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SIGNIFICANT DEVELOPMENTS IN FEDERAL TAX ADMINISTRATION DURING 1965

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INTRODUCTION

I am always flattered to receive an invitation to speak to a group of tax practitioners. Although I am not completely unfamiliar with the technical side of tax administration, I must admit that I try to avoid it whenever possible. So, as I told Tom Atkeson when he invited me, I am always a little bit sensitive about my ability to make a contribution to the typical tax institute program.

But quite aside from his persuasive abilities—which are considerable, and the thought of spending the day here in Williamsburg—which is a very pleasant idea, I welcome this opportunity to review the important developments in federal tax administration during 1965.

Although an important part of your job and the Internal Revenue Service's mission is to interpret the Internal Revenue Code, the non-technical aspects of tax collection are also of vital interest to us both. As tax practitioners you deal with the Service on a day-to-day basis. You know our strengths and weaknesses and you know how well we respond to your client's needs. And, in all candor, your attitude about administrative plans and programs is extremely important to the Service. If you like what you see and hear, if you think we are going in the right direction, your clients can be expected to adopt the same attitude.

With that short rationalization for my existence out of the way, I would like to deliver my version of the Revenue Service "State of the Union" message for 1965.

As a prelude to my description of specific programs, I think you will be interested in some overall figures. A comparison of fiscal year 1964 and fiscal year 1965 reveals that:

Gross collections soared to \$114.4 billion despite a tax reduction—more than \$2 billion above last year's all-time record;

Returns filed increased by 2.4 million;

100,000 more delinquent returns were secured and the total amount collected from this source increased by \$6 million;

Disposal of taxpayer appeals increased by about 2,000 cases;

Additional taxes and penalties recommended by examining officers reached \$2.7 billion, or \$179 million more than last year's record sum.

As operating results go, these statistics are impressive. But they also reflect the most important challenge facing tax administration today—a

growing population and a vigorous, booming economy. I will have more to say about this when I discuss the Service's automatic data processing program.

New Commissioner

The first 1965 development I want to mention, though, goes back to January 25, when President Johnson appointed Sheldon S. Cohen as the 35th Commissioner of Internal Revenue. If you attended this institute last year, you will remember Sheldon as the bright, young Chief Counsel of the Revenue Service who talked to you about the Revenue Act of 1964. Before he was appointed Commissioner, the Revenue Service was his client—his only client—for over a year. During that period, Sheldon gained an overall knowledge of Service programs, goals and activities. As us old bureaucrats would put it, he was really no problem at all to break in.

Sheldon has done a magnificent job since he took office. He has taken hold of the reins tightly and has made a tremendous impression on all of us who work with him. I predict that he is destined to be one of the most effective Commissioners in the history of the Revenue Service.

Long Committee

I cannot discuss 1965 developments without mentioning the Organized Crime Drive and the "Invasion of Privacy" hearings now taking place.

The Senate Subcommittee on Administrative Practices and Procedures is engaged in a continuing investigation of the Internal Revenue Service's programs, especially its participation in the organized crime drive—a program coordinated by the Department of Justice. In order to cooperate completely and to be fully responsive to the Subcommittee, we conducted an exhaustive review of our enforcement programs, particularly the use of investigative equipment and techniques.

We learned that some instances of use of improper investigative techniques have indeed occurred within IRS. We found out that a few overzealous investigators have overstepped the bounds of propriety in their efforts to develop organized crime drive cases. Internal inquiry showed, however, this had happened *only* in organized crime drive cases—and in very, very few cases at that.

We are taking vigorous corrective action to assure that it doesn't happen again. We have issued new instructions—with teeth in them—to all investigative personnel. We are also effecting closer, improved supervision in this program. In addition, Commissioner Cohen appointed a high-level committee to make an internal investigation, and to come up with specific recommendations.

Perhaps the most difficult task for everybody concerned is to keep this matter in proper perspective, and to resist the impulse to over-react.

It is important to remember that irregularities occurred in only a tiny fraction of OCD cases. But—because of the “newsworthy” nature of the subject, it has been blown up out of all proportion to Internal Revenue’s overall enforcement efforts. Furthermore, we are deeply concerned over the effect of this whole business on the most important thing we have going for us—the confidence of the American people.

In the proceedings of the current Subcommittee inquiry, it has been alleged by witnesses that there has been a pattern of harassment and spying on ordinary taxpayers by the IRS throughout the country. Except for these unsupported statements, no evidence has been brought to our attention that these devices have been used against taxpayers other than racketeers. We are confident that they have not been used except in the organized crime drive.

I think I can sum up our position in this way:

First, we in the IRS are sensitive to the need for respecting the constitutional rights of *all* citizens.

Secondly, the ordinary taxpayer need have no apprehension about methods used by the Revenue Service. There has been no spillover from our defense against organized crime to our dealings with noncriminal taxpayers. We have always been and we remain sensitive to the obligation to treat taxpayers decently and courteously.

ADP—Direct Filing

On January 1, 1965, a milestone was reached when the business master file under the Service’s automatic data processing system became operational nationwide.

In my opinion, the installation of a nationwide data processing system is perhaps *the* most important undertaking in the history of the Internal Revenue Service. It is crystal clear to me that without the highspeed manipulations of data and mass storage capabilities made possible by ADP, we could not hope to keep up with our increasing workload.

Since the first of the year, for the first time in history, the Service has a central file of all business taxpayers. It is now virtually impossible for an employer, once recorded on the master file, to “disappear” into another business guise across a state line; to avoid detection for failure to make timely deposits of Federal taxes; to get away without filing a return; or to obtain a tax refund while indebted to the Government. I think you would be interested to know that so far, in just two regions, the system has succeeded in offsetting over \$36 million in refunds against outstanding accounts in the names of the same taxpayers.

Eventually, of course, we will have on magnetic tape a master file of all taxpayers—individual taxpayers as well as businesses. Right now, the Southeast Service Center, in Chamblee, Georgia and the MidAtlantic Service Center at Philadelphia are fully processing individual returns,

and by 1967 all seven service centers will become part of a complete and unified system.

The next step for us, however, is to have taxpayers mail their returns directly to a regional service center, instead of to a district office. We estimate this would save upwards of \$3.8 million a year in administration costs, and will speed up processing of tax returns and refunds, especially. Legislation on this was introduced in the first session of the 89th Congress. However, the Congress—and particularly the Ways and Means Committee—was so busy that it didn't get around to acting on the centralized filing bill in 1965. Recently, Chairman Mills of the Ways and Means Committee issued a press release soliciting the written comments of all interested persons on the bill. We interpret this to mean that the bill will come up early in 1966.

During the 1965 income tax filing period, direct filing to a service center was tried successfully in seven Southeastern states. Taxpayers expecting refunds were given the option of mailing their returns directly to the service center. All told, more than four million individual 1040 and 1040A returns were sent directly to Chamblee on a voluntary basis.

While on the subject of automatic data processing, I want to acknowledge some complaints we have received to the effect that service under the new mechanized system is not as good as it was under the old manual system. I have been told that taxpayers and tax practitioners are being put to a lot of needless trouble as a result of notices and inquiries generated by the computers. In following up on these criticisms we have made some interesting discoveries. In fact, we have concluded that the new system, in the main, is working well and is producing results we anticipated when we decided to install it.

We are doing a lot of things that have needed doing for the last generation and that we haven't been able to accomplish by old-fashioned manual methods. Many of the contacts about which complaints have been received arise from this expansion of various compliance programs and the increased processing capability made possible by the ADP system.

In the course of our efforts, we have, of course, made our share of mistakes. You just do not automate a system like this and get it working perfectly in a year or two. Our master file has been characterized quite accurately as the most complicated system of its type in the world. Our technicians have tried to anticipate all of the situations, many of them rare and unique, which arise, and instruct the computers in advance on how to deal with them. They have not always been successful and machine malfunctions have resulted.

Errors have also been made by our people. Not many realize that the seven service centers, in which the data is processed, are really people-oriented installations. Each of these centers has a small-scale computer,

but less than fifty people in each center work directly with the computer. In the typical center during the peak filing season, there are about 2,000 employees preparing the data for the computer by coding information from returns and keystroking it into punched cards. These people, like all human beings, make errors just as will any clerical force. We believe, however, that our error rate compares very favorably with anything in the commercial world or elsewhere in Government.

The pilot installation in the Southeast Region was intended for the specific purpose of identifying trouble spots and ironing out weaknesses before expanding the program to other parts of the country. So it is perhaps not surprising that these errors have shown up. We are concentrating on them and we hope to develop procedures to reduce them to an absolute minimum. In the meantime, we solicit your patience and understanding.

Joint Committee Cases

In April of this year, the Service announced a major change in procedures for the processing of Joint Committee refund cases. As you know, the Code requires that before the Service can make a refund in excess of \$100,000, the case must be submitted to the Joint Committee on Internal Revenue Taxation for review.

Under the Service's old procedures, Joint Committee cases were subject to special audit and documentation requirements, and received several successive reviews before being reported to the Joint Committee. It was not unusual for as much as 12-14 months to elapse before the refund was actually issued.

In conjunction with the Joint Committee Staff, the Service launched a comprehensive study of the old procedures and came up with several major recommendations for change. The two most important benefits we hope to derive from these changes are:

(1) A dramatic reduction in review time. We expect to curtail the elapsed time for processing these cases from 12-14 months, down to 4-6 months.

(2) Substantial manpower savings and reduction in processing costs. After we work our way out of the heavy backlog of cases now in the pipeline, we anticipate annual savings of about \$850,000. In addition, we expect to save the Government about \$2 million per year in interest costs.

Although I don't have time to get into the details of the new procedures, let me briefly summarize the most important changes:

First, we have eliminated all the special documentation requirements we previously required.

Second, cases agreed upon at the District level will no longer be subject

to review by the Regional Appellate Office and the Chief Counsel's office. These cases are forwarded for a thorough procedural and technical review by newly created staffs of "Joint Committee Coordinators," located at a central point in each of our 7 IRS Regions. The report to the Joint Committee is prepared by the coordinator, and is forwarded to Washington for final processing and official signature. If the taxpayer files a protest with Regional Appellate or a petition in the Tax Court, and agreement on the case is reached at the Regional Appellate or Regional Counsel level, the report to the Joint Committee is prepared by an Appellate Conferee, and is forwarded to the National Office for transmission to the Joint Committee.

Along with the Joint Committee Staff, we intend to watch the new system closely to make sure it operates smoothly.

For those of you who have in the past suffered through the tedious procedure involved in a Joint Committee refund case—and are lucky enough to cultivate another client with a \$100,000 refund claim—I think you will appreciate the new development in this area.

International Enforcement Program

This year, the Service took a giant step toward full implementation of its International Enforcement Program.

Since World War II, there has been a tremendous increase in the volume and complexity of international business transactions. As trade barriers crumbled and the Common Market boomed, the Service faced an administrative crisis. We simply did not have the luxury of time to train our revenue agents on a nationwide basis to handle international tax issues.

In extremis, we were forced to temporarily depart from the principle of decentralization—a principle to which we are firmly committed in the overall picture. Responsibility for the new program was centralized in the Office of International Operations in Washington. Revenue Agents were recruited and trained by OIO to handle international issues.

The essence of the new program was the so-called "coordinated examination." An agent from OIO collaborated with the local district agent in examining certain international issues reflected on returns filed by domestic taxpayers. The district agent retained jurisdiction of the case but "The Man from OIO" furnished assistance on the foreign aspects of the examination.

In the spring of this year, we discovered that we had enough trained, experienced agents to justify a move toward regional self-sufficiency. Accordingly, we started assigning these agents to key districts in our 7 regions. While our long-range goal is to have each *district* self-sufficient in the international area, this will take considerable time.

As far as the here and now is concerned, our operations have the following salient characteristics:

- (1) International issue examiners are located in one or two key districts in each region and service all districts in that region.
- (2) Requests for specialist assistance are approved at the regional level, after which the key district assigns an international issue examiner to work with the agent of the originating district.
- (3) All international issue cases are reviewed by specialist reviewers, typically located in the same key districts as the international issue examiner.
- (4) A member of the conference staff of the key district, experienced in international issues, is utilized to assist conferees in other districts until such time as properly trained personnel are available.
- (5) Emphasis is on strong regional coordination and program guidance.

What's going to happen to OIO as we move ahead with our program?

Its principal job will be to handle the returns of U.S. taxpayers residing abroad who file here, and examine the returns of foreign taxpayers with U. S. taxable operations.

Also, OIO's Economic Advisory Branch will provide information and guidance to district offices in cases involving allocations under Section 482.

We confidently believe that, under this new setup, we will have solved most—if not all—of the problems which have beset our international operations over the last several years.

Realignment of Organizational Structure of Assistant Commissioner (Technical)

Our Office of Assistant Commissioner (Technical) is responsible for providing basic principles and rules for the uniform interpretation and application of the Federal tax laws.

That office carries out this responsibility primarily by: (1) issuing rulings to taxpayers and technical advice to Internal Revenue Service field offices; (2) publishing rulings, booklets, and other tax guide materials; and (3) developing tax return forms and instructions.

Since its establishment in 1952, the office had been organized on a functional basis, i.e., its Tax Rulings Division issued rulings and technical advice; its Technical Planning Division likewise worked on all tax legislative and regulatory matters; and its Special Technical Services Division published tax guide material and performed certain other functions involving most of the provisions of the Revenue Code.

In 1964 the responsibility for representing the Commissioner on legislative matters and for drafting regulations was shifted from the Technical Planning Division in Technical to the Legislation and Regulations Division in the Chief Counsel's office. This shift highlighted an organizational problem which we had recognized for some time: the ever increasing complexity of the tax laws requires the development of highly

trained specialists who deal in more or less narrow areas of the Code. Accordingly, we decided to realign our entire Technical Organization into Divisions that would be concerned with only certain types of taxes, or areas of the Code.

Following this concept, the Organization was realigned in July 1965, into four divisions. The first three, Income Tax, Exempt Organizations and Pension Trust, and Miscellaneous Tax, will be responsible in certain tax areas for the broad range of technical functions—including the issuance of rulings to taxpayers and technical advice to our field offices. This will bring the specialists in particular areas of the Code together into one Division.

The fourth division, Technical Publications and Services, will develop the tax return forms and guide material, and perform certain other supporting functions.

We are confident that this organizational realignment will provide better utilization of our technical manpower and result in improved services to taxpayers and to Service field offices.

Tax Forms—L&M Contract—IRS Eagle

I would like to mention briefly the 1965 Tax Forms and a couple of related matters.

I am sure that you have seen the 1965 version of the 1040 by this time. As a matter of fact, we tried an experiment this year which brought forth considerable favorable comment. In October, we mailed to accountants and tax practitioners a copy of our new 1040 package. We thought you would appreciate an advance look at the new form in order to prepare for the up-coming filing period.

We, of course, have been struggling for years to simplify the tax forms. In fiscal 1965, for example, we had to contend with 102.5 million of them—and we are always searching for ways to simplify the appearance and layout of the forms (particularly the 1040) to make them easier to fill out and less forbidding looking. While this obviously does not rank in importance with the actual simplification of the law itself, we feel that it is the least we can do for the Nation's befuddled taxpayers.

It had been suggested to us on more than one occasion that our internal efforts were inadequate and that we ought to go outside for help. For this reason and because we are ready to admit that we are not always infallible we decided to give commercial firms a chance to see what they could do. We, therefore, put out invitations to bid among design firms and eventually awarded a contract to Lippincott and Margulies, a prominent New York firm in the communications field.

We asked Lippincott and Margulies to improve the format and appearance of the 1040, 1040A, and the Form 1120. While they were at it, we also asked them to attempt to correct other deficiencies the Service

presents to the public, including the appearance of our "tax package", itself, which goes to some 48 million Americans, but, which, at a glance is undistinguishable from advertising circulars.

I know the firm found this assignment one of the most difficult they had undertaken and, frankly, they did not come up with as many changes in tax forms as one might have hoped for. Like our own staff, they discovered that the need for compressing so much information on limited space militated against producing a simple form. Nevertheless, Lippincott and Margulies did make a contribution by improving the typography and general appearance of our current 1040 and its sister forms. They also made a number of suggestions that in a small but significant way will improve the appearance of our letters, pamphlets, and office signs.

As part of its work, the design firm pointed out to us that few people could tell our official seal from the many similar seals used by other Federal agencies, and they suggested that we adopt a new emblem as a method of identifying our communications. The result is the new "Internal Revenue Eagle" which you will see shortly, if you haven't already.

While these design improvements should make it easier for taxpayers to deal with us, we realize that they are, in the end, only surface improvements. We do not hope, nor is it our purpose by these designs to acquire a "new image." We fully recognize that the impression people have of us depends on how well we do our work and how fair and courteously we treat taxpayers. We continue to strive for excellence in these areas, and our effort to improve the layout and appearance of our forms and instructions is one part of this overall goal.

There is a story on this subject which is currently making the rounds of the Washington wits. It seems that the Commissioner received an urgent phone call from the White House the morning after we publicized the new IRS emblem. The familiar voice at the other end of the wire said in a slow Texas drawl . . . "Sheldon, I said *beagle* not eagle."

New District Director—Virginia

Finally, I would like to call attention to an important personnel change which should be of particular interest to this group.

On May 28th, the Service announced the promotion of Mr. James P. Boyle to director of the district covering the State of Virginia. Jim succeeds Andy Stoepler who—as you all know—did an outstanding job here in Virginia. Andy, incidentally, has been promoted to director at Detroit for the State of Michigan, one of the largest Internal Revenue Districts in the country.

Jim Boyle began his career with us in 1946, as an agent in Atlanta, Georgia. In 1962, he was selected for our Executive Development Pro-

gram. This program is highly selective—we rely on it to identify and train officials who demonstrate the greatest executive potential. After completing the program, Jim served as assistant director in Nashville.

Jim was born in Callao, Virginia, and is a double threat man—he is an attorney and a Certified Public Accountant.

I want to thank you for giving me this opportunity to speak to you. 1965 has been a good year for us—I hope 1966 is even better.