Big Tax Reform, Little Tax Reform (Keynote Presentation)

Clarissa C. Potter
KEYNOTE PRESENTATION

BIG TAX REFORM, LITTLE TAX REFORM

CLARISSA C. POTTER*

In Washington, as elsewhere, there is a lot of talk about tax reform. Today, we had an excellent panel discussing major tax reform. We have also had many speakers talk about the smaller changes Congress seems to make every year in the tax law. I would like to link these two strands of discussion today under the heading of something like, “Big Tax Reform, Little Tax Reform.” It is the “big” tax reform that is exciting to talk about, that generates the attention in the press, and that is the topic of speeches and journal articles. But it is “little” tax reform that is most important to people in their daily lives. It is the reform that is most likely to be enacted, and, notwithstanding that it seems incremental and of no great interest from a policy or scholarly perspective, it can have profound effects on individual taxpayers and the tax system as a whole.

Let me start by discussing the current political environment and the current state of “big” tax reform. The realization that this year and in the foreseeable future there may be government budget surpluses has really brought the tax reform debate to a head. The development of budget surpluses is a very exciting event. It is no surprise that politicians, Congressmen in particular, have been walking around with dollar signs in their eyes,

* Clarissa C. Potter is the Acting Tax Legislative Counsel in the Office of Tax Policy in the Department of the Treasury. She is a graduate of Miami University of Ohio and she received her J.D. in 1989 from Yale Law School. She is a member of the New York State Bar. Before joining the Treasury Department in mid-1994, Clarissa was Legislative Counsel with the Joint Committee on Taxation, where she worked on the Tax Reform Act of 1983.

In her pre-public service days, Clarissa was a tax associate with the New York office of Sullivan & Cromwell. Her specialties included the taxation of financial products and institutions, taxation of damage awards, tax incentives for education, and recently, the tax treatment of farmer cooperatives.
trying to spend these surpluses before someone else can get their hands on the money.

For the current fiscal year, the Congressional Budget Office has projected that the surplus would be about $8 billion. The Administration’s estimators think that there will be a slight shortfall this year of about $10 million. But for future years, it is agreed by both Congress and the Administration that there will be fairly sizable surpluses.

So how is this windfall to be spent? President Clinton has taken the initiative and said that those surpluses should not be spent before the future of Social Security is assured. Although this idea seems very popular with the electorate, there are still some avid proponents of dedicating the surplus to other purposes such as infrastructure, tax cuts and so forth.

One of the possibilities that the budget surplus creates is a more meaningful context for the tax reform debate. Congress and other experts have used the discussion about the budget surplus as an opportunity to increase the public conversation about tax reform. The last panel addressed itself to the theoretical and academic debate about tax reform—I am addressing myself now to the political debate. What are people saying when they talk about tax reform? In particular, what are members of Congress talking about when they are in their districts or are out on the road having debates? What kind of reform is necessary and on what scale? Should the tax code be buried in a casket somewhere? Should it be burned or dumped in Boston Harbor?

There are two competing proposals being widely discussed. The first is the flat tax or “Hall-Rabushka” tax, as it is referred to in policy an academic circles. At this point, it appears that most people do not realize the flat tax is a consumption tax, a type of tax that has not gathered a great deal of public support outside the expert and academic circles. It has always seemed to me that what draws the general public to the flat tax is the flat

---

1 See Jacob M. Schlesinger, IRS-Reform Legislation Faces Delays Amid Effort to Find Ways to Pay for It, WALL ST. J., Mar. 19, 1998, at A2 (noting that the Congressional Budget Office predicted an $8 billion surplus for the fiscal year ending September 30); The Economy Perspective; What's Left of Reform, INVESTOR'S BUS. DAILY, Mar. 19, 1998, at A6 (stating that Congressional Budget Office anticipates $8 billion budget surplus, although some private estimates predict a much larger surplus).

2 These were among the solutions to current frustration over the tax law proposed by a number of members of Congress, including Representatives Richard Armey and Billy Tauzin on their famous “Scrap the Code Tour.”
tax rates. There is irony in this. While progressive rates create some complexity by encouraging tax arbitrage, most individual taxpayers do not encounter much complexity attributable to the current rate structure. Moreover, I believe most people recognize the importance of progressive rates for the fairness of our tax system. Nonetheless, many seem to believe that a flat rate is the characteristic that makes the flat tax a desirable alternative to the income tax. Frankly, I believe the X-tax\(^3\) has failed to receive much public notice because of the graduated rates that would apply under this proposal.

The second proposal being discussed openly and actively right now is the national retail sales tax. It seems the appeal of the national retail sales tax is its familiarity; the vast majority of states have retail sales taxes and so most taxpayers are experienced with them. The national retail sales tax is distinguished by having a well-organized and funded group advocating its adoption through newspaper advertisements, op-ed pieces, and white papers. This makes the debate seem more immediate and the proposal somehow more serious.\(^4\) I believe taxpayers have yet to catch on that the national retail sales tax is also a consumption tax.

Two interesting things to observe when you are watching reports of discussions of the flat tax and the national retail sales tax are first, what kind of rates are proponents talking about, and second, what level of detail is contained in these proposals (in most cases they were being described very simplistically).

One of my favorite newspaper columnists recently said there are three kinds of people in the world: People who can count and people who can't.\(^5\) Some of the proponents of major tax reform seem to fall into the second category; others seem to think their audience—the taxpaying public—does. Nevertheless, there seem to be some counting problems.

The flat tax is often talked about as a 17 percent tax, or maybe

4 See Ryan Donmoyer, "Friends of Bill" Archer Propose New National Sales Tax Plan, 98 TAX NOTES TODAY 5-2 (Jan. 8, 1998) (describing proposal by affluent Texas businessmen to repeal income and payroll taxes while replacing them with twenty-three percent national sales tax on new goods and services).
5 Tony Kornheiser, A Duck Walks into a Bar, WASHINGTON POST, Jan. 4, 1998, at F1.
a 20 percent tax.\textsuperscript{6} When you get down to the numbers and look at the bills that have been introduced, however, you begin seeing much higher rates of tax. An example of this is the USA Tax bill sponsored by Senators Nunn and Domenici, which is quite a detailed proposal.\textsuperscript{7} The Nunn-Domenici proposal contemplates rates that reach 40 percent. The rates are so high and begin to apply at such low levels of income that the average person would be shocked if they knew about it.

What I find very interesting about the national sales tax proposal is that it is often described as a 23 percent tax.\textsuperscript{8} In other words, it is a very low flat-rate tax—23 percent of everything you buy. It is not widely understood, however, that 23 percent is the "tax-inclusive" rate. For example, under a "tax-inclusive" rate, when you buy something for $1 you are going to be paying 23 cents of tax with 77 cents being remitted to the manufacturer or the retailer. The analogue to this is under a "tax-exclusive" approach is buying something that is priced at 77 cents, but you are paying $1 for it with tax. Now if I were to go out and buy something for $1 before tax, how much tax would I pay? I would pay 30 cents. The difference between the 23 percent tax-inclusive rate and a 30 percent tax-exclusive rate is really quite significant. Since state sales taxes are quoted on a "tax-exclusive" basis, I think most taxpayers fail to appreciate just how high the proposed tax rate under the national retail sales tax would be. Voters are likely to react to this proposal quite differently if they know the tax rate is much higher than appears from the material being used to promote the tax.

The tax rates these reform measures would require, and whether proponents are being up front about them, are political issues. The various tax reform proposals also raise critical policy issues. The President has enunciated four principles to evaluate these or any other competing major tax reforms. Les Samuels already spoke about them, so I will be brief and generally de-

\textsuperscript{6} See H.R. 2060 104th Cong. (1995) and S. 1050 104th Cong. (1995) [hereinafter Ar- 


\textsuperscript{8} See Group Marks Tax Freedom Day with Call for National Sales Tax, 1998 DAILY 

\textsuperscript{9} See Group Marks Tax Freedom Day with Call for National Sales Tax, 1998 DAILY 

\textsuperscript{10} See Group Marks Tax Freedom Day with Call for National Sales Tax, 1998 DAILY 

\textsuperscript{11} See Group Marks Tax Freedom Day with Call for National Sales Tax, 1998 DAILY
scribe the Administration's view of whether the proposals that have been submitted for public discussion meet any of the principles.

The first question, as Mr. Samuels said earlier, is whether the proposal is fair. Does it protect lower and middle-income families? As proposed, the flat tax and the national retail sales tax do not meet this test. The purely flat tax with no graduation of rates undercuts the core principle built into our tax system that people should be taxed based on their ability to pay.

It is relatively clear based on the number of studies that the flat tax and the national retail sales tax would generally raise taxes on those who earn income of less than $200,000 a year and would cut taxes for people who have annual incomes over $200,000. From the Administration's perspective, this is not a desirable result. It is debatable, although it seems more likely, that a graduated-rate-based flat tax could alleviate part of this problem. But of course, there might be other significant costs, both politically and from a policy perspective, to introducing graduated rates. As it stands, the existing proposals clearly violate this fairness principle.

The second principle that needs to be addressed is fiscal discipline. Even though it appears that we will soon be enjoying budget surpluses, the President has said, and I agree, that it would be unwise to abandon our current course for a new system that could produce a greatly reduced revenue stream for the federal government. As I mentioned before, the 17 percent flat tax that has been promoted is probably not sufficient to keep the budget in line. In fact, Treasury economists estimated that a 17 percent flat tax fully phased-in in 1994, for instance, would have lost an estimated $138.3 billion a year.

In addition, in the case of the national retail sales tax, even a 30 percent tax-exclusive rate might not raise sufficient revenue to protect the fisc if exemptions to the tax begin to creep in. As proposed, the tax base is relatively comprehensive. But if Congress began to create exclusions, for new housing for example,

---


the tax could easily increase above the 30 percent rate. When we evaluate whether a reform proposal will be sure to raise enough revenue to protect the fisc, we must inquire what sorts of assumptions are built into the tax that have not become clear. For instance, what kind of political compromises would have to be made in the tax base, how would the administration of the tax differ from our current system and what sorts of compliance gains or losses could we expect? The political environment surrounding the tax reform proposals being what it is, my guess is that for any proposal to be transformed from an abstract idea into viable legislation, the tax rates imposed would have to increase quite considerably to meet revenue needs.

The third test is whether the proposed system promotes economic growth and stimulates job creation. Our whole economic system, as evidenced by the discussion earlier about the transition from income tax to a flat tax, is built on important assumptions about the taxes that will be imposed in the future—not only the tax that is going to be imposed next year but the tax that is going to be imposed ten years from now. Businesses and individuals have made investments, projected their capital needs and made other plans based on an assumption that our system of taxation will remain relatively stable.

This is not an argument that individual rules in our tax code cannot change. Obviously they do change, although I think a very compelling case has been made for reducing the rate of change in the tax law, even when we know the law is imperfect. A major change in the system, however, could undermine assumptions on which businesses and individuals rely in planning for the future and could create considerable distortions in our economy.

Finally, the fourth principle I described queries whether a proposal would simplify the tax system for the average American. One of the things mentioned earlier today is that something like 70 percent of individual Americans take the standard deduction. They do not itemize their deductions and do not have terribly complex tax returns. Yet many of these individuals still feel the need to consult tax preparers and worry about coming

11 See Julie Tripp, Itemized Deductions, PORTLAND OREGONIAN, Mar. 9, 1998, at E03 (stating that about 70 percent of taxpayers take standard deductions).
under scrutiny by the IRS. I find this quite puzzling. What is their concern about filing their tax returns? Could it be that their worries are informed by something other than the complexity they have encountered in their own tax returns?

These are interesting questions that need to be discussed openly, but about which politicians and experts seem to be reluctant to speak. It takes courage to tell constituents that their fears are not based on the complexity of the law as it applies to them, but upon something else. I will talk a little bit more about that later.

Still, the question remains whether an alternative tax system would be simpler for those who face complexity under the current tax regime, even though there may be fewer of those taxpayers than some would have us believe. The issue is whether it would be politically feasible for Congress to refrain from enacting a host of new exemptions, exclusions, tax credits and so forth, as they have been doing to the income tax for as long as it has been around. One of the popular theories about income tax reform is that the base has to be broadened and rates lowered every ten years or so to give lobbyists something to work on in the future. If Congress removes all those special interest provisions from the law, then lobbyists can bill their clients for getting the provisions re-enacted. I do not want to sound too cynical, but sometimes it seems like that is exactly what is going on. If so, then I am not very optimistic about how much more simple a flat tax or national retail sales tax would be than our current system.

The other tax reform idea that has received considerable attention lately (and I think, unfortunately, is generating a lot more heat than light) is the proposal to sunset the tax code. Why is this proposal being given as much or even more public attention than the national retail sales tax or the flat tax? Simply because it is an easy concept to grasp. People love the idea that they will not have to deal with the tax code. In the current environment it is difficult enough for experts and politicians who share the same political agenda to reach a consensus over what kind of tax system we should have. It may be too much to ask for individuals who do not fully understand the implications to have a view on the best alternative to the income tax. It seems

---

easier to talk about something many can agree on: That the tax code is big and scary.

There are a couple of ways you could characterize the sunset-the-tax-code campaign. The idea on which the legislation is based is that the tax code would expire in the future, by which time Congress would, because of the expiration, have instituted some new and as-yet unspecified system. This merely converts an abstract public sentiment against the tax code into a literal proposal to eliminate it. One could claim the proposal is disingenuous, and is really not intended to be a serious proposal. Rather, one could view it as being intended to generate dialogue. The frightening reality, however, is that until very recently both the House of Representatives and the Senate appeared to favor passing the sunset legislation.

There has been a substantial effort to publicize why the legislation is not a good idea despite its appeal. The same concerns I discussed earlier in the context of the flat tax and the national retail sales tax also apply to sunsetting the tax code. For the proposal to make any sense at all, one has to assume the tax code would be replaced with some other system. Sunsetting the tax code, however, has its own set of serious drawbacks. For instance, incredible uncertainty would prevail during the time between when Congress enacted the sunset legislation and when Congress made a decision about its replacement. What are people who are buying new homes and saving for their retirement supposed to do in the interim? What kind of decisions would business make about investing in plants, equipment, and employees? This kind of uncertainty is something we could not tolerate. Given the potentially devastating ramifications of the uncertainty, it is irresponsible to seriously discuss sunsetting the tax code before we have a viable alternative with which to replace it.

I am hopeful that the growing awareness that sunsetting the tax code is not a viable option will result in greater focus on the more serious proposals. We will have to wait and see.

Nonetheless, other than sunsetting the tax code, it is unlikely that any other major tax reform legislation will be taken up seriously by Congress in the near future. By seriously, I mean a full-blown bill introduction, with actual drafting of specific legislative language, committee hearings and legislative mark-up. In the
absence of consensus on the type of reform to make, no politician is going to advocate specific legislative language that may upset constituents. So what are we likely to see in the way of tax legislation? The answer is "little tax reform." I am talking about legislation like the current bill that is being considered in the Senate to restructure the IRS.13 This is a bill that was based on the work of the National Commission on Restructuring the IRS14 and originally introduced in the House.15 After some negotiation, the Administration concluded that it could agree to the House version of the bill. The bill does two things. It affects the management of the IRS, such as how the IRS's executives function, the kind of rewards given to employees for good service, and how a culture of customer service can be encouraged at the IRS. It also provides new taxpayer rights.

This legislation may be the only realistic vehicle for trying to address the concerns and fears that sparked the movement to sunset the tax code. But will the IRS reform legislation really address the concerns that cause taxpayers to hire professionals to prepare their returns, and worry nonetheless that the IRS will "come after" them? Probably not, although after hearing the horror stories taxpayers told before the Congressional hearings on the legislation, one can only conclude that changes need to be made in the collection and compliance functions of the IRS. One hopes that the legislation can effect those changes. Some of the provisions in the legislation may actually improve the public perception of the IRS and the tax system as a whole by reducing fear of the IRS. That would be a worthwhile result.

There is nothing meaningful in the tax restructuring bill, however, that would actually address the complexity of our tax laws in the way major tax reform is purported to do. This may or may not be an important criticism. It is a question of what kind of problems the political system and policy makers are trying to correct with the legislation.

Today, there has been an interesting development. Senator Roth, chairman of the Senate Finance Committee, finally introduced his version of the IRS restructuring bill. This version is similar to the House bill, but it has some profound differences as well.

The House bill contains a number of provisions about which both the IRS and the Treasury Department expressed some concern. One concern was the management structure dictated for the IRS by the House bill, particularly in that it provided for a special board to manage the IRS.\footnote{Id.} There was concern about the kinds of activities in which the board could engage.

The provisions in the Senate bill regarding the management board are still contentious.\footnote{S. Rep. No. 105-174 (1998) (providing for establishment of IRS Oversight Board within Treasury and setting forth responsibility of Board such as reviewing strategic plans for IRS and ensuring proper treatment of taxpayers). See also H.R. Conf. Rep. No. 105-599 (1998) (discussing make up of Oversight Board).} One of the problems I perceive in the Senate bill (and the House bill as well, although to a lesser extent) is that it has conflicting goals—the need to bring the views and concerns of private citizens to the IRS and the need to protect private citizens in their role as taxpayers from misuse of personal information and other IRS abuses. Although the Senate bill does not allow the management board to participate in law enforcement, the authority of the Senate-proposed management board to obtain information about specific transactions and taxpayers from the IRS is unclear. That is not necessarily a problem if the board consists of government officials who are subject to limits on the disclosure of taxpayer information and who are duty-bound to protect taxpayer privacy. That, however, is not what is contemplated here. Rather, the Senate bill proposes a board made of private individuals and businessmen. To what extent should they have access to private taxpayer information and to what extent can they make judgments without having access to that information? This is a very difficult question and one that is of grave concern to the IRS and others who think about taxpayer privacy.

The other general concern about this board—and certainly I have seen this in my work—is the conflict between ethics and efficiency. Officials who come into government from private busi-
ness invariably have lists of matters from which they must recuse themselves to prevent either an appearance of or an actual conflict of interest. When you contemplate a board of private businessmen who serve only to manage the IRS, you have real questions about how many of these individuals will face a constant conflict of interest between the decisions they are asked to make as board members and their private business or employment concerns. It is a huge impediment to the decision-making process when participants have these kinds of conflicts. The last thing the IRS needs is the addition of another layer of bureaucracy that slows down the decision-making process.

In the category of taxpayer rights, there were some concerns about the shift of the burden of proof from taxpayers to the IRS contained in the House bill. The motivation for the provision was the worry that in particular cases, the IRS may be able to put taxpayers in the very difficult position of proving the negative. For example, many members of Congress have expressed outrage that the IRS could allege a taxpayer had income and then require the taxpayer to show otherwise. It would, however, be very difficult for the IRS to bear the burden of proof in cases where they do not already have that burden. Generally, our system is based on self-assessment and individual willingness to file tax returns, provide evidence about income and deductions and keep appropriate records. Thus, it makes sense generally to place the burden of proof on the taxpayer, because the taxpayer is already obligated to know the facts relevant to his or her tax situation. But it is an over-generalization to say that under current law the taxpayer always bears the burden of proof: There are a number of situations in which the IRS already bears the burden, as exemplified by criminal cases.

One interesting thing about the burden-shift is that it applies only at the trial level. It does not apply during the administrative process. Consequently, if a taxpayer is going through an IRS tax audit, the burden-shift would not apply; and, in the House bill, it would only apply at the trial level to the extent the taxpayer fully cooperated with the IRS in the audit process, in-

---

cluding complying with record keeping requirements.

Another concern about the House bill is that it extends the current attorney-client privilege to accountants and other professionals representing taxpayers before the IRS. That sounds fair and appealing. But the impact of the provision is not fully understood because politicians and policy makers do not necessarily understand what the attorney-client privilege covers. If one does not understand the scope of the currently existing privilege, it may be a mistake to extend it.

It seems that the burden-shift and the extension of privilege to non-lawyer tax professionals will themselves create controversy between the IRS and taxpayers even when taxpayers cooperate and keep the required tax records. Courts are likely to see litigation over a number of issues, such as when the burden of proof would shift. It is unclear how the shift in burden of proof interacts with the extension of attorney-client privilege to accountants. What would happen if all of the taxpayer's records are kept by his accountant? Could one assert the privilege and still be treated as fully cooperating with the IRS?

The bill that was introduced in the Senate also contains the provisions shifting the burden of proof and extending the attorney-client privilege to other tax professionals. In an effort to alleviate some of the concerns about the kinds of disputes that would arise between taxpayers and the IRS over whether the burden of proof would shift to the IRS at trial, the Senate bill removed the word “fully” from the phrase “fully cooperate with the IRS.” I am not sure the change is going to really address the problems with the provision that have already been identified, but it is an interesting shift.

More than anything, my concern is that if you remove the word “fully” from the requirement that taxpayers “fully cooperative with the IRS” during the administrative process, people will wrongly believe that this eliminates their need to deal with the IRS, to keep records, and to come forward with evidence about


21 Id.
their income and deductions. We could then face a major compliance problem, not because the law has changed, but because taxpayers' perception of the law has changed.

There are two other taxpayer rights provisions added to the Senate bill that have already generated wide discussion and will get even more attention. The first is innocent spouse relief.22 We are all familiar with the newspaper accounts of women, mostly divorced, whose husbands have committed all sorts of truly terrible acts against them, and who discover later that the bum did not pay their taxes either. Since the husband is nowhere to be found, and the wife signed joint tax returns for the years in question, the IRS holds the wife responsible for the tax bill. I do not mean to be flippant. These are very compelling stories. Often, you can agree that these women have not been fairly treated by their husbands or the tax system. Their cases have been mishandled by the IRS, with the result that their already difficult problems are compounded. But it seems that with a bit of creativity, current law could be molded to make procedural remedies available to address these problems—remedies such as enhanced notice of tax assessments and restrictions on IRS collection activities.

The Senate bill, however, approaches the innocent spouse problem from a substantive perspective rather than a procedural one. It radically changes the way tax liability is allocated between the members of a married couple. Currently, when spouses file a joint tax return, each agrees to joint and several liability. That means they both owe the tax no matter from whose income the tax is attributable. The Senate proposal provides that in certain cases, however, tax obligations will not be calculated according to that theory of liability. Instead, one would have to figure out how much wages, capital gains, dividends, investment income or other income the wife really had and what her own deductions, exclusions, credits and other adjustments would have been. She would only be liable for tax on that basis, not the tax on her husband's income.

22 Id. The Senate would protect an innocent spouse by allowing a spouse to elect to limit his or her liability for unpaid taxes on a joint return to the spouse's separate liability amount. Id. A plan such as this, however, would require each spouse to divide up income, as well as expenses, which could be a daunting task. Id. See also IRS has New Form and Publication for Innocent Spouse Relief, IRS NEWS RELEASE, Jan. 12, 1999, available in 1999 WL 8755 (discussing IRS response to innocent spouses).
Anyone who is married and who has filed separate tax returns realizes how difficult it can be to divide up family income, deductions and ownership of particular assets. It is both practice and law under the tax code to treat a married couple as a single economic unit. To attempt to divide that economic unit into two individual pieces is going to be tremendously difficult, especially if the division comes years after the income is earned and the deductions are incurred. It is questionable whether this profound change is the most appropriate response to the relatively low number of taxpayers who have valid arguments of unfair treatment under the innocent spouse provisions of current law. It is hard to reconcile the scope of the solution with the magnitude of the problem.

Finally, there is an interesting proposal in the Senate to toll interest charges and penalties on taxpayers when the IRS fails to contact them about delinquencies in a timely manner. The arguments in favor of the provision sound like arguments in favor of making the IRS more competitive and service-oriented: What reasonable business would ever fail to collect a debt within one year? Moreover, is it fair for the IRS to receive interest when they have not notified the taxpayer about the debt? That would be a poor debt-collection practice. For argument's sake, the assertion that the IRS engages in poor debt collection practices may be true. IRS Commissioner Charles Rossotti has admitted that one of the things the IRS can improve on is its debt-collection practices. Taxpayers should not be told for the first time ten years after they filed a return that they owe additional taxes. The problem, however, with using private business models for evaluating how the IRS should charge interest on tax delinquencies is that there are big differences between the IRS and private businesses. First, the IRS must sort out what a taxpayer's true tax liability is. Then the IRS must determine whether the taxpayer has paid the liability. These can be very complicated and time-consuming determinations to make.

The problems with IRS debt collection are probably more ap-

---

23 S. Rep. No. 105-174 (1998) (describing provision that would suspend accrual of interest and penalties after one year if IRS has not sent due notice to taxpayer of deficiency).

appropriately dealt with by changing IRS management than changing substantive taxpayer rights. When an individual fails to pay taxes owed, the individual has borrowed money from the government. This person may not have intended to be a borrower, but he is nonetheless. The relevant consideration in determining whether a taxpayer should owe interest is whether he or she had use of the funds belonging to the government, not whether the taxpayer knew of the obligations. The lack of knowledge might be pertinent to the interest rate imposed, but not to whether interest is charged. Eliminating the interest charge also would create some very odd incentives—taxpayers might purposefully borrow by underpaying their taxes because of the possibility that an IRS mistake could toll interest charges.

One of the results of these differences between the House bill and the Senate bill is that the latter turns out to be much more expensive. The Senate bill is currently estimated to cost about $10 billion more than the revenue it raises. Accordingly, the Senate is either going to have to come up with a way to pay for these two new provisions, or the Senate will have to waive the budget rules that require a tax bill to be revenue-neutral. Waiving the budget rules in the Senate would require 60 votes in favor of the bill. That kind of vote is not beyond imagining, but it does mean that the process becomes a lot more difficult.

So, big tax reform or little tax reform? The little tax reform is more likely, but even that, at least in the form of the IRS restructuring bill, is not a sure thing. Although there has been tremendous pressure to enact the IRS restructuring bill by April 15, 1998, it is probably going to be delayed. What provisions it will contain after conferences, and whether it will be enacted at all, are still open questions.25

Nevertheless, it is interesting to watch the dual tracks of tax reform—the very abstract discussion of major tax changes like the flat tax and the national retail sales tax, and the very detailed and technical, yet very important, changes discussed in connection with restructuring the IRS. It has been fascinating for me

to observe how politically explosive it can be to attempt to make relatively small changes in the management and culture of the IRS. I find it very instructive, though not wholly reassuring, about the future of the tax system.

Thank you very much.