

## Change and the IRS

By David Cay Johnston

David Cay Johnston is a former tax reporter with *The New York Times*. He is also the author of two books about taxes: *Free Lunch* and *Perfectly Legal*.

*The revenue of the state is the state. In effect all depends upon it, whether for support or for reformation.*

— Edmund Burke

The government needs revenue. President-elect Barack Obama promised voters change. How about combining change in how the tax burden is distributed with change in how the tax system is administered?

Paying taxes should not be a task so daunting that millions pay to have the EZ and short forms filled out for them. Millions more with only moderately complex economic lives find that completing the long form and its schedules is a job that makes parenting seem easy — even with the help of software that does most of the work.

A politician who can make paying taxes easier and fairer, while raising more money, is sure to become a political hero to a broad spectrum of Americans.

For more than a decade we have been promised a better IRS.

Remember Frank Luntz, the perceptive pollster who told his clients that the best way to win votes was to attack taxes in general and the IRS in particular? Remember those Senate Finance hearings where dubious claims of taxpayer abuse were treated as capital “t” Truth?

In that toxic amalgam of demagoguery and high dudgeon was the promise of a modern, efficient IRS with sophisticated technology that speaks to its customers in plain English, resolves problems, and sorts through its records to separate the chiselers and cheats from the honest and forthright. Remember?

Change — the kind of real change promised voters during the campaign — would be making the promises of a smooth, efficient, and effective IRS a reality.

David Burnham, long one of the most devoted examiners of the IRS, says that this task requires “two different but complementary approaches. First, the tax code must be simplified, not beginning with a grand reordering of the economic class system, but in an achievable step-by-step way to make it easier for all taxpayers to understand and comply with the requirements of the law. Second, the administration and Congress must at the same time see

to it that the IRS is given the resources it needs to enforce these laws in a smarter and tougher and fairer way.”

Burnham is right on. So here are a series of steps that would demonstrate that the new administration is interested in governing, not just politicking, and focusing not on polishing the statutes, but modernizing the federal tax police department.

“Plain English” was a cause to Charles O. Rossotti when he ran the IRS. Rossotti, a smith of words concise and clear, started a team working on rewriting IRS forms so they would make sense to people.

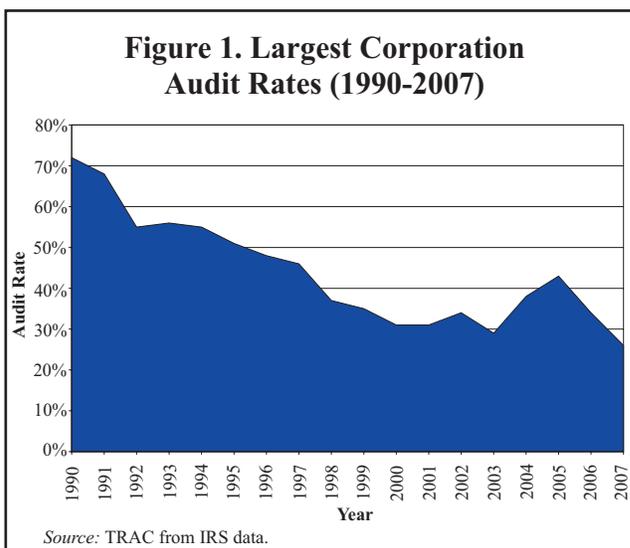
Alas, IRS publications still seem to be written on the theory that each sentence must contain unnecessary words and each paragraph unnecessary sentences. And that’s just the instructions. Many forms seem to violate the rules against drawings having unnecessary lines, and, like machines with unnecessary parts, they do not work — or at least not well.

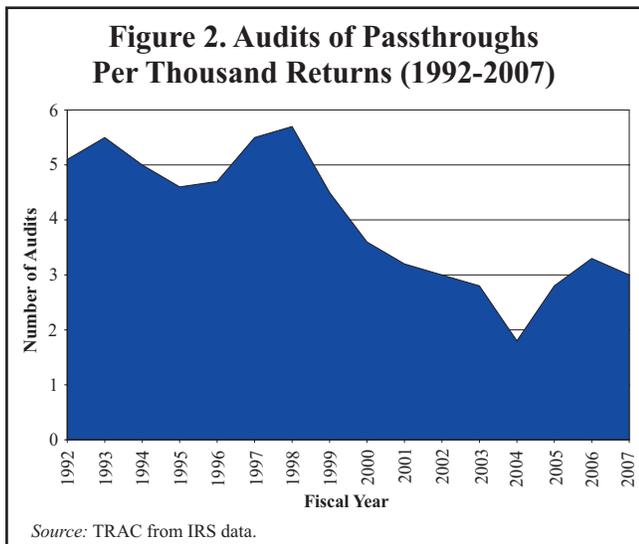
On a related front, Nina E. Olson, the national taxpayer advocate, wants to encourage consideration of those for whom English is a second language. At a Tax Analysts conference in July, in urging that any more taxpayer bills of rights include taxpayer responsibilities, she called again for the use of “plain English.” (For an unofficial transcript of Olson’s remarks, see *Doc 2008-16374* or *2008 TNT 146-50*.)

How can we make English, and not bureaucratese, the first language of the IRS?

First, no titles like a Deputy Chief Counsel to Identify Deeply Ingrained Obfuscations for Terminal Sanctions (IDIOTS).

Put master editors in a high-level position or two and give them power and titles that succinctly describe their





work. How about a Deputy Chief Counsel for Clarity and a Deputy Commissioner for Simple Declarative Sentences?

Then hire other devoted fans of William Strunk and E. B. White (and perhaps Lynn Truss) who can translate the core value that made Apple such a success into a new IRS culture: Taxpayers are the users, and IRS forms should be friendly. Period.

Second, hire Stanford's Joseph Bankman to make real a brilliant idea he proposed in *Tax Notes* — letting most people pay their income tax without filing. (For Bankman's article, see *Tax Notes*, June 13, 2005, p. 1431, *Doc 2005-11952*, or *2005 TNT 113-33*.)

Bankman cited a National Public Radio poll showing that "approximately 80 percent of those with annual income below \$20,000 reported they found the tax system either very or somewhat complex; that figure rises to nearly 100 percent for taxpayers with incomes exceeding \$150,000."

The average citizen dislikes income taxes, the professor wrote, "not because it distorts or discourages investment (although it does), but because it is complicated, because she finds filing expensive, time consuming, and anxiety provoking, and because she believes that complexity (and other factors) allow others to avoid paying their fair share."

Among the many reasons to admire Bankman's proposal is that it cuts against his desire to move us to a consumption tax by taking away some of the anger people have at income taxes, thus making them more palatable. Would that those who fought him — the big tax preparers and Grover Norquist — shared his high level of intellectual honesty.

Should anyone suggest that tax preparation creates jobs and we need jobs right now, keep this in mind: We need jobs that add economic value, not make-work. And if creating jobs for the sake of jobs is the plan, then let's be really effective and replace earth-moving equipment at construction sites with shovels or, if the need becomes really acute, demitasse spoons.

Third, stop the consumer fraud inherent in letting anyone prepare a tax return for a fee.

In September the Treasury Inspector General for Tax Administration reported errors by 61 percent of unlicensed tax preparers whose returns it sampled. The sample was small, but that is no significant criticism of a problem that has been keeping consumer reporters busy at return filing time for decades.

The IRS Advisory Council in November asked for the simplest of reforms: requiring unlicensed preparers to have a unique identification number. That is far short of regulating all preparers, but it is still a terrific idea. Why?

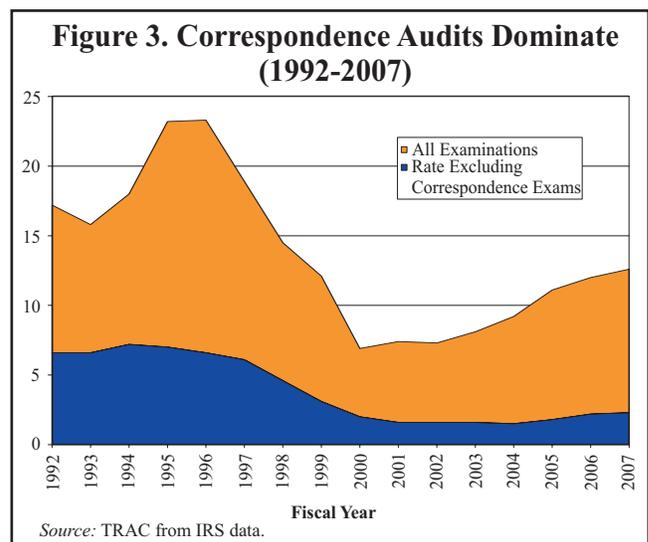
If every preparer could be tracked, the IRS could electronically sort through tax returns for patterns, identifying the incompetent to offer skills classes, while targeting the dishonest for civil injunctions (and prosecutions in egregious cases) and finding ways to encourage and even reward those who are both competent and honest.

Of course, such sorting would be slow and difficult for an agency that still uses computer systems from the Kennedy years, which brings us to the next necessary change.

The IRS appears to be unique in America among large organizations that still rely on sequential searching — a huge task when there are almost 140 million individual tax returns filed each year. How can it be that the taxpayers, in the form of CIA contracts, created what became Oracle with its fabulous system to slice and dice data and yet the IRS still does not have modern database technology?

More than 11 years after the tax reform commission promised us state-of-the-art technology, the IRS has only reached tryout mode. Last spring the IRS boasted that its CADE (Customer Account Data Engine) was finally processing a quarter of individual income tax returns. Wow! A whole quarter.

With the right technology, the IRS will be able to do something much more important than process tax returns. It will, like Oracle, be able to analyze data to detect patterns and identify not just blatant cheats, but chiselers. This could more than pay for itself, given that in 2000 the IRS had a 13 percent no-change rate when revenue agents audited individuals, and that rate was still 12 percent last



year. Add in a similar number of audits that conclude the taxpayer is owed money, and we have a system that wastes a quarter or so of audit resources.

Finally, hire tens of thousands of auditors.

Rossotti, just before his term ended in late 2002, said the IRS needed to more than double its auditing staff to 30,000.

"The tax system continues to grow in complexity," he told me, "while the resource base of the IRS is not growing and in real terms is shrinking. Basically, demands and resources are going in the opposite direction. This is systematically undermining one of the most important foundations of the American economy."

In fiscal 2000, the IRS audited just 1 in 200 income tax returns, but most consisted of letters asking for more information. Revenue agents examined only 91,418 individual returns out of 125 million filed. The audit rate is now up to 1 in 100, but is still far below the levels of the late 1980s, when far fewer people had business, investment, and other income, which is harder to track than wages.

Since 1990, audits of the largest corporations — those with \$250 million or more of assets — have declined by almost two-thirds. Back then 72 percent were audited, but last year just 26 percent were a record low, according to analysis of IRS data by the Transactional Records Access Clearinghouse (TRAC) at Syracuse University.

(Disclosure: TRAC is a joint research project of Syracuse University's Whitman School of Management and the journalism school; starting in January, I will be teaching at the Whitman school and Syracuse's law school.)

The audit rates for passthroughs are simply scandalous, especially considering how much income has been shifted to these entities in the past two decades and the well-established abuses of them, from misreporting when real estate deals close out to John Edward's little trick to avoid the Medicare tax by declaring millions of dollars of compensation to be dividends.

Last year the audit odds were 1 in 263, down a third from the peak year of 1998, both much too low to deter anyone but a Casper Milquetoast.

There is no moral argument for the tax cops letting tax cheats go. More on that in my next column. For now, let's hope that the next president really is about change, including change that makes government operate more efficiently and effectively. And let's remember those wise words by Edmund Burke, who both founded modern conservatism with the letter containing his brilliant observation about the state and revenue and defended the colonies in their quest to become what we are today, the United States of America.

Your thoughts? E-mail me at [JohnstonsTake@tax.org](mailto:JohnstonsTake@tax.org).