

Testimony of Helen Hecht, Uniformity Counsel  
Multistate Tax Commission

**NATIONAL TRENDS IN TAX POLICY**

*Responding to Growing Complexity*

Before the New Mexico Legislature's  
Revenue Stabilization and Tax Policy Committee

July 15, 2021

### **HELEN HECHT – BIO**

- 2020 – Current
  - Uniformity Counsel for the Multistate Tax Commission
- 2014 – 2020
  - General Counsel for the Multistate Tax Commission (Washington, D.C.)
- 2009 – 2014
  - Tax Counsel for the Federation of Tax Administrators (Albuquerque, NM)
- 2003 – 2009
  - Of Counsel – Sutin, Thayer & Browne law firm (Albuquerque, NM)
- 1995 - 2003
  - Senior Manager - KPMG accounting firm (Albuquerque, NM)
- 1984 – 1995
  - Various - New Mexico Taxation and Revenue Department (Las Cruces, Santa Fe, and Albuquerque, NM)
  
- Education
  - Juris Doctor, University of New Mexico
  - Masters in Accountancy, New Mexico State University
  - Bachelors in Accountancy, New Mexico State University
  
- Other
  - Member of the New Mexico and U.S. Supreme Court Bar
  - New Mexico Licensed CPA
  - Founding member of the New Mexico Tax Research Institute

### **MULTISTATE TAX COMMISSION**

The Multistate Tax Commission (MTC) is an intergovernmental state tax agency formed in 1967. New Mexico is a founding member of the MTC, enacting the Multistate Tax Compact in June of that year. In addition to compact members, states can also participate in the Commission as “sovereignty” or “associate” members. The overarching goal of the MTC is to facilitate states working together. The MTC’s uniformity committee drafts model state tax regulations and statutes. The joint audit and nexus programs provide services to participating states. (New Mexico participates in these programs.) The MTC also provides training, research, litigation support, and other services, as requested. See the MTC’s website at [www.MTC.gov](http://www.MTC.gov).

***Unless indicated, the views express in this testimony are my own and not the official positions of the Multistate Tax Commission or any of its member states.***

---

## NATIONAL TRENDS IN TAX POLICY

### *Responding to Growing Complexity*

---

First, let me say as I always do—thank you for your continued support of my organization, the Multistate Tax Commission (MTC). And second, since the subject of my presentation is “National Trends in Tax Policy,” you may be expecting that I will speak about what states are taxing and how much, whether taxes are going up or down, and what new incentives states are offering. But that’s not what I’m going to talk about. Instead, I want to talk about what I think is the biggest problem facing all taxing systems—growing complexity—and also what tax policy-makers are doing to respond to that complexity.

#### **Growing Complexity**

In 2013, George Washington University estimated there were over a million people working in the federal tax industry in the U.S. and that the number of pages in a common tax reference service devoted to the federal tax law had gone from 19,500 in 1974 to 72,536 in 2011, an increase of 272%.<sup>1</sup>

In 2015, the federal Joint Committee on Taxation presented a report to the Senate Finance Committee entitled “Complexity in the Federal Tax System.” Like the George Washington University project, the Joint Committee makes the case that the tax law itself is the reason for the complexity of the tax system—that it often tries to do too much or is too often shaped by special interests—but also leaves too many of the details to the IRS to figure out.<sup>2</sup>

But if this is the primary cause of complexity in the tax system, then I would say it’s not limited to the federal government. It’s universal. Many tax rules exist simply because some group of taxpayers was persuasive enough to convince lawmakers of the merits of their position. And, it’s also true that for every word of law enacted, the administrative agency has to fill in the gaps with dozens of additional words, through regulations, instructions, and other guidance. Nor is any of this new. And I believe it’s unlikely to change. It is also my opinion that administrative agencies generally work hard to carry out what they believe was the intention of lawmakers—and they need support for doing that work.

So while there is a case to be made that the tax law itself is unnecessarily complex, I want to focus instead on what I believe are four other important causes of increasing complexity in the tax system and what policy-makers are doing to respond to those causes.

---

<sup>1</sup> “Complex U.S. Tax Code Spawns and Industry,” Face the Facts Project of George Washington University, available here: <https://facethefactsusa.org/facts/when-tax-complexity-puts-dinner-on-the-table/>.

<sup>2</sup> “Complexity in the Federal Tax System,” Joint Committee on Taxation, before the Senate Finance Committee, Mar. 10, 2015, pp. 2-5, available here: file:///C:/Users/heh.MTC/Downloads/x-49-15-4738%20(1).pdf.

### ***Accelerating Technological Changes***

The first, and probably most important source of complexity in our tax systems is accelerating technological change. Technology has made countless new products and services available. This has transformed markets, as demand for these new products and services have displaced other more traditional goods.

For example, technological changes have given rise to digital services, including digital advertising, streaming, and artificial intelligence enabled services, that have greatly increased in profitability in recent years. Another important innovation is blockchain technology. It is this technology that makes “non-fiat” cryptocurrencies (e.g. Bitcoin) possible as well as something called a non-fungible token, which can be used to sell digital products of all sorts while retaining a kind of copyright or proof of ownership.<sup>3</sup>

Technology has also revolutionized how people work and how business is done. Even small businesses can market and sell their products throughout the country and the world over the Internet. And as a result of the pandemic, remote working has become much more common, facilitated by new technology which makes that remote work possible.

These digital products and services often escape both sales and income tax under our current systems for various reasons.<sup>4</sup> Now, policy-makers and tax administrators throughout the world are focusing on questions such as:

- Are sales or profits from new products included in the tax base under existing rules?
- If not, should they be? Can they be?
- What about cross-border transactions—which state or country gets to tax those transactions—and how are they tracked?
- And how do new ways of doing business affect taxes owed?

And, not only is technology changing what businesses and other taxpayers do and how they do it, but the rate of change is accelerating, so that the pressure on existing tax systems to address these and other questions is increasing.<sup>5</sup>

---

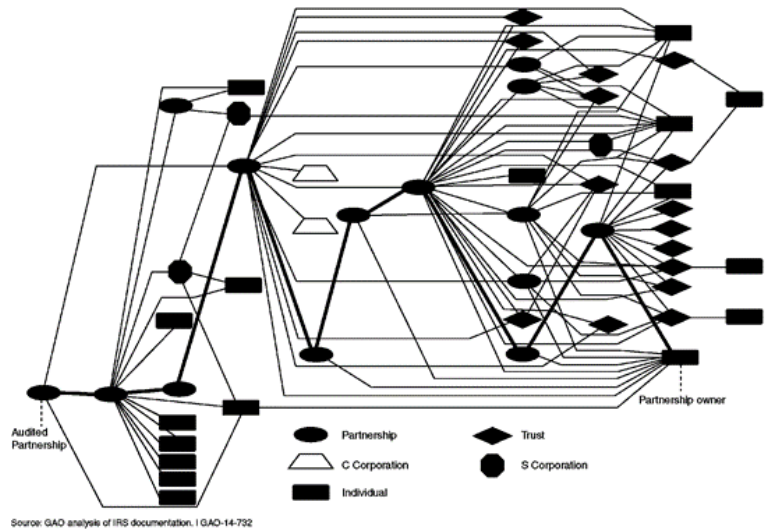
<sup>3</sup> See “Frequently Asked Questions on Virtual Currency Transactions,” Internal Revenue Service, here: <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>, and Tax Administration: Compliance, Complexity, and Capacity, Bipartisan Policy Center, April 2019, available here: <https://bipartisanpolicy.org/download/?file=/wp-content/uploads/2019/04/Tax-Administration-Compliance-Complexity-Capacity.pdf>. See also Walter Effross, Leonard Goodman, Anthony Pochesci, and Jay A. Soled, “Tax consequences of Nonfungible Tokens (NFTs),” *Journal of Accountancy*, June 24, 2021, available here: <https://www.journalofaccountancy.com/news/2021/jun/tax-consequences-of-nfts-nonfungible-tokens.html>; and

<sup>4</sup> See Congressional Research Service, Digital Services Taxes (DSTs): Policy and Economic Analysis, Feb. 25, 2019, available here: <https://fas.org/sgp/crs/misc/R45532.pdf>.

### ***Growth of Complex Partnerships***

When it comes to income taxes, probably the greatest source to complexity is pass-through taxation, especially partnership taxation. Both partnerships and S corporations pay no tax at the entity level. Instead, any income is passed through and taxed to individual or corporate owners. But unlike S corporations, partnerships can create very complex structures, so that the income may have to pass through multiple partnerships before being reported by taxpaying partners. Also, unlike S corporations, partners can generally choose to share income and expense in different proportions, which sometimes leads to abuse.<sup>6</sup>

The graphic here illustrates what I mean by a complex partnership structure. But this is not nearly as complex as many large partnerships today, which are composed of hundreds of related partnerships and thousands of individual and corporate partners. Indeed, the IRS concluded that some partnership structures are complex on purpose—to avoid transparency and presumably make income more difficult to trace.<sup>7</sup>



In recent decades, the amount of taxable income reported by pass-through entities has exceeded that reported by taxable corporations. But because of the complexity of large partnership structures, the IRS has been unable to effectively audit the income generated by these structures to ensure complete reporting. For example, in 2014, the General Accounting Office found that while the IRS audited between 31-95% of taxable corporations with over \$1 billion in assets, the audit rate for similar partnerships was only 7%.<sup>8</sup>

<sup>5</sup> For information on how digital technology has presented challenges for tax systems throughout the world, see information provided by the Organisation for Economic Co-operation and Development (OECD) website page, here: <https://www.oecd.org/going-digital/topics/tax/>.

<sup>6</sup> See the IRS webpage on Recognized Abusive and Listed Transactions, listing three common abusive strategies, available here: <https://www.irs.gov/businesses/corporations/listed-transactions>.

<sup>7</sup> In 2015, the U.S. Treasury Department Office of Tax Analysis published a report entitled, "Business in the United States: Who Owns It and How Much Tax Do They Pay?," setting out the problems of complexity with large partnership structures. See a copy of that report, here: <https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Informational-Project/OTA-Business-in-the-United-States.pdf.aspx>

<sup>8</sup> Government Accountability Office, "Large Partnerships: Characteristics of Population and IRS Audits," GAO-14-379R, Mar 19, 2014, available here: <https://www.gao.gov/products/gao-14-379r>.

### ***Need for Greater Uniformity***

Individual states may have laws that are more complex than others. But the single biggest factor contributing to complexity at the state level comes from the dissimilarity in certain aspects of state tax systems. And since technology now enables even small, local businesses to sell into or operate in multiple states, this complexity affects many smaller start-ups and mom-and-pops. And the more complex the multistate tax system, as a whole, becomes, the greater the level of non-compliance and the greater the risks to these smaller businesses.

Too much diversity in tax systems also causes problems for tax administrators who, because of the uniqueness of their state's laws, may have to develop administrative rules and systems from scratch, which not only takes longer but is more costly and prone to mistakes. For small states, this can be especially challenging since they will need to devote relatively more resources to managing their tax systems than larger states.

### ***Lack of Sufficient Administrative Resources***

The more complexity tax systems face, the more resources administrative agencies need to respond adequately. This lack of resources at the federal level has contributed to the inability to address the federal tax gap.<sup>9</sup> Nor is it a new issue, as the IRS taxpayer advocate noted in a 2011 report: "The most serious problem facing U.S. taxpayers is the combination of the IRS's expanding workload and the limited resources available to the IRS to handle it."<sup>10</sup>

What about the workload of the Taxation and Revenue Department? In the last two years, there have been substantial changes in the state's tax systems, including:

- Mandatory combined filing for corporate income tax;
- Market-based sourcing for purposes of apportioning business income;
- Imposing gross receipts tax on marketplace providers and Internet sellers;
- Change from origin to destination sourcing for gross receipts tax;
- Removing the gross receipts tax exemption for most out-of-state services; and
- Imposing a new tax on marijuana.

---

<sup>9</sup> See Testimony of Charles O. Rossotti, Former IRS Commissioner (1997-2002) before the Senate Committee on Finance Subcommittee on Taxation and IRS Oversight, May 11, 2021, available here: <https://www.finance.senate.gov/imo/media/doc/SFC%20written%20submission%20final05082021.pdf>; and Chart Book: The Need to Rebuild the Depleted IRS, Center on Budget Policy and Priorities, July 2, 2021, available here: <https://www.cbpp.org/research/federal-tax/the-need-to-rebuild-the-depleted-irs>.

<sup>10</sup> National Taxpayer Advocate, 2011 Annual Report to Congress, Vol. 1, p. 2, available here: <https://www.taxpayeradvocate.irs.gov/reports/2011-annual-report-to-congress/full-report/>. See also: <sup>10</sup> "Investing in the IRS and Improving Tax Compliance," April 28, 2021, available here: <https://home.treasury.gov/news/press-releases/jy0150>.

I believe these were positive changes. But I also believe, taken together, these changes are bigger than any in this state's history. They are also as significant as any I've seen a state undertake in as short a time.

Every significant change in a tax system, even a positive change, comes with a cost. The change has to be properly implemented by taxpayers and tax administrators, which is often a lot harder in than I think most people appreciate. The need to properly implement these changes can create problems for years and put businesses and other taxpayers at risk of uneven enforcement.

### **The Obvious and Not So Obvious Problems with Complexity**

Obviously, there is only so much complexity a tax system can handle without breaking down, creating costs that are excessive or issues that cannot be addressed with available resources. This inevitably reduces overall compliance.

But there is another, less obvious, problem with excessively complex tax systems. Studies of the federal tax gap—the difference between the tax owed and the amount that actually is paid—show that this gap is much greater for high-wealth taxpayers who earn significant income through pass-through structures and complex investments. In a recent public statement, IRS Commissioner Rettig noted that this is because these taxpayers have the incentives and the resources to take advantage of the complexity of the tax system by employing sophisticated, often aggressive strategies.<sup>11</sup>

Part of the problem is that while the taxes owed by high-wealth, sophisticated taxpayers may be significant, their numbers represent a tiny fraction of all taxpayers. And their transactions and activities are also often unusual. Policy-makers understandably focus first on the most common issues that affect the greatest number of taxpayers. So, for example, we have a general mechanism for employers to report the wages of employees and withhold taxes, ensuring compliance for a significant percentage of taxpayers. But similar tools have not been devised for ensuring that taxes on investment activities, especially cross-border activities, are properly reported and paid. And the IRS is just beginning to employ its new partnership audit system, which may enable it to conduct more audits of large, complex partnerships. But even when rules are developed to address sophisticated tax planning, those rules are often made generally applicable, requiring compliance by less sophisticated taxpayers as well, making their compliance costs much greater relative to the taxes they owe.

In other words, tax complexity works against small taxpayers, and in favor of larger ones.

---

<sup>11</sup> "Impacting the Tax Gap," Comm'r Chuck Rettig, Apr. 23, 2021 Available, here: <https://www.irs.gov/about-irs/impacting-the-tax-gap>.

## **Responses to Complexity**

Increasingly, policy-makers are responding to the pressure that complexity puts on their tax systems by taking three general approaches to issues—intergovernmental cooperation, committing the right resources to tax administration, and adopting processes that may enable taxpayers to better handle the complexity. What follows is a discussion of some current trends in using these approaches to developing policies that reduce complexity.

### ***Intergovernmental Cooperation***

Competition between governments takes attention away from a much more common and important intergovernmental dynamic—cooperation. Today, no major tax system operates without substantial cooperation between governments. That cooperation is sometimes “built-in” to our systems to such a degree that it goes unnoticed. For example, every state ties its income tax, at least in part, to the federal system. States therefore depend on the federal government to properly administer that system and enforce the tax laws.

Between the states, cooperation can take very different forms ranging from simply taking advantage of other states’ experiences to actively working together to develop model or uniform policies, or to conduct joint enforcement. Cooperation is also a critical tool, and I believe the most important one, for the states in addressing growing complexity.

### **Lessons from Past Intergovernmental Cooperation**

I can’t tell you that intergovernmental cooperation is simple or easy, or that uniform laws will always emerge quickly. Like competition, however, while dissimilarity of tax systems often gets all the attention, there is a constant, if slow, trend toward uniformity. There are two real-life examples that demonstrate that, despite the difficulty and messiness, intergovernmental cooperation can tackle complexity and lead to a better tax system.

#### **Example No. 1 – Taxing Income of Multijurisdictional Companies**

In the mid-Twentieth Century, as U.S. businesses began to grow, states struggled to apply their income taxes to multistate companies. As originally designed, those state taxes required multistate companies to separately compute their income in each state. This meant companies had to “pretend” that their operations in each state were, essentially, self-contained businesses, separate from other operations. As you can imagine, this did not work well.

So a handful of states began experimenting with an alternative, what we now call “formulary apportionment.” Formulary apportionment divides up the total income of a business operating in different states using an average of what are called “factors,” or percentages, based on the business’s in-state to its total activities, tradi-



tionally property, payroll and sales. Formulary apportionment has been blessed by the U.S. Supreme Court.

In the 1950's, the Uniform Law Commission developed a uniform apportionment formula, which today we call UDITPA (the Uniform Division of Income for Tax Purposes Act). At that same time, the federal government began to scrutinize what states were doing and, for several years, threatened to impose limits on state taxes. In response, states uniformly tied their income tax base to the federal base, at least as a starting point, and adopted UDITPA. This movement toward a more uniform system removed the threat of federal intervention, for a while.

Meanwhile, the U.S., like other countries, was still using a version of the system the states had abandoned—separate geographic accounting—to determine the domestic income of multinational businesses. In the 1980's the state and federal systems clashed when some states began applying formulary apportionment to the worldwide income of multinational companies, ignoring the federal calculation of domestic income. The federal government, pressured by its foreign treaty partners, convinced the states to voluntarily agree to apportion only domestic income as determined under federal (and international) rules.

But states had serious doubts that separate geographic accounting would work any better internationally than it had at state level. Sure enough, as time passed and global electronic commerce began to grow, it became apparent that this outdated system could not prevent multinational companies from artificially shifting income to low-tax countries. This led the Organisation for Economic Co-operation and Development (OECD) to begin work on reforms.<sup>12</sup> And, while this was going on, the states were also updating the UDITPA apportionment formula so that the sales factor would generally reflect company's market for services and intangibles.

You have probably heard reports that the Biden administration is now urging the OECD to impose a minimum tax on multinational income, an idea that the organization had been studying as part of its reform efforts. The method that the OECD has been considering to make this minimum tax work is based on one with which the states are very familiar—*formulary apportionment using a market-based sales factor*.<sup>13</sup>

---

<sup>12</sup> Information on the OECD Base Erosion and Profit Shifting (BEPS) project is available here: <https://www.oecd.org/tax/beps/>.

<sup>13</sup> The MTC submitted public comments to the OECD outlining the states' experiences implementing and administering both formulary apportionment generally and the market-based sales factor apportionment formula, available here: <https://www.mtc.gov/The-Commission/News/MTC-Responds-to-OECD-Public-Consultation-Document>.

What I think this first example shows is that the collective problem-solving capability of the states is second to none. Formulary apportionment is not a perfect system for taxing income, but it turns out to be better than the alternative widely used at the national and international level, as states concluded decades ago. This example also shows that states and their intergovernmental organizations can also maintain and update model laws over time, building on the collective work they have done in the past, and they sometimes can do it more efficiently than the federal government or international groups.

#### Example No. 2 – Sales Taxation of Internet Transactions

Again, this second example of intergovernmental cooperation begins in the middle of the Twentieth Century. At that time, very few businesses could sell goods to customers in a state without having some physical presence there (such as an office or salesmen). Consequently, states generally had jurisdiction to require those businesses to collect sales tax on sales to in-state customers.

In the 1960s, mail-order sellers argued that the states where they lacked physical presence could not require them to collect sales tax. The U.S. Supreme Court agreed. But, as years passed, it appeared that the Court's thinking might have changed. So, in the late 1990's, the states asked the Court to overturn its mail-order holding, but the Court declined, ruling once again that sellers without physical presence could not be required to collect tax. The Court was particularly concerned with the burdens imposed by the complexity of diverse state sales tax rules.

After this, the states began a concerted effort to reduce this complexity by creating a common framework of rules and definitions. This eventually led to the Streamlined Sales and Use Tax Agreement (Streamlined), that a number of states signed onto. These state efforts also helped give rise to technology that could assist with multistate sales tax compliance. But by that time, it was not mail-order sales that concerned the states, but the rapid growth in online sales.

Since state authority was still limited, they began exploring ways to collect the tax from consumers directly. This was difficult because most consumers don't keep records of their remote purchases or have information on what purchases are taxable. Then, over a decade ago, Colorado imposed requirements on Internet sellers to provide information reports and notices, helping consumers pay the tax owed. Soon after, the MTC drafted a similar model law. Colorado's requirements were quickly challenged, but were ultimately upheld. More importantly, in that process, the Supreme Court signaled it was finally ready to reconsider its earlier rulings.

The states cooperated in arguing their case to the Court, which overruled its prior cases and held that states could impose tax on Internet and other remote sellers.<sup>14</sup>

It's not clear exactly what changed the Court's thinking, but it's likely that one factor was the availability technology to help deal with the burden of multistate tax reporting. Another related factor was likely the work states had done through the Streamlined project.

While the states were waiting for Supreme Court to act, they were also considering another issue—whether marketplace providers might collect and pay sales taxes on sales made by marketplace sellers. This would simplify tax reporting, especially for small sellers. Because of this work, after the states were given the green light by the Court, they were ready to implement this idea as well, using best practices.<sup>15</sup>

The take-away from this second example is that, when states are facing a common challenge, intergovernmental cooperation may be more than just the best option, it may be the only option. And, while a solution may take time to achieve, that time can often be put to good use, as long as states continue to push in the same direction.

### Opportunities for Future Intergovernmental Cooperation

As it happens, the MTC's uniformity committee is currently working on two joint-state projects that seek to tackle two of the particularly complex problems currently facing tax systems discussed above—the taxation of partnership income and sales tax on digital products and services.

#### *State Taxation of Partnerships*

As I noted above, partnerships are taxed on a pass-through basis, which is more complicated than imposing tax at the entity level, and partnership structures are also growing in size, profitability, and complexity. This is also an area of state tax systems that has been called “underdeveloped,” which I think is an understatement.

The states are not alone in needing to address the complexity of the partnership tax system. In recent years, the IRS has admitted that it has been virtually impossible to do effective audits of large complex partnerships. In 2015, Congress passed the Bipartisan Budget Act, which included a new process for the IRS to audit partnerships, determine any adjustments, and assess tax at the partnership level. This, in turn, required changes in state law so that states would have the means to assess state tax that might also result

---

<sup>14</sup> *South Dakota v. Wayfair*, 585 U.S. \_\_\_, 138 S. Ct. 2080 (2018).

<sup>15</sup> See the MTC *Wayfair* Implementation and Marketplace Facilitator work group project and Final White Paper, available here: <https://www.mtc.gov/Uniformity/Project-Teams/Wayfair-Implementation-Informational-Project>.

from these federal partnership-level adjustments. The MTC worked with the American Institute of CPA's, the American Bar Association, the Counsel On State Taxation, the Tax Executives Institute, and others to come up with a model state law for this purpose, which New Mexico and a number of other states have recently adopted.<sup>16</sup>

Now, the MTC has begun a new project to address state taxation of partnerships more generally. This project is just starting, but we expect that it will focus on a number of issues including how to source both the income generated by large, complex partnerships and gains from the sales of partnership interests, how to implement effective administrative processes including updating withholding and composite return rules, and how to impose entity level taxes, an option that a number of states are now offering.

I think this is a project where there is already a fair bit of uniformity—with states largely conforming to federal tax law and using formulary apportionment principles. But what is missing in most states are the detailed, specific rules for addressing particular facts and circumstances, and the processes and administrative tools to make the system work.

#### *Sales Taxation of Digital Products*

The MTC is also considering a joint state project that would address the complex problem of applying the traditional sales tax to new digital products and services. We expect that the staff of the Streamlined governing board will also participate.

The project was proposed by Washington state at a recent MTC meeting—recounting that state's experience taxing digital products and services and what they recommend other states do, and don't do.<sup>17</sup> I was particularly interested in Washington's recommendation that, rather than itemizing specific types of digital products or services subject to tax, states instead should broadly impose the tax on such items and then specifically exempt items that states might choose not to tax. In case you're wondering where else you've seen that approach, it's also the general approach New Mexico has always taken to imposing its gross receipts tax on property and services.

One of the most complex questions in taxing digital products and services is determining where the sale should be sourced for tax purposes. Of course, New Mexico has had some recent experience in implementing destination sourcing for these kinds of items under the gross receipts tax, and those rules were based, in part, on general rules put forward by the Streamlined project.<sup>18</sup>

---

<sup>16</sup> See New Mexico SB 410, 2021.

<sup>17</sup> Washington's presentation is available on the MTC website, along with related information on the project, here: <https://www.mtc.gov/Uniformity/Standing-Subcommittee>.

<sup>18</sup> I should also note that some states are considering a gross receipts tax targeted at digital advertising as an alternative to sales tax. Maryland recently enacted such a tax but it has been challenged in court and we are

These kinds of uniformity projects are not just about drafting model statutes, they are also about sharing resources and information between states, learning from experiences of other states, identifying new issues, and developing better administrative tools. I believe New Mexico would get a lot out of actively participating in both of these projects.

### ***Right Resources***

As I noted above, it takes adequate resources to deal with complexity facing tax administrators. Many state tax administrators have been closely watching what is going on at the IRS. In recent months, there have been debates over exactly how much additional revenue the IRS could bring in if it were given additional funding—with estimates ranging from a total of \$350 billion to over \$1 trillion.

But no one disputes the fact that IRS funding has fallen below what is necessary to achieve acceptable levels of tax enforcement. Last year, the Congressional Budget Office reported that:

- The IRS's appropriations have fallen by 20 percent in inflation-adjusted dollars since 2010, resulting in the elimination of 22 percent of its staff. The amount of funding and staff allocated to enforcement activities has declined by about 30 percent since 2010.
- Since 2010, the IRS has done less to enforce tax laws. Between 2010 and 2018, the share of individual income tax returns it examined fell by 46 percent, and the share of corporate income tax returns it examined fell by 37 percent. The disruptions stemming from the 2020 coronavirus pandemic will further reduce the ability of the IRS to enforce tax laws.<sup>19</sup>

Nor can anyone dispute that the IRS's job has become more complex. In 2017, Congress passed the Tax Cuts and Jobs Act, described by many as the largest tax reform package in three decades. Implementing this act occupied the IRS, with its reduced resources, for over two years. Just as that was wrapping up, the agency was tasked with getting out pandemic aid, while its own employees were working from home. Undoubtedly, it now has a backlog of work that will exceed its available resources for the foreseeable future.

And no matter what the tax gap really is, and no matter how efficiently the IRS might use the additional funding to address enforcement and compliance, there is also no one who genuinely doubts that collecting taxes owed is better than raising taxes on those who are already complying.

---

following that litigation. The lawsuit, in part, argues that the tax violates the anti-discrimination clause of the Permanent Internet Tax Freedom Act because it does not tax traditional advertising as well.

<sup>19</sup> Trends in Internal Revenue Service's Funding and Enforcement, Congressional Budget Office, July, 2020, available here: [https://www.cbo.gov/publication/56467#\\_idTextAnchor037](https://www.cbo.gov/publication/56467#_idTextAnchor037).

As IRS Commissioner Rettig said in remarks to the Senate Finance Committee on June 8:

“The tax gap has many underlying causes, including complexity, opaque sources of income and insufficient IRS enforcement. Budget cuts over the past decade have resulted in an agency that lacks the capacity to address sophisticated tax evasion efforts.”

One last note on this subject—some experts, including past IRS commissioners, have commented that, even with additional funding, it will take years for the IRS to restaff, due to the time it takes to recruit, interview, hire, and train new professionals. In addition, as with all tax administrative agencies, the IRS must compete against private employers who can generally offer much higher compensation for the expertise that the IRS is looking to add. Which just goes to show that it takes more effort to substantially repair a tax agency than to properly maintain one.

The reason I focus on these discussions about the need for IRS funding is that, in my experience, I think many state tax agencies are facing similar challenges.

### ***Processes Enabling Taxpayers to Handle Complexity***

Of course, complexity in the tax system burdens not just tax administrators, but taxpayers. Having the right administrative resources is necessary for taxpayer assistance, as well as tax enforcement.

But there are other ways to lessen the burdens of complexity on taxpayers. One way is to make the process for resolving tax disputes simpler and fairer. Six years ago, New Mexico followed a number of states and adopted an independent administrative hearings office to handle tax protests, that is, tax disputes where the taxpayer chooses not to litigate in the district court. I commend this office and the work that they have done, and I believe that this process has been a success in helping to ensure that the resolution of tax disputes is fair, in both reality and in perception.

While the tax protest process is less formal than litigation in the district court, and is likely to be somewhat simpler and less costly, there are other processes—commonly called alternative dispute resolution—that are designed to be even more efficient. Such processes vary in a number of ways including:

- Timing – when the dispute can be raised and resolved through the process (e.g. prior to or after assessment, prior to or after filing a formal protest or appeal, etc.);
- Scope – what types of issues are eligible for the process;
- Agreement – whether both parties must agree to the alternative process;
- Process – how the mediator or other facilitator is selected and how the process of resolving the issue works;

- Rules – the formality or informality of the process;
- Speed – whether the process is designed to reach resolution within a shortened time period;
- Confidentiality – whether information made part of the process is confidential;
- Independence – whether the process is part of or independent from the tax agency; and
- Whether and to what extent the result is binding on the parties.

The IRS has long had an independent appeals process that seeks to resolve disputes, particularly involving IRS audits, and ensure that IRS positions are clear and correct, and taxpayers have the opportunity to respond and provide information.<sup>20</sup> States are also beginning to adopt alternative dispute resolution processes, especially in matters that can be more simply resolved.<sup>21</sup>

I believe that New Mexico should consider a pilot project to create a mediation or alternative dispute resolution process aimed at reducing the cost to taxpayers as well as the Taxation and Revenue Department's workload. One important additional benefit of such processes is that, because they operate more efficiently, they can also serve to raise issues sooner and provide information on what issues need further guidance or clarification. I would be happy to work with the department and the administrative hearing office to draft a proposal for this purpose.

### **Conclusion**

The problem of complexity facing all tax systems stems from common sources, including changes in technology and markets, complex taxpayers and structures, a need for more uniformity, and a lack of administrative resources. To address this complexity, tax policy-makers are increasingly looking to intergovernmental cooperation, committing the right administrative resources, and developing particular processes that enable taxpayers to better handle the complexity. But, as I noted at the beginning of my testimony, some experts believe the main source of complexity in the tax system is the system itself—the complicated web of laws and rules that seems to grow and expand over time. While I believe this is simply a characteristic of our tax system and the process by which it is

---

<sup>20</sup> See information on the IRS appeals process, here: <https://www.irs.gov/appeals>.

<sup>21</sup> See, for example, information on the Massachusetts Early Mediation Program, available here: <https://www.mass.gov/administrative-procedure/ap-635-early-mediation-program>; information on the Utah Tax Commission mediation process, available here: <https://tax.utah.gov/commission-office/appeals/mediation-process>; information on the Oregon Tax Court mediation process, available here: <https://www.courts.oregon.gov/courts/tax/help/Documents/TAX-MediationHandbook.pdf>; and information on the Texas property tax arbitration process, available here: <https://comptroller.texas.gov/taxes/property-tax/arbitration/index.php>.

created, I would also encourage lawmakers and administrators to candidly face the costs that additional complexity impose on governments and taxpayers.