Administration's split refund proposal is the most significant effort in this area. This universally acclaimed proposal would dramatically simplify savings and financial management by literally tens of millions of taxpayers and provide a platform for other policy initiatives in years to come. It has no material budget cost. Given its overriding importance, I encourage you to monitor the IRS in its efforts to carry out a commitment made by this Administration. Finally, I urge you and your colleagues to address the opportunity for fundamental reform. Each of us has referred to that area. In my judgment, the Federal income tax has served the Nation well for close to a century, but it 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 judgment, beyond repair.

True simplification requires fundamental change. Now, a simplification is a worthwhile objective. It does not provide sufficient impetus for tax reform. However, the tax system's perfect storm is on the horizon. Nothing can be done to delay or prevent its arrival later this decade. All of the following are certain to happen. The AMT is devouring our income tax. Temporary tax cuts enacted since 2001 will expire and the baby boomer generation will start retiring. The pressing need to deal with these issues creates a unique opportunity for fundamental tax reform. The question is whether Congress and the Administration will seize that opportunity in a bipartisan fashion or whether we will continue our futile efforts to patch the current rules. Simplification that could be accomplished in this broad framework are striking. One approach would be to try again what was tried in 1986: reduced rates, eliminate preference items. Unfortunately, the experience of the past 18 years suggests that reforms along these lines may be short lived. The alternative is more fundamental change, proposals ranging

from mandated conformity between book and tax accounting to a comprehensive business income tax.

Others advocate replacing some of all the individual income tax or corporate tax or the payroll tax with a value-added tax, national sales tax or flat tax. All of these ideas have been around for a long time. They merit serious bipartisan consideration. Pretty much any combination would greatly simplify the system while reducing distortions and improving economic efficiency. I want to emphasize they can be accomplished in ways that maintain, increase, or decrease revenues and can be implemented in ways that maintain, increase or decrease the progressives of our system. Mr. Chairman, the system is far more precarious than many acknowledge and the benefits of decreased complexity far outweigh the cost of change. I congratulate you and your colleagues for your efforts.

[The prepared statement of Mr. Goldberg follows:]

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

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 stream-line 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.

---

Chairman HOUGHTON. Thank you very much. Of course, the question is not that we don't have a problem; the question is how do you get at it? Do you do the targeted, do you do the grand, do you do a combination? One of the things that we had suggested, that if you get rid of the AMT in one swipe, it costs you about \$600 billion. If you phase it in, start it now—got to start—then it costs you about \$260 billion. The pain isn't so great there, and it has enormous impact. If we do nothing—you have seen these figures, but 3, 11, 14, 17 million people a year just cutting right into the system. So, the question is, how do you get at it not only from a financial standpoint but from a political standpoint? What are those marks that we must look at now specifically rather than just waiting for the whole system to change? I would appreciate any other comments that you have. I know that, Mr. Cohen, you feel we shouldn't wait for the grand plan and do the targeted. What is the most important targeted thing we could do? Tell us.

Mr. COHEN. AMT is the broadest—

Chairman HOUGHTON. Would you phase it in or cut it out?

Mr. COHEN. You have boxed yourself in. When you went to indexing you took—Congress over the years—I have been practicing tax law for 52 years, 53 years—Congress over the years kept the percentage of Gross Domestic Product (GDP) that was taken out through the tax system pretty consistent, but it would change it every 4 to 5 years, and when it would change it, there was a little juice, if you will, to spread amongst those provisions where you needed to spread the income. Now, having indexed the system, you don't have any surplus revenue to spread to the people, to the losers.

Chairman HOUGHTON. I understand that. What do you do about it?

Mr. COHEN. You have to bite the dang bullet.

Chairman HOUGHTON. I would like to find what the bullet is to bite.

Mr. CAPLIN. You may need a surplus to even play with offsetting tax increases.

Chairman HOUGHTON. Or you could index the AMT.

Mr. ALEXANDER. It would curtail the increase.

Mr. GOLDBERG. I am with Mr. Portman on this issue. I would simply repeal the damn thing. I think we are fooling ourselves. By the end of this decade, the combination of expiring provisions, retirement of the baby boomers, the other pressures on the entitlement system, are going to require that we rebuild our fiscal house. In the meantime, as we heard today, there are real people suffering real costs and I wouldn't screw around with it. I would just repeal it. You can sunset the repeal in 2010 and deal with that when you deal with all of the sunset provisions. I think we are monkeying around and just ought to do it.

Mr. ALEXANDER. That is the time bomb that goes off. You have to remember that it does go off. We are going to have to find some money somewhere and that is going to be really difficult. If we take all the little ornaments—that most people would agree are ornaments and don't belong in the Internal Revenue Code—out, then some of those have constituencies that are going to be very unhappy about the removal of their particular ornament and they are going to let you know about it. So, that is going to be a real problem for you. If, on the other hand, you address the AMT the way it should have been addressed way back in 1986, that is, what if we don't cut the rates by the last 2 percentage points, do we need this monster? Can we get by with a little monster that might grow, but might take 100 years to grow up to be a big monster? Maybe we could have done it, but we didn't.

Chairman HOUGHTON. I am going to turn to Mr. Pomeroy.

Mr. POMEROY. Mr. Chairman, the explorer Ponce de Leon roamed all over the Southwest looking for the fountain of youth. Hell, he should have gone to the IRS building. It is obvious that the commissioners have tapped into it there. The vitality and energy you still exhibit as our witnesses, there must be something in the water over there. The Native Americans I am proud to represent back in North Dakota have a culture of listening to the elders. I believe that the Committee on Ways and Means ought to have you in about every month just to hear your opinion about putting a historic context on what we are wrestling with.

Mr. CAPLIN. Tax collections is one of the lifeblood of the Nation. When you live in that environment, they roll right through us and keep each of us going.

Mr. GOLDBERG. I think we are all meaner than snakes.

Mr. POMEROY. I have enjoyed this panel enormously. I would ask you a couple of other issues. We are heading toward a train wreck. In the absence of pressing leadership, we are going to have another fiscal disaster on our hands and we will have to do something, and maybe this gets to the perfect storm that will pave the way for very substantial tax clarification, simplification. This business of the budget. We are in a fiscal disaster and that means there is no money to address everything that the constituencies are asking us to address. That is going to place enormous pressure on

the Tax Code. I have seen it build in the 12 years that I have served in Congress, and I believe that is going to build a great deal in the years ahead. Second, I would like your answers on this one. Our political system is more expensive than it has ever been and more dependent upon campaign fundraising, which places really the—those seeking some agenda in the Tax Code in a very powerful position, especially if they have financial resources to play significantly in a political year to drive a legislative agenda. Have you noticed an acceleration of these tax changes as we moved into the modern era of campaign finance reform?

Mr. CAPLIN. I think the fact that the Washington Post has devoted a specific portion of its paper to following the activities of new lobbying firms and new additions, this has become an unbelievable industry in the time I have been here.

Mr. COHEN. Once the genie gets out of the bottle and people learn there are more effective ways in dealing with these issues than trying to deal with the substance of the issues—that is, going to you folks for legislative solution—once that genie is out of the bottle, then, of course, everybody knows how to do it now so everybody joins. So, you have lobbying from A to Z on every particular issue from every particular point of view. You can't—it is hard to stuff that genie back in the bottle.

Mr. POMEROY. I believe the demise of the legislative process around here is in no one's interest. Certainly not a partisan interest, not an ideological interest. The place doesn't work like it needs to work in a transparent and fair—we are the world's greatest democracy and it doesn't function like that. Rather than substantive issue addressing through a straight-up legislative process, you simply buy your way into the Chairman's mark.

Mr. COHEN. I remember Mr. Mills, when he was Chairman of this Committee, in an executive session putting down a number, saying we won't talk about that because the issue was a very narrow-based issue. That can't happen today. Number one, we have all open hearings as opposed to closed executive sessions, as we used to have then. Two, the lobbyists won't let it happen. They are sitting there and they are watching. So, if a Congressman or Senator has promised to bring the issue up, he has to do it and he has to act serious about it, and all that takes time and energy and some of it works.

Mr. POMEROY. Well, the hearings are public, the deliberation on a bill is public. Basically our work product generates from a mark brought in from somewhere. I don't mean to talk about this Committee or particular leadership of this Committee generally. There is no transparency in terms of what is plunked down in front of us at the beginning of a hearing. I am out of time, but I would like you to comment on these issues, demise of the legislative process or the role of campaign financing in terms of the provision of the Tax Code.

Mr. ALEXANDER. I am not sure that things are demonstrably worse than they were back when I was working for IRS. Back then, I was greatly concerned about highly successful lobbying, in fact, highly successful lobbying that in my judgment prevented the IRS from being able to produce a better computer system than my distinguished predecessors had—well, they had a great computer sys-

tem at that time, and we still haven't gotten our new computer system. One of our problems was from very successful lobbying in my time. I don't know about your time.

Mr. GOLDBERG. I don't know if it is as grim as you describe. I think the work that Congressman Portman and Congressman Cardin have done really has made the retirement system better than it otherwise would have been; 1986 isn't all that long ago, and there were folks who really did a remarkable job. I don't think it is hopeless. I think we have to keep in mind that the government is laying claim to 35 percent of the income of all workers at the high end and all businesses at the high end. That is a big profit share and I have my 100 shares of IBM. So, the stakes are very real and very serious. We have exactly what we designed is my response to your question. I think the issue is whether it is possible to put a collective good where it belongs to design a system that reduces these kinds of pressures. I don't think there is a final solution. I think Jefferson's notion of a revolution every 12 years is a good idea. It is trying to strip it off and start over, recognizing—

Mr. CAPLIN. He wanted to do it every 10 years.

Mr. GOLDBERG. I am more conservative. I don't think we have a choice. I think when you look at everything that is out there, the entitlement programs are fiscally a mess. I think that we are going to be forced to deal with the reality that all of us folks want to face today, and I think in that context, I think it is possible to do enormous good and I think you and your colleagues show that it is possible to work on a bipartisan basis for the good of the country.

Mr. POMEROY. If I believed it was hopeless I wouldn't be here. I do think we have to understand very clearly the pressures so that as we look for that perfect storm moment, we know how to put it together. Thank you all very much.

Mr. CAPLIN. I taught tax law for some 30 years and the general approach over this period of time was you had a problem, you worked it out with the IRS. You didn't call on the Hill. This was the worst thing you could do in a controversy, try to go to the Hill. Today the style is changed. The tendency is to go up to the Hill and deal with the Congressmen and put it into law.

Chairman HOUGHTON. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I thank the witnesses for their testimony and their perspective, because Mr. Pomeroy is absolutely right. It is good to get that historical perspective as we think we are dealing with these new issues. Most of them have been dealt with before, some successfully and some not so successfully. We do get things done around here on a bipartisan basis that is focused on the public good. Mr. Pomeroy has been a big part of that. On the retirement legislation, some of his provisions went in almost as he wrote them, as opposed to the way perhaps the Committee Members would have, and it is a tribute to him working with the folks in the retirement community that know about these issues. So, we do have some hopeful examples, Earl.

On taxes, I guess my feeling is as we said earlier, the AMT philosophically is not something we should have in our system, and yet you have this huge revenue loss due to the fact that it is taking more and more revenue every year and that would be, I suppose, a microcosm of the bigger issue we face. If we are going to go to

big bang tax reform, which I support, over the next couple of years, then maybe we ought to stop the tinkering, allow the pressure to build, and then do the right thing, whatever that is. On the other hand, if it is just not going to happen for all kinds of reasons as it hasn't for 18 years, it is our responsibility as Members of this Subcommittee to try to figure out ways to simplify in small ways. Again last night, I would argue we did some of that. Yes, we complicated the Tax Code in certain ways with that legislation that is going to be on the floor later this week. On the international side, we actually put in place some reforms that make some sense, that simplify the Tax Code and will help with compliance costs and our competitiveness.

So, having said all that, let me ask you if I can, a question about a specific reform proposal, and this would be something that would be in the big bang category. I want to get the input of all four of you if I could. Starting with acknowledging that we currently have not one tax system, but several tax systems. We have a gift and estate tax law system. We have an AMT tax system. We have an income tax system for individuals. We have a corporate tax system. I would start by removing all of those. So, having none of the existing systems in place. Then putting in place a consumption tax. My personal preference would be a value-added tax, because I think it is much more easy to administer, much more efficient and much more likely to be successful in our complicated economy. Instead of millions of transactions a day, you would have thousands of transactions a day. The value-added system, as you know, is used by all of our competitors now with the possible exception of one country in the developed world, and so we have a lot of experience on that. That value-added system, the VAT (Value Added Tax) tax would take the place of the corporate income tax system in essence. There wouldn't be a corporate tax—solving one of our many competitiveness issues we talked about last night in this Committee room.

Then you would have another tax system on top of the value-added tax system, and it would be a flat rate for individuals who have income, defined under the current definition of income. It is very complicated, but it would be wage income and so-called unearned income. You would choose a number. I would choose \$125,000 because that is roughly the top 5 percent. You would index that to inflation if you did this based on the numbers that I have had run for me. If you had a rate that was in the high teens for the VAT tax, high teens, maybe low twenties for the low rate, you could end up with revenue comparable to the revenue we have today. I am not taking into account the enormous impact positively on the economy this could have and should have in terms of compliance costs being reduced and encouraging savings and investment. You would have 95 percent of the people currently dealing with the IRS and the Tax Code no longer involved with that. I just wonder what you think about that just as a big bang idea. I am jumping way ahead. I believe in Mr. Caplin's idea of a commission, and I think it needs a lot of legitimacy, and why people like you want it. What do you think about that?

Mr. CAPLIN. I am intrigued by that very much. I know professor Michael Graetz of Yale has written on this, and he has a book that goes into that. I really think that this so-called \$311 billion annual

tax gap understates the picture. That estimate deals with so-called legal income only. It doesn't touch illegal income. You reach far over \$500 billion very easily if you start expanding the study. I think we need another sieve in collecting taxes. I think there ought to be some form of VAT or sales tax underneath the income tax system. I think it ought to be explored. I think it is worthy of consideration.

Mr. COHEN. Well, I am not a VAT or consumption tax person. The British experience is interesting. I have spent time with the British folks who administer the VAT. I spent several days with them. The Auditor General of Britain just issued a report on the VAT. I think there is a 17 percent evasion of the British VAT. It is approximately equal to our evasion of income tax. If you forgive me a moment of personal reflection, I was driving back once in the late sixties from the airport from Santiago, Chile, and a car passed us and it had a little platform built on the back of the trunk. I didn't pay attention to it until I saw two or three like it. I turned to the economic counselor at the embassy who was driving and I said, What is that? He said, "That is a truck." The excise tax on automobiles imported into Chile was 300 percent. The excise tax on trucks was 50 percent.

So, you get into the same definitional problems some have with the income taxes. The British had this described to me vividly, running through the definition of everything, because you won't enact a VAT that is pure and one-rated; you will enact the VAT that has got exemptions and multi-rated. By the way, I think there is one or two in the world that are pure. So, those are the problems. You see, nothing is pure because, as I said, that genie is out of the bottle. We now know how to deal with these issues. All of us good guys or bad guys, as the case may be, will come at you with these problems and you are going to have to deal with them.

Mr. CAPLIN. We had that same problem with the excise tax.

Mr. COHEN. We repealed all excise taxes while I was in office, all except three or four, because they were too costly to administer.

Mr. PORTMAN. Good point in keeping it broad. I think you need to have it broad based and keep the rate lower, too.

Mr. ALEXANDER. Back to the VAT, I think that Professor Gratz's VAT would be a VAT that would replace the income tax on individuals below a fairly sizeable income level. Whether the income level was \$200,000 as one of the Presidential candidates was suggesting should be the tip point. I am not sure. I think a credit-invoice VAT—it would have to be a credit-invoice and not a subtraction VAT. Subtraction VATs aren't much better than our old excise taxes were. I think a credit-invoice VAT would work—sure it will get loused up after a while. We are better at complicating things than we were a few years ago. It might take us a little while to complicate the VAT. If you zero rate it for food, you could have a VAT that makes sense from the standpoint of ability to pay. Then you might have an income tax, if you wanted to supplement that with an income tax for higher income individuals. You might keep an income tax, or you could change the VAT, of course, for corporate entities. You would have to deal with the fact that I guess you dealt with last night, that some businesses are conducted as



subchapter (C) entities and some are pass-through entities. I know that is a problem that concerns the Chairman, and rightly so.

Mr. PORTMAN. Just one quick comment on that, and Mr. Tanner has been patient, and the Chairman, but I would want to repeal the corporate income tax, which is going to be controversial, and that is different from the proposal by Professor Gratz, and that would require additional revenue. That amount of revenue is shrinking as a percentage of our total revenue.

Mr. COHEN. The corporate income tax was a third of our income tax when we were in office. It is now around 10 percent.

Mr. GOLDBERG. Just a couple of observations. One, you could look at the consumed business income tax, comprehensive business tax replacement for the corporate tax. I think the difficulty with value-added tax is the overall progressives of the tax system. As I am probably the far-right guy on this panel, I am little uncomfortable raising that, but I think it is terribly important. Another piece you want to put in the mix is what you are going to do with the payroll tax. We need to deal with entitlements. I think if you would replace the payroll tax, for example, with the consumption tax, it is a much more progressive levy. I think you would want to put that in the mix of what you are thinking about. Having said that, the path you are describing is the right and probably the only plausible path to go down in the years ahead.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman HOUGHTON. Thank you. Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman. I also want to thank all of you for being here. I have enjoyed thoroughly this panel. It has been something that I think we need to do more of, and that is talk to people who have been there. People who are sitting up here today think they are inventing the wheel oftentimes instead of realizing that mostly everything that has been talked about has been talked about before, just by different people.

I think I get the consensus that we are in a mess and we need to do something rather dramatic with our Tax Code, our tax system. I think I am correct in assuming we all believe we are in a place we don't want to be with respect to our Tax Code. If that is true, I want to ask how we bridge the gap that we have immediately to that day when we have the consensus, both inside and outside, to enact a big bang tax reform. Here's where we are. This country now owes in hard dollar numbers about \$4 trillion. This country—we on your behalf have raised the debt ceiling \$2 trillion in the last 36 months. Last year this government spent \$370 billion more money than we had, 70 percent of which was bought not by American citizens but by foreigners. The central bank of Beijing has increased the holdings of our paper by over 100 percent over the last 26 months. China and Japan, Asia, we will say, owns almost over \$900 billion of our paper. We will approach a \$500 billion deficit this year; could go more, depending on what happens in Iraq.

The best that we have been able to discern from the budget that we passed, assuming a 4 percent rate of growth in the economy, is to cut that in half in the next 5 years. That means we are going to borrow another trillion dollars if we reach that goal, assuming a 4 percent rate of growth in the economy. Now, Commissioner

Goldberg said we have to face reality. This reality is that we are spending far more money today than we have. We are borrowing money from virtually anyone in the world that will lend it to us. When that day comes when they don't see the world as we do, they will have enormous leverage, in my judgment, owing to the policy-makers that sit on that day, because we will owe them so much money that they will be able to exercise undue influence, if you will.

Now, my question is, with that background—and I don't think anyone would dispute what I have said, it is right out of the Treasury reports on where we are—with that background, Commissioner Goldberg, you said we needed to repeal the AMT right now. I would love to do that. With this background and putting that much more on the red-ink pile we are building, how do we get—in this interim, how do we keep from going another trillion or \$2 trillion in the red? This is just an aside; I believe it is the largest tax increase in history. The reason I say that is because at 5 percent, \$2 trillion is going to cost the American taxpayers \$100 trillion a year, every year. Five percent is fairly cheap if China, for example, Japan, Saudi Arabia or anybody else we owe money to, said we don't want the interest check, we want the money; then I know of no other way we get it than to auction it to whoever will buy at whatever price it takes to refinance.

I just think this is a national security matter. I have talked a lot about it on the floor. I have written op-eds about this foreign holding. It is true that the deficit has been as a percentage of our GDP this high before. What is different is most of that debt was bought by Americans; war bonds, savings bonds. This debt is being financed by foreign interest. I think that is a huge difference, number one, from the national security standpoint. Number 2, under our present budget we are operating on, we will never get back to balance. If the best we can do in 5 years is cut it in half, assuming 4 percent rate of growth in the economy, which is not a small number, and then if we make the tax cuts of 2001 permanent, knowing the baby boomers are going to retire in 2012, if you can figure out how 2 and 2 is going to make 4 in that situation, I sure would be glad to know it, and I just can't get there. I made my speech.

Chairman HOUGHTON. Let me interrupt, though, because one of the parts of this piece of legislation that we have is literally phasing in the elimination of the AMT, so by the end of 2013 you wouldn't have any AMT at all, but you would start working on it. It would be \$10 billion in 2006 and \$26 billion in 2008 and so on and so forth. So, that you don't take it in one great huge lump, because I don't think the system can handle that. You are going to get at it in some way, and it would be nice to have a value-added tax and I think that would be great. We could do it. From a political standpoint, you can see what happened in Canada when that went through and the Conservative Party went from 150 to 1. Now, maybe it will come back on June 28. There has got to be some way of starting that process and also starting the education. Maybe you ought to ask the question.

Mr. GOLDBERG. Mr. Tanner, I think there are serious structural issues relating to the entitlements program and relating to the tax system. I think one of the difficulties we have is we run

the government as a cash-method person and the rest of the world doesn't function as a cash-method person. I believe at the end of the day, long-term financing is going to be necessary as part of a restructuring. That is just what is going to happen.

I think the current deficits as a percentage of GDP are actually materially lower than they were 20 years ago. I think, while foreign ownership of debt is an issue—and I agree with you, it is in some sense a national security issue—I think the fundamentals of our political economy and society are such that I don't think people are going to take a hike. I can't sit here and listen to these folks tell the stories they have been telling you. I can't listen to the stories about the EITC recipients who are just being torched, and say in the scheme of the issues we are facing, yes, the deficit is a terrible problem, but I think it is so broke that there is an opportunity to do some very good things for very real people over the next 2 or 3 years while those responsible for policy figure out how we are going to restructure these various programs.

Frankly, I think fixing the AMT over the next years, fixing the EITC, fixing the definition of a child, those are rounding errors in the context of the difficulties we are facing. When you try to strike a balance, I don't understand why you don't strike the balance the same way, and say we know this thing is messed up for the reasons you are saying, but in the short one, get off these people's backs.

Mr. COHEN. Politically we have gotten ourselves in the view, or many people into the view, that it is a dirty word to say raise taxes. When President Johnson was in office, I was one of those people who told him 2 years before he did to raise taxes, because I could see what was happening. In any event, he did have a surtax in 1968. That year was the first surplus in many, many years and it was the last surplus before those 3 or 4 years in the nineties. There is such a thing as saying you have to pay the piper. You could either keep the present corrupt system that we have designed, or you can go honest and tax yourself what you need to tax yourself in order to do the right thing. Getting rid of the AMT is the right thing, and the only thing to do it is to pay for it. Now, whether you pay for it over 3 years or 5 years or over 1 year, you need to sit down and say we need to address this now. Let us see politically whether we can do it in 3 years or 2 years or if it is going to take us 7 or 8 years, but you need to deal with it.

Mr. CAPLIN. In the olden days, we tried to present tax packages in a balanced way. If we cut rates or something, we tried to really close special privileges or preferences. We tried to balance it out. We seem to have forgotten that in recent years. I think we ought to stick to this balancing of our tax legislation. Also we have the whole question of Social Security. What are we doing about that? We had commissions before. They have made recommendations. We need to follow up in terms of what has to be done.

Chairman HOUGHTON. Well, gentlemen, I hope we continue to tap into your knowledge, because this thing is not going to go away and we are not going to be able to solve it this afternoon. I thank you on behalf of all of us for your wisdom and guidance. I hope that Ms. Doherty and Ms. Maresca and Ms. Parshall have gotten some-

thing out of this discussion in addition to your own testimony. So, we thank you very much.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

**Statement of Timothy J. Carlson, Arlington, Virginia**

I am writing to request your help in a serious and urgent matter threatening to destroy me and thousands of other hardworking, productive taxpayers. The IRS has filed liens on my friends' assets, and is weeks—if not days—away from filing liens on my assets also. After the IRS is done with me, I will be penniless with no apartment or car, and no matter how hard I work I will have to live on less than \$1,000 a month for many years, despite having *already prepaid over \$850,000* in excess of any tax actually owed, a tax rate of over 350%. And all this because I was honest.

Please allow me to provide some background on who I am, to give some context for the situation I describe below. My father was a minister and my mother a stay-at-home housewife in a small town in Minnesota. I worked my way through college and law school pursuing the American dream. I am currently the Broadband Communications Group Team Leader for Legal Affairs at Texas Instruments. Prior to that I was General Counsel for Telogy Networks, an entrepreneurial software company. I am Vice President of Childhelp Virginia (a child abuse prevention and treatment organization) and have worked for years with World Vision (an international charity) in its children's programs. Prior to the situation described below, I donated tens of thousands of dollars to World Vision Africa AIDS Orphans projects, DC Inner City work, and to Childhelp. For years I have supported my retired parents by contributing to the mortgage for their modest retirement home in Minnesota, and have helped to pay for high school and college tuition for several other family members.

I describe my life merely to show the kind of hardworking, productive people being negatively affected by the unintended effects of the Alternative Minimum Tax (AMT) as applied to Incentive Stock Options (ISOs). I also hope to show you that the ripple effects go far beyond the victims themselves, but also affect their families, their ability to work with and support charitable organizations, and of course their ability to engage in productive and entrepreneurial activities.

After three years of struggling to work out a compromise with the IRS, the IRS has rejected my offer in compromise (OIC) for my 2000 tax liability (more than \$1.6 million with penalties and interest). In a letter I received on June 18, 2004, Joel Goverman, Area Director for the Small Business Self-Employed Office in Baltimore, assured me that the IRS has conducted "a thorough review of [my] particular issue . . . before preparing a final response." Yet, upon even cursory analysis, the stated reasons for rejecting the offer are so illogical and irrational as to approach the bizarre. I mean no disrespect to Mr. Goverman, who I realize is just the messenger in this situation and I apologize in advance if my writing becomes too colorful or strident, but the situation is so strange I hardly know how to convey it otherwise.

The first reason stated for rejecting my OIC was that "based on the financial information you submitted, we have determined you can pay the amount due in full." Mr. Goverman concurred with this analysis and suggested that the Taxpayer Advocate did as well. However, given the facts, this is nothing short of Kafkaesque. I have nowhere near the \$1.6 million that the IRS currently seeks. The Taxpayer Advocate determined that the IRS was overestimating my ability to pay by more than \$650,000. I earn less than \$175,000 a year and have already offered all of my tangible assets to the IRS. For years the IRS has insisted I have money I simply do not have.

Even if I could pay the amount in full, the IRS could, and should, accept my offer based on something called Effective Tax Administration. "Effective Tax Administration," as Mr. Goverman (and published regulations) noted, "is only applicable if . . . requiring full payment would create an extreme hardship, or if collection of the full liability would be unfair, inequitable and would adversely impact voluntary compliance by other taxpayers." The second reason stated for rejecting my OIC was that "we have determined that [to accept your OIC] would have a negative impact on compliance by the general public."

After years in law school and practicing law, I can not understand the "logic" of the assertion that accepting my offer will "have a negative impact on compliance by the general public". What taxpayer is going to look at my case and think

OK, let me get this straight, I have two choices:

*Choice One, under the regular tax code* I am not required to pay any tax when I exercise ISOs. The regular tax code encourages long term investment by offering

more favorable long term capital gains rates if hold the stock for at least one year. Of course, if I report under the AMT code I will owe prepayment taxes that will destroy me and my family, but if I do not report the transaction the IRS is unlikely to catch it because the government has no “checks” or information reporting requirements in place to find out about the exercise. If I don’t report under AMT I’m not really cheating the system because I haven’t realized a dime in profits yet because I haven’t sold the stock, and I intend to fully pay my regular taxes once I do so. Technically, I suppose this is wrong. But, by not reporting I avoid destroying my life and, in the end, I still fulfill my duties as a citizen and a taxpayer when I sell my stock and then report and pay my fair share of tax.

*Choice 2, under the ISO AMT provisions*, if I report my ISO exercise and disclose those phantom profits then I will be complying with an unintended quirk in the tax code that makes me *prepay* based on tax rates that exceed 350% of my actual income. I can always ask the ‘more friendly’ IRS to please recognize the irrationality at work and give me a ‘break’ by making me overpay ‘only’ 200% rather than more than 350%. After all, the legislative history relating to offers based on effective tax administration tells the IRS it has broad discretion to accept offers based on public policy.

Of course, the IRS will reject my offer despite the legislative directive. It will charge me interest and penalties on the amount I am unable to pay, liquidate all my assets and garnish my wages for several years, leaving me destitute and destroying any incentive I have to work. It does not matter that the IRS position of not compromising any AMT liability is based on some secret memo that it will not disclose to taxpayers and their representatives. The AMT I am able to prepay through borrowing and selling other assets, will become a ‘credit’ that will take hundreds of years to recoup at the \$3,000 per year maximum.

**“So in conclusion**, I guess the IRS policy makes a lot of sense; I really should report my ISO exercise and be forced to pre-pay tons of taxes on income I haven’t received yet. It’s okay that this will mean that I’ll lose my house and car, because I will have millions of dollars of tax ‘credits’ that I can recoup in \$3,000 per year increments. And really, I want to work more than 60 hours a week to live on less than 1/5 of my salary while the rest goes to build up more useless tax credits. My family will understand that I can no longer contribute to sending the kids to college, and that I will need their help in the years to come because I can no longer save for my own retirement. I will have the satisfaction of knowing that I reported honestly, while those who snubbed the law and did not report their AMT liabilities enjoy their “ill-gotten” gains.”

As is obvious from the imaginary internal dialogue above, in fact this policy to blindly force an outdated, unfair and unjust law in no way encourages compliance, but rather presents taxpayers a Hobson’s choice—use ‘self-help’ by not reporting ISO exercises or face the blind, financially devastating, life-altering enforcement of an unjust and unintended tax law.

Mr. Goverman suggested that a special Effective Tax Administration Group in Cincinnati had reviewed my file and determined that my offer did not meet the criteria because “the position that the tax law itself is in [sic] inequitable is not a basis for an ETA offer. As you are aware, the authority to change the tax law rest [sic] with Congress.” Unfortunately, with the exception of the last clause, which properly notes that Congress has the authority to change the law, his statement is patently false. The Cincinnati committee never received my file because an IRS agent who acts as “the gatekeeper” saw my tax liability was due to the AMT/ISO problem and sent it back. This agent said that the IRS does not have the authority to accept any compromise of an AMT liability because only Congress can change the law. The agent could not cite any authority for his statement, nor could he explain how compromising an AMT liability was any different than compromising any regular tax liability.

Moreover, my request for an offer in compromise is not based on the blanket assertion that the AMT law is inequitable. I have only ever asked the IRS to focus on the individual circumstances of my case. The only way I could have had the money to pay this exorbitant tax was if I would have sold the stock before it started dropping in value. Unfortunately, a sale at that point could have subjected me to the risk of insider trading in violation of SEC guidelines. It is difficult to find a time when I could have sold the stock without risking a possible investigation by the SEC or state attorneys generals because of my position and the rapid and continued decline in the stock’s price. How can the government stated public policy to encourage strong corporate governance practices if taxpayers must choose between complying with tax law and securities law?

Accepting my offer in compromise (and, truthfully, those of many others who were caught by the AMT/ISO labyrinthine rules) will *encourage* voluntary compliance.

Further, it would and would be more fair and equitable than forcing hard-working, middle class people into bankruptcy to pay a tax on phantom gains they did not receive because they continued to invest in their employers and the economy as the government encouraged when it created ISOs. Congress has already recognized that the stock market crash in 2000–2001 was a unique event divorced from the normal market risk that investors assume. Congress has enacted a number of tax cuts and other reforms to stimulate the economy and provide relief to ailing taxpayers. It should do the same for the hardworking individuals and families who have been financially ruined by the ISO AMT rules as a result of that crash.

My case as described above is not imaginary, and the facts are not hyperbole. And, tragically, I am not alone. Thousands of similarly bizarre cases have arisen across the country. The IRS decision to blindly enforce an outdated, misguided and misapplied AMT/ISO tax provision (which became even more absurd in the context of the market bubble burst) is ruining the lives of good citizens in practically every state in this country.

I would never have believed this could happen in America if I wasn't living through it. I encourage you to first (1) as an interim measure, instruct the IRS to accept reasonable offers in compromise for ISO AMT liability to prevent honest taxpayers from being destroyed by this tax before proper legislation can be passed, and then (2) adopt focused legislation amending the AMT as it relates to ISOs to restore fairness and justice to a system gone severely awry. Like me, ISO AMT taxpayers are willing to pay taxes on actual gains and recognize the risks of losing an investment in the stock market. Our actions and intentions were honorable and consistent with Congressional policy, and hurt no one but ourselves. In fact, our faith in our companies and refusal to foist losses on an unsuspecting public is exactly the kind of behavior the government should encourage—not punish. I am not asking the government to replace my lost investment; I am simply asking the government not to collect taxes as if the investment was never lost.

---

**Statement of Efrain Rodriguez, Jr., Father's Rights Association of  
New York, Mahopac, New York**

I am Efrain Rodriguez, Jr., President of the Father's Rights Association of NYS. I thank the Committee for allowing us the opportunity to be a part of this system of government.

There has been a bill, H.R. 86 which would call for, among other things, the ability of a parent who is paying Child Support to be able to deduct such support from their Federal Income Tax. I am not sure if this bill is still active or whether it has been re-numbered.

Sir's, the Child Support System in this country is a train wreck. While the Father's Rights Association agrees with its tenet, it is the way it is administered and assessed that cause the most frustration and sadness for Non-Custodial parents, many who have to choose between paying their support and supporting their own basic needs. We have many members who are forced to move in with family and friends who cannot pay their own rent or provide for their own basic needs. And with the current Poverty Level of \$12,123, where can a parent go and live on that? Also, in most states, Child Support is based on a parents Gross Income and taken from their Net Income with make that number almost untenable, especially when that number does not take into account that payers personal expenses.

Therefore, the Father's Rights Association of NYS respectfully asks that the Ways and Means Committee consider hearings on the impact Child Support has on the payers, the so-called "Dead Beats" who for what ever reason cannot come up with their support obligation and still maintain their own standard of living. We are NOT an organization of "deadbeats" who are trying to shirk their parental responsibility to our children. We just want the same opportunity as everyone else to live and grow with our children and not have to choose between being a parent and supporting oneself at the very bare minimum.

Further, we propose the following changes to the current Tax Formula:

Any parent who pays Child Support be allowed to deduct that amount that is paid to supporting their children from their Federal and local taxes. This will serve two purposes; encourage more parents who currently not paying their support to give an added incentive to paying and, this will take that "bitter taste" put of the mouths of parents who feel that they pay this support and have nothing to show for it, especially the inability in many states to know what the custodial parent does with the money.

Thank you for your time and attention to this very important matter. If there is an opportunity to speak to the committee in person I am available to do so.

---

**Statement of David R. Klaassen, Marquette, Kansas**

Thank you for allowing me to provide this written statement explaining how the Alternative Minimum Tax has affected my family and how it continues to affect my family today.

My name is David R. Klaassen. I am a resident of McPherson County, Kansas, duly admitted and licensed to practice law in the State of Kansas and before the United States Tax Court, the United States Bankruptcy Court for the District of Kansas, the United States District Court for the District of Kansas, the Eighth and Tenth Circuit Courts of Appeal, and the Supreme Court of the United States. I am a solo practitioner and maintain my business office at 2649 6th Avenue, Marquette, Kansas 67464. The focus of my practice is representing individuals and businesses in financial distress or facing bankruptcy throughout the State of Kansas.

My wifes name is Margaret. Margaret and I are the parents of thirteen children. The ages of our children range from six years old to 24 years old. Our youngest just started school at Marquette Elementary School in Marquette, Kansas, where all of her brothers and sisters have gone before her. This Fall, five of our children will be attending Marquette Elementary School and three of our children will be attending Smoky Valley High School in Lindsborg, Kansas. All of our children who have graduated from high school have graduated with honors and gone on to Bethany College which is also located in Lindsborg, Kansas. Three of our children will be in college at Bethany this Fall. Our two oldest children have graduated from Bethany with honors and gone on to graduate school. Our oldest child is in medical school and our second oldest child is pursuing a graduate degree in business. To date, it does not appear that there is a bad apple in the whole batch and Margaret and I are very proud of each of them.

In 1987, our second oldest child, Aaron, was diagnosed as having cancer. While we were not very successful at first, we ultimately won the battle for his life thanks to a bone marrow transplant in 1991 from one of his younger brothers. Well prior to 1994, Margaret and I liquidated any interests we had in outside investments and retirement accounts to help pay for the costs associated with Aaron's treatment which were not covered by our health insurance. The only investments which Margaret and I now have are in our home and in our family. We are not involved in any tax shelters or other investment activities which are normally associated with triggering the AMT.

In 1994, Margaret and I were entitled to and claimed 12 total personal exemptions on our federal tax return. This increased to 13 in 1995, 14 in 1996 and 1997, and 15 in 1998, 1999, 2000, and 2001. In 2002 and 2003, our total personal exemptions fell to 14. Our joint adjusted gross income for each of these tax years was well below the threshold amount established by Section 151(d)(3)(C) of the Internal Revenue Code which would otherwise reduce the total exemption amount we could claim. Despite this fact, the subtle mathematics of the AMT in effect has reduced the total exemption amount to which we are entitled each year. In this manner, the AMT has become a penalty on large families solely because of their size. I doubt that this was an intended purpose of the AMT. However, it is in this very manner that the AMT has cost my family in excess of \$25,000.00 over the past ten years.

While Aaron's cancer has given us some experience with the AMT and its treatment of medical expenses, it appears that our most significant experience with this aspect of the AMT is happening this very year. Since 1991, Margaret and I decided that we would try to maintain the health insurance policy we had at the time of Aaron's bone marrow transplant as long as we could just in case his cancer reappeared and we had to go through another round of chemotherapy and radiation. During the year of 1991, this cost us \$263.82 per month. However, the premiums steadily increased reaching \$1,441.20 per month in 2003. In January of this year, we were notified by our health insurance carrier that our premiums were increasing to \$2,063.47 per month in April of 2004 and that Aaron would no longer be covered by our policy after he reached the age of 23 that same month. We cannot pay such high monthly premiums for any extended period of time. Unfortunately, at this very same time, I was diagnosed as having prostate cancer. The sad point is that if we are unable to continue to pay our current health insurance premiums and must drop our current health insurance coverage, our AMT bill will increase significantly

at the very time when we are facing a substantial increase in our out-of-pocket medical expenses. Once again, I doubt that this was an intended purpose of the AMT.

We have sought relief for our situation with the AMT through the Internal Revenue Service's administrative appeals process, the United States Tax Court, and the Tenth Circuit Court of Appeals. In 1999, the Tenth Circuit ruled against us. However, in his concurring opinion, Circuit Judge Kelly made the following comments:

- A. The legislative history supports an argument that the original purpose of the AMT, one of the more complex parts of the Internal Revenue Code, was to insure that taxpayers with substantial economic income pay a minimum amount of tax on it.

For a variety of reasons, the number of moderate income taxpayers subject to the AMT has been steadily increasing. From a fairness perspective, many of these taxpayers have not utilized I.R.C. '57 preferences (or other more arcane AMT adjustment items) to reduce regular taxable income but are caught up in the AMT's attempt to impose fairness. In the interest of progressivity, the regular tax already reduces or phases out itemized deductions and personal exemptions based upon income; surely Congress never intended a family of twelve that still qualified for these items under the regular tax to partly forfeit them under the AMT.

That said, we must apply the law as it is plainly written, despite what appears to be the original intent behind the AMT. The solution to this inequity, must come from Congress, as the tax court rightly concluded. *Klaassen v. C.I.R.*, 182 F.3d 932 (10th Cir. 1999) (unpublished) (concurring opinion of Circuit Judge Kelly).

Please help us to obtain from Congress an equitable solution to these unintended effects of the AMT.

Thank you again for allowing me to present this written statement to you. If I can be of any further assistance to your Committee, please let me know.

---

#### Statement of Alan Veeck, Reform AMT, Pittsburgh, Pennsylvania

I strongly urge you to support legislation that would modify or repeal the Alternative Minimum Tax (AMT), especially as it applies to incentive stock options (ISOs). Although unintended, the AMT adjustment for ISOs has had a significantly detrimental, and in some cases, devastating, financial impact on individuals like me who exercised ISOs before the stock market downturn of 2000. Due to a severe depression in stock prices, many taxpayers who exercised ISOs in that year face AMT liabilities that are far larger than the exercised stock was worth in 2001 and beyond.

Affected taxpayers face huge tax bills, some in the hundreds of thousands and millions of dollars, on income that they will never receive. Although taxpayers can use their AMT payments as credits against future income, they will likely never recover the AMT credit because of the way the current law is written. Moreover, collecting credits into the future is hardly a consolation for those facing unbelievable cash crunches due to the magnitude of the tax. This result is vastly inconsistent with Congressional intent in enacting the AMT. Instead of assuring that "the rich pay their fair share of taxes", the AMT on ISOs is literally leaving middle-class Americans like me in, or near, financial ruin.

Here is my story: in April 2000, I exercised 6,000 options that I earned with the company that I helped to build in Pittsburgh—FreeMarkets, Inc. My exercise price was about \$5/share, so I had to scrape together \$30,000 to exercise these options. My plan was to hold the shares for a minimum of year, but more realistically several years because I truly believed in the long-term success of my company, and in this way I could recognize profits from stock sale as capital gains as opposed to income. I always do my own taxes, so when I fired up TurboTax and input my financials, I was more than a little shocked to find that I owed the IRS \$85,000, and state and local taxing authorities about \$10,000. ***This amounted to 110% tax on my earnings, when I have realized no actual cash gain!*** In analyzing my available solutions, even if I exercised my next set of options and sold the entire lot (12,000 shares), I would not be able to meet my tax obligation for the 2000 tax year.

Quite obviously, this is an absurd situation. I have always, and will continue to, pay my taxes like every other red-blooded, patriotic American. I fully agree with the concept of paying my "fair share" on realized cash gains. But the AMT is forcing me and my family of five to face real financial ruin. My mother and father pulled significant money from their retirement savings to loan me money to pay the gov-



ernment so that my family did not have to sell its most important possessions. I haven't had to borrow money from my parents since I was sixteen!

Your support for AMT reform is crucial, as this unfair and unintended tax is beginning to affect more and more honest, hard-working taxpayers in the lower and middle income brackets.

Thank you for your consideration of this very important issue.

