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# Education Or Regulation — *Which Road Will The Government Take Toward Closing The Tax Gap?*

The June 2005 issue of *Agency Sales* ran an article about the potential impact on the small business community of the IRS's attempt to close the tax gap through more rigorous enforcement activities. While we all share in the cost of tax avoidance and dishonesty and believe in tax compliance, small business should not have to bear an unfair proportion of taxes, regulation or audits. The following testimony of John Satagaj, MANA's corporate counsel and president of the Small Business Legislative Council (SBLC) was given on behalf of small business to Congressman Don Manzullo's House Small Business Committee on April 27, 2005.

Note, among other remarks, John's comments on proposals to create withholding on payments to independent contractors. After Satagaj's testimony, IRS Commissioner Mark Everson indicated that he did not think withholding from payments to independent contractors was a good idea (in response to a question from Chairman Manzullo).

Dues from MANA, AIM/R, NEMRA and other rep associations help to fund SBLC's efforts to keep reps in the small-business community competitive, and this is one reason you need to encourage non-members to join MANA and our industry-specific, sister associations.

## **Statement of John Satagaj, President of the Small Business Legislative Council, Before the House Small Business Committee Legislative Hearing On The Tax Gap**

Mr. Chairman, Ranking Member Velázquez, and members of the Committee, my name is John Satagaj, and I serve as president and general counsel for the Small Business Legislative Council (SBLC). SBLC is a permanent, independent coalition of nearly 60 trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of small businesses in such diverse economic sectors as manufac-

turing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. Our policies are developed through a consensus among our membership. Individual associations may express their own views. I wish to thank the Committee for the invitation to testify on the issue of the tax gap.

While we all can agree that there is a tax gap and there are individuals, large corporations and small

businesses out there that are not paying their fair share of the tax burden, we do believe the statistics tell the story of why that is so, and as a result it appears we and the IRS have different views on what to do about it.

SBLC firmly believes that education is of vital importance when it comes to collecting taxes. While enforcement is also needed, it should not be at the expense of education. We believe that most people are law-abiding citizens who want to do the right thing. The Regulatory Flexibility Act, with which everyone in this room is familiar, was passed to stop the federal government from painting everybody with the same

broad brush when it comes to “fixing” a problem. One has to strike the right balance between making everybody miserable just to catch a few bad apples, and accomplishing a public policy goal.

The IRS needs to find the balance between enforcement of the tax code and tax education. No amount of enforcement is going to result in 100 percent compliance with the tax code; and over-aggressive enforcement or unfair burdens placed on small businesses stifle innovation and growth in the small-business community, the leading creator of jobs in our country.

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John Satagaj, president of the Small Business Legislative Council (SBLC), is a partner in the Washington, D.C.-based law firm of London and Satagaj. He has held several positions in the Office of Advocacy for Small Business, U.S. Small Business Administration, including Special Counsel to the first Chief Counsel for Advocacy, where he worked on the development of now landmark small-business legislation.

## Education and Enforcement

The logical goal of any tax collecting agency is to collect money from taxpayers to fund the government. However, the IRS has an additional goal to motivate taxpayers to pay their taxes voluntarily. Former IRS Commissioner Mortimer Caplin expressed this over 40 years ago when he said:

“We cannot forget that 97 percent of our total revenue comes from self assessment or voluntary compliance, with only three percent coming directly from enforcement. Our chief mission is to encourage and achieve more effective voluntary compliance. Accordingly, we should concentrate our attention and efforts on getting the greatest possible number of taxpayers to voluntarily file returns, to report what they should report, and to pay their taxes in the amount they should pay. In turn, the activities of our professional people in Audit, Collection, and Intelligence should be aimed primarily at securing voluntary compliance — not primarily at quantitative goals in terms of cases and dollars.

It was this feeling that was reaffirmed by the National Commission on Restructuring the IRS when they published their report in 1997 that led to the “Tax Payers Bill of Rights” also known as the “IRS Restructuring and Reform Act of 1998.” In their report the Commission stated that “The Commission believes that good customer service and taxpayer education, which assists taxpayers in meeting their tax obligations to the government, leads to increased compliance.”

The message now being delivered to the small-business community from the IRS is that education is no longer a priority and that enforcement is the way to increase compliance. We at SBLC fear that by focusing on enforcement, at the expense of education, the pendulum will swing back to the days of the 1990s and before when taxpayers were guilty until proven innocent.

From our perspective, the pendulum swing in favor of the taxpayer was of short duration, the pendulum swing now proposed by the IRS appears to be long and steep!

One of the great successes of the IRS Restructuring and Reform Act of 1998 was the creation of the Small Business/Self Employment Division and its Taxpayer Education and Communication (TEC) section. We at SBLC believe that a greater emphasis on education can have a significant impact by helping to

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bring in those individuals that want to pay their taxes but for one reason or another are not doing so. That is why we were disheartened recently to learn that TEC is being cut substantially and many of the employees there will be moving into enforcement roles.

TEC's mission is to educate and inform small-business and self-employed taxpayers and representatives about their tax obligations by developing educational products and services focusing on the needs of small businesses and the self-employed. In doing this they have consistently provided top quality pre-filing services to help taxpayers understand and comply with the often complex tax laws.

TEC also provides leadership and direction in the design, development and delivery of services for small-business stakeholders. Activities of TEC staff include formulating short- and long-range program policies, strategies, and objectives to educate and inform stakeholders. TEC also coordinates program activities with other top-level IRS executives to prepare service-wide policies, address cross-functional issues, develop strategies, and ensure consistency of approach. TEC collaborates with major stakeholders to identify, develop and maintain leveraged partnerships through negotiated voluntary agreements.

For this reason and many more, TEC was named the Small Business Administration's (SBA) Agency of the Year in 2002 for its outstanding progress in creating an effective education and compliance assistance program for small businesses and the self-employed.

Over the past few years TEC and SBLC, with our colleagues at the National Federation of Independent Business (NFIB) and the Chamber, have hosted a bi-monthly small-business forum where small-business leaders come together to meet with the IRS and hear about their latest programs. It also serves as a valuable resource for small-business leaders to discuss issues affecting the small-business community. Will this staff and resource reduction force TEC to end these forums? What will be the impact of this restructuring on a state-by-state level, and at any given time how many people will be available to assist the small-business community? How many people will be doing education and research on the state level? I urge Congress to make these inquiries. With these reductions we fear that the successes over the years of the IRS through the Small Business/Self Employment TEC Division will be turned back and those seeking assistance will be turned away, all for the sake of greater enforcement that may not have been neces-

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sary if someone had been there to answer a question or proactively reach out.

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### Withholding

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We believe that proposals that call for withholding from independent contractors, either contracted by the government or small businesses, place unfair burdens on both the small-businessperson and the independent contractor. This idea would threaten the very existence of independent contractors and be a burden to those that engage independent contractors. We at SBLC firmly believe that individuals should have the right to choose to be independent contractors, and those small businesses that choose to engage independent contractors should have the free and unfettered ability to do so.

In a recent Joint Committee on Taxation (JTC) report to Congress, the JTC recommends a three percent withholding on all payments for goods and services made by all branches and agencies of the Federal government and all units of state and local governments, including counties and parishes. Why is this needed? If the proper paperwork is filed by the government, doesn't the IRS then know who should be paying and who isn't? In the case of a small business engaging an independent contractor, an IRS form 1099 is filed for all payments made. Does the IRS match up the 1099s to taxes paid? What percentage of 1099s are checked for compliance? To require that a small business withhold say five percent, as was suggested by Taxpayer Advocate Nina Olson in her 2004 report to Congress, would be unfair to the small businesses engaging the independent contractor as well as to the independent contractor. Many small businesses are one-person operations, and to be burdened with the task of collecting money for the government would be time-consuming. Also, in some cases the

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amount withheld would be more than the profit on the service performed, thus making some jobs a money-losing proposition for the independent contractor.

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#### **Simplicity**

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Does the IRS have any figures on how much income is underreported because people do not understand the tax code? It is important to understand why there is noncompliance with the tax code. The complicated and often contradicting laws that make up the tax code form a barrier in many cases to compliance with the tax code. Inadvertent errors and confusion are often caused by complex laws. These same complex laws also contribute to intentional noncompliance. Many that do not understand the tax code may per-

ceive unfairness in the code. Studies have shown that these same people use this feeling of unfairness to justify their noncompliance to themselves.

One action that would go a long way to make tax return preparation easier and increase compliance would be to eliminate the alternative minimum tax.

The President's Commission on Tax Reform is currently studying the tax code and we look forward to their recommendations. It is our hope that through reform suggestions from the panel and action from Congress that the code will be simplified.

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#### **Conclusion**

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Mr. Chairman, in conclusion I wish to once again thank you for the opportunity to be here today. The SBLC looks forward to working with the Committee in the future to find ways to increase compliance through education and also to help small businesses grow so that they can create more of the jobs that our nation depends on.

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