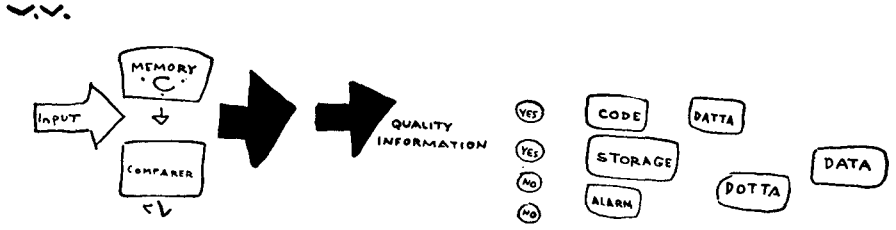


The Tax-Appeal Ordeal

WILLIAM R. FRYE

Pity the poor taxpayer. He assembles his records, studies the instructions, wrestles with the forms, pays his tax—and then sits back to await doomsday. Doomsday, for him, is the day Form 3R73 arrives with this message: "Your above-described tax return or document for the year indicated has been assigned to the above-named Agent for examination. Please communicate with the Agent. . . ."

The possibility of being audited is the third dimension of the income-tax nightmare. Substantiating that office at home, finding that Washington hotel bill, proving that lunch was a business entertainment—these could be more difficult than making out the return itself. They could even be impossible.

Some sixty-six million personal income-tax returns were filed in fiscal 1965; 3,092,000—one in twenty, or just over five per cent—were "examined," as the Internal Revenue Service puts it. Deficiencies, or taxes due, were found in fifty-one per cent of the cases, producing $1,063,000,000 in additional revenue; refunds were paid by the government fourteen per cent of the time, for a total of $47,052,000. No change was made in thirty-five per cent of the returns. The average deficiency was just below $700; the average refund just above $100. Aside from gamblers and other special cases, only 1,216 of those who were examined (or .04 per cent) were prosecuted for fraud.

How many of the more than 1.5 million taxpayers who were made to pay additional tax really had short-changed the government, accidentally or intentionally? How many ran afoul of an IRS overeager to maximize collections? The IRS feels sure it was practically always right (an understandable view), but many taxpayers are by no means sure.

I know how they feel. I have just been through the mill. Mine was one of the relatively rare cases—one in seven—where the taxpayer is found to have overpaid his tax. The return had been prepared for me while I was abroad and contained several major errors in the government's favor. I was due for a refund.

It was, nevertheless, a miserable experience. Day after day after exhausting day was taken up in minutely detailed, repetitive nit-picking. Accountants whom I told about the case said that they had never known an audit to be so detailed and prolonged. At the end of each session, I was assigned to prepare further data for the next visit—a task requiring long days and longer nights, sometimes running into weeks. (Everything involved had happened three years before.) My professional life was intermittently disrupted for more than seven months. The lost time was worth conservatively $4,000 to $5,000—and since I was self-employed, I had no way to cushion the loss. Moreover, legal and other fees ate up much of the refund.

The only comic relief was that each time I was ordered to dive deeper into the records, I came up with a new accounting error in the government's favor, and hence a larger potential refund. This was not what the agent had in mind. "How am I going to justify my time?" he asked. Finally, as a consequence of another of his probes, I discovered a $1,500 reimbursement that had been reported both as income and as a credit against expense. Whether by coincidence or not, the roof promptly fell in.

My agent (or his supervisor) reopened the whole audit and disallowed deductions that previously had been fully substantiated. The law had not changed; the facts had not changed; nothing had, except that someone seemed to have decided that letting a taxpayer get back *that* much money would not look good at all on the report of such a prolonged audit.

I could appeal the ruling, first to a "conferee"—a higher official of the IRS—and then, if necessary, to a still higher one. I could even go to tax court. But in the process, the additional time lost and the new legal fees incurred could more than wipe out any tax recovered. It seemed I would have to take the licking; either way, I would lose. After considerable additional dispute, the agent reconsidered and an appeal became unnecessary. But in my bitterer moments, I felt my government had subjected me to a form of legalized extortion.

The High Cost of Appeals

A spot check of accounting firms in the New York area suggests that thousands of taxpayers every year may have similar unpleasant experiences. Similar, that is, not in the denial of refunds that are due but in the levying of additional taxes which they consider unjustified but which they cannot recover economically through the normal appeal process. By comparison with the total number of returns filed, the number of these taxpayers may be small, but to the people concerned it is a serious matter.

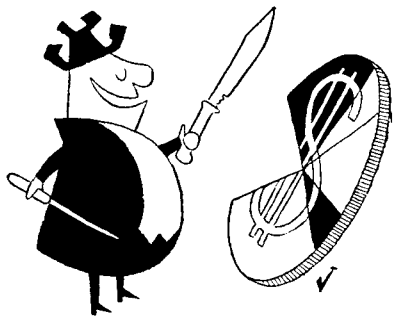
Mr. S., a partner in a New York accounting firm that specializes in tax work (because of his continuing dealings with the IRS, he insisted on remaining anonymous), said he used to fight, on behalf of his clients, as many as fifty appeals at a time. But in virtually every case, once the appeal was over the client was so angry at the size of the accounting bill that, whatever the results of the appeal, Mr. S. would lose the account. So he made it a firm rule never to handle appeals. He now

negotiates with the IRS agent as stoutly as possible the first time around, and then proposes to the client that he accept the outcome, favorable or otherwise. If the taxpayer wants to appeal, some other firm must take the case. His relationship to the client is then finished, either way.

The effect of this policy is that in cases where Mr. S.'s advice is accepted, the government has been allowed virtually to dictate its terms to the taxpayer on the issues in dispute. If Mr. S. is right, many if not most appeals are too expensive to be practical. Other accountants are not quite so sweeping; but they say that unless at least $1,500 to $2,000 in tax is involved, the taxpayer can scarcely expect to break even from an appeal to "conference," even if he wins. Unless he feels qualified to handle it on his own, he must pay an accountant $50 to $200 a day, not merely during the conference itself but throughout a period of preparation. And the taxpayer's own time is also a factor. Still higher appeals, beyond the conference stage, are not considered economical unless something in the neighborhood of $10,000 in taxes is involved. The IRS does not release figures on how many cases went to conference; but in 1965, 21,737 disputes (less than one per cent of the total) were handled at the appellate level, the next stage, and only 5,448 (roughly one quarter of one per cent) were disposed of by the tax courts. The money in question, however, was in the hundreds of millions.

The man who decides to do without costly help is, in effect, throwing himself on the mercy of the IRS. Mr. C., a partner in a Connecticut consulting firm, was on the road five days a week, year round, returning home only for weekends. He naturally had a large travel and entertainment deduction. When the return was selected for audit, he could not take time off to attend personally; his "billing rate" (the rate at which clients were charged for his services) was $250 a day, and he was fully booked. So he sent his wife to the tax auditor, armed with canceled checks and credit-card bills. The auditor contended there was no proof the travel was not personal, and disallowed the whole amount. The wife did not know how to protest persuasively. So the whole year's travel was lost.

THIS COUPLE could have hired professional help, but did not. Many others cannot afford to. Few men making less than $15,000 a year care to pay $15 to $50 an hour for an accountant, let alone $25 to $100 an hour for a lawyer. A return showing a $4,000 income is not as likely to be examined as one showing $400,000, but it can happen. The test, the IRS says, is not the size of the income but whether there is anything *unusual* about the return, anything that causes raised eyebrows. If the



ax falls, the little men have no choice but to fend for themselves.

Experiences vary. If the agent is conscientious and high-principled, as is sometimes the case, they get a fair deal. If he is casehardened, callous, or young and eager to impress his superiors, taxpayers may come off badly indeed. Discouragement, dismay, fear, and ignorance all may serve to keep them from making use of the appeals machinery.

Something obviously is amiss. The IRS insists that serious injustices are very isolated cases. Agents, it is said, operate under strict instructions to collect the tax due and only the tax due. Each year, just before the Ides of April, the Bureau engages in a national advertising campaign to convince the American people of its virtue. Nice, reasonable men say soothing and high-minded things on television and radio, encouraging people to pay up and assuring them that the IRS will deal with them as gently as possible.

Somewhere between theory and practice, however, the benevolent-father image breaks down. No doubt the complexity of the tax law is in part at fault; reasonable men can and do interpret the law in differing ways. No doubt many taxpayers who believe they have a grievance have in fact been fairly treated. But the absence of a readily available appeals system creates serious doubts.

Moreover, even if the government were right fifty times for every time it does an injustice, the 3,092,000 audits that took place in fiscal 1965 would have resulted in more than sixty thousand injustices. And there may have been another half million taxpayers who came out of their experiences with the IRS believing themselves wronged, though in fact they were not. Some of them undoubtedly resolved to get the lost money back the next time they filed a return. The government thus had made dishonest taxpayers out of honest ones. Another protection of the appeals system—the easing of legitimate doubts—was therefore not fully operative.

The Agents

To far too great an extent, taxpayers are forced to rely on the objectivity and competence of one man. Deny it as the IRS may, most agents find that there is a premium on getting tough with the taxpayer, on producing results for their superiors in terms of cash on the barrelhead. In private, they admit it is so. The old quota system, under which each agent had to extract a given amount in a given time, is now officially banned. But agents acknowledge that they believe their standing with their superiors and their prospects for promotion depend in part on the money they collect for the government. They must account strictly for their time, and if it is not spent productively, they fear it may be a black mark on their record. If they are inexperienced or insecure, they may be afraid to give the taxpayer the benefit of a reasonable doubt, lest they be set down as naïve or even corrupt.

IRS employees are not highly paid. Salaries start at $5,181 for trainee technicians and go up to $11,715 for experienced field agents. Supervisors get $10,000 to $13,000. Opportunities being more lucrative in private accounting practice, the government cannot always get and keep high-quality personnel. Moreover, the

man making $6,000 cannot always readily believe the expenses reported by the man making $60,000, because they are too far removed from his own experience. How could a man really spend $20 for lunch or $7,000 for a boat just to entertain customers? Such figures just don't make sense to him.

One accountant says that when he runs into this kind of incredulity, he asks that the item be put aside temporarily, and then, come lunchtime, takes the agent to a nearby hotel dining room. He buys him a martini, a lobster cocktail, and a steak. When the bill is presented, the accountant inquires and "discovers" what he knew in advance—that the hotel does not honor credit cards, that the meal must be paid for in cash. He hands over a $20 bill, and the agent sees there is little or no change. A lunch can cost $10 a person, he has learned, and it may not always be easy to obtain a written record of the expense. When the agent returns to the audit, he has had an education in business expenditures.

IN ADDITION to collecting revenue and deterring cheating, the audit system is supposed to have the function of boosting the morale of the honest taxpayer. He needs to be assured that he will not, relatively speaking, be penalized for his honesty. One of the gnawing resentments of April 15 is the feeling that Joe Sharp has been getting away with murder. The majority of taxpayers, though they wail, are willing to pay what they owe (or most of it) provided everybody else does, too. But that is the rub. Many taxpayers who have been audited are not persuaded that the law has been applied fairly to them. The IRS is the only branch of government in which the basic assumption of Anglo-American jurisprudence—that a man is innocent until proved guilty—does not fully apply. By law, a deduction is subject to disallowance until it is proved allowable.

To some extent, this attitude is understandable. Some taxpayers ask agents to believe pretty farfetched stories. A man who had canceled checks showing $90 in contributions to his church claimed he had also given $1,000 in cash. A man who kept receipted bills for entertainment expense down to $2 and $3 claimed he also spent $4,000 without getting receipts. It could be true, but the agent can be forgiven for being skeptical.

Sometimes the taxpayer's records may be accurate, but he is unable to prove it; or perhaps he does not have complete records and has had to estimate. This is no longer permissible in all cases. The old "Cohan rule" of reasonability—that an entertainment expense was allowable if it was reasonable under the circumstances—has been replaced by a requirement that every item over $25 must be substantiated by a receipted bill. These new travel and expenses regulations, which went into force on December 31, 1962, have not yet been tested in the courts, but they are being strictly applied.

The taxpayer may approach the audit in a difficult frame of mind. Some panic, and prepare for disaster. Others become belligerent and self-righteous, ready to take on the Congress, the President, and the Supreme Court as well as the IRS. Still others try desperately to pull political strings, an effort that is usually highly counterproductive.

When the examination occurs, it sometimes is almost anticlimactic. The taxpayer finds he is not being summoned to court for commission of a crime; he may arrange the appointment at a convenient time. He need not go to the IRS with his papers and other records stuffed into a suitcase or a trunk. If the data involved are voluminous, the agent is willing to come to him. The agent is authorized to take into account evidence of a taxpayer's good faith, and need not check every minute detail—though some do. He has instructions to be courteous and fair.

Rough Sailing

If the agent is indeed reasonable and the taxpayer well prepared, the audit can be over in a few hours—a day at most. If the return is complicated, the records incomplete, and/or the agent difficult, it can drag on and on. It is then that it becomes an affliction. If in addition to being difficult, the agent misapplies the law, then the taxpayer really needs a friend.

A man who used a twenty-three-foot sailboat for entertaining business contacts deducted half the expenses on his return. He was audited, and the agent, a man in his twenties, expressed much concern about the deduction. He inquired in detail about personal use of the boat, and was shown records in a diary indicating that such use occurred less than half of the time. He asked for, and obtained, corroborative evidence that business discussions had taken place on board. He studied a record of who went sailing, and saw proof that the entertainment had led to production of income. Nevertheless, he disallowed the deduction.

Lots of people have boats on Long Island Sound, he said, and in most cases they are strictly for personal use. The taxpayer's boat must also have been largely personal. It was too expensive to have been bought primarily for business. Did the taxpayer's wife go along on the trips? She did? Then it obviously was personal. The taxpayer argued that the presence or absence of a business discussion was the test, not the presence or absence of a spouse. The agent pulled out a copy of the Internal Revenue Service regulations (a large volume) and quoted from regulation 1.274-2 (e) (4) (b): "Any use of [an entertainment] facility (of a type described in this subdivision) during one calendar day shall be considered to constitute a 'day of business use' if the primary use of the facility on such day was ordinary and necessary within the meaning of section 162 or 212 and the regulations thereunder. For the purposes of this subdivision, a facility shall be deemed to have been primarily used for such purposes on any one calendar day if the facility was used for the conduct of a substantial and bona fide business discussion (as described in paragraph (d) (3) (i) of this section) notwithstanding that the facility may also have been used on the same day for personal or family use by the taxpayer or any member of the taxpayer's family not involving entertainment of others by, or under the authority of, the taxpayer."

The agent repeatedly quoted the phrase ". . . not involving the entertainment of others." Relating it to the earlier part of the paragraph, rather than the portion in which it occurred, he said it meant that

if "others" were present at the time the business entertainment took place, the facility at that time was not being used for business purposes. The fact that this interpretation was directly at variance with other regulations did not disturb him. No amount of argument could shake him from this extraordinary distortion of logic, of the law, and of the English language. It developed that the agent's personal philosophy was that all entertainment was a form of bribery; that business should be obtained strictly on its merits, so that the IRS really ought to disallow *all* entertainment expense.

It seemed that the taxpayer had no option but to bow or go to the prohibitive expense of an appeal. Then, when he was just about at the end of his tether, the agent suddenly reconsidered and allowed the expense.

The Ombudsman Idea

The appeal procedure, spokesmen for the commissioner say, is really not very difficult or expensive. They claim that the district conference, the first step, is just an informal discussion, with a friendly, experienced official—the father image again—who does not represent either the government or the taxpayer but is seeking pure and objective justice. The taxpayer doesn't need professional advice, they contend; he is in good hands. All this, however, is somehow at variance with the experience of most taxpayers who go "to conference." They regard it as a highly formal, even quasi-judicial proceeding, requiring extensive preparation, including legal briefs and affidavits; and they have little inclination to accept at face value the conferee's detachment and objectivity. He is, after all, an employee of the IRS.

Recently there have been some proposals for the creation of tax review boards, consisting of one or more experienced, well-paid specialists, to protect taxpayers from questionable rulings by the IRS. There is a kind of precedent in the Ombudsman system in force in Scandinavian countries and in New Zealand. The Ombudsman, a widely respected individual of national stature, is appointed by Parliament to guard against infringement of established rights. Any individual or group may petition him for relief, and he has extensive power to provide it. He may be removed by Parliament but is otherwise wholly independent. In the United States, Representative Henry Reuss (D., Wisconsin) and Senator Claiborne Pell (D., Rhode Island) have proposed a not dissimilar plan for an "administrative counsel," an employee of Congress who would investigate and seek to correct citizens' grievances, whether against the IRS or any other branch of government, when asked to do so by a Senator or a Representative. The bill was referred to the Rules Committee in February, 1965, and little has been heard from it since.

More recently, Senators Warren Magnuson (D., Washington) and Edward Long (D., Missouri) have mapped out a plan for a nationwide system of small-claims tax commissioners, under the aegis of the tax courts, to whom citizens could bring disputes with the IRS without the expense and formality of court procedure. Two commissioners would be appointed for each of the eleven regions into which the IRS has divided the United States. People who could not afford to hire legal help would be entitled to go to the commissioner, just as they now can go to small-claims court with other kinds of legal disputes involving amounts up to a few hundred dollars.

Commissioners or boards of this type are urgently needed. They should exist primarily to protect taxpayers' rights. The IRS could be forbidden to appeal their decisions if the taxpayer, for his part, also agreed in advance to accept the decision as binding. What would result would be analogous to binding arbitration.

No doubt there would be snags to be ironed out in practice. Safeguards might be needed against frivolous use of the boards. A taxpayer who appealed to them against the decisions of an agent and had his obligations to the government affirmed, or even increased, might have to assume the costs of the action—the costs, however, being scaled in proportion to his income, so that the poor could afford the risk as easily as the rich. If the taxpayer's obligations were reduced by the board, the government ought to be assessed for costs, a procedure calculated to inhibit arbitrary and ill-founded IRS rulings in the first instance. With such revenue the boards could be largely self-supporting, and they would greatly ease the case load under which many tax courts are staggering. (At the end of fiscal 1965, 10,765 cases were pending, about a two-year backlog.)

The possibility of a simple and inexpensive appeal from a tax audit would do much to restore public confidence. Taxpayers who lost would be more likely to swallow the judgment with good grace, less haunted by the suspicion of injustice, less determined to get their money back. The effect on the attitudes and behavior of agents might also be healthy. They would be under pressure to be right, as opposed to pressure to be tough. If they were proved wrong, the government would have to pay costs. To a far greater extent than at present, prestige and advancement within the IRS would logically derive from being infrequently overruled. The balance of bargaining power between taxpayer and agent during the initial audit would be restored.

What are involved are some of the textbook precepts of American democracy—that the government is a government of laws, not of men; that no citizen is ever at the mercy of an official; that if an official exceeds his authority, there must be effective remedies available. This is the way the tax system is *supposed* to operate today, but a sizable number of American taxpayers doubt it.

The Moscow Congress: Prudence and Semantics

ADAM ULAM

Apart from his relatives, it is the western Kremlinologists who have suffered most through Nikita Khrushchev's abrupt departure from power. Under Khrushchev, they had grown accustomed to anticipate eagerly that vast gathering of the ruling elite, the Communist Party Congress. Each was almost guaranteed to bring further revelations of Stalin's crimes, a growing list of former leaders who had collaborated in them, and more engrossing details of intrigues by remaining Stalinists against the First Secretary, Comrade Khrushchev. Khrushchev, to be sure, would invariably crush the latter with the help of the Central Committee of the party and the unanimous support of the great Soviet people.

Apart from such fascinating tales, the First Secretary would intermittently threaten the West and speak in honeyed words of coexistence, implying a virtual Soviet-American alliance. Thunderbolts would descend, sometimes on the heads of "dogmatists" and sometimes on those of "revisionists." Even in discussing inanimate objects Khrushchev was dramatic and unpredictable. No sooner did his passion for steel production cool off than it was replaced by an infatuation with reinforced concrete. Kolkhozniks who have been urged by Nikita Sergeievich to plant corn, corn, and more corn were abruptly told to drop practically everything else and grow beans.

No such pyrotechnics were to be expected at the Twenty-Third Congress concluded on April 8. Khrushchev's two successors, Brezhnev and Kosygin, have practiced what might be called the cult of non-personality. They are much more the products of the Stalin era than Khrushchev, who had joined the party in 1918 and who retained to the end the Leninist belief in the power of oratory and dramatic improvisation. Brezhnev and Kosygin, in contrast, have always operated in the Stalinist bureaucratic fashion, unobtrusively and behind the scenes. Where Khrushchev went in for bluster, they have ushered in what they hope to be the age of discretion and circumspection.

At the Twenty-Third Congress, as speaker after speaker pronounced the ritualistic formulas of praise for the Central Committee's policy and its proposed Five-Year Plan, many delegates must have wondered whether and when the name of *that man* would be mentioned. Yet through an amazing display of self-control, none of the procession of party secretaries, ministers, etc., ever did utter Stalin's name. The reasons are as complex as they are instructive about the current dilemmas and style of Soviet politics.

The Unnamed Man

Before the Congress took place, it had been public knowledge that the rulers intended a partial and circumspect rehabilitation of Stalin. Khrushchev's obsessive serialization of his crimes was held to have had a profoundly unsettling effect, especially on the younger generation. More damaging than Khrushchev's constant harping on the terror and sufferings of the Stalin era, which the middle-aged party oligarchs believed the younger generation ought now to forget, was his portrait of Stalin as a fool and a coward. ("He was afraid to go into the city, he was afraid of people," announced the First Secretary in 1962.)

The Twenty-Third Congress was scheduled to be treated to a more balanced view, more in keeping with the original and subdued period of de-Stalinization which lasted from 1953 to 1956. At that time, the dead despot was depicted as a man who had rendered great services to the party and the country, but who had regrettably strayed from the Leninist path in his later years. As part of this program of rehabilitation it was decided to restore the names of two Soviet institutions that have definite Stalinist associations: Secretary General of the Communist Party and the Politburo. Since 1953 the highest party official has borne the name of First Secretary—until now Stalin was the only Soviet leader to be named Secretary-General of the party. The Politburo had been rechristened "Presidium" in 1952 with the explanation: "It expresses better the nature of its functions." At the latest Congress the name was changed back again with exactly the same explanation.

The projected rehabilitation of Stalin evidently encountered a good deal of determined opposition. A number of leading intellectuals addressed a letter to Brezhnev imploring him not to revive old fears and painful associations. And there are grounds for believing that even in the highest party councils fears were expressed that the move would be untimely and unfortunate. Plans for a broad historical reassessment of the Stalin era were dropped and all that remained was the restoration of the two names. This led to awkward locutions at the Congress. In proposing the restoration of the term "Politburo," Brezhnev explained that this was the term used "under Lenin and *later*." And in proposing the re-establishment of the post of Secretary-General, Nikolai Yegorychev, the Moscow party head, found it expedient to mention that it had been established "in 1922 on the initiative of Vladimir Ilyich Lenin" while skipping any reference to the only man who had actually carried the title.

More significant was the fact that though several local party secretaries mentioned approvingly the restoration of the Secretaryship General and the Politburo, other leading delegates limited themselves to a mere general statement of support for the party line. And a totally new precedent was set when several members of the highest party body—the Presidium-Politburo—did not take the floor at all. It is risky to read meaning into such developments, but in the ritualized process of Soviet politics such omissions cannot be accidental. They testify to a deep division of opinion among party leaders as to whether and to what