



CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 30, 1998

H.R. 2676
Internal Revenue Service Restructuring and Reform Act of 1998

As reported by the Senate Committee on Finance on April 22, 1998

SUMMARY

H.R. 2676 would make a number of changes to the management and oversight of the Internal Revenue Service (IRS), add or amend more than 70 taxpayer rights, and require the IRS to implement several changes designed to increase the number of forms filed electronically by taxpayers. The Joint Committee on Taxation (JCT) estimates that this act would increase governmental receipts (revenues) by \$582 million in fiscal year 1998 and would decrease receipts by a net amount of about \$1 billion over the 1998-2003 period. (The act would result in higher receipts for the first three years, but would lead to a gradually increasing loss of receipts in each year after 2000.) Over the 1998-2007 period, JCT estimates that enacting this legislation would decrease governmental receipts by about \$9 billion.

In addition, CBO estimates that enacting H.R. 2676 would increase direct spending by \$7 million in fiscal year 1998, about \$330 million over the 1998-2003 period, and about \$750 million over the 1998-2008 period. Because enacting this legislation would affect both direct spending and receipts, pay-as-you-go procedures would apply. H.R. 2676 also would affect discretionary spending, subject to the availability of funds. At this time, CBO cannot estimate the act's total effect on discretionary spending because the extent and results of efforts by the Treasury and the IRS under current law to increase the availability and use of electronic filing by taxpayers are very uncertain, because the Administration has already begun implementing many of the act's procedures, and because we have not had sufficient time to fully review the more than 70 provisions that would affect taxpayer rights. The increase in discretionary spending necessary to implement H.R. 2676 could be substantial.

JCT has determined that H.R. 2676 contains five new private-sector mandates as defined in the Unfunded Mandates Reform Act of 1995 (UMRA). Title V of H.R. 2676, Revenue Provisions, contains all five mandates. JCT estimates that the cost to the private sector to comply with the new mandates would be \$7.1 billion over the 1998-2003 period, which is equal to the increase in tax revenue from provisions that would impose the mandates. The

act contains no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

DESCRIPTION OF MAJOR PROVISIONS

H.R. 2676 would make a number of changes to the management and oversight of the IRS and to the rights of taxpayers. Specifically, the act would:

- establish a nine-member Internal Revenue Service Oversight Board within the Department of the Treasury to oversee the service's management, planning, budgeting, and operations;
- provide the IRS with the flexibility to reorganize its organizational structure and many of its personnel policies;
- eliminate the IRS Office of the Chief Inspector and transfer most of its responsibilities and resources to a new, independent Treasury Inspector General for Tax Administration within the Department of the Treasury;
- require the IRS to begin developing a paperless tax return system and authorize it to offer certain incentives to encourage taxpayers to file tax returns electronically;
- require the IRS, subject to the proper safeguards, to create a system under which taxpayers could review their own IRS files electronically by calendar year 2007;
- add or amend more than 70 provisions affecting taxpayer rights, including shifting the burden from the taxpayer to the IRS in certain court cases, making it easier for taxpayers to recover court costs and to sue the IRS for civil damages, increasing the amount of interest paid by the federal government to noncorporate taxpayers for overpayments of taxes, suspending the time limit for disabled individuals to file for a refund, and requiring that the IRS provide additional notification to taxpayers of certain rights and deadlines;
- impose several new reporting requirements on the IRS and JCT;
- clarify employer deductions for vacation pay and add other measures to raise governmental receipts and partially offset the cost of other provisions; and
- make numerous technical corrections to the Taxpayer Relief Act of 1997.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2676 is shown in Table 1. The costs of this act fall within budget function 800 (general government).

TABLE 1.
ESTIMATED COST TO THE FEDERAL GOVERNMENT^a

	By Fiscal Year, in Millions of Dollars					
	1998	1999	2000	2001	2002	2003
CHANGES IN REVENUES						
Estimated Revenues	582	814	654	-663	-1,052	-1,328
CHANGES IN DIRECT SPENDING						
Estimated Budget Authority	7	55	63	66	69	73
Estimated Outlays	7	55	63	66	69	73

a. Implementing the act would also require increases in spending subject to appropriation, but CBO cannot estimate these costs at this time.

In addition to the above effects, the act also would impose costs on the IRS and JCT, subject to the availability of funds, to carry out various requirements. Those increases—for the IRS only—would probably be substantial, but CBO cannot estimate the act’s likely effect on discretionary spending at this time. The major provisions that could affect discretionary spending are discussed in detail below.

BASIS OF ESTIMATE

For purposes of this estimate, CBO assumes that H.R. 2676 will be enacted by July 1, 1998.

Revenues

H.R. 2676 would make numerous changes to the Internal Revenue Code. The major provisions affecting receipts are summarized in Table 2.

TABLE 2. ESTIMATED CHANGES IN REVENUES

	By Fiscal Year, in Millions of Dollars					
	1998	1999	2000	2001	2002	2003
Clarify Deduction for Accrued Vacation Pay	603	1,141	1,160	141	148	156
Modify Foreign Tax Credit Carryover Rules	76	525	468	441	416	390
Make Certain Trade Receivables Ineligible for Mark-to-Market Treatment	33	317	500	333	117	70
Suspend Accrual of Interest and Penalties When IRS Fails to Contact Individual Taxpayer	0	0	-438	-529	-596	-636
Innocent Spouse Relief	-58	-350	-288	-273	-346	-480
Eliminate Penalties on Unpaid Taxes During Period of Installment Agreements	-29	-272	-287	-302	-317	-338
Burden of Proof	-1	-221	-232	-243	-256	-269
Mitigate Penalty for Failure to Deposit Payroll Taxes	0	-47	-64	-64	-65	-66
Software Trade Secrets Protection	0	-26	-32	-39	-45	-53
All Other Provisions Affecting Revenues	-42	-253	-133	-128	-108	-102
Total Estimated Revenues	582	814	654	-663	-1,052	-1,328

Direct Spending

Increase in the Interest Rate IRS Pays Certain Taxpayers on Overpayments. Most of the projected increase in direct spending would result from the provision that would increase by 1 percentage point the amount paid by the federal government to noncorporate taxpayers who overpay their taxes. Based on our estimate of the amount of annual overpayments by taxpayers of individual income, estate, and gift taxes, CBO estimates that increasing the rate of interest by 1 percent would increase direct spending by \$7 million in fiscal year 1998, by \$310 million over the 1998-2003 period, and by about \$700 million over the 1998-2008 period.

Taxpayer Bill of Rights. The act would increase the amount of penalties (payments covering attorneys' fees and administrative costs) and civil damages that courts could award

to taxpayers in certain cases brought against the federal government. For penalties, H.R. 2676 would: (1) lengthen the period of time over which taxpayers who substantially prevail against the IRS could recover administrative costs, (2) remove the hourly rate caps limiting the amount of reasonable fees that attorneys can collect in such cases, (3) permit the award of reasonable attorneys' fees to pro bono attorneys, and (4) allow taxpayers to recover reasonable costs and attorneys' fees in cases where an offer to settle the case is made, the IRS rejects the offer, and the IRS later obtains a judgment against the taxpayer in an amount that is equal to or less than the taxpayer's offer.

For civil damages, the act would: (1) provide for the payment of up to \$100,000 in civil damages to taxpayers in cases where a court finds that officers or employees of the IRS negligently disregarded provisions of the Internal Revenue Code or regulations, (2) provide for the payment of up to \$1 million in civil damages to taxpayers in cases where an office or employee of the IRS willfully violates certain provisions of the Bankruptcy Code, and (3) allow individuals other than the taxpayer to sue for civil damages as a result of unauthorized collection actions. Courts could award the damages only after the taxpayer had exhausted all administrative remedies at the IRS. Under current law, taxpayers may receive payments for damages in cases where a court finds that an IRS officer or employee has recklessly or intentionally disregarded provisions of the Internal Revenue Code. The government would pay the additional penalties and damages from the permanent, indefinite appropriation for claims and judgments.

Although considerable uncertainty exists as to how the courts would determine and award penalties and damages under H.R. 2676, CBO estimates that the provisions would increase direct spending by \$23 million over the 1998-2003 period and by \$56 million over the 1998-2008 period. This estimate assumes that broadening and increasing the amount of allowable penalties and lowering the standard for civil damages would result in awards of additional penalties and damages to taxpayers by the courts. Because the provisions affecting penalties would not take effect until 180 days after enactment and because the provisions affecting damages would apply to new actions and would require taxpayers to first exhaust administrative remedies, CBO expects that these provisions initially would have no significant impact on direct spending, but would result in a steady increase in penalties and damages awarded beginning in 1999. On average, we estimate that they would increase direct spending by about \$4 million annually over the 1998-2003 period.

Spending Subject to Appropriation

Electronic Filing. The act's biggest potential impact on discretionary spending involves its requirements to increase the availability and use of electronic filing. H.R. 2676 would generally require the IRS to study and implement several major changes to the way taxpayers

file their returns each year. Specifically, the act would: (1) require the Secretary of the Treasury to develop a strategic plan to eliminate barriers and provide incentives to increase the number of returns filed electronically to at least 80 percent of all returns, (2) beginning in fiscal year 2000, extend the due date for electronic filers of information returns from February 28 to March 31, (3) require the Treasury to develop procedures for accepting signature information from electronic filers in a digital or other electronic form, (4) require the Treasury to develop procedures for implementing a return-free tax system beginning with tax years that begin after 2007, and (5) provided the necessary safeguards are in place, require the Treasury to develop procedures to enable taxpayers to review their account information electronically by 2007.

The Treasury is already developing or studying most of these proposals. For instance, according to the Department of the Treasury, the IRS currently is using some signature alternatives and studying others. The Treasury also has already awarded a contract to design and develop a large educational campaign to encourage taxpayers to file electronically. In addition, the IRS is implementing new payment methods and preparing its systems to accept new forms that should reduce the amount of paper filed by taxpayers each year. Finally, the Treasury is studying alternatives for allowing taxpayers to eventually review account information electronically. Thus, even though CBO expects that implementing the act's procedures would increase costs for the Treasury, subject to the availability of funds, we cannot estimate the amount that such costs would increase. The amount of the costs would depend, in part, on the overall effort at the IRS to modernize its information systems, for which the Congress has appropriated about \$4 billion over the last decade.

In general, receiving and processing forms electronically should reduce costs of the IRS in the long run. The IRS has estimated that it costs at least two and one-half times more to process such forms by paper, since the data must be input manually into IRS's systems, the error rate in processing such forms is significantly higher, and the papers require handling and storage. Thus, if enacting H.R. 2676 results in an increase in the number of taxpayers that file electronically with the IRS each year—in fiscal year 1997, 19.1 million of the estimated 120 million individual income tax returns were filed with the IRS by computer or phone—then the act should eventually reduce the government's annual costs to process tax information.

IRS Oversight Board. H.R. 2676 would establish a nine-member management board within the Department of the Treasury to oversee the management and operations of the IRS. Its responsibilities would include reviewing and approving the agency's strategic plans and annual budget request. The board would consist of six members from outside the federal government, the Secretary of the Treasury, a union representative, and the IRS Commissioner. The act would compensate the nonfederal members at a rate of \$30,000 per year, except for the chair, who would receive an annual salary of \$50,000. The members also

could receive reimbursement for any travel expenses incurred in performing official board work. In addition, the act would allow the board to hire permanent staff. The board would be required to meet at least once a quarter. Upon enactment, the President would have six months to submit nominations to the Senate.

Based on the act's requirements and specifications for compensation, CBO estimates that the board would cost less than \$500,000 in fiscal years 1998 and 1999 and between \$500,000 and \$1 million in each of fiscal years 2000 through 2003. That estimate assumes the board would not meet until the beginning of fiscal year 1999.

IRS Management and Personnel Flexibilities. The act would allow the IRS to change its organizational structure and would provide it with significant flexibility in how it compensates, trains, and organizes its workforce. In January, the Commissioner announced plans to reorganize the agency along customer service lines. Because the act would simply allow the IRS to carry out the reorganization plans that are already under development, that provision would impose no additional costs on the IRS. In the case of the personnel flexibilities, the additional costs would likely be significant, although it is difficult to predict how much the IRS would employ such flexibilities and whether the Commissioner could reach agreement with the employees' union, as required by the legislation, regarding measures that would affect its members.

CBO estimates that the measures allowing the IRS to increase pay and other forms of compensation could increase annual payroll costs of the IRS by at least several million dollars. In addition, providing the IRS with the authority to offer buyouts without necessarily reducing the total number of positions through calendar year 2002 also could increase its personnel costs by tens of millions of dollars over the 1998-2003 period.

Treasury Inspector General for Tax Administration. The legislation would eliminate the IRS Office of the Chief Inspector and transfer most of its responsibilities and resources to a new, independent Treasury Inspector General (IG) for Tax Administration within the Department of the Treasury. The new IG for Tax Administration would assume responsibility for the duties currently assigned to the Treasury IG with respect to the IRS and for the duties currently delegated to the IRS Office of the Chief Inspector. CBO estimates that this provision would have no significant budgetary effect.

Taxpayer Bill of Rights. H.R. 2676 would add or amend more than 70 taxpayer rights. In most cases, the new rights would result in minimal additional costs for the IRS to write regulations and procedures, provide additional information to taxpayers, and create or amend tax forms and other tax-related documents, although the sheer magnitude of the number of such changes would likely result in a significant increase in administrative costs, particularly if the changes would require a significant computer reprogramming effort on the part of the

IRS. Similarly, the totality of such changes could result in a substantial increase in the workload of the offices of Appeals and Taxpayer Advocate at the IRS. CBO, however, has not had sufficient time to review these provisions and estimate their impact.

Complexity Analyses and Studies. H.R. 2676 would expand the responsibilities of the JCT. It would require JCT to prepare a detailed "Tax Complexity Analysis" for proposed legislation amending tax laws and to conduct two studies within one year from the date of enactment. The act also would require the IRS to report annually to the House Committee on Ways and Means and the Senate Committee on Finance regarding sources of complexity in the administration of federal tax laws and the Department of the Treasury to conduct the same pair of studies required of JCT.

CBO estimates that implementing H.R. 2676 would cost JCT less than \$500,000 a year, assuming appropriation of the necessary amounts. Depending upon the amount and nature of tax legislation considered by the Congress, analyzing the complexity of legislative initiatives could increase this cost somewhat. In addition, CBO estimates that requiring the IRS to report annually on the complexity of tax laws would cost less than \$500,000 a year. Finally, CBO estimates that the two reporting requirements would cost the Treasury less than \$500,000 over fiscal years 1998 and 1999. (The Administration is already planning to conduct at least one of the studies.)

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act of 1985 specifies procedures for legislation affecting direct spending and receipts. The projected changes in direct spending and receipts are shown in the following table for fiscal years 1998 through 2008. For purposes of enforcing pay-as-you-go procedures, however, only the effects in the current year, the budget year, and the succeeding four years are counted.

TABLE 3. SUMMARY OF EFFECTS ON DIRECT SPENDING AND RECEIPTS

	By Fiscal Year, in Millions of Dollars										
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Changes in outlays	7	55	63	66	69	73	77	80	84	88	92
Changes in receipts	582	814	654	-663	-1,052	-1,328	-1,713	-1,908	-2,080	-2,269	NA

N.A. = Not available (JCT has estimated revenue effects through 2007 only.)

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 2676 contains no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments. The bill would allow the IRS to collect and remit (from overpayments) certain past-due income tax obligations owed to state governments and would authorize grants for low-income taxpayer clinics operated by institutions of higher education (public or private) and tax-exempt organizations.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

JCT has determined that H.R. 2676 contains five new private-sector mandates, as defined in UMRA. Title V of the act, Revenue Provisions, contains all five mandates. JCT estimates that the cost to the private sector to comply with the new mandates would be \$7.1 billion over the 1998-2003 period, which is equal to the increase in tax revenue from provisions that would impose the mandates.

First, the provision clarifying the deduction for deferred compensation is estimated by JCT to increase tax revenue by \$3.3 billion over fiscal years 1998 through 2003. Second, the act would change the carryback period and carryforward period for foreign tax credits, which is estimated to increase tax revenue by \$2.3 billion between 1998 and 2003. Third, H.R. 2676 would freeze the grandfathered status of stapled or paired-share real estate investment trusts (REITs). As a result of the proposed freeze, JCT estimates that tax revenue would increase by \$34 million over the 1998-2003 period. Fourth, the act would make certain trade receivables ineligible for mark-to-market treatment, which is estimated to increase tax revenue by \$1.4 billion over the six-year period. Finally, H.R. 2676 would add vaccines against rotavirus to the list of taxable vaccines, thus increasing tax revenue by an estimated \$15 million over fiscal years 1998 through 2003.

COMPARISON WITH OTHER ESTIMATES

The committee report filed on April 22, 1998, included an estimate by JCT that enacting H.R. 2676 would increase direct spending by \$409 million over the 1998-2002 period and by \$989 million over the 1998-2007 period. According to JCT, that estimate would result from enacting three provisions affecting taxpayer rights: (1) increasing by 1 percent the interest rate paid by the government to noncorporate taxpayers who overpay their taxes, (2) expanding the court's authority to award taxpayers costs and certain fees, and (3) adding or increasing civil damages for certain collection actions by the IRS.

By comparison, CBO estimates that enacting the three provisions would increase direct spending by \$260 million over the 1998-2002 period and by \$662 million over the 1998-2007 period. In total, CBO's estimate of the increase in direct spending is about \$150 million lower than JCT's over the 1998-2002 period and about \$330 million lower over the 1998-2007 period. The difference between the JCT and CBO estimates results from three factors. First, according to JCT, part of its estimated increase in direct spending includes effects on revenues (about \$110 million over the 1998-2002 period and about \$220 million over the 1998-2007 period). Second, JCT and CBO have different estimates of the extent to which the provision expanding the court's authority to award taxpayers costs and certain fees would increase payments from the Claims and Judgment Fund. JCT estimates an additional \$55 million in such payments over the 1998-2002 period and about an additional \$150 million over the 1998-2007 period. Finally, JCT and CBO make different assumptions as to the taxes that would be affected by the provision increasing the rate of interest on overpayments. CBO assumes that the provision would apply to estate and gift tax overpayments in addition to individual income tax payments, which increased our estimate of direct spending by about \$20 million over the 1998-2002 period and by about \$40 million over the 1998-2007 period.

PREVIOUS CBO ESTIMATE

On October 31, 1997, CBO prepared a cost estimate for H.R. 2676, the Internal Revenue Service Restructuring and Reform Act of 1997, as ordered reported by the House Committee on Ways and Means on October 22, 1997. For the House version of H.R. 2676, JCT estimated that the legislation would have no net effect on governmental receipts over the 1998-2002 period and would decrease them by \$2.9 billion over the 1998-2007 period.

The Senate version of H.R. 2676 includes several additional measures that would add to the government's revenues, but also includes a more extensive set of new and revised taxpayer rights. In total, JCT estimates that the Senate version would bring in about \$0.3 billion more in revenues over the 1998-2002 period, but would decrease governmental receipts by about \$6 billion more over the 1998-2007 period.

CBO estimated that enacting the House-reported version of H.R. 2676 would increase direct spending by \$5 million in fiscal year 1998, \$25 million over the 1998-2002 period, and \$50 million over the 1998-2007 period. CBO's estimate of the increase in direct spending for the Senate version of H.R. 2676 is higher, mostly because we reestimated and reclassified the budgetary effects of several provisions included by JCT as decreases in governmental receipts for the House version of H.R. 2676. Thus, the increase in direct spending estimated by CBO for the Senate version is more than offset by a corresponding reduction in JCT's estimate of reduced governmental receipts. The increase in the rate of interest on taxpayer

overpayments is the main provision projected to cause an increase in direct spending in this estimate rather than a decrease in governmental receipts, as was reported for the House version.

In addition, the House version would have required that the Secretary make \$3 million in annual grants to low-income taxpayer clinics, whereas the Senate version would make such payments subject to appropriation. Finally, this estimate reflects a slight, upward revision in the annual estimate of new payments from the Claims and Judgment Fund for penalties and civil damages. In total, our estimate for the Senate version of H.R. 2676 reflects an increase in direct spending over the 1998-2007 period that is about \$610 million higher than the estimate for the House version.

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