CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 31, 1997

H.R. 2676

Internal Revenue Service Restructuring and Reform Act of 1997

As ordered reported by the House Committee on Ways and Means on October 22, 1997

SUMMARY

H.R. 2676 would make a number of changes to the management and oversight of the Internal Revenue Service (IRS), add or amend 28 taxpayer rights, and require the IRS to implement several changes designed to increase the amount of forms filed electronically by taxpayers. The Joint Committee on Taxation (JCT) estimates that this bill would increase governmental receipts (revenues) by $327 million in fiscal year 1998 but would have no net effect on such receipts over the 1998-2002 period. Over the 1998-2007 period, JCT estimates that enacting this bill would decrease governmental receipts by $2.9 billion.

In addition, CBO estimates that enacting 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. Because enacting the bill would increase 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. Because of the uncertainty of efforts by the Treasury and the IRS under current law to increase the availability and use of electronic filing by taxpayers, CBO cannot estimate the bill's total effect on discretionary spending at this time.

JCT has determined that H.R. 2676 contains one new private-sector mandate, as defined in the Unfunded Mandates Reform Act of 1995 (UMRA). JCT estimates that the provision clarifying employer deductions for vacation pay would increase tax revenue by $2.65 billion over the 1998-2002 period, which is the estimated cost to the private sector to comply with the mandate. The bill 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 bill would:

- establish an 11-member Internal Revenue Service Oversight Board within the Department of the Treasury to oversee the service's planning, budgeting, and operations;

- 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 fiscal year 2007;

- add or amend 28 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, eliminating the threshold and allowing for partial relief from the tax bills owed by innocent spouses, 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;

- make several congressional reforms to discourage the Congress from adding further complexity to the tax code and to coordinate the oversight functions of the various committees that have jurisdiction over the IRS; and

- clarify employer deductions for vacation pay to raise governmental receipts and offset the cost of other provisions.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2676 is shown in Table 1. The costs of this bill fall within budget function 800 (general government). The legislation would also affect revenues.

TABLE 1. ESTIMATED COST TO THE FEDERAL GOVERNMENT

	By Fiscal Year, in Millions of Dollars				
	1998	1999	2000	2001	2002
CHANGES IN DIRECT SPENDING AND REVENUES [a]					
Direct Spending					
Estimated Budget Authority	3	3	5	5	6
Estimated Outlays	3	3	5	5	6
Revenues					
Estimated Revenues	327	602	43	-480	-493

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

BASIS OF ESTIMATE

H.R. 2676 would affect both revenues and direct spending. JCT estimates the bill would increase revenues by nearly $1 billion over the fiscal year 1998-2000 period, but decrease such receipts by an equal amount over fiscal years 2001 and 2002. For the 1998-2007 period, JCT estimates that enacting H.R. 2676 would decrease governmental receipts by about $2.9 billion. CBO estimates that enacting the bill would increase direct spending, on average, by about $5 million in each of fiscal years 1998 through 2002, for a total of about $25 million. For fiscal years 1998 through 2007, CBO estimates the bill would increase direct spending by a total of about $50 million.

Subject to the availability of funds, the bill also would increase costs at the IRS and JCT to perform various requirements of the bill and those increases would probably be significant. But, because of the Treasury's plans for increasing the availability and use of electronic filing by taxpayers are uncertain, CBO cannot estimate the bill’s likely effect on discretionary spending at this time. The bill's major provisions that could affect discretionary spending are discussed in detail below.

This estimate assumes the bill would be enacted by the middle of fiscal year 1998.

Revenues

H.R. 2676 would make several 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
Clarify Deduction for Accrued Vacation Pay	705	1,111	584	120	126
Failure to Pay Penalty Capped at 9.5 Percent for Individuals	-176	-198	-209	-220	-231
Burden of Proof	-80	-166	-174	-183	-192
Increase Refund Interest Rate to AFR plus 3 Percent for Individuals	-49	-51	-54	-56	-59
Suspension of statute of limitations on filing refund claims during periods of disability	-40	-50	-25	-15	-16
Elimination of Interest Rate Differential on overlapping periods of interest on income tax overpayments and underpayments	-1	-9	-28	-42	-54
All Other Provisions Affecting Revenues	-32	-35	-51	-84	-67
Total Estimated Revenues	327	602	43	-480	-493

Direct Spending

Low-Income Taxpayer Clinics. H.R. 2676 would require the Secretary of the Treasury to make grants on a matching basis to clinics that provide services to low-income taxpayers. The bill would limit the total amount of such grants in any one year to $3 million. Thus, CBO estimates that enacting this provision would increase direct spending by $3 million in each of fiscal years 1998 through 2002, or by a total of $15 million.

Taxpayer Bill of Rights. The bill also would increase the amount of penalties—attorney's fees and administrative costs—and civil damages that courts could award to taxpayers in certain cases brought against the federal government. In particular, the bill would provide for 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.

Courts could award damages only after the taxpayer had exhausted all administrative remedies at the IRS. Under current law, taxpayers may receive damages only for 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 amounts from the permanent, indefinite appropriation for claims and judgments.

Although considerable uncertainty exists as to how the courts would determine and award damages based on negligent behavior, CBO estimates that the provisions would increase direct spending, on average, by $10 million over the 1998-2007 period and by $28 million over the 1998-2007 period. That estimate assumes that lowering the standard for civil damages would result in courts awarding additional damages to taxpayers. Because the provision would apply only to actions that occur after enactment and would require taxpayers to first exhaust administrative remedies, CBO expects the provision initially would have no significant impact on direct spending, but would result in a steady increase in damages awarded after 1999. On average, we estimate that the provision would increase direct spending annually by $2 million over the 1998-2002 period and by $3 million over the 1998-2007 period.

Spending Subject to Appropriation

Electronic Filing. The bill'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 bill 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, (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. The IRS is also 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 and is studying alternatives for allowing taxpayers to eventually review account information electronically. Thus, even though CBO expects that implementing the bill'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 at the IRS in the long run. The IRS is currently analyzing the per-unit costs of processing tax forms electronically. In the past, 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 the bill 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 bill should eventually reduce the government's annual costs to process tax information.

IRS Oversight Board. H.R. 2676 would establish an 11-member management board within the Department of the Treasury to oversee the management and operations of the IRS, including reviewing and approving the agency's strategic plans and annual budget request. The board would consist of eight members from outside the federal government, the Secretary of the Treasury, a union representative, and the IRS Commissioner. The bill 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 attending official board meetings. The bill would not provide the board with its own permanent staff. The bill would require that the board meet at least once a month. Upon enactment, the President would have six months to submit nominations to the Senate.

Based on the bill's requirements and compensation, CBO estimates that the board would cost about $400,000 in each of fiscal years 1999 through 2002. That estimate assumes the board would not meet until the beginning of fiscal year 1999.

Taxpayer Bill of Rights. H.R. 2676 would add or amend 28 taxpayer rights. In general, the new rights would result in minimal additional costs for the IRS to write regulations, provide additional training to employees, and create or amend tax forms and other tax-related documents. CBO estimates that these provisions would increase costs at the IRS over fiscal years 1998 and 1999 by between $5 million and $10 million. In later years, we expect such costs would not be significant.

Congressional Accountability. H.R. 2676 would expand the responsibilities of the Joint Committee on Taxation (JCT) and streamline Congressional procedures for overseeing the IRS. It would require JCT to coordinate joint Congressional oversight hearings and various reports related to IRS matters, report annually on the overall state of the federal tax system, prepare a detailed "Tax Complexity Analysis" for proposed legislation amending tax laws, and conduct two studies within one year from the date of enactment. The bill also would require JCT to review all Congressional requests (other than requests by the chairman or ranking member of a Congressional committee or subcommittee) for General Accounting Office (GAO) investigations that access confidential information under section 6103 of the U.S. Code.

Under the current structure, several committees have jurisdiction over the IRS. Assuming enactment of H.R. 2676, the Congress, with the assistance of JCT, would hold two joint hearings each year on the IRS. The first would review the strategic plans and budget for the IRS; the second would focus on the status of the IRS in meeting its budgetary and policy goals. The bill would require the JCT to prepare annual reports on the overall state of the federal tax system, along with recommendations for simplification and other matters. The JCT also would be responsible for providing a tax complexity analysis for legislation resulting in changes in tax law. This review would identify and analyze proposals in a bill or conference report that would add or reduce complexity in the tax laws.

CBO estimates that enacting H.R. 2676 would cost JCT approximately $200,000 in 1998 and $400,000 beginning in 1999 and each year thereafter, 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. According to the GAO, securing JCT approval for certain tax investigations would affect perhaps one study annually, and thus would have no significant budgetary effect. Streamlining the legislative process for overseeing the IRS could result in some savings to Congressional committees, but any such savings is not expected to be significant.

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 2007. For purposes of enforcing pay-as-you-go procedures, however, only the effects in the budget year and the succeeding four years are counted.

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
Changes in outlays	3	3	5	5	6	6	7	7	8	8
Changes in receipts	327	602	43	-480	-493	-517	-542	-570	-597	-627

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 provide $3 million a year for low-income taxpayer clinics that could be operated by accredited law schools (public or private) or certain tax-exempt organizations.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

JCT has determined that H.R. 2676 contains one new private-sector mandate as defined in UMRA. The provision relating to clarification of deduction for accrued vacation pay is estimated to increase tax revenue by $2.65 billion over fiscal years 1998 through 2002, which is the estimated amount that the private sector would be required to spend in order to comply with this mandate. The revenue provision would offset the budgetary cost of the Internal Revenue Service restructuring provisions of the bill. The revenue provision would not impose a federal intergovernmental mandate on state, local, or tribal governments, as such governmental entities are generally exempt from the federal income tax.

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