Neil H. Buchanan, JD, Ph.D.
Associate Professor of Law,
The George Washington University

Testimony Before the Committee on Ways and Means
April 13, 2011

Chairman Camp and Ranking Member Levin, and Members of the Committee:

Thank you for giving me the opportunity to address the Committee today. At the outset, at the risk of stating the obvious, I want to acknowledge that there are many areas of the Internal Revenue Code that could benefit from rationalization and simplification. In areas in which multiple provisions have accumulated over time, such as retirement savings and education incentives, the same incentives and benefits surely could be provided in a simpler fashion. That being said, I hope through my testimony to warn the Committee of some red herrings – issues that need **not** be addressed as you work to simplify the lives of Americans who honestly try to comply with the tax laws. Clearing away some tempting distractions will, I hope, provide more clarity – and time – for the Committee to focus on genuine tax simplification.

False Simplification

Assuming that the goal of simplifying the tax code is truly to simplify the lives of citizens, and that the exercise is not merely a cover for the elimination of the housing, education, retirement savings and other incentives that past Congresses have enacted to benefit the American people, the Committee should be wary of reducing "tax complexity" without reducing what we might call "overall complexity." A simple way to reduce the complexity of the tax code, after all, would simply be to stop running certain benefits through the tax code and, instead, run them through some other agency of the government. The mortgage interest deduction, for example, could be turned into a benefit program run by HUD. The earned-income tax credit, which is a benefit to workers, could be run by the Department of Labor. The medical expense deduction could go through HHS.

Doing any of those things, however, would do nothing to make the lives of American taxpayers less complicated. If anything, compliance burdens would become even more onerous, as our citizens would now have to deal not just with the IRS but with newly-created administrative arms of other cabinet departments, or "mini-IRS's" – which would also add to federal spending, by the way.

The IRS has the advantage of being a single agency with which citizens interact, and it is the logical agency to provide incentives and benefits the eligibility for which are conditioned on income levels. In addition, decades of experience have shown that the IRS and its employees possess the expertise, dedication, and experience – notwithstanding years and years of chronic under-funding – to handle the administration of important benefits that we administer through the tax code.

Multiple Rate Brackets

Reducing the number of tax brackets is **not** an important aspect of simplifying taxes, and it has the undesirable effect of making the tax code less progressive. Some analysts have asserted that the existence of multiple brackets is confusing, making it more difficult for taxpayers to figure out how much they owe in taxes each year. In fact, all of the work and uncertainty involved in tax compliance is related to what happens **before** tax rates even become relevant.

That is, once a taxpayer has determined his or her "taxable income," it takes merely a few seconds to look at the relevant table to determine the tax owed. We could have ten or twenty tax rates without increasing the compliance burden. The taxpayer's uncertainty is in figuring out what to include, exclude, deduct, credit, and so on, not in dealing with different rates. Again, it is the determination of taxable income, not the final step of determining the tax owed, that takes up all of a taxpayer's time.

Phase-outs

As a related matter, the existence of so-called phase-outs is not inherently complicated, either. Again, the difficult part of the process is in figuring out whether a person is eligible for a particular provision, and what facts must be known before one can even understand the provision in question. The arithmetic involved in the phase-outs is a relatively simple after-thought, and the IRS is perfectly capable of providing simple tables to assist the taxpayer in determining how a phase-out alters the final tax computation.

I should add the qualification that phase-outs can pile up, with a different phase-out for each of several different tax provisions, which complicates compliance somewhat. Combining separate phase-outs into a consolidated phase-out would, therefore, allow taxpayers to apply a simple adjustment to all of the relevant provisions for which they might otherwise qualify. For example, if we were to set a "universal phase-out" range from, say, \$100,000 to \$250,000 for a single taxpayer, then any single taxpayer earning more than \$250,000 would know that it is not worth the time to work through the various tax benefits. Taxpayers with incomes below \$100,000 would know that they qualify for full benefits, and taxpayers in between would know in advance the fraction of the benefits that they can expect to receive.

More to the point, however, as the Committee sets priorities, its time would be much better spent simplifying tax provisions themselves – who qualifies, what can be deducted, and so on – than on hunting down and eliminating phase-outs.

In addition, it is important to remember that phase-outs serve two important purposes: First, they limit the cost of any tax benefit, by reducing the benefits received by people who can afford to live without the deduction. They are, therefore, a way to means-test benefits – benefits that, after all, cost the federal government money. Second, phase-outs avoid abrupt, all-or-nothing changes to tax benefits, with a taxpayer suddenly losing all of a benefit after hitting an income limit or some other arbitrary threshold. Without phase-outs, taxpayers can face especially harsh tax consequences as they suddenly lose a benefit that they would otherwise have received.

My message today, Mr. Chairman, therefore amounts to taking three items off of the list of possible approaches to tax simplification. First, taking policies out of the tax code – and out of the IRS's jurisdiction – can make citizens' lives **more** complicated, rather than less so, as it would simply relocate the complexity that our citizens face, rather than actually reducing it. Second, the number of tax rates is a non-issue, as far as complexity and compliance burdens are concerned. And third, the existence of phase-outs is nearly a non-issue, and the complexity of phase-outs can be all but eliminated by harmonizing phase-outs across all provisions that Congress chooses to means-test.

The Committee's work is daunting, involving important work in eliminating and combining duplicative and sometimes ineffective tax benefits. That work will be difficult enough without becoming distracted by false promises of reduced complexity. I hope that my testimony will prove useful in directing the Committee away from those distractions.

Thank you.

NOTE: These comments represent my own thoughts on the issues presented. They in no way are meant to represent the views of my employer or any other organization with which I might be affiliated.