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Wright: Comparative Conflict Resolution Procedures in Taxation

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Book Reviews

COMPARATIVE CONFLICT RESOLUTION PROCEDURES IN TAXATION. Edited by *L. Hart Wright.* Ann Arbor: The University of Michigan Law School. 1968. Pp. xxv, 468. $10.

Review I

Any workable tax system must include mechanisms for resolving the uncertainties and disputes which inevitably arise in the operation of the system. In the nature of things, those who establish the governing statutory structure can foresee only a small part of the total universe of transactions, plans, and events to which the law will ultimately apply; and even if they could anticipate all of the questions, the statute would hardly afford them an appropriate vehicle for all of the answers. Necessarily, then, interpretative problems will occur. How does the law apply to classes of activities for which it makes no explicit provision? What are the tax consequences of transactions which are subject to inconsistent or ambiguous statutory mandates?

The officials charged with the administration of the system need answers to these questions. So do the taxpayers affected by the system. When a taxpayer contemplates a transaction the desirability of which is heavily influenced by tax considerations, he may well want to know the position of the system's administrators before he proceeds. When the administrators seek to collect a tax from a person who believes that he does not owe it, the resultant controversy must be resolved, either within the administrative framework, or by an independent adjudicative body.

The methods which the United States, Belgium, France, West Germany, Great Britain, and the Netherlands have developed to cope with problems like these are the subject of the recent *Comparative Conflict Resolution Procedures in Taxation,* by Professor L. Hart Wright in collaboration with a research associate and tax experts from each of the European nations included in the study. Written with care and sophistication, the work should be of use to a variety of persons concerned with taxes: tax practitioners and business advisors whose work brings them into contact with the European administrative systems described, parties in and out of the Government who wish to refer to the experience of other countries to improve their own tax procedures, and participants in the establishment of new tax structures in emerging nations or elsewhere.

Professor Wright has himself had a good deal to do with the practical operation of the machinery by which the United States tax system resolves uncertainties and settles disputes. One of the most ac-

complished and best known of our tax educators, he has taught at the University of Michigan Law School for almost twenty-five years; and the alumni of his classes now form considerable parts of both the private tax bar and the legal staffs which represent the Government in tax matters. If their analysis is not always clear and precise or their methodology not always ordered, the defect does not lie with their education in tax law. Professor Wright's books and articles have contributed to our understanding of such substantive subjects as the law of tax liens[1] and the participation of domestic enterprises in Common Market dealings.[2] Of greater importance for present purposes, Professor Wright has repeatedly advised the Internal Revenue Service on matters of organization, training, and procedure; he prepared the materials which the Service presently uses to train both its audit and its rulings personnel; and his work with the Service has left him intimately familiar with its operations and its problems. When he discusses tax administration, then, one does well to listen.

Characteristically, Professor Wright's direction of the preparation of *Comparative Conflict Resolution Procedures* has brought meticulous organization to the work. Separate sections of the book describe the procedures by which tax disputes are resolved in each of the six nations covered by the study. Each section explains (1) the administrative rule-making system of the country under consideration, (2) the country's procedures for assessment, refund, and administrative appeal, and (3) the function of the country's independent tribunals in the decision of contested issues. Professor Wright draws the material together in an extended initial section which provides an exposition of the United States' procedures, compares them with those of the other nations, and outlines his own views on the ideal approach to each problem.

The fundamental tripartite division of the subject matter of the book lends itself naturally to separate review of each of the work's three major areas of coverage. This Review limits itself to the treatment of administrative rule-making.

The over-all theme of Professor Wright's discussion of this subject is the necessity, in any relatively complex tax system, of a centrally administered interpretative program. In the United States, the Treasury Department and the National Office of the Internal Revenue Service perform this function through the promulgation of regulations, the publication of generally applicable rulings, the issuance of private rulings, and the provision of technical advice to the Service's field offices. With the proposition that these programs have been of

1. *See, e.g.*, T. PLUMB & L. HART WRIGHT, FEDERAL TAX LIENS (2d ed. 1967); Wright, *Michigan Title Examinations and the 1954 Revenue Code's New General Lien Provisions*, 53 MICH. L. REV. 393 (1955).

2. *See* TAXATION, AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET: A LEGAL PROFILE ch. 11 (E. Stein & T. Nicholson ed. 1960).

major advantage to the operation of the American system, few would be inclined to disagree. However, the use of these programs in this country has exposed some important problems, which Professor Wright examines with insight and realism.

A critical set of problems can, for example, arise from the relationship between the program of private rulings and that of published rulings. The goals of the two programs are quite different. The essential aim of private rulings is to permit commercial dealings to go foward unimpeded by the absence, in the tax statute and other authorities, of clear and definite guides to the tax results of such dealings. Hence, willingness to come to grips with reasonably difficult issues is at least a desirable feature of a private-rulings program, and promptness in responding to taxpayer inquiries is an essential attribute of a successful one. If the administrative agency answers only the easy questions, its rulings will be of limited assistance to the business planner; and if it answers slowly, the rulings will frequently be of no assistance to a business world in which action often must be taken quickly or not at all.

Published rulings, on the other hand, are designed to provide information to all taxpayers and to the field personnel of the agency charged with the administration of the nation's tax system. Such rulings explain the application of the statute and the regulations to situations which neither statute nor regulations treat specifically, but which have been demonstrated by experience to have importance for a significant number of taxpayers. Because published rulings state positions which the agency intends to apply to all similarly situated taxpayers, and because in practice it is often difficult for the agency to reverse a position adopted in a published ruling, it is crucial that these rulings be correct. Today's erroneous publication can too easily become tomorrow's major tax reform issue, capable of resolution, as a practical matter, only by legislative action. The long history of the United States' tax rulings reveals surprisingly few instances of such errors, particularly in light of the volume of rulings published each year; but the effects of the mistakes which have occurred have been exceedingly difficult to root out. An illustration of the difficulty is the 1920 ruling which held that premiums paid by an employer on group-term life insurance do not constitute income to the insured employees[3]—a holding which, despite partial correction by the Revenue Act of 1964,[4] even now produces a revenue loss of 400 million dollars each year.[5] Another example is the 1954 ruling

3. O. 104, 2 CUM. BULL. 88 (1920).

4. INT. REV. CODE of 1954, § 79.

5. Statement of Joseph W. Barr, Secretary of the Treasury, in *Hearings on the 1969 Economic Report of the President before the Joint Economic Comm.*, 91st Cong., 1st Sess. 8-44 (1969).

which passed favorably on industrial-development bonds[6] and was not finally corrected by Congress until 1964 (again with exceptions).[7] Therefore, while it is useful to have rulings published as soon as possible after problem areas surface at the administrative level, the promptness so necessary to the success of the private-rulings program must, in the public-ruling program, take second place to soundness of result; and it must do so particularly when the issues are difficult.

These differences in priority of aims between the private-rulings program and the published-rulings program can lead to serious distortions if the two programs are closely interrelated in operation. If private rulings are limited by the standards which govern public rulings, delay in the issuance of at least some rulings necessarily results —and produces a slowing or a rechanneling of the very commercial processes which the private-rulings program is undertaken to free from tax impediment. Reluctance to resolve difficult issues may also ensue. Conversely, if rulings are published as quickly as they are issued privately, without undergoing a thorough review beyond that required for private rulings and, in some instances, without awaiting the development of greater experience with the problem area, incorrect rulings will be published and may become irretrievably incorporated in the interpretative system.

Professor Wright's solution is strict separation of the objectives of the two programs, with the personnel responsible for each program instructed to adhere to the standards appropriate to their own program. It is a good solution, and perhaps the best that can be given in the abstract. Still, strong pressures to conjoin the two programs will persist, and strict separation will be a good deal more difficult to maintain in practice than it is to justify in theory. In the United States, members and committees of Congress have repeatedly taken the position that the published-rulings program should be used to police the private-rulings system by making public *all* significant private rulings soon after they are issued to the particular taxpayers who have requested them.[8] Again, those responsible for the published-rulings program may become subject to institutional pressures to increase their output. Because the major source of grist for publication will be the products of the private-rulings program, any such influence will inevitably tend to draw the publication program closer to the private program—and make it increasingly subject

6. Rev. Rule. 54-106, 1954-1 CUM. BULL. 28.

7. INT. REV. CODE of 1954, § 103(c).

8. *See, e.g., Hearings Before the Senate Select Comm. on Investigation of the Bureau of Internal Revenue,* 68th Cong., 1st & 2d Sess. 30-31, 56-57, 3630-61 (1924-1925); S. REP. No. 27, 69th Cong., 1st Sess. 229-34 (1926); *Hearings on Administration of the Internal Revenue Laws Before a Subcomm. of the House Comm. on Ways and Means,* 83d Cong., 1st Sess. 1340 (1953).

to the standards of the private program. Finally, even in the absence of these forces, persuasive argument can be made that what the administrative agency does for the taxpayer who requests a private ruling, it should also do for all other taxpayers. Indeed, how else can one achieve the national uniformity upon which a sound tax system must be based? Yet if the agency accedes entirely to this argument, all private rulings will forthwith be published, and the objectives of one or the other program will have to be sacrificed.[9]

In the last analysis, it is probably impossible to preserve perfect independence for the two programs. At least, such separation has not been achieved in the United States. As elsewhere in government—and life—the final result will most likely be a compromise; and the agency responsible for the administration of the tax system will be doing well if it can establish the proper standards for each program and adhere to them with reasonable success in most cases.

The ideal administrative rule-making system which Professor Wright suggests departs from present American practice in another respect. Professor Wright recommends that published rulings be adopted as the official interpretative position of the administrative agency only after they have been issued in proposed form and the public has been given an opportunity to comment on them. Presumably, this recommendation would make published rulings subject to much the same procedures as are now applied to regulations—with a proposed draft published, the public allowed to submit written comments within a specified period of time, a public hearing held if sufficient interest appears, and a final form adopted only after consideration of the public comments.

The judgment of the Internal Revenue Service has so far been that the large volume of rulings processed for publication makes it unfeasible to solicit public comments before adoption. Nevertheless, Professor Wright can make a good case for his view. Particularly with issues which have not previously aroused wide-spread concern among taxpayers, a private ruling adverse to the taxpayer's interest may finally be published—and thereby made applicable to all taxpayers—even though the Service has had the benefit of only a single party's presentation of the contrary view. The ruling will, of course, have been subjected to the Service's own analysis and review at several levels. Nonetheless, if those who represented the taxpayer in the original ruling application presented their case badly—or posed

9. Perhaps the fact that one taxpayer applies for a ruling and the others do not is sufficient ground to justify at least a delay in the accomplishment of uniformity. The taxpayer who applies, after all, thereby provides evidence of the reality and immediacy of his need. Hence, it can be argued that the administrative agency is justified in postponing publication—making the answer available to all those who did not ask for it—until it has subjected the private ruling to rigorous review and, when necessary, developed a more thorough knowledge of the problem and its implications.

the issue in such a way that the Service's subsequent independent research does not reveal the true strength of the taxpayer's case—the Service may reach the wrong result. Thereafter, with the result hardened into official Service policy by publication, other taxpayers, seeking to reverse the ruling, will be confronted with an uphill battle, no matter how well they present their case. They may finally prevail—through litigation if they are unable to convince the Service itself of the error—but the going will have been difficult, time-consuming, and expensive. If such trouble can be avoided by permitting public comments on the issue before the Service has taken any official position, why not provide a mechanism for such comments?

The argument in favor of the existing practice is that the publication program is helpful to a broad range of taxpayers in a number of ways. Since any general solicitation of public views on proposed rulings would divert a substantial share of the manpower resources presently devoted to the program, the number of rulings which could be published in any given time would be diminished, and to that extent the public benefit from the program would be curtailed. It is also worth noting that, although the mechanism which Professor Wright suggests would establish a safeguard against anti-taxpayer errors by the Service, it would do nothing to reduce the number of pro-taxpayer errors. Presumably, advance notice of the rulings on group-term life insurance and industrial-development bonds would have evoked nothing but praise (or a studied silence) from the interested members of the public. If the Service must maintain an internal review machinery satisfactory to guard against mistakes in favor of taxpayers, why is not the same machinery adequate protection against mistakes of the contrary variety?

Plainly, proper resolution of the issue requires more precise data than the public, at least, now has about the impact which advance publication would have upon the two competing interests involved. By how much would the step diminish the flow of published rulings? Would that reduction be likely to apply to important rulings, or to those of marginal utility? How worthwhile would the protection provided by notice in fact be? Are there really a significant number of erroneous anti-taxpayer rulings which it could reasonably be expected to prevent?

It would require no great ingenuity to develop some useful responses to these questions. The Service might even test the procedure on a limited basis with a sample group of its pending rulings. Perhaps a middle ground would afford the optimum solution. The Service might, for example, provide notice only for selected rulings involving issues which are unusually difficult or of widespread interest. Such an approach might minimize the drain on the resources of the publication program and at the same time con-

centrate the use of the advance-publication safeguard upon those areas most likely to profit from it. In any event, the idea of advance publication of at least certain types of rulings seems worth further exploration; and while the suggestion did not originate with Professor Wright, his renewal of it and his persuasive argument in its behalf are to be commended.

One aspect of Professor Wright's discussion of the American regulations program deserves comment. In his exposition of the treatment accorded regulations in our courts, Professor Wright outlines three rationales which have been employed to justify the grant of special weight to them: the contemporaneous-construction analysis, the re-enactment doctrine, and the argument that disinclination to overturn a regulation ought to increase with its duration. The implication is that, unless one of these theories applies to a regulation, it will not be given special consideration by the courts.

Such an approach would preclude a small, but important and highly useful group of regulations from receiving appropriate weight. Occasionally serious problems develop long after the enactment of a relevant statutory provision. They may result from the advent of new commercial practices; from efforts by taxpayers to plan around the statutory provision or to use it for purposes not originally intended; or from activities which existed when the statute was enacted, but which gained public prominence—and the attention of taxing authorities—only much later. For a variety of reasons, the rulings process may not be suitable for a comprehensive, principled resolution of these problems. When the policy underlying the original legislative action extends also to the new problems, and when the statutory implementation of that policy can be reasonably construed to deal with them, it would seem entirely proper for the Treasury Department and the Internal Revenue Service to exercise their administrative authority to issue regulations on the matter. Recent examples of such situations include the revised and much expanded regulations adopted under section 482;[10] the regulations proposed in 1968 on industrial-development bonds;[11] and the comprehensive 1967 revision of the regulations under the unrelated business income tax[12]—which provided a systematic elaboration of the principles of that tax and explained their application to such activities of exempt organizations as publication advertising and trade shows.[13]

In each of these cases, the regulations were based upon a thor-

10. T.D. 6952, 1968-1 CUM. BULL. 218.

11. 33 Fed. Reg. 4950 (1968). As has been stated, these regulations were quickly superseded by new congressional action proceeding in the same direction.

12. INT. REV. CODE of 1954, §§ 511-13.

13. T.D. 6939, 1968-1 CUM. BULL. 274.

ough review of the policy considerations which led Congress to adopt the statutory provisions in question; in each, painstaking investigation of the factual nature and background of the new problems preceded the drafting of the regulations; and in each case, the work was performed by a joint task force of specialists from the Internal Revenue Service and the Treasury Department, consulting with experts outside the Government. The two regulations which were ultimately promulgated were finalized only after extensive public commentary and hearings on proposed drafts; and in all three instances the regulations had been reviewed and approved at a number of levels in the Service and the Treasury Department which would not have been required to pass upon published rulings. Since these regulations succeeded by many years the legislative acts upon which they were grounded, they cannot claim the benefit of the contemporaneous-construction argument; and if they were to be challenged in the courts within a few years of adoption, neither the extended-duration nor re-enactment rationales would apply. Yet it would require no more than a realistic recognition of the procedures by which they were developed and adopted—because of their formal status as regulations, rather than ad hoc rulings—to hold that these regulations are entitled to substantially more weight than rulings. And in fact the approach of the Supreme Court would seem to confirm that judgment.[14]

Those familiar with the rule-making system of the Internal Revenue Service and the Treasury Department will find themselves quite at home with the ideal system which Professor Wright recommends. The two systems are very much alike. As has been shown with respect to the proposal for advance publication of rulings of general application, there are some differences; but they are not major. The fundamental structure of the ideal system—and a good many of its details—come from American experience. Presumably all of this is as it should be. The configuration of the ideal undoubtedly stems from Professor Wright's independent evaluation of the problems, his general rejection of the approaches which have evolved in the European nations included in the study, and his conclusion that the United States' mechanisms are essentially the best. Still, one would like to know a bit more about the results which have followed from some of the approaches of other nations. If a centralized interpretative program is necessary to the operation of a complex tax system, how has Britain, with a tax statute almost as complex as our own, managed to avoid such a program altogether? What problems have resulted? How have they been met? Information of this sort would surely be helpful to one who is attempting

14. Helvering v. Reynolds, 313 U.S. 428 (1941); Helvering v. Wilshire Oil Co., 308 U.S. 901 (1939); Morrissey v. Commissioner, 296 U.S. 344 (1935).

to determine which is the best procedure, and it might also suggest possibilities for improving the United States' procedures. Gulliver, after all, finally understood the English only after a rather impressive series of foreign travels; and perhaps we could learn important lessons about our own system from the experiments of others with entirely different systems.

If one feels mild disappointment with *Comparative Conflict Resolution Procedures* on this score, however, it detracts very little from the over-all judgment of strong approval. The book represents an impressive undertaking, impressively carried out. Professor Wright and his co-authors deserve compliments on a careful, incisive, and thoroughly useful job.

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and
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Review II

Professor Wright and five European colleagues have addressed themselves to a central question facing all governments founded on law and public opinion: how to provide their citizens with uniform, fair, inexpensive, readily available, and timely resolution of their disagreements on tax matters. As Professor Wright emphasizes, the structures and procedures of all organizations represent a trade-off among these multiple criteria.

The prevention and resolution of conflict is a salient problem of this country's Internal Revenue Service. Each year more than a million taxpayers are informed, after examination, that there have been deficiencies in their self-report of taxes. Only a small percentage of them take their cases to the appeals process, whether it be through administrative or judicial channels. Professor Wright has admirably analyzed the interplay, in the six counties studied, of the administrative and judicial methods for resolving such conflicts, and has described methods for preventing conflicts. He comprehensively discusses the major aspects relevant to preventing conflict

15. Mr. White's views stated here are his own, and are not necessarily those of the Internal Revenue Service.

—the clarity of the law, a centralized interpretative unit, comprehensive regulations, publicly available rulings, and technical assistance. But even these steps, he says, are not sufficient in a complex society to prevent conflict.

In the United States we take many steps at the original examining level to "avoid" conflict: a thorough training program for examiners, to which Professor Wright has contributed more than any other single person; technical guidance provided to examiners on specific issues; a general directive that the examiner fully explain to the taxpayer both the reasons for the deficiency and the fact that he will be satisfied with substantial, not perfect, compliance; and the review process. But these steps will not prevent the appeal of all disputes, because the initial examining officer is not permitted to take litigation hazards into account in resolving disputes,[1] and hence some questions cannot be settled at the examining level. However, the taxpayer is granted a right of appeal to the Appellate Division at which litigation hazards may be considered.[2] Since there are thousands of examining officers, and since it is not possible to review the large number of discretionary judgments made by those officers with the same time and care that is given to matters handled in the Appellate Division, it would be impractical to vest the examining officers with the discretionary authority to consider litigation hazards.

The only common component in the six countries studied is the availability of an independent tribunal—a necessary institution, but, as Professor Wright explains, one which can be costly and inefficient if the tribunal is forced to handle too many disputes. The authors state that Belgium, France, and Great Britain use independent lay tribunals, but that in the first two countries these bodies are only advisory and can be bypassed. They state further that in Belgium and France, as in the United States, the regional office provides the highest level of administrative appeal. In Germany, however, according to the authors, the taxpayer has no administrative appeal and instead goes from the local examiner directly to a specialized, decentralized court; while the Netherlands provides specialized chambers within its regular court system. In the United States the taxpayer may choose to resolve his conflict through administrative or judicial channels, or through a combination of both; and within each of these channels the taxpayer has a choice of avenues. In each country the design of the administrative and judicial appeals systems has been influenced by tradition, geographical dispersion, and the calibre and integrity of officials; and in our own nation, the sheer number of taxpayers has had a significant influence as well.

1. 26 C.F.R. 601.105(c)(5) (1970).
2. 26 C.F.R. 601.106(f)(2) (1970).

There can be no single solution among all countries to the problem of achieving a proper balance between administrative and judicial methods of "conflict" resolution. Generally, the administrative route is cheaper, quicker, and better able to handle a large volume of cases. In addition, since the administrator, as Professor Wright emphasizes, is bound by his own regulations and rulings, and since the judges in most countries are not specialized, the administrative route is also generally more consistent. On the other hand, the judicial route is generally seen as more independent. Nevertheless, in the United States, policy guidance, organizational separation of appeals from examining officers, the right of the Appellate Division's conferees to take into account the hazards of litigation, supervision, review, and easy access to the judicial process help to ensure both an independent review by existing appeals officials and the responsiveness of such officials to judicial interpretations. Professor Wright feels that an appeals official would be even more responsive to judicial interpretation if he were required to try his own cases before the judiciary. But there is another side to this argument. An official who must try the case might be tempted to yield in order to avoid a potential "loss" in court, whereas a purely administrative official might in some cases be less willing to compromise and more willing to go to court to clarify the issue. In addition, a purely administrative official knows that in many cases there will be no appeal to the judiciary. In any event, the American experience suggests that the separate administrative process has proved responsive, as is evidenced by the relatively few cases that go through any channel of appeal, and the far fewer cases that are tried in court. Indeed, the size and rate of agreement of the nondocketed cases in the Appellate Division has increased over the past years, while the Division has continued to increase its accessibility to the small taxpayer, who is less likely to carry his appeal to the judicial system.

In summary, considering the complexity of tax law, the multitude of factual situations, the thousands of examining officers, the amounts of money involved, and the relatively simple system for appeals, there will always be tax disputes moving "up the line." Professor Wright has charted a course for organizing a system to prevent and resolve those disputes. All tax administrators are in his debt.

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United States Internal Revenue Service[3]

3. The *Michigan Law Review* may be unique in asking an administrator to review a book analyzing his function. I assume that neither conflict of interest nor entrapment is involved.