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Focus on Tax Policy: An Introduction

By: Professor Annette Nellen
SJSU MST Program Director

This section of *The Contemporary Tax Journal* includes tax policy work of SJSU MST students. We offer it here and on the journal website to showcase the range of tax knowledge students gain from the program and to provide a public service. We think the analysis of existing tax rules and proposals using objective tax policy criteria will be of interest to lawmakers, staff and individuals interested in better understanding taxation.

One of the learning objectives of the SJSU MST Program is:

To develop an appreciation for tax policy issues that underpin our tax laws.

Students learn about principles of good tax policy starting in their first MST class - Tax Research and Decision-making. The AICPA's tax policy tool, issued in 2001,⁵⁶ which lays out ten principles of good tax policy, is used to analyze existing tax rules as well as proposals for change.

Beyond their initial tax course, SJSU MST students work on tax policy in the capstone course. In other courses, such as corporate taxation and accounting methods, students learn the policy underlying the rules and concepts of the technical subject matter in order to better understand the rules and to learn more about the structure and design theory of tax systems. The MST Program also has an elective course - Tax Policy and Tax Reform.⁵⁷

Two tax policy analyses are included in this section and join the growing archive of such analyses on the journal website (under "Focus on Tax Policy").

- 1) Increase in Standard Mileage Rate for Certain Charitable Work ([here](#))
- 2) Election by Certain Individuals to Have Their Income Tax Return Prepared by the IRS (next page)



⁵⁶ AICPA, *Tax Policy Concept Statement 1 – Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, 2001; available at <http://www.aicpa.org/INTERESTAREAS/TAX/RESOURCES/TAXLEGISLATIONPOLICY/Pages/TaxReform.aspx>.

Professor Nellen was the lead author of this AICPA document.

⁵⁷ Information on this MST course (BUS 225R) can be found at http://www.cob.sjsu.edu/nellen_a/bus225R_reading.html.

Election by Certain Individuals to Have Their Income Tax Return Prepared by the IRS

By: MST Students in Fall 2011, BUS 223A Tax Research Class, Fall 2011

H.R. 1069 (112th Congress) proposes to amend IRC Section 6020, *Returns prepared for or executed by Secretary*, to allow certain unmarried individuals who claim the standard deduction (rather than itemizing deductions) to have their income tax return prepared by the IRS. Individuals using the surviving spouse or head-of-household filing status would not be eligible to make the election. Also, individuals with gross income from a trade or business may not make the election.

An individual making the election can still opt not to have the IRS-prepared return filed. Per H.R. 1069, the IRS "may not use either the election or failure to sign in any way that disadvantages the taxpayer."

The IRS must report to Congress by August 31, 2013, how many returns were prepared under the new rule, whether the program should be expanded to include other taxpayers, and whether any changes are needed.

The sponsor of H.R. 1069, Congressman Jim Cooper (D-TN), states that the purpose of the proposal is to simplify compliance for individuals and utilize information the IRS already has. Per the sponsor: "Make the IRS do your paperwork. They already have much of your tax information like copies of your W-2 and 1099s. Today they use that information to catch you if you make a mistake. Why not get the IRS to use that information to help you instead of punish you?"⁶⁰

The policy analysis below uses the ten principles of good tax policy outlined in the AICPA Statement #1, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals*, to analyze H.R. 1069.

Principles of Good Tax Policy Evaluation

Principle	Application	+/-
Equity and Fairness Similarly situated taxpayers treated similarly.	Within the narrowly defined category of eligible taxpayers - single (other than those using either the head-of-household or surviving spouse filing status), claiming the standard deduction and without gross income from a trade or business, taxpayers are treated the same, regardless of income level. However, not all individual taxpayers with similar income levels are treated similarly. For example, an individual with \$50,000 of wage income may take	+/-

⁶⁰ Congressman Cooper press release of March 15, 2011; available at http://cooper.house.gov/index.php?option=com_content&task=view&id=456&Itemid=73.

	<p>advantage of the election to have the IRS prepare her return, but an individual with the same income who claims the head-of-household filing status, may not make the election. Some of the inequity can be excused though because H.R. 1069 is a trial measure as indicated by the fact that it is a new program and the IRS must report on its effectiveness after one year and the feasibility of extending the program to other taxpayers.</p>	
<p>Certainty The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.</p>	<p>H.R. 1069 does not include the details of how and when the election is to be made, how to ensure that a return is filed and how individuals submit information, such as eligibility for certain credits and special reporting requirements. For example, a spouse in a same-sex marriage in a community property state is required to report one-half of each spouse's community property income and withholding on a return and is not allowed to file as married for federal income tax purposes. Guidance would be needed as to how the information needed by the IRS to prepare the returns would be submitted.</p> <p>Guidance will also be needed on how the IRS obtains information from electing individuals on their sales of capital assets.</p> <p>The IRS will also have to provide guidance on what income from a trade or business means. Does that include a sole proprietorship, a farm, an interest in a partnership or S corporation, a rental property, or any income for which a W-2 or 1099 is not issued?</p>	<p>-</p>
<p>Convenience of Payment A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.</p>	<p>Presumably, individuals would pay their tax in the same manner as without H.R. 1069. If the IRS handles the filing for an individual, but does not also handle calculation of estimated tax payments (if any) for the subsequent tax year, individuals may have large liabilities and penalties when they file the subsequent year's return.</p> <p>H.R. 1069 allows participating individuals the choice of filing the IRS prepared return or preparing their own. Depending on how long it takes for the IRS to provide the return to electing taxpayers, such taxpayers may not have enough time to prepare their own return should they decide to do so after seeing the IRS return. While they can file an extension of time to file, they may need more time to determine how much (if any) they owe to the IRS or may face burdens in getting an extension filed.</p>	<p>+/-</p>

<p>Economy in Collection</p> <p>The costs to collect a tax should be kept to a minimum for both the government and taxpayers.</p>	<p>Costs will increase for the IRS as they will require more employees and computing capacity to prepare returns and communicate with electing taxpayers. The IRS will also need to issue guidance on how to make the election and provide necessary information to enable the IRS to complete a return.</p> <p>Preparation costs should go down for electing individuals. Per H.R. 1069 sponsor Congressman Jim Cooper (D-TN): "It is estimated that around 40 million Americans would be able to use this service saving \$2 billion in preparation fees and 225 million hours of preparation time. Converting that time into money, it is estimated that savings could reach \$44 billion over 10 years."⁶¹</p> <p>Some opponents of IRS prepared returns observe that costs to providers of information, such as employers and financial institutions may go up if Congress were to advance the due date for information returns in order to allow the IRS time to prepare the returns.⁶² H.R. 1069 does not propose to change due dates for filing of information returns.</p>	<p>+/-</p>
<p>Simplicity</p> <p>The tax law should be simple so that taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.</p>	<p>Compliance should be simplified for electing individuals. However, some complexity may exist if an individual does not know if they are ineligible because they qualify for head-of-household status or should be itemizing deductions. Also, since the system is not in place, it is unknown whether the process of individuals providing the information to the IRS and interacting with the IRS will be simple. Given complexity of some notices that the IRS sends to taxpayers and the lack of one responsible person for a taxpayer to interact with, it is possible that individuals may find it difficult to comply with what the IRS requires of them to participate in the H.R. 1069 program.⁶³</p> <p>The aim to simplify and improve compliance will not be fully realized by all participating individuals as many will also need to file state income tax returns.</p>	<p>+/-</p>

⁶¹ Congressman Cooper press release of March 15, 2011; available at http://cooper.house.gov/index.php?option=com_content&task=view&id=456&Itemid=73.

⁶² See letter provided to the Senate Finance Committee by Joseph Cordes, Professor of Economics at The George Washington University and Arlene Holen, Senior Fellow at the Technology Policy Institute, 4/25/11; available at <http://www.techpolicyinstitute.org/files/comment%20to%20senate%20finance1.pdf>.

⁶³ For example, in the 2011 National Taxpayer Advocate report to Congress, it is noted that about 78% of examinations are conducted by correspondence. The report notes that such examinations occur "in a highly automated campus setting where no single IRS employee was responsible for the audit, making it more difficult for the taxpayer to communicate with the IRS about his or her case." IR-2012-6 (1/11/12); <http://www.irs.gov/newsroom/article/0,,id=252284,00.html>.

<p>Neutrality The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>To be effective, H.R. 1069 must change taxpayer behavior to encourage eligible individuals to have the IRS prepare their return, rather than preparing them on their own, purchasing tax preparation software, using a VITA site,⁶⁴ or hiring a paid return preparer.</p>	<p>–</p>
<p>Economic Growth and Efficiency The tax system should not impede or reduce the productive capacity of the economy.</p>	<p>The H.R. 1069 tax preparation proposal will result in some loss of revenue for return preparers as well as for companies selling tax preparation software. Given the small subset of eligible taxpayers and the reality that not all will take advantage of the IRS preparation services, the effect is likely to be low.</p>	<p>+/-</p>
<p>Transparency and Visibility Taxpayers should know that a tax exists and how and when it is imposed upon them and others.</p>	<p>The IRS will need to find ways to let individuals know of the new preparation program and how to participate. Because the IRS no longer mails tax forms and instructions to taxpayers, it may be challenging for the IRS to find effective ways to let individuals know of the program.</p>	<p>–</p>
<p>Minimum Tax Gap A tax should be structured to minimize non-compliance.</p>	<p>H.R. 1069 should result in a small decrease in the tax gap as it may improve compliance and better ensure that all of the W-2 and 1099 forms an individual receives are reporting on the return and that any deductions or credits are properly computed and claimed.</p> <p>The program may result in some individuals paying more tax than they owe (a reverse tax gap effect) because they may not know of special deductions or credits or filing status they are eligible for unless the IRS is able to incorporate some type of questionnaire, for example, that helps individuals determine this information.</p>	<p>+/-</p>
<p>Appropriate Government Revenues The tax system should enable the</p>	<p>The government should be able to estimate the cost of creating a system whereby the IRS prepares returns for some taxpayer and the likely tax revenue to be collected.</p>	<p>+</p>

⁶⁴ VITA stands for Volunteer Income Tax Assistance which is a program run by the IRS where trained volunteers prepare tax returns for primarily low-income individuals. See <http://www.irs.gov/individuals/article/0,,id=107626,00.html>.

government to determine how much tax revenue will likely be collected and when.		
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Conclusion

The aim of H.R. 1069, reducing compliance costs for individuals and reducing the likelihood of missed reporting of W-2s and 1099s, seems laudable. Yet, there are many details to work out, such as creating a system to enable the IRS to notify eligible taxpayers and to prepare the returns timely and accurately.

Possible improvements to better enable H.R. 1069 to meet the principles of good tax policy include:

- Providing funding to the IRS to enable them to comply with the legislative proposal including being able to make eligible individuals aware of the program.
- Piloting the program first in states without an income tax so that the tax compliance burden of electing individuals is reduced. Should the system work, later expansion could be with states that allow a similar program so that individuals are more inclined to elect to use the system because both their federal and state income filing would be simplified.
- Incorporate a system to help individuals and the IRS preparers know if the individuals are eligible for preferential deductions, credits or filing status. Interactive tools similar to what the IRS currently uses, for example, to help individuals know if they are required to file, could be considered (<http://www.irs.gov/ita/>).
- Reduce the likelihood of individuals not knowing what W-2s and 1099s were issued to them but not received by having the IRS provide that information to them prior to filing with enough time for individuals to file. Such a system was proposed by IRS Commissioner Shulman in April 2011.⁶⁵
- Simplify the individual income tax system to make it easier for individuals to file their returns on their own or for the IRS to do so without the need to gather numerous pieces of information.

⁶⁵ See remarks of Commissioner Shulman at the National Press Club, IR-2011-38 (4/6/11); available at <http://www.irs.gov/newsroom/article/0,,id=238204,00.html>.