Theory and Practice in Tax Administration

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"In theory, there is no difference between theory and practice. But, in practice, there is."[2]

Table of Contents

Good articles deserve to be read. Great ones deserve to be re-read. What Mortimer Caplin wrote some forty-five years ago deserves our renewed attention for the value it adds to the theory of tax administration. The insights and observations of a subtle intellect about his experience as Commissioner of the Internal Revenue Service ("IRS" or "Service") help keep theory properly connected to the context in which it must be applied. This article will illustrate how several of Commissioner Caplin's comments from 1964 continue to inform both the theory and practice of tax administration today. Part I will review the rise of automation in tax administration that

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[1] Copyright 2009 Bryan T. Camp, George H. Mahon Professor of Law, Texas Tech University School of Law. I am very grateful to both T. Keith Fogg and Joseph Thorndike for their valuable review and insightful comments on prior drafts. Despite their best efforts, I am sure errors remain; for those, only I am to blame.

[2] Attributed to Yogi Berra, among others. See http://en.wikiquote.org/wiki/Yogi_Berra

Caplin help foster during his tenure. Part II will focus on the problems created by overuse of automation, both those that Caplin warned about and one more difficult to forsee. The challenge for the Service in using automation is to administer the tax laws in such a manner as promotes voluntary compliance. Part III will offer some thoughts on that question and on how Commissioner Caplin's ideas of proper tax administration find support with current theories of taxpayer compliance behavior. Not only must theory attend to practice, so must practice attend to theory.

I. The Beginning

The new machines will help us spot errors and omissions, and will strengthen our enforcement programs. –Mortimer Caplin, "A Personal Letter to Taxpayers," 1962[3]

Caplin wrote at the dawn of the computerization of tax administration. He oversaw the beginnings of the Automated Data Processing ("ADP") system, a process completed under the aegis of his equally capable successor, Sheldon S. Cohen. Even today, both theorists and those who write the tax laws far too often overlook the impact of automation on tax administration. Caplin did not. To fully understand the transformative moment that Caplin presided over, one must understand what came before. A brief look at the history of tax administration up to the dawn of automation will help us fully appreciate the effect of ADP on Service operations, and of the prescience of Caplin's thoughts.

A. Tax Administration from Civil War to 1872

[3] This was the introduction to the Instructions for Form 1040.

In the beginning---some one hundred years before Caplin was Commissioner---tax administration was up close and personal, with every return examined. I shall first describe the statutory structure, then the administrative reality.

Congress first established the Bureau of Internal Revenue (BIR) in the Revenue Act of 1862, long before Hewlett and Packard made Charles Babbage's vision of an "analytical engine" a reality.[4] In the 1862 Act, Congress divided up the nation into administrative districts, and authorized the President to appoint assessors and collectors for each district who, in turn, were authorized to hire assistants.[5] The operations of independently appointed officers were to be coordinated by a Commissioner of Internal Revenue. The first Commissioner, George S. Boutwell, quickly discovered that he was operating in uncharted territory. He wrote:

> I examined the records of the Excise Bureaus, established during the war of 1812, but they furnished no aid whatever in the execution of the work that was before me. I had neither the time nor opportunity to study the excise system of Great Britain; and hence the organization of the system of the United States was based upon, and grew out of, the requirements of the law. ....[6]

The "requirements of the law" presumed an administration built around personal contact within limited geographic spaces. To start with, collecting the returns was a face-to-face operation. The statutes required the "assistant assessors to proceed through every part of their respective districts and inquire after and concerning all persons being within the assessment

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[4] Revenue Act of 1862, ch 119, 12 Stat. 423 (1862).

[5] Id. §2 – §4. See generally Edwin R. A. Seligman, The Income Tax 439 (2d ed. 1914) (describing actual operation of the 1862 Act).

[6] George S. Boutwell, A MANUAL OF THE DIRECT AND EXCISE TAX SYSTEM OF THE UNITED STATES, at v (1864) (hereinafter "Boutwell's Manual"). He continued: "The preliminary work of the office consisted in the division of the States into collection districts, the examination of the papers filed in behalf of applicants for the places of assessor and collector, the preparation of forms and books, and of instructions to collectors and assessors."

districts where they respectively reside."[7] When the assistant assessor came calling (in the first Monday in May), every taxpayer was to hand over "a list or return, verified by oath or affirmation...of the amount of annual income...."[8] If the taxpayer was "absent from his or her place of residence at the time an assistant assessor shall call to receive the list of such person," the assistant assessor was supposed to leave a note for the taxpayer to bring the return to the assessor within 10 days.[9] If the taxpayer failed to do that, then the assistant assessor had the extraordinary power to "enter into and upon the premises...of such persons," make up the return "on his own view and information," and then add a penalty of 50% of the tax owed.[10]

Processing returns was equally personal and individualized. After the assistant assessor collected all the returns, he (and it was always a "he") was to make up a list of all the returns, determine the tax liability, and send the list of assessed taxes to the assessor: "Let assistant assessors understand that it is their business not merely to take returns, but to ascertain whether they are correct, and when they have reason to believe them incorrect, to act...." [11] The assessor then published the list in order "to submit the proceedings of the assessor and assistant assessor, and the annual lists taken and return as aforesaid, to the inspection of any and all persons who may apply for that purpose."[12] The assessor was to then "hear and determine, in a summary way,

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[7] Revenue Act of 1862, §7, 12 Stat. at 434.

[8] Revenue Act of 1862, §6, 12 Stat. at 434.

[9] Revenue Act of 1862, §10, 12 Stat. at 435.

[10] Revenue Act of 1862, §11, 12 Stat. at 435. The statutes use the terms "list" and "return" interchangeably when discussing the document to prepared by the taxpayer and given to the government. For clarity, I refer to all such documents as "returns" and reserve the term "list" for documents prepared by government employees.

[11] Commissioner's Special No. 12 (January 9, 1865) as reprinted in THE WORK AND JURISDICTION OF THE BUREAU OF INTERNAL REVENUE (U. S. Treasury Department, Bureau of Internal Revenue 1948) at 36.

[12] Revenue Act of 1862, §15, 12 Stat. at 437.

according to law and right, upon any and all appeals which may be exhibited against the proceedings of the said assistant assessors."[13] After the time for appeals had run, the assessor was to create a summary list of the taxes assessed "which lists shall contain the name of each person residing with the said district...together with the sums payable by each."[14] It was at that point that the assessment was set.

Most significantly, after signing that summary list, the assessor had no powers to alter the assessment.[15] He was *functus officio* because his duty was to ascertain the correctness of a return before making the assessment. He was, literally, to "assess" the return by examining it when it was made. Congress partially remedied this *functus officio* problem by giving assessors the power to re-assess returns, even after transmittal of the summary list. But the new power was circumscribed: it could only be exercised if the assessor discovered a "false" or "fraudulent" return within 15 months after he delivered the summary list.[16]

After assessing taxes, the assessor then sent the summary to the collectors, whose job was equally individualized. They collected voluntary payments and, if necessary, took enforced collection action through distraint.[17] They were personally on the hook to account for the

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13 Id.

14 Id. §16.

15 In re Brown 4 F. Cas 330, 332 (N.D.N.Y. 1866)("There should be some limit of time, beyond which this inquisitorial power of the assessor to examine into all the private business transactions of every person, should not be exercised. ... The tax-payer cannot be heard after the list has gone to the collector; why then should the assessor be permitted on his own motion to review his own action, after the list has passed from him to the proper officer to whom it belongs? It appears to me that the assessor should be regarded as to such list *functus officio* -- his power is spent.").

16 Revenue Act of 1866, § 9 (amending § 20 of the 1864 Act) at 14 Stat. 103-104.

17 Another key concept of tax administration that remains embedded in the system to this day is this separation of the liability determination function from the collection function. Although later laws required the collector to collect returns as well as money and the 1952 reorganization abolished the position of "collector," the separation of functions has always constituted a fundamental aspect of tax administration. See generally Bryan T. Camp, Tax Administration as

collection of all the amounts on the summary list.[18] If they judged that a taxpayer was unable to pay, they had to justify that decision on Form 53 ("Abatement for Inability to Collect") and had to "state, in a concise but clear manner, the reason for non-collection under the head of 'Cause of inability to collect." For example, 'Insolvent before demand could be legally made.' 'Died before receipt of list, and estate insolvent.' .... 'Property would not pay expense of distraint.'"[19] " This required an individualized judgment about specific taxpayers, based on personal knowledge on the part of each collector and his deputy as to whether a taxpayer was truly a turnip or a tax dodge.

Actual administration fulfilled those statutory presumptions of personal and local administration. We know how assessors really did their work thanks to Charles N. Emerson, a lawyer who was the assessor for the 10th Massachusetts District. In 1867, Emerson put together a Guide "for the purpose of giving to subordinate revenue officers and the public such assistance as his experience might dictate, in the administration and proper understanding of a complex

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Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998, 56 Fla. L. Rev. 1, 87-91, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=496239; see also Robert W. Kean, House Subcommittee on Administration of the Internal Revenue Laws, Report to the Committee on Ways and Mean (1953) at 25-27 (explaining the division of function). This idea of tax determination as separate from the tax collection was thus built into the structure of the agency at its inception. In fact, in one of his earliest rulings, Commissioner Boutwell reaffirmed that "no Revenue Agent or Inspector, Assessor or Assistant Assessor, possesses any authority of law to receive money or checks in payment of taxes... Nor have Revenue Agents, Inspectors, Collectors, or Deputy Collectors any authority of law to estimate or fix the amount of tax due from any individual." Treasury Circular 22, as reprinted in Charles N. Emerson, EMERSON'S INTERNAL REVENUE GUIDE (Samuel Bowles & Co., Springfield, Mass., 1867)("Emerson's Guide"). at 12, note †.

[18] Revenue Act of 1862 §24, 12 Stat. at 442

[19] Regulations for Completing the Collection of Taxes Returned to Collectors, for Rendering Final Account of the Same as Provided in Section 33 of the Act of June 30, 1864, and for the Abatement of Erroneous and Uncollectible Taxes (February 26, 1866), reprinted in Emerson's Guide at 319 – 322.

system....”[20] His Guide restated the statutes then in effect, along with annotations and reproductions of relevant administrative guidance applicable to each statute.

Emerson’s Guide gives several clues on just how personal the “proceed...and inquire” part tax administration was in actual practice. First, official administrative guidance emphasized personal contact. Emerson reprints a letter from the Commissioner to the assistant assessors that instructs them to canvass their territory each March 1st and “see to it, that every person...who, from the best information the offers can obtain, is probably liable to some income tax, makes his proper returns...” The letter urges “the greatest diligence and faithfulness” and suggests each assistant assessor could “do much in furthering his labors...by making a list of all the persons in his division, who are probably liable, and giving them notice to be prepared to fill up the formal returns.”[21]

Second, Emerson’s own advice was “know your taxpayers.” Each assistant needed to “have continually before him an intimate knowledge of his division, with it shops, factories, storehouses and stores, railroads, banks, insurance offices, bridges, ferries, etc.”[22] Each assistant also needed to know “every person in his division who may be liable to license duty or income assessment...” and because the assistant could not automatically know which taxpayers would be liable for paying taxes on incomes (because tax was due only on incomes greater than $600), “it becomes necessary...that his annual visitation should extend to every part of his subdivision,

[20] Charles N. Emerson, EMERSON’S INTERNAL REVENUE GUIDE, at iii (Samuel Bowles & Co., Springfield, Mass., 1867)(“Emerson’s Guide”).

[21] Emerson’s Guide at 457

[22] Emerson’s Guide at 17.

which would seem to extend to every household, shop, store, factory, mill, warehouse, or other place of business....”[23]

Third, Emerson notes how, as a practical matter, taxpayers relied upon the government official to help them make their return. Assistant assessors did not only collect returns, they helped prepare them:

> It is apparent, that practically the assistant has personally to perform much labor premised by the law to be performed by the person liable to the tax. Very many person, unfamiliar with business, and totally unfamiliar or ignorant of the law, are wholly unable to make out a proper return...however willing and desirous they may be to conform to every requirement; and are unable to procure the services of others, more competent for this purpose; many...seek a personal interview with the assistant, that he may ‘explain matters,’ and, if a return is necessary, get the latter to make out the list or return.[24]

The personal and local nature of tax administration cannot be overemphasized. The numbers help illustrate: In 1863 there were fewer than 300 employees in the Washington office and more than 3,500 in the field.[25] These field employees made the individualized determinations of taxes; their actions of assessment and collection were directed towards taxpayers they knew personally. The role of the headquarters staff was far removed from actual administration.

There were some feeble attempts to interpose central authority. Boutwell created an intermediate step after the assessor heard appeals and before the assessor signed the summary list over to the collector: he required that each summary list be returned by the assessor to the Bureau Headquarters in Washington D.C. where it would be:

> carefully examined in detail, and all errors in the rate of taxation, or in computation are noted and the assessor informed thereof. Inasmuch as the office is in possession of the name and residence of every assistant assessor, and the limits of every division or sub-assessment

[23] Emerson’s Guide at 17-18.

[24] Emerson’s Guide at 18.

[25] Lillian Doris (ed.), THE AMERICAN WAY IN TAXATION: INTERNAL REVENUE 1862 – 1963 (Prentice Hall, Englewood Cliffs, N.J. 1963) at 32, 38.

> district, each officer can be made responsible at once for any error which he may have committed.[26]

But these attempts did little to change the reality that the assessors and their assistants were the key players. They made the determinations of tax liabilities and, as noted above, they had the power to make up a return for any taxpayer who did not prepare one. The process thus relied almost entirely on the assistant assessors' and deputy collectors' personal knowledge of taxpayers in their geographic jurisdictions and their judgments about taxpayer affairs. Emerson tells us the practical consequence of that statutory confidence for the assistant assessors:

> There are in the United States many thousands of assistant assessors, who, for the time being, are in their particular subdivision 'the law upon this subject.' An appeal to the district assessor is often difficult and inconvenient, and sometimes well-nigh impossible; while an appeal to the department at Washington must necessarily be expensive and dilatory.[27]

In sum, the story of tax administration up to 1872 is a story of personal contacts between government employees and taxpayers within small geographic subdivisions. Tax administration was personalized with government employees performing a separate judgment about each taxpayer who might be liable for any type of tax within their districts. What would now be viewed as the audit function was performed on <u>every</u> return <u>before</u> the assessment was made. This is not to say that such personal contacts were happy ones. In fact, this state of affairs was not popular. The assessors and their assistance were widely despised, in part because of popular resentment at their duty to "inquire."[28] For example, during consideration of an 1864 proposal to give assessors contempt powers in conjunction with their summons powers, one senator's objection expressed the common view: "Why, sir, it is clothing a pigmy with the power to wield

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[26] Boutwell's Manual at vi.

[27] Emerson's Guide at 180, note.

[28] <u>See</u> a very thorough discussion in Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 Admin. L. Rev. 717, 725-730 (2001).

a thunderbolt."[29] Nonetheless, regardless of their stature in the community, the work of tax administration was carried out largely by individuals exercising individual judgment about individual taxpayers.

B. Setting the Stage for Automation

From 1872 to 1952 Congress carried forward the basic statutory structure described above, codifying it first in the Revised Statutes in 1874 (which were reenacted in 1877), then in the first edition of the United States Code some 50 years later and, finally, in the Internal Revenue Code of 1939.[30] The statutes still presumed personal contact: they still required government employees "to proceed through every part of [the] district and inquire after and concerning all persons therein who are liable to pay any internal revenue tax." and they required taxpayers to

[29] Remarks of Sen. Davis, 64 Cong. Globe 2439.

[30] The statutes are difficult to trace. Particularly after 1913, Congress passed Revenue Acts at least every other year and could not codify them. The basic problem was that while Congress made the Revised Statutes absolute law first in 1874, 18 Stat. 113, and then again by reenactment in 1877, 19 Stat.268, Congress provided no mechanism for incorporating new statutes into that codification. Thus by 1925 Congress had produced 23 more volumes of Statutes At Large in which it had impliedly repealed well over 1,000 sections of the Revised Statutes. Cannon, Preface to the United States Code 1934 Edition (January 15, 1935), reprinted in USCS, 1934 Edition, page v of Title 26. Tax statutes, in particular, were a mess. Some Revenue Acts repealed all provisions of prior Acts and substituted new ones and some repealed only the substantive parts of prior Acts, extending administrative provisions, and some had no clear directions either way! For an example of an "extension" provision, see §1100 of the 1926 Revenue Act (44 Stat. 111): "All administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act." But even the most careful practitioner might become confused on what provisions of prior Acts had been repealed. I demonstrate the problem more fully in Camp, *Tax Administration as Inquisitorial Process*, 56 Fla. L. Rev. at 45-48, where I give the legislative history of the tax summons powers and show how, at one point, the Bureau relied on a summons power that had actually been repealed. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=496239

make their returns to field employees.[31] During this time, however, several important developments moved tax administration away from the personal relations between BIR employees and taxpayers contemplated by the statutory scheme. The idea of returns processing became separated from the idea of examination of returns. The disconnect between theory and practice became so great that Congress revised the administrative statutes to reflect the actual administration of the laws. Thus, instead of the agency conforming its administration to the statutes, as Boutwell did, Congress conformed the statutes to reflect the changes in administration. The largest change, by 1954, was the beginnings of the automation that Caplin wrote about in 1964.

Three significant changes in tax administration set the stage for the development of ADP under Caplin: the lapse of the income tax in 1872, the revival of the tax in 1913, and the expansion of the income tax in 1942. I shall give a brief note on each.

First, in 1872 Congress allowed the Civil War income tax to lapse.[32] This substantive change in the law resulted in a large decrease in the work of the BIR.[33] The decrease in workload gave then Commissioner John W. Douglass an opportunity to better consolidate and centralize control over tax administration within the office of Commissioner. He proposed that the field offices of

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[31] The quoted language appears in all reenactments of the tax laws and was codified in R.S. §3172 and then as §91 of the 1926 U.S. Code, then as §1500 of the 1934 U.S. Code, then as §3600 of the 1939 Tax Code, which was incorporated into U.S. Code and, finally, coming to rest in §7601 of the 1954 Tax Code where it has stayed.

[32] The income tax was increasingly resented, at least in the press. See IRS Historical Fact Book 44 – 49. For example, an 1871 New York Times editorial claimed "the income tax hyas been unpopular from the moment of its enactment..." Reprinted in IRS Historical Fact Book at 47.

[33] IRS Historical Fact Book at 49. The absolute number of income tax returns fluctuated from year to year, with the high being 276,661 in 1870 and the low being 72,949 in 1872. The decrease in workload caused a corresponding decrease in workforce, from 6,141 in 1872 to 5,136 in 1873 to 4,784 in 1874. IRS Historical Fact Book, Appendix 4 at 248.

assessors be abolished and that the collectors take on the responsibility of collecting returns.[34] The assessment of taxes, however, would now be done by employees of the Commissioner.

Congress implemented this change at the end of 1872, abolishing the unpopular assessors and their assistants and making the collectors and their deputies responsible for the collection of returns from taxpayers.[35] Congress also transferred the assessment power to the Commissioner, and the statute now requiring him "to make the inquires, determinations, and assessments" of the internal revenue taxes.[36] The Commissioner was also authorized to "employ competent agents" whenever, "in his judgment the necessities of the service so require," and he could deploy them either at the BIR Headquarters or in the field.[37] Collectors still collected tax returns in their districts but now sent their summary lists to Commissioner to be assessed, work increasingly done in the Bureau headquarters in Washington D.C.[38]

The second significant set up for automation came from the revival of the income tax in 1913 and the increased revenues needs generated by World War I. In 1913 Congress added an income tax on individuals in Section II of the Underwood Tariff Act of 1913.[39] The administrative goal

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[34] His scheme is detailed in THE WORK AND JURISDICTION OF THE BUREAU OF INTERNAL REVENUE (U. S. Treasury Department, Bureau of Internal Revenue 1948) at 74 (hereinafter "WORK & JURISDICTION")

[35] Act for the Reduction of Officers and Expenses of the Internal Revenue, 17 Stat. 401, § 1 (December 24, 1872).

[36] Act of December 24, 1872, 17 Stat. 402.

[37] Revised Statutes §3152. These positions were the forerunner of the current position of Revenue Agent. The Commissioner was at first limited to 25 appointments, but by 1913 the number was limited by the Commissioner's discretion. See WORK & JURISDICTION at, 86; IRS Historical Fact Book at 96.

[38] For a description of the process see Roger Foster and Everett V. Abbot, A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1894 (Boston Book Co., Boston 1895) at 187.

[39] The Act begins at 38 Stat. 114. Section II begins at 38 Stat. 166. The provisions addressing the income tax obligations of individuals were separated from the provisions addressing the income tax obligations of "corporations, joint-stock companies or associations, or insurance

in 1913 remained the same as during the Civil War: to have every return touched by an employee who would make an individualized decision on the proper assessment of tax. As during the Civil War, the return processing started with the collection of returns in March. The collectors offices processed returns much the same way that the assessor offices had. After collecting all returns, they made up summary lists of all the taxpayers and their liabilities on Form 23 and forwarded that summary, along with the returns and all attachments, to BIR headquarters in Washington, D.C. [40]

Each return still received individualized attention, only now with the assessment power lodged with the Commissioner, the returns were reviewed by the BIR headquarters staff who entered their assessments on the Form 23 received from the collector.[41] The headquarters staff was instructed to, "immediately upon receipt of the lists on Form 23 from the Collector, inquire, determine, assess, and enter in columns, 8,9, 10 and 10½ thereof the amount ascertained to be assessable, including the amounts returned by the Collector, if found correct."[42] The 1913

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companies." Section II, Parts A through Part F addressed the obligations of individuals, including the procedure for assessing tax. Part G, starting at 38 Stat. 172, addressed the obligations of "corporations, joint-stock companies or associations, and insurance companies." The procedural provisions of Part E regarding assessments are replicated exactly in Part G(c).

[40] Regulation II, as published in Roger Foster and Everett V. Abbot, A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1894 (Boston Book Co., Boston 1895) at 176 ("said returns, and all matters relating thereto, must be securely sealed, in envelopes or packages, by collector forwarding the same, and, with all returns of delinquents made and forwarded by collectors, and all data relating to returns of income, will be filed and securely and permanently retained in the office of the Commissioner of Internal Revenue.")

[41] Harrop Freeman and Nathan Freeman sum up the interwar period in THE TAX PRACTICE DESKBOOK at 104, note 4 (Little, Brown & Co., Boston, 1960)("From 1918 to 1934 auditing centered in Washington, though some of the more difficult cases were field-audited. In 1934 the Bureau was decentralized and auditing thereafter occurred under the supervision of revenue agents in charge of branch offices. Small returns were given office audits by the Collector's office.").

[42] Instructions to Form 23, as published in Roger Foster and Everett V. Abbot, A TREATISE ON THE FEDERAL INCOME TAX UNDER THE ACT OF 1894 (Boston Book Co., Boston 1895) at 187.

statute required the Commissioner to assess each individual's taxes by June 30th.[43] As before, the assessment lists would then be given to the collectors who would then receive either voluntary payments or take enforced collection action. Taxpayers did not pay money with their returns.

Just as the lapse of the income tax in 1872 had reduced the BIR workforce, so its revival soon led to a tremendous increase in BIR workload as millions of new taxpayers filed returns. The workforce in place in 1913 was wholly inadequate to handle the volume of returns, particularly after Congress expanded the income tax to meet the revenue demands of World War I. At the end of 1915, the Bureau's total workforce was 4,730, with 530 working out of the BIR headquarters and the remaining 4,200 in the field.[44] But while the BIR received about 500,000 individual tax returns in 1915, it received more than 3.5 million in 1917.[45]

The Bureau struggled to review every return individually but, as one might imagine, it got further and further behind in making assessments. By June 1918, "the problem confronting the Bureau...was to devise an administrative system by which an accumulation of approximately 4,000,000 income returns of individuals and corporations could be audited and any additional tax due could be discovered, assessed, and collected in the briefest possible time."[46] In October 1919, the Commissioner Roper reported that Bureau was "occupied with those cases arising out of 1917 and 1918 returns" and "the Bureau will be regarded as current as soon as a condition is

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[43] 38 Stat. at 169. ("all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year and said assessment shall be paid on or before the thirtieth day of June..."). The parallel corporate language is in Paragraph G(c), 38 Stat. at 174.

[44] IRS Historical Fact Book at 89.

[45] IRS Historical Fact Book at 91.

[46] WORK & JURISDICTION, AT 97.

reached in which every return will be examined within three months after the date on which the fourth installment payment of tax is due."[47] By 1923, "the agency was still trying to process a backlog of more than 3 million returns."[48]

To handle this increased workload within the paradigm of individualized attention, the BIR not only increased its workforce from 4,730 in 1915 to over 14,000 by 1919 but also delegated some of the tax determination function to the collectors and their deputies.[49] Thus, the BIR hired over 1,000 revenue agents in the first six months of 1919 alone as headquarters staff in Washington D.C. zoomed from 585 in 1917 to over 4,000 in 1919, with many of the new employees being women.[50] Meanwhile, in January 1918 the BIR delegated audit authority to deputy collectors for all Forms 1040-A and in 1919 allowed deputy collectors to review and verify all 1918 income tax returns reporting less than $5,000 of income.[51]

With the volume of returns, however, the goal of personalized attention had changed. No longer was the goal to actually audit each return. Instead, the goal become to have each return reviewed to see whether to accept the return as filed or seek additional explanation from the taxpayer. Just as today, the term "audit" then was a "chameleon-hued word...used interchangeably with the words "verification," "examination," and "investigations."[52] Of necessity, tax administration was now less up close and personal, with the audit process becoming a distinct concept from returns processing.

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[47] Annual Report to Congress, reprinted in WORK & JURISDICTION, AT 98.

[48] Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 Admin. L. Rev. 717, 745 (2001)(citations omitted).

[49] IRS Historical Fact Book, Appendix 4, at 249.

[50] IRS Historical Fact Book, at 93, 99.

[51] IRS Historical Fact Book 93, 99.

[52] WORK & JURISDICTION, AT 97.

The volume of returns led to a separation of the returns processing function from the auditing function and Congress changed the laws to conform to the administrative realities. One can see this separation of concepts---the idea of returns processing being different than the idea of audits---in two new provisions in the Revenue Act of 1918. First, that Act required taxpayers to pay their taxes *with their returns*.[53] No longer were taxpayers permitted to wait for the Commissioner to make the formal assessment and make demand upon them before being obligated to pay; they had to pay before assessment. This could well be the origin of the popular perception that ours is a "self-assessment" system.

Second, while earlier statutes had required the Commissioner to assess income taxes by the end of June, the Revenue Act of 1918 provided instead that "as soon as practicable after the return is filed, the Commissioner shall **examine** it."[54] Thus the Bureau was expected to "examine" the returns "as soon as practicable" but the Commissioner now had five years to make the assessment after his examination. That is, the first time the term "assessed" was used was in the newly-created statute of limitations on assessment: "Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made..."[55] Unlike the 1862 Act, the 1918 provision gave the BIR the power to change assessments within 5

53 Revenue Act of 1918, §250(a), 40 Stat. at 1082.

54 Id. §250(b) (emphasis added). The Revenue Act of 1921 further confirmed and elaborated on this change by providing, in § 250(e) that "the instructions printed on the return shall be sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's [own] computation of the tax on the return shall be sufficient notice of the amount due." 42 Stat. 227, 265.

55 Id. § 250(d). For a detailed history of the assessment limitations statutes and of why they are really statutes of repose and not statutes of limitations, see Camp, *Tax Return Preparer Fraud and the Assessment Limitation Period* 116 Tax Notes 687 (August 20, 2007) (reviewing the interplay of the assessment limitation period with fraud penalties and their intertwined statutory history since 1862).

years. And, in fact, the BIR's willingness to reopen supposedly closed cases led Congress to enact the §7605(b) restrictions on multiple examinations in 1921.[56]

The third significant step on the road to automation was the well known shift from a "class tax" to a "mass tax" during WWII.[57] In 1939, approximately 7.6 million taxpayers were serviced by about 22,600 Bureau employees.[58] By the close of the war in 1945, the Bureau had more than doubled its size, to almost 50,000 employees, but the taxpayer population had exploded to approximately 42 million.[59] Moreover, the type of taxpayer had changed as well: "Prior to 1940, taxpayers were generally business people with adequate records; after 1940 they were everyone, and most of us had no records or at best incomplete ones..."[60] Indeed, the expected lack of records on the part of the new taxpayer population is partly what prompted Congress to create the standard deduction.[61] And, in fact, in 1944, 82% of taxpayers filing returns used the standard deduction, thus saving the Bureau an enormous amount of work.[62]

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[56] See United States v. Powell, 379 U.S. 48, 55-56 (1964)(reviewing legislative history of §7605(b)). In 1921 Congress also reduced the limitations period to four years instead of five. Still, by 1927 the BIR had reopened over 5 million settled cases in the previous 5 years. Joseph Thorndike, *Reforming the Internal Revenue Service*, 53 Admin. L. Rev. at 745-46.

[57] For a nicely-written account of the way in which the government tried to sell the expanded tax to citizens, see Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 Buff. L. Rev. 685 (1988).

[58] 1 ADMINISTRATION OF INTERNAL REVENUE LAWS, 1, note 3, and 16 (May 1940). This document was Monograph No. 22 created by the Staff of the Attorney General's Committee on Administrative Procedure.

[59] IRS Historical Fact Book, Appendix 4, at 249, gives the numbers of employees. The numbers for taxpayers comes from Jones, supra at 686.

[60] Harrop Freeman and Nathan Freeman, THE TAX PRACTICE DESKBOOK at 103, note 1 (Little, Brown & Co., Boston, 1960).

[61] For a discussion of the legislative history of the standard deduction Ellen P. Aprill, Churches, Politics and the Charitable Contribution Deduction, 42 B.C. L. Rev. 843, 850 (2001). Professor Aprill quotes, among other sources, the Senate Finance Committee Report, which said "the standard deduction is in lieu of the nonbusiness deductions and certain credits against net income

Nonetheless, the massive expansion of federal taxation after WWII produced unmanageable stress on tax administration structure. Gone was any expectation that Bureau employees would actually be able to "proceed through every part of their respective districts and inquire after and concerning all persons" who might owe income tax. In 1956, for example, the Service considered a door-to-door canvass of each district to find non-filing taxpayers, but apprantly decided against it because of resource constraints.[63]

The stress of administration also revealed a central weakness in tax administration: a divided command system. The typical story about this period of IRS history centers on Truman's Reorganization Plan No. 1 of 1952. While that story is important, it ignores a more fundamental change in tax administration that had nothing to do with the scandals.

First, the typical story: recall that the 1862 structure put the power of assessment as well as the power of collection into the hands of presidentially appointed assessors and collectors who were the sovereigns of their geographic jurisdictions. While the Commissioner had been able to acquire assessment jurisdiction in the 1872 restructuring and while various Commissioners had been slowly bringing the field workforce into the civil service, the collectors still reigned.

In early 1950's, the House Ways and Means Committee spent some two years investigating irregularities within the Bureau and issued its chief findings in a 1953 report commonly called the King Report.[64] The extensive and careful investigations resulted in the removal or

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and against tax" so that a taxpayer "is not required to itemize and substantiate his nonbusiness deductions." Id. at 850, citing S. REP. NO. 78-885, reprinted in 1944 C.B. 858, 860 (1944).

62 Allan J. Samansky, Nonstandard Thoughts about the Standard Deduction, 1991 Utah L. Rev. 531, 532-33.

63 Harrop Freeman and Nathan Freeman, THE TAX PRACTICE DESKBOOK at 116 (Little, Brown & Co., Boston, 1960).

64 The Committee's work was done chiefly through a Subcommittee on Administration of the Internal Revenue Laws, chaired alternatively by Cecil R. King (D - N.Y.) and Robert W. Kean

resignation an extraordinary number of high-level officials, including the Assistant Commissioner in Charge of Operations, the Chief Counsel, the Assistant Attorney General in Charge of the Tax Division of the Department of Justice, and 9 of the 64 Collectors, 3 of whom were also criminally prosecuted.[65] One of the chief conclusions of the investigators was that collectors could not be effectively supervised by the Commissioner, or even by Treasury, because of their political connections.[66] Although the results of the investigation were reported in 1953, the deficiencies in tax administration structure were quickly apparent during the investigation, leading President Truman to propose a major restructuring, known as Reorganization Plan No. 1, in January 1952, which was quickly approved by Congress and implemented over the next two years.[67]

In most histories, the story of the 1952 restructuring focus on the important story of how this reorganization abolished the corrupt offices of the collectors, and how it re-organized tax administration from type of tax (income, excise, employment) to type of function (assessment, collection, etc.).[68] The usual story also emphasizes the decentralization of tax administration as

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(R - N.J.) depending on which party controlled the House at the time. The Committee issued its report as H.R. Rep. No. 82-2518 (1953), commonly called the "King Report." A follow-up report from the Subcommittee On Administration of the Internal Revenue Laws to the full Committee in later 1953 was never adopted by the Committee but may still be found as a subcommittee print titled "Internal Revenue Investigation" and was chiefly authored by Representative Kean and so is known as the "Kean Report."

[65] Kean Report at 3 (as to the 9 Collectors) and King Report at 2 (as to the rest).

[66] Kean Report at 3-6, 26-27.

[67] The Reorganization Act of 1949, 63 Stat. 203, allowed the President to propose organizational changes to Congress which would become law if Congress did not object within a set time period. Truman's Reorganization Plan No. 1 became effective on March 14, 1952. A good description of the changes wrought by the Plan is in Hugh C. Bickford, SUCCESSFUL TAX PRACTICE (2d) (Prentice-Hall, NY 1952), 182 – 206 (hereinafter "Bickford (2nd ").

[68] See e.g. Doris, supra, at 40-41, Thorndike, supra, at 762-763; Freeman, supra, 103-113. Congress did an almost complete about face on this point in 1998, requiring the IRS to re-organize itself from type of function to type of tax and taxpayer. See IRS Restructuring and

the country was now divided into nine geographic regions, each headed by a regional director, and 64 districts, each headed by a district director. District directors now held all the old powers of the assessor and collector combined and were responsible for performing all the major functions of tax administration: audits, collections, criminal investigations, internal appeals, and legal support with the National Office taking direct roles in limited classes of cases or issues.[69] While this story is true and important to tell, there is more.

The 1952 reorganization is also the story of automation and the effect of automation on tax administration, a story in some tension with the idea that tax administration became decentralized. For while the reorganization allowed the agency to decentralize in one direction, it also allowed the agency to consolidate operations in another direction and to incorporate automation in those operations. For example, in 1948 the Bureau began using punch card equipment in the Cleveland collector's office to mass-mail notices to taxpayer.[70] The next year, the Bureau started to centralize mass mailings on behalf of several collectors offices in the Commissioner's Processing Division in Kansas City.[71] By 1952, the Processing Division in Kansas City was also performing a limited document matching review for individual returns. Taxpayer were required to send in their copy of their W-2 wage withholding statement. The Kansas City Branch compared the version submitted by employees to the version submitted by

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Reform Act, P.L. 105-206, 112 Stat. 685 (1998). I am indebted to Professor Keith Fogg of Villanova for this interesting point.

69 Id. See also Bickford 2nd , supra, at 184c, describing the collection of powers now concentrated in the hands of the district directors. See also Hugh C. Bickford, Successful Tax Practice (4th) (Prentice-Hall, Englewood Cliffs, N.J. 1967)(hereinafter "Bickford 4th") at 171 (The main effect of the Reorganization Plan of 1952 has been to complete the decentralization of the Commissioner's work to the field.")

70 IRS Historical Fact Book at 143.

71 IRS Historical Fact Book at 145.

employers and if there was a mis-match, the return would be flagged for investigation.[72] It was from this modest beginning that the ADP trend towards centralization of operations began.

C. Centralization under ADP

By putting all personnel and all operations under the Commissioner's control, the 1952 reorganization facilitated the centralization of operations begun in 1872. After the 1952 reorganization was completed in mid-1953, the newly designated Internal Revenue Service ("Service") started to use computer technology to centralize more and more types of operations, the most important of which was returns processing. In 1955, the Service created a new type of facility called the "Service Center," first in Kansas City (the Midwest Service Center), then in Lawrence, Massachusetts (the Northwest Service Center) and bought its first computer to test computer processing of returns.[73]

In 1959, after some years of planning, pilot projects, and testing, the Service obtained Treasury and Congressional approval for the idea of nationwide ADP, the centerpiece of which was to be the creation of the National Computing Center ("NCC").[74] The NCC was built to create and retain "master files" of each individual taxpayer and each individual business so that relevant tax data could be stored in a single, centralized location and be readily retrievable by any Service employee in any office in the country.[75] The Service Centers were to be the information-gathering and data-input locations. The Service implemented the plan over the next

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[72] Bickford 2nd at 208.

[73] IRS Historical Fact Book at 161.

[74] IRS Historical Fact Book at 166, 174.

[75] Doris, The American Way in Taxation at 77,

eight years, creating the NCC in Martinsburg, W.Va., and five additional regional Service Centers.[76]

It was thus during Caplin's time as Commissioner---from February 1961 to July 1964---that the major pieces of the ADP puzzle were shaped and fitted together so that by the end of his tenure, he could rightly say "[t]he Service is over the hump on the basic groundwork."[77] More importantly, however, Caplin saw what automation meant for the centralization of tax administration operations. He wrote:

> But to be faced are many problems and challenges. For one thing, some traditional concepts must be set aside. Regional service centers, for example, will assume greater importance in tax administration. Tax returns will be processed there as well as classified and selected for audit there. Inevitably, tax returns will be filed there. The present system of filing in 58 district offices----with trans-shipment to the 7 ADP service centers---is cumbersome, time-consuming and costly. As ADP becomes fully operational, the Service will be drawn closer and closer to centralized tax returns filings, and will have to call upon Congress for enabling legislation wherever it is needed to fully implement such as system.[78]

Automation and centralization went hand-in-hand. Caplin's predictions would come true as Congress did once again conform the law to reflect the necessities of administration. In 1966, Congress amended §6091 to allow the Service to require returns be filed "at a service center serving the internal revenue district" of the taxpayer.[79] And the 1967 filing season became the first filing season where the Service processed all returns to the Individual Master File for the first time.[80]

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[76] IRS Historical Fact Book at 171. In addition to the Service Centers in Kansas City and Lawrence, Service Centers were opened in Ogden (1956), Atlanta (1961), Philadelphia (1961), Austin (1963), and Cincinnati (1963).

[77] Mortimer Caplin [cite to reprinted PH article from July 16, 1964, p. 2]

[78] Mortimer Caplin [cite to reprinted PH article from July 16, 1964, p. 3]

[79] An Act To amend the Internal Revenue Code of 1954 to promote savings under the Internal Revenue Service's automatic data processing system, 80 Stat.1107 (Nov. 2, 1966).

[80] IRS Historical Fact Book at 185.

Returns processing was, however, only the beginning of the push towards automation and a fundamental shift in the methods of tax administration. For along with the centralization of tax administration came a concomitant shift in the methods by which all tax laws were applied to taxpayers. No longer would taxpayers be treated as individuals. Instead, taxpayers would become part of groups and the decisions on how to administer tax laws would now be made as decisions about aggregate groups of taxpayers and not as decisions about individuals. Call it batch processing.

II. The Rise of The Machine and the Shift to Batch Processing

There may be a tendency to overcentralize operations, to overextend capabilities and, yes, to capitulate to overmechanization and underhumannization of tax administration. In brief, IRS must constantly weigh machine capability against the actual and psychic costs to the nation.

– Mortimer Caplin

When Caplin wrote these words, not only was computerization new within the Service but it was also new in society and, as with many new ideas, trends, and inventions, people were somewhat uneasy with it. Popular media was filled with stories of computers taking human forms, taking control of human affairs, and eclipsing human judgment. From television episodes of Get Smart and the Twilight Zone to popular science fiction works of Arthur C. Clarke and Isaac Asimov, to hit movies such as 2001: A Space Odyssey, there was widespread awareness of machines run amok.[81] Caplin's article reflects this popular theme. He warned: "the

[81] For illustrative episodes of The Twilight Zone, see "The Brain Center at Whipple's," aired on May 15, 1964, at http://en.wikipedia.org/wiki/The_Brain_Center_at_Whipple%27s ("The point is that too often man becomes clever instead of becoming wise. He becomes inventive, but not thoughtful."); "From Agnes, With Love," aired February 14, 1964, at http://en.wikipedia.org/wiki/From_Agnes%E2%80%94With_Love, ("Machines are made by men for man's benefit and progress, but when man ceases to control the products of his ingenuity and imagination he not only risks losing the benefit, but he takes a long and unpredictable step into—the Twilight Zone."). For illustrative movies, one cannot ignore the infamous HAL from 2001: A Space Odyssey. Although the movie was completed in 1968, Clarke had knocked out a draft of the screen-play in 1964. See http://en.wikipedia.org/wiki/Arthur_C._Clarke

‘Martinsburg Monster’ must be domesticated; it must be kept as an office pet and not an uncontrolled Frankenstein.”

It was not to be. In this section I want to trace out some of the problems---some foreseen by Caplin and others not---that have occurred as a result of the growth of ADP since Caplin was Commissioner. The very efficiency which is the lure of machine processing also contributes to difficulties for taxpayers caught in the tentacles of a monster they cannot understand or interact with. I will first describe the impact of ADP on returns processing, then its impact on two other tax administration functions to demonstrate the similar impacts of ADP on tax administration: the centralization of operations and the substitution of batch processing algorithms for individualized judgment. I shall then conclude this section of the article with a look at the problems resulting from these impacts.

A. Impact of ADP on Returns Processing

One can see the twin impacts of ADP on tax administration---the substitution of batch processing algorithms for individualized judgment and the centralization of operations---by comparing how returns were processed in 1952, at the end of the BIR era, how they were processed in 1967, the start of the nationwide ADP era, and then in 1984, when ADP had become more sophisticated.

In 1952, Hugh C. Bickford’s treatise on tax practice described a return filing process that was more like 1862 than it was different. Processing was still more personal than not, more individualized than not, and the Collector’s offices continued to perform small-dollar audits as they had after WWI.

In 1952, taxpayers submitted their yearly returns to a local office, which at that time was still the Collector's office. When the returns were received, they were classified and numbered, assessment lists prepared for the taxes shown (still on a paper Form 23), and an account opened for each return.[82] The returns were then surveyed by human eyes for mathematical errors. The W-2's were sent to the Kansas City Processing Branch (this was before Service Centers, remember) for the limited kind of document matching review, described above, also done by humans. They were then sorted by human brains into two categories for further processing: "collector returns" were small-dollar returns that would be further processed by the Collectors and their employees; "agent returns" were higher-dollar returns that would be further processed by the Commissioner field employees, led by a Revenue Agent in Charge.

Both collector returns and agent returns received similar processing by field employees. First, certain types of returns, such as very high-dollar returns or returns that raised a particular issue, would be automatically assigned for examination. "In point of numbers, however, the greatest list of "automatics" is made up of those returns that are referred for examination simply because the income exceeds a certain amount, the level of which is fixed by the Bureau from time to time depending on the pressure of business."[83]

Second, returns that claimed something more than the standard deductions were reviewed for supporting documentation of the claimed deductions. "If all deductions are properly explained, if the withholding forms match the income reported, and if there is nothing else to indicate that the return is not correct, it will probably be accepted as filed." On the other hand, if a return lacked support for claimed deductions, the employee would correspond with the taxpayer and

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[82] Bickford 2nd at 207. All the description in this paragraph is taken from Bickford, as I was not alive, much less practicing tax, in 1952.

[83] Bickford 2nd at 216.

ask the taxpayer to come to the Collector or Agent's office to explain matters. "In a great many cases, the taxpayer never shows up and the additional assessment follows. If the taxpayer brings his receipts or other proof, the matter is adjusted on the spot."[84]

Through this method, approximately 1 in 25 returns required additional interaction between the taxpayer and individual BIR employees.[85] The strength of this system was the use of local knowledge to spot improper deductions. The weakness was an inability to spot unreported income. Because of the "pressure of business" (i.e. volume), the Bureau simply could not verify, except in the most limited way, income reported by taxpayers. However, on the deduction side, "the reviewers who make these classifications are experienced men who have developed a 'sixth sense" concerning questionable items...and an old, experienced hand at reviewing returns...can usually guess with some degree of accuracy how much the expenses in any particular business should amount to in proportion to gross receipts. In addition, the examiners in particular localities become thoroughly familiar with local conditions." Thus, although most returns were accepted as filed, that is because probably about 80% of individual taxpayers did not itemize and unless the reported income put the return in the "automatic" examination category, there would be little reason to pause over such a return.[86]

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84 Bickford 2nd at 212 (describing the process for low-dollar collector returns).

85 Bickford 2nd at 218. Bickford reports that of the 55 million returns filed for 1947, about 52.8 million were classified as Collector returns, of which 51.2 million were accepted as filed and 1.6 million were audited by the Collectors. Of the remaining 2.2 million classified as Agent returns, 1.4 million were accepted as filed after human review and 780,000 were audited and closed after audit.

86 I cannot find the exact data on the IRS Statistics Of Income (SOI) web site for tax year 1947; however, Professor Samansky reports that the SOI historical data shows that 82% of filers in 1944 did not itemize. I believe it reasonable to assume a similar percentage for 1947. See Allan J. Samansky, Nonstandard Thoughts about the Standard Deduction, 1991 Utah L. Rev. 531, 532-33.

By 1967, the fourth edition of Bickford's treatise recognized that "the relatively new Data Processing Divisions with electronic computers are assuming an ever widening roll."[87] Taxpayers were increasingly instructed to file their returns to a Service Center and not their local offices.[88] Temporary workers staffed the Service Centers, and pushed paper, starting with the Tingle Tables in the extracting room and moving down the line to the data entry rooms.[89] Simple returns (Forms 1040-A and what was then called the "short form" 1040) were processed almost entirely at the Service Centers by machines which checked for math errors and performed a limited document matching process to verify the amount reported on the return matched the amounts reported on W-2s and 1099s.[90] Subject to this mechanical verification process, these simple returns---which reported no itemized deductions----were accepted as filed and effectively closed.[91] The effect of ADP on processing time is apparent. The pace of processing increased: by 1967 practitioners reported that "the Service attempts to clear all refunds and tax adjustments of small amounts...within 30 days after the returns are filed. Cases involving a refund of more than $200 are given a closer check by office audit and are cleared, usually, by June 1st following the filing date."[92] The returns that were not processed by computer, however, were still reviewed

[87] Bickford 4th at 190.

[88] The Service completed the transition by 1970. IRS Historical Fact Book at 184, 187.

[89] The Tingle Table was invented in 1961 by James Tingle, an employee of the Atlanta Service Center. See http://www.doubletongued.org/index.php/citations/tingle_table_1/ . The purpose of the table was to help employees quickly extract all materials from income correspondence and sort the materials into the appropriate boxes to be routed to the proper processing function down the line.

[90] Bickford 4th at 190. The Service started mechanizing the wage matching process in 1967 with a project titled Wage and Information Document Matching Program; it became fully operational nationally in 1969. See IRS Historical Data at 186.

[91] Bickford 4th at 191 (describing the effect of a return being accepted as filed as "for all practical purposes a closed return.")

[92] Bickford 4th at 190.

by humans and selected for examination based on human judgment.[93] Local knowledge still mattered.[94]

By 1984, the human role had diminished even more. Not only was the returns processing function highly automated, but now the audit selection criteria were automated as well. As one practitioner put it, "[t]he handling of returns by the Service Centers is an extraordinarily complex process, requiring familiarity with computers for understanding."[95] After employees sorted returns, scanning them for missing items, entered data, and after the computer performed math errors checks and calculated taxes for those taxpayers who had requested that service, each taxpayer's liability was entered into the computer. Each week, the data entered would be summarized on the same form the Collectors were required to prepare in 1872 and 1913, now renumbered as Form 23C. Only now this Form was signed by the Service Center employee authorized to sign and it was the computer that "carefully examined in detail" the information input into system for "errors in the rate of taxation or computation."[96] The Form 23C information and all underlying records were then be transmitted each week to the NCC in Martinsburg where the information would be added to any other information about the taxpayer contained in the NCC.

By 1984, therefore, the Service basically accepted all returns as filed (unless they contained missing forms, schedules, or signatures or had math errors). It was only after sending the assessments to the NCC that returns were selected for audit. Notably, returns were <u>not</u> selected

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93 Bickford 4th at 192.

94 Bickford 4th at 192, giving example of a 1965 hurricane in the lower Mississippi valley, thus updating the example he used in his 1952 edition of his treatise (which was of a 1938 hurricane in New England).

95 James W. Quiggle and Lipman Redman, Procedure Before the Internal Revenue Service, ALI-ABA (6th Edition 1984) at 86, note 47.

96 Boutwell's Manual at vi.

for audit based on what they looked like to the human eye, or the sufficiency of letters or other non-standard documents attached to the return. Nope. Gone were those "experienced men" working in each district office with their "sixth sense." Instead, the NCC computer scored each return in the nation based solely on the information that had been entered into the data fields designed by computer programmers and comparing that data against an algorithm also created by programmers.[97] In 1969, the Service had began developing a computer algorithm, called the Discriminant Income Function (DIF) to decide which returns to classify for further examination.[98] The computer program tagged returns which produced a high enough DIF score. Only then would those returns be pulled for further review by employees in the Service Center.

The double impact of ADP on returns processing is evident here again: centralization and mechanization. With the most significant aspect to verification of returns---audit selection---now done by the NCC, the separation of returns processing from return examination which had begun after 1918 was almost complete. No longer were experienced humans making the primary classification of returns for potential audit. The humans got to see only those returns selected for them by a computer. In this way, decisions about audit became less decisions about individual returns and become more decisions about classes of returns, batches of returns. The decisions that computer programmers implemented were decisions about aggregates of taxpayers and about the bulk-processing of their returns.

[97] The programmers built their programs on the basis of information supplied by the Taxpayer Compliance Measurement Program (TCMP) which was a program where the Service would randomly select returns for line-by-line exam to see where taxpayers made common errors. The last series of TCMP audits occurred in the early 1990s for tax year 1988. The program was then abandoned under pressure from Congress. It was partially revived in 2002 under the new name "National Research Program." See generally, George Gutman, *IRS National Research Program on Track Despite Training Delays* 97 Tax Notes 331 (Oct. 21, 2002). See also Treasury Inspector General Report No. 2004-30-044, "*Additional Efforts Could Further Improve the Execution of the National Research Program*," (January 2004).

[98] IRS Historical Fact Book at 191.

B. Impact of ADP on Other Tax Functions

Both during and after Commissioner Caplin's tenure, automation spread to other tax administration functions as well. As noted above, it was in fact first used in 1948 to facilitate mass mailing of notices. A brief look at just two areas affected by automation---document matching and automated collection ---will suffice to set up a discussion of the larger problems created by ADP.

First, ADP expanded to document matching. In 1958 when the Service employed 60,000 workers, there were about 300 million information returns to process and compare to about 130 million taxpayer returns.[99] In 2008, with only approximately one-third more workers (91,000), the Service was able to process almost 1.89 **billion** returns against about 250 million taxpayer returns.[100] It could not happen without ADP. In a speech to Congress on April 20, 1961, President Kennedy emphasized the need for increased withholding mechanisms in the tax code---especially for interest and dividends---calling it "unfortunate" that "the application of the withholding principle has remained incomplete."[101] As to how the Service would handle the increased information provided by the new information returns, Kennedy blithely noted that "[i]ntroduction of equipment for the automatic processing of information returns would be especially helpful for this purpose and would thus supplement the extension of withholding."[102] Congress obliged the President in the Revenue Act of 1962, requiring the Service to develop an

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[99] Harrop Freeman and Nathan Freeman, THE TAX PRACTICE DESKBOOK at 103 (Little, Brown & Co., Boston, 1960).

[100] IRS Data Book 2008, Figures ___, ___.

[101] John F. Kennedy, "Our Federal Tax System," House Document No. 140, 87th Congress, 1st Session, at 10.

[102] Id. at 11.

income information document matching program to verify income reported and to catch non-filers.[103]

By 1978, the Service was not only able to perform the limited matching function that the old Kansas City Processing Center had performed (matching W-2s submitted by taxpayers against the W-2's submitted by employers) but was now able to match all W-2's and 1099's submitted electronically against taxpayer returns.[104] The automation still extended only to the matching process, however. When mismatches were found, it required human judgment to decide how to respond to the mismatch.

In 1982, the Service began planning for an automated exam program to remove the human element.[105] Completed in 1989 the project, known as the Automated Underreporter Program (AUR), was designed "to replace the manual process of screening cases initially identified from matching income and deduction documents received from third party payers against tax returns."[106] That is, no longer would the computer matching programs simply spit out the returns where there was mismatch and leave to humans to figure out if that was a problem and, if so, how to fix it. Instead, the computer system itself would identify the problem and attempt to fix it by shooting out computer-generated letters to taxpayers, generally in the form of a "CP 2000" notice which tells the taxpayer that because of the mismatch the Service will assess the indicated amount of additional tax unless the taxpayer convinces the Service not to.[107] Along with the

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103 Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960.

104 IRS Historical Fact Book at 213.

105 IRS Historical Fact Book at 219.

106 IRS Historical Fact Book at 232. For details of the AUR operations, see Internal Revenue Manual (IRM) §4.19.3

107 See IRM §4.19.3.18.2. Sometimes, the AUR system will generate a "softer" letter, called the CP 2501, which is simply a request for information rather than a proposed assessment. See IRM

AUR came the AUR control system in 1990 to provide automated case management and tracking, "relieving the problems of tracking approximately 9 million underreporter cases annually."[108]

The Service has since succeeded in reducing or removing the human element in automated processes similar to AUR --- processes that seek additional information from taxpayers when some event triggers a need for more information. As with the AUR, these programs generally do not simply write a polite letter to taxpayers for the information but instead inform the taxpayer that the Service will assess a deficiency based on third party information returns unless the taxpayer contacts the Service and convinces someone otherwise.[109]

Thus, when the document matching programs cannot find a taxpayer return to match with information returns received, the Automated Substitute For Return (ASFR) program kicks in, again sending out computer-generated notices to taxpayers, proposing an assessment based solely on the information received from third parties and leaving it to the taxpayer to respond with reasons why no return needed to have been filed.[110] Likewise, the Service has also

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§4.19.3.6. There is some degree of human intervention in the AUR system. See generally, Treasury Inspector General For Tax Administration Report No. 2008-40-180, *Most Automated Underreporter Program Notices Are Correct; However, Additional Oversight Is Needed*, (September 25, 2008).

[108] IRS Historical Fact Book at 235.

[109] The two types of notices sent by the Service here are generally either a Notice of Deficiency (90-day letter) or a Proposed Notice of Deficiency (30 day letter). When the Service identifies a "deficiency" in tax, as defined in §6211, it may not assess the deficiency until after giving the taxpayer notice and waiting at least 90 days during which time the taxpayer may file a petition in Tax Court to contest the deficiency. §6213. That is why the Notice of Deficiency is also called the 90-day letter. Sometimes, however, the Service sends a pre-notice notice to taxpayers saying that the Service will send them the Notice of Deficiency in 30 days unless they convince the Service not to. This is called the 30-day letter. For description of the 30-day letter process see Debra A. Chini, *The 1988 Amendment to 26 U.S.C. Section 7430: Expanding Taxpayers' Rights to Recover Costs in Tax Controversies*, 42 Vand. L. Rev. 1711, 1715 (1989).

[110] For details of the ASFR operations, see Internal Revenue Manual (IRM) §5.18.

automated most of its correspondence exams through the Automated Correspondence Exam (ACE) program. The following official description of this program is emblematic of all these computerized interactions with taxpayers:

> Automated Correspondence Exam (ACE), formerly Batch Processing (BP) is an IRS-developed, multifunctional software application that fully automates the initiation, Aging and Closing of certain EITC and non-EITC cases. Using the Batch System, Correspondence Exam can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received. Because the batch system will automatically process the case through creation, statutory notice and closing, tax examiner involvement is eliminated entirely on no-reply cases. Once a taxpayer reply has been considered, the case can be reintroduced into Batch for automated Aging and Closing in most instances.[111]

Another important expansion of ADP has been to the tax collection function, which begins once the tax liability has been assessed. Again, this is the story of centralization, mechanization, and batch processing. It started in 1975 when each Service Center established a Collection Branch to consolidate all collection cases worked in the Center.[112] In 1982, the Service began planning for an Automated Collection System (ACS) and a pilot program went forward in 1983.[113] The consolidation was completed in 1984. At that point, Service Centers took over responsibility for performing all collection functions from the first issuance of a Notice and Demand for Payment notices through notices of intent to levy to automatic levies. It is useful to think of these functions as occurring in two stages, which are typically called the Notice Stage and the ACS stage. I shall briefly describe each to give the reader a sense of the mechanization and bulk-processing nature of these operations.

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[111] IRM §4.19.20.1.

[112] IRS Historical Fact Book at 208

[113] IRS Historical Fact Book at 219, 220

What happens during the Notice Stage is that computers automatically send out a series of Notices and Demands for Payment to taxpayers at their last known address.[114] The automation cannot be overemphasized. As with the AUR and ACE programs on the tax determination side, computers generate the correspondence. No human hand writes a line. No human tongue licks an envelope. No human eye reviews an account before sending out a collection notice. Most importantly, no human brain makes any individualized decision about what notice to send.

The decision to send out multiple notices is an example of aggregate decision-making. The Tax Code requires only one Notice and Demand for payment before the tax lien arises and a second notice before the Service may seize assets.[115] Nonetheless, the IRS has made the aggregate decision that for this class of taxpayers (those who have not fully paid their assessed tax), additional demands for payment beyond those two minima will often resolve the account. And so the computer sends non-business taxpayers four notices and business taxpayers three notices, spaced five weeks apart. No individual Campus employee decides this for each account: it is an institutional decision made for the bulk-processing of accounts receivable.

One might think the decision to send the multiple notices to <u>all</u> taxpayers makes little sense for many taxpayers. For example, taxpayers who self-reported their liability know full well they have not paid. Why do they need more than one notice? Similarly, individual taxpayers who

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[114] The Service has contemplated using outgoing call centers to contact taxpayer but, as with the idea in 1956 to canvass the districts, resource constraints have prevented this approach. See TIGTA Report No. 2006-30-055, *Trends in Compliance Activities Through Fiscal Year 2005*, (March 2006), Appendix V, Figures 5, 6 for trends in compliance staffing between FY96 and FY05.

[115] IRC §6303, §6331(d). Since 1998, the Code requires a third notice to tell taxpayers of their rights to a Collection Due Process Hearing. §6330(a). The Service made the processing decision to send that notice out, automatically, during the Automated Collection System processing stage, after the Notice Stage. See generally, Bryan T. Camp, *The Failure of Adversary Process in the Administrative State*, 84 Ind. L. J. 57, 80-82 (2009).

lose their pre-assessment litigation in Tax Court have ample notice of the assessed amount due and payable. So while the first notice perhaps serves the purpose of letting the taxpayer know that yes, the IRS is now ready and willing to receive the payment---just as the Collector who received the assessment lists in the 1860's would approach taxpayers first for voluntary payment---it is difficult to think of any purpose served by additional notices not required by statute. But to make individualized decisions about which taxpayers should get what notices would involve the time and attention of human beings, which is very expensive. The cost of identifying and exempting those subgroups and individual taxpayers from the notice process most likely outweighs the gains to the Treasury given the huge numbers of taxpayers involved.[116]

Accounts of taxpayers who do not respond to the stream of notices move to the ACS stage. Here is where the Service first sends out levies and files Notices of Federal Tax Lien (NFTLs).[117] Again, I emphasize that this work is done mainly by computer systems with little human intervention and on the basis of aggregate decision incorporated into the computer programming. Computers decide which accounts get priority in processing.[118] Computers interact with other

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[116] The collection statistics show that in FY2005 the IRS collected almost as much money from the later notices ($13.4 billion) as from the first ($15.3 billion). See 2006 Data Book, Table 16 ("Delinquent Collection Activities"). Unfortunately, since 2006, the Service has changed the information reported in Table 16 so one cannot find these numbers for more recent years.

[117] Before the Service may enforce the tax lien against certain types of creditors, it must first file a Notice of Federal Tax Lien in the proper jurisdiction. §6323. The difference between automated and manual levies is well explained in TIGA Report No. 2004-30-094, *Additional Efforts Are Needed to Ensure Taxpayer Rights Are Protected When Manual Levies Are Issued* (March 2004). As with AUR, while there is some human intervention in ACS levy processing, the human decisions are highly constrained by the computer outputs.

[118] See TIGTA Report 2004-30-165 *The New Risk-Based Collection Initiative Has the Potential to Increase Revenue and Improve Future Collection Design Enhancements*, (2004)("initiative used predictive models to characterize accounts according to the probability of productive or unproductive closure, for [automated] routing to the most effective treatment area.")

computers to identify types and locations of taxpayer assets (such as employer name, bank accounts, etc.) and computer algorithms determine the most likely levy sources.[119] The Collection Due Process (CDP) notices required by § 6320 and § 6330 (informing taxpayers their rights to an administrative hearing the result of which they may appeal to Tax Court) are automatically issued by computer on form letter LT11, with no human intervention.[120] It is the computer system that prevents most levies until the statutory 30 days passes from the date of the CDP notice (with an extra 15 days built in to allow time for taxpayer CDP requests to be input into the system).[121] For some levies, an IRS employee in the Collection Branch reviews the information on a computer screen and decides how many levies to send, but even then the employee exercises little discretion on what to do and engages in little individualized decision-making.[122] The decisions have been made beforehand, in the aggregate. Levies exempt from

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119 See IRM 5.19.4.3.2 (12-01-2000) ("Levy Sources and ACS Display").

120 See IRM 5.19.4.3.4 (04-24-2001)("Pre-Levy Requirements").

121 Some levies are not subject to the CDP restrictions, notably those seeking to seize state income tax refunds. Such exempt levies sail right through the system with no check. IRM 5.19.4.3.5(1) (01-11-2001)(Levy Routing and Duties). In 2004, The Treasury Inspector General for Tax Administration (TIGTA) found the computerized systemic levy process was better than humans at complying with the 30 day CDP wait period. See TIGTA Report No. 2004-30-094, *Additional Efforts Are Needed to Ensure Taxpayer Rights Are Protected When Manual Levies Are Issued*. By 2006, TIGTA found both error-free. TIGTA Report No. 2006-30-101 *Fiscal Year 2006 Statutory Review* (August 2006).

122 See generally IRM 5.19.1 (Balance Due Collection). Along these lines note that the ACS process does not generate paper files. All data is kept in electronic format which is then picked up by the Integrated Collection System if the account is transferred to the field. Id. (giving instructions on the virtual "Desktop Integration" system).

CDP, such as those to states (to grab state tax refunds) are completely automatic, running on weekly or monthly database matches between the IRS and the state or federal levy source.[123]

C. Problems Created by ADP

The expansion of ADP has produced some impressive numbers, both as to assessments as collections. On the tax assessment side, in FY 2008 the AUR system sent letters to some 3.5 million taxpayers, and assessed a resulting $6.4 billion in tax liabilities.[124] That same year the ASFR system attempted contact with over 1.3 million taxpayers and ended up assessing over $10 billion.[125] Meanwhile, correspondence audits have grown dramatically in recent years, from some 500,000 in FY2000 to 1.1 million in FY2007.[126]

On the tax collection side, the stats are equally impressive. In FY 2008, ACS spit out over 2.25 million levies and brought in over $2.36 billion. That compares with 374,000 levies issued by field employees, who collected a total of $3.23 billion.[127] More importantly, ACS was able to

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[123] § 6330(f); The state levy program is described in IRM 5.19.9 ("Automated Levy Program")(11-01-2003).

[124] IRS Data Book, 2008, Table 14, available at http://www.irs.gov/taxstats/article/0,,id=211513,00.html.

[125] Id.

[126] National Taxpayer Advocate 2008 Report To Congress (December 31, 2008) at 244, available here: http://www.irs.gov/advocate/article/0,,id=97404,00.html. I cannot find statistics on what percentage of correspondence audits are performed by ACE but I suspect the answer is all or nearly all, given the description of the program in the National Taxpayer Advocate's 2008 Report to Congress.

[127] Treasury Inspector General For Tax Administration Report No. 2009-30-082, *Trends in Compliance Activities Through Fiscal Year 2008* (June 10, 2009) at 25, Figure 9 (for amounts collected) and 30, Figure 20 (levies issued). Those statistics suggest, correctly, that the automatic levies spewed forth from Service Centers like machine gun bullets do not actually "hit" on assets at nearly the rate manual levies in the field do. However, as I explain in greater detail in another article, the ACS uses levies primarily to hit up taxpayers and goad them into providing information to the Service. Levies are as much a means of gathering information as

process and close over 3.45 million taxpayer accounts, 1.36 of them by full payment of the tax, interest and penalties owed.[128] In contrast, field employees were able to close 1.2 million accounts, 360,000 of them by full payment.[129]

Along with its success, however, ADP has created the very problems for tax administration that Caplin warned of. The first problem arises from the loss of human contact between those who administer the tax laws and those who seek to obey them. The second is an often overlooked function of batch-processing: the shift from individualized decision-making to aggregate decision-making. These two problems basically flow from the centralization and batch-processing features of ADP that generate the lovely numbers above. I shall note each in turn.

1. The Challenge of Centralization

Caplin warned of over-centralization and urged future tax administrators to keep the focus on individual taxpayers:

> Always to be kept in mind is the human element. The Revenue Service must think of the individual and must maintain local offices---regardless of what they are called---as the main focal point to day-to-day contacts with taxpayers. These offices will continue to be the Internal Revenue Office to the great mass of taxpayers. This is as it should be; and the IRS must strive for better service and better individual treatment to the greatest possible extent.[130]

Unfortunately, Congress has moved the Service in the opposite direction, beginning with the reorganization mandated in the IRS Restructuring and Reform Act of 1998.[131] Centralization

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assets. See Bryan T. Camp, *The Failure of Adversary Process in the Administrative State*, 84 Ind. L. J. 57, 72 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997475.

[128] Id., at 29, Figure 17.

[129] Id. The work flow of collection gives the most difficult cases to the field employees, so it is not surprising that they close many fewer cases by full payment.

[130] Mortimer Caplin, [cite to reprint – original at 4].

[131] IRS Restructuring and Reform Act, P.L. 105-206, 112 Stat. 685 (1998).

has been a core feature of Service re-organization over the past decade. As two highly respected clinical professors observed:

> An integral part of the reorganization [resulting from the 1998 restructuring act] has been the automation and computerization of many IRS functions, as well as the centralization of many of those functions in the campuses: For example, innocent spouse claims are now worked exclusively at the Covington, Kentucky, campus. Offers in compromise go to Brookhaven, N.Y., and Memphis. Docketed "S" cases are reviewed by Appeals at the Philadelphia and Fresno campuses. EITC certification, if instituted, will be handled in Kansas City.[132]

The key question is when does centralization become "over"-centralization? The National Taxpayer Advocate has given her usual keen analysis on the subject of centralization in almost every one of her yearly reports to Congress.[133] In her 2008 Annual Report to Congress, she does a masterful job in articulating exactly the problem that Caplin warned of. She notes that while centralization can provide significant benefits to taxpayer service as well as to tax administration, it carries two significant drawbacks: the loss of human interaction and the loss of local expertise.

As to the first, the NTA notes "one significant consequence of centralization is the diminished level of face-to-face service that IRS offers to taxpayers."[134] A good example of this problem is the centralization of Collection Due Process (CDP) hearings. CDP hearings occur during the tax collection process. Before the Service may make its first levy or file its first Notice of Federal Tax Lien, it is supposed to allow taxpayers to ask for a hearing where the

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[132] Janet Spragens and Nancy Abramowitz, *Low-Income Taxpayers and the Modernized IRS: A View From the Trenches*, 107 Tax Notes 1407 (June 13, 2005).

[133] For example, the Service's Offer In Compromise Program has been an especial focus of NTA concern. See NTA 2007 Annual Report at 375 (critiquing centralization of the Offer In Compromise Program); 2004 Annual Report at 311 (same); 2003 Annual Report 99 (same); 2002 Annual Report at 15 (same).

[134] NTA 2008 Annual Report at 265.

taxpayer has the opportunity to show why the proposed collection is unwarranted, either in law or policy.[135]

When one thinks of a "hearing" one naturally thinks of a some type of meeting where the parties are physically present where the appellant has the opportunity "to support his allegations by argument however brief, and, if need be, by proof, however informal."[136] However, the pressure on the IRS Office of Appeals to handle and close the large volume of CDP hearings led it to attempt to centralize the processing of CDP hearing requests at Service Centers in 2004, with the result that a CDP "hearing" can consist of telephone calls, or even simply an exchange of letters, and can occur without the taxpayer even being fully aware that the "hearing" has taken place.[137] This is a far cry from Caplin's call to keep "local offices."

The second downside to centralization is the loss of local expertise. For example, knowledge of local conditions might be important when evaluating the expenses that a taxpayer claims are

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[135] IRC §§ 6320 and 6330 govern the process and content of CDP hearings.

[136] Londoner v. City and County of Denver, 210 U.S. 373, 386 (1915).

[137] Treas. Reg. 301.6630-1(d)(2), Q&A D6; see e.g. Stewart v. Comm'r, 2004-1 U.S. Tax Cas. (CCH) ¶ 50,212 (W.D. Pa. 2004)(holding that taxpayers had received a CDP hearing even though the Settlement Officer stated that the meeting "was an informal meeting and was not the due process hearing"). For a complete discussion of how "the IRS has transformed the meaning of "hearing" into something completely different from what was contemplated by Congress," see Bryan T. Camp, The Failure of Adversary Process in the Administrative State, 84 Ind. L. J. at 82-87 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997475. One can see the evolution of the CDP appeals process in the yearly reports of the National Taxpayer Advocate. In her 2003 Annual Report she criticized the Office of Appeals for its backlog of cases and long processing time, see NTA 2003 Report to Congress at 45-48. If ADP and centralization do nothing else, they reduce processing times. It was no surprise to see the Service then try and centralize and automate the CDP appeals process and away from face-to-face hearings, a trend the National Taxpayer Advocate notes with some concern in her 2004 Annual Report, at 466 ("Appeals is beginning to send some CDP case files to the IRS campuses (formerly known as service centers)." By 2005, the NTA was concerned enough by the centralization of Appeals in Service Centers---both of CDP hearings and other types of hearings----that she listed it as one of the most serious problems encountered by taxpayers. See NTA 2005 Annual Report 138-161.

necessary when evaluating an Offer In Compromise.[138] Or it might be that local employees can gain insights into certain types of taxpayers concentrated in a local geographic area, such as farmers, or fishermen, or permanent residents, or farmworkers. This kind of local expertise is lost when the Service requires all Offer In Compromises to be evaluated by employees in New York. [139] It is lost when the Service closes local Taxpayer Assistance Centers ("walk-in" centers) of the type that Caplin thought should always be available to taxpayers.[140] In the latter case it is not just that local knowledge is lost, it is that a centralized decisionmaker gives orders on what is acceptable and what is not acceptable. Even if the local physical office remains open, the centralization of work assignments adversely affects service. The National Taxpayer Advocate gives an excellent example: a farmer who has questions about income averaging and how to depreciate farm equipment may still be able to go to a local walk-in center, but the employees of that center are not allowed to answer those questions because those questions are deemed too "unusual" to warrant training Service employees on them.[141] .

2. No Soul in the Machine: The Problem of Operational Presumptions

Just as with centralization, the key question is when does an automated system become "over"-mechanized. A look at ADP's impact on the document matching system may provide a good answer: find and evaluate the operational presumption. That is, the document matching system presumes all third party information returns correct and presumes that any mismatch with

[138] See James P. Angelini, Tracy Noga, *Distortions in Equity Caused by Cost-of-Living Differences*, 121 Tax Notes 1165 (2008)

[139] See Allen Kenney, *Taxpayer Advocate Olson Finds Fault With Offer-in-Compromise Program*, 2004 TNT 192-3 (Oct. 4, 2004).

[140] See Dustin Stamper, *TIGTA Faults Data in IRS Attempt to Close Walk-In Centers*, 2006 TNT 57-1 (March 24, 2006).

[141] National Taxpayer Advocate, 2008 Report at 102.

a taxpayer returns is taxpayer error. This aggregate decision is characteristic of ADP batch-processing. Decisions must be made as to batches of taxpayers; there is neither time nor money to make individualized decisions. So the Service presumes, and indeed must presume, that the information returns are correct and the taxpayer returns are incorrect. That is the operational presumption. It reflects the statutory presumption that inclusion provisions are to be interpreted broadly and taxpayers must affirmatively demonstrate why income they receive should be excluded from gross income.[142] The IRS would be remiss to administer the tax law any other way. However, like any bright-line rule, the operational presumption is both under- and over-inclusive.[143] The broader the presumption---the bigger batch it applies to---the greater room for error. While it would be poor tax administration indeed to abandon the presumption, I believe that Caplin would agree the presumption could be more narrowly tailored when circumstances warrant.

For example, two years ago, the newspapers were full of stories about taxpayers whose homes were foreclosed on by lenders, who wrote off the unpaid mortgage balance as a bad debt.[144] These taxpayers were getting caught by the AUR system because lenders were required

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142 See e.g. Commissioner v. Schleier, 515 U.S. 323, 328 (1995)("We have repeatedly emphasized the "sweeping scope" of [section 61] and its statutory predecessors. We have also emphasized the corollary to § 61(a)'s broad construction, namely, the default rule of statutory interpretation that exclusions from income must be narrowly construed.")(internal quotes, citations omitted).

143 When rule does not apply to a situation it should it is under-inclusive and when it applies to a situation it should not, it is over-inclusive. All rules suffer this defect. For example, a sign near a school may say "Speed Limit 20 mph When Flashing." The rule is to protect students walking the streets so the sign is programmed to flash every day from 7:45 to 8:00 a.m. which is when the students normally cross the street. But on days when the opening of school is delayed by an hour, the sign does not flash when it is most needed. Then it is an under-inclusive rule. And by flashing on days when the school is unexpectedly closed, it is over-inclusive rule.

144 For one typical such story, see "After Foreclosure, A Big Tax Bill from the I.R.S.," New York Times, August 20, 2007, available at http://www.nytimes.com/2007/08/20/business/20taxes.html?emc=eta1. For the tax commentary

by §6050P to file Form 1099-C's to reflect the Cancellation Of Debt ("COD"). Section 61(a)(12) says that COD is gross income and when the taxpayers did not report it as income, the AUR system automatically sent them Notices of Proposed Deficiency. For many, if not most, of these taxpayers, however, the forgiven debt would be excluded from gross income by §108(a) because most, if not all, of these taxpayers were probably insolvent at the time of debt forgiveness. However, many of these taxpayers did not fill out the correct Form 982 to claim the exclusion and so although they might well have entitled to substantive relief, they encountered what for many would prove to be an insurmountable procedural problem.

So long as the AUR contained the operational presumption that the lender Form 1099-C's were correct, taxpayers who had just lost their homes to foreclosure were in the same procedural position regardless of their substantive rights under § 108 or any other substantive tax provision. The taxpayer's proper reporting position (exclusion) triggered the matching programs which, some 18-24 months later, would spit out a proposed notice of deficiency based on the unreported COD reflected in the third party information return. If the taxpayers failed to respond to the notices---and one might easily imagine that taxpayers in dire financial straits could well fail to timely respond---they got hit with an assessment, interest and penalties and their case moved into the rough waters of the collection stream.

Congress claimed it fixed this particular problem by passing the Mortgage Forgiveness Debt Relief Act, which amended §108 in late 2007 to exclude COD generated by the forgiveness of

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on the problem, <u>see</u> Stephen B. Cohen, *Mortgage Double Whammy: First, You Default; Second, You're Taxed*, 117 Tax Notes 169 (Oct. 8, 2007)("As the subprime mortgage crisis deepens, more and more homeowners default on their mortgages and face what The New York Times calls a double whammy. First, they lose their homes; then they get billed for taxes on the amount of debt . . . wiped away in foreclosure.)(quotations omitted); Bryan T. Camp, Proceduralist Reflections on Home Mortgage Foreclosures, 117 Tax Notes 483 (Oct. 29, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1026002.

qualified debt.[145] The Service then administered that change in the law by creating a modified Form 982 for taxpayers to attach to their return.[146] This form allows taxpayers to report the excluded COD and creates a document on the return for the AUR system to match to the third party information return. But the modified Form 982 does not change the operational presumption---it just added a new box for taxpayer to check. Taxpayers who fail to fill out the Form 982 but are entitled to exclude forgiven debt---for whatever substantive reason---are still subject to the operational presumption.

Congress did not have to write new law, particularly a law that is subject to some powerful substantive criticisms.[147] The Service could have solved the problem faced by home mortgage forgiveness by temporarily modifying the operational presumption for a certain subclass of taxpayers---those whose COD arose from mortgage foreclosures. The Service would have done this by modifying the third party information return, Form 1099-C, so the lender could check a box indicating the forgiven debt was a home mortgage. Then the AUR could then be programmed to ignore mismatches between those Form 1099s and taxpayer returns.

Reversing the operational presumption for an identified subclass makes perfect sense in the ADP World, where individualized determination is subordinated to aggregate decisionmaking.

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[145] P.L. 110-142, 121 Stat. 1803.

[146] See Internal Revenue News Release IR-2008-14, *Mortgage Workouts, Now Tax-Free for Many Homeowners;Claim Relief on Newly-Revised IRS Form* (IR-2008-17, Feb. 12, 2008)

[147] See Stephen B. Cohen, *Mortgage Double Whammy: First, You Default; Second, You're Taxed*, 117 Tax Notes 169 (Oct. 8, 2007); Deborah Geier, *Another Take on the Mortgage Debt Relief Situation*, 117 Tax Notes 389 (Oct. 22, 2007); Bryan T. Camp, Proceduralist Reflections on Home Mortgage Foreclosures, 117 Tax Notes 483 (Oct. 29, 2007); Stephen B. Cohen, "Cohen Responds to Geier on Mortgage Debt Relief;" 117 Tax Notes 533 (Oct. 29, 2007); Deborah Geier, *Mortgage Debt Discharge Income: A Response to Prof. Camp.* 117 Tax Notes 625 (Nov. 5, 2007); and Stephen B. Cohen, *Home Mortgage Debt Relief: The Debate Continues*, 117 Tax Notes 727 (Nov. 12, 2007).

In my example, it would be the same humane decision that Congress ultimately made to modify (unnecessarily) the substantive law to provide relief to that same subclass of taxpayers.

I seriously doubt, however, that any tax administrator would have agreed to modification of the AUR's operational presumption. For the modification (blinding the AUR system to COD from mortgage foreclosures) would also be over-inclusive, allowing some taxpayers to escape reporting COD income who would not be excluded under the unmodified §108.. The reluctance of tax administrators to let go of an operational presumption that results in a default tax liability is well illustrated by the history of §6201(d), which Congress added to the Code in 1996 in the Taxpayer Bill of Rights 2 legislation.[148] Section 6201(d) provides that when a taxpayer challenges a deficiency based solely on third party information returns, the Service "shall have the burden of producing reasonable and probative information concerning such deficiency in addition to such information return." Congress put this section in the Code only after the Service refused to follow circuit court decisions coming to similar conclusions.[149] Notice, however, how this statute does not require the Service to change the operational presumption; the statute is only

[148] Taxpayer Bill of Rights 2, P.L. 104-168, 110 Stat. 1452.

[149] In Portillo v. Commissioner, 932 F.2d 1128 (5th Cir. 1991), the Service had assessed a deficiency based solely on a Form 1099, even when the third party who submitted the Form 1099 could not verify the payments to the taxpayer he reported on the form. The Fifth Circuit roundly criticized the Service practice of relying on the Form. In response, however, the IRS Office of Chief Counsel refused to apply the lesson of Portillo. Although the Service initially decided that "it is our position that Portillo should be narrowly confined to Form-1099 situations." 1992 FSA LEXIS 198, it later decided to completely reject Portillo and fight it at every turn. "The Service does not agree with the holding of the Fifth Circuit in Portillo. It will continue to rely on information returns in generating notices of deficiency and will seek to limit the application of the Portillo reasoning to factually identical cases in the Fifth Circuit, as discussed below. In general, the Service opposes any attempt to shift the burden of proof." Litigation Guideline Memorandum, *"The Presumption of Correctness In Cases Where The Service Relies In Whole or In Part on An Information Return As Evidence Of An Omission of Income*" 1994 LGM LEXIS 10.

triggered when a taxpayer manages to obtain individualized consideration. For taxpayers who are not able to challenge a proposed assessment before it is made, §6201(d) is of little help.

Taxpayers suffer similar hardships from the same type of operational presumption used by the Automated Correspondence Exams under the ACE system, as the National Taxpayer Advocate ("NTA") recently explained in her massive 2008 Annual Report To Congress.[150] Briefly, the operational presumption here is that taxpayers who do not respond to the automated requests for information are presumed to be noncompliant and, accordingly, a "default" assessment results. The problem with this operational presumption is this:

> Once the IRS engages the batch system, cases move through the examination process automatically. Each step in the process has a pre-established period programmed into the system. Files are not created or examiners assigned to the cases until the IRS receives and controls a taxpayer's correspondence. If a taxpayer fails to furnish the requests documentation precisely within the prescribed period, the case automatically moves to the next phase in the process. ... Because the batch system automatically processes a case from its creation through the issuance of a Statutory Notice of Deficiency and subsequent closing, the IRS has effectively eliminated the need for human involvement in every case in which a taxpayer does not reply in a timely fashion.[151]

The operational presumption at work here is that <u>all</u> taxpayers who do not respond in 30 days (plus 15 extra days to account for mail and processing delays) are noncompliant. But only certain responses count. And only if timely. If a taxpayer actually responses but not in a way that can be processed in time for an employee to enter the response data in the computer system, the system "purges" the case and immediately sends out the next document in the series, such as the Notice of Deficiency.[152] Since there is no examiner assigned to the case until the computer recognizes that the taxpayer has sent in the requested documentation, "the automated process limits the ability of taxpayers to engage in a meaningful dialogue with tax examiners, to ask

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150 National Taxpayer Advocate, 2008 Annual Report to Congress, at 243–259.

151 <u>Id</u> at 248-249.

152 NTA 2008 Report to Congress at 249.

questions about the process and the issues, and to resolve problems that invariably arise during the course of an examination."[153] This operational presumption overwhelms taxpayers and tags as "noncompliant" those who cannot respond, with the proper kinds of documents, and strictly within the time limits. The NTA rightly criticizes the ACE system as being precisely what Caplin warned about: over-mechanized.

Finally, an operational presumption that creates repeated problems for all ADP systems is the presumption of "last known address." That is, in many situations, the Code requires the Service to give taxpayers notices and the mere sending of the notices to the taxpayer's "last known address" is what triggers the timer period for taxpayers to convince the Service not to take some action adverse to their interests. Given our mobile society where not everyone remembers to tell the Service when and where they move, it is no wonder that this requirement has generated much litigation.[154] The Service gamely wrestled with the issue in a regulation and came up with a result that one might expect from an agency committed to ADP.[155] The regulation basically says that the "last known address" is the address recorded in the Service's main computer system unless and until the Service updates that record through certain information pathways. Thus, for example, the last known address is the address given on a taxpayer's last filed return and not the address on a return under examination. Nor does the regulation permit taxpayers a wide scope of methods to inform the Service of their address change. Therefore, just because some Service employee knows that a taxpayer has moved does not mean that the official "last known address" has changed. One can see how this operational presumption of "last known address" interacts

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[153] NTA 2008 Report to Congress at 249.

[154] See David M. Richardson, Jerome Borison, Steve Johnson, CIVIL TAX PROCEDURE (2nd) (LEXIS NEXIS 2008) at 211 – 214 (reviewing rules and noting "this has been an area rife with litigation.")

[155] Treas. Reg. 301.6212-2.

with the operational presumptions in the AUR and ACE systems to create huge problems for what I call "inarticulate taxpayers," which are taxpayers---usually the poor---who do not have the wherewithall to meet the challenges of speaking to a mechanized bureaucracy.[156]

I should emphasize here that I but echo Caplin's point that ADP is neither inherently bad" or "good." Rather, my point is simply to bring Caplin's insights about tax administration up to date: ADP forces us to think about tax administration---and hence about how the Service can foster taxpayer compliance---in a different way than in 1862, or 1918, or 1952, or even at the dawn of ADP in 1964, as I hope to demonstrate in the last section.

III. Theory and Practice in an ADP World

"*the heart of the system really beats with the citizen's confidence that he is being treated fairly and honestly, required to pay no more than his just share, and his assurance that his neighbor is paying a proper share as well.*" -Mortimer Caplin, 1962.[157]

Politicians and commentators have always bragged about the United States "voluntary" tax system. Back in 1862, the first Commissioner of Internal Revenue, George Boutwell, reported glowingly that, "sustained by the patriotic sentiments of the people, it is a matter for congratulation that the taxes assessed have, with few unimportant exceptions, been paid with cheerfulness..."[158] Almost 100 years later President Kennedy declared that "[o]ne of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment."[159]

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156 See Bryan T. Camp, *The Failure of Adversary Process in the Administrative State*, 84 Ind. L. J. at 98, note 107, and at 100, describing one such inarticulate taxpayer's interaction with the system.

157 News Release IR-540.

158 Boutwell's Manual at vii.

159 Message to Congress of April 20, 1961, House Doc. 140, 87th Congress, 1st Sess. at 14.

Behind the rhetoric, however, everyone knows the system cannot rely simply upon the altruistic cheerfulness of taxpayers. The tax assessor Charles Emerson made the point simply in 1867: "Human nature must greatly change, before we shall find that patriotism is more universal than selfishness."[160] President Kennedy put it more eloquantly: "For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in [the] uniform and vigorous enforcement of these laws."[161] A former IRS Commissioner reportedly used the term "voluntary compulsion" rather than voluntary compliance.[162]

The goal of good tax administration, therefore, is not only to enable compliant taxpayers to obey the law but also to disable noncompliant taxpayers from disobeying the law. Tax administrators such as Mortimer Caplin have long recognized two successful approaches to achieve this goal: structural mechanisms that put taxpayers into a default posture of compliance, and procedural mechanisms that assure taxpayers of the fairness of tax law administration.

Both of these points are particularly relevant to thinking about tax administration in an ADP world. Like any tool, ADP can be used well or badly. But it must be understood and considered properly before its use can be evaluated.

A. Structuring Rules

Taxpayer compliance does not come simply from audits and penalty assessments but comes instead from a <u>structure</u> that both promotes compliance and retards evasion. As scholars have

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[160] Emerson's Guide at 130, note.

[161] Message to Congress of April 20, 1961, House Doc. 140, 87th Congress, 1st Sess. at 14.

[162] George Guttman, *The Interplay of Enforcement and Voluntary Compliance*, 83 Tax Notes 1683, 1685 (1999), attributing the term to former Commissioner Jerome Kurtz.

long recognized, Congress can write structural laws, such as "stoppage at the source" (now called "withholding") requirements that payors must withhold tax from payments made to payees and turn the tax over to the government.[163] These structural laws regulate payment compliance by making compliance the default position.[164] Similarly, laws imposing third-party reporting requirements promote reporting compliance by increasing the risk of detection.[165]

These structural laws would not be effective, however, if they could not be administered. Likewise, choices in administration of the laws can enhance their effectiveness. For example, the Service can enhance reporting compliance by administering the withholding system so that most taxpayers find themselves in a refund posture. Social scientists confirm what we intuit: the lure of refunds increases reporting compliance.[166]

The most important structural change in tax administration in the past forty years is the expansion of ADP. It is ADP that allows the Service to process the billions of information returns increases the effectiveness of the reporting structure and so present a credible threat to taxpayers that discrepancies <u>will</u> be spotted and addressed. That is why scholars who scoff at the low rate of "audits" need to be more attentive to ADP. For example, Professor Raskolnikov has recently asserted both that "[a]udit rates are exceedingly low and have been falling for

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[163] Edwin R. A. Seligman, THE INCOME TAX: HISTORY, THEORY AND PRACTICE OF INCOME TAXATION,. (MacMillin Co., New York, 1914) at 660-663;.

[164] <u>See generally</u> Piroska Soos, *Self-Employed Evasion and Tax Withholding: A Comparative Study and Analysis of the Issues*, 24 U.C. Davis L. Rev. 107 (1990).

[165] <u>See generally</u> Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 Stan. L. Rev. 695 (2007)

[166] Jahn Hasseldine, Peggy A. Hite, *Framing, gender, and tax compliance,* 24 J. of Economic Psychology 317, 318 (2003)("Experiemental research in the tax arena has supported the suggestion...that taxpayers in a balance-due situation, as opposed to those who are expecting a tax refund, are generally less compliant in their tax reporting decisions."); Accord, Erich Kirchler, Boris Maciejovsky, "*Tax compliance within the context of gain and loss situations, expected and current asset position, and profession*," 22 J. of Economic Psychology 173 (2001)(studying what constitutes the reference point for "refund" or "payment").

decades," and that "audits are expensive."[167] Both points ignore ADP and that oversight undermines his central argument regarding the effectiveness of IRS enforcement. Between the matching programs and ACE, the IRS effectively and efficiently "audits" the income items of almost every single return subject to third-party withholding. Scholars need to recognize this actual practice of tax administration.

The most important ADP feature to recognize when thinking about tax administration is the operational presumption. The operational presumption is like a rule of law. One of the problems with ADP I point out above is that, like any bright-line rule of law, an operational presumption will be both over- and under-inclusive. But legal rules, no matter how bright their line, have exceptions and require for their ultimate application the judgment of a human decisionmaker. Not so these operational presumptions. And that is the point I wish to emphasize here, a point too often overlooked by legal scholars concerned with tax administration.

Tax scholars often overlook the impact of ADP when addressing issues about structural laws. For example, different scholars create different compliance typologies, all of which are reasonable but none of which have much relevance to actual tax administration through ADP. Thus, Professor Leandra Lederman divides taxpayers into three kinds, defined by behavior: (1) taxpayers committed to compliance; (2) taxpayers committed to noncompliance; and (3) the vast middle of taxpayers who can go either way, depending on circumstances.[168] Professor Raskolnikov posits two kinds of taxpayers, defined by primary motivation: (1) those who seek

[167] Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 Colum. L. Rev. 689, 700-701, 703.

[168] Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance,* 64 Ohio St. L. J. 1453, 1499 (2003).

to game the system; and (2) everyone else.[169] Professor Sagit Leviner says there are five degrees of non-compliance, defined by intention: (1) commitment; (2) capitulation; (3) resistance; (4) disengagement, and (5) game playing.[170]

What such typologies ignore is that ADP has room for only two categories: compliant and non-compliant. And it has no room for intention or motivation. One result of mechanization is the loss of human interaction and, hence the loss of a role for human Service employee judgments about human taxpayer motivations. Computers are run by zeros and ones. On and off. Compliant or noncompliant. That is the importance of the operational presumption. When there is a mismatch between a taxpayer return and an information return, the taxpayer is noncompliant until the taxpayer can prove otherwise. It does not matter whether a taxpayer's failure to report information on his or her tax return or to respond to the computer-generated letters or notices is because of altruism, game-playing, cognitive dissonance, death in the family, medical emergency, or any other event or circumstance. When the NCC scores a tax return such as to trigger the Automated Correspondence Exam, the taxpayer is noncompliant until the taxpayer makes the proper response in the proper form within the proper time period. And, as I discuss at length in another article, when a taxpayer fails to pay as assessed tax, that taxpayer is presumed to be able but unwilling to pay, when the reality might well be that the taxpayer simply cannot pay.[171]

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[169] Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 Colum. L. Rev. 689, 694-701 (justifying separation of taxpayers into gamers and non-gamers).

[170] Sagit Leviner, *An Overview: A New Era of Tax Enforcement - From 'Big Stick' to Responsive Regulation*, 2 Regulation and Governance 360, 370 (2008).

[171] See Bryan T. Camp, *The Failure of Adversary Process in the Administrative State*, 84 Ind. L. J. at 82-87 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997475.

It is true that programmers can fine tune the rules computers run on. Rules can be very complex. But they are still rules. And, more importantly, they are structural rules, not legal ones. This is what tax administrators knew long before Lawrence Lessig had this insight in relation to cyberlaw.[172]

While one might, in theory, want to operationalize motivations, in practice one cannot do it. Professor Raskolinkov tries, by proposing that taxpayers self-report whether they are compliant or not compliant --- a kind of "check the box" regime for compliance. Taxpayer who self-identify as "non-gamers" would be subject to lower penalties for errors but would be required to suffer under what Raskolnikov believes are stronger pro-government procedural rules than currently in the Code. What Raskolinkov overlooks is that the current system of information returns performs the function of separating taxpayers into his two categories, with his "game-players" being exposed by requirements that they self-report the games they engage in or else face extra penalties for noncompliance with the reporting requirements.[173]

Understanding the role of ADP in performing what we might term the structural administration of the law leads to better thinking about tax administration. Professor T. Keith Fogg focuses his two excellent articles on the §6672 Trust Fund Recovery Penalty on, first, its current flawed structure and, second, on ideas for other structural reforms---both in law and in administration. He criticizes those who say the Service must simply "work harder" to catch

[172] LAWRENCE LESSIG, CODE AND OTHER LAWS OF CYBERSPACE (1999)

[173] Professor Zelenak makes this critique of Raskolnikov's proposal in much more detail. *See* Lawrence Zelenak, Tax Enforcement for Gamers: High Penalties or Strict Disclosure Rules?" 109 Columbia Law Review Sidebar 55 (June 24, 2009) available at http://www.columbialawreview.org/articles/tax-enforcement-for-gamers-high-penalties-or-strict-disclosure-rules. One can see a similar information-forcing structural mechanism in the transfer pricing regime's interplay of §6662 with §482 where corporate taxpayers can avoid imposition of the accuracy-related penalty---even if they have a §6662 substantial valuation misstatement caused by a net section 482 transfer price adjustment---by complying with certain reporting requirements.

employers who withhold their employees' income taxes but keep the money and use it for their business rather than turn it over to the Treasury.[174] He points out that penalty regimes must be properly structured to deter violators and he also has some inventive ideas on creating a reporting regime that will channel taxpayer behavior towards compliance. His ideas on structural reforms will go a long way to address a nagging compliance problem that leads to a loss of some $58 billion tax dollars a year. It is no accident that before becoming an academic Professor Fogg had a long and illustrious career in the IRS Office of Chief Counsel.

Another reform that seeks to leverage ADP's value to tax administration is Professor Joseph Bankman's proposal that the Service provide taxpayer return preparation services.[175] In one sense this is a throwback to the 1862 method of tax administration. However, in another sense it reflects an understanding of how ADP has transformed tax administration. The term "voluntary compliance" really refers to the idea that the chief source of information needed to ensure that each taxpayer pays the correct tax has traditionally been the taxpayer. However, with the explosion of reporting requirements---just look at the §6050 series---it is quite possible that the Service has more information about most taxpayer's financial affairs than even the taxpayers themselves. If so, it makes a lot of sense for the Service to share that information with taxpayers and let taxpayers correct it. Such a regime would, again, channel taxpayer behavior *ex ante* into compliance without using the more expensive and awkward penalties or other traditional *ex post* efforts.

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[174] See T. Keith Fogg, *Leaving Money on the Table and Providing an Incentive Not to Pay --- The Story of a Flawed Collection Device*, 5 Hastings Bus. L. J. 1 (2009); T. Keith Fogg, In Whom We Trust (draft article in my possession).

[175] Joseph Bankman, *Using Technology to Simplify Individual Tax Filing*, 61 Nat'l Tax J. 773 (2008).

In sum, the United States tax administration runs on rules, both those embodied in the law and those coded into computers. It is the latter that can have a tremendous impact on the structure of tax laws and has the potential to help compliant taxpayers to meet their tax obligations and disable noncompliant taxpayers from evading their tax obligation. Tax administration is no longer so much about individual employees administering the law to other individuals; it is much more about individual employees monitoring machines.

B. Fairness

Mortimer Caplin believed strongly that the voluntary compliance so critical to tax administration was best achieved by ensuring that the system treated taxpayers "fairly." By that he meant the Service should perform its work "in a fair and impartial manner, with neither a government nor a taxpayer point of view."[176] The Service should instead adopt what he called "a fair and reasonable attitude."[177] Caplin believed this so strongly that he enshrined his philosophy in a Revenue Procedure, Rev. Proc. 64-22 which emphasized the mission of the Service to apply the law properly: "The revenue is properly protected only when we ascertain and apply the true meaning of the statute."[178]

The theoretical and empirical literature on both fairness and taxpayer compliance is large and complex, but supports Caplin's insight into the importance of fairness. Social scientists repeatedly find that taxpayers respond to a much broader set of stimuli than simply potential audits and penalties. In particular, perception of the procedural fairness of a system affects

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[176] Rev. Proc. 64-22, 1964-1 C.B. 689.

[177] Mortimer Caplin, *A Personal Letter to Taxpayers*, Form 1040 Instructions for 1962.

[178] Rev. Proc. 64-22, 1964-1 C.B. 689.

taxpayer willingness to participate in the system and comply with the law's requirements. As one literature review summarized it:

> Taxation offers an interesting context for examining the effect that procedural justice has on taxpayer compliance behaviour because most people assume that taxpayer behaviour is dominated by financial self-interest concerns. However, research in this area has found that taxpayers also value and respond well to fair treatment when dealing with tax authorities.[179]

In 1998, Congress became very concerned---one might say hysterical---that tax administration was unfair and that the Service was "abusing" taxpayers.[180] I recount the full story elsewhere, but essentially Congress---and here I mean the Senate Finance Committee in particular----worked itself into a lather and mostly over the wrong problem. It was fixated on the idea that individual Service employees were abusing individual taxpayers. When one looks at all the examples trotted out before the Committee of taxpayer "abuse," they were all concerned with taxpayers interacting with IRS field employees. The real "abuse' of taxpayers, however, occurred (and continues to occur) because ADP mis-classifies compliant taxpayers as non-compliant. By mis-identifying the problem, Congress wrote some pretty ineffective statutory remedies.

One striking example of this mis-match of remedy to cause is the so-called Collection Due Process provisions added in the 1998 Reform Act.[181] Like tax scholars, the taxwriters there ignored both the true cause of taxpayer abuse, and the remedy they wrote was quickly captured

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[179] Kristina Murphy, Tom Tyler, "*Procedural justice and compliance behaviour: the mediating role of emotions,*" 38 Eur. J. Soc. Psychol. 652, 655 (2008). The authors there conduct a study supporting those findings.

[180] *See generally*, Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 Fla. L. Rev. 1, 87-91, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=496239.

[181] IRC §6220, 6320.

by the IRS and transformed into just another batch processing system, a system which abuses taxpayer by continuing to mis-classify them.[182]

Understanding the potential abuse of ADP requires an understanding of operational presumptions and how they are essentially designed to sort taxpayers into the two categories: "compliant" or "noncompliant." On the tax determination side, those categories relate to the taxpayer's compliance with properly reporting his or her relevant financial transactions. On the tax collection side, those categories relate to the taxpayer's compliance with his or her payment obligations. Either way, however, taxpayers are presumed to be non-compliant until they become responsive. Responsive taxpayers receive human consideration but those tagged as non-compliant (because of non-responsiveness) get the brush-off. If the classification is properly made, then the treatment is proper. But if a taxpayer who everyone agrees should be in the "complaint" box is mis-classified and treated as non-compliant, then that is abuse.

Eliminating this type of abuse must thus focus on getting the ADP sorting mechanisms right so they make the proper discrimination on the proper grounds. The improper selection of sorting criteria is one recurring critique made by the National Taxpayer Advocate about various ADP systems in almost every one of her annual reports to Congress. Whatever one thinks of the substance of her critiques, she is absolutely correct in the approach she takes to thinking about fair tax administration in an ADP world: she evaluates the effect of batch processing on certain categories of taxpayers. It is no coincidence that the current National Taxpayer Advocate, Nina Olson, ran a low income taxpayer clinic in Richmond, Va. in the early 1990's. It was that

[182] I analyze these matters at great length, including an empirical analysis of the first 976 court decisions regarding their operation in Bryan T. Camp, *The Failure of Adversary Process in the Administrative State,* 84 Ind. L. J. 57, 72 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997475.

experience that allowed her to realize, first-hand, the enormous impact of ADP on inarticulate taxpayers.

A more subtle type of taxpayer abuse caused by ADP is tunnel vision: a myopic focus on that which can be counted, rather than on that which should be done. The ease of counting what can be processed by computers has exerted a hidden but constant pressure to move the Service from far-sighted neutral administration of the tax laws to short-sighted collection of maximum dollars for the Treasury. Caplin's warnings about these dangers need to be revived and respected.

For example, in the mid-1980's the Service embarked on a project called "Compliance 2000" or "CP 2000" The idea was to have local field offices identify categories of taxpayers whose potential noncompliance could be addressed *ex ante*, through training or soft notices or the like. The National Taxpayer Advocate gives a good history of Complaince 2000 in her 2008 Annual Report:

> Over 15 years ago, the IRS acknowledged it could be more effective in improving tax compliance if it understood and addressed the local reasons for noncompliance.1 Local organizations (e.g., small business groups) and local sources of information (e.g., local government lists of license or permit holders) can help the IRS identify, understand, and address noncompliance at the local level. Research suggests that concentrated IRS activity to reverse noncompliance norms among local businesses may have a greater "ripple effect"on voluntary compliance by other taxpayers than seemingly random examinations.[183]

The project was great in theory. But it floundered along, partly because the Service could not develop any good measurements, and was eventually abandoned as collateral damage to the death of the TCMP program.[184] Ironically, the only remnant of the program now are the CP 2000 notices that are spit out of the AUR system. They were originally designed to be a "soft"

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[183] NTA 2008 Annual Report to Congress at 176.

[184] See e.g. GAO Report No. 96-109, IRS Has Made Progress But Major Challenges Remain, (June 5, 1996). NTA 2008 Report to Congress at 176-178.

notice to encourage taxpayers to voluntarily come forward with information but since 1999 they have turned into a combo request for documents and 30-day letter, thus putting taxpayers under a tight deadline to overcome the classification of "noncompliant" because of a failure to respond.[185] CP 2000 letters, however, can be counted, tracked, and reported.

The tendency to focus on numbers is illustrated by the lovely numbers I give at the start of Part II.C above to show the "success" of ADP. Most readers probably accepted those numbers as support for the proposition. However, I am sure that some readers asked "relative to what"? The corrective is to put those lovely numbers into context. The proper context for the numbers, I suggest, is the context of voluntary compliance. Only about 2.5% of the approximately $2.3 trillion in net income and employment tax dollars received by the Service from corporations and individuals in FY2008 (gross collections less refunds) represent dollars obtained through enforced collection mechanisms, including the AUR, ASFR, ACE, and ACS.[186] While a billion here and a billion there eventually adds up, one must always keep in mind the proper perspective when evaluating how one might change ADP or use alternative administrative tools to better achieve that less quantifiable, but very important, goal of tax administration, fairness.

Caplin's article recognized the potential for abuse by over-mechanization. He urged his successors to keep what he called "the human element" alive. How can this be done? While the Service has always tried to be responsive to individual taxpayers who seek administrative

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[185] Id at 247.

[186] IRS Data Book 2008, Table 1 (total tax receipts), Table 16 (enforced collection receipts); Treasury Inspector General For Tax Administration (TIGTA) Report No. 2009-30-082, *Trends in Compliance Activities Through Fiscal Year 2008* (June 10, 2009) at 21, 22, Figures 1, 3. The IRS Data Book suggests that enforced collection dollars amounted to just over $32 billion (Table 16, $28,465,648,000 in "Total amount collected" from "Returns filed with additional tax due" plus $3,773,528,000 in "amount collected with delinquent returns.") TIGTA, however, uses other data and reports total enforcement dollars in FY 2008 were $56.4 billion. I use the latter number.

reviews and appeals, there are large classes of taxpayers who get tangled up in the system and suffer from the operational presumptions that tag them as noncompliant when they are really only inarticulate. Although Congress focused on the wrong analysis in the 1998 reform legislation, it did create one structural mechanism and strengthen another to help taxpayers respond to the mechanized bureaucracy: tax clinics and the Taxpayer Advocate Service (TAS). Both mechanisms can be seen as a reaction to increased ADP.

First, as part of its focus on helping individual taxpayers prevent abuse from individual IRS employees, Congress established and funded Low Income Taxpayer Clinics (LITC).[187] While these clinics represent only a modest number of taxpayers, they have arguably had an important impact by creating a lobbying voice for formerly inarticulate class of taxpayers. For example, the ABA Tax Section's Low Income Taxpayer Committee has in recent years become very active and very vocal. Similarly, many LITC are located in law schools and their clinical professors are writing proposals and articles about tax administration that come at the subject from this non-traditional viewpoint.[188]

The second structural change that appears to be a response to the rise of ADP is the creation of an independent office with the IRS to help taxpayers with procedural snafus by issuing "Taxpayer Assistance Orders (TAO's).[189] What is now the Office of the National Taxpayer

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[187] Section 3601 of the IRS Restructuring and Reform Act, P.L. 105-206, 112 Stat. 685 (1998). This provision is not codified.

[188] Among the many, many, examples of good work that I could cite, I refer the interested reader to any of Professor Fogg's works, which reflects a nuanced understanding of the actual practice of tax administration. In addition, Professor Carlton Smith at Cardozo has put forward an intriguing proposal to reverse an operational presumption---the "full pay" rule of Flora v. United States, 362 U.S. 145 (1960)---for taxpayers in installment agreements). *See* Carlton M. Smith, *Let the Poor Sue for Refund Without Full Payment*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1354145

[189] IRC §7803, 7811. I am indebted to Professor Fogg who first suggested this idea.

Advocate traces back to the Office of the Ombudsman, created administratively in 1979 to administer the Problem Resolution Program (PRP). PRP was designed to help taxpayers for whom normal administrative procedures had failed.[190] Congress codified this function in §7811 in 1988 in the first Taxpayer Bill of Rights (TBOR I), then expanded it, first in 1996 and then again in 1998.[191]

Section 7811 authorizes the National Taxpayer Advocate to issue TAOs to different Service functions to prevent a taxpayer caught up in the system from being crushed by the gears of automation. The power is triggered by a taxpayer who encounters "hardship" within the statutory meaning.[192] One problem with the original §7811 was that it did not explicitly authorize TAOs to require the Service to take positive actions to relieve taxpayer hardship. For example, while a TAO could forbid the Service from filing a Notice of Federal Tax Lien, it could not require the Service to release an Notice if already filed. This problem was first remedied by administrative practice and then by Congress in the 1996 Taxpayer Bill of Rights 2.[193] In 1996 Congress also renamed Ombudsman the Taxpayer Advocate. In the 1998 IRS Restructuring and Reform Act, Congress significantly strengthened the Taxpayer Advocate's role by giving the National Taxpayer Advocate direct communication channels to Congress and by charging the National Taxpayer Advocate with not only helping individuals but also performing "systemic

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[190] Conference Report on the Technical and Miscellaneous Revenue Act of 1988, H. Rep. 100-1104, at 215.

[191] TBOR I was part of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647 (TAMRA), 102 Stat. 3342, 3390 (1998). TBOR 2 was part of Pub. L. No. 104-168, 110 Stat. 1452 (1996). The modifications in the IRS Restructuring and Reform Act are in §1102 of the Act, Pub. L. No. 105-206, 112 Stat. 685 (1998). The structure and powers of the Taxpayer Advocate Service are codified at IRC §7803(c) and 7811.

[192] §7811(a)(2).

[193] Delegation Order 239 (01-31-92); Taxpayer Bill of Rights 2, P.L. 104-168, 110 Stat. 1452.

advocacy" which she now does in a very comprehensive Annual Report to Congress each December.[194]

The Taxpayer Advocate Service thus provides the structural mechanism to pull taxpayers out of the automatic processing regime and put their individual situation before the appropriate IRS employee. As it proclaims on its website, it is the voice of taxpayers within the IRS.[195] It does this both at the individual level and the batch processing level.[196] It is a fitting counterweight to the problems of increased ADP and helps keep tax administration human, and humane.

IV. Conclusion

To a system like ours that runs on information, ADP promises wonderful gains in efficiencies and in the ability to help taxpayers meet their responsibilities. At the same time, ADP poses a constant threat to unbalance the Service, to degrade tax administration into an exercise in putting up the right numbers instead of doing the right thing. Caplin believed in doing right and believed that the American way of taxation was, ultimately, the identification of government interest with taxpayer interest. The interests were not divergent and, indeed, could not be divergent because it was taxpayers who, ultimately, controlled the government.

Proper attention to both the theory and practice of tax administration, as articulated by Mort Caplin in his 1964 article, will yield desirable results, even if difficult to quantify. Misunderstanding either one leads to unwise choices about administration, as the 1998 IRS Restructuring and Reform Act evidences. The most under-theorized aspect of tax administration

194 Examples of the National Taxpayer Advocate's Reports can be found at http://www.irs.gov/advocate/article/0,,id=97404,00.html.

195 See http://www.irs.gov/advocate/article/0,,id=212313,00.html.

196 Pub. L. No. 104-168, Sec. 101, 110 Stat. 1452, 1453-54 (July 30, 1996).

is the expansion of ADP and its impact on the current tax system. Caplin forsaw both the potentials and pitfalls of the then emerging ADP technology and his article captures both the problem to be faced as well as the approach to be taken. For these reasons his thoughts deserve our renewed attention and, in recognition of that, his words from long ago provide a fitting conclusion to this article:

Regardless of the miracles of automation, our type of tax system cannot operate effectively without the human element. Courtesy and a fair and reasonable attitude---on the part of both tax administrator and taxpayer---are other essential ingredients if this system is to continue to serve the Nation well. - Mortimer Caplin, A Personal Letter to Taxpayers, 1962.