James Bovard

The IRS vs. You

Secret informants, searches at will, contempt for the courts, hatred for the small businessman and the self-employed, and even anti-clericalism—a frightening portrait of how the federal government feeds its habit.

In 1989 Emil Pikul, a rookie agent with the Internal Revenue Service, called Glenview, Illinois businessman Vince Han with some bad news: he was going to be auditing the personal tax returns of Han and his wife, as well as the return of their antique reproduction clock business. The couple's first meeting with agent Pikul went smoothly. But for their second rendezvous, Pikul insisted they meet at the couple's home. And that's when Vince Han's IRS nightmare began.

About a half-hour after Pikul arrived, his supervisor Sherwin Stern showed up at the couple's house as well. In their basement, Stern pointed a finger at Han and bluntly announced, "You have to pay $70,000 now. If you don't pay, you're going to jail." Stern also told the Hans that if they didn't come up with the money, they would end up forking over "a whole lot more"—and then mentioned a figure in excess of $345,000. He gave Han seven days to come up with the money.

Vince Han, who had given the IRS every document the agency had requested to see, refused to pay. But agent Pikul had not bothered to read some of the key documents in the file, and concluded that Han had lied when claiming outstanding debts of several hundred thousand dollars. He made no effort to contact the people that Han owed to see if the debts had been forgiven or written off; the agent did nothing to verify his hunch or find a single speck of evidence of tax fraud. In his official agency report, Pikul merely asserted that Han "was not an honest taxpayer."

Han then took his case to the Appeals Division of the IRS, which concluded that Han in fact owed the agency nothing. Han then sued the IRS to recover his legal costs, but the agency, as is its wont, fought tooth-and-nail to avoid paying any of Han's legal costs. U.S. Tax Court Judge David Laro ruled in 1993 that the IRS's case "was not reasonable in fact or in law," and that the agency's treatment of Vince Han was a "textbook example of how the IRS should not conduct an examination."

Yet the case is also a textbook example of how today's IRS goes about its business. Its contempt for citizens like Vincent Han is so routine, and so unlimited, that the agency has become a kind of Frankenstein, running wild and terrorizing Americans at will. The IRS hypocritically requires mistake-free returns when its own books are in shambles. It demands exorbitant sums of money without regard to the accuracy of its claims. It doesn't hesitate to use every possible legal maneuver to get what it wants, sometimes destroying businesses—and lives—in the process. And on those rare occasions when the courts rule against it, the agency blithely declares itself in a state of "nonacquiescence"—its euphemism for unbridled contempt for the law.

As Daniel Pilla noted in a recent study for the Cato Institute:

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Congress has doubled the IRS budget over the past 10 years—making that agency one of the fastest growing nonentitlement programs. It has increased its employment by 20 percent. The IRS's powers to investigate and examine taxpayers transcend those of any other law enforcement agency. Virtually all of the constitutional rights regarding search and seizure, due process, and jury trial simply do not apply to the IRS.

The increase in IRS power over private citizens is mirrored by the increase in the number of tax rulings, regulations, and laws that citizens must obey. The agency's tax rules and regulations have exploded in recent decades, increasing from less than 200 pages in 1913 to over 7,000 today. Advisory opinions and tax court rulings amount to scores of additional pages. *Money* magazine noted, "Although the *Internal Revenue Manual* runs to 260 densely printed volumes, tax collectors enjoy tremendous latitude, partly because courts have ruled through the years that the manual is not the law. As a result, the IRS can flout its own rules with impunity." And David Burnham, author of *A Law Unto Itself: The IRS and the Abuse of Power*, observes, "The reality that so many are somehow in violation of a supremely murky law gives the agency and the individual agent an astonishingly free hand to pick and choose their targets."

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The tens of thousands of often arbitrary and sometimes contradictory regulations and rulings mean that it is easy enough for even the most conscientious taxpayer to run afoul of them. Nevertheless, the agency follows an abusive policy of near-tyranny in enforcing them. The General Accounting Office (GAO) found that the IRS made more than 20 million unjustified changes to taxpayer accounts last year—resulting in millions of unjustified additional penalties and wrongful demands for additional tax payments. Because so many people are intimidated by the agency, however, Internal Revenue collects billions of dollars each year in unjustified surtaxes and penalties.

According to the GAO, the IRS makes unjustified seizures of the paychecks and bank accounts of tens of thousands of citizens and businesses each year. The most frequent reason for the wrongful levies is sloppy bookkeeping by the agency. An August GAO report noted that, in just one type of tax account, it took the IRS an average of 316 days to log in payments received from businesses—thus virtually guaranteeing that many of them would be accused of not paying taxes they had already paid.

The GAO also noted that IRS computer systems do not even "identify cases of abuse or taxpayer mistreatment from the taxpayer's perspective." After the report was issued, IRS Deputy Commissioner Michael Dolan complained, "We believe that the use of the term 'taxpayer abuse' is misleading, inaccurate and inflammatory."

But what's inflammatory is the absurd behavior of the agency itself: its flagrant violations of decency, of common sense—and of United States law. Consider the recently settled case of Daniel Heller. Heller is an attorney who represented the *Miami News*, which in a 1975 exposé revealed that IRS agents were engaged in "illegal spying on the sexual and drinking habits of important local citizens." The agency demanded that Heller reveal the newspaper's sources at the agency, which Heller refused to do.

The IRS retaliated with a tax fraud investigation against Heller. When the IRS could not find any evidence of wrongdoing, it engaged in what a federal appeals court later ruled was "intentional intimidation" of Heller's accountant. (The lead agent in the case publicly denounced Heller as a "despicable human being.") The accountant then perjured himself with false testimony against Heller, who was subsequently sent to prison for four months in 1987—more than eleven years after the appearance of the original *News* article. The appeals court overturned the conviction, and Heller sued the agency, which settled out of court for $500,000 in 1994. To this day, the IRS refuses to disclose whether the agents who abused Heller were ever disciplined.

It's unlikely they were, for the IRS seems loath to punish even the most outrageous errors with anything more than a slap on the wrist. In August 1993 the agency revealed that 369 of its employees in one regional office had been investigated for browsing through the returns of friends, relatives, celebrities, and others. (A staggering fact: Roughly half of the agency's 115,000 employees have access to computer systems with private and corporate tax information.) Some at the office even altered the files of neighbors or created fraudulent returns. Most of the guilty employees received only minor reprimands, in keeping with the attitude of IRS Commissioner Margaret Milner Richardson, who seems blithely uninterested in the privacy rights of the Americans whose financial histories she is responsible for safeguarding. When one senator urged her agency to take the rather minimal step of notifying those citizens whose files had been perused, Richardson replied, "I'm not sure there would be a serious value to that in terms of protecting the taxpayers' rights."

If abuses of privacy do not trouble IRS superiors, seizing assets or concocting large payment demands during audits makes them happy—regardless of whether the assessments hold up later in court. Since agents are rarely, if ever, punished for overturned assessments, they have virtual carte blanche to extort payments from their hapless victims, very few of whom have any understanding of the hellish complexities of tax law.

Incentives for claiming high assessments also corrupt the agency's own financial records and cast serious doubt on the reliability of their statistics. *Worth* magazine reported earlier this year that a 1993 Treasury Department Inspector General report noted that twenty-four employees in the agency's Buffalo office filed formal complaints that their managers were manipulating audit statistics "to receive merit pay awards." The Inspector General concluded that IRS managers were "gaming the numbers" and "building a house of cards."

However accurate or inaccurate the agency's numbers may be, tax law explicitly presumes that the IRS is always right—and implicitly presumes that the taxpayer is always wrong—in any dispute with the government. In many cases, the IRS introduces no evidence whatsoever of its charges; it merely asserts that a taxpayer had a certain amount of unreported income and therefore owes a proportionate amount in taxes, plus interest and penalties.

The IRS believes it is entitled to impose penalties—or even seize property—for overdue taxes, even if it sent tax deficiency notices to the wrong address. Frank and Ann Cook relocated from Seattle to Connecticut in 1985. The Cooks filed a proper change of address form with the IRS; but after the agency audited their previous returns, it sent a bill for $6,300 to the old address. The post office failed to forward the letter. *Worth* reported: "Despite repeated phone calls and letters to the Hartford office, the Cooks did not receive written notice of the IRS audits until 1989. Ultimately, the IRS seized $35,000 in salary and savings. The couple and their children were reduced to living on $150 per week for part of a year."

Simply requiring the IRS to notify citizens of tax assessments before sending out final seizure notices, the Justice Department argued, would impose "unmanageable detective burdens" on the IRS.

Clayton and Darlene Powell moved from one Maryland town to another in late 1987, filing a tax return with their new address in early 1988. Several weeks after receiving the new address, the agency nonetheless sent a notice of deficiency for their 1984 tax return to the old address. The local post office—even though it had a forwarding address for the Powells—returned the notice to Internal Revenue. Though the three-year statute of limitation on demanding more taxes due on their 1984 return had expired, the IRS sent a notice to the couple's new address giving them ten days to pay $6,864 or have their property seized. The Powells promptly paid—and then sued the IRS to get a refund.

A federal court of appeals ruled that the Powells were "entirely innocent" and ordered the IRS to give them a refund. The agency appealed that decision to the Supreme Court, contending that as long as the IRS mails a tax deficiency notice to a taxpayer's "last known address," the taxpayer must be presumed to have received the notice, even when it is indisputable that the notice was not received.

In its brief on the case the Justice Department noted that the IRS issues more than 2 million such notices annually, "and approximately 240,000 of those notices were returned undelivered during the past year." (The GAO reported last December that a 1991 internal IRS audit found IRS employees incorrectly entering almost half-a-million new address changes to its master file each year. In 1988, these resulted in approximately 300,000 undeliverable notices that claimed a balance due of about $49 million.) But requiring the IRS to notify citizens of tax assessments before sending out final seizure notices, the Justice Department argued, would impose "unmanageable detective burdens" on the IRS. "This case," they maintained, "threatens to create a 'window of time' during which the Internal Revenue Service may be helpless to protect its rights in pursuing delinquent taxpayers." That is, the IRS would be "helpless" if obligated to notify those people whose property it intends to seize. The Supreme Court denied the government's request to hear the Powell case.

Though it finally gave the Powells a refund, the agency announced that it would not be bound by the appeals court ruling in other disputes; the judges, it said, had misinterpreted the law, leaving the agency free to declare "nonacquiescence." In other words, the agency gives itself license to disregard court decisions it disagrees with—making a mockery of due process and the constitutional rights of Americans. And since good tax lawyers routinely cost more than $200 an hour, those embroiled in a nonacquiescence case with the IRS can have an extremely difficult time securing the legal rights to which a court decision has entitled them. In such cases, the IRS customarily only obeys Supreme Court rulings.

Hardly anything diverts the agency's shameless grab for any imagined gain by taxpayers. In November 1994 the IRS mailed a breathtaking notice to Paul Zwynenburg, whose brother Mark was killed in the 1988 Lockerbie terrorist bombing of Pan Am Flight 103. The IRS notice announced, "In accordance with the provisions of the existing Internal Revenue laws, notice is hereby given that the determination of the estate tax liability discloses a deficiency of $6,484,339.39." Zwynenburg and his parents, who were named beneficiaries in the son's will, were given 90 days to pay the entire amount or appeal to the U.S. Tax Court.

The Zwynenburg family had not received a single cent in payment for the death of Mark Zwynenburg. A group of relatives and survivors of the blast's victims sued the now-defunct airline, but no settlement has been reached. The IRS simply made a "guesstimate" that the final settlement for Zwynenburg's death would be $11,702,925—and then demanded that the family pay up. The IRS refused to back down even after it had been publicly ridiculed. John Zwynenburg, the victim's father, said, "I have to go out and hire my lawyer and my accountant to fight something that has no merit."

Like other federal agencies, the IRS has adopted the technique of recruiting undercover informants from all walks of life. By the agency's own admission, it was using 900 "controlled informants" in 1989—and 40 of those were accountants. Indeed, the IRS is happy to provide bugging devices and expert tips to financial consultants who want to earn a windfall by betraying their clients.

In 1979 St. Louis accountant James Checksfield was recruited to be "controlled informant No. 43111" after facing a criminal investigation for failing to pay his own taxes for three years. The IRS dropped its investigation, and instead put Checksfield on its payroll. Checksfield provided the IRS with information on how one of his own clients, Steve Noles, was allegedly skimming money from his pizza business and not reporting it on his tax returns. Noles was indicted by a federal grand jury and faced up to $900,000 in fines—and twenty-four years in prison.

The *Wall Street Journal* subsequently reported, however, that Checksfield had helped Noles create one of the special accounts for his alleged scheme—what amounted to a clear case of entrapment. Checksfield swore in a subsequent affidavit that Noles's tax omissions "could have been prevented" had Checksfield done his job properly. But IRS assistant regional commissioner Michael Orth denied his agency's role in the sting anyway, saying, "We don't recruit informants. They generally come to us on their own initiative because they're upset someone else is avoiding their share of taxes. Why should we discourage this sort of patriotism?"

Federal magistrate William Bahn observed in 1991 that the "tawdry facts" of the case left a "bitter taste," and observed that the case "strongly suggests a lack of honesty and integrity" on the part of the IRS agents supervising Checksfield. The IRS finally dropped the charges against Noles just before the case was to go to trial—but, as Keith Stroup of the National Association of Criminal Defense Lawyers observed, "I'm sure they did it because they knew the judge was going to slam them."

The IRS applies scant controls over agents conducting undercover activities. In fact, the official *Internal Revenue Manual*—in a chapter entitled "Illegal Acts or Violations of Rights by Informants"—declares:

> Special agents, in the performance of their official duties, may utilize investigative techniques which appear to, but do not in fact violate a state or local criminal statute. . . . In receiving unsolicited information for the first time from an informant, the Service may accept the information and, in accordance with its value, may pay for such information even if it may have been obtained illegally by the informant.

In 1993 the IRS paid a record $5.3 million to informants for turning suspected tax violators in to the agency. And federal judges have ruled that even evidence seized illegally in federal non-tax investigations can be used by the IRS to prosecute taxpayers.

As with other government escapades gone amok, however, the agency frequently goes far overboard in its zeal to nab ordinary citizens and convict them of wrongdoing. Its undercover operation Project Layoff, a sting against illegal bookies, was launched in 1985 in Las Vegas. The project, which cost the agency in excess of $500,000, quickly degenerated into a monumental fiasco. Sen. Harry Reid (D-Nev.) observed that the IRS officials involved in Project Layoff were "so incompetent that they couldn't even agree on who was going to pay the monthly phone bill." The GAO noted that the IRS operation lost money "because the IRS could not use the normal methods bookmakers use to collect unpaid debts, such as threats, bodily harm or loan-sharking."

Furthermore, the agency destroyed many of the key documents from the investigation, thus preventing federal investigators from determining whether IRS agents themselves robbed the till. The agency's own internal audit report noted, "As this type of operation was new to the Service, there was some uncertainty as to proper recordkeeping." Such a lackadaisical attitude toward the books was hardly unusual; a 1992 GAO review found that the IRS failed to do close-out financial audits of almost half of all undercover operations in which tax dollars had been spent. And yet the agency is making surprise visits all around the country to verify the recordkeeping of private citizens.

IRS Commissioner Margaret Milner Richardson has written that the goal of the new approach is to "audit the taxpayer, not just the tax return."

Recently the agency revised its procedures for performing such verifications, transforming the already awful audit process into an absolute nightmare. The IRS has begun including "economic reality" tests as part of its audit routine. Newt Gingrich recently denounced these lifestyle audits as an opportunity to "decide they are going to review everything about your life to see whether or not they approve of the amount of taxes you pay." And the reviews have already become known as "Calvin Klein" audits—because the IRS agent practically goes through a person's closet to see how expensive his jeans are.

While some IRS officials have downplayed the new "economic reality approach," others admire how the IRS is planting its flag on vast new territories of private lives. IRS Commissioner Richardson has written that the goal of the new approach is to "audit the taxpayer, not just the tax return."[1] *Tax Notes* reported last December, "According to Kay Howard, project manager for the economic reality training program, the Service has a right to ask how taxpayers spend their money. To taxpayer incredulity, she directs agents to respond that all of what goes on with a taxpayer's income is within the scope of an audit. The Service wants the economic reality approach to be applied in every audit."

IRS spokesman Frank Keith counters that the public's concern about the "economic reality" audits is all a mistake, since the IRS has used such audit techniques for decades: "The only thing new about it is the name. That's how we caught Al Capone in the '30s." Maybe so—but the IRS had good reason to believe that Capone was a major tax swindler, while the average John should not be treated with the same presumption of extreme guilt. The IRS is now asserting that it has the right not merely to determine whether a citizen complied with tax law and paid what he owed; instead, the agency is claiming a right to go through every nuance of a citizen's private life to paw for evidence of malfeasance. The official IRS list of questions that agents now routinely inflict during these audits captures the breadth of the new policy:

- What cash did you have on hand in 1993, usually, personally or for business, not in a bank—at your home, safe deposit box—etc.?
- What is the largest amount of cash you had at any one time in 1993?
- Did you transfer funds between your accounts? If so, how much and when?
- Did you ever redeposit funds previously withdrawn from your accounts?
- Do you have a safe deposit box? Where? What is kept in it?

IRS agents also ask about the taxpayer's health and the health of his family members, and who is paying for the college education of his children and grandchildren. Daniel Pilla, author of *How to Fire the IRS*, says, "The IRS wants to evaluate your home, your furniture, your fixtures, how much you spend on reading materials and smoking and alcoholic beverages; they want to evaluate your wedding, the wedding of your children—your educational background, your cultural background, your level of sophistication, the neighborhoods you live in, and the clubs you belong to."

There is rich irony in the IRS conducting "economic reality" tests on private citizens—the GAO found that the agency "failed to account for 64 percent of the $6.7 billion it spent in 1992 for items such as office rental, salaries, and computers" and that it was incapable of confirming that it "actually holds some $797 million in assets it claimed it seized."

Yet if the economic reality audits are bad, they are a breeze compared to the IRS's most devastating audit weapon of all—the Taxpayer Compliance Measurement Program (TCMP). In December the IRS will begin notifying 151,439 lucky families and businesses that they have been selected for TCMP. It will be by far the biggest mega-audit in IRS history. Newt Gingrich has already likened it to "the return of the Inquisition."

The TCMP audits will go line by line down the tax return

[1]It remains to be seen if Richardson, a longtime friend of Hillary Clinton, feels the same way about Robert "Red" Bone, the commodities trader who handled Mrs. Clinton's infamous cattle-futures account. Shortly after Richardson was appointed IRS commissioner, the agency settled a long-standing dispute with Bone and lifted the $7 million lien it had placed on his property. Sen. Lauch Faircloth (R-N.C.) is pressing for an investigation into the matter because, as he so delicately put it, "Mr. Bone may not have been in a financial position to settle such a large tax bill without the help of a third party."

and across the taxpayer's hide. Married taxpayers will be required to show the IRS auditor a copy of their marriage certificate—even if they have half a dozen kids and dozens of grandchildren. Taxpayers will be required to provide documentation and sworn affidavits regarding practically any financial transaction during the audit year, even if the IRS has no suspicion of wrongdoing. One doctor who went through a previous TCMP audit described the process as "an autopsy without the benefit of dying." Verenda Smith, a *USA Today* columnist at the time, told the House Ways and Means Committee that, during her 1983 TCMP audit, the auditor suggested "digging up my backyard to see if I had not reported money earned writing freelance articles, which he said might have been secreted in cash in coffee cans."

The purpose of the TCMP—aside from allowing IRS auditors to drag scores of thousands of taxpayers through financial hell—is to permit the IRS to gather information to make proposals for legislative changes to the tax code. But Rep. Nancy Johnson (R-Conn.), chairman of the House Ways and Means Oversight Subcommittee, complained on July 18 that the IRS had failed to provide her committee with any reports analyzing its findings from the 1985 and 1988 TCMP surveys. Johnson observed, "We have to ask ourselves, 'Is it fair for the government to place a burden and expense on innocent people in order to better identify those who may not be so innocent?'"

Former IRS Commissioner Fred Goldberg told a congressional hearing in July that the TCMP data were "likely to have little practical value." The TCMP suffers from a huge defect: a blind reliance on the relatively uninformed judgments of IRS auditors. Goldberg said, "As the name implies, TCMP is intended to measure taxpayer compliance. Proper 'compliance' means paying the proper amount of tax. But far too often that may be an uncertain number." Thus, the IRS's conclusions from the TCMP survey consist largely of what items IRS auditors could browbeat people into paying penalties and additional taxes for—rather than what people actually owed. The bogus nature of IRS audit demands is illustrated by the agency's dismal record in federal court. In 1993, in tax cases involving over $10 million, the IRS was permitted by judges to collect only 17 cents on the dollar of taxes assessed.

But Commissioner Richardson says the TCMP offers many benefits: "The government gets more money from people who haven't been paying their fair share, thereby reducing the burden on those who have been playing by the rules." She also reasons, "Jury duty sometimes disrupts our lives temporarily, but it is a price we pay for our system. And when you think of the Taxpayer Compliance Measurement Program, you should consider what you get for that price."

One thing America has been getting for that "price" has been an idiotic policy of unrelenting attack on the self-employed. Thousands of small businesses have been devastated by what amounts to an all-out war on the self-employed entrepreneur, and emerging high-tech industries have been particularly hard hit. The IRS is enforcing with a vengeance legal standards that even the Treasury Department admits do "not yield clear, consistent, or satisfactory answers."

The war on the self-employed originates in arcane federal regulations on the proper classification of workers. If a person is an employee, the employer must withhold payroll taxes and remit them to the IRS, paying half of the employee's Social Security taxes and all of his unemployment insurance tax. If an individual is an independent contractor, however, a business need only send a Form 1099 to the IRS reporting how much it paid that person; the contractor then pays his taxes directly to the IRS.

The IRS bases its classification decisions on a list of twenty questions concerning the relation between the employer and the contractor/employee. An official Internal Revenue Commissioner advisory report concluded in 1990 that "the process of classifying workers is confusing, complex, antiquated and unfair." The House Government Operations Committee, in a 1992 report, declared that the IRS "enforcement activities [on independent contractors] present small business taxpayers with a veritable nightmare of problems and policies that defy common sense."

Craig Willet, a CPA from Provo, Utah, explained how the process works to the House Small Business Committee last January:

> I had a client who was examined under one of these audits. As a CPA, I represented him, and the auditor came in and he said, "Let me explain to you. I'm going to go down this 20 point common law test, and I want to tell you that I might find in favor on 19 points for your clients but 1 of those 20 points I may find in favor of the Internal Revenue Service, and if that point is overriding then I will have the subjective opinion to classify them as an employee." That was the exact result, and I would say that the instructions I believe that aren't known to the public are that the examiners are trained to reclassify and let it be resolved in appeals. This is a particular burden to small business. Small business owners can't afford to appeal this type of an audit. It is extremely costly, can cost from $4,000 to $5,000 for just one employee under an audit.

The IRS agents ask a businessman the twenty questions, after which they sometimes destroy his business. The announcement that a company has misclassified its employees (which is the official IRS finding in an unbelievable 97 percent of the audits) means that firm is likely to be facing a staggering tax bill—largely because the IRS intentionally forces businesses to double-pay taxes already paid by independent contractors. As the House Government Operations Committee noted, "The assessments are based on the use of preset mandatory formulas which even the IRS admits result in double tax collections. These back tax assessments have been responsible for putting a number of those businesses out of business."

Since 1988 IRS agents have assessed over $650 million in penalties and back taxes in such reclassifications (averaging $68,000 per company) and forced businesses to count more than 430,000 independent contractors as employees. The IRS is now forcibly "converting" almost 2,000 independent contractors into employees each week. Tax lawyer Harvey

Shulman says, "Too many IRS field audits view self-employed workers and businesses which use their services as some sort of disease that needs to be cured. . . . As one IRS auditor told me, 'By the time we finish audits of the computer industry in this state, there won't be any more self-employed computer consultants left here.'"

Roadway Services, the nation's second-largest package delivery service, forked over $25 million to the IRS in January to settle a long-standing dispute over the status of its truck drivers. As part of the settlement, the IRS issued a letter ruling that Roadway's operations properly classified its drivers as independent contractors—but the company was liable for previous years' taxes of its "employees" anyway. Said Roadway's chairman Joseph Clapp: "We dislike making any payment in this matter. We feel we would have prevailed in this litigation, but it would have taken years."

The IRS crackdown is devastating the health-care industry. Marc Catalano, president of the Private Care Association, an association of health-care agencies, accused the IRS of following a "search and destroy posture with respect to businesses that use independent contractors." John Bailey, a psychologist at the Family Therapy Center of Madison, Wisconsin, complained to a congressional committee in 1992 that his clinic "has come under attack. . . . The IRS methods have been too subjective, applied with ferocity and arbitrariness, and have caused untold grief for us and other well-meaning small businesses."

As part of its crackdown, IRS agents seized $2,000 out of the center's bank account, and then, after being forced to concede that its case was baseless, claimed that it could not return the money because of difficulties with its computer system. The IRS's persecution of the center ended after a Justice Department attorney reviewed the case and concluded that the IRS's charges were so weak that they would be thrown out of court.

Federal court decisions have found that the IRS violated the law in its refusal to recognize certain nurses and real estate appraisers as independent contractors. In 1994, however, the agency announced it would nonacquiesce to those rulings, and continues to pursue those professions with a vengeance.

Another industry being hard hit by the crackdown is the adult entertainment business. In June the IRS slapped a jeopardy assessment of $700,000 (allowing the agency to confiscate the money instantly) on the owners of the Hide-A-Way Spa Bathhouse in Adams County, Colorado, claiming that the hot tub bathhouse owners had not classified the women who leased hot tubs (and directly charged their customers roughly $100 an hour) as employees. (The bathhouse owners had no control over any pleasures the women may have inflicted on their customers.) Last December, the IRS slapped a $6 million lien on the owners of Rachel's, a strip club in Casselberry, Florida. Though the women paid the club owners for the privilege of dancing and collecting tips, the IRS insisted that they were employees. The $6 million lien amounted to a death warrant for the business.

Tax attorney Shulman says, "I have had grown men and women—40 or 50 years old—cry on the phone to me telling me that their marriage is threatened, they are seeking counseling, all because the business that they built the last fifteen years of their lives, the house and other things they've earned from the fruits of their labor, is all threatened by this IRS employment classification audit. They ask me, 'What did I do wrong? Why am I being persecuted?'"

IRS officials have even encouraged private companies to secretly betray their competitors. At a 1990 meeting in California, an IRS agent distributed "snitch sheets" to businessmen and asked them to make allegations of illegal independent contractor use by their competitors. The IRS agent told the attendees to mail the completed "snitch sheets" to him in unmarked plain envelopes and promised to follow up on all leads. Considering that an IRS audit imposes extremely heavy burdens on a company, the IRS agent's behavior was in effect an invitation to business to use the government to ambush its competitors.

IRS efforts to subjugate the citizenry have even extended to the church, in blatant violation of freedom of religion. The federal tax code classifies all ordained religious ministers as self-employed for the purpose of Social Security taxes. But the agency has been zealously reclassifying Methodist ministers from self-employed to employee status. In one case, the IRS argued that ministers could not be independent contractors because no "special skill" is required to do the work they do. Rev. Robert McKibben of Alabama informed the House Ways and Means Committee that he was told by an IRS examiner that "all ministers" are "statutory employees." McKibben told the agent about a U.S. Tax Court decision upholding the self-employment status of United Methodist ministers, but the IRS official claimed that he was not bound by the court's ruling—another episode of nonacquiescence. McKibben observed, "The systematic misclassification of United Methodist ministers also results in a violation of First Amendment rights . . .

[with] the IRS dictating to the church the type of relationship they must have."

Craig Hoskins, counsel for the United Methodist Church, estimates that more than a thousand Methodist clergymen have faced IRS audits over their employment status. Hoskins complains, "The IRS . . . procedurally wishes to treat the tax filing status of United Methodist clergy as a tax shelter matter. We find it incredible that a system of clergy selection and placement in place in this country for over two hundred years is to be procedurally comparable to concerns about tax avoidance schemes."

Some employers, of course, do ignore federal law and misclassify legitimate employees as independent contractors. But these employees tend to be those in low-paid positions, such as farm workers and janitors, who would be covered by minimum wage laws and be eligible for disability and other benefits if they were properly classified by their employers. The IRS, however, puts little energy into such blatantly illegal cases. Instead it focuses almost solely on independent contractors who wish to remain independent contractors. The agency estimates that there are 3.4 million Americans now working as independent contractors who should be reclassified as employees. The Small Business Administration estimates that there are roughly 5 million independent contractors nationwide. Thus, if the IRS achieves "total compliance," more than half of all current independent contractors in the United States could be forced to abandon their own businesses.

Some believe this amounts to an attempt to abolish the right to work for oneself. David McFadden, president of a New York referral agency for architects, declared in 1993: "I believe that the IRS wants to make every working person in America someone's employee." As Rep. Richard Schulze (R-Penn.) put it in 1989, "The mind-set of the IRS is to eliminate any . . . independent relationship to ensure that all American workers are easily tracked through corporate payroll accounting."

The assault on independent contractors is typical of the agency's contempt for personal freedom in America. The IRS almost always seeks to impose a "solution" that would legally subjugate the contractor to some employer—to require a business to exert far more control over a contractor in order to convert that person into a legitimate "employee."

At the White House Conference on Small Business in June, the crackdown on independent contractors was voted the number one concern of the attendees. Commissioner Richardson had this to say: "Believe me, if there were an easy solution, we would have found it by now. . . . Where we have wage withholding, compliance levels are 99 percent, but where we don't, that level drops to 30 or 40 percent."

Richardson's portrayal of most independent contractors as tax-dodging scofflaws is blatantly false. IRS surveys show that more than 80 percent of self-employed contractors pay their taxes, and their compliance rate rises to 97 percent when the party that pays the contractor complies with tax law and files a Form 1099 with the IRS. Anyway, as the Treasury Department concluded in a 1991 report: "Misclassification of employees as independent contractors increases tax revenues, however, and tends to offset the revenue loss from undercompliance by such individuals, because direct compensation to independent contractors is substituted for tax-favored employee fringe benefits."

In 1988 Congress enacted the original so-called Taxpayer's Bill of Rights in order to rein in the most egregious IRS abuses. But the act has thus far had little impact. Justice Department tax lawyer Edward Robbins asserted in 1992 that lawsuits involving agency violations of its own regulations are "not relevant to anything." As *Tax Notes* reported, Robbins "stressed that the Justice Department knows that violations of the *Internal Revenue Manual* will not go anywhere in a court case."

Now, however, Sen. Charles Grassley (R-Iowa), Sen. David Pryor (D-Ark.), and House Ways and Means Oversight Subcommittee Chairman Nancy Johnson are pushing the Taxpayer's Bill of Rights II. The proposed legislation—which has been attached to the giant congressional budget reconciliation bill—would strengthen the right of taxpayers to recover against the IRS when its agents have acted negligently or recklessly, make it easier for taxpayers to recover legal costs when they defeat the IRS in court, and restrict the agency's ability to issue retroactive regulations.

IRS Commissioner Richardson, appearing before a congressional committee in March 1995 to urge congressmen to defeat the measure, declared, "Contrary to what is often, in my experience, a very distorted stereotype, the vast majority of our employees care very deeply about providing good customer service and protecting taxpayers' rights. . . . My hope is that the overwhelming number of taxpayers who come in contact with us will come to know us as a genteel, Gulliver-like giant."

The gentle giant is likely to be in for a nasty budget fight this fall. The Clinton administration has requested an almost 10 percent increase in the agency's allocation—from $7.5 billion to $8.23 billion. The House of Representatives has already approved a slight increase, but as we go to press, the Senate is hammering out an agreement to cut agency funding.

Many of the congressmen in favor of slashing the IRS budget maintain that the agency has grossly mismanaged its Tax Systems Modernization program. This program was designed to bring IRS computers into the twenty-first century, but the project has become yet another federal government boondoggle. The GAO reported in July that the modernization has been an abysmal failure, with the IRS buying already grossly outdated technology and making extremely poor decisions in automating its taxpayer service. And those taxpayers, as with all the other mismanaged, ill-conceived, and reckless programs the IRS has undertaken, have been footing the bill for their own persecution. Thus far the modernization has cost $8 billion—in tax money, of course. ❐

Commerce Under Siege: An Exchange

William A. Reinsch, Under Secretary of Commerce for Export Administration, defends his department's turf. Kenneth R. Timmerman replies.

Once again I must write to correct the errors, omissions, and misrepresentations that fill Kenneth R. Timmerman's recent article in your publication about the Bureau of Export Administration (BXA) ["Close-Out Sale at Commerce," *TAS*, August 1995]. I had hoped that his willingness to talk with me beforehand was a sign of his interest in producing an objective and accurate article. Unfortunately, that was not the case. It became apparent during our meeting that he had already largely written the article and was not interested in anything but a few *pro forma* quotations he could use to create the illusion of fairness. The body of Mr. Timmerman's work, both in *The American Spectator* and elsewhere, demonstrates that he is not a journalist but an advocate. He has a narrow, focused agenda, which he pursues single-mindedly, ignoring facts that do not fit his predetermined conclusions and liberally cutting corners on the truth to make it fit his design.

His most recent article, "Close-Out Sale at Commerce," also unfortunately, takes on a politically partisan cast. It is clearly one more chapter in the ongoing Republican effort to abolish the Commerce Department at the very point when it is at the peak of its success in creating jobs and promoting economic growth. It makes no more sense to tear apart the Commerce Department than it does to dismantle a pennant-winning baseball team, although the adverse consequences of the former in terms of jobs, exports, and technology development are far greater.

It is worth noting, in addition, that Mr. Timmerman's various comments about BXA, aside from his character assassinations of several of our career employees, are not new. Most of his points have been publicly reported, analyzed, and dismissed. What continues to distress me is his reliance on anonymous "critics" of BXA or other "observers" or "policy makers" who are apparently not willing to make their points on the record. I was asked to respond on the record, and I did so, despite the fact that Mr. Timmerman has refused to make public the basis or sources for his assertions. I regret that he has not been willing or able to provide more than innuendo and vague attacks by anonymous critics.

The Issue Is Export Control Policy

Turning to the substance of the article, let me begin by making clear that Mr. Timmerman is really driven by his disagreement with the administration's export control policy, not by concerns about agency competence. This administration, from the president on down, has made no secret of its view that export control liberalization is overdue. Residual Cold War controls are blocking American access to foreign markets at a critical time for our global competitiveness without contributing to our national security. We are proud of the actions we have taken and do not believe that export control liberalization has compromised our national security or non-proliferation goals.

Obviously, there are people who disagree with our policies, and, judging from the leaks of confidential business information Mr. Timmerman has used, some of them apparently are inside the U.S. government. The fact is that these individuals have lost the policy debate, and they have lost it *within* their own agencies, as the actions Mr. Timmerman complains about were the result of interagency agreement rather than unilateral action by Commerce.

Decisions Are the Product of an Interagency Process

This administration from its inception has recognized that most export licensing decisions involve input from multiple sources: They have foreign policy implications, which brings in the State Department; they have military security implications, which requires input from the Defense Department; they have clear economic implications for business, which explains Commerce's involvement; those decisions relating to nuclear equipment are of concern to the Energy Department; and as proliferation of weapons of mass destruction becomes an increasing concern, the Arms Control and Disarmament Agency also has a role to play.

We proposed in legislation 18 months ago a license process which fit these agency equities into a transparent and disciplined framework that guaran-