

IRS Rides the Ups and Downs of Congress

Onetime Critics of Tax Agency's Zeal Now Clamor for Tougher

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WASHINGTON—Four years ago, leaders of the Senate Finance Committee bashed the Internal Revenue Service as heavy-handed and pushed the agency to ease its pursuit of tax dodgers. Audits and penalties, property liens and seizures, declined steadily.

Now many of the same politicians are prodding the IRS again—to be tougher. And audits and penalties are on the rise.

The swing of the political pendulum will be on full display Thursday, when the Senate's tax experts hold a hearing designed to boost IRS tax-compliance efforts. The headline-grabbing witness list includes at least one jailed tax-shelter user and victims of illegal tax gimmicks. Tax agency leaders are being portrayed heroically by the politicians, and are being asked to testify about their pursuit of those villains. A committee press release gives the event this marquee: "Hearing on Schemes, Scams, and Cons... The IRS Strikes Back."

Back in 1997 and 1998, the same committee also held headline-grabbing IRS hearings. At the time, the stars were small-business owners and others who had been the victims of raids by gun-toting IRS agents. The agents, meanwhile, testified behind screens with voice distorters about how they ruined families and businesses in reckless pursuit of back taxes.

"The IRS has used secrecy and intimidation to hide its abuses," Iowa Republican Sen. Charles Grassley, a veteran Finance Committee member, said back then. "That's why it is critical that Congress commit to sustained and aggressive oversight of the IRS in the future."

This year, Mr. Grassley helped organize the coming hearings and makes a point of publicly cheerleading new enforcement efforts. When the IRS announced this past

month it had taken the extraordinary step of cracking longstanding privacy restrictions to obtain more than one million records of offshore credit-card transactions in pursuit of tax evaders, Mr. Grassley issued a press release saying, "I'm glad to see the IRS following up so aggressively."

Throughout American history, political opinions about tax collection have swung between outrage over cheaters and indignation over the government's sometimes-zealous attempts to catch them. Widespread reports of slipping compliance led Congress in the 1980s and early 1990s to boost the IRS budget and urge the agency to step up enforcement. Complaints about the extremes of that campaign in turn led Congress to pass the stringent 1998 laws tying the IRS's hands.

During the past few months, the political focus has turned to a perceived explosion of tax avoidance, with the Enron Corp. scandal giving the issue extra momentum. Even though Enron executives haven't been accused of tax evasion, they have cast a spotlight on dicey financial dealings by rich executives.

And although the IRS is ostensibly an independent agency, such congressional mood swings make a big difference in how it goes about its job.

"If you see the chairman and ranking member of the Finance Committee expressing concern about compliance in a particular area you can be sure the service is going to respond and provide the necessary resources," said Ronald Pearlman, a Georgetown University Law Center professor and a former Treasury tax official.

Beyond mere exhortation, Mr. Grassley, the ranking Republican on the Finance Committee, and Montana Democratic Sen. Max Baucus, the chairman, have become active participants of sorts in the IRS's major investigations into offshore accounts, tax-shelter transactions and other

schemes. Working on a bipartisan basis, Finance Committee staffers have met with IRS officials on more than half-a-dozen occasions in recent months, pushing the agency to act swiftly on offshore credit-card accounts, as well as on tax shelters promoted by Big Five accounting firms and other well-paid advisers.

Officials even are making it clear that the Finance Committee's enormous power now is available to back up the IRS, in

Sen. Grassley explains his support for the IRS as an attempt at 'breaking the back of tax cheats.'

case it runs into problems getting cooperation from the major companies involved. "They've probably been fortified knowing we're behind them..." says one committee aide, adding, "it's been helpful for them to get a clear signal that Finance wanted them to perform their role."

The committee also is using its weight to put gentle but firm pressure on the IRS. Mr. Baucus has asked the General Accounting Office, the congressional watchdog agency, to monitor IRS efforts in pursuing tax avoidance.

Mr. Grassley acknowledges in an interview that his recent acts are "a little out of character." But, he adds, "I see such a drive by people who want to avoid taxes and their ingenuity, that I'm going to opt for a little while on breaking the back of tax cheats."

Personal Whim

enforcement

After hearings in the late 1990s on tax agency abuses, Congress passed far-reaching overhaul legislation that reorganized the agency virtually from top to bottom. It so quickly brought IRS enforcement activity virtually to a standstill—particularly by requiring the firing of agents who violated certain code-of-conduct rules.

Congress also was in the process of slashing the IRS budget, thereby further reducing the number of agents available for audit work.

For the fiscal year ended Sept. 30, 2000, the IRS audited just 0.49% of individual tax returns filed, less than a third of the level of returns audited for fiscal 1996, when the agency looked at 1.67% of returns. The drop was especially sharp among high-income taxpayers, or those making \$100,000 or more. The audit rate fell from 3.21% in 1996 to 0.96% in 2000. In 2000, the IRS conducted just 174 seizures of property against taxpayers—down from 1,449 in 1996.

As the IRS was scaling back its enforcement, dodges including tax shelters and offshore accounts were proliferating. Mr. Grassley says he sees no connection between congressional actions and the rise in tax cheating, however. "I think it's a direct result of the shelter industry," Mr. Grassley says. "That was in progress a long time before 1998. And I think it's got a life of its own unrelated to any reforms."

Some experts disagree. Congressionally mandated reorganization sapped the agency's resources, says Donald Alexander, an IRS commissioner in the Nixon administration, while the provision for firing agents who committed any of the so-called deadly sins "was vast overkill and it

The IRS Is Back in Favor

Four years ago, the Senate Finance Committee bashed the IRS for heavy-handed enforcement and took away agency powers. This week, the same body is urging tax collectors to be more aggressive.



Sen. Charles Grassley

but dislike their American tax obligation. Since tax cheats are endlessly creative, the IRS has to be just as creative to catch the crooks."

Sources: WSI research; IRS

As Congress reversed course...

Sen. Charles Grassley, Chairman, Senate Finance Committee:

October 1, 1997:

"The management culture at the IRS has led to institutional arrogance and abuse of taxpayers. Substantial changes must be made to eliminate the 'we-versus-them' mentality at the agency."

March 25, 2002:

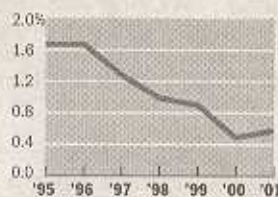
"I'm amazed at the creativity of those who like being Americans

scared the daylights out of IRS people." IRS leaders added to the problem by allocating too many resources to restructuring, Mr. Alexander said.

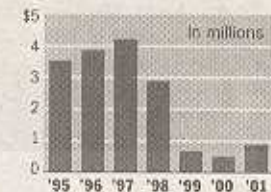
IRS officials say the drop in enforcement was driven largely by shifting congressional priorities, including the long-term staffing cuts, as well as the workload increases, training needs and other changes stemming from the 1998 law. In response to congressional demands for better customer service, some compliance agents also were redeployed to help taxpayers during filing season. Now, with staffing on the upswing, "we aren't just moving an imaginary pendulum one way or another," IRS Commissioner Charles

So did IRS enforcement

Individual audit rate



Levies, liens, and seizures



Rossotti said recently. "We are improving the entire way the IRS works."

During the past year, IRS enforcement actions have started to increase again. In fiscal year 2000, the audit rate rose to 0.58%—still well below levels of the mid-1990s, but the first uptick in years. The number of seizures also increased in 2001, as did liens and levies imposed on errant taxpayers. IRS officials say those figures are expected to keep going up this year and in the foreseeable future.

"As one who is concerned about the effective administration of the tax laws," Mr. Alexander says, "I'm greatly in favor of the current approach."