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FEDERAL TAX ADMINISTRATION AND THE SMALL TAXPAYER

L. Hart Wright*

The actual or supposed complexity of substantive federal tax law has generated two unresolved administrative by-products of peculiar importance in the case of small taxpayers. In each of these circumstances the Internal Revenue Service (and in one, the Congress) has tended to default on its programmatic responsibility to facilitate payment by small taxpayers of no less and no more than they owe under the tax law.

For too long and to too large an extent, these taxpayers, although completely bewildered and devoid of self-confidence in the conduct of their tax affairs, have had to fend for themselves, both at return time, and later—at the point of an audit—in dealing with personnel of the Internal Revenue Service (IRS or Service). In the first instance, concerning a small taxpayer's dilemma at return time, the principal adverse consequence is suffered by the tax system itself (or by all other taxpayers viewed in aggregate), and the cumulative prejudice has now reached alarming proportions. In the second instance, of the relatively few small taxpayers audited after having filed returns, only the individual small taxpayer actually undergoing audit is likely to suffer prejudice from his dilemma.

Both circumstances warrant remedial action.

I. ASSISTANCE FOR SMALL TAXPAYERS AT RETURN TIME

A. Chronological Profile of the Past

The problem regarding assistance at return time ultimately requires resolution of one general question: to what extent does the government itself have a responsibility to see that small tax-

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payers, whether provided for by the IRS or by some other means, have the *proper* kind of aid in preparing their returns? In trying to determine the correct answer, a brief chronology of the federal reaction to this problem and the consequence thereof will provide a healthy perspective.

That the government's traditional reaction can be characterized alternatively as either too little or as totally blind to over half the problem is not to say that it has traditionally been wholly insensitive to the plight or bewilderment of small taxpayers. For example, the Commissioner of Internal Revenue appointed by President Kennedy, Mortimer Caplin, emphasized in a message to the Secretary of the Treasury that the government's own taxpayer assistance effort was a necessary "component of the Service's program of fostering voluntary compliance."¹ As to the extent of help provided in a given case, however, he also acknowledged that in "recent years increasing emphasis has been placed on the use of the telephone to assist taxpayers because it requires less time on the part of both taxpayer and Service personnel."²

The extent of this emphasis, reflecting in a large sense the actual limited thrust of the program in the Kennedy era, is indicated by data covering the last year of Commissioner Caplin's tenure, fiscal 1964.³ Approximately 14.4 million taxpayers received assistance only over the telephone. Of the 8.6 million other taxpayers who personally came to one of the IRS offices for aid, the assistance accorded 7 million consisted of nothing more than answers to specific inquiries.⁴

Given this stress in the then otherwise quite limited program, Commissioner Caplin would have done well not to have ignored so completely the other side of the coin, namely, the consequent emergence of a completely unregulated, outside commercial return-preparation industry. Illustratively, the customer list of one such small company, then not known to most taxpayers but later to become a household word, tripled during Commissioner Caplin's term of office, reaching 400,000 names in 1963.⁵

During the next seven years, up to the time when President Nixon's first appointed Commissioner, Randolph Thrower, left

¹ 1963 COMM'R INT. REV. ANN. REP. 4.

² 1961 COMM'R INT. REV. ANN. REP. 12.

³ Since Commissioner Caplin left office at the end of fiscal year 1964, the report covering that period actually was signed by his successor, Acting Commissioner Harding, who also emphasized that help via telephone was "the method stressed as the type of assistance taxpayers normally should seek." 1964 COMM'R INT. REV. ANN. REP. 3.

⁴ *Id.*

⁵ *Hearings on H.R. 7590 Before a Subcomm. of the House Comm. on Government Operations*, 92d Cong., 2d Sess. 108 (1972) [hereinafter cited as *Hearings on H.R. 7590*].

office in mid-1971, the government did expand its taxpayer assistance program, principally, however, only with respect to its educational component. For example, by then a kit—"Teaching Taxes"—was being supplied to 21,000 high schools for use by teachers in helping students learn how to prepare returns.⁶ The government also enlarged the volunteer income tax assistance (VITA) program, under which volunteers from civic organizations and the like were trained to help senior citizens and others prepare their returns; in 1971 these volunteers assisted 172,000 taxpayers.⁷

Taxpayers themselves learned, however, from the last tax-return packet they received from Commissioner Thrower that the Service had discontinued the short form 1040A. This change, although apparently prompted by the most decent motives,⁸ obviously further complicated small taxpayers' lives as they saw it.⁹

Nevertheless, on the cover of the tax packet mailed to taxpayers in January, 1972, the succeeding Commissioner, Johnnie M. Walters, still felt justified in saying: "We believe most American taxpayers can make their own tax returns for 1971." After explaining why the Service held this conviction, the message went on to acknowledge that a given taxpayer might feel otherwise because, illustratively, he might think it would be more profitable for him to itemize his deductions rather than to take the standard deduction. In such a case, the message reminded him, the Service could "not make the computations" for him, although, as before, it said, "Your local Internal Revenue Service office stands ready," free of charge, "to help you by answering your questions."

To the taxpayer who felt he needed help beyond that available from the Service, the message stated that the taxpayer bore the responsibility to determine that the person employed to assist in preparation of a return was "both competent and trustworthy."

This abbreviated recital of the Service's reaction through 1971 to the needs and obligations of taxpayers at return time is offered only to make two matters crystal clear. The first is not that the government in that era disclaimed responsibility to render assistance to the small taxpayer at filing time. Rather, it is that a very substantial difference developed over this period between the tax

⁶ 1971 COMM'R INT. REV. ANN. REP. 6.

⁷ *Id.*

⁸ See 1970 COMM'R INT. REV. ANN. REP. 4. Under the old short form 1040A, taxpayers could not claim head-of-household status, sick-pay exclusions, and certain other benefits to which they otherwise might be entitled.

⁹ *Id.*

experts who ran the Service on the one hand, and small taxpayers on the other, regarding the character of the latter's "need" during the filing season.

This proposition is easily demonstrated. The previously mentioned commercial company, which just seven years before had prepared only 400,000 returns and which was then not known to most people, found itself in 1971 preparing 7,200,000 returns.¹⁰ This figure was equal to 10 percent of all individual returns filed,¹¹ and the name of the firm, H & R Block, had indeed become widely known. While the operations of H & R Block had become giant-like when compared with the operations of other pygmy-sized commercial return-preparation services, the small taxpayers' view of their own need had led thousands of small operators to enter this profitable industry. As a result, after the close of 1971, the Commissioner of Internal Revenue acknowledged that there might be as many as 200,000 commercial return preparers.¹² This is at least a reasonable approximation, given two other pieces of otherwise relevant data. H & R Block alone, in 1971, used 28,500 workers.¹³ Its franchisees employed another 15,000,¹⁴ and together they prepared less than one-third¹⁵ of the 46 percent of all individual returns which, according to the Commissioner, were prepared for taxable year 1971 by someone other than the taxpayer himself.¹⁶

These data merely illustrate that, whatever tax experts in the IRS may have thought, by 1971 taxpayers themselves viewed their needs in terms of a demand for services involving 200,000 workers. Admittedly, most of the latter were only seasonally engaged and often then only part-time. Nevertheless, their absolute number was more than three times the total of the Service's entire employee roster.¹⁷

Furthermore, because the giant of the return-preparation industry, H & R Block, reported fee receipts of \$87,000,000 in 1971,¹⁸ quite obviously small taxpayers must have paid several times that amount to the horde of other commercial preparers.

¹⁰ *Hearings on H.R. 7590, supra* note 5, at 84, 108.

¹¹ In 1971, 76.6 million individual income tax returns were filed. 1971 COMM'R INT. REV. ANN. REP. 15.

¹² *Hearings on H.R. 7590, supra* note 5, at 20, 197.

¹³ *Id.* at 85. Only 85 percent of these employees actually prepared returns. Many of the others acted in the capacity of checkers and other functions.

¹⁴ *Id.* at 79.

¹⁵ This assumes that the franchisees' employees each prepared approximately the same number of returns as were prepared, per person, by H & R Block's own employees.

¹⁶ *Hearings on H.R. 7590, supra* note 5, at 37.

¹⁷ 1971 COMM'R INT. REV. ANN. REP. 66 (reporting that 61,952 permanent and 7,035 temporary employees were engaged by the IRS in 1971).

¹⁸ *Hearings on H.R. 7590, supra* note 5, at 85.

This total expenditure dwarfed in size the then relatively microscopic cost of the Service's own taxpayer assistance program.¹⁹ In fact there can be no doubt that this figure was closer to, and probably even larger than, the \$357,000,000 manpower cost of the entire IRS audit force for 1971.²⁰

The striking difference between the attitudes of the Service and taxpayers regarding the character of the latter's needs at filing time was, through 1971, complemented by the second equally traditional, but more disastrous, governmental supposition previously mentioned. The IRS had assumed that small taxpayers, although unable or unwilling to learn enough about the tax terrain to enable them to prepare their own returns, somehow would know enough to bear alone the responsibility, as the Commissioner put it in the covering letter on 1971 return packets, to see that persons employed to do their work were "competent and trustworthy." In the face of a rapidly growing, highly competitive, and completely unregulated commercial preparation industry, this erroneous supposition has left in its wake something akin to a disaster.

While the Commissioner himself understandably might shy away from such a characterization, it was he, in 1972, who exposed the fact that sample examinations of returns filed by 3,174 preparers revealed that over 2,200 "appeared to have prepared incorrect returns,"²¹ and that a pilot project covering just one region indicated that a very significant percentage "of the returns being prepared by return preparers in that . . . seven-state region were being fraudulently prepared."²² Indeed, the latter test showed that only thirty out of 536 commercially prepared returns were correct and that the "average loss of tax per return was \$234.99."²³ In aggregate, this amounted to \$1,025,954.96 for just those 506 returns.²⁴

B. Profile of Current Governmental Reaction

On acknowledging to the nation, in 1972, the dimensions of the difficulty in which we then found ourselves, the Commissioner

¹⁹ For 1972, the Service's assistance program during the filing season alone cost about \$13 million, but in 1973 this was to be increased to \$18.4 million. *Id.* at 251.

²⁰ 1971 COMM'R INT. REV. ANN. REP. 127. Indeed, the Commissioner himself estimated that total fees paid by all taxpayers to all preparers probably "were in excess of \$600 million per year." *Hearings on H.R. 7590, supra* note 5, at 198.

²¹ *Hearings on H.R. 7590, supra* note 5, at 19. *See also id.* at 196.

²² *Id.* at 30. While the Commissioner himself in the cited statement used the figure 97 percent, another witness testified that then Secretary of the Treasury John Connally had said the correct figure was 19 percent. *Id.* at 103.

²³ *Id.* at 30.

²⁴ *Id.*

more or less simultaneously announced that two different types of corrective steps were being taken.

One set focused on improvement and enlargement of the government's own direct assistance program. First, while the assistance program was formerly carried out under the supervision of a division director whose "primary interest lay in *enforcement* actions,"²⁵ a new Taxpayer Service Division was created in December, 1971, with its "sole responsibility" being "to provide services and assistance to taxpayers."²⁶ Second, it was decided that the use of audit and collection agents to staff this function would be phased out over a two-year period.²⁷ Replacing them were to be 1,430 full-time assistants, located in about 800 scattered offices.²⁸ The number of total assistants was to be increased, it was hoped, to 5,300 in the peak filing season²⁹ during which 360 temporary off-site locations also would be staffed at least part-time.³⁰ Third, the Centiphone system, enabling taxpayers in remote areas to make toll-free telephone calls to a central location, was to be expanded from the then twenty-six districts to encompass the entire nation by 1974.³¹ Fourth, an after-hours program to provide services to taxpayers after normal working hours and on Saturdays was to be reinstated.³² Finally, a modified version of the earlier short form 1040A was to be brought back into use.³³

However commendable these changes may be, one must note the omission of any suggestion that the Service itself, as a general practice, would prepare returns for any small taxpayer requesting such service. The Commissioner had said, in early 1972, that because of the Service's lack of manpower, such assistance must be confined to "unusual cases where the taxpayer for some reason simply cannot make his return."³⁴ Later, however, he expressed the hope that increased manpower would enable the Service during 1973 to more than double the number of returns prepared for

²⁵ *Id.* at 21 (emphasis added).

²⁶ *Id.* at 22. In ultimate effect, however, whereas formerly the government's chief audit official (Assistant Commissioner (Compliance)) had jurisdiction over the assistance program, now that jurisdiction is exercised by the chief collection official (Assistant Commissioner (Accounts, Collection and Taxpayer Service)). *Id.*

²⁷ *Id.*

²⁸ *Id.* at 250. The efforts of these employees will not, however, be devoted exclusively to assistance during the filing season, for 36 percent of all inquiries are made after that season is over and concern various problems including, for example, collection matters. Indeed the nonfiling season assistance will absorb \$15.2 million of the \$33.6 million assistance budget projected for 1973. *Id.* at 251.

²⁹ *Id.* at 250.

³⁰ Unpublished data furnished by the IRS.

³¹ *Hearings on H.R. 7590, supra* note 5, at 23.

³² *Id.* at 23, 24.

³³ *Id.* at 29.

³⁴ *Id.* at 22.

taxpayers in 1972, reaching perhaps 3.5 million,³⁵ although even this would be less than half the number prepared by H & R Block alone.

A second set of remedial steps represented an acknowledgement by the IRS that the tax system itself should assume some responsibility regarding the integrity and competence of the commercial preparer industry. Initial steps, however, were directed only at the matter of integrity. Fraud charges were immediately initiated against a number of allegedly fraudulent preparers.³⁶ Complementing this was a cooperative effort with the Federal Trade Commission to enjoin those commercial preparation services indulging in deceptive advertising.³⁷

The long-range solution, according to the Commissioner, is still under consideration,³⁸ although with respect to both the matter of competence and integrity, he expressed a tentative preference for a system of new after-the-fact penalties to be meted out to preparers whose prepared returns proved they were untrustworthy or incompetent.³⁹ A licensing system, designed in the first instance to qualify within the industry only those of character and competence, would, in his view, "consume too much manpower needed by IRS compliance work,"⁴⁰ and would be "beyond any resources we are likely to secure at this time."⁴¹ The annual cost of licensing was put at \$17.5 million.⁴²

C. *The Ultimate Issue Viewed in Practical Terms*

An objective appraisal, responsive to the manner in which our tax system actually operates, leads to at least one inescapable conclusion: the system itself, rather than any given taxpayer alone, acting in its own interest and to protect the legitimate interest of all other taxpayers, must bear the primary responsibility of assuring that those who make it their *business*, either in or out of government, to prepare returns for others are "competent and trustworthy."

This follows from the cumulative effect of two propositions. First, each taxpayer has a legitimate interest in having every other

³⁵ *Id.* at 250 (letter from Commissioner Johnnie M. Walters to Hon. John S. Monagan, Sept. 1, 1972).

³⁶ *Id.* at 25, 33.

³⁷ *Id.* at 25.

³⁸ *See id.* at 27.

³⁹ *See id.*

⁴⁰ *Id.*

⁴¹ *Id.* at 26.

⁴² *Id.* at 198.

taxpayer ultimately pay the correct tax. Furthermore, the legitimacy of this interest extends to the correctness of returns as initially filed, for thereafter not more than 2 percent can be audited despite the fact that two-thirds of the returns actually audited in 1971 were deemed by the IRS Audit Division to warrant an adjustment.⁴³ Second, if millions of small taxpayers have demonstrated—and they have unequivocally—that they are either unwilling or unable to engage in the self-education required to enable them to prepare their own returns, this also means they will not know enough about tax terrain to enable them to determine whether the person who does prepare their return is competent, and, if that person is at all subtle, whether he is trustworthy. Relevant to this is the fact that the small taxpayer hopes to pay the smallest fee possible and, therefore, does not want to incur the added cost of a greater degree of competence than *his* return requires. Given the taxpayer's legitimate competing concerns of cost and a minimum required competence, and also of his own inadequate understanding of the law, it is the height of folly to expect him to be able to determine whether a given preparer has the requisite competence to do *his* return.

If from all this it follows that the system itself, acting in its own interest and in protecting the legitimate interests of other taxpayers, must bear the principal responsibility to assure competence and honesty on the part of those who make it their business to prepare returns for others, the only real issue worthy of argument is whether the tax system itself (*i.e.*, the government) should now begin to try to supply the requisite preparation-type service, or whether, in light of the ever-present problem of priorities, its first need is to develop an effective regulatory program regarding the commercial preparer industry.

D. A Proposed Solution

On the one hand, arguing in favor of the government's assumption of a major return-preparation burden are the expectations generated in the American people by the practices of the economic community in which they have been reared. They are bound to think it is a most unusual creditor who is unwilling to take out pencil and paper and calculate, at the point at which they are

⁴³ In 1971, of the 1,529,454 returns examined, the Audit Division proposed adjustments to 1,006,325. 1971 COMM'R INT. REV. ANN. REP. 33. H & R Block had indicated that only half of 1% of the returns prepared by it are audited by the Service. *Hearings on H.R. 7590*, *supra* note 5, at 104.

ready to pay, the exact amount owed. An unwillingness to do that on the part of their own government is no doubt peculiarly exasperating to a taxpayer-debtor who believes at return time that he simply does not understand how to calculate it himself. This argument, at first blush, no doubt is appealing to all Americans, who might characterize, perhaps almost emotionally, the government's unwillingness as an unbecoming bureaucratic exception to a quite general, customary creditor practice.

Yet in terms of priority needs, there is encountered on the other side of the basic issue a much more awesome array of valid arguments. At the outset, it is imperative to recognize that a large commercial return-preparation industry will survive regardless of what the government otherwise does programmatically, and that effective government oversight regarding the competence and integrity of that industry will itself require substantial additional funding.

A large industry will survive in any event because of the cumulative impact of at least five factors. First, there is the matter of habit. Millions of small taxpayers are now in the habit of using a commercial return preparer. No doubt, a substantial proportion are reasonably satisfied with the service rendered. This habit pattern would not be easy to reverse overnight, if at all.⁴⁴ Second, there is the matter of convenience. There are over 6,435 so-called urban areas in the United States with a population of 2,500 or more.⁴⁵ At this moment, even under the newly expanded IRS program, taxpayer assistants are to be stationed in only 800 permanent, scattered offices, although in some areas their work—presently consisting primarily of answering questions—will be complemented in certain off-site locations and by “taxmobiles” which visit shopping centers and other appropriate locations.⁴⁶ Compare these circumstances, however, with the fact that H & R Block alone and its franchisees maintained 6,431 tax offices in 1972.⁴⁷ Furthermore, tens of thousands of other commercial preparers, who frequently operated only temporarily in homes or otherwise vacant store fronts, were able to exist, presumably with a profit. In part their existence may derive from the fact that they were even more conveniently located to neighboring taxpayers

⁴⁴ For example, H & R Block indicated that, although its customers increased from 6,800,000 in 1970 to 7,200,000 in 1971, about 70 percent of its 1971 customers were “repeats.” *Id.* at 84, 79.

⁴⁵ U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF UNITED STATES: 1971, at 17 (92d ed.).

⁴⁶ See notes 28 and 30 *supra*.

⁴⁷ *Hearings on H.R. 7590*, *supra* note 5, at 84.

than H & R Block offices. It would stretch the imagination to conceive that the government would be willing or able to operate with the degree of convenience to which taxpayers have become accustomed through the use of commercial services.

A third factor which would contribute in any event to the outside industry's survival relates to the range of services to which the small taxpayer has become accustomed. Commercial preparers prepare not only a taxpayer's federal return, but also his state return. For example, recognizing the migratory character of the local population, the H & R Block office in Ann Arbor, Michigan, keeps on hand blank returns used by all fifty states, in order to accommodate the customer who moved in mid-year from one state to another.⁴⁸ Whatever the IRS ultimately does in providing assistance with respect to *federal* returns, it is likely that it would resist to the end the taking on of this complementary *state-return* burden.

A fourth contributing factor concerns an easily demonstrable, but ugly, fact of our lives, namely, the growing distrust toward many of our important institutions, including government at all levels. There is ample reason to suspect, at this state of our nation's life, that millions of our small taxpayers, although honest, might rather pay a relatively modest fee to a commercial preparer than place their trust in one of the enforcing agency's own employees. Indeed, in one type of circumstance their distrust, whether or not they comprehend the more subtle implications, is well founded. Reference here is to a dilemma which is common even to the existing question-and-answer type of assistance program. Pivotal in this respect is the question of whom does the government assistor really represent.

Obviously this dilemma arises only in instances where competing arguments actually could be advanced regarding the correct answer to a tax question. In the 1920's, the Congress itself created what is now known as the Tax Court primarily because it believed that as to a truly arguable item a taxpayer should be able to carry the matter even through the judicial arena before being required to pay the amount of tax associated with that type of contested item. In short, even in the eyes of Congress, a taxpayer need not forfeit his interest in an otherwise arguable item, voluntarily paying the amount otherwise attributable to that item, without a judicial determination that the tax is properly due.⁴⁹ Indeed,

⁴⁸ Since no commercial preparers can hope to know much about the income tax laws of fifty different states, state commissioners of revenue have just cause to worry about the correctness of returns covering taxpayers who moved in mid-year.

⁴⁹ INT. REV. CODE OF 1954, § 6213.

not surprisingly it is customary for both professional accountants and lawyers, in handling a client's affairs, to resolve arguable items in the taxpayer's favor. Last year, in speaking to a congressional committee, even the president of a nonprofit, all-volunteer organization (Community Tax Aid, Inc.) engaged in preparing returns without charge for small taxpayers in New York stated without equivocation that "Questionable items are resolved in favor of the taxpayer; he is entitled to no less."⁵⁰ To this writer's knowledge, similar instructions have not been issued by the Service either to its enforcement personnel or to employees in the assistance program. In fact the last known instructions to enforcement personnel were to the opposite effect.⁵¹

A fifth reason why a large commercial return-preparation industry will survive even if the IRS should try to expand its own preparation-type service program involves the matter of cost. As a practical matter, one simply cannot conceive that Congress would provide the requisite funds—regardless of the merits of such a proposal—to try to do even half of the return preparation work now done, to say nothing of undertaking the whole job. During the filing season in 1971, H & R Block and its franchisees alone had 43,500 employees, to say nothing of the estimated 150,000 other preparers engaged in this work.⁵²

Consideration must also be given, in respect of the matter of cost, to what is involved in preparing a return, for whatever is involved, the government, to undertake the job at all, must do it

⁵⁰ *Hearings on H.R. 7590, supra* note 5, at 219.

⁵¹ L. H. WRIGHT, NEEDED CHANGES IN INTERNAL REVENUE SERVICE CONFLICT RESOLUTION PROCEDURES 36-42 (1970). The purpose here is not to quibble with the Service's existing instructions to its personnel. Rather it is to highlight (1) one dilemma the government encounters in trying both to provide assistance and also to enforce the law, and (2) the complementary dilemma faced by small taxpayers in having the IRS prepare their returns.

A closely related problem which would be raised if the government sought to prepare a substantial number of returns relates to the significance attached to the fact that a government employee signs the return as preparer. If we are to say that all such returns are thereby immunized from the audit program, then as a practical matter a portion of these returns require an audit at the very point they are being prepared, with all the complementary, time-consuming, practical difficulties that will entail. In contrast, if we say that such returns will be free of the audit program except in cases of taxpayer fraud, it still would be necessary to conduct some audits at the very point of preparation if only because some taxpayers will supply erroneous subtotal figures, not because there was any intention to commit fraud, but simply because of their lack of knowledge regarding the niceties of the law. Furthermore, to gear the line of demarcation to fraud would open up the problem always triggered when hard-to-prove subjective intent fixes the dividing line. Consider how easy it would be for a given taxpayer to say that the government employee orally told him that a given figure was appropriate, and how hard it would be for any such employee to remember what he told that one, out of hundreds of taxpayers served.

⁵² Even in light of minimizing costs or assuring efficiency it is unlikely that the government agency would adopt the quite modest guaranteed pay per hour or the complementary and questionable piecemeal pay formula used by H & R Block. No doubt these techniques

properly. To prepare a return for someone implies that, if done properly, much more than a mere act of penmanship will be required. Implied is the supposition that a knowledgeable preparer will take the time to ask the taxpayer numerous questions and subquestions, all to the end of being sure that proper account has been taken of every advantage to which the taxpayer is entitled under law. Even now, particularly at the height of the filing season, one should worry over the prospect that government employees who assist taxpayers, although only asked by a taxpayer to respond to a general question, will not take the time in replying first to raise all the other requisite questions necessary in trying to get a grip on all the facts which must be understood before the employee can, wisely, fairly, and precisely, respond to the taxpayer's actual problem, a problem frequently initially obscured by the generality of the taxpayer's first question.

Be that as it may, the five factors previously mentioned—taxpayer habits, their convenience, the problem of state returns, the growing distrust toward government, and the awesome cost of large scale return-preparation services—when viewed cumulatively clearly suggest that whatever the government tries to do programmatically, a big commercial return-preparation industry will survive and continue to prepare a substantial proportion of returns filed.

Given this, the question becomes what should the government now do, in terms of *priorities*. The scandalous circumstances, reflected in previously mentioned data released by the IRS as to the quality of work done by at least a segment of this industry, obviously indicates that the first need is to develop an oversight program covering the industry. Indeed, given the fact that IRS can audit less than 2 percent of all small returns, and the facts that the industry is devoid of an organizational structure, lacking in century-old professional traditions, wholly unencumbered by any educational requirements or standards of proficiency, composed in large part of thousands of independent operators who move in and out of the business like transients, but led by a giant which expends enormous sums on advertising, and with competition

are used as a management tool to achieve efficiency and to maximize profit. Mr. Block testified in 1972 that tax preparers were paid

a minimum of \$1.60 per hour against 20 percent of fees received for returns prepared, for the first-year employee. Thereafter, the tax preparer is guaranteed an hourly rate equal to 80 percent of the previous year's hourly earnings (not less than \$1.60 per hour) against 20 percent of fees received for the returns prepared and a longevity increase.

Hearings on H.R. 7590, supra note 5, at 93. Given this, an off-the-cuff, uneducated guess would be that the government in fact, quality aside, is not likely to do the job as inexpensively as it is done by the private sector.

being the norm among the larger enterprises of the industry, the IRS should never have supposed other than that a regulatory system would be necessary.

The practical problem with this approach is that neither the administration nor Congress may be willing to face up to the fact that an effective regulatory program will not be inexpensive and will thus require additional funds.

Additional funds will be required for several reasons. The first reason is that it would be unthinkable to allow the Service to try to absorb the cost by reducing its current audit or collection programs.⁵³ Nor, second, can the IRS be relieved of the principal assistance-type burden it now assumes, namely, to answer questions, primarily over the telephone or in a government office, usually from those taxpayers (still 54 percent of the total)⁵⁴ who seek otherwise through self-help to determine for themselves what they owe the government. The government must continue to provide at least this degree of help, for no taxpayer alone is responsible for the complexity of the tax law. Help of this type, reflecting the government's interpretation of the law, is also a proper cost to be borne by the system itself, to say nothing of the further fact that it obviously serves the government's self-interest to answer a given taxpayer's questions. Indeed, applause was warranted when the Commissioner of Internal Revenue, in 1972, announced that this assistance effort would be augmented, that field offices would be open evenings and Saturdays to accommodate this function during the filing season, and that by 1974 the Centiphone system, enabling taxpayers in remote areas to make toll-free telephone calls to a central location, would be expanded from the then twenty-six districts to encompass, by 1974, the entire nation.

A third reason supporting the need for additional funds is that absent these funds the Service, to avoid inroads on those programs, will foster an inexpensive but ineffective oversight program designed for public consumption to indicate that it is, at long last, attacking the problems the return-preparer industry has been permitted to generate. It almost goes without saying that a supposedly inexpensive program will serve only as a display window, leaving unresolved the real problem which is inside the store.

⁵³ Indeed there is reason to believe the audit program is underfunded now, given the fact that, while less than 2 percent of returns are audited, in 1971 the Audit Division proposed adjustments to two-thirds of the returns audited. 1971 COMM'R INT. REV. ANN. REP. 33. At the end of fiscal year 1971, the Collection Division had an inventory of 759,000 delinquent accounts, involving \$1.9 billion, this being \$87 million more than the previous year's closing inventory. *Id.* at 25.

⁵⁴ *Hearings on H.R. 7590, supra* note 5, at 37.

In short, at stake is a choice between two programmatic approaches. One program ostensibly would seek to penalize preparers after they have been actually caught doing wrong. The other, while also including some system of penalties, would also gear much of the effort toward preventing wrongs before they are committed. This approach would employ a licensing system which would qualify only those who proved themselves, *prima facie*, to be competent and trustworthy. The Service has already indicated a preference for the first or penalty approach, deeming the alternative licensing arrangement “effective only if accompanied by strictly enforced standards of performance and integrity”; the IRS also believes that given the large number of preparers, there is “no realistic way” for it to perform this task, particularly because such a program would be “beyond any resources we are likely to secure at this time.”⁵⁵

Having made that tentative choice, the IRS indicated an interest in asking Congress to consider a program which would (1) establish a statutory penalty, ranging from 10 to 25 percent of any tax deficiency caused by a preparer who “knowingly” understates income, or overstates deductions or credits; (2) authorize the government to obtain an injunction to prevent further preparation of returns by a preparer who “consistently prepares false or deficient returns”; (3) establish a penalty of “approximately \$5” for each return not signed by the preparer; (4) require each preparer to furnish an annual information return listing all taxpayers and their identification numbers for whom returns were prepared; and (5) take account of the Service’s acknowledged willingness to prepare model courses and materials and make them available to schools and universities willing to conduct courses open to preparers and the general public.⁵⁶ This set of proposals, advanced by the agency which waited far too long before even openly acknowledging a problem (the horse having long since left the barn) falls far short, given the stakes, of the necessary mark.

In this regard consider first the matter of competence. In any given case, if the competence of a return preparer is the only issue at stake, the proposed program makes available only one tooth with any bite—an injunction prohibiting further preparation of returns where a preparer has “consistently” prepared “deficient” returns. To propose that this matter of competence be turned over to the already overcrowded federal courts on a case-by-case basis

⁵⁵ *Id.* at 26.

⁵⁶ *Id.* at 27-29.

necessarily assumes (1) that a judicially manageable (and, therefore, only an infinitesimal) fraction of this industry's 200,000 members is incompetent; (2) that federal judges, during the height of the filing season and before an appropriate remedy becomes irrelevant because of mootness, would actually grant an injunction without first requiring the case to be placed at least at the bottom of the motion docket (and at worst the trial docket) to await, after some delay, a hearing permitting both sides to present evidence; (3) that once it becomes clear that evidentiary hearings will first have to be held — with all that this entails — the Justice Department would actually initiate a sufficient number of suits annually to assure a satisfactory industry-wide level of competence; and (4) that following such suits injunctions would tend to follow. In summary, to turn this matter of enforcement over to the federal courts is “to bay at the moon like a dog, thinking you have it tree'd.”

To suppose that a 200,000-man industry, which *anyone* can join at any time, includes only a judicially manageable and, therefore, infinitesimal fraction of members lacking in technical proficiency, is to suppose that the IRS itself, although funding at significant cost a substantial tax-oriented educational program which must be taken and passed by employees who devote their audit time to small taxpayers, would have done almost as well to save the money and use for this purpose any untrained citizen.

To suppose that a federal judge will, at the height of the filing season and before a particular defendant-preparer has done his year's worth of damage, deprive him of his livelihood then and there, without postponing the case for an evidentiary hearing, is to believe that *Sniadach v. Family Finance Corporation*,⁵⁷ *Goldberg v. Kelly*,⁵⁸ and *Bell v. Burson*⁵⁹ had not been decided by the Supreme Court, or as one federal judge suggested to this writer, is to suppose something that will seldom happen.

To suppose that the Justice Department would actually initiate many such suits each year, once it becomes clear that evidentiary hearings will in fact be required, is to demonstrate little knowledge of the Justice Department. In 1971, even in the *fraud* area, the Department willingly initiated suits not where it could see the

⁵⁷ 395 U.S. 337 (1969) (*held*, as a matter of constitutional due process, wages may not be tied up until after an evidentiary hearing bearing on the validity of the underlying debt).

⁵⁸ 397 U.S. 254 (1970) (*held*, welfare recipients' payments may not, as a matter of due process be terminated until after an evidentiary hearing bearing on eligibility). *Cf.* the situations dealt with in the line of cases cited *id.* at 263 n.10.

⁵⁹ 402 U.S. 535 (1971) (*held*, uninsured motorist's driver's license, following an accident and failure to post bond for the amount claimed by an aggrieved party, may not, as a matter of due process, be suspended until after an evidentiary hearing bearing on fault).

whites of a fraudulent taxpayer's eyes, but rather only in the more remote circumstance when it could see behind the inner part of the taxpayer's retina. Of those brought to trial, two-thirds, or 645, were so clearly guilty that they pleaded guilty or *nolo contendere*.⁶⁰

To expect equal cooperation even from those few preparers facing a hearing for an injunction which will turn on their competence and possibly prejudice their immediate livelihood is to ignore reality. In attempting to demonstrate his competency such a defendant might introduce evidence showing that in 1971 two-thirds of *all* audits, not just of *his* returns, resulted in an adjustment.⁶¹ He would then indicate the proportion he filed correctly and go on to claim an opportunity to show, as to many of the incorrect returns he filed, that it was the taxpayer who often was at fault if fault there be. In short, one cannot assume that evidentiary hearings will be concluded in a moment's time or that they necessarily would result in an injunction.

In addition, the somewhat different matter of trustworthiness must be considered. The primary new weapon proposed here by the Service is a statutory civil penalty of from 10 to 25 percent of any tax deficiency caused by a preparer who "knowingly" understates income or overstates deductions or credits. Once again, we are considering a penalty which could be contested through the judiciary with all this entails. Here, however, the issue would turn on the word "knowingly." That word, as well as its ancestors, lineal descendants, and cousins, is one of the most elusive words in the English language, as one discovers on seeking to apply it.⁶² This would be particularly so in this context where the circumstances provide the target of the prosecution, allegedly a crafty crook, with a built-in patsy. Apart from pointing to the complexity of the law, the preparer can also point to the taxpayer on whom he would say he must rely for information necessary to fill out the return.

In conclusion, it is regrettable that the IRS, which for so long underestimated the tax system's responsibility regarding commercial preparers, now, in the face of a consequence full blown

⁶⁰ 1971 COMM'R INT. REV. ANN. REP. 29, 31.

⁶¹ *Id.* at 33.

⁶² Indeed, the Commissioner himself said:

It is difficult to be precise at this point [April 24, 1972] as to how many improprieties are attributable to just plain incompetence and how many constitute a seemingly willful attempt to defraud the government. Indeed, some of the "incompetence" unearthed has been so gross as to make nice distinctions virtually impossible.

Hearings on H.R. 7590, supra note 5, at 196.

and acknowledged by it to be "cause for genuine alarm,"⁶³ nevertheless continues either to underestimate the dimensions of the problem or to underestimate what is required by way of a remedy. In either case, the Congress, instead of responding passively, would serve the nation's tax system better by affirmatively mandating, as a complement to the Service's proposals and existing arrangements, a return-preparer licensing system. In terms of additional funding, the Service itself estimated in 1972 that the cost would be \$87.50 per preparer or \$17.5 million for 200,000 preparers. This, under its estimate, would accommodate character investigations, preparation of instructional and test materials, administration and grading of examinations, and issuance of licenses.⁶⁴ Obviously, the licensees, on the basis of their showings, would be categorized by the type of returns they are deemed competent to handle, and their respective license numbers, which they should be required to add to their name on the return, would be designed so as to reflect automatically their eligibility to prepare the given type of return on which their name appears.

E. Conclusions Concerning Assistance at Return Time

In terms of the relative compelling needs of our tax system, new funds should be devoted first to a licensing program rather than to an attempt by the Service to accommodate another million or so small taxpayers understandably interested in a free return-preparation service from the IRS. The latter, as a practical matter, would still leave enormous numbers of small taxpayers to the commercial preparers. Discrimination as to those to whom the IRS service is available would frequently be dependent on the taxpayer's mere geographical location.

II. ENFORCEMENT PRACTICES AND THE SMALL TAXPAYER

A. Appraising the Exposed Tip of the Enforcement Iceberg: An Accolade

The exposed tip of an iceberg almost always differs substantially from the base hidden below, and so it is with the tax system's enforcement arrangement. If one looked only at its ex-

⁶³ *Id.*

⁶⁴ *Id.* at 198.

posed tip, he would conclude on a comparative basis that this nation's tax enforcement machinery has accomplished an amazing feat. It has administered the most complicated law known to man in such a way that, while collecting almost \$200 billion in fiscal year 1971, fewer than 1500 tax cases had to be tried on their substantive merits before our trial courts.⁶⁵ In appraising this feat, one must remember that the underlying law itself includes several thousand different sections, and several hundred thousand words. One must remember also that most of those words, having diverse shades of meaning, are capable of generating any number of controversies in the setting of the infinitely varied transactions consummated in this, the most sophisticated economy known to man, with only the subtotals of these transactions actually being reflected in almost 80 million income tax returns received by the Service in fiscal 1971.

Certainly those fewer than 1500 court cases represented a small number when compared with the 1,006,325 returns which the Audit Division proposed to adjust for deficiencies in that same fiscal year. Viewed internationally, that number of trial court cases also seems not so large when it is recognized that little Belgium typically generates almost as many in the administration of its tax system, that Ohio-sized Netherlands typically requires more such cases, and that Germany typically generates a greater number of appeals to its appellate tax courts than are tried in the first instance by our trial courts.⁶⁶

This same exposed tip of the iceberg would generate a second accolade if only because our Tax Court instituted a Small Claims Division, enabling those relatively few small taxpayers sufficiently hardy to carry a tax dispute that far⁶⁷ to present their cases on a *pro se* basis, with a Commissioner of that court having the responsibility, inquisitorially and not as adversary, to take the time, sometimes substantial, to ask the questions, subquestions, and sub-subquestions necessary to help that small taxpayer present and argue his case there.

B. The Base of the Enforcement Iceberg: One Other Accolade

A profile, not of the exposed tip but of the much larger and hidden base of the tax system's enforcement iceberg, encompass-

⁶⁵ 1971 COMM'R INT. REV. ANN. REP. 123 (table 19).

⁶⁶ L. H. WRIGHT *et al.*, COMPARATIVE CONFLICT RESOLUTION PROCEDURES IN TAXATION 34-42 (1968).

⁶⁷ In calendar year 1972, the Tax Court's Small Claims Division received only 2,258 petitions. While 2,279 such cases were closed out that same year, the court found it

ing as it does the system's relationships with hundreds of thousands of small taxpayers, hardly warrants a similar accolade. That the IRS has not been *sufficiently* sensitive to the peculiar problems arising out of its audit of small taxpayer's returns does not mean, however, that it has been *wholly* insensitive to the plight and bewilderment of small taxpayers who are at the point of audit.

Indeed, the government has shown increasing concern, albeit not yet enough, with respect to that confusing circumstance. Ten years ago, in 1963, the Service was able to audit 3,054,700 individual returns through its office-audit operation, in part because 62.1 percent of those audits were completed solely through correspondence.⁶⁸ Critics of that operation—and this writer was one—maintained that thousands of those individuals capitulated too quickly and paid more than they owed, only because their technical understanding of the tax terrain made it impossible for them to respond wisely to a correspondence-type audit. The Service's growing awareness of this fact hopefully was one of the factors which prompted it, albeit slowly, to modify the audit program. In contrast to that earlier 62.1 percent proportion of correspondence-type audits, by 1971 the proportion had dropped to just over one-third of all audits,⁶⁹ the balance being accommodated by the more time-consuming but far more trustworthy interview-type audit. This fairly dramatic change in the type of audits conducted, which was surely appropriate in the interest of justice, was accomplished even though it involved some added cost to our tax system: for the change in emphasis at least contributed to the otherwise disturbing fact that, although the Service's office-audit operation had been able to examine just over three million returns in 1963, by 1971 this figure had dropped to about half that number.⁷⁰

The change in emphasis just described did not, however, affect two other subsequently discussed dilemmas long peculiar to a small taxpayer undergoing an audit.

C. The First Shortcoming of the Iceberg's Base: The Examiner's Advocacy Role

The first such dilemma arises toward the end of the initial audit. Assume that the examiner had already solicited sufficient in-

necessary to file only 173 opinions. This was because in 1,672 cases, the Service and the taxpayers entered into a stipulated settlement prior to trial, with another 434 cases being dismissed either because of a failure by the taxpayer to proceed with the case or because of a finding that the Small Claims Division lacked jurisdiction. Data furnished by the Tax Court.

⁶⁸ Unpublished data furnished by the IRS.

⁶⁹ Unpublished data furnished by the IRS.

⁷⁰ Unpublished data furnished by the IRS.

formation about the situation to enable him to measure, as he sees it, the substantiality of the taxpayer's side of the argument and has decided, at least on balance, that he should set up a proposed deficiency. Assume further, however, that the examiner himself still has some doubt about the matter. Given this set of facts, the problem is whether the examiner should try to persuade the small taxpayer to sign a form 870 and agree to the deficiency or whether instead he should openly express doubt about the matter and explain not only arrangements regarding administrative appeals but also, in quite realistic terms, the settlement policies followed by the Service's higher field echelons.

A difficulty with the first approach, involving an examiner who seeks to persuade the taxpayer to agree, emerges because often the amount involved is so small that the taxpayer cannot afford representation and typically is not represented. Furthermore, instead of being confident and knowledgeable in this context, the small taxpayer, typically knowing nothing about the niceties of tax law or what evidence is really helpful, assumes the existence of tax expertise on the part of anyone who works for the Service, and expects that each such employee has at least been instructed to be impartial as well as completely open and above board with all citizens.⁷¹ In consequence, many such taxpayers will capitulate if the examiner hides his own doubts and seeks, through persuasion, to obtain agreement to his proposed deficiency.⁷²

For two reasons, this frequently will lead to injustice. The first reason is that, not suprisingly, examiners of the type who audit small returns can be wrong, particularly in deciding close questions. After all, the setting involves an eyeball-to-eyeball confrontation between the least sophisticated of the Service's audit staff and the least sophisticated and knowledgeable of our taxpayers. Too often the latter are in no position to meet the examiner's arguments head on, to the end of helping the examiner understand why a given deficiency would be error.

More concrete evidence is also available to show that errors can be made in these circumstances. Of the office-audit-type taxpayers subjected to a deficiency, relatively few appeal the examiner's determination. Nevertheless, these appeals do represent a large absolute number, totaling 16,508 in 1971.⁷³ Dispositions regarding earlier counterpart cases are revealing. Before the 1964 precedural change regarding appeals within the district, of 38,536 appeals to a district conferee, small taxpayers were fully sustained

⁷¹ L. H. WRIGHT, *supra* note 51, at 34.

⁷² In 1967, examiners themselves secured agreement in over 99 percent of the office-audit deficiency cases. L. H. WRIGHT, *supra* note 51, at 33.

⁷³ 1971 COMM'R INT. REV. ANN. REP. 23.

as to the principal issue in 21.1 percent of the cases and were partially sustained in another 28.5 percent.⁷⁴ As to the period since the 1964 procedural change, in 1967, the latest year for which data has been published, conferees and office-audit taxpayers who appealed reached agreement in 71 percent of the cases. Significantly, in these settled cases the examiner's own proposed deficiencies were reduced by an average of 57 percent.⁷⁵

In fairness to the Service, however, one should understand, first, that both sets of these figures involve distortions which significantly magnify the real degree of error, because of offsets that necessarily occur. Illustratively, in the context of a divorced couple, one taxpayer is sustained as to a deduction which the other then loses. While these offsets clearly do not account for the whole range of errors below, it should not be supposed that errors approaching the proportion reflected in the balance of these appeals are currently being made among the office-audit cases not appealed.

Nevertheless, these figures, coupled with the lack of sophistication of unrepresented small taxpayers, suggest that the first need is to require examiners, if they have some doubt about the validity of a deficiency which they nonetheless believe should be set up, to inform the affected taxpayer about their doubts. This course would serve to indicate to the taxpayer that it is at least conceivable that the District Conference Office might reach a result somewhat more favorable to the taxpayer.

Because office-audit personnel are the least skilled of the audit staff, some IRS officials have been reluctant for them to express personal doubts about the adjustments they make. Yet it is hardly becoming of the government to trust such an auditor to decide a question *against* small, completely unknowledgeable taxpayers, but not trust that same auditor to take the further step of admitting doubts he may have, particularly where without this further step the taxpayer probably will concede the issue.

*D. The Second Shortcoming of the Iceberg's Base:
The Need for a Convenient
Small-Case Settlement Office*

If the small taxpayer, being forewarned, chooses to appeal, the second need of the system bears on the ultimate types of justice available. To the small taxpayer, the convenience of that justice also will be of great importance.

⁷⁴ L. H. WRIGHT, *supra* note 51, at 35.

⁷⁵ *Id.* Cf. Wall Street Journal, Feb. 5, 1973, at 25, col. 5 (table 11).

Where an apparently arguable issue is of the type which a court, to conform to the statute, would have to decide *entirely* for the government or *entirely* for the taxpayer, it is not enough to say that a small taxpayer may carry his case on a *pro se* basis to the Small Claims Division of the Tax Court. This is not enough if only because, in the instance of larger cases not calling for so-called "guinea pig" treatment, the taxpayer is afforded an election: to settle his case administratively at the regional level on the basis of mutual concessions responsive to the anticipated litigation hazards, or to carry the case to the Tax Court with the attendant risk of a complete win or complete loss. The existence of such an election can be easily defended, both in terms of justice and the necessities of administering the tax system. To elaborate further here, however, on details showing these to be awesomely compelling justifications⁷⁶ would carry the discussion too far afield from some things which here are much more pivotal.

Far more central to our concern are three other facts. First, in larger cases, a taxpayer dissatisfied with an examiner's determination can easily afford to take his case first to the District Conference office and then to the regional level to which the previously described complete settlement authority is reserved. Second, the reason that the system generates so relatively few tax cases actually tried by courts is that in the great preponderance of *disputable* larger cases, the taxpayer, on reaching the regional level, chooses to settle on the basis of *mutual* concessions responsive to the *anticipated* litigation risks, rather than actually litigate. Third, if a small taxpayer in such a situation is to have an equally realistic chance for an administrative settlement based on mutual concessions geared to the litigation hazards, it is imperative that the complete type of settlement authority now theoretically reserved to the regional level⁷⁷ be delegated, as to *small* deficiencies, to the more conveniently located, circuit-riding District Conference Office.

Settlement authority of the type just mentioned is now restricted in the case of the conference office to situations where a "substantially identical issue or pattern case" previously had been disposed of by the regional Appellate Division.⁷⁸ The practical need, in terms of the interest of small taxpayers, to eliminate this restriction, given otherwise appropriate and complementary monetary ceilings on the settlement authority exercised at the District Conference level, is more important in the interest of equity than

⁷⁶ See L. H. WRIGHT, *supra* note 51, at 9.

⁷⁷ 1971 COMM'R INT. REV. ANN. REP. 23.

⁷⁸ Rev. Proc. 68-30, 1968-2 CUM. BULL. 915.

are theoretical objections resting on the notion that, by training or experience, district conferees are less suited to the settlement task than are the less accessible regional level conferees.

E. Conclusions Concerning Enforcement Practices

One must bear in mind that any such change will have been in vain unless, in small cases, both examiners and district conferees are also instructed to think of themselves, even at the point of audit, as extensions of the Service's taxpayer assistance program. This should mean, first, that if an examiner has some doubt about a matter but concludes, on balance, that a deficiency should be set up, he ought to reveal his doubt, simultaneously explaining in realistic terms the appeal machinery, and noting the *possibility—not more*—that the District Conference office might reach a result more favorable to the taxpayer. Second, district conferees, in small cases, should be given the true type of settlement authority presently reserved to the regional level and should be instructed in such cases to be as fair in their settlement practice as they would be if the case had turned on a large issue where the taxpayer was well represented.