Internal Confusion in Internal Revenue

BY NORMAN REDLICH

THE subcommittee of the House Ways and Means Committee headed by Representative Cecil R. King of California has brought joy to the Republicans and anguish to the Administration by its revelations of corruption in the Internal Revenue Bureau. As a direct result of the committee's investigation, President Truman recently announced that the bureau would be completely reorganized and more revenue officials placed under civil service. But the scandals uncovered by the King subcommittee strike at the heart of our tax-collection system, and the problems raised will remain with us whether or not Congress approves the President's plan. They will exist as long as personal judgments determine how much money individuals and corporations shall pay to the federal Treasury each year.

Taxes no longer have a direct and dreaded impact only on the wealthy few. This year the federal tax system will drain off approximately one-fourth of the national income. Yet this vast collection process, which garners over sixty billion dollars annually, is largely voluntary. The government could never enforce the tax laws if individuals and corporations should decide to ignore them *en masse*. Weak governments have usually discovered, as Nationalist China did, that the tax-collection system falls apart if public confidence is forfeited. And the quickest way to destroy confidence is to let the public think that some persons, by bribing revenue officials, are "getting away with something."

With this fact lurking in the background, it is essential that the agency responsible for administering the tax-collection system should be a model of efficiency and integrity. The Bureau of Internal Revenue, at least in the last ten years, has deviated sharply from the required standards. Its organization is antiquated, and it is pitifully understaffed for the tremendous burden placed upon it by the revenue demands of the Second World War and the present defense program. Fair-minded observers would agree with President Truman that the majority of the bureau's employees are honest, but there has been enough dishonesty and inefficiency to arouse distrust about many of its activities. An especially unfortunate situation has developed in the offices of the sixty-four collectors of internal revenue. Although technically under the jurisdiction of the Commissioner, these collectors are direct appointees of the President and enjoy a large measure of autonomy in their respective districts. Many of their offices have been notoriously inefficient. Only the pressure of the recent investigation, for example, brought about a genuine effort by the Third New York District to issue warrants for delinquent taxpayers. The collectors' offices are supposed to audit returns under $8,000, but in many districts there is no auditing at all. John B. Dunlap, the present Commissioner, pointed out recently that only fifteen of the sixty-four collectors are career men and that twenty of them have outside business interests.

If all taxes were automatically computed and deducted from income like pay-roll taxes, corrupt officials would have a narrow field of operation. Unfortunately, preparation of a tax return by business men, corporations, executives, professional men, and those who are self-employed in various capacities is not a cut-and-dried affair. In a perfectly legal and aboveboard manner accountants and tax lawyers are constantly advising clients on ways to minimize their taxes. The Kiplinger Washington Agency, for example, in its tax letter of December 29, 1951, presented a detailed analysis of the use of charitable foundations as a device for passing corporate stock from generation to generation without paying an estate tax. Of course, beyond the accepted methods of tax saving lies the area of fraud. A business man may try to deduct $2,500 for "entertainment of customers" when actually he bought his wife a mink coat. A doctor may try to conceal part of the cash he receives for house calls. A merchant may take a few dollars out of the cash register each night and charge it to "petty cash."

Returns in which the taxpayer has consciously sought to minimize taxes by either honest or dishonest means, and usually with the assistance of experts, offer tempting opportunities to venal officials. And these opportunities have been multiplied by lax administrative practices. For example, the collectors of internal revenue hand on returns of over $8,000 to the internal-revenue agents for auditing; the collectors audit those under $8,000. Often the receipt of many thousands and even millions in tax dollars hinges on an agent's decision to allow or disallow a deduction. It is at this point that smart accountants and lawyers, representing wealthy clients, come face to face with agents whose incomes are small and whose scruples are flexible. In thousands of instances, for a few hundred or a thousand dollars or even for friendship or a minor favor, an agent will decide a close question in favor of a taxpayer; these transactions rather than the pub-

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licized $500,000 shake-downs constitute the typical corruption in the tax service. The King subcommittee is aware that this type of corruption, because it is more widespread, is even more dangerous than the corruption in high places. Unfortunately, it is extremely difficult to uncover.

The prosecution of fraud cases also offers opportunities for shake-downs and fixes. Between the time a tax-fraud case is first turned over to the special agent's office and the time prosecution is started by the Assistant Attorney General in charge of such cases, charges can be dropped at any one of seventeen points along the line. Tax evaders anxious to stay out of jail can dangle attractive bait before the eyes of officials who have discretionary power to stay prosecution. Corrupt officials have been assisted by the bureau's practice of permitting a prosecution for fraud to be discontinued if a taxpayer's health or sanity would be impaired by a trial. The investigations of the King subcommittee have made it plain that under the direction of T. Lamar Caudle the Tax Division of the Department of Justice did not prosecute fraud cases solely on the basis of apparent guilt.

GIVEN an administrative problem as complex as this, a Congressional committee of inquiry can obtain only certain limited results. The King subcommittee has neither the money nor the personnel to conduct a full-scale investigation of the Bureau of Internal Revenue. Its chief function is rather to cast a spotlight in different directions, awakening the public to the problems and leaving corrective measures to the Administration.

While the exposure of deals between local agents and accountants or lawyers has been of great interest, the more sensational revelations of the corruption of high officials have grabbed the headlines. These headlines may have placed an unfair amount of the blame on the shoulders of the Truman Administration, but they have already resulted in some important changes in the bureau. Commissioner Dunlap has replaced Commissioner Schoeneman, a notable improvement. The chief counsel has resigned. A new assistant commissioner, a new head of the alcohol tax unit, and a new Assistant Attorney General in charge of the Tax Division of the Department of Justice have been appointed. Tax-fraud cases will now be referred directly from field offices to the Department of Justice, thus by-passing the complicated hierarchy in the Internal Revenue Bureau. New collectors have been named in New York, Boston, and St. Louis.

Commissioner Dunlap has also organized an inspection service which is conducting its own investigation of dishonest practices in the bureau. Half the bureau's employees have filled out forms which detail their property holdings and net worth. Of course, an official dishonest enough to take a bribe will be dishonest enough not to include it in his net worth, but the forms may reveal some unexplained accumulations of wealth by men earning small salaries. And the necessity of filling out these forms may act as a deterrent against bribe-taking in the future.

Representative King

Perhaps the most tangible result of the committee's work to date has been President Truman's reorganization plan. The new inspection service will be made a permanent part of the bureau. Twenty-five district commissioners will replace the present loose network of collectors, agents, and special agents. The district commissioners will be under civil service and forbidden to have outside employment or business interests. Abolition of the politically appointed collectors is a big step forward; civil-service career men are far less susceptible to the pressure of people with "influence."

Apart from these immediate gains, the current investigation has unquestionably achieved some important long-range results. The public has been made aware of a deplorable situation. For some time, at least, revenue agents, tax accountants, and taxpayers will be on their good behavior. Fear may not be the most desirable method of securing compliance with the law, but it is often an effective one. As more disclosures are made by the King subcommittee, the public can look forward to still greater efforts by the Administration to clean house. However, the President's choice of Attorney General McGrath to conduct an investigation of the bureau is not likely to inspire confidence, in view of the justified charges leveled by the King subcommittee at McGrath's own department.

Congress will be asked to authorize an expanded staff for the overworked bureau and to increase salaries of field officials. The subcommittee itself, in a report to be released in the spring, will undoubtedly come up with some excellent suggestions for improving administrative and civil procedures. It will also recommend stricter regulation of federal tax practice in order to keep uncertified accountants, so-called "tax experts," and influence peddlers from negotiating with revenue officials. The committee has found that lawyers as a group are guilty of fewer dishonest acts than other tax practitioners.

But even if all these corrective steps are taken and the bureau becomes, as President Truman has predicted, a "blue-ribbon civil-service career organization," the danger of corruption will remain. On the lower levels of tax auditing and collecting, men of means will still offer bribes which some officials will accept. The improvements already made and those in prospect will narrow but not eliminate the problem.

It is unfortunate that the subcommittee's disclosures have provided some unearned political ammunition for the Republicans. While the Administration will say that the changes it has instituted have solved the problem, the Republicans will insist that the only hope for greater honesty lies in a Republican victory in November. Neither claim will be true. So long as revenue officials can give or withhold favors at their will the possibility of dishonesty will exist. This fact cannot be used as an argument for lower taxes, for a large and complex revenue system is now an essential part of our national existence. Instead, the public must insist that vigorous and non-partisan investigation be carried on constantly by the new inspection service of the bureau and periodically by Congressional groups like the King subcommittee. Corruption in tax-gathering can never be entirely eliminated from a tax system as extensive as ours. But it can be minimized, and certainly it should not be encouraged by inefficient organization, careless administrative practices, lax enforcement of the law, or patronage politics.

Granddaddy of the Tax Scandals

BY HARRY BARNARD

THE current Washington production, "Tax Scandals of 1951"—and presumably of 1952—is but a new version of the original show that reached the stage on Capitol Hill in 1924. The leading actors in this granddaddy of "Tax Scandals" were President Calvin Coolidge and Secretary of the Treasury Andrew Mellon; Senator James Couzens of Michigan was the producer. The piece was a great hit and ran for years.

Attracted to every controversy, especially if it gave off even a slight odor of graft, political favoritism, or any other governmental wrongdoing, Senator Couzens was drawn inevitably into an investigation of tax collection. Having amassed forty million dollars by showing Henry Ford how to run an automobile company in a business-like way, he thought every other multimillionaire ought to be as honest as he was. And probably also because of his own millions, he had not an iota of awe for other multimillionaires, not even for Mr. Mellon, "the greatest Secretary of the Treasury since Alexander Hamilton."

Secretary Mellon was putting through Congress the tax program described as the Mellon Plan for Assuring Permanent Prosperity. Its nub was the reduction of World War I surtaxes on large incomes. Quite persuasively Mellon argued that if big corporations had their taxes reduced, they would put the money back into their business, and everybody would benefit. A few progressives challenged this plan, but the opposition got little attention until Senator Couzens opened up against it.

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Couzens had written a letter to Secretary Mellon asking him for the facts with which he backed his tax theory. Mellon considered this an affront and sent Senator Couzens a reply which in effect told him to mind his own business and to let Alexander Hamilton's successor handle such complicated matters as taxation. The belligerent Senator from Michigan let out a rejoinder foreshadowing an atomic explosion. Mr. Mellon, not as meek as he looked, replied in the same style, implying that Senator Couzens was not only a dolt in financial matters, in spite of his accomplishments with Henry Ford, but also a tax slacker, since he had admittedly invested much of his forty million in government securities.

That did it. On February 21, 1924, Couzens presented to the Senate a resolution for a committee to investigate the Bureau of Internal Revenue, which then as now was under the jurisdiction of the Secretary of the Treasury. The bureau had not been investigated by Congress since the income tax had gone into effect eleven years earlier. Though controlled by the Republicans, the startled Senate passed the resolution. When the Senators recovered, they tried to remedy matters by denying Couzens the chairmanship of the investigating committee, which by precedent he should have had, and giving it to faithful old Jim Watson of Indiana. The committee was further loaded with good friends of Mr. Mellon, but Couzens insisted on a real investigation and stole the show. The first thing he did was to subpoena from the Bureau of Internal Revenue its top-secret files on all the corporations in which Mr. Mellon owned a substantial interest—a sizable file indeed. Next he retained as counsel for the committee the famous prosecutor of the San Francisco "graft" cases, Francis J. Heney. It did not bother